

Pre- and Post-Tax Audit Differences of The Firm Value

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<Abstract>

This study addresses and examines differences in firm value after tax audits by the Korean Internal Revenue Service. Tax audits can potentially depreciate a firm's value due to the mass cash outflow that often results from the additional tax charges involved. However, tax audits that reveal negative aspects of a business, such as excessive entertainment expenses, fraudulent accounting, or inappropriate business practices, may have positive effects on a firm's value, as the monitoring involved can improve accounting transparency and reduce agency costs.

This study shows that there is typically an increase in a firm's value in the year after a tax audit has been conducted, in comparison with the previous year. This result suggests that firm value can increase after a tax audit is conducted, despite the possible value depreciation resulting from a mass cash outflow.

Key Words: firm value, tax audit, tax charge, tax evasion

I. Introduction

Tax audits can majorly impact firms' value. Firms undergoing tax audits may be forced to spend excessive amounts of time on subordinate activities and less time on management activities, and may face mass cash outflows resulting from additional tax charges. For these reasons, most corporations avoid getting audited. However, not all aspects of a tax audit are bad for business. After undergoing a tax audit, a firm's value may increase, as a result of external monitoring effects that reveal its negative aspects and increase its transparency. A study by Lee(2012), for example, shows that corporations reduce their earnings management activity after a tax audit has been conducted. Faber(2005) find a positive association between fraud detection and subsequent improvements in the quality of the board of directors and audit committee activity. Yeom and Song(2013) shows the result shows that corporate governance greatly improves on the next year after fraud detection. Yeom and Song(2013) find the strong evidence that the fraud firms improving corporate governance show increasing the value of the firm considerably in Korea stock market.

While a tax audit may reveal negative aspects of a firm and its value, which could cause value depreciation, it may also have a positive impact, leading the firm to increase its accounting transparency and business activities, which may increase its value. Intensive tax audits may reveal errors and processes mishandled by individuals in

charge of accounting and tax disposal, as well as business misconduct by CEOs. When negative information of a company is revealed by a tax audit, the manager can improve management method and value of the corporation can be increased as the result.

The potential advantages and disadvantages brought by a tax audit are of great concern to stakeholders, but obtaining information on them is difficult. Unless there are special reasons for disclosure, any information on a tax audit is kept confidential. Therefore, the influence of a tax audit on a firm's value has to be estimated based on approaches such as an analysis of fluctuation in firm value caused by the disclosure of the audit.

The effects of disclosing a tax audit can be compared with the effects of disclosing an external accounting audit, because both tax audits and external accounting audits are external monitoring measures.¹⁾ Through the continuous monitoring and disclosure of an external auditor, a firm can increase its value(Park and Jeon, 2011).²⁾ An external accounting audit saves costs through external monitoring, because it separates ownership and management. However, in some external accounting audit, a corporation can appoint the auditor, decide on the period covered, and choose which subjects will be audited. In a tax audit, however, the corporation has no control over these factors. Compared with an external accounting audit, therefore, a tax audit has more power over a corporation as an external monitoring mechanism.

1) A tax audit by the Korean IRS is compulsory, whereas external audits by accounting firms are generally optional. The Korean IRS decides on tax audits for corporations according to its internal rules. Corporations are generally afraid of tax audits, but if the effects of an IRS tax audit can act as a preventive measure in the early days of a business, over time, huge cumulative tax charges can be prevented.

2) Park and Jeon(2011) have verified that an external audit enhances the accounting transparency of a corporation by analyzing the measured values of the earnings management of corporations. Their study found that an external audit decreased earnings management and enhanced accounting transparency.

External accounting audits carried out by external organizations also have significant limitations. In 2001, when Enron was on the verge of going bankrupt, the accounting auditor of Worldcom, Andersen Accounting Firm, gave an unqualified opinion report on the settlement of accounts, regardless of the fact that it knew all about the company's accounting fraud and the risks that it presented (Zekany et al., 2004). Peecher et al. (2007) has shown that external accounting audits have weaknesses and should be more strictly carried out. The surprising exposures of major corporations' accounting fraud and the poor management of savings banks in Korea in 2011 was a particular demonstration of the limitations and problems involved in external accounting audits.³⁾ In one such case, although a savings bank had engaged in numerous instances of accounting fraud, the auditor for the company provided an unqualified opinion. Such incidents call the reliability of external audits into question and demonstrate their defects. External audits conducted by accounting firms simply express their opinions on the appropriateness of financial statements, and are very vulnerable to the concealment and manipulation of accounting information.

In contrast, tax audits can have much more useful external monitoring functions, revealing concealed, omitted, and fabricated information in balance sheets. They also investigate all business factors, such as a corporation's excessive donations, unnecessary entertainment expenses, or

the inappropriate business practices of its CEO. Consequently, they publicize a great amount of internal information on a corporation. Park and Lee (2005) argue that if an accounting audit has been properly conducted by an accounting firm, the corporation should not be charged by the IRS after a tax audit, but in practice, this is unlikely to occur, and most corporations are asked to pay significant charges. Tax evasion by tax adjustment can be mostly caught by examining a firm's books, but when a corporation tries to avoid paying taxes by using methods such as earnings management and account rigging, an intensive audit has to be conducted to expose the attempted tax evasion. After a tax audit, additional taxes may or may not be charged, but in most cases, such charges are certain to occur.

The purpose of this study is to change negative perspectives on tax audits by examining their positive effects on firm value, and to raise stakeholders' interest in tax audits by providing them with useful information. Negative perspectives on tax audits could increase firms' tendencies to engage in tax evasion and, in some cases, lead them to be caught in a vicious circle of tax evasion and audit avoidance. Corporations must endeavor to take advantage of the favorable aspects of tax audits, regarding them as opportunities for self-purification rather than penalties to be avoided. The government must also take a stronger interest in changing the direction of tax audits, reinforcing the positive aspects that they involve. Reducing the number of tax audits

3) Savings banks in Korea are controlled and restricted by the Financial Supervisory Service, which is similar to those of general commercial banks. Savings banks can only be established, with approval from the Financial Supervisory Service, after they have demonstrated their financial integrity and the morality of the major stakeholders. They are compelled to report all deposits received and loans to the Financial Supervisory Service. However, in 2011, 16 of 85 savings banks were liquidated, and four more followed in 2012. Savings banks have often stayed in business despite corruption and poor management because their accounting fraud is not exposed by external accounting audits. In such cases, the accounting firm involved receives thousands of Won in bribes to release incorrect audit reports (November 02, 2011, Yonhap News).

conducted is not the best way to move forward, as it causes additional taxes to be charged to corporations in the future. This could lead to a waste of national resources. By instead focusing on proactive initiatives, the IRS should endeavor to attain corporate accounting transparency and minimize tax evasion.

This study analyzes differences in firms' values after tax audits. All of the sample corporations used in this study were listed on the securities market and the KOSDAQ(Korea Securities Dealers Automated Quotations) market from 2000 to 2011, and all underwent tax audits by the IRS of Korea.

This study is organized as follows. Chapter 1 describes the purpose and the necessity of the study. Chapter 2 examines the tax audit disclosure system and the relationship between firm value and tax audits, based on previous studies. Chapter 3 sets up a theory and research model based on existing research. In chapter 4, an empirical analysis is conducted. Lastly, in chapter 5, the author offers a conclusion and explains the limitations of the study.

II. Previous research on Tax Audit Disclosure Regulations and the relationship between tax audits and firm value

In this chapter, existing research on corporate tax audits and firm value is examined. Disclosure

Regulations and previous research on disclosure systems is described, followed by a description of past studies on the relationship between tax audits and firm value. This previous research involves studies of firm value after tax audits have been conducted, of the effects of negative disclosure on firm value, and of the effects of positive disclosure on firm value.

1. Overview of Tax Audits by the IRS in Korea

In Korea, both periodic tax audits and random tax audits are conducted. Periodic tax audits are carried out once every 4-10 years or more. Companies may be selected based on ratio of tax returns amounts, size, or the date of their last tax audit, although the full details of this process are not known outside the IRS. Many corporations do not undergo a tax audit for more than 10 years. Random tax audits ensue when tax evasion becomes obvious, but how this is determined is also not made public. The percentage of corporations that are audited is 1.07%, as shown in <Table 1>. The average assessed tax amount by tax audits in 2012 was 9.68% of total corporation income tax(4,443million dollars/47,252million dollars=Assessed tax amount by tax audits in 2012/ Corporation income tax amount in 2012), which is very high. Tax audits can be heavy burdens for corporations, so carrying them out proactively, before acumulative tax charge is incurred, could be preferable.

<Table 1> Statistics of tax audit of Korea

Annual Sales Amount of a company	The Number of Corporations	Income Tax Amount	Number of Undergoing Audits	All Revenue after Audit	All Income before Audit	All Income after Audit	Assessed Tax Amount	Tax Audit Ratio
0.5 or under	211,665	352	154	16	40	184	168	0.07%
1 or under	55,772	231	84	62	10	70	25	0.15%
2 or under	56,994	564	442	707	42	114	50	0.78%
5 or under	61,039	1,360	831	3,290	251	556	204	1.36%
10 or under	27,645	1,658	755	6,059	467	1,546	615	2.73%
20 or under	13,752	1,916	482	6,676	673	1,068	234	3.50%
30 or under	4,525	1,281	522	13,067	747	983	117	11.54%
50 or under	3,446	1,550	481	19,090	1,376	1,923	294	13.96%
100 or under	2,621	2,391	539	38,091	3,745	4,646	597	20.56%
500 or under	1,997	6,649	315	61,786	8,016	9,609	992	15.77%
500 or more	567	29,300	84	307,017	54,384	56,401	1,141	14.81%
total	440,023	47,252	4,689	455,866	69,755	77,104	4,443	1.07%

2. Research on Tax Audits and the Transparency of Corporations

Jung and Jun(2010) has found that the tax audit has positive impact on the average stock prices, as they examined the abnormal returns(AR) and the cumulative abnormal returns(CAR) for the period encompassing each of the two events dates separately. They have asserted that the tax audit can improve accounting transparency through the monitoring of business management. The monitoring effect of business management may reduce agency costs between external shareholders and management, and between internal management and staff.

The accounting transparency is a important information for decision-making of the accounting information users(Park, 2012). According to Choi and Her(2007), the higher the level of transparency of a corporation is, the smaller the extent of its earnings management. the sensitive information for investors, the company's loss etc, affects earnings management of the company(Park and Ra, 2013). Lee(2012) has found that corporations reduce their

earnings management after tax audits, which could be the result of increased transparency. The transparency of a corporation can be calculated based on its degree of protection of the rights of shareholders, adequacy of board operations, relevance of disclosures, adequacy of internal audit activity, and adequacy of performance allocation.

3. Research on Depreciation of Firm Values after Tax Audits

In general, tax audits cause cash outflows in corporations, as a result of tax charges(Park and Lee 2005). Lee and Jung(2008) analyzed the stock fluctuations of corporations by using cumulative abnormal returns before and after tax audit disclosures. According to their analysis, stock prices typically depreciate after a tax audit is disclosed, and decrease further when the tax charge involved is bigger.

The value of shareholder equity can be calculated based on the current value of future cash flow. Cash flow is considered to have explanatory power over stock fluctuation(Bowen et

al., 1987; Chung, 1995; Song et al., 1999). A survey of investors carried out by Oh and Jang(1993) found that information on cash flow was useful as a standard for decision-making among investors. In general, when the present value of future cash outflow is viewed as a proxy for assessing firm value, tax audits are considered to decrease firm value.

4. Research on Non-Depreciation of Firm Values after Tax Audits

Corporations tend to minimize the corporate tax that they pay, in order to maximize their profits and those of their CEOs. Tax audits, and especially tax charges, may have significant negative effects on firm value over the short term, but may have positive effects over the long term. Once a corporation figures out that the costs of being exposed for tax evasion are greater than the advantages gained from tax evasion, it will endeavor to avoid evading taxes and increase its accounting transparency and reliability.

Past research has found that after a corporate tax charge is disclosed, the stock price of the corporation involved drops slightly, and only on the first day after the disclosure. According to a study on stock fluctuation, two contrasting results occur in such situations: a decrease in firm value due to the tax charge incurred and an increase in value for other reasons. The underlying facts prove that when a corporation undergoes a tax audit, firm value is affected by the cash outflow over the short term, but that over the long run, a tax audit eases the moral hazards connected to CEOs, which boosts corporate management performance. Long-term research is required to examine this effect more thoroughly(Jung and Jun

2010).

A study by Lee and Jung(2008) has found that KOSDAQ-listed corporations that evade taxes suffer no negative effects after the disclosure of tax charges resulting from a tax audit, while KOSPI-listed corporations that are found to have evaded taxes suffer negative effects with regard to firm value. This indicates that smaller enterprises have better chances to enjoy the positive effects of tax audits.

5. Differences from Previous Research

This study examines the probability that firm value will increase after the disclosure of a tax audit, which is generally seen as a negative event. Previous studies of decreases in firm value or the irrelevance of firm value after the disclosure of a tax audit have found that an audit is generally a negative event(Lee and Jung 2008).

This study examines changes in firm value in relation to tax audits over the long term, unlike previous studies. The studies of Jung and Jun(2010) and Lee and Jung(2008) only address excess returns after a tax audit, examining the fluctuations of stock prices over the short term. If tax audits exercise any real influence on firm value, this must be apparent in long-term fluctuations. Over the short term, firm value may depreciate, but it can not only recover from a slight depreciation, but potentially increase over the long term.

The effects on firm value after the disclosure of negative or positive events have been examined in previous research. Previous studies have found that the disclosure of accounting fraud, the disclosure of excellence in corporate governance,

and the disclosure of large losses are relevant to firm value. This study researches the impacts of disclosures of tax audits on firm value.

III. Research Hypothesis and Empirical Model

1. Hypothesis

The purpose of this study is to assess the impact of tax audits on firm value before and after a tax audit is carried out. Jung and Jun(2010) have found that on the day after a tax audit, statistically, there is the significant increase in a firm's corporate stock value. Lee and Jung(2008) assert that the disclosure of tax evasion by a corporation is the main reason for the fluctuation of stock, and claim that the amount of tax charged influences the range of fluctuation. These results indicate the possibility that the disclosure of imposed taxes after a tax audit can affect a firm's value.

The study by Lee and Jung(2008) has found that after the disclosure of a tax audit, a firm's value temporarily drops, but soon recovers to the point before the disclosure. Jung and Jun(2010) suggest that a prolonged study of fluctuations of firm values in such cases is needed, since cash outflow is only a temporary factor in depreciation, and because it occurs alongside firm value factors that could boost value. Prolonged studies should consider positive effects such as enhancing transparency in management and monitoring effects, which are beneficial to firm value. Fluctuations of firm value in the years before and after a tax audit must also be examined. This study thus sets up the following hypothesis.

[Hypothesis 1] There is a difference in corporate value before and after a tax audit.

2. Empirical Model

The empirical model used in this study examines differences in firm value after a tax audit is conducted. It analyzes differences in firm value through regression analysis, with the firm value as a dependent variable. For control variables, this study used the following: debt ratio, business scale, cash flow for operation, tangible asset investment, research and development expenses, advertising expenses, major shareholder equity ratio, year dummy, and industry dummy.

$$TQ(MB) = \alpha + \beta_1 TD + \beta_2 LEV + \beta_3 SIZE + \beta_4 PPE + \beta_5 OCF + \beta_6 RND + \beta_7 ADV + \beta_8 MSE + \beta_9 EBT + \sum YD + \sum ID + \epsilon$$

<dependent variables>

$TQ(MB)$: firm value

<independent variables>

TD : 0 if it is before tax audit and 1 otherwise

LEV : debt ratio(total debt/total assets)

$SIZE$: business scale(ln(total assets))

PPE : tangible asset investment(PP&E/total assets)

OCF : operational cash flow(operational cash flow/total assets)

RND : research and development expenses(R&D/total assets)

ADV : advertising expenses(advertising expenses/total assets)

MSE : major shareholder equity ratio

EBT : earning before tax ratio

YD: year dummy

ID : industry dummy

3. Dependent Variables

Firm value is used as a dependent variable. This study uses Tobin's Q and M/B ratio as a proxy of firm value.

Tobin's Q is the ratio between the market value and replacement value of the same physical asset. To get the market value of assets, actual evaluation data is required. However, asset revaluation is rarely executed in Korea, and it is difficult for corporations to calculate the replacement costs of assets, since each corporation makes financial statements on an acquisition cost basis. Therefore, Tobin's Q has been calculated for this study by dividing the market capitalization of corporations(debt included) by the book values of total assets(Chung and Pruitt, 1994; Choi et al., 2004; Black et al., 2006; Koh et al., 2010).

Tobin's Q is calculated as below.

$$TQ = \frac{\text{Common stock prices} + \text{preferred stock prices} + \text{Book value of Debt}}{\text{Total asset}}$$

The prices of common stock and preferred stock reflect the current year-end price. To gather data on stock prices and the numbers of stock, this study refers to KIS-FAS of Korea Investors Service Inc.

This study also uses the M/B ratio for the proxy variable of firm value, and analyzes firm value by utilizing the M/B ratio used in studies of firm value carried out by Black et al.(2006) and Koh et al.(2010), which is a net asset value/net book value ratio.

4. Independent Variables

In this study, a dummy variable(*TD*) has been used to measure differences in firm value after a tax audit. The study sets the value of the variable at 0 for the year before the tax audit, and at 1 for the year after the audit. The year of the audit is excluded due to the chance of distortion in financial statements.

To control factors that might affect firm value after a tax audit, this study used the following variables.

First, debt ratio(*LEV*) was calculated by dividing the total debt by total assets. According a study by Kim(2008), when a debt ratio is high, so is firm value. Because corporations with aggressive investment tendencies and increasing levels of debt do not typically miss an opportunity to invest in positive NPV, they have a greater chance of boosting their firm value. According to a study by Black et al.(2006), when a firm's debt ratio is higher, firm value also increases. However, this relationship has an inverted U shape. When debt ratio is low, the tax reduction effect is strong, while when debt ratio is high, an increase in bankruptcy costs occurs. If debt is controlled at the proper level, it has a positive effect on firm value. Park(2011) and Wi(2001) have also confirmed that when a debt ratio is high, so is firm value. Kim and Jeon's(2010) study of the KOSDAQ market found that firm value increases when debt ratio decreases. However, according to Fama and French(1998), increasing debt leads to cash outflow and eventually depreciates a firm's value. Choi and Kwon(2009) find that corporate diversification leads to an increase in debt ratio and depreciation in firm value.

Second, this study uses a business scale(*SIZE*)

variable. Business scale was calculated based on natural log values of total assets. A study by Kim(2010) shows that business scale is positively related to firm value. Koh et al.(2010) and Park(2011) state that when business scale gets larger, firm value increases accordingly. However, according to Kim and Lee(2006), Choi and Kwon(2009), Ahn(2006), Wi(2001), and Black et al.(2006), when business scale increases, firm value decreases accordingly.

Third, tangible asset investment in property, plant, and equipment(*PPE*) was used as a control variable. According to Black et al.(2006), tangible asset investments depreciate firm value. However, according to Lee and Cho(2009), the possession of property has a positive effect on firm value. Property is the sum of land, buildings, and other investment assets. As heavy investment in tangible assets is a unique characteristic of Korean corporations, tangible assets are used as a control variable in this study.

Fourth, operational cash flow(*OCF*) was used as a control variable. This study calculates this by dividing cash flow for operations into ending total assets. Koh et al.(2010) have found that higher OCF leads to greater firm value. A study by Oh et al.(2004) finds that the greater OCF gets in the KOSDAQ market, the more the stock price increases.

Fifth, research and development expenses(*RND*) were used as a control variable. Chun and Lee(2003) find that research and development costs have significant explanatory power over firm value, regardless of gains and losses in net income before extraordinary items. Their study classified and analyzed venture businesses, general businesses, and all businesses together. Both R&D expenses treated as assets and R&D expenses treated as costs were found to be significantly

positively related to firm value. A study by Kim(2008) states that the greater R&D expenses are, the greater a firm's value becomes. The study estimated total R&D expenses by summing up asset-treated R&D expenses and cost-treated R&D expenses. Kim(2010) has analyzed and classified asset-treated R&D expenses and cost-treated R&D expenses. While asset-treated R&D expenses were found to have no relation to firm value, cost-treated R&D expenses were found to be positively related to firm value. Koh et al.(2010), Kim and Lee(2006), and Black et al.(2006) state that increasing R&D expenses leads to greater firm value. As such, it can be assumed that R&D expenses have a significant relationship to firm value.

Since statements on the costs of goods manufactured are not disclosed in Korea, R&D expenses included in selling and administrative expenses were used in this study. R&D expenses included in statements on the costs of goods manufactured were not used.

Sixth, advertising expenses(*ADV*) were used as a control variable. According to Chun and Lee(2003), advertising expenses have significant explanatory power with regard to firm value, regardless of gains and losses in net income before extraordinary items. Kim(2008) states that the more advertising expenses increase, the greater a firm's value becomes. Since advertising expenses are intangible investments, corporations with greater advertising expenses have greater firm value. Kim(2010) and Black et al.(2006) have both found that advertising expenses boost firm value.

Seventh, major shareholder equity ratio(*MSE*) was used as a control variable. Shin and Kim(2010) studied the relationship between major shareholder equity ratio and firm value. For the corporations listed on the Korea KOSPI market or

KOSDAQ market, there is a possibility that major shareholders and management infringe on the gains of minority shareholders. The percentage of management shareholding has nonlinear effects on firm value, and owner-controlled firms show more depreciation in value than manager-controlled firms. Kim and Park(2005) assert that there is a significant negative relationship between a single major shareholder's ratio of share and firm value. Choi and Kwon(2009) and Wi(2001) stress that the lower the percentage of owner-manager shareholding, the higher a firm's value.

Eighth, earning before tax ratio(*EBT*) was used as a control variable. Baek and Choi(2014) said the operating income was related the corporation value.

Ninth, year dummy(*YD*) was used as a control variable, because firm value can be influenced by year.

Lastly, industry dummy(*ID*) was used as a control variable. Firm value can be influenced by

industry characteristics. For this study, industries are classified into the categories of manufacturing, construction, distribution, service, and holding companies.

5. Observations

This study examines corporations that disclosed a tax audit between 2000 and 2011.⁴⁾ For the sample period, the years before and after a tax audit have to be included, so the financial data used for the sample period ranges from 1999 to 2012(see <Table 2>). The sample uses only corporations listed on the KOSPI market and the KOSDAQ market as research objects. The observations are not included in those that are in the financial business and those that have been tax audited at least once and not more than twice. This study uses financial data from the KIS-VALUE data of Korea Investors Service Inc.

<Table 2> observations

Observations	2000	2001	2002	2003	2004	2005	2006	2010	2008	2009	2010	2011	Total
Positive Observations	7	4	13	5	23	17	5	4	0	1	0	9	88
Negative Observations	0	2	4	4	7	7	5	3	2	4	1		39
Total Observations	7	6	17	9	30	24	10	7	2	5	1	9	127

IV. Empirical Analysis

1. Descriptive Statistics

<Table 3> shows descriptive statistics on the

main variables used in regression analysis to verify the hypothesis of this study.⁵⁾ The total subjects included 127 corporations. This study verified 254 observations, including the years before and after disclosed tax audits. The average

4) Corporations that have not disclosed a tax audit have been excluded from the samples in this study, even if the corporations underwent tax audits. The schedules and the subjects of tax audits are closed to the public by the IRS. Listed corporations not forced by the Disclosure Regulations of the stock market to disclose audits do not have to do so if they involve a small tax charge. Therefore, this study selects corporations with disclosed tax audits as its sample.

5) Any value that deviates up-and-down 1% from each variable is adjusted to the value applicable to upper-lower 1%.

value of Tobin's Q was 1.020, and the standard deviation was 0.402. The average value of the M/B ratio was 1.036, and the standard deviation was 0.778. The average value of the debt ratio (control variable) was 0.476, and the standard deviation was 0.179. The average value of the business scale was 25.982, and the standard deviation was 1.431. The average value of asset investment was 0.295, and the standard deviation was 0.163. The average value of operating cash flow was 0.056, and the

standard deviation was 0.087. The average value of R&D expense was 0.011, and the standard deviation was 0.024. The average value of advertisement expense was 0.029, and the standard deviation was 0.065. The average value of the equity ratio for major shareholders was 0.262, and the standard deviation was 0.203. The average value of the earning before tax ratio was 0.070, and the standard deviation was 0.100.

<Table 3> Descriptive Statistics for All Corporations with Positive or Non-Positive Income before Tax

Variables	N	Mean	Std	Min	Median	Max
<i>TQ</i>	254	1.020	0.402	0.466	0.916	2.238
<i>MB</i>	254	1.036	0.778	0.221	0.823	3.485
<i>LEV</i>	254	0.476	0.179	0.123	0.488	0.783
<i>SIZE</i>	254	25.982	1.431	23.859	25.688	29.354
<i>PPE</i>	254	0.295	0.163	0.016	0.296	0.590
<i>OCF</i>	254	0.056	0.087	-0.158	0.059	0.226
<i>RND</i>	254	0.011	0.024	0.000	0.000	0.099
<i>ADV</i>	254	0.029	0.065	0.000	0.001	0.287
<i>MSE</i>	254	0.262	0.203	0.000	0.256	0.662
<i>EBT</i>	254	0.070	0.100	-0.197	0.065	0.321

Notes : Definitions of variables

TQ is Tobin's Q

MB is M/B ratio

LEV is Total liability/total assets

SIZE is Natural logarithm of total assets

PPE is Tangible assets/total assets

OCF is Operating cash flow/total assets

RND is R&D/total assets

ADV is Advertisement expenses/total assets

MSE is Major shareholder equity ratio

EBT is earning before tax ratio

<Table 4> includes descriptive statistics for corporations with positive net profits before tax. Eighty-eight corporations with positive net profits before tax were included in the study. The study gathered 176 observations, including those from the years before and after tax audits. The average

value of corporations with positive net profits before tax is 0.991, which is lower than the average for all other corporations.⁶⁾ In addition, the standard deviation of corporations with positive net profits before tax is 0.366, indicating relatively low deviation in firm value. The average value of debt

6) The Tobin's Q was found to be bigger for corporations with positive net profits before a tax audit than for corporations with negative net profits before a tax audit. This is a unique finding that is generally in accordance with suggestions that a high positive current net income is likely to indicate high firm value. However, since the denominator of Tobin's

ratios is 0.467, which is lower than the average value of all corporations. There are two ways to analyze the relationship between profitability and debt ratio. In the eclectic model, a higher level of debt is used, since the tax reduction effect is important when profitability is high. Corporations with high profitability are seen as not requiring external funds, since they have sufficient internal fund inflow, which leads to low debt ratios. Kim(2010) has found that debt ratios increase in proportion to profitability. In this study, the standard deviation of debt ratio was 0.164, showing relatively low value in comparison with all other corporations. Business scale was 26.294, showing

relatively high value in comparison with all other corporations. Operating cash flow was 0.074, showing relatively high value in comparison with all other corporations. The average value of R&D expense was 0.007, and the standard deviation was 0.016. The average value of advertisement expense was 0.023, and the standard deviation was 0.052. Major shareholder equity ratio was 0.249, The average value of the earning before tax ratio was 0.070, and the standard deviation was 0.100 also showing relatively high value in comparison with all other corporations. The average value of the earning before tax ratio was 0.097, and the standard deviation was 0.069

<Table 4> Descriptive Statistics: Corporations with Positive Net Profits before Tax

Variables	N	Mean	Std	Min	Median	Max
<i>TQ</i>	176	0.991	0.366	0.498	0.909	2.106
<i>MB</i>	176	0.933	0.629	0.196	0.789	2.779
<i>LEV</i>	176	0.467	0.164	0.169	0.470	0.726
<i>SIZE</i>	176	26.294	1.424	24.141	25.991	29.415
<i>PPE</i>	176	0.297	0.152	0.016	0.306	0.580
<i>OCF</i>	176	0.074	0.072	-0.060	0.071	0.229
<i>RND</i>	176	0.007	0.016	0.000	0.000	0.077
<i>ADV</i>	176	0.023	0.052	0.000	0.001	0.218
<i>MSE</i>	176	0.249	0.125	0.082	0.227	0.512
<i>EBT</i>	176	0.097	0.069	0.013	0.086	0.272

Notes : Definitions of variables

TQ is Tobin's Q

MB is M/B ratio

LEV is Total liability/total assets

SIZE is Natural logarithm of total assets

PPE is Tangible assets/total assets

OCF is Operating cash flow/total assets

RND is R&D/total assets

ADV is Advertisement expenses/total assets

MSE is Major shareholder equity ratio

EBT is earning before tax ratio

Q is total assets, the denominator of corporations with negative current net income may be found to be smaller, and thus indicate higher firm value. Since corporations with positive net incomes are found to have a positive relationship between firm value and business scale, and corporations with negative net income are found to have a negative relationship between firm value and business scale, there is a possibility of distortion in firm value when corporations are evaluated with negative business scales.

2. Correlation Analysis

<Table 5> depicts a Pearson's correlation analysis of the main variables. Tobin's Q and M/B ratio show a positive correlation with a 1% significance level (Pearson's correlation=0.952). In a study by Chung and Pruitt(1994), the correlation coefficient of the two is 0.966, while Servaes(1996) finds a correlation coefficient of 0.97. Firm value(Tobin's Q and M/B ratio) and the dummy variable before and after a tax audit show a positive correlation with a 5% significance level(0.146 and 0.131). Other analyses are as follows: a negative correlation between firm value(Tobin's Q or M/B ratio) and tangible asset investment with a 1% significance level, a negative correlation between firm value and major

shareholders equity ratio with a 5% significance level, a positive correlation between debt ratio and business scale with a 1% significance level, a negative correlation between debt ratio and EBT with a 10% significance level, a negative correlation between business scale and R&D expenses with a 1% significance level, a positive correlation between business scale and EBT with a 10% significance level, a negative correlation between tangible asset investment and operating cash flow with a 5% significance level, a positive correlation between tangible asset investment and major shareholders equity ratio with a 5% significance level, and a positive correlation between R&D expenses and advertising expenses with a 1% significance level.

<Table 5> Pearson's Correlation Analysis Chart

Variables	<i>TQ</i>	<i>MB</i>	<i>LEV</i>	<i>SIZE</i>	<i>PPE</i>	<i>OCF</i>	<i>RND</i>	<i>ADV</i>	<i>MSE</i>	<i>EBT</i>
<i>MB</i>	0.952***									
<i>TD</i>	0.146**	0.131**								
<i>LEV</i>	-0.014	-0.003	-0.047							
<i>SIZE</i>	0.051	0.027	0.053	0.227***						
<i>PPE</i>	-0.207***	-0.188***	-0.042	0.061	0.093					
<i>OCF</i>	0.131**	0.084*	0.019	-0.119	0.159	0.142**				
<i>RND</i>	0.097	0.079	0.004	0.056	-0.182***	-0.023	-0.040			
<i>ADV</i>	0.029	-0.009	-0.024	0.040	-0.243	0.009	0.083	0.294***		
<i>MSE</i>	-0.179**	-0.150**	-0.143**	-0.160	0.034	0.157**	0.036	-0.086	0.035	
<i>EBT</i>	0.082	0.038	0.199***	-0.160**	0.116*	-0.091	0.286	-0.048	0.023	-0.037

Notes : Definitions of variables

TQ is Tobin's Q

MB is M/B ratio

TD is 0 if it is before tax audit and 1 otherwise

LEV is Total liability/total assets

SIZE is Natural logarithm of total assets

PPE is Tangible assets/total assets

OCF is Operating cash flow/total assets

RND is R&D/total assets

ADV is Advertisement expenses/total assets

MSE is Major shareholder equity ratio

EBT is earning before tax ratio

3. T-Test(Mean Difference Tests)

The T-test was run by pairing each corporation with its firm value before and after a tax audit. The average value of Tobin's Q before tax audit was 0.962, the average value of Tobin's Q after tax audit was 1.079, and the t-value was 3.38. The average value of M/B ratio before tax audit was 0.934, the average value of M/B ratio after tax audit was 1.138, and the t-value was 3.23. The test results showed that average firm value after tax audit was higher than before tax audit, and that

the differences between the two values were statistically significant. Meanwhile, these results were similar for corporations with positive net profits before tax. The average value of Tobin's Q before tax audit was 0.923, the average value of Tobin's Q after tax audit was 1.058, and the t-value was 4.20. The average value of M/B ratio before tax audit was 0.812, the average value of M/B ratio after tax audit was 1.053, and the t-value was 4.58. The results are shown in <Table 6>.

<Table 6> Paired T-Test of Firm Value before and after Tax Audit

Samples	Variables	Tax audit	Mean	Stdev	t-value	N
All Observations	<i>TQ</i>	Before	0.962	0.329	3.38***	127
		After	1.079	0.457		
	<i>MB</i>	Before	0.934	0.685	3.23***	
		After	1.138	0.851		
Positive Observations	<i>TQ</i>	Before	0.923	0.282	4.20***	88
		After	1.058	0.424		
	<i>MB</i>	Before	0.812	0.501	4.58***	
		After	1.053	0.718		

*, **, *** represent significance at the 10%, 5%, and 1% levels, respectively

Notes : Definitions of variables

TQ is Tobin's Q

MB is M/B ratio

4. Regression Analysis of all Corporations Disclosing Tax Charge Amounts after Tax Audit

A regression analysis was carried out on 127 corporations disclosing the tax charge amounts resulting from tax audits. The results of the analysis are shown in <Table 7>, which demonstrates that there is a difference in Tobin's Q after tax audit. The t-value of the dummy variable(*TD*) before and after tax audit was 2.21. This implies that firm value is higher in the year

after a tax audit than in the year before a tax audit, with a 5% significance level. The t-value of Tobin's Q and tangible asset investment was -4.75, showing a 1% significance level. This result is similar to that of Lee and Cho(2009). The t-value of firm value and operating cash flow was 2.59, with no statistical significance. This result is similar to that of Koh et al.(2010) and Oh et al.(2004)

For the Tobin's Q and debt ratio, the t-value was 1.41, with no statistical significance. These results are the same as those of Kim(2008), Park(2011), and Wi(2001), who all found that

corporations with large amounts of debt have high firm values. The t-value of firm value and business scale was 0.98, with no statistical significance. This result was similar to those of Kim(2010), Koh et al.(2010), and Park(2011), who found that firm value and business scale have negative relevance. It is different, however, from the findings of Kim and Jeon(2010), Ahn(2006), Wi(2001), Kim and Lee(2006), and Choi and Kwon(2009). The t-value for Tobin's Q and research and development expenses was 1.02, with no statistical significance. The t-value of Tobin's Q and advertising expenses was 0.72, also with no statistical significance. The t-value of firm value

and major shareholder equity ratio was 0.61, with no statistical significance. The t-value of firm value and *EBT* was 0.30, with no statistical significance.

The analysis of M/B ratio showed a similar result to the previous analysis of Tobin's Q. The t-value of M/B ratio and pre/post tax audit dummy(*TD*) was 2.17, showing a 5% significance level. Statistically, M/B ratio and tangible asset investment were found to have a significantly negative relevance to each other, but M/B ratio and operating cash flow had significantly positive relevance.

<Table 7> Multivariate Tests: All Corporations with Positive or Non-Positive Income before Tax

$$TQ(MB) = \alpha + \beta_1 TD + \beta_2 LEV + \beta_3 SIZE + \beta_4 PPE + \beta_5 OCF + \beta_6 RND + \beta_7 ADV + \beta_8 MSE + \beta_9 EBT + \sum YD + \sum ID + \epsilon$$

Variables	TQ		MB	
	β -Value	t-Value	β -Value	t-Value
Intercept	0.907	1.57	1.321	1.16
<i>TD</i>	0.103	2.21**	0.195	2.17**
<i>LEV</i>	0.217	1.41	0.372	1.25
<i>SIZE</i>	0.021	0.98	0.022	0.54
<i>PPE</i>	-0.807	-4.75***	-1.330	-3.97***
<i>OCF</i>	0.779	2.59**	0.964	1.65**
<i>RND</i>	1.159	1.02	1.428	0.63
<i>ADV</i>	0.291	0.72	-0.010	-0.01
<i>MSE</i>	0.127	0.61	0.417	1.03
<i>EBT</i>	0.078	0.30	0.187	0.37
<i>YD</i>	Included	Included	Included	Included
<i>ID</i>	Included	Included	Included	Included
<i>F-value</i>	3.66***		3.54***	
<i>adj-R²</i>	0.195		0.194	
Samples	254(127 corporations)			

*, **, *** represent significance at the 10%, 5%, and 1% levels, respectively

Notes : Definitions of variables

TQ is Tobin's Q

MB is M/B ratio

TD is 0 if it is before tax audit and 1 otherwise

LEV is Total liability/total assets

SIZE is Natural logarithm of total assets

PPE is Tangible assets/total assets

OCF is Operating cash flow/total assets

RND is R&D/total assets

ADV is Advertisement expenses/total assets

MSE is Major shareholder equity ratio

EBT is earning before tax ratio

YD is year dummy

ID is industry dummy

5. Additional Analysis of Corporations with Positive Net profits before tax, among Corporations Disclosing Tax Charge Amounts after Tax Audit

In <Table 7>, due to the small sample size, all of the corporations with both positive and negative net profits before tax were analyzed. However, in general, in the analysis using the financial statements of listed companies, corporations with negative net profits before tax were excluded because the financial materials of them are unreliable. All corporations with positive net profits before tax were analyzed. As a result, 88 corporations were analyzed for differences between the year before a tax audit and the year

after the tax audit. The results are shown in <Table 8>.

<Table 8> presents the results of an analysis of the data of corporations with positive net profits before tax and their firm value fluctuation after tax audits. The t-value of Tobin's Q and the tax audit dummy were 2.86, showing a 1% significance level. This result is almost identical to the analyzed result presented in <Table 3>. The t-value of Tobin's Q and tangible assets was -4.45, showing a 1% significance level of negative relevance. The t-value of Tobin's Q and operating cash flow was 3.63, showing a 1% significance level of positive relevance. These results are similar to the analyzed results in <Table 6>.

The result of the analysis of M/B ratio and the tax audit dummy is similar to that of the previous analysis of Tobin's Q and the tax audit dummy.

<Table 8> Multivariate Tests: Corporations with Positive Net Profits before Tax

$$TQ(MB) = \alpha + \beta_1 TD + \beta_2 LEV + \beta_3 SIZE + \beta_4 PPE + \beta_5 OCF + \beta_6 RND + \beta_7 ADV + \beta_8 MSE + \beta_9 EBT + \sum YD + \sum ID + \epsilon$$

Variable	TQ		MB	
	β -Value	t-Value	β -Value	t-Value
Intercept	0.255	0.46	-0.552	-0.57
<i>TD</i>	0.125	2.86***	0.219	2.91***
<i>LEV</i>	0.048	0.30	-0.069	-0.26
<i>SIZE</i>	0.039	1.89*	0.075	2.12**
<i>PPE</i>	-0.818	-4.45***	-1.233	-3.84***
<i>OCF</i>	1.206	3.63***	1.501	2.60**
<i>RND</i>	1.369	0.77	1.673	0.50
<i>ADV</i>	-0.090	-0.17	-0.727	-0.80
<i>MSE</i>	0.275	1.37	0.574	1.65
<i>EBT</i>	0.075	0.21	0.387	0.64
<i>YD</i>	Included	Included	Included	Included
<i>ID</i>	Included	Included	Included	Included

<i>F-value</i>	6.22***	6.14**
<i>adj-R²</i>	0.385	0.392
Samples	176(88 corporations)	

*, **, *** represent significance at the 10%, 5%, and 1% levels, respectively

Definitions of variables can be found in <Table 7>, above

V. Conclusion and Limitations

The purpose of this study is to look into changes in firm value after a tax audit. In general, a tax audit can lead to depreciation in the value of the firm involved, because it hinders daily business due to its complexity, and may lead to a large amount of cash outflow, due to the imposed charges involved. However, by having an external monitoring effect, a tax audit may reduce agency costs, and thus increase a firm's value accordingly.

Corporations typically avoid tax audits, considering their negative effects of increased work hours and tasks, as well as cash outflow. From another perspective, however, by undergoing intensive tax audits, corporations can find mistakes in bookkeeping and avoid future errors accordingly. Tax audits also increase perceptions of wrongdoing and poor management on the part of owner-managers.

This study examines the possibility that increases in firm value can occur after a tax audit. It anticipated that tax audits would have strong external monitoring effects on corporations. It found that a tax audit can enhance accounting transparency and management efficiency, which can reveal negative factors that could negatively affect firm value, such as excessive entertainment expenses, doctored books, and inappropriate business performance.

This study examines corporations disclosing tax audits from 2000 to 2011. For the analysis of the

sample, financial data from the year before and after the tax audit had to be included. Therefore, the financial data involved is from 1999 to 2012.

The outcomes of the study show that, in general, firm value increases after a tax audit in comparison with the year before the tax audit. By analyzing the dummy variables before and after a tax audit along with firm value, the study finds that there is a 5% significance level of increase in firms' value after they undergo tax audits. This result shows that firm value increases after tax audits are conducted.

The study also analyzes 88 corporations with positive net profits before tax, among 127 corporations that disclosed their tax audit reports. The test result shows similarity with the result for all 127 corporations, in that firm value increased after the tax audit. However, in a sample analysis of corporations with positive net profits before tax, firm value and major shareholder equity ratio showed a 5% significance level of relevance, indicating a slight difference from the overall corporation sample analysis.

These findings suggest that in reacting to tax audits, corporations can work to enhance and improve their management transparency and stability, and thus enjoy benefits that surpass the potential negative effects of depreciation as a result of the disclosure of negative events.

The study makes several contributions to the existing literature.

First, it shows that tax audits may have positive effects, despite the mass cash outflows

that can result from additional tax charges. It demonstrates that tax audits do not merely act to impose taxes and limit business activities, and in doing so, it contributes to positive perspectives on tax audits. It shows that corporations should consider tax audits as a means of strengthening their competitiveness in a heavily competitive marketplace. Like the argument of Jung and Jun(2010), tax audits may reduce agency costs between external shareholders and management, and between internal management and staff . Tax audits can be more valuable than the external audits and outside director systems that corporations typically adopt to reduce agency costs, and can contribute to the improvement of firm value.

Second, this study examines differences between firm values in the years before and after a tax audit disclosure, taking a long-term perspective that is missing in other studies, which only consider the days before and after disclosure.

Third, this study indicates that tax audits should not be used solely to impose taxes but rather to provide guidance for corporations. It suggests that the IRS should approach corporate tax audits as means of enhancing accounting transparency and preventing future tax evasion.

Finally, this study describes the relationship between financial character and firm value after the disclosure of a tax audit. It also indicates the effects of and relationships between debt ratio, business scale, asset investment scale, operating cash flow, major shareholder equity ratio, and firm value. This result will provide useful information to the management of corporations, investors, and the government.

This study also has several limitations. First, It is concern about sample data. According to the disclosure standards of the Securities and

Exchange Act, only corporations with tax amounts of over 5% of their equity capital are required to disclose their tax audit reports. Since corporations with tax amounts of less than 5% typically do not voluntarily disclose, they are missing from the data.

Second, this study does not analyze causes of fluctuation in firm values after a tax audit, which may be diverse. Due to the lack of opportunities to examine this in more detail, this study has assumed that tax audits may alleviate management hazards and positively affect firm value, while positive effects may also be increased by other factors. Further studies on this issue are required.

Finally, fluctuations of firm value over even longer terms would have been useful.

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Abstract

세무조사전후의 기업가치의 차이

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본 연구는 세무조사추징세액을 공시한 기업을 대상으로 세무조사공시 전후에 기업가치의 차이가 있는지 살펴보는 연구이다. 세무조사로 인한 세무조사 추징세액은 거액의 현금 유출을 수반하며 이로 인하여 기업가치가 낮아질 가능성이 있다. 그러나 세무조사로 인한 외부감시기능은 기업의 투명성을 증가시켜 기업가치를 오히려 증가시킬 수도 있다.

세무조사로 인하여 탈세액을 추징하는 과정에서 과도한 접대비, 회계장부의 조작, 경영자 등과의 부적절한 거래 등 많은 기업가치에 부정적인 요소들이 상세히 공개되므로 기업경영의 투명성이 제고될 수 있다. 이러한 기업투명성의 제고는 기업의 대리인비용을 감소시켜 기업가치를 높일 수 있다.

연구 결과 세무조사공시 직전년도에 비하여 세무조사공시 후 년도에 기업가치가 증가하는 것으로 나타났다. 이는 세무조사라는 행위가 현금흐름유출이라는 기업가치에 음(-)의 영향을 줄 수 있는 가능성에 불구하고 오히려 기업의 긍정적인 영향요인이 되고 있다고 할 수 있다.

이러한 결과는 세무조사에 대한 부정적인 시각을 바꾸어야 함을 나타내고 있다. 세무조사가 기업영업 활동을 위축시키지 않을 수 있으며, 오히려 세무조사가 기업가치에 긍정적인 영향을 준다고 설명할 수 있다. 따라서 기업은 세무조사를 기업가치 상승의 기회로 삼아야 한다.

핵심주제어: 기업가치, 세무조사, 조세추징, 조세회피

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