The Value of a Loss:
Restricting Tax Loss Transfers and its Impact on Acquisition Activity

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Abstract

This paper examines the economic consequences of so-called anti-tax loss trafficking (or change in ownership) rules, which disallow the use of loss carry-forwards after a substantial change in ownership or activity. For our empirical analysis, we utilize 17 changes in legislation and data on Merger and Acquisition (M&A) deals in the EU28 Member States and Norway from 1998 to 2019. Our findings provide evidence that limiting the transfer of tax losses impacts the market for corporate control. We document a significant negative relationship between the value of M&A deals and anti-tax loss trafficking rules. This supports the idea that such rules decrease the value of accumulated loss carry-forwards, reducing the firm value of acquisition targets.

Further, the detected impact on the market for corporate control has important economic consequences. We find that loosening restrictive anti-tax loss trafficking rules positively affects firm entrant survival rates and improves industry-level performance, measured by mean return on assets and aggregate output. Overall, our study offers important policy implications on the desirability of anti-tax loss trafficking rules. This topic is particularly relevant due to the recent strong comeback of M&A activities, which likely involves many firms with losses given the damages of the global COVID-19 pandemic.