

Firm and Investor Responses to Uncertain Tax Benefit Disclosure Requirements

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ABSTRACT

We examine whether proprietary costs affect disclosure quality and how investors react to disclosure quality in a new proprietary cost setting. We apply [Verrecchia's \(1983\)](#) proprietary cost theory to the FIN 48 adoption setting and argue that proprietary costs result from beliefs that the new disclosures could weaken a firm's competitive position when negotiating with tax authorities. FIN 48 is an ideal setting to examine how proprietary costs affect disclosure given the proprietary nature of uncertain tax positions, and the ability to construct objective measures of both proprietary costs and disclosure quality. We construct disclosure quality scores for S&P 1500 firms and offer two empirical findings. First, we find a negative association between proprietary costs and disclosure quality. Second, investors reward firms for low disclosure quality, especially small firms and firms with high proprietary costs. Both findings are consistent with [Verrecchia's \(1983\)](#) theory, and suggest that proprietary costs moderate investor demand for full disclosure.

JEL Classifications: G14, L15, M41, M44, M45

Keywords: [FIN 48 \(ASC 740-10\)](#), [proprietary costs](#), [disclosure quality](#), [tax avoidance](#)

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