Eric Ohrn
Research Statement

My research interests lie at the intersection of public economics and corporate finance and focus on how taxation affects corporate behavior. My current and proposed future projects examine the impacts of tax policies on investment, mergers, payout decisions, and charitable giving and pay careful attention to the role of corporate control and principal-agent problems in mitigating or enhancing tax policy effects. Answers to the questions posed by my research shed light on optimal tax policy design as well as optimal corporate governance decisions.

In the following, I first discuss works in progress then proceed to future research directions.

1. Current Research

Does Corporate Governance Induce Earnings Management? Evidence from Bonus Depreciation and the Fiscal Cliff (Job Market Paper)

This paper formally develops and tests the hypothesis that commonly used corporate governance mechanisms, such as threat of takeover or equity incentives, can induce managers to manipulate current financial statement earnings at the cost of long-run economics benefits to the firm, a practice know as "earnings management." The empirical analysis exploits exogenous variation in "bonus depreciation," a counter-cyclical corporate tax incentive that effectively decreases the net present value of new investments but does not change accounting profits.

During the years 2000-2010, investment by better-governed firms responded less to bonus depreciation than investment by firms with less effective governance; for example, one percent greater managerial share ownership was associated with 22 percent less investment response to bonus depreciation. These results are complemented by additional analysis documenting stock price reactions to the Fiscal Cliff resolution which unexpectedly extended bonus depreciation in early 2013. Abnormal returns were 1% higher for firms which stood to gain from bonus depreciation and were the least strongly governed. Taken together, the analyses suggest not only that strong corporate governance induces earnings management and leads to under-response to bonus depreciation, but also that this under-response is value decreasing.

This research supports the widely held belief that the accounting treatment of bonus depreciation undermines the policy. However, the results also indicate that the policy was particularly effective among firms with little incentive to engage in earnings management implying that private firms are very responsive to bonus depreciation. The welfare implications of these observations are substantial considering the magnitude of the policy – estimates suggest that, in 2011 alone, bonus depreciation stimulated approximately $50 billion in new investment.

Dividend Taxation and Merger Behavior: A New View Explanation For The Post-Merger Performance Puzzle (with Nathan Seegert)

This paper considers the impact of dividend taxation on the merger and acquisition behavior of publicly traded firms. Mergers and acquisitions are a large part of the United States economy. Between 2000 and 2012, the dollar value of merger and acquisition activity in the US was $12.78 trillion. Mergers are also an important aspect of the economy because, done well, they can capitalize on positive synergies and economies of scale, thereby increasing efficiency and creating value for shareholders. However, executed poorly, mergers can dampen innovation, decrease efficiency, and destroy shareholder value. Because of the scale and significance of this topic, large literatures in finance and economics have developed that discuss possible mechanisms which distort merger and acquisition behavior.

We consider a new mechanism of distortion: dividend taxation. We develop a "new view" of corporate taxation model in which dividend taxation causes inefficient mergers. Mergers can be interpreted as an alternate mechanism to distribute funds to shareholders and therefore a substitute for dividend payments. When dividend taxation increases, firms shift towards mergers and away from dividends. As a result, dividend taxation increases merger behavior and decreases merger performance. We test these implications by exploiting differential effects of the 2003 US dividend tax reform across firms with different payout strategies. We find strong empirical support for the model, demonstrating long-run returns are 8 to 10 percent higher for dividend paying firms following the reform.

Estimating Investment Response to User Cost of Capital using New Micro-Evidence From the Domestic Production Activities Deduction

This paper examines the investment impacts of the Domestic Production Activities Deduction (DPAD), a tax incentive that lowers the corporate statutory tax rate on domestic manufacturing activities by approximately 3%. In order to analyze the DPAD, I collect data on the deduction from firms' tax footnotes contained 10-K filings. I identify 454 firms for which the deduction was large enough to produce a "material" difference between their statutory and effective corporate tax rates. The average firm in the sample reports a $3.18 million tax deduction.

To analyze the investment impacts of the DPAD, I combine the firm-level data on the deduction with industry level variation in investment depreciation rates to construct a "user cost of capital" variable which summarizes the after-tax cost of investment. I estimate the investment response these user costs for the 454 DPAD firms. Because user costs are constructed at the firm level, this elasticity, that is central to the public finance literature, is identified for the first time using firm level, not industry level, variation. Estimates are slightly larger than prior industry-level

estimates and suggest that a 1% decrease in the user cost of capital results in a 1.37% increase in investment as a fraction of installed capital. This estimate suggests that for the average firm in the sample, the DPAD increases investment behavior by approximately 1%.

2. Future Research

Looking forward, I plan to continue to focus my research agenda on the effects of taxation on corporate behavior and how corporate control affects the impacts of tax policy. In the very near future I hope to explore two particularly exciting and more focused questions within the broader agenda:

a. The Effects of Taxation and Managerial Entrenchment on Corporate Charitable Giving (with Nicolas J. Duquette)

The US tax code allows C-corporations to deduct charitable contributions from taxable income; in 2012, US corporate giving totaled $18 billion. This significant sum is surprising behavior for profit-maximizing firms. We present a model of corporate giving that considers two explanations: first, that charitable contributions are a form of shadow executive compensation, and therefore are concentrated among firms with weak corporate governance; or charitable contributions may also be a form of tax-preferred distribution to shareholders, who would otherwise pay capital gains taxes prior to personal giving. We construct a novel panel dataset of public corporations' SEC filings, corporate charitable foundations, and measures of corporate governance to present a descriptive analysis of corporate charitable giving using micro data, and to test the effects of taxation and governance on corporate charity.

b. Payout Behaviors of Target Firms and Merger Performance

My research with Nathan Seegert examines how the taxation of acquiring firms affects merger performance. An equally interesting topic is the impact on merger performance of the payout behavior and taxation of target firms. "New view" models of dividend taxation carry the implication that the shadow value of capital is lower in firms that pay dividends. This counter-intuitive observation may lead returns to acquisition to be higher when the target does not pay dividends. This theory may be tested empirically using data on mergers and acquisitions in conjunction with information on target firm payouts.

My current and future research projects are only the first steps in understanding the interaction of tax policy and corporate governance and resulting firm behavior. I am thrilled to be on the leading edge of this new and exciting field that combines the worlds of public and corporate finance to produce research that is immediately applicable both from the perspectives of the firm and the government.