Firm Tax Uncertainty, Cash Holdings, and the Timing of Large Investment

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Giovedì 26 Febbraio 2015, ore 15.00 Aula della Scuola di Dottorato, Palazzo Cà Borin, Via del Santo 22

Firms accumulate cash holdings for a variety of reasons, including as a buffer against uncertainty and to finance large investments. This paper explores whether there is a trade-off between two competing uses of cash holdings: precautionary savings that result from increased tax uncertainty and savings devoted to large investments. Specifically, we test whether firm-specific tax uncertainty affects firmsâ€™ timing of large investments. Empirically, we first show that firms with higher tax uncertainty have higher cash holdings and lower levels of investment. We then focus on the timing of large investments within a hazard framework, finding that, on average, greater tax uncertainty delays large capital investments. However, tax uncertainty has distinct effects across firms. Firms with high (low) tax rates face an upside (downside) tax risk and, thus, they accelerate (delay) investments as tax uncertainty increases. Overall, our results imply that, from a policy standpoint, a reduction in tax uncertainty could free up valuable financial capital for large investment in firms that are highly uncertain about their future tax incidence.