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Political Affiliation and  
Dividend Tax Avoidance:  
Evidence from the 2013 Fiscal Cliff

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Evidence from the 2013 Fiscal Cliff.

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## **Abstract**

This paper uses the 2013 fiscal cliff as a natural experiment to examine how the political affiliation of the CEO affected a firm's response to an expected increase in personal taxes on dividends. Firms could avoid such additional taxes by paying extra dividends and accelerating dividends in the last two months of 2012. These tax avoiders are compared with a sample that could have easily accelerated dividend payments, but did not. We find that the difference in behaviour between firms that avoid taxes and firms that do not, but could have, is explained by the CEO's political sympathies: Republican CEOs are more likely to help their investors to save money on income taxes. However, other effects seem to be more significant, such as: the consequences for the CEO's personal wealth as well as the percentage of insider holdings. Larger firms are also more reluctant to engage in avoiding taxes for "the rich", possibly indication reputational concerns.

Key words: Supply Chain; Information Transfers; Analyst Following; Forecast Revisions; Forecast Accuracy

## 1. Introduction

During the last two months of 2012 more than 400 U.S. firms announced special dividends or accelerated the payment date of their future planned dividends to December 2012. While mostly the acceleration only involved the payment of a single quarterly dividend, in some cases several planned dividend payments were accelerated. For example, on December 3, 2012 Oracle announced that it would pay a dividend of 18 cents per share in December, which replaced the three quarterly 6 cents per share dividends that were planned to be paid in 2013. The obvious motivation for this decision was tax avoidance: the re-election of Barack Obama in November 2012 significantly increased the probability that, starting January 1, 2013, the dividend tax cuts, introduced by George W. Bush in 2003, would expire. Specifically, President Obama clearly stated he wanted to increase these tax rates from 15 % to 43.4 %, at least for the “rich”, defined as anyone who makes more than \$ 250,000 per annum<sup>1</sup>. The threat of this tax increase was commonly referred to as the tax side of the “fiscal cliff”: because of a prior agreement to cut the government deficit, these increases in tax rates as well as reductions in government spending were supposed to take effect on January 1, 2013.

The fiscal cliff was a heavily debated issue in the fall of 2012 so it is reasonable to assume that every CEO in the country was aware of the high likelihood that taxes on dividends would increase after January 1, 2013, at least for the wealthy investors.<sup>2</sup> Although a large number of firms announced special or accelerated dividends, the overwhelming majority did not. The fact that many firms did not pay an extra dividend is not surprising, as in general, very few firms pay extra dividends. For example, Hanlon and Hoopes (2013) show that since 2000 in normal times (i.e., ignoring the anticipation of tax changes in 2011,

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<sup>1</sup> See e.g. “The economic and fiscal effects of the Obama tax plan”, heritage.org, December 14 2012

<sup>2</sup> A Google search in January 2013 produced more than 70 million references to “fiscal cliff”.

2010 and 2012) fewer than 10 firms per month pay extra dividends. Hence the extra dividends that were paid in December 2012 represent a 20-fold increase.

What is surprising is the behavior of 199 firms that could have moved up the payment date of their regular quarterly dividend from January, February or March 2013 to December 2012, but did not, in spite of the fact that such a costless move could have saved wealthy investors a lot of taxes. So, we can distinguish three types of firms: 1) the 218 firms that paid a special dividend (*the special dividend payers*) 2) the 201 *accelerators* that moved the payment date of their first planned 2013 quarterly dividend to December 2012 and finally 3) the 199 firms that obviously showed no interest in accelerating their next quarterly dividend (*the deliberate tax payers*) although this would not have affected firm cash flows. One caveat: perhaps these firms were concerned about taxes but were extremely confident that the tax laws would be extended, since they had always in the past in spite of Obama's rhetoric. However, we would not expect extreme confidence to be correlated with variables such as political preference, personal wealth consequences and insider holdings, correlations that we will document below.

The purpose of this paper is to use this unique experimental setting to investigate whether the political affiliation of the CEO has an effect on corporate governance, which we define as concern for *after-personal-tax* shareholders wealth. We test whether the CEO's political orientation helps explain whether their firm joined a specific group (extra dividend payers, accelerators or deliberate tax payers). Why should political affiliation matter? While political opinions are based on a variety of criteria, one major difference between Democrats and Republicans is the attitude towards "taxes on the rich". Mitt Romney, Mr. Obama's Republican opponent, made it clear that, if elected, he would not let the Bush tax cuts expire

while Mr. Obama clearly promised to do the opposite<sup>3</sup>. Moreover, prominent wealthy Democrat CEOs such as Warren Buffet have repeatedly argued for higher taxes on the rich, including higher taxes on dividends and capital gains. So if Democrats are more driven by social motives such as reducing income inequality one would expect that fewer of them would engage in dividend policies designed to avoid income taxes for wealthy shareholders. If political orientation matters, then investors should not only pay attention to governance indicators but also collect information about the CEO's political orientation. We use information about political donations of individuals available at <http://fec.gov> to classify a CEO's political view. In addition we use a list of 80 CEOs who endorsed tax increases to "Fix the debt", a list published in the *Wall Street Journal* on October 24 2012, to get a more direct measure of the CEOs view on the dividend tax.

Alternatively, CEO's political views may be irrelevant, or subservient to other considerations such as personal wealth: CEOs who are likely to be in the top tax brackets may be more willing to become tax avoiders if they own a lot of stock. For example, Oracle CEO Larry Ellison received \$199 million of the accelerated dividends paid in December 2012. The early payment (assuming a 2012 tax rate of 15 % and 43.4 % tax rate in 2013) would have saved him more than \$56 million in income taxes<sup>4</sup>. Hence, the fact that Mr. Ellison is a Republican may not have been the fundamental driver behind the payout. Moreover, if insiders (officers and directors) as well as individual shareholders own large stakes in the firm, it is more likely that the Board will propose measures aimed at reducing personal taxes. Note that institutional investors such as pension funds or individual investors who hold their shares in a 401K account should not care as they are not directly affected by the tax change. Some middle class investors may actually be hurt by the extra dividend

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<sup>3</sup> See e.g. "Surprise! Romney tax plan favors the rich", Bloombergview.com, August 1 2012.

<sup>4</sup> "Oracle's Ellison could save a cool\$ 50 million on tax bill after paying dividend early", Streetinsider.com , December 3 2012.

income as it would make them subject to the alternative income tax.<sup>5</sup> Hence considerations of dominant shareholders (which we assume are representatives of “the rich”), may well explain why some firms accelerate dividends and others don’t.

Note that all of these explanations may be particularly relevant to explain why firms chose to become accelerators rather than deliberate tax payers, as in these cases the operating cash flows or the capital structure of the firm are unaffected by the payout policy. However for the other firms, (i.e. the extra dividend payers), there would be an impact on operating cash flows and capital structure. Firms may choose not to pay an extra dividend because they are financially constrained (i.e., they don’t have excess cash), because they have large growth opportunities and or because they never paid a dividend in the past. Moreover, share buybacks may be a more flexible and tax friendly way to pay out excess cash, especially considering that executive stock options may not be dividend protected. Trying to avoid personal taxes for wealthy shareholders may also hurt profits if such behavior generates a consumer backlash, especially at times when there is high unemployment, and consumers can get easily mobilized via social networks. Such a backlash led Starbucks to promise a “voluntary” 20 million pound corporate tax payment to the U.K. in December 2012<sup>6</sup>. We expect this to be a potential concern for large firms as their activities are more closely followed by the media.

The basic conclusion of this paper is that political orientation matters: firms are more likely to change their dividend policy to lower personal income taxes if the CEO is a Republican. However, the most important determinant of income tax avoidance is the personal wealth consequences of the CEO: the larger his/her tax benefits, the larger the

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<sup>5</sup> “Paying 2013 Dividends in 2012 may save on taxes, but not for everyone”, by Robertson Williams, December 12 2012, Tax Policy Center.

<sup>6</sup> “Starbucks pledges to pay £20 million tax over next two years”, The Independent, December 6, 2012.

probability of accelerating dividends or paying extra dividends. In addition firms are more likely to become tax avoiders if insiders own more shares and if firms are relatively smaller, i.e., when they are subject to less public scrutiny.

This paper contributes to the emerging literature on the impact of political inclination on corporate financial policies and investment behavior. Di Giuli and Kostovetsky (2014) find that firms with Republican CEOs and founders have lower corporate social responsibility (CSR) rankings than firms run by Democrats. Hong and Kostovetsky (2012) find similar results on the investor side: Democrat mutual fund managers are less likely to hold socially irresponsible companies in their portfolios than Republican mutual fund managers. Using a unique data base from Finland Kaustia and Torstilla (2011) find that left-wing Fins invest less in the stock market than right-wing Fins. Hutton, Jiang and Kumar (2013) find that firms run by Republicans are more profitable and pay higher dividends, but invest less in R&D and have lower leverage. They describe these as conservative financial policies and argue that conservative management teams follow conservative policies. Note that a special dividend or an accelerated dividend is consistent with conservatism: although the tax increase is not certain, the safe thing to do is try to take initiatives that will lower expected taxes. Not doing anything is more or less “gambling” that the tax increase will not happen. Christensen, Dhaliwal, Boivie and Graffin (2014) show that companies run by Republicans engage less in *corporate* tax avoidance than Democrats. They explain this result by the same logic as Hutton, Jiang and Kumar et al (2013): although Republicans don’t like taxes, they have lower risk tolerance than Democrats, and thus engage in less tax avoidance.

Our paper also adds to the extensive literature on dividend policy. Whether dividend policy is influenced by the investor level taxes on dividends is a controversial issue. Chetty and Saez (2005) and Blouin, Ready and Shackelford (2011) find that the 2003 decision to lower the tax rate on dividends from a maximum of 35 % to a maximum of 15 % increased

dividend payout ratios. However, others argue that the results are due to other factors such as the change in free cash flows or other firm characteristics (e.g., Edgerton 2012; Julio and Ikenberry 2005). The controversy is the result of the fact that dividend policy can be determined by other motivations such as signaling or reducing agency costs of free cash flow and that it is difficult to do an event study with one event. Moreover, as many investors are not taxable or can avoid taxes (e.g., by selling shares before ex-dividend days) it is not obvious that a CEO should worry about personal tax rates when determining payout policy. The managerial survey results of Brav, Graham, Harvey and Michaely (2008) are consistent with the low priority given to personal taxes, relative to other considerations.

However, in this paper, the comparison between the sample of the 201 accelerated dividend payers and 199 deliberate tax payers provides a unique experimental setting as accelerating or not accelerating has no impact on free cash flow or the fundamental value of the firm. *The basic conclusion of this paper is that, when agency costs and signaling are irrelevant, taxation influences dividend policy, provided the CEO and other insiders' wealth and reputation is personally affected and provided the decision is consistent with the CEO's political opinion.* The finding that personal wealth considerations are a driving force behind dividend policy is consistent with other research on dividend policy. Chetty and Saez (2005) find that firms with more insider ownership responded more significantly to the dividend tax reduction of 2003. Perez-Gonzales (2003) and Holmen, Knopf and Peterson (2008) show that firms with large shareholders adjust their payment policy in a way to reduce the tax burden of these shareholders.

Recently, a number of studies have examined the consequences of the anticipated 2013 tax hike. Perez-Cavazos and Silva (2014) show that executives reacted strategically by realizing capital gains, as well as save taxes for their shareholders by increasing dividends

prior to the expected tax change. Hanlon and Hoopes (2013) show that the anticipation of the expiration of the low Bush tax rates on dividends on January 1, 2011 as well as in January 2013 led to an increase in the number of special dividends as well as the acceleration of dividend payments. Another paper closely related to our work is Hribar, Savoy and Wilson (2013) who also measure to what extent firms accelerated dividends and paid extra dividends in December 2012. Our paper differs in three aspects. First, we examine the impact of political opinions on the decision to avoid personal taxes on dividends. Second our search process to find acceleration of dividends in 2012 seems to be more comprehensive as we find 201 accelerators, which is larger than the numbers reported by Hanlon and Hoopes (2013) as well as Hribar, Savoy and Wilson et al (2013). The way we find accelerators is not through press releases or SEC filings, but by directly observing the change in dividend payment behavior from 2012 using a specialized website: <http://dividend.com>. We also don't restrict ourselves to acceleration from January to December, but we also find acceleration from February and March 2012. And finally, rather than comparing accelerators and extra dividend payers with numerous other firms, we compare them with a specific sample of deliberate tax payers, firms that could have easily accelerated their dividend, but did not. In other words, we are comparing the firms with the most different responses to the anticipated dividend tax increase.

This paper is organized as follows. In section 2 we describe the data, methodology and our main hypotheses. Section 3 shows some descriptive statistics consistent with the hypothesis. Section 4 tests the hypotheses more rigorously by testing whether the probability of tax avoidance depends on the political opinion of the CEO, *ceteris paribus*. Section 5 concludes.

## 2. Identification, data and hypotheses

### 2.1 Identification

The goal of the study is to estimate the importance of CEO related characteristics on the firm's decision to take personal tax consequences of dividend payments into account. A key challenge is identification. Payout policy decisions are affected by many different factors including taxation issues, but more importantly, factors such as investment opportunities relative to cash available. Thus, we need two at least two conditions for a valid identification. First, an exogenous shock to the taxation of dividends. Second, a measure that is not affected by potential business consequences of such a tax change.

The re-election of US-President Barack Obama in November 2012 significantly increased the probability that, starting January 1, 2013, the dividend tax cuts, introduced by George W. Bush in 2003, would expire. Specifically, President Obama clearly stated he wanted to increase top personal tax rates on dividends from 15 % to 43.4 %, at least for the "rich", defined as anyone who makes more than \$ 250,000 per annum<sup>7</sup>. The threat of this tax increase was commonly referred to as the tax side of the "fiscal cliff": because of a prior agreement to cut the government deficit, these increases in tax rates as well as reductions in government spending were supposed to take effect on January 1, 2013. To the extent that the re-election of President Obama was closely contested, the election outcome significantly increased the probability of a personal tax rate increase since the opponent would have likely extended the Bush tax cuts. Thus, the event has had an exogenous part to it in the sense that the election outcome has exogenously changed the probability of a personal tax rate change. However, the tax rate change could be the result of and/or affect future investment

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<sup>7</sup> See e.g. "The economic and fiscal effects of the Obama tax plan", heritage.org, December 14 2012

opportunities of US-firms. Thus, the fiscal cliff per se does not constitute a sufficient event to analyze all firms' dividend decisions.

In order to tackle the second condition, i.e., that we can study whether personal taxes affect the payout decision, we focus on a subset of dividend paying firms. Those firms have pre-announced quarterly dividend schedules. Our main identification relies on the fact that a subset of firms with pre-scheduled quarterly dividend payments in January, February, or March of 2013 have moved up the payment of the dividend to the last months of 2012. Thus, our main analysis does not require firms to change the cash payout to shareholders. It is only the timing that differs by a few months. To the extent that firms might be still cash constraint at the end of the year relative to the early months of 2013, we control for such variables as cash-to-assets, and net income. The effect of such a payout timing change is purely relevant for the personal taxes of the shareholders. Note, however, that not all shareholders might benefit from such a change in the payment scheduled due to the alternative minimum tax implication. To assess the importance of this argument, we control for ownership dispersion.

In sum, our tests are based on a comparison of firms that have changed their tax payment date to 2012 from 2013 (ACCELERATORS) relative to those firms that could have moved their payment date but did deliberately not (DELIBERATE TAX PAYERS).

We complement our analysis by considering firms that announced a special dividend payment for the end of 2012. Clearly, this is a group of firms where the payout decision affects cash available within the firm. Thus, this set of firms should be compared to firms that could have paid a special dividend but did not. However, Hanlon and Hoopes (2013) show that since 2000 in normal times (i.e., ignoring the anticipation of tax changes in 2011, 2010 and 2012) fewer than 10 firms per month pay extra dividends. Thus, any model predicting a special dividend payment among the set of thousands of US firms has very low

power. Rather than introducing noise into the analysis by addition a handful of firms which might have likely paid out a special dividend, but did not, we decided to maintain the ‘deliberate tax payers’ as the control group. Given that we find 218 special dividend paying firms in December of 2012, compared to an expected ten based on Hanlon and Hoopes (2013) estimates, we believe this is a reasonable strategy. However, given that special dividend payments are affected by the availability of cash relative to investment opportunities, we include additional control variables in the regression analysis.

## 2.2 Data

We collected data on announcements of accelerated dividends and special dividends using two main sources: Capital IQ and the website <http://dividend.com><sup>8</sup>. Using Capital IQ, we identified these dividends using keywords such as “accelerated dividend” and “special dividend” made during the last 3 months of 2012. Announcements made by foreign firms and REITs were excluded. This generated 86 accelerated dividend announcements and 218 extra dividend announcements. We noticed from examining the information on <http://dividend.com> that an additional 115 firms had shifted their quarterly dividend payment date from 2013 to December 2012, without any trace of such announcement on Capital IQ. This is consistent with the hypothesis that the majority of firms wanted to keep a low profile when engaging in activity purely designed to “save taxes for the rich”. Thus, we ended up with a total of 201 dividend accelerators and 218 extra dividend payers. Note that some of the special dividend payers also announced at the same time the acceleration of the regular quarterly dividend payment. These firms were included in the accelerated dividend sample. From dividends.com we could also identify which companies paid out their quarterly 2012 dividend in January, February or March 2013, and thus did not accelerate the payment date to December 2012. In

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<sup>8</sup> [www.dividend.com](http://www.dividend.com) is owned and operated by Mitre Media Corp.

other words, these 199 firms, described as deliberate tax payers, kept more or less<sup>9</sup> the same payment date as in 2012 and made no effort to accelerate the dividend to potentially help out their shareholders. An important identification strategy of our study is that we identify firms that could have avoided taxes but chose not to. However, as a consequence we exclude from our comparable sample firms that either pay no dividends or that do not pay dividends in the first three months of 2013. Including such firms would make it necessary to model the dividend decision in a first stage and dilute our identification.

In order to estimate and identify the political orientation of the CEO (POLITICS), we follow prior literature and infer it from their political contributions made to senate, house and presidential candidates (the same procedure as Hong and Kostovetsky (2012) and Hutton, Jiang, and Kumar (2013) and Christensen, Dhaliwal, Boivie and Graffin (2014), at least for firms that are included in the S&P 1500<sup>10</sup>. We collect political contributions made to senate, house and presidential candidates between the years of 1991 to 2012 for firms that are included in the S&P 1500, from 2000 to 2012 for non-S&P1500 firms. These contributions are tracked by the FEC and can be found on <http://www.fec.gov>. Managers can make contributions indirectly through their own company sponsored by Political Action Committees (PACs) or donate directly to candidates. Because PACs usually contribute to multiple parties at the same time (Cooper, Gulen and Ovtchinnikov 2010) we only use donations to specific candidates. We obtain the CEO's individual contributions from FEC "detailed files". These files record the name, address, occupation of the donor and the amount donated. POLITICS is calculated as follows: for each two-year election cycle we take the total dollar value of the CEO's contributions to the Republican Party and subtract the contributions to the Democratic Party. The difference is then divided by the sum of the

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<sup>9</sup> Dividend payment dates are remarkably constant over time. The firms who paid a dividend during the first 3 months of 2013 were paying dividends within a few days of the 2012 payment date.

<sup>10</sup> We are grateful to Dane Christensen for providing us with this data. Data for non-S&P 1500 firms was hand-collected.

contributions to both parties. This variable ranges between 1 and -1, where 1 indicates that the CEO has made all his contributions to the Republican Party and -1 indicates all his contributions were made to the Democratic Party. We then average this number across all election cycles to obtain a value for POLITICS. While taking such a long look-back period can be subject to the criticism that it does not allow manager's political preferences to change over time, the fact is that political preferences are remarkably stable (Green, Palmquist and Schickler (2002), Christensen, Dhaliwal, Boivie and Graffin (2014)). To check the robustness of our measure, we also measure political inclination by using a variable set equal to 1 if POLITICS is positive, -1 if POLITICS is negative and zero otherwise. In the tables below we refer to this measure as POLITICS (DUMMY).

One critique of these measures is that political preferences orientation can be driven by non-financial considerations such as social values. Ideally we would like to have the opinion of the CEO about tax reform. We address this criticism partially by using a list of 80 CEOs who endorsed tax increases to "Fix the debt", a list published in the *Wall Street Journal* on October 24 2012. Sixteen CEOs in our sample were on the list. In this case we assumed he/she was a Democrat "for tax purposes" and set POLITICS and POLITICS (DUMMY) equal to = -1. Not surprising, 13 out of the 16 were "deliberate tax payers", they could easily have saved taxes for their investors but they did not. Note that our classification made a difference: on the basis of the <http://fec.gov> website data we would have classified twelve of these sixteen CEOs as Republicans, two as Democrats and two without political affiliation. Hence the list allowed managers who normally would support the Republican party to express disagreement with the Republican party's standing on "taxing the rich" and most of them behaved according to this public statement by not accelerating dividends or paying extra dividends. One interesting exception: although the CEO of Marriott endorsed

the list, he accelerated dividends anyway. The fact that Mitt Romney was on the Board of Marriott may well explain this apparent inconsistency.

Data on managerial ownership and ownership of insiders (officers and directors and 5 % owners) was collected from SEC filings (form 4, or the recent proxy statement on file 14A). The advantage of manual collection is that we can correctly identify the CEO as well as insider ownership at the time of the decision, December 2012. As these shareholders' ownership stake (INSIDERS) increases, we predict that there will be more pressure on the Board to accelerate dividend payments or to pay extra dividends. Given the number of shares N owned by the CEO, we can calculate the CEO expected personal benefit (BENEFIT) of paying out extra dividend and/or accelerated dividend (DIVIDENDS):

$$\text{BENEFIT} = N \times (0.434 - 0.15) * \text{DIVIDENDS}$$

This calculation reflects the fact that in 2012 the personal tax rate on dividends was 15% and the expectation was that this rate would increase to 43.4%. For the “deliberate tax payers”, there was of course a wealth loss for the CEO. In this case BENEFIT should be considered as a measure of the opportunity cost of the CEO of deciding not to accelerate dividends. The larger the opportunity cost of the CEO, the larger the probability that he/she will accelerate dividends rather than pay a higher tax.

In short, we hypothesize that the probability of becoming a tax avoider rather than a deliberate tax payer is positively related to POLITICS, BENEFIT and INSIDER.

### **3. Summary statistics**

Table 1 shows summary statistics on our explanatory variables, for each of the subsamples (“accelerators,” “extra dividend payers,” and “deliberate tax payers”). Note that the first group (the “tax avoiders” (i.e. “accelerators” and “extra dividend payers”)) and the

“deliberate tax payers” can be considered as the two extremes of the universe of firms: those that show that reducing personal taxes is a high priority and those that believe that pre-occupation with such tax savings is not important.

Special dividend payers are largely controlled by insiders who, on average, own more than 25% of the shares (median 19.5%). The average CEO is expected to save \$651,562 in taxes while the median is expected to save only \$130,308. Note that the BENEFIT variable is heavily skewed as it can be seen from the large difference between median and mean, possibly as a result of outliers. We therefore also calculated the log of the absolute value of BENEFIT. Only 1 out of these 218 CEOs who paid special dividends signed the “Fix the debt” declaration and the average POLITICS score is 0.27, suggesting that the typical CEO is a Republican. POLITICS (DUMMY) gives a slightly higher score (0.32).

On the other end of the spectrum, in the sample of 199 “deliberate tax payers”, we find much smaller insider ownership (average: 6.31%, median 2%). The average CEO suffers only a small opportunity cost of \$26,468 (median \$8,328) by not accelerating the dividend. 13 out of these 199 CEOs signed the “Fix the debt” declaration which means that 16% of all CEOs in America who signed the declaration are represented in this sample of 199 firms. The average POLITICS score is only 0.11 (POLITICS (DUMMY) = 0.15), suggesting a profile that leans less to the Republican Party than the extra dividend payers.

The sample of 201 accelerators is somewhere in between: average insider ownership of 16.4% (median 8%) while, on average, CEOs would be expected to save \$343,167 (median \$10,344) in taxes. The large difference between mean and median is caused by Larry Ellison’s \$56 million gain. When calculating logs, the distribution becomes symmetric. Two out of these 201 CEOs signed the “Fix the debt” declaration and the average political score is

0.21 (POLITICS (DUMMY) = 0.22), so CEOs in this group lean more towards the Republican party than the deliberate tax payers, but less than the special dividend payers.

So the first impression we get from table 1 is that those firms where insiders are important, where CEOs lean towards the Republican Party and have a lot of their personal wealth at stake tend to exert efforts to lower personal taxes on dividends, especially by paying extra dividends.

#### 4. Regression analysis

Next we run regressions using the cleanest sample, i.e., the sample of accelerators and deliberate tax payers, excluding extra dividend payers. We use the following model:

$$ACCELERATOR = \beta_0 + \beta_1 POLITICS + \beta_2 LnBENEFIT + \beta_3 INSIDER + \varepsilon$$

Where the dependent variable, ACCELERATOR, equals one if the firm paid its regular first quarter 2013 dividend in December 2012 (i.e., an accelerator), and zero if the firm chose to pay its regular first quarter dividend in 2013 (i.e., a deliberate tax payer). The decision to move the dividend payment from 2013 to December 2012 does not affect firm cash flows so there is no need for obvious control variables that are typically associated with the ability to pay dividends.

We start with an OLS regression and report the results in Table 2. As predicted, the politics variables (whether measured by POLITICS or POLITICS (DUMMY)) are statistically significant although POLITICS appears to be stronger (p-value of 0.017) than POLITICS (DUMMY) (p-value of 0.054). This suggests that the higher precision of the POLITICS variable is more informative. In other words, there is a difference between a CEO

with a POLITICS score of 0.25 and a POLITICS score of 1 (note that both would have a POLITICS (DUMMY) score of 1). Insider holdings and especially the personal wealth consequences of the CEO appear to be driving the decision to be an accelerator rather than a deliberate tax payer. The coefficients have the expected sign and are significant at the 1 % level.

Because our dependent variable is a binary variable, it seems preferable to run logistics regressions. The results are shown in table 3 and are similar to the results of table 2. It is more likely that a firm is an accelerator if the CEO is a Republican, and gets more personal benefits from changing the firm's dividend policy. As before, insider holdings are also very significantly related to the probability to become an accelerator. The coefficients are also economically significant. The regression coefficient on POLITICS is 0.38. This implies an odds ratio<sup>11</sup> of 1.46. The odds ratio measures the change in probability when the independent variable changes with one unit. Hence when the CEO is a loyal Republican (POLITICS = 1) rather than a loyal Democrat (POLITICS = -1) the independent variable changes with 2 units. This means that in this case the likelihood of being an accelerator increases by a factor of  $2 \times 1.46$  or 2.92. Or, *ceteris paribus*, the likelihood of being an accelerator is nearly 300 % higher when the CEO is a Republican. Using the same logic it is possible to interpret the 0.28 coefficient on LOG (BENEFIT) (which implies an odds ratio of 1.32): a 100 % increase in the personal financial benefit from accelerating will generate an increase in the likelihood of becoming an accelerator by 132%. Similarly, important, the coefficient on INSIDER of 0.05 implies an odds ratio of 1.05. An increase in insider ownership by one percentage point implies a doubling of the likelihood of becoming an accelerator.

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<sup>11</sup> The odds ratio is the exponent of the coefficient.

Next, we pool the accelerators and the extra dividend payers in one group (which we can call the tax avoiders) and set the dependent variable equal to 1 if the firm belongs to this group and 0 when it is a deliberate tax payer. Table 4 shows the results without incorporating any additional control variables. The results are qualitatively similar to those in Table 3. Even quantitatively, the coefficient of 0.37 on the POLITICS variable leads to the same inference about the impact of the political affiliation with tax avoidance. However, the pseudo r-squared is higher indicating that the decision to pay out an extra dividend is apparently more strongly predicted by political preference than accelerating dividends. However, the stronger results could also be simply due to the fact that we now have approximately 50 % more observations.

In Table 5, we use logistic regressions to estimate whether a firm is a tax avoider or a deliberate tax payer, but now controlling for a number of variables that could be associated with the decision to pay an extra dividend: one would expect that low leverage firms have a larger capacity to pay dividends, hence we add LEVERAGE, measured by book value of debt divided by total assets, as an independent variable. Firms with high growth opportunities may prefer not to pay dividends, hence we use MARKET-TO-BOOK and CAPEX/ASSETS to control for investment opportunities. Firms that never paid a dividend are unlikely to start paying an extra dividend now, so we expect DIVIDEND YIELD to be negatively related to the likelihood of being a tax avoider. We also expect that firms who have excess cash and are profitable are more likely to become a tax avoider, so we add CASH/ASSETS as well as a dummy variable, LOSS, which is set equal to 1 if the firm reported negative net income in the last fiscal year ending before October 2012 and zero otherwise. Finally, we want to control for reputational risk, by adding firm size as a control variable. When larger firms engage in aggressive tax avoidance such as paying an extra dividend it is more likely this will be reported in the financial press. Hence, large firms may be more concerned about reputation

risk and less inclined to openly engage in activities to benefit “the rich”. The fact that all the 80 CEOs who pleaded to “Fix the debt” in their Wall Street Journal editorial were leading large firms supports this hypothesis. Hence we add FIRM SIZE, measured as the logarithm of the book value of assets as per the last fiscal year ending before October 2012, as an additional control variable. We also include industry fixed effects where industry is defined at the one digit SIC level.

The results in Table 5 show that, using POLITICS, there still is a marginally significant ( $p=0.084$ ) positive relation between political sympathies for the Republican Party and the likelihood to become a tax avoider. Using the less precise measure POLITICS (DUMMY) lowers the p-value to 0.12. Out of all the control variables only CASH/ASSETS ( $p \leq 0.06$ ) and FIRM SIZE ( $p \leq 0.000$ ) are statistically significant and have the predicted sign. Thus, one concern is that the fact that cash is significantly positively related to the likelihood of being a tax avoider, might be a result of some of the tax avoiders being extra dividend payers. Indeed the decision to become an accelerator should not be influenced by the availability of cash. To verify this we re-ran the regression with all the control variables, but now for the “pure” sample that only includes accelerators and deliberate tax payers. The results in Table 6 are consistent with our intuition: while firm size is still negatively related to the probability to become an accelerator, the coefficient on cash is no longer significant ( $p > 0.54$ ).

A second potential concern comes from the following identification strategy argument: dividend accelerators are compared to deliberate tax payers, which could have accelerated without influencing cash flows or having a dividend signaling issue. However, the extra dividend payer firms do not have a natural counterpart in our sample. The counterpart would have to be firms that could have paid an extra dividend but decided not to.

Based on Hanlon and Hoopes (2013), however, this is almost an empty set, since in normal times only about 10 firms have paid an extra dividend in a given year. Thus, running a predictive regression to determine which firms could have paid an extra dividend leads to exceedingly low powered predictions. Therefore, we use the assumption that firms are not expected to pay an extra dividend and hence not include any ‘predicted extra dividend payers’ in our sample.

## **5. Conclusion**

We document (as Hribar, Savoy, and Wilson, 2013, Perez-Cavazos and Silva, 2014, and Hanlon and Hoopes, 2013) that firms accelerated dividends and paid extra dividends in anticipation of the 2013 increase in personal taxes on dividends. We also find, surprisingly, about 200 firms that easily could have accelerated their dividend, but chose not to. This paper argues that the difference in behavior is explained by the political sympathies of the CEO, the consequences for his personal wealth, and the percentage of shares held by insiders. These findings suggest that, *ceteris paribus*, Republican CEOs are more likely to reduce the tax bill of their investors. However, personal benefits coming from CEO and insider ownership are more significant. The implication from these findings is that investors should be aware of the political sympathies of the CEO and a visit to <http://fec.gov> website to identify a CEO’s political orientation may be worth their time. The fact that large firms are reluctant to engage in tax avoidance at a time of high unemployment and government deficits suggests that reputational concerns may outweigh the tax benefits related to modifying the firm’s payout behavior. Announcements by large firms have more visibility in the financial press and may generate negative responses from the public, especially customers.

This paper sheds also some light on the question of whether firms care about personal taxes when they set dividend policy. Some would argue that firms pick a stable dividend policy and attract a clientele that likes this policy, for a variety of reasons, including tax considerations. Others would argue that investors who don't want to pay taxes on dividends could simply sell the shares before the ex-dividend day. What this paper shows is that occasionally CEOs care about the personal taxes their investors pay, in particular when the tax rate increase is substantial and the wealth of the CEO is significantly affected. As they own significant stakes in the firm selling shares before the ex-dividend day and buying them back afterwards is not an option. This illustrates the importance of ownership in assessing the quality of after-tax corporate governance.

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**Table 1: Summary Statistics**

The sample consists of 618 firms which either accelerated their dividend payment from the January-March 2013 period to December 2012 (201 Accelerator firms), could have accelerated the dividend payment because they had a dividend payment scheduled in the January-March 2013 period but did deliberate not (199 Deliberate Tax Payers), or did pay an extra dividend between October and December of 2012 (218 Extra Dividend Payers firms). Mean, median and standard deviation are shown for 5 variables: INSIDERS which is the percentage of shares held by insiders; POLITICS is a variable that measures the difference between the contributions of the CEO to the Republican party and the Democrat party, divided by the total contributions. It is a continuous variable with an upper limit of 1 when all contributions go to Republican candidates and a lower limit of -1 if all contributions go to Democrats. POLITICS (DUMMY) is a variable that is set to 1 if POLITICS is greater than 0, to -1 if POLITICS is less than 0 and 0 otherwise. BENEFIT measures the personal benefit to the CEO of accelerating or paying an extra dividend. LOG(BENEFIT) is the logarithm of absolute value of BENEFIT.

<b>Variable</b>	<b>Accelerators</b>	<b>Deliberate Tax Payers</b>	<b>Extra Dividend Payers</b>
Number of Firms	201	199	218
<b>INSIDERS</b>			
Mean	16.40	6.31	25.20
Stdv	1.38	0.71	1.39
Median	8.00	2.00	19.50
<b>POLITICS</b>			
Mean	0.20	0.10	0.27
Stdv	0.044	0.046	0.043
Median	0.00	0.00	0.00
<b>POLITICS (DUMMY)</b>			
Mean	0.22	0.15	0.32
Stdv	0.051	0.051	0.048
Median	0.00	0.00	0.00
<b>BENEFIT</b>			
Mean	332,756	-24,861	659,743
Stdv	294,616	-4,371	130,300
Median	10,334	-8,328	107,956
Min	129	-546,840	0
Max	5,5703,873	0	17,419,554
<b>LOG(BENEFIT)</b>			
Mean	9.45	8.54	11.05
Stdv	0.13	0.16	0.184
Median	9.24	9.03	11.59

**Table 2: Accelerators versus Deliberate Tax Payers: OLS Regressions**

The table shows coefficients of OLS regressions where the dependent variable in the regression is the ACCELERATOR DUMMY set to 1 if the firm is an accelerator and equal to zero if the firm is a deliberate tax payer. The sample only includes accelerators and deliberate tax payers. The independent variables are defined in Table 1. The two regressions differ in the way political preferences are measured. P-values in parentheses are based on robust standard errors. \*\*\* indicates significance at the 1 % level, \*\* significance at the 5 % level and \* significance at the 10 % level. N refers to the number of observations.

Dependent Variable:	ACCELERATOR DUMMY	
	(1)	(2)
POLITICS	0.08 (0.017) **	
POLITICS(DUMMY)		0.06 (0.054)*
LOG (BENEFIT)	0.05 (0.000) ***	0.05 (0.000) ***
INSIDER	0.01 (0.000) ***	0.01 (0.000) ***
CONSTANT	-0.075 (0.36)	-0.077 (0.35)
R <sup>2</sup>	0.157	0.156
N	400	400

**Table 3: Accelerators versus Deliberate Tax Payers: Logistic Regressions**

The table shows coefficients of logistic regressions where the dependent variable in the regression is the ACCELERATOR DUMMY set to 1 if the firm is an accelerator and equal to zero if the firm is a deliberate tax payer. The sample only includes accelerators and deliberate tax payers. The independent variables are defined in Table 1. The two regressions differ in the way political preferences are measured. P-values in parentheses are based on robust standard errors. \*\*\* indicates significance at the 1 % level, \*\* significance at the 5 % level and \* significance at the 10 % level. N refers to the number of observations.

Dependent Variable:	ACCELERATOR DUMMY	
	(1)	(2)
POLITICS	0.38 (0.021) **	
POLITICS (DUMMY)		0.28 (0.057)*
LOG (BENEFIT)	0.28 (0.000) ***	0.28 (0.000) ***
INSIDER	0.05 (0.000) ***	0.06 (0.000) ***
CONSTANT	-3.12 (0.000) ***	-3.12 (0.000) ***
Pseudo R <sup>2</sup>	0.135	0.131
N	400	400

**Table 4: Tax Avoiders versus Deliberate Tax Payers: Logistic Regressions**

The table shows coefficients of logistic regressions where the dependent variable in the regression is the TAX AVOIDER DUMMY set to 1 if the firm is either an accelerator or pays an extra dividend, and equal to zero if the firm is a deliberate tax payer. The independent variables are defined in Table 1. The two regressions differ in the way political preferences are measured. P-values in parentheses are based on robust standard errors. \*\*\* indicates significance at the 1 % level; and \*\* significance at the 5 % level. N refers to the number of observations.

Dependent Variable:	TAX AVOIDER DUMMY	
	(1)	(2)
POLITICS	0.37 (0.012) **	
POLITICS (DUMMY)		0.31 (0.017) **
LOG (BENEFIT)	0.30 (0.000) ***	0.30 (0.000) ***
INSIDER	0.07 (0.000) ***	0.07 (0.000) ***
CONSTANT	-2.94 (0.000) ***	-2.96 (0.000) ***
Pseudo R <sup>2</sup>	0.21	0.21
N	618	618

**Table 5: Tax Avoiders versus Deliberate Tax Payers, with Additional Controls: Logistic Regressions**

The table shows coefficients of logistic regressions where the dependent variable in the regression is the TAX AVOIDER DUMMY set to 1 if the firm is either an accelerator or pays an extra dividend, and equal to zero if the firm is a deliberate tax payer. The independent variables are defined in Table 1. The additional control variables are: dividend yield, cash/assets, loss (a dummy variable equal to one if the firm reports a loss), leverage (book value of debt divided by book value assets), capex/assets, market-to-book and size (logarithm of book value of assets). Industry fixed effects at the one-digit SIC level are included. P-values are in parentheses based on robust standard errors. \*\*\* indicates significant at the 1 % level, \*\* significant at the 5 % level and \* significant at the 10 % level.

Dependent Variable:	TAX AVOIDER DUMMY			
	(1)		(2)	
POLITICS	0.29	(0.084)*		
POLITICS (DUMMY)			0.23	(0.12)
LOG(BENEFIT)	0.41	(0.000)***	0.42	(0.000)***
INSIDER	0.04	(0.000)***	0.04	(0.000)***
DIVIDEND YIELD	-6.55	(0.198)	-6.30	(0.219)
CASH/ASSETS	2.07	(0.056)**	2.00	(0.061)**
LOSS	-0.23	(0.59)	-0.24	(0.57)
LEVERAGE	-0.29	(0.72)	-0.31	(0.698)
CAPEX/ASSETS	-3.38	(0.234)	-3.33	(0.242)
MARKET TO BOOK	-0.12	(0.39)	-0.11	(0.394)
FIRM SIZE	-0.44	(0.000)***	-0.45	(0.000)***
Industry F.E.	Yes		Yes	
Pseudo R <sup>2</sup>	0.29		0.29	
N	601		601	

**Table 6: Accelerators versus Deliberate Tax Payers, with Controls. Logistic Regressions**

The table shows coefficients of logistic regressions where the dependent variable in the regression is the ACCELERATOR DUMMY set to 1 if the firm is an accelerator and equal to zero if the firm is a deliberate tax payer. The sample only includes accelerators and deliberate tax payers. The independent variables are defined in Table 1. The additional control variables are: dividend yield, cash/assets, loss (a dummy variable equal to one if the firm reports a loss), leverage (book value of debt divided by book value assets), capex/assets, market-to-book and size (logarithm of book value of assets). Industry fixed effects at the one-digit SIC level are included. The two regressions differ in the way political preferences are measured. P-values in parentheses are based on robust standard errors. \*\*\* indicates significance at the 1 % level; \*\* significance at the 5 % level and \* significance at the 10 % level. N refers to the number of observations.

Dependent Variable:	ACCELERATOR DUMMY			
	(1)		(2)	
POLITICS	0.35	(0.06)*		
POLITICS (DUMMY)			0.23	(0.15)
BENEFIT	0.41	(0.000)***	0.41	(0.000)***
INSIDER	0.04	(0.000)***	0.04	(0.000)***
DIVIDEND YIELD	-0.10	(0.99)	0.24	(0.97)
CASH/ASSETS	0.69	(0.54)	0.59	(0.52)
LOSS	-0.51	(0.31)	-0.52	(0.30)
LEVERAGE	-1.27	(0.19)	-1.31	(0.17)
CAPEX/ASSETS	-3.97	(0.23)	-3.91	(0.24)
MARKET TO BOOK	-0.03	(0.85)	-0.04	(0.394)
FIRM SIZE	-0.34	(0.000)***	-0.34	(0.000)***
Industry F.E.	Yes		Yes	
Pseudo R <sup>2</sup>	0.19		0.20	
N	387		387	

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