Political Connections, Financial Constraints, and Corporate Taxation*

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Abstract

We find that the effect of political connections on tax planning depends on firms' financial conditions. After increased political connections, financially unconstrained firms increase tax planning and spending on tax services, as documented in prior studies, whereas constrained firms decrease tax planning and spending on tax services. Moreover, decreases in tax planning are only present for constrained firms that obtain new bank loans and public debt, and when the connected politicians serve on banking-related committees. Our results suggest that by facilitating access to external financing, political connections reduce financially constrained firms' use of tax planning as an internal financing tool.

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I. Introduction

A large and growing literature documents that connections between firms and politicians are widespread in the United States and worldwide, and shows that these connections significantly affect firm value (e.g., Fisman (2001), Johnson and Mitton (2003), Faccio (2006), Goldman, Rocholl, and So (2009), Cooper, Gulen, and Ovtchinnikov (2010), Amore and Bennedsen (2013), and Akey (2015)). Extant literature also shows that politically connected firms on average avoid more taxes and are subject to less tax scrutiny (e.g., Kim and Zhang (2016), Lin, Mills, Zhang, and Li (2018)). In this paper, we contribute to the literature by hypothesizing and providing empirical evidence that the effect of political connections on corporate taxation depends critically on firms' financial conditions and that political connections can *reduce* the tax planning of financially constrained firms.

Our hypothesis builds on two strands of literature. One is the literature on the effect of political connections on firms' financial constraints. This literature shows that political connections can increase the likelihood of firms being bailed out when they experience financial distress (Faccio, Masulis, and McConnell (2006)) and can lead to lower costs of debt financing (Houston, Jiang, Lin, and Ma (2014)), thereby mitigating firms' financial constraints (Cull, Li, Sun, and Xu (2015), Bussolo, de Nicola, Panizza, and Varghese (2019)). The second literature studies the role of tax planning as a source of internal financing. This literature shows that financially constrained firms pursue more aggressive tax strategies than their unconstrained counterparts (Law and Mills (2015)) and that changes in financial constraints are positively associated with changes in future tax planning (Edwards, Schwab, and Shevlin (2016)), consistent with internal financing being an important motive for financially constrained firms to avoid taxes.[1] We thus expect that by mitigating firms'

[1] Following Law and Mills (2015) and Edwards et al. (2016), we refer to increased tax planning saving taxes as internal financing to differentiate from bond issues and bank loans.

financial constraints and consequently reducing the relative benefit of using tax planning as a source of internal financing, political connections have the potential to *reduce* tax planning, especially for financially constrained firms (*financing* effect).

Besides the *financing* effect, political connections can also influence corporate taxation through weakened enforcement of tax laws and regulations (*protection* effect) and the provision of confidential information regarding future changes in tax laws (*information* effect) (e.g., Kim and Zhang (2016), Lin et al. (2018)). The *protection* and *information* effects are associated with lower expected cost of tax planning and consequently should increase firms' incentives to engage in such an action. To the extent that these two effects overwhelm the *financing* effect, political connections can result in more tax planning. Thus, the effect of political connections on corporate taxation is an empirical question and likely depends critically on firms' financial conditions.

To empirically identify the effect of political connections on firms' tax planning and the role of their financial constraints, we exploit *close* congressional elections as exogenous shocks to firms' political connections. The idea of this approach is that although the outcome of a congressional election is determined by many factors, such as candidate, region, and time, an element of randomness shapes the outcome of a *close* election, in which candidates marginally win or lose (Lee (2008), Akey (2015)). Thus, firms that contribute to politicians who just win a close election can be considered to experience an exogenous increase in political connections, while those that donate to politicians who narrowly lose the election can be considered to experience an exogenous decrease in political connections. The effect of political connections on tax planning can then be identified by comparing changes in the tax planning of financially constrained firms connected to marginally winning politicians versus those connected to politicians who just lose. Moreover, changes in tax planning of financially unconstrained firms in response to shocks to political connections provide a benchmark for

how firms' tax behavior would have evolved in the absence of financial constraints, which enables us to disentangle the role of financial constraints in shaping the effect of political connections on corporate tax planning.

We first study the tax behaviors of a full sample of firms regardless of whether they are financially constrained. We measure firms' tax planning using both cash effective tax rates (Cash ETR) and book–tax differences (BTD). Cash ETR captures the extent to which firms reduce cash tax payments and thereby preserve internal financing, while BTD reflects discrepancies between accounting income and taxable income that arise from tax planning activities. We find that exogenous increases in political connections arising from winning or losing of close elections are not associated with significant changes in cash effective tax rates, which appears to be inconsistent with prior studies that document positive associations between politicians' campaigns and corporate lobbying expenditures and corporate tax planning (Richter, Samphantharak, and Timmons (2009), Brown, Drake, and Wellman (2015)). These conflicting results could arise for several reasons. First, political connections are endogenous (Hillman and Hitt (1999)). The positive cross-sectional relation between political connections and tax planning in prior studies is likely to be a manifestation of firms that avoid more taxes investing more in political connections or driven by unobserved firm characteristics that are related to both political connections and tax planning (Faccio (2016)). Second, political connections may affect the tax behaviors of firms with different financial conditions in different ways. To the extent that the *financing* effect of decreased tax planning dominates in financially constrained firms and the *protection* and *information* effects of increased tax planning dominate in firms without financial constraints, we may observe no changes in tax planning in response to shocks to political connections for an average firm using the full sample.

Accordingly, we partition the full sample by firms' financial conditions and examine changes in corporate tax planning for financially constrained and unconstrained firms separately in response to shocks to political connections. Following Hadlock and Pierce (2010), we measure financial constraints using the Hadlock–Pierce (HP) index, which is constructed mainly based on firm size and age. Consistent with our prediction, we find that, after obtaining more political connections in closely won elections, financially constrained firms experience a significant increase in cash effective tax rates, suggesting that firms with financial constraints engage in *less* tax planning in response to increases in political connections. As more direct evidence, constrained firms' tax-related spending on auditor provided tax services declines following increases in political connections. In contrast, financially unconstrained firms engage in *more* tax planning and *more* tax-related expenditures in response to increases in political connections, as evidenced by a lower Cash ETR and a tax-related fee measure, consistent with findings in prior studies.

We next examine the mechanisms through which political connections affect the tax planning of financially constrained firms. The *financing* effect builds on the idea of more and cheaper external financing after obtaining more political connections. We thus study changes in bank loans and bond issuances in response to shocks to political connections and the effect of these changes on the tax planning of constrained firms. We find that after increases in political connections, financially constrained firms are more likely to obtain new bank loans and issue new public bonds. Their cost of debt financing, defined as the loan spread quoted in basis points over a floating benchmark and bond yield, is also significantly lower. More importantly, decreases in tax planning are only present among financially constrained firms that obtain new bank loans and public bonds in the year after increases in political connections. We do not find corresponding changes for financially unconstrained firms. These findings support the idea that financially constrained firms have better access to

external debt financing after becoming more politically connected and consequently have less incentive to use tax planning as an internal source of financing.

Dhaliwal, Judd, Serfling, and Shaikh (2016) argue that government contractors are less risky and find that these firms have lower cost of capital. Goldman (2020) documents that government contractors receive more bank credit during the financial crisis, suggesting that government contracts can improve firms' credit quality as perceived by lenders, which helps firms access bank credit. In addition, government contracts can also increase firms' cash flows. We thus study changes in government contracts for financially constrained firms, which could be an indirect way through which connected politicians mitigate firms' financial constraints. We find that after obtaining more political connections, constrained firms are more likely to receive government contracts and that the value of government contracts awarded to these firms also increases. Again, we find weak evidence on changes in government contracts for unconstrained firms.

To provide further evidence that changes in tax planning are driven by changes in political connections, we explore variation in the characteristics of connected politicians and firms that make campaign contributions. First, we examine whether the impact of political connections on tax planning is more pronounced when the connected politicians serve on committees related to banking and financing matters. We focus on the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services (financing-related committees). The former has jurisdiction over matters related to banks and financial aid to the industry. The latter oversees the entire financial services industry, such as the banking and securities industries, as well as the work of financial regulators. Consistent with our expectation, we find that decreases in the tax planning of financially constrained firms are significantly greater when the winning connected politicians are on financing-related committees. In contrast, we show that increases in the tax planning of unconstrained

firms are not related to whether the connected politicians serve on financing-related committees but are more pronounced when the newly connected politicians are on tax-related committees. These findings provide further support to the idea that political connections reduce the incentives of financially constrained firms to engage in tax planning by providing more and cheaper external financing opportunities.

Second, favorable treatments in financing are valuable resources that are unlikely to be granted to everyone. As banks and regulators are interested in maximizing their economic benefits, they are more likely to favor firms connected with more powerful politicians. We find that the effects of political connections on corporate tax planning are significantly stronger when the connected politician holds a leadership position in the Congress,[2] belongs to the majority party in both the Senate and the House, and his or her seniority is among the top 25% of the members of the two bodies.

Third, a politician may not uniformly cater to his or her contributors and is likely to pay more attention to firms that are more important to her. We find that the relation between political connections and tax planning is significantly greater when the firm is a top donor for a winning candidate and when the firm is in one of the top three important industries in its headquarters state. Taken together, the results on politician power and firm importance support our argument that it is the change in political connections that drives the decrease in tax planning of financially constrained firms.

This study makes several contributions to the literature. First, it contributes to the understanding of the tax behaviors of politically connected firms (Hanlon and Heitzman (2010), Faccio (2016)). Existing research focuses exclusively on the role of political connections in reducing the expected *costs* of tax planning (e.g., Richter et al. (2009), Brown et al. (2015), and Kim and Zhang (2016)), leaving unexplored the possibility of political

[2]A leadership position is defined as majority leader, majority whip, speaker, minority leader, or minority whip.

connections decreasing the relative *benefits* of tax planning and thus reducing firms' incentives to engage in such activity. We fill this void and show that after obtaining more political connections, although financially unconstrained firms increase tax planning, constrained firms decrease their tax planning and this decrease is driven by better access to external debt financing. These findings highlight the importance of financial constraints and the financing effects, which have been largely ignored in prior literature, in understanding the tax planning of politically connected firms. In this regard, our paper answers the call of Faccio (2016) for research to use plausibly exogenous shocks to better understand the driving forces behind the relation between political connections and corporate taxation.

Second, this paper adds to the literature on the consequences of political connections. Prior studies show that political connections improve firm value and consider some mechanisms through which firms benefit from political connections (e.g., Fisman (2001), Johnson and Mitton (2003), Faccio (2006), Khwaja and Mian (2005), Leuz and Oberholzer-Gee (2006), Faccio et al. (2006), and Duchin and Sosyura (2012)). As taxes have a first-order effect on firm value, studying changes in tax planning in response to shocks to political connections provides further insights into how firms benefit from connections with politicians. We contribute to the literature by showing that political connections benefit financially unconstrained firms by lowering their taxes and help constrained firms obtain external financing and government contracts that substitute for costly internal financing through tax strategies. These findings suggest that political connections do not necessarily benefit all firms in the same way.

The remainder of this paper is organized as follows. Section II links our paper to the literature, discusses its contribution and develops our hypotheses. Section III describes our setting and measures of main variables. Section IV presents the empirical results. Section V concludes.

II. Related Literature and Hypotheses Development

In this section, we review the literature from which our study draws and develop our hypotheses. The first stream of literature examines the economic consequences of political connections. Fisman (2001) documents that the market value of Indonesian firms connected with former President Suharto significantly declined in response to bad news about Suharto's health. Faccio (2006) studies the political connections of firms in 47 countries and finds that the announcements of large shareholders or officers entering politics are associated with significantly positive market reactions. Goldman et al. (2009) show that the announcement of the nomination of politically connected board members is associated with positive abnormal stock returns. Cooper et al. (2010) find that firm contributions to U.S. political campaigns are positively associated with the cross-section of future returns. These findings suggest that political connections boost firm value. Recent studies examine the mechanisms through which political connections improve firm value and document that politically connected firms have preferential access to finance, either because banks grant favorable terms to politically connected firms (Khwaja and Mian (2005), Claessens, Feijen, and Laeven (2008)) or because these firms are more likely to be bailed out and have a lower bankruptcy probability (Faccio et al. (2006), Duchin and Sosyura (2012), and Houston et al. (2014)), and receive favorable treatment in the allocation of procurement contracts (Goldman, Rocholl, and So (2013), Tahoun (2014)). They also show that political connections are associated with weaker enforcement of laws and regulations (Hunter and Nelson (1995), Young, Reksulak, and Shughart (2001), Yu and Yu (2011), Correia (2014), Lin et al. (2018), and Fulmer, Knill, and Yu (2023)).

The second strand of literature studies the costs and benefits that affect firms' incentives to engage in tax planning. On the one hand, tax avoidance is typically associated with potential future costs such as tax repayments, penalties, and interests. Firms with a large

difference between book and tax income are likely to face greater scrutiny by tax authorities (Mills (1998), Rego and Wilson (2012)). Using a sample of 14 tax shelters that were successfully challenged by the tax authorities, Wilson (2009) shows that the interest and penalties associated with tax sheltering are economically significant. Consistent with firms avoiding more taxes when the expected cost of tax enforcement is lower, studies document that the rate of Internal Revenue Service (IRS) tax audit is negatively associated with corporate tax planning (Hoopes, Mescall, and Pittman (2012)) and that firms in countries where tax enforcement is perceived to be weaker engage in more tax planning (Atwood, Drake, Myers, and Myers (2012)). On the other hand, tax planning is also associated with immediate cash tax savings that can be used by financially constrained firms, which face more frictions and higher costs in raising external funds, as a source of internal financing. In particular, Law and Mills (2015) use a linguistic measure of financial constraints based on firms' qualitative disclosures and find that financially constrained firms pursue more aggressive tax planning strategies and have lower effective tax rates. Edwards et al. (2016) show that increases in firm-specific and macroeconomic measures of financial constraints are associated with increases in cash tax planning. Dyreng and Markle (2016) suggest that the benefits of shifting income from the U.S. to foreign jurisdictions are lower for financially constrained firms because they have higher costs of external financing and thus are less able to defer the repatriation, which face the same U.S. tax as non-shifted income. Campbell, Goldman, and Li (2021) show that firms engage in more tax planning after an exogenous increase in financial constraints arising from the immediately required pension contributions in response to the Pension Protection Act of 2006. Overall, these studies suggest that internal financing is an important motive for tax planning by financially constrained firms.

Existing research on the tax planning of politically connected firms has focused exclusively on the role of political connections in reducing the expected *costs* of tax planning.

This research argues that politicians can protect connected firms by reducing regulatory oversight (*protection* effect) and provide firms with policy-relevant information regarding future regulatory or policy changes (*information* effect). A growing literature in political economy and accounting documents that political connections can lead to regulatory forbearance and weaker enforcement of laws and regulations (e.g., Mehta, Srinivasan, and Zhao (2020), Mehta and Zhao (2020), Akey, Heimer, and Lewellen (2021), Bourveau, Coulomb, and Sangnier (2021), and Baker, Frydman, and Hilt (2023)). Another related line of research shows that political connections can provide firms with policy-relevant information and insights about regulatory priorities or future policy changes (e.g., Gao and Huang (2016), Christensen, Mikhail, Walther, and Wellman (2017), and Ovtchinnikov, Reza, and Wu (2020)). As a result, politically connected firms should have stronger incentives to avoid taxes given the lower detection risk and less uncertainty about tax enforcement. Consistent with this prediction, Richter et al. (2009) document that firms spending more on lobbying in a given year have lower effective tax rates in the next year. Brown et al. (2015) find firms making campaign contributions to tax policy makers have lower future cash and GAAP ETRs and their future Cash ETRs are also less volatile. They also show that tax-specific lobbying has an incremental tax benefit for firms that build connections with tax policymakers via campaign contributions. Kim and Zhang (2016) use campaign contributions, lobbying, and employment of connected directors to measure political connections and find that politically connected firms engage in more aggressive tax planning activities. Using Chinese data, Lin et al. (2018) find that the relation between tax enforcement and effective tax rates is lower for firms with politically connected board members, supporting the idea that lower detection risk and penalties are one mechanism through which political connections affect corporate tax planning. Overall, the extant literature is consistent with politically connected firms avoiding more taxes.

Besides lowering the expected *costs* of tax planning, political connections can also affect corporate tax planning by lowering the costs of external financing and relaxing firms' financial constraints, and consequently, reducing the relative *benefits* of using tax planning as a source of internal financing. This *financing* effect has been largely ignored in the literature and would suggest *decreases* in firms' incentives to avoid taxes after increases in political connections.

Because the *protection* and *information* effects and the *financing* effect are in opposite directions, changes in tax planning in response to shocks to political connections likely depend on the degree of firms' financial constraints. We expect the *financing* effect to be more important for financially constrained firms, because they are more likely to use cash flows from tax planning as a source of internal financing. Thus, they face decreases in both the costs of tax planning (*protection* and *information* effects) and the relative benefits of using it as a financing tool (*financing* effect) in response to shocks to political connections. To the extent that financing is the primary motive for tax planning of financially constrained firms, the *financing* effect is likely to be more pronounced and outweighs the *protection* and *information* effects for these firms. In such a scenario, constrained firms are likely to pursue *less* tax planning in response to increases in political connections. We thus test the following two hypotheses in alternative forms.

H1: Political connections have differential effects on the tax planning of financially constrained and unconstrained firms.

H2: Political connections reduce the tax planning of financially constrained firms by alleviating their financial constraints.

III. Data and Variable Construction

A. Measures of Tax Planning

We construct two measures to proxy for corporate tax planning. The first one is cash effective tax rate (*CASH_ETR*). We follow a similar definition to that of Graham, Hanlon, Shevlin, and Shroff (2014) and measure *CASH_ETR*, as follows.

$$CASH\_ETR = -1 \times \frac{TXPD}{PI}, \quad (1)$$

where *TXPD* refers to total cash taxes paid and *PI* refers to pre-tax income. We drop observations with negative pre-tax income because the effective tax rates of these loss firms are difficult to interpret when pooled with profitable firm-year observations. We also truncate effective tax rates at zero and one. We multiply the measure by -1 so that *CASH_ETR* is increasing in firms' tax planning.

Our second measure, book-tax differences (*BTD*), following Goh, Lee, Lim, and Shevlin (2016), is defined in Equation (2) as follows.

$$BTD = PI - \frac{TXFED + TXFO}{STR}, \quad (2)$$

where *PI* refers to pre-tax income, *TXFED* refers to current federal tax expense, *TXFO* refers to current foreign tax expense, and *STR* refers to the statutory tax rate. The book-tax differences are then scaled by lagged total assets. Firms that engage in more tax planning are expected to have higher book-tax differences.[3]

B. Measures of Political Connection

As suggested by Hillman and Hitt (1999), political strategies are endogenously adopted by firms to achieve favorable public policy outcomes that lead to sustainable success. To isolate the effect of political connections on the tax planning of financially constrained firms from other firm characteristics, we follow Akey (2015) and use changes in

[3] The number of observations is smaller for BTD (4,052) than for Cash ETR (4,999) because BTD requires more data items—such as current federal and foreign tax expense and lagged total assets for scaling—and, following Chen, Chen, Cheng, and Shevlin (2010), we further exclude firm-year observations with total assets less than $1 million. In contrast, Cash ETR relies on fewer inputs and therefore retains more observations.

political connections arising from *close* elections to establish causality. The identification assumption of this approach is that there is some randomness in determining the outcome of a close election (Lee (2008)). We compare the outcomes of firms contributing to candidates who marginally win to those of firms donating to candidates who marginally lose and document the causal effect of political contributions on firms' tax planning. Following Do, Lee, Nguyen, and Nguyen (2012) and Do, Lee, and Nguyen (2015), we define close elections as those that are won or lost by five percentage points or fewer.[4]

We manually collect federal congressional election results from the Federal Election Commission (FEC) and Constituency-Level Elections Archive (CLEA). To make a political contribution to a candidate in a federal congressional election, a firm must first establish a political action committee (PAC). The candidate must also establish a PAC to receive contributions because they cannot personally receive money from firms' PACs. After the Supreme Court ruling in Citizens United v. Federal Election Commission on January 21, 2010, the "Super PAC" was created, which allows donors to shield their identities. Thus, our sample is restricted to 1980–2010 because we cannot clearly map Super PAC donors to recipient politicians after 2010.

Figure 1 presents a histogram of the margin of victory for all elections in the United States from 1980 to 2010. The average election was won by a margin of 31.4%, whereas the median election was won by 26.8%, comparable to the numbers reported in Akey (2015). The 5% cutoff we impose for our analysis falls at about the sixth percentile. Thus, in comparison with a typical election, these elections are close.

[4] If in each election cycle a firm only supported one just winning or just losing politician, we could use a regression discontinuity design (Lee (2008), Akey (2015)) with the percentage of the vote obtained by the candidates as the forcing variable (i.e., cut off score). However, firms support multiple candidates in each election cycle, some of which might just win or just lose an election and thus we cannot simply sum or average the votes across candidates. Thus, we adopt the design below which nevertheless exploits the randomness of outcomes in close elections, as would a regression discontinuity design. In Section IV.I.3, we apply the regression discontinuity design to special elections, in which a member of Congress dies or resigns before the completion of his or her term, and find consistent results.

[Insert Figure 1]

We identify the flow of money from firm PAC to candidate PAC by examining PAC money transfer records from FEC bulk datasets. We first match the firm names in the contribution-level data and Compustat and obtain 1,580,770 contribution records donated by Compustat-firm PACs. The PAC-level data define six PAC designations.[5] We merge the Federal Election Commission-level data with the contribution-level data and require that the recipient must be a Senate or House election candidate's PAC, and its designation must be either authorized by a candidate, authorized by the principal campaign committee of a candidate, or unauthorized.[6] After excluding records with missing candidate IDs and dropping contributions that are donated to neither Democratic nor Republican candidates, we are left with 1,255,415 contribution records.

Next, we merge the contribution-level data with the election results data from the Federal Election Commission (FEC) and the Constituency-Level Elections Archive (CLEA), which have candidate-level information, such as election outcomes and voting shares. From the election outcomes, we define an election as "close" if the winner's vote share differs from that of his or her closest competing candidate by less than five percentage points. We manually match candidate names when merging the contribution-level data with election result data. When candidate names are missing, we drop the observations. After the merger, we are left with 984,604 direct contribution records of which 119,369 records relate to Senate elections and 865,235 records relate to House elections. Out of these contribution records, 90,071 are close elections.

[5] The six designations are: authorized by a candidate, authorized by the principal campaign committee of a candidate, unauthorized, lobbyist/registrant PACs, joint fundraisers, and leadership PACs.
[6] Besides the three categories, the dataset also has the other three PAC designations including lobbyist/registrant PACs, joint fundraisers, and leadership PACs.

We then aggregate the contribution amount for each firm PAC-candidate PAC-election cycle observation and obtain 45,726 observations from 1980 to 2010.[7] We further aggregate the contribution amount into firm-cycle-level data. We record the number of winning and losing candidates *j* that each firm *f* supported in one cycle prior to each close election at time *t*. Specifically, we compute the following two variables for each firm-cycle-candidate combination.

$$(3) \qquad WinP_{ft}(LoseP_{ft}) = \sum_j \left(Donated_{fjt} \times Election\ Outcome_{jt}\right)/100,$$

where $Donated_{fjt}$ equals one if firm *f*'s PAC donated to candidate *j*'s election PAC in cycle *t* and zero otherwise. $Election\ Outcome_{jt}$ takes the value of one if candidate *j* wins (loses for $LoseP_{ft}$) the close election in cycle *t* and zero otherwise. We divide *WinP* and *LoseP* by 100 to have sizeable coefficients in empirical analysis. We then construct a variable $TotalP_{ft}$ as the difference between $WinP_{ft}$ and $LoseP_{ft}$ to measure a firm's net political connection portfolio.

C. Measures of Financial Constraint

We proxy financing frictions using two established indices: an index based on firm size and age developed by Hadlock and Pierce (2010), the HP index, and the text-based financial-constraint measures of Hoberg and Maksimovic (2015), the Hoberg and Maksimovic (HM) index. The HP index is computed from Compustat as:

$$(4) \qquad HP\ Index = -0.737 \times Size + 0.043 \times Size^2 - 0.040 \times Age,$$

where *Size* is the log of inflation-adjusted total assets (2004 dollars) capped at log($4.5 billion), and *Age* is the number of years the firm has a non-missing stock price on Compustat, capped at 37. Higher HP values indicate tighter constraints.

[7] A very small number of aggregated contributions are zero or even negative, which are very likely due to wrong data input. We exclude these observations.

The HM Index is obtained from the authors' data library. [8] We focus on the *DelayCon* score, which captures the degree to which a firm resembles those prone to delaying investment due to liquidity constraints. Higher values of the HM Index indicate greater external financing frictions.[9] Table 1 reports summary statistics for all variables.[10]

[Insert Table 1]

IV. Empirical Results

A. The Impact of Political Connections on Tax Planning

To examine the effect of political connections on tax planning, we estimate the following regression model.

$$TP_{ft+1} = \alpha + \beta Con_{ft} + \chi_{ft} + \Phi_f + \Phi_t + \epsilon_{ft}, \quad (5)$$

where TP_{ft+1} represents our measures of tax planning in the year after election cycle t for firm f. Con_{ft} is our proxy for the political connections of firm f in an election cycle t. We use two different measures of Con_{ft}. The first one uses a net change in firms' political connection portfolio (*TotalP*), and the second one uses separate measures of obtaining political connections (*WinP*) and losing such connections (*LoseP*). We also include firm fixed effects, Φ_f, which control for the effects of time-invariant firm characteristics on tax planning, and year fixed effects, Φ_t, which control for the time trend in tax planning and changes in the top federal corporate statutory tax rate across years. χ_{ft} represents a vector of

[8] Source: https://faculty.marshall.usc.edu/Gerard-Hoberg/MaxDataSite/index.html

[9] The HM Index yields fewer observations because it is available only from 1998 and requires a separately identifiable "Capitalization and Liquidity" section in 10-K filings, limiting coverage relative to the HP index.

[10] Data availability limits the sample windows for two datasets used in this table. Audit Analytics tax-fee data (for *TAX_FEES*) are available starting in 1998, and federal government contract data begin in 2001. Accordingly, columns that include *TAX_FEES* or government-contract variables (*OBTAIN_CONTRACT, CONTRACT_VALUE*, and *POTEN_CONTRACT_VAL*) are estimated on shorter subsamples and may have fewer observations than other columns.

control variables following prior studies (e.g., Chen et al. (2010)). Detailed definitions of control variables are provided in Appendix A.

Using the full sample, we present our first set of estimation results in Table 2. In column 1, we use *CASH_ETR* and find that the coefficient on *TotalP* is positive but not statistically significant, suggesting that changes in political connections are not associated with significant changes in cash effective tax rates. In column 2, we decompose *TotalP* into *WinP* and *LoseP* and regress *CASH_ETR* on *WinP* and *LoseP*. Consistent with the result in column 1, we do not find statistically significant coefficients on *WinP* and *LoseP*. In columns 3 and 4, we use *BTD* as the dependent variable and find that *BTD* is not related to *TotalP*, *WinP*, and *LoseP*. Taken together, the results in Table 2 suggest that corporate tax planning does not change *on average* in response to shocks to political connections arising from connected politicians winning or losing close elections.

[Insert Table 2]

Next, we separate our sample into two subsamples based on firms' financial constraints. The financially constrained subsample consists of firms whose HP Index is above the sample median in the year preceding election cycle *t*, while the unconstrained subsample includes those with scores below the median. We present the regression results for financially constrained firms in Panel A of Table 3. In column 1, we use *CASH_ETR* to measure tax planning and find that the coefficient of *TotalP* is significantly negative, suggesting that financially constrained firms pursue less tax planning after they obtain more political connections. In terms of economic significance, a net increase in one connected politician is associated with a 0.835-percentage-point decrease in *CASH_ETR* (≈2.97% of the sample

mean in absolute terms).[11] In column 2, we regress *CASH_ETR* on *WinP* and *LoseP* and find results consistent with those in column 1. In columns 3 and 4, we present the results of using *BTD* to measure tax planning and find consistent results. Taken together, the results in Panel A of Table 3 suggest that financially constrained firms decrease tax planning after obtaining more political connections.

Table 3 Panel B presents the results for financially unconstrained firms. We find that political connections have opposite impacts on the tax planning of unconstrained firms. In particular, using *TotalP* as the measure of shocks to political connections, we find that unconstrained firms reduce cash effective tax rates and increase book tax differences. Moreover, winning (losing) close elections by connected politicians leads to lower (higher) cash effective tax rates and higher (lower) book tax differences for financially unconstrained firms. These results suggest that financially unconstrained firms pursue more tax planning after obtaining more political connections.

[Insert Table 3]

As a robustness test, we use the HM Index as an alternative measure of financial constraints in Table 4 and find results consistent with those in Table 3. Collectively, these results are consistent with our conjecture that, for financially constrained firms, more political connections lead to less tax planning, while, for their financially unconstrained counterparts, similar increases lead to an *increase* in tax planning.

[Insert Table 4]

B. Tax-related Fees[12]

[11] The economic magnitude is calculated as $-0.835 \times 1 \div 100 \div (-0.2810) \approx 2.97\%$, where -0.835 is the estimated coefficient and -0.2810 is the mean value of *CASH_ETR* for financially constrained firms.

[12] We thank the anonymous referee for insightful suggestions regarding Sections IV.B and IV.C

Previous literature suggests that higher fees paid to auditors for tax services enable firms to achieve their tax planning objectives through greater tax avoidance (e.g., McGuire, Wang, and Wilson (2014), Hogan and Noga (2015), Klassen, Lisowsky, and Mescall (2016), and Cook, Kim, and Omer (2020)). To provide more direct evidence of firms' tax planning activities, following Francis, Neuman, and Newton (2019) and Brown, Guo, and Zheng (2024), we construct the variable *TAX_FEES* as the ratio of tax fees paid to the auditor divided by audit fees to measure audit fees allocated to tax services. The data are from Audit Analytics.[13]

We regress *TAX_FEES* on *TotalP*, *WinP*, and *LoseP*, together with controls, estimating the model separately for financially constrained and unconstrained firms classified by the HP index. The results are presented in Table 5. Net increases in political connections induced by close elections are associated with significant reductions in tax-related expenditures for constrained firms, but significant increases for unconstrained firms.

[Insert Table 5]

C. Alternative Explanations

1. Performance or Investment Policy Change

We conduct a number of additional empirical tests to rule out plausible alternative explanations. Political connections could boost the performance and profits of financially constrained firms, increasing tax liabilities; they might also enhance bargaining power and prompt changes in capital expenditures, innovation, and mergers and acquisitions (M&A) that result in higher taxes.

[13] Audit Analytics fee data are available beginning in 1998, which limits the sample period for analyses using *TAX_FEES*.

To test these possibilities, we construct year $t+1$'s pretax profit margin, capital expenditure, R&D expenditure, merger and acquisition indicator, and a measure of M&A value as five additional dependent variables. We regress these five variables on *TotalP*, *WinP*, and *LoseP* separately for financially constrained and unconstrained firms. The estimated coefficients on our political connection variables are not significantly different from zero for all five dependent variables and for both constrained and unconstrained samples, indicating that the aforementioned alternative possibilities about firms' performance and investment policy change cannot explain the results we find. The regression results are provided in Table OA1.

2. Tax Policy Change

Another possible explanation for our results is that tax policy changes in our sample period. To address this concern, we refer to Romer and Romer (2010) and use the corresponding Congressional election years to define *TaxReformYear* and *CorporateTaxChange* dummies. We classify 1980, 1982, 1984, 1986, 1988, 1992, 1996, 2000, and 2002 as *TaxReformYear* reflecting election years associated with major federal tax reforms. In addition, following Mertens and Ravn (2013), we identify 1980, 1982, 1984, 1986, and 2002 as *CorporateTaxChange* years, capturing elections tied to reforms with significant corporate tax components.[14] In Table OA3, we regress the two tax planning variables on *TotalP* and the interaction term between *TotalP* and either *TaxReformYear* (Panel A) or *CorporateTaxChange* (Panel B), and find that the coefficients of *TotalP* are significantly negative for constrained firms and significantly positive for unconstrained firms, while the estimated coefficients of all eight interaction terms are statistically insignificant, suggesting that our findings cannot be explained by tax policy changes in specific years.

[14] See Table OA2 for the detailed list of tax reforms between 1980 and 2010 and their corresponding election years.

3. Firm Lifecycle

In addition, one might argue that unconstrained firms are already at a lifecycle stage where political connections are no longer needed to finance growth and are instead used to optimize other dimensions (e.g., lobbying for favorable tax provisions). To mitigate this concern, we control for variables that proxy for firms' lifecycle stage —*SIZE*, *ROA*, *LEVERAGE*, and *R_D* — so that comparisons of tax-planning measures between more and less politically connected firms are made among otherwise similar firms. Prior studies support the use of these firm characteristics as lifecycle indicators (Ho, Tjahjapranata, and Yap (2006), Dickinson (2011)). We also implement a matched-sample test: for each constrained firm, we select unconstrained counterparts in the same industry and with founding years equal to, or within two years of, the constrained firm's founding year.

The matched-sample regression results are reported in Table OA4: Columns 1-4 cover constrained firms and Columns 5-8 cover the matched unconstrained firms. The estimates are robust and consistent with those in Table 3, indicating that after gaining political connections, financially constrained firms reduce tax planning, whereas unconstrained peers in the same industry and with similar founding years increase it.

4. Firms with Pre-tax Loss

In the main analysis, we exclude firm-years with negative pre-tax earnings. One might question whether this restriction disproportionately affects constrained versus unconstrained firms; moreover, loss years may at times reflect optimal tax-planning choices.

To address this concern, we re-estimate the regressions including firms with negative pre-tax earnings. As shown in Table OA5, the results remain robust: the signs and statistical significance of the coefficients are unchanged. Net increases in political connections arising from close elections are associated with significant reductions in tax planning for financially constrained firms and significant increases for unconstrained firms.

D. Changes in Bank Loans and Public Bonds

In this section, we provide evidence that political connections decrease the tax planning of constrained firms by alleviating their financial constraints. In particular, we examine (1) the effects of political connections on changes in the probability of obtaining new bank loans and issuing new public bonds and the costs of these new bank loans and public bonds, and (2) the role of obtaining new bank loans and bond financing in explaining decreases in the tax planning of financially constrained firms.

In Panel A of Table 6, we construct two indicator variables, *OBTAIN_LOAN* and *ISSUE_BOND*, which are equal to one if the firm obtains any new bank loans and issues any new bonds in the next year after the federal election and zero otherwise, respectively, and regress these two variables on political connections for financially constrained and unconstrained firms separately.[15] In Columns 1 and 2, we focus on constrained firms and use *OBTAIN_LOAN* as the dependent variable. We find that the coefficients on *TotalP* and *WinP* are significantly positive and the coefficient on *LoseP* is significantly negative. These results suggest that after connected politicians win (lose) close elections, financially constrained firms are more (less) likely to obtain bank loans. In Columns 3 and 4, we use *ISSUE_BOND* as the dependent variable and find that constrained firms are more likely to issue new public bonds after obtaining more political connections. In columns 5 to 8, we focus on unconstrained firms and find no changes in the probability of obtaining new bank loans and issuing new public bonds for these firms after increased political connections.

In Panel B of Table 6, we follow Frank and Shen (2016) and Shevlin, Urcan, and Vasvari (2020) and measure the cost of new bank loans (*AISD*) as the loan spread quoted in basis points over a floating benchmark (typically, the London Interbank Offered Rate),

[15] We consider both bank loans and public bonds because political connections not only help firms obtain favorable loan terms but also insure firms against the risk of default (e.g., Khwaja and Mian (2005), Faccio et al. (2006), and Houston et al. (2014)).

divided by 100, and the cost of new public bonds by (*OFFERING_YIELD*) as the bond's percentage yield to maturity at issuance. In column 1, we regress *AISD* on *TotalP* for financially constrained firms and find that the coefficient on *TotalP* is significantly negative. In column 2, we replace *TotalP* with *WinP* and *LoseP* and find that the coefficient on *WinP* is significantly negative and the coefficient on *LoseP* is significantly positive. These results suggest that increases (decreases) in political connections are associated with significant decreases (increases) in the cost of new bank loans. In Columns 3 and 4, we use *OFFERING_YIELD* as the dependent variable and find that the cost of new public bonds issued after obtaining (losing) political connections is significantly lower (higher). We focus on unconstrained firms in columns 5 to 8 and find that the costs of new bank loans and public bonds of these firms do not appear to change after obtaining or losing political connections.

If political connections reduce corporate tax planning of financially constrained firms by providing better access to external financing, such decreases in tax planning in response to increases in political connections should be more pronounced for firms that obtain new bank loans and issue public bonds. We test this idea by constructing an indicator variable, *Obtain_Finance*, which is equal to one for firms that obtain new bank loans or issue new public bonds in the next year after federal elections and zero otherwise. We regress measures of tax planning on *WinP*, *Obtain_Finance*, and their interactions, *WinP* × *Obtain_Finance* for financially constrained firms in columns 1 to 2 of Table 6, Panel C. Consistent with our expectation, we find that the coefficients on *WinP* × *Obtain_Finance* are significantly negative in both columns where we use different measures of tax planning. In columns 3 and 4, we focus on unconstrained firms and find that the coefficients on *WinP* × *Obtain_Finance* are not significantly different from 0, indicating that changes in the tax planning of unconstrained firms in response to changes in political connections do not depend on whether these firms obtain new bank loans or issue new bonds.

Collectively, the results in Table 6 support the idea that alleviating financial constraints is one mechanism through which political connections affect the tax planning of financially constrained firms.

[Insert Table 6]

E. Changes in Government Contracts

Dhaliwal et al. (2016) argue that government contractors are less risky and find that these firms have lower costs of equity capital. Goldman (2020) documents that government contractors receive more bank credit during the financial crisis, suggesting that government contracts can improve firms' credit quality as perceived by the lenders, which helps firms access bank credit. In addition, government contracts can also increase firms' cash flows. These arguments suggest that government contracts could be an indirect avenue through which connected politicians mitigate firms' financial constraints.[16] In this section, we study whether financially constrained firms receive more government contracts after obtaining more political connections.

We collect data on government contracts from the USAspending.gov website, which provides data from the Federal Procurement Data System (FPDS) starting in 2000. We create one indicator variable, *OBTAIN_CONTRACT*, which equals one if firms obtained any government contract in a given year and zero otherwise. We also construct two variables based on the number and dollar amount of government contracts, *CONTRACT_VALUE*, which is the natural logarithm of one plus the dollar value of contracts awarded to the firm in a given year, and *POTEN_CONTRACT_VAL*, which is the natural logarithm of one plus the

[16] It is also possible that the political costs of being tax aggressive increases after obtaining government contracts (Mills, Nutter, and Schwab (2013)), which reduces the incentives of constrained firms to use tax planning as a source of financing.

maximum potential dollar value of contracts awarded to the firm in a given year (i.e., if performance/target bonuses are earned). We regress each of the three government contract measures on *TotalP, WinP,* and *LoseP* and present the estimation results for financially constrained and unconstrained firms in Panels A and B of Table 7, respectively.

In column 1 of Table 7, we use *OBTAIN_CONTRACT* as the dependent variable. We find that the coefficient on *TotalP* is significantly positive, suggesting that after obtaining more political connections, financially constrained firms are more likely to receive government contracts. In column 2, we regress *OBTAIN_CONTRACT* on *WinP*, *LoseP*, and control variables. We find that the coefficient on *WinP* is significantly positive and the coefficient on *LoseP* is significantly negative. These results suggest financially constrained firms are more (less) likely to obtain government contracts after connected politicians win (lose) close elections.

In columns 3 to 6, we present the results of using *CONTRACT_VALUE* (columns 3 and 4) and *POTEN_CONTRACT_VAL* (columns 5 and 6) to measure the value of government contracts, respectively. Consistent with the results in the first two columns, we find that the value of government contracts awarded to financially constrained firms significantly increases (decreases) in response to connected politicians winning (losing) close elections. Taken together, the results in Panel A of Table 7 suggest that financially constrained firms are more likely to be awarded government contracts and the contract value is also higher after obtaining more political connections. To the extent that government contracts increase firms' cash flows and help decrease firms' cost of capital and access to external financing, these results provide further support for the argument that mitigating financial constraints is one mechanism through which political connections decrease the tax planning of firms with financial constraints.

In Panel B of Table 7, we present results for changes in government contracts of financially unconstrained firms in response to changes in political connections. All coefficients on *TotalP*, *WinP*, and *LoseP* are not significantly different from 0, indicating that the likelihood and value of government contracts awarded to financially unconstrained firms are not sensitive to winning or losing connected politicians.

[Insert Table 7]

F. The Committees of Connected Politicians

If political connections reduce financially constrained firms' tax planning incentives by alleviating their financial constraints, we expect these connections to have a greater impact on their tax planning when the politicians are more likely to help with their financing activities. In this section, we test this prediction by exploring variations in connected politicians' committee assignments. As discussed in the introduction, the banking-related committees oversee the entire financial services industry and have jurisdiction over matters related to banks and banking and financial aid to the industry.[17] Thus, politicians serving on the banking-related committees should have more direct power to help connected firms access external financing and lower their financing costs than politicians on other committees. As a result, the negative relation between political connections and tax planning for financially constrained firms should be more pronounced when the connected politicians serve on banking-related committees. Because unconstrained firms have less difficulty in obtaining external financing, the impact of political connections on their tax planning should not depend on whether connected politicians serve on banking-related committees. We use the following regression model to examine these predictions.

[17] The banking-related committees include the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services.

$$TP_{ft+1} = \alpha + \beta_1 WinP_{ft} \times Banking\_Committee_{ft} + \beta_2 Win_{ft} + \beta_3 Banking\_Committee_{ft} + \chi_{ft} + \Phi_f + \Phi_t + \epsilon_{ft}, \quad (6)$$

where TP_{ft}, $WinP_{ft}$, χ_{ft}, Φ_f, and Φ_t are defined in Section IV.A.[18] Note that here we only use $WinP$ instead of *TotalP* as our measure of shocks to political connections because $Banking\_Committee_{ft}$ is an indicator variable that takes the value of one if at least one of the winning candidates supported by firm *f* is assigned to a banking-related committee in election cycle *t* and zero otherwise. The variable of interest is $WinP_{ft} \times Banking\_Committee_{ft}$. The coefficient β_1 captures the incremental impact of political connections on tax planning when the connected politicians serve on banking-related committees. We expect β_1 to be negative for financially constrained firms and not significantly different from zero for unconstrained firms.

We present the regression results for financially constrained firms in the first two columns of Table 8. We find that the coefficients on the interaction term, *WinP* × *Banking_Committee*, are significantly negative in both columns, suggesting that the impact of political connections on decreases in constrained firms' tax planning is significantly greater when the connected politicians are on banking-related committees. In contrast, the regression results for unconstrained firms reported in the last two columns of Table 8 indicate that the coefficients on *WinP* × *Banking_Committee* are not significantly different from zero, suggesting that the impact of political connections on the tax planning of unconstrained firms does not depend on whether the connected politicians are on banking-related committees. These results provide further support to the argument that political connections lead to less tax planning of financially constrained firms by alleviating their constraints.

[18] Here we use *WinP* instead of *TotalP* because *TotalP* cannot accurately capture the connections between firms and committees. Take an example that a firm has a negative *TotalP*, which means this firm donated to more losing candidates than winning ones in one election cycle; among those winning candidates, one was assigned to the Banking Committee. If we use *TotalP* here, we will find that a connection with the Banking Committee would hurt the firm, which does not make sense. Therefore, using *WinP* is more appropriate.

[Insert Table 8]

In Section IV.A, we find that financially unconstrained firms pursue more tax planning after they obtain more political connections. If these firms have lower detection risk or receive more information regarding tax law and enforcement changes, we expect political connections to have a greater impact on their tax planning when their connected politicians serve on tax-related committees, which oversee the IRS and all bills regarding taxation.[19] We expect politicians assigned to these committees can better provide protection against tax enforcement and more information to connected firms than politicians on other committees can. As a result, the positive association between political connections and tax planning for financially unconstrained firms should be more pronounced when the connected politicians serve on tax-related committees. To the extent that alleviating firms' financial constraints is the primary way political connections affect the tax planning of constrained firms, changes in tax planning of these firms do not necessarily depend on connected politicians' serving on tax-related committees. We estimate the following regression model to test these predictions.

$$TP_{ft+1} = \alpha + \beta_1 WinP_{ft} \times Tax\_Committee_{ft} + \beta_2 WinP_{ft} + \beta_3 Tax\_Committee_{ft} + \chi_{ft} + \Phi_f + \Phi_t + \epsilon_{ft}, \quad (7)$$

where TP_{ft}, $WinP_{ft}$, χ_{ft}, Φ_f, and Φ_t are defined in Section IV.A. $Tax\_Committee_{ft}$ is defined as an indicator variable that takes the value of one if at least one of the winning candidates supported by firm *f* is assigned to the tax-related committees in election cycle *t* and zero otherwise. The variable of interest is $WinP_{ft} \times Tax\_Committee_{ft}$. The coefficient β_1 captures the incremental impact of political connections on tax planning when the connected politicians serve on tax-related committees. We expect β_1 to be not significantly different from zero for constrained firms and positive for financially unconstrained firms.

[19] The tax-related committees include the Senate Finance Subcommittee on Taxation and IRS Oversight and the House Committee on Ways and Means.

We present the estimation results for financially constrained firms in the first two columns of Table 9. We find that the coefficients on *WinP* × *Tax_Committee* are not significantly different from zero in both columns, suggesting that the effect of political connections on the tax planning of financially constrained firms is not related to whether connected politicians serve on tax-related committees. In the last two columns of Table 9, we report the estimation results for financially unconstrained firms. We find that the coefficients on the interaction term, *WinP* × *Tax_Committee*, are significantly positive in both columns, indicating that political connections have a greater impact on the tax planning of financially unconstrained firms when the connected politicians serve on tax-related committees. Collectively, the results in Table 9 provide evidence consistent with political connections increasing the tax planning of financially unconstrained firms by providing more protection against tax enforcement or more tax-related information.[20]

[Insert Table 9]

G. The Power of Connected Politicians

Favorable treatment in financing and tax enforcement is a valuable resource that is unlikely to be provided to all firms with political connections. As banks and regulators are concerned with maximizing their own benefits, they are more likely to favor firms connected

[20] In an attempt to provide evidence on whether the increased tax avoidance in politically connected financially constrained firms is explained by lower enforcement or an information benefit from political connections, we examine two proxies for tax audit probability. Specifically, one is the tax audit probability measure developed by Hoopes et al. (2012) and the other one is book-tax-difference (Mills 1998). The idea is that firms with higher tax audit probability and higher book-tax-difference are more likely to attract tax scrutiny and thus under the protection mechanism, these firms are expected to increase tax planning more after obtaining more political connections. We construct two indicator variables using these two measures. The coefficients on the interaction between political connections and these indicator variables are not significantly different from zero (untabulated). Thus, these tests fail to provide evidence that suggests lowered tax enforcement explains the increased tax avoidance. This suggests the remaining channel, information benefit, explains the increased tax avoidance in financially unconstrained firms but we cannot provide direct evidence as we cannot identify proxies for this channel. We thus leave the exploration of the two channels to future research.

to more powerful politicians (Heitz, Wang, and Wang (2023)). In this section, we test this prediction by carrying out an additional cross-sectional analysis, as follows.

$$TP_{ft+1} = \alpha + \beta_1 WinP_{ft} \times Power_{ft} + \beta_2 WinP_{ft} + \beta_3 Power_{ft} + \chi_{ft} + \Phi_f + \Phi_t + \epsilon_{ft}, \quad (8)$$

where TP_{ft}, $WinP_{ft}$, χ_{ft}, Φ_f, and Φ_t are defined in Section IV.A. $Power_{ft}$ represents our proxies for the power of connected politicians. In Panel A of Table 10, we use *Leadership*, which takes the value of one if at least one of the candidates supported by the firm wins the close election and holds a leadership position in the Congress and zero otherwise. A leadership position is defined as a majority leader, majority whip, speaker, minority leader, or minority whip. Around half of the firms (47% for financially constrained sample and 50% for financially unconstrained sample) have connections with members of the Congress holding leadership positions. The variable of interest in this regression is $WinP_{ft} \times Power_{ft}$. The coefficient on this variable, β_1, captures the incremental impact of politicians' power on the relation between political connections and tax planning. We find that β_1 is significantly negative for financially constrained firms and significantly positive for unconstrained firms. These results suggest that political connections have a greater impact on corporate tax planning when these connections are with more powerful politicians.

In Panel B of Table 10, we use whether the connected politicians are members of Congress who belong to the majority party in both the Senate and the House to measure political power. The indicator variable, *Majority_Seats*, takes the value of one if at least one of the candidates supported by the firm wins the close election and belongs to the Majority party and zero otherwise. In our sample, 80% of financially constrained firms and 85% of financially unconstrained firms are politically connected to senators or representatives whose party holds the majority of seats. Consistent with the results of using *Leadership* to measure power, we find that the coefficients on $WinP_{ft} \times Majority\_Seats$ are significantly negative

for financially constrained firms and significantly positive for unconstrained firms, consistent with the argument that more powerful politicians have a greater impact on the tax planning of connected firms.

In Panel C of Table 10, we use whether the connected politicians are senior members of the Senate and the House to measure political power. To measure member seniority, we use *Seniority*, an indicator variable that takes the value of one if at least one of the candidates supported by the firm is a senior member and zero otherwise. A member of Congress is considered a senior member if that person has seniority in the top 25%.[21] Consistent with the results in Panels A and B, we find that the effect of political connections is more pronounced when the connected politicians are senior members of Congress. Taken together, the regression results in Table 10 further support the view that it is the connection with politicians that drives the change in corporate tax behavior after the election.

[Insert Table 10]

H. The Importance of Firms

A politician may not uniformly cater to contributors. That is, a candidate who wins an election may pay more attention to the potentially more-valuable connected firms. In this analysis, we use two sets of proxies to measure the importance of firms and examine the role of firm importance in shaping the change in tax planning after an increase in political connections. In particular, we estimate the following regression model.

$$TP_{ft+1} = \alpha + \beta_1 WinP_{ft} \times Importance_{ft} + \beta_2 WinP_{ft} + \beta_3 Importance_{ft} + \chi_{ft} + \Phi_f + \Phi_t + \epsilon_{ft}, \quad (9)$$

where TP_{ft}, $WinP_{ft}$, χ_{ft}, Φ_f, and Φ_t are defined in Section IV.A. $Importance_{ft}$ represents our measures of the firm importance. Political contributions are a major source of

[21] Since there are 100 members in the Senate and 435 members in the House, the 25 longest serving Senators and 109 longest serving House of Representatives are classified as senior members of Congress.

campaign funding for politicians. Thus, politicians may expend more effort on more generous donors to encourage these donors to donate in the future. Following this line of reasoning, we construct two indicator variables based on a firm's donation to proxy for its importance. The first one, *Top5_Donor*, takes the value of one if the firm is one of the top five donors by amount for at least one of the winning candidates supported by the firm and zero otherwise. The second one, *Donate10Pct*, takes the value of one if the firm's donation to at least one of the winning candidates is over 10 percent of the total donations received by that candidate and zero otherwise. In Panel A of Table 11, we present the results of using *Top5_Donor* to measure firm importance. We find that the coefficients on *WinP* × *Top5_Donor* are significantly negative for financially constrained firms and significantly positive for unconstrained firms, consistent with political connections having a greater impact on corporate tax planning when the firms are more important to the politicians. In Panel B of Table 11, we use *Donate10Pct* to measure firm importance and find consistent results.

In Panel C of Table 11, we measure firm importance by whether the firm is in an important industry, following Cohen, Diether, and Malloy (2013). For each state, we first aggregate the employment in each industry and then rank industries by the aggregated number of employment. Important industries are those ranked as the top three in aggregate employment in that state. We construct an indicator variable, *Crucial_Industry_Emp*, which is equal to one if the firm is in one of the important industries in its headquarter state and zero otherwise. Consistent with the results in Panels A and B, we find that the coefficients on the interaction term, *WinP* × *Crucial_Industry_EMP*, are significantly negative for financially constrained firms and significantly positive for unconstrained firms.

[Insert Table 11]

I. Additional Tests

1. Weighted Campaign Contributions

In our main analyses, we construct the measures of political connections without considering the amount of firms' contributions to politicians' campaigns. However, firms that donate more to winning candidates would be expected to receive greater access to those politicians. In this section, we construct alternative measures of political connections by weighing firm campaign donations using Equation (10).

$$(10) \qquad AmountWinP_{ft}\left(AmountLoseP_{ft}\right) = \sum_{j}\left(Donated\_Amount_{fjt} \times Election\ Outcome_{jt}\right)/10000,$$

where $Donated\_Amount_{fjt}$ captures the amount of firm f's PAC donation to candidate j's election PAC in cycle t. $Election\ Outcome_{jt}$ equals one if candidate j wins (loses) the close election in cycle t and zero otherwise. $AmountWinP_{ft}$ ($AmountLoseP_{ft}$) is then the campaign contribution weighted measure of increase (decrease) in political connections. The variable *AmountTotalP*, which looks at a firm's net change in contribution-weighted political connection portfolio, is calculated as the difference between *AmountWinP* and *AmountLoseP*.

We present the estimation results for financially constrained and unconstrained firms in Columns 1-4 and 5-8 of Table OA6, respectively. Consistent with our main results in Table 3, after obtaining more political connections, financially constrained firms decrease their tax planning, while their unconstrained counterparts do the opposite.

2. An Alternative Measure of Tax Planning

As financially constrained firms are motivated to save cash taxes as a source of internal financing to fund operations, we also use total cash taxes paid scaled by lagged total assets, *TXPD_AT*, as an alternative measure of tax planning. Again, we multiply this measure by -1 so that *TXPD_AT* is increasing in firms' tax planning. In Table OA7, we regress *TXPD_AT* on changes in political connections arising from close elections and continue to

find that after obtaining more political connections, financially constrained firms decrease tax planning, while unconstrained firms increase tax planning.

3. Special Elections

When a member of Congress dies or resigns before the completion of his or her term, a special election is held to fill the vacant seat. This kind of election is unanticipated, which means that close special elections offer an even more exogenous setting to explore the impact of political connections. In Table OA8, we follow the empirical approach used by Akey (2015) and examine the impact of shocks to political connections arising from close special elections on tax planning. Consistent with our results using regular elections, after connected politicians win special elections, financially constrained firms pursue less tax planning, while their unconstrained counterparts behave in the opposite way.

4. P-Hacking Test

A possible concern is whether our findings are restricted to a particular set of control variable combinations. To alleviate this concern, we conduct p-hacking tests to confirm that our model specification is robust to different combinations of control variables. Specifically, we follow Brodeur, Cook, and Heyes (2020) and re-estimate our regressions in Table 3 Panel A (columns 1, 3, 5, 7) and Panel B (columns 1, 3, 5, 7) using 1024 combinations of control variables. The results are presented in Figure OA1.

We find that all *t*-statistics on our test variables exceed the conventional significance level, confirming the statistical significance of associations in all cases. Taking the *CASH_ETR* of financially constrained firms as an example, the median absolute values of *t*-statistics are all above 2.4 when we use different combinations of control variables (Panel A of Figure OA1).

V. Conclusion

Using changes in political connections from close congressional elections, we examine how political connections help financially constrained firms access external financing, thereby reducing their incentives to use tax planning as internal financing. We find that after exogenous increases in political connections, financially unconstrained firms engage in more tax planning and have higher tax-related expenditures, while constrained firms pursue less tax planning and incur lower tax-related expenditures. We further show that financially constrained firms are also more likely to obtain new bank loans and issue new public bonds at significantly lower cost. Importantly, the decreases in tax planning are more pronounced for constrained firms that obtain new financing and when the connected politicians serve on banking-related committees. Taken together, these findings support the idea that political connections reduce the tax planning of constrained firms by alleviating their financial constraints.

Our paper contributes to the understanding of the tax behaviors of politically connected firms by highlighting the role of firms' financial constraints and the importance of the financing effects, which have been largely ignored in prior literature. Our work also adds to the literature on the value of political connections by showing that connected politicians help constrained firms obtain external financing and government contracts, which substitute for costly internal financing through tax strategies, and benefit unconstrained firms by lowering their taxes.

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Appendix A Variable Definitions

Variable Name	Definition	Source
Tax Planning Measures		
CASH_ETR	defined as cash taxes paid (TXPD) divided by pre-tax income (PI). We multiply it by -1 so that it is increasing in tax planning. We omit firm-year observations if PI < 0 and truncate *CASH_ETR* at zero and one.	Compustat
BTD	book-tax differences computed as $\frac{PI_t - \frac{TXFED_t + TXFO_t}{STR_t}}{AT_{t-1}}$, where PI refers to pre-tax income, TXFED refers to current federal tax expense, TXFO refers to current foreign tax expense, STR refers to the statutory tax rate, and AT refers to total assets at the beginning of the year.	Compustat
TXPD_AT	defined as cash taxes paid (TXPD) divided by lagged total assets (AT). We multiply it by -1 so that it is increasing in tax planning. We truncate *TXPD_AT* at zero and one.	Compustat
Political Connection Measures		
TotalP	*WinP – LoseP*.	FEC, CLEA, OpenSecrets
WinP	# of winning candidates involved in a close election that a firm donated to prior to the election. This variable is divided by 100 to obtain a sizeable coefficient.	FEC, CLEA, OpenSecrets
LoseP	# of losing candidates involved in a close election that a firm donated to prior to the election. This variable is divided by 100 to obtain a sizeable coefficient.	FEC, CLEA, OpenSecrets
AmountTotalP	*AmountWinP – AmountLoseP*.	FEC, CLEA, OpenSecrets
AmountWinP	# of winning candidates involved in a close election that a firm donated to prior to the election multiplied by the firm's contribution to the candidate. This variable is divided by 100,000 to obtain a sizeable coefficient.	FEC, CLEA, OpenSecrets
AmountLoseP	# of losing candidates involved in a close election that a firm donated to prior to the election multiplied by the firm's contribution to the candidate. This variable is divided by 100,000 to obtain a sizeable coefficient.	FEC, CLEA, OpenSecrets
Win	an indicator variable equal to one if the firm-supporting candidate won a close special election and zero otherwise.	FEC, CLEA, OpenSecrets
Financial Constraint Measures		
HP Index	Hadlock and Pierce (2010) index, constructed as $-0.737 \times Size + 0.043 \times Size^2 - 0.040 \times Age$ $Size$ equals the natural logarithm of inflation-adjusted total assets (AT) in 2004 dollars, capped at the log of $4.5 billion. Age is the number of years since the firm first appeared in Compustat with non-missing stock price data, capped at 37 years.	Compustat
HM Index	Hoberg and Maksimovic (2015) text-based financial constraints index, constructed from linguistic analysis of 10-K filings. Higher values correspond to more financially constrained firms.	Hoberg and Maksimovic (2015)

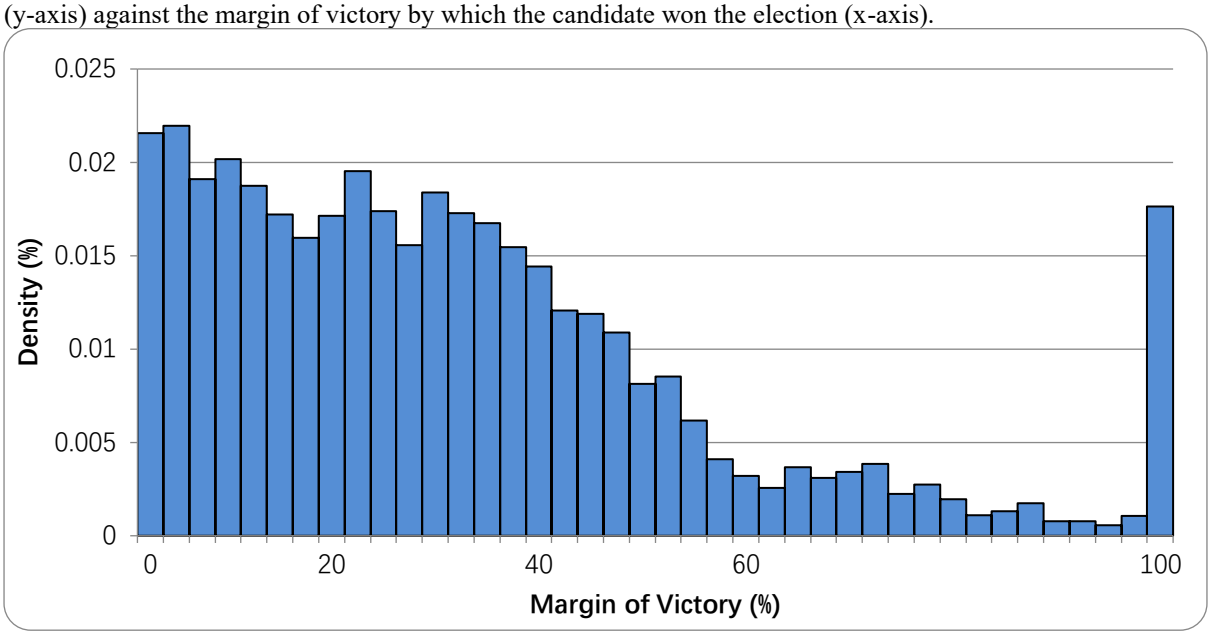
Interaction Variables		
Banking_Committee	an indicator variable equal to one if at least one of the candidates supported by the firm wins the election and joins either the Senate Committee on Banking, Housing, and Urban Affairs, or the House Committee on Financial Services, and zero otherwise.	Charles Stewart's Congressional Data
Tax_Committee	an indicator variable equal to one if at least one of the candidates supported by the firm wins the election and joins either the Senate Finance Subcommittee on Taxation and IRS Oversight, or the House Committee on Ways and Means, and zero otherwise.	Charles Stewart's Congressional Data
Leadership	an indicator variable equal to one if at least one of the candidates supported by the firm wins the election and has one of the following positions in the Congress: majority leader, the majority whip, speaker, minority leader or minority whip, and zero otherwise.	Charles Stewart's Congressional Data
Majority_Seats	an indicator variable equal to one if at least one of the candidates supported by the firm wins the election and belongs to the Majority Party, and zero otherwise.	Charles Stewart's Congressional Data
Seniority	an indicator variable equal to one if at least one of the candidates supported by the firm is a senior member (top 25%) of the Senate or House, and zero otherwise. Senior members are the 25 longest-serving Senators or 109 longest-serving members of the House of Representatives.	Senate and House websites
Top5_Donor	an indicator variable equal to one if the firm is one of the top five donors by the amount for at least one of the winning candidates supported by the firm, and zero otherwise.	FEC, CLEA, OpenSecrets
Donate10Pct	an indicator variable equal to one if the firm's donation to at least one of the winning candidates is over 10 percent of the total donations received by that candidate, and zero otherwise.	FEC, CLEA, OpenSecrets
Crucial_Industry_Emp	an indicator variable equal to one if the firm's industry is one of the top three important industries in its headquarters state in terms of employment, and zero otherwise.	Compustat
Obtain_Finance	an indicator variable equal to one if firms obtain any new bank loan or issue any new bond in the next year after the federal election and zero otherwise.	DealScan, Mergent FISD
TaxReformYear	an indicator variable equal to one for Congressional election years in which federal tax reforms were under consideration (1980, 1982, 1984, 1988, 1992, 1996, 2000, 2002) and zero otherwise	Romer and Romer (2010)
CorporateTaxChange	an indicator variable equal to one for Congressional election years in which business-related tax reforms were under consideration (1980, 1982, 1984, 1986, 2002) and zero otherwise.	Mertens and Ravn (2013)
Other Firm-level Dependent Variables		
OBTAIN_LOAN	an indicator variable equal to one if firms obtain any new loan in the next year after the federal election and zero otherwise.	DealScan
AISD	all in spread drawn, defined as the sum of the spread over LIBOR plus the facility fee, divided by 100, for the new loans obtained.	DealScan
ISSUE_BOND	an indicator variable equal to one if firms issue any new bond in the next year after the federal election and zero otherwise.	Mergent FISD

OFFERING_YIELD	the bond's percentage yield to maturity at issuance for the new bonds issued.	Mergent FISD
CONTRACT_VALUE	the natural logarithm of one plus the dollar value of contracts awarded to the firm in a given year. Government contracts include bases and different options. A contract does not necessarily trigger all options. This variable records the value of the firms' awarded contracts in the year, that is, when bases and the exercised options.	FPDS
POTEN_CONTRACT_VAL	the natural logarithm of one plus all the maximum potential dollar value of contracts awarded to the firm in a given year. Government contracts include bases and different options. A contract does not necessarily trigger all options. This variable records the maximum possible value of the company's all awarded contracts in the year, that is, when bases and all options are exercised.	FPDS
OBTAIN_CONTRACT	an indicator variable equal to one if firms obtained any government contract in a given year and zero otherwise.	FPDS
PRETAX_MARGIN	pre-tax margin, measured as pre-tax income (PI) divided by sales (SALE).	Compustat
CAPEX	capital expenditures (CAPX) scaled by lagged total assets (AT).	Compustat
RD_INTENSITY	research and development expenditures (XRD) scaled by sales (SALE).	Compustat
TAX_FEES	The ratio of tax fees paid to the auditor divided by audit fees.	Audit Analytics
MA_DUMMY	an indicator variable equal to one if the firm completed at least one merger or acquisition deal in the year, and zero otherwise.	SDC Deals
MA_DEAL_VAL	the natural logarithm of one plus the total value of merger and acquisition deals completed by the firm in a given year (in millions of U.S. dollars).	SDC Deals
Firm-level Controls		
SIZE	the natural logarithm of total assets (AT) at the beginning of the year.	Compustat
ROA	return on assets, measured as operating income (PI - XI) scaled by lagged total assets.	Compustat
LEVERAGE	total debt (DLTT + DLC) scaled by lagged total assets.	Compustat
SGA	selling, general, and administrative expenses scaled by lagged total assets.	Compustat
R_D	research and development expenditures scaled by lagged total assets.	Compustat
NOLCF	net operating loss carryforward (TLCF) scaled by lagged total assets. NOLCF is set equal to 0 if TLCF is missing.	Compustat
CHG_NOLCF	change in net operating loss carryforward (TLCF) scaled by lagged total assets (AT).	Compustat
FOR_INCOME	foreign Income (PIFO) scaled by lagged total assets.	Compustat
LOSS	an indicator variable equal to one if the firm reports a loss (IB < 0) in any of the last three years, and zero otherwise.	Compustat

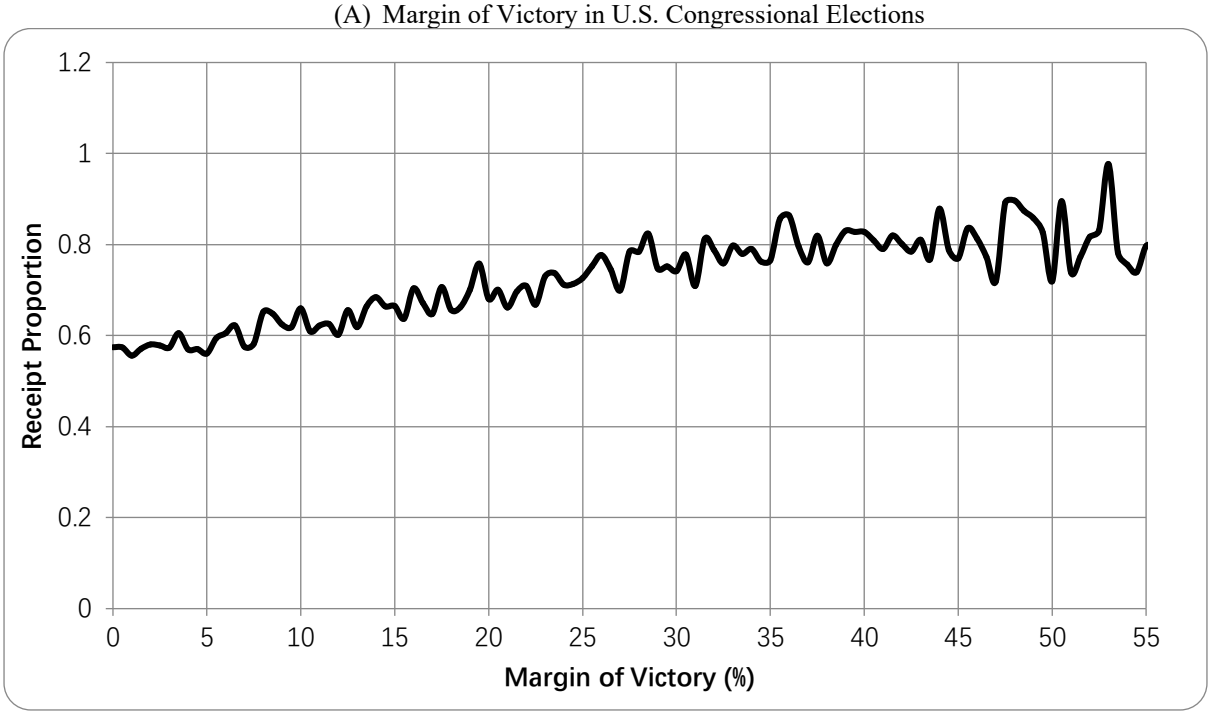
STR	state statutory corporate income tax rate.	Serrato and Zidar (2018)
Loan-level Controls		
LOAN_MATURITY	loan maturity in years.	DealScan
LOAN_AMT	total dollar face value of the loan issue.	DealScan
PERFORMANCE_PRICE	an indicator variable equal to one if the loan has a performance pricing provision and 0 otherwise.	DealScan
DEBT_REPAY	an indicator variable equal to one if the loan is taken to repay existing debt and 0 otherwise. Investment.	DealScan
INVEST_PURPOSE	an indicator variable equal to one if the loan is taken for corporate investment purposes and zero otherwise. Namely the loans whose purpose is labeled "acquisition line, " "capital expenditures," "corporate purposes," or "takeover."	DealScan
WC_PURPOSE	an indicator variable equal to one if the loan is taken to finance working capital needs and zero otherwise.	DealScan
FINA_COVENANT_NUM	the number of financial covenants in the loan contract.	DealScan
GEN_COVENANT_NUM	the number of general covenants in the loan contract.	DealScan
LENDER_NUM	the number of individual banks that participate in the loan.	DealScan
REVOLVER	an indicator variable equal to one if the loan is revolving and zero otherwise.	DealScan
TERM_MIX	the percentage of individual loans in the loan package with a specified repayment schedule and maturity.	DealScan
SENIOR	an indicator variable equal to one if the loan is senior and zero otherwise.	DealScan
SECURE	an indicator variable equal to one if the loan is secured and zero otherwise.	DealScan
Bond-level Controls		
RATING	the numerical credit rating of the bond issue, where lower values mean higher credit quality.	Mergent FISD
BOND_MATURITY	the bond's maturity in years.	Mergent FISD
BOND_AMT	the total dollar face value of the bond issue.	Mergent FISD
SUBORDINATED	an indicator variable equal to one if the bond is subordinated to other debt securities and zero otherwise.	Mergent FISD
CALLABLE	an indicator variable equal to one if the bond is callable and zero otherwise.	Mergent FISD
PUTABLE	an indicator variable equal to one if the bond is putable and zero otherwise.	Mergent FISD
SINKINGFUND	an indicator variable equal to one if the bond has a sinking fund feature and zero otherwise.	Mergent FISD

Figure 1 Electoral Statistics

Panel (A) presents a histogram of the margin of victory for all U.S. general congressional elections from 1980 to 2010. Panel (B) plots the average proportion of total contributions made to the winning candidate of an election (y-axis) against the margin of victory by which the candidate won the election (x-axis).



(A) Margin of Victory in U.S. Congressional Elections



(B) Proportion of Contributions Received by the Winning Politician

Table 1 Summary Statistics

All variables are defined in Appendix A. All continuous control variables are winsorized at 1% and 99% levels.

	Full Sample			Financially Constrained			Financially Unconstrained		
	Count	**Mean**	**Std. Dev.**	**Count**	**Mean**	**Std. Dev.**	**Count**	**Mean**	**Std. Dev.**
Tax Avoidance Measures									
CASH_ETR	4,999	-0.2793	0.2200	2,282	-0.2810	0.2341	2,717	-0.2778	0.2074
BTD	4,052	0.0294	0.0442	2,022	0.0320	0.0488	2,030	0.0269	0.0389
TXPD_AT	4,999	-0.0248	0.0258	2,282	-0.0278	0.0294	2,717	-0.0224	0.0220
Political Connection Measures									
TotalP	4,999	0.0099	0.0265	2,282	0.0072	0.0216	2,717	0.0121	0.0299
WinP	4,999	0.0383	0.0407	2,282	0.0278	0.0331	2,717	0.0471	0.0443
LoseP	4,999	0.0284	0.0306	2,282	0.0206	0.0256	2,717	0.0350	0.0328
AmountTotalP	4,999	0.0172	0.1055	2,282	0.0117	0.0731	2,717	0.0219	0.1263
AmountWinP	4,999	0.0960	0.1841	2,282	0.0627	0.1137	2,717	0.1239	0.2232
AmountLoseP	4,999	0.0788	0.1884	2,282	0.0510	0.1072	2,717	0.1020	0.2334
Interaction Variables									
Banking_Committee	4,999	0.2753	0.4467	2,282	0.2209	0.4149	2,717	0.3209	0.4669
Tax_Committee	4,999	0.3151	0.4646	2,282	0.2125	0.4092	2,717	0.4012	0.4902
Leadership	4,999	0.0568	0.2315	2,282	0.0539	0.2259	2,717	0.0593	0.2361
Majority_Seats	4,999	0.4101	0.4919	2,282	0.3422	0.4746	2,717	0.4671	0.4990
Seniority	4,999	0.2573	0.4372	2,282	0.1897	0.3922	2,717	0.3139	0.4642
Top5_Donor	4,999	0.1268	0.3328	2,282	0.0942	0.2922	2,717	0.1542	0.3612
Donate10Pct	4,999	0.0418	0.2002	2,282	0.0399	0.1957	2,717	0.0434	0.2039
Crucial_Industry_Emp	4,999	0.2080	0.4059	2,282	0.1845	0.3880	2,717	0.2278	0.4195
Obtain_Finance	4,999	0.4195	0.4935	2,282	0.3777	0.4849	2,717	0.4545	0.4980
TaxReformYear	4,999	0.2605	0.4389	2,282	0.2528	0.4347	2,717	0.2668	0.4424
CorporateTaxChange	4,999	0.0888	0.2845	2,282	0.0828	0.2757	2,717	0.0939	0.2917

Control Variables									
SIZE	4,999	7.9866	2.0925	2,282	6.5513	2.0239	2,717	9.1922	1.1970
ROA	4,999	0.0871	0.0966	2,282	0.0944	0.1153	2,717	0.0809	0.0770
LEVERAGE	4,999	0.3188	0.2381	2,282	0.3109	0.2714	2,717	0.3255	0.2058
SGA	4,999	0.1596	0.2081	2,282	0.2099	0.2319	2,717	0.1174	0.1749
R_D	4,999	0.0170	0.0440	2,282	0.0208	0.0538	2,717	0.0137	0.0333
NOLCF	4,999	0.0344	0.1618	2,282	0.0602	0.2261	2,717	0.0128	0.0646
CHG_NOLCF	4,999	0.0019	0.0431	2,282	0.0026	0.0571	2,717	0.0013	0.0261
FOR_INCOME	4,999	0.0136	0.0307	2,282	0.0098	0.0275	2,717	0.0168	0.0327
LOSS	4,999	0.2126	0.4092	2,282	0.2629	0.4403	2,717	0.1704	0.3761
STR	4,999	0.0606	0.0334	2,282	0.0615	0.0330	2,717	0.0597	0.0338
Other Dependent Variables									
PRETAX_MARGIN	4,872	0.1007	0.1374	2,204	0.0881	0.1626	2,668	0.1112	0.1114
CAPEX	4,816	0.0645	0.0607	2,184	0.0663	0.0704	2,632	0.0630	0.0511
RD_INTENSITY	4,999	0.0156	0.0382	2,282	0.0187	0.0450	2,717	0.0131	0.0312
MA_DUMMY	4,999	0.3019	0.4591	2,282	0.2962	0.4567	2,717	0.3066	0.4612
MA_DEAL_VAL	4,999	1.6969	2.7957	2,282	1.4433	2.4505	2,717	1.9100	3.0398
TAX_FEES	2,126	0.0992	0.1208	989	0.0933	0.1144	1,137	0.1043	0.1259
OBTAIN_LOAN	4,999	0.3477	0.4763	2,282	0.3431	0.4749	2,717	0.3515	0.4775
ISSUE_BOND	4,999	0.1568	0.3637	2,282	0.0876	0.2828	2,717	0.2149	0.4109
OBTAIN_CONTRACT	2,450	0.0261	0.1595	1,123	0.0116	0.1070	1,327	0.0384	0.1923
CONTRACT_VALUE	2,450	0.3414	2.1757	1,123	0.1228	1.1911	1,327	0.5264	2.7327
POTEN_CONTRACT_VAL	2,450	0.3905	2.5642	1,123	0.1356	1.3636	1,327	0.6062	3.2356

Table 2 Full Sample Results

This table presents the regression results of tax planning on political connections using all firms in the sample. *CASH_ETR* is calculated as the sum of total tax paid scaled by pretax income. We multiply *CASH_ETR* by -1 so that it is increasing in tax planning. *BTD* is book-tax differences scaled by lagged total assets. *WinP* is the number of winning candidates involved in a close election that a firm donated to prior to the election scaled by 100. *LoseP* is the number of losing candidates involved in a close election that a firm donated to prior to the election scaled by 100. *TotalP* equals *WinP* minus *LoseP*. Control variables include *SIZE, ROA, LEVERAGE, SGA, R_D, NOLCF, CHG_NOLCF, FOR_INCOME, LOSS*, and *STR*. All other variables are defined in Appendix A. Robust standard errors clustered at the firm level are reported in the parentheses. ***, **, * indicate two-tailed significance at 1%, 5%, and 10%.

	1	2	3	4
	CASH_ETR		*BTD*	
TotalP	0.058		0.008	
	(0.137)		(0.026)	
WinP		0.076		0.008
		(0.135)		(0.027)
LoseP		-0.000		-0.008
		(0.211)		(0.036)
SIZE	-0.016*	-0.016*	-0.011***	-0.011***
	(0.009)	(0.009)	(0.002)	(0.002)
ROA	0.349***	0.348***	0.034**	0.034**
	(0.066)	(0.066)	(0.013)	(0.013)
LEVERAGE	-0.003	-0.003	-0.016***	-0.016***
	(0.027)	(0.027)	(0.005)	(0.005)
SGA	-0.044	-0.045	-0.019	-0.019
	(0.048)	(0.048)	(0.013)	(0.013)
R_D	-0.039	-0.037	0.040	0.040
	(0.198)	(0.198)	(0.060)	(0.060)
NOLCF	0.106***	0.106***	0.017	0.017
	(0.041)	(0.041)	(0.011)	(0.011)
CHG_NOLCF	-0.005	-0.005	-0.064**	-0.064**
	(0.086)	(0.086)	(0.027)	(0.027)
FOR_INCOME	0.482**	0.483**	0.045	0.045
	(0.225)	(0.225)	(0.050)	(0.050)
LOSS	0.035***	0.035***	0.006***	0.006***
	(0.012)	(0.012)	(0.002)	(0.002)
STR	0.097	0.102	-0.042	-0.042
	(0.522)	(0.521)	(0.147)	(0.146)
Year FE	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm
Observations	4,999	4,999	4,052	4,052
Adj. R-sq	0.25	0.25	0.38	0.38

Table 3 Subsample Analyses by Financial Constraints

Panel A presents the regression results of tax planning on political connections for financially constrained firms. Panel B presents the regression of tax planning on political connections for financially unconstrained firms. Financial constraints are defined using the Hadlock and Pierce (2010) HP Index, with firms above the sample median in the pre-election year classified as constrained. *CASH_ETR* is calculated as the sum of total tax paid scaled by pretax income. We multiply *CASH_ETR* by -1 so that it is increasing in tax planning. *BTD* is book-tax differences scaled by lagged total assets. *WinP* is the number of winning candidates involved in a close election that a firm donated to prior to the election scaled by 100. *LoseP* is the number of losing candidates involved in a close election that a firm donated to prior to the election scaled by 100. *TotalP* equals *WinP* minus *LoseP*. Control variables include *SIZE, ROA, LEVERAGE, SGA, R_D, NOLCF, CHG_NOLCF, FOR_INCOME, LOSS*, and *STR*. All other variables are defined in Appendix A. Robust standard errors clustered at the firm level are reported in the parentheses. ***, **, * indicate two-tailed significance at 1%, 5%, and 10%.

Panel A: Financially Constrained Firms

	1	2	3	4
	CASH_ETR		*BTD*	
TotalP	-0.835***		-0.110**	
	(0.275)		(0.048)	
WinP		-0.729**		-0.097*
		(0.289)		(0.052)
LoseP		1.149***		0.148**
		(0.334)		(0.062)
Controls	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm
Observations	2,282	2,282	2,022	2,022
Adj. R-sq	0.29	0.29	0.42	0.42

Panel B: Financially Unconstrained Firms

	1	2	3	4
	CASH_ETR		*BTD*	
TotalP	0.351**		0.075**	
	(0.158)		(0.029)	
WinP		0.317**		0.069**
		(0.153)		(0.030)
LoseP		-0.461*		-0.092**
		(0.259)		(0.043)
Controls	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm
Observations	2,717	2,717	2,030	2,030
Adj. R-sq	0.24	0.24	0.31	0.31

Table 4 Subsample Analyses by Financial Constraints (HM Index)

Panel A presents the regression results of tax planning on political connections for financially constrained firms. Panel B presents the regression of tax planning on political connections for financially unconstrained firms. Financial constraints are measured using the Hoberg and Maksimovic (2015) HM Index. *CASH_ETR* is calculated as the sum of total tax paid scaled by pretax income. We multiply *CASH_ETR* by -1 so that it is increasing in tax planning. *BTD* is book-tax differences scaled by lagged total assets. *WinP* is the number of winning candidates involved in a close election that a firm donated to prior to the election scaled by 100. *LoseP* is the number of losing candidates involved in a close election that a firm donated to prior to the election scaled by 100. *TotalP* equals *WinP* minus *LoseP*. Control variables include *SIZE, ROA, LEVERAGE, SGA, R_D, NOLCF, CHG_NOLCF, FOR_INCOME, LOSS*, and *STR*. All other variables are defined in Appendix A. Robust standard errors clustered at the firm level are reported in the parentheses. ***, **, * indicate two-tailed significance at 1%, 5%, and 10%.

Panel A: Financially Constrained Firms

	1	2	3	4
	CASH_ETR		*BTD*	
TotalP	-1.111***		-0.249***	
	(0.401)		(0.079)	
WinP		-1.135***		-0.254***
		(0.405)		(0.091)
LoseP		1.043**		0.231**
		(0.526)		(0.108)
Controls	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm
Observations	844	844	520	520
Adj. R-sq	0.34	0.34	0.52	0.52

Panel B: Financially Unconstrained Firms

	1	2	3	4
	CASH_ETR		*BTD*	
TotalP	0.699***		0.273***	
	(0.261)		(0.078)	
WinP		0.641**		0.269***
		(0.273)		(0.082)
LoseP		-0.849**		-0.282**
		(0.423)		(0.138)
Controls	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm
Observations	844	844	575	575
Adj. R-sq	0.46	0.46	0.42	0.42

Table 5 Tax-Related Fees

This table reports regressions of tax-related fees on measures of political connections. Columns 1 and 2 present results for financially constrained firms, and Columns 3 and 4 for financially unconstrained firms. Financial constraints are defined using the HP Index, with firms above the sample median in the pre-election year classified as constrained. *TAX_FEES* is the ratio of tax fees paid to the auditor divided by audit fees. *WinP* is the number of winning candidates involved in a close election that a firm donated to prior to the election scaled by 100. *LoseP* is the number of losing candidates involved in a close election that a firm donated to prior to the election scaled by 100. *TotalP* equals *WinP* minus *LoseP*. Control variables include *SIZE, ROA, LEVERAGE, SGA, R_D, NOLCF, CHG_NOLCF, FOR_INCOME, LOSS*, and *STR*. All other variables are defined in Appendix A. Robust standard errors clustered at the firm level are reported in the parentheses. ***, **, * indicate two-tailed significance at 1%, 5%, and 10%.

	1	2	3	4
	Financially Constrained Firms		***Financially Unconstrained Firms***	
	TAX_FEES			
TotalP	-0.361***		0.271**	
	(0.137)		(0.121)	
WinP		-0.318**		0.245*
		(0.152)		(0.129)
LoseP		0.436**		-0.336**
		(0.219)		(0.157)
SIZE	-0.001	-0.002	0.025	0.026*
	(0.012)	(0.012)	(0.016)	(0.016)
ROA	0.142**	0.141**	0.076	0.076
	(0.056)	(0.056)	(0.084)	(0.084)
LEVERAGE	-0.007	-0.007	0.060*	0.060*
	(0.029)	(0.028)	(0.035)	(0.035)
SGA	-0.040	-0.040	0.039	0.042
	(0.043)	(0.042)	(0.085)	(0.085)
R_D	0.272	0.275	1.542**	1.542**
	(0.287)	(0.286)	(0.662)	(0.658)
NOLCF	-0.022	-0.022	-0.078	-0.078
	(0.023)	(0.023)	(0.049)	(0.049)
CHG_NOLCF	-0.018	-0.018	-0.060	-0.059
	(0.059)	(0.059)	(0.058)	(0.058)
FOR_INCOME	0.010	0.010	-0.303	-0.303
	(0.289)	(0.289)	(0.252)	(0.252)
LOSS	-0.003	-0.002	-0.008	-0.009
	(0.011)	(0.011)	(0.011)	(0.011)
STR	0.721	0.731	0.156	0.152
	(0.573)	(0.569)	(0.532)	(0.533)
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm
Observations	989	989	1,137	1,137
Adj. R2	0.49	0.49	0.58	0.58

Table 6 The Role of External Financing

Panel A examines changes in the likelihood of obtaining new external financing in response to changes in political connections. Panel B examines changes in costs of new bank loan and public bond in response to changes in political connections (loan or bond level regression). Panel C examines the role of obtaining new external financing in changes in tax planning in response to changes in political connections. Financial constraints are defined using the HP Index. *OBTAIN_LOAN* is an indicator variable equal to one if firms obtain any new bank loan in the next year after the federal election and zero otherwise. *ISSUE_BOND* is an indicator variable equal to one if firms issue any new bond in the next year after the federal election and zero otherwise. *AISD* is a loan spread quoted in basis points over a floating benchmark, divided by 100, for new bank loans obtained. *OFFERING_YIELD* is the bond's percentage yield to maturity at issuance for new bonds issued. *Obtain_Finance* is an indicator variable equal to one if firms obtain any new bank loan or issue any new bond in the next year after the federal election and zero otherwise. *WinP* is the number of winning candidates involved in a close election that a firm donated to prior to the election scaled by 100. *LoseP* is the number of losing candidates involved in a close election that a firm donated to prior to the election scaled by 100. *TotalP* equals *WinP* minus *LoseP*. Firm-level control variables including *SIZE, ROA, LEVERAGE, SGA, R_D, NOLCF, CHG_NOLCF, FOR_INCOME,* and *LOSS,* bond-level control variables including *RATING, BOND_MATURITIY, BOND_AMT, SUBORDINATED, CALLABLE, PUTABLE,* and *SINKINGFUND*, and loan-level control variables including *LOAN_MATURITY, LOAN_AMT, PERFORMANCE_PRICE, DEBT_REPAY, INVEST_PURPOSE, WC_PURPOSE, FINA_COVENANT_NUM, GEN_COVENANT_NUM, LENDER_NUM, REVOLVER, TERM_MIX, SENIOR,* and *SECURE* are defined in Appendix A. Robust standard errors clustered at the firm level are reported in the parentheses. ***, **, * indicate two-tailed significance at 1%, 5%, and 10%.

Panel A: The Likelihood of Obtaining New Bank Loans and Issuing New Public Bonds

	1	2	3	4	5	6	7	8
	Financially Constrained Firms				***Financially Unconstrained Firms***			
	OBTAIN_LOAN		*ISSUE_BOND*		*OBTAIN_LOAN*		*ISSUE_BOND*	
TotalP	1.200**		0.865**		-0.093		0.347	
	(0.547)		(0.400)		(0.327)		(0.363)	
WinP		1.075*		0.841*		0.066		0.574
		(0.557)		(0.438)		(0.344)		(0.393)
LoseP		-1.572*		-0.939*		0.616		0.402
		(0.829)		(0.495)		(0.487)		(0.438)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm	Firm	Firm	Firm	Firm
Observations	2,282	2,282	2,282	2,282	2,717	2,717	2,717	2,717
Adj. R-sq	0.21	0.21	0.19	0.19	0.33	0.34	0.24	0.24

Panel B: The Costs of New Bank Loans and Public Bonds

	1	2	3	4	5	6	7	8
	Financially Constrained Firms				***Financially Unconstrained Firms***			
	AISD		*OFFERING_YIELD*		*AISD*		*OFFERING_YIELD*	
TotalP	-2.971**		-13.202**		-0.688		-3.424	
	(1.420)		(5.517)		(0.851)		(2.870)	
WinP		-2.707*		-12.365*		-0.484		-3.199
		(1.500)		(6.979)		(0.838)		(2.867)
LoseP		3.887*		14.130**		1.665		5.049
		(2.171)		(6.677)		(1.259)		(4.130)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm	Firm	Firm	Firm	Firm
Observations	2,609	2,609	2,713	2,713	2,145	2,145	2,000	2,000
Adj. R-sq	0.67	0.67	0.84	0.84	0.64	0.64	0.79	0.79

Panel C: External Financing and the Relation between Tax Planning and Political Connections

	1	2	3	4
	Financially Constrained Firms		***Financially Unconstrained Firms***	
	CASH_ETR	*BTD*	*CASH_ETR*	*BTD*
WinP × *Obtain_Finance*	-0.650*	-0.141**	-0.194	-0.013
	(0.342)	(0.065)	(0.192)	(0.032)
WinP	0.053	0.014	0.244	0.039
	(0.307)	(0.055)	(0.153)	(0.030)
Obtain_Finance	0.033**	0.005	0.007	0.003
	(0.016)	(0.003)	(0.013)	(0.003)
Controls	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm
Observations	2,282	2,022	2,717	2,030
Adj. R-sq	0.28	0.42	0.24	0.31

Table 7 Government Contracts

Panel A examines changes in government contracts in response to changes in political connections for financially constrained firms. Panel B examines changes in government contracts in response to changes in political connections for financially unconstrained firms. Financial constraints are defined using the HP Index, with firms above the sample median in the pre-election year classified as constrained. *OBTAIN_CONTRACT* is an indicator variable equal to one if firms obtained any government contract this year and zero otherwise. *CONTRACT_VALUE* is the natural logarithm of one plus the dollar value of contracts awarded to the firm in a given year. *POTEN_CONTRACT_VAL* is the natural logarithm of one plus the maximum potential dollar value of contracts awarded to the firm in a given year. *WinP* is the number of winning candidates involved in a close election that a firm donated to prior to the election scaled by 100. *LoseP* is the number of losing candidates involved in a close election that a firm donated to prior to the election scaled by 100. *TotalP* equals *WinP* minus *LoseP*. Control variables including *SIZE, ROA, LEVERAGE, SGA, R_D, NOLCF, CHG_NOLCF, FOR_INCOME,* and *LOSS* are defined in Appendix A. Robust standard errors clustered at the firm level are reported in the parentheses. ***, **, * indicate two-tailed significance at 1%, 5%, and 10%.

Panel A: Financially Constrained Firms

	1	2	3	4	5	6
	OBTAIN_CONTRACT		*CONTRACT_VALUE*		*POTEN_CONTRACT_VAL*	
TotalP	0.395**		3.717**		3.986**	
	(0.179)		(1.541)		(1.696)	
WinP		0.371*		3.363**		3.686*
		(0.209)		(1.675)		(1.878)
LoseP		-0.440**		-4.351**		-4.526**
		(0.208)		(2.081)		(2.136)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm	Firm	Firm
Observations	1,123	1,123	1,123	1,123	1,123	1,123
Adj. R-sq	0.35	0.35	0.43	0.43	0.47	0.47

Panel B: Financially Unconstrained Firms

	1	2	3	4	5	6
	OBTAIN_CONTRACT		*CONTRACT_VALUE*		*POTEN_CONTRACT_VAL*	
TotalP	0.118		2.790		2.635	
	(0.212)		(3.475)		(3.787)	
WinP		0.280		5.973		6.168
		(0.292)		(4.805)		(5.180)
LoseP		0.293		5.283		6.323
		(0.332)		(4.424)		(5.186)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm	Firm	Firm
Observations	1,327	1,327	1,327	1,327	1,327	1,327
Adj. R-sq	0.40	0.40	0.52	0.52	0.57	0.58

Table 8 The Banking-Related Committees

This table examines the role of connected politicians' memberships in the banking-related committees in the effect of political connections on tax planning. Columns 1 and 2 present the results of financially constrained firms. Columns 3 and 4 present the results of financially unconstrained firms. Financial constraints are defined using the HP Index, with firms above the sample median in the pre-election year classified as constrained. *Banking_Committee* is an indicator variable equal to one if at least one of the firm's supported candidates wins the election and joins either the Senate Committee on Banking, Housing, and Urban Affairs of the House Committee on Financial Services, and zero otherwise. *CASH_ETR* is calculated as the sum of total tax paid scaled by pretax income. We multiply *CASH_ETR* by -1 so that it is increasing in tax planning. *BTD* is book-tax differences scaled by lagged total assets. *WinP* is the number of winning candidates involved in a close election that a firm donated to before the election scaled by 100. Control variables including *SIZE, ROA, LEVERAGE, SGA, R_D, NOLCF, CHG_NOLCF, FOR_INCOME, LOSS,* and *STR* are defined in Appendix A. Robust standard errors clustered at the firm level are reported in the parentheses. ***, **, * indicate two-tailed significance at 1%, 5%, and 10%.

	1	2	3	4
	Financially Constrained Firms		***Financially Unconstrained Firms***	
	CASH_ETR	*BTD*	*CASH_ETR*	*BTD*
WinP × *Banking_Committee*	-0.542*	-0.131**	0.077	-0.017
	(0.288)	(0.058)	(0.184)	(0.036)
WinP	-0.005	0.030	0.110	0.037
	(0.314)	(0.058)	(0.161)	(0.028)
Banking_Committee	0.019	0.002	-0.007	0.003
	(0.018)	(0.003)	(0.016)	(0.003)
Controls	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm
Observations	2,282	2,022	2,717	2,030
Adj. R-sq	0.28	0.42	0.24	0.31

Table 9 The Tax-Related Committees

This table examines the role of connected politicians' memberships in the tax-related committees in the effect of political connections on tax planning. Columns 1 and 2 present the results of financially constrained firms. Columns 3 and 4 present the results of financially unconstrained firms. Financial constraints are defined using the HP Index, with firms above the sample median in the pre-election year classified as constrained. *Tax_Committee* is an indicator variable equal to one if at least one of the candidates supported by the firm wins the election and joins either the Senate Finance Subcommittee on Taxation or IRS Oversight of the House Committee on Ways and Means, and zero otherwise. *CASH_ETR* is calculated as the sum of total tax paid scaled by pretax income. We multiply *CASH_ETR* by -1 so that it is increasing in tax planning. *BTD* is book-tax differences scaled by lagged total assets. *WinP* is the number of winning candidates involved in a close election that a firm donated to before the election scaled by 100. Control variables including *SIZE, ROA, LEVERAGE, SGA, R_D, NOLCF, CHG_NOLCF, FOR_INCOME, LOSS,* and *STR* are defined in Appendix A. Robust standard errors clustered at the firm level are reported in the parentheses. ***, **, * indicate two-tailed significance at 1%, 5%, and 10%.

	1	2	3	4
	Financially Constrained Firms		***Financially Unconstrained Firms***	
	CASH_ETR	*BTD*	*CASH_ETR*	*BTD*
WinP × *Tax_Committee*	0.553	-0.056	0.349*	0.062*
	(0.398)	(0.071)	(0.200)	(0.033)
WinP	-0.483*	-0.024	-0.035	-0.004
	(0.283)	(0.063)	(0.163)	(0.032)
Tax_Committee	-0.011	0.006*	-0.017	0.001
	(0.021)	(0.004)	(0.017)	(0.003)
Controls	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm
Observations	2,282	2,022	2,717	2,030
Adj. R-sq	0.28	0.42	0.24	0.31

Table 10 The Role of Politician Power

This table examines the role of the power of connected politicians in the effect of political connections on tax planning. Panel A uses *Leadership*, an indicator variable equal to one if at least one of the candidates supported by the firm wins the election and has one of the following leadership positions in Congress: majority leader, the majority whip, speaker, minority leader, or minority whip, and zero otherwise, to measure politician power. Panel B uses *Majority_Seats*, an indicator variable equal to one if at least one of the candidates supported by the firm wins the election and belongs to the Majority Party, and zero otherwise, to measure politician power. Panel C uses *Seniority*, an indicator variable equal to one if at least one of the candidates supported by the firm is a senior member of the Senate or House, and zero otherwise, to measure politician power. Columns 1 and 2 present the results of financially constrained firms. Columns 3 and 4 present the results of financially unconstrained firms. Financial constraints are defined using the HP Index, with firms above the sample median in the pre-election year classified as constrained. *CASH_ETR* is calculated as the sum of total tax paid scaled by pretax income. We multiply *CASH_ETR* by -1 so that it is increasing in tax planning. *BTD* is book-tax differences scaled by lagged total assets. *WinP* is the number of winning candidates involved in a close election that a firm donated to before the election scaled by 100. Control variables including *SIZE, ROA, LEVERAGE, SGA, R_D, NOLCF, CHG_NOLCF, FOR_INCOME, LOSS,* and *STR* are defined in Appendix A. Robust standard errors clustered at the firm level are reported in the parentheses. ***, **, * indicate two-tailed significance at 1%, 5%, and 10%.

Panel A: Leadership

	1	2	3	4
	Financially Constrained Firms		***Financially Unconstrained Firms***	
	CASH_ETR	*BTD*	*CASH_ETR*	*BTD*
WinP × Leadership	-0.809*	-0.315***	0.568*	0.108*
	(0.442)	(0.085)	(0.296)	(0.063)
WinP	-0.154	-0.001	0.071	0.025
	(0.264)	(0.048)	(0.134)	(0.026)
Leadership	0.033	0.025***	-0.094***	-0.012
	(0.036)	(0.008)	(0.035)	(0.008)
Controls	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm
Observations	2,282	2,022	2,717	2,030
Adj. R-sq	0.28	0.43	0.24	0.31

Panel B: Majority_Seats

	1	2	3	4
	Financially Constrained Firms		***Financially Unconstrained Firms***	
	CASH_ETR	*BTD*	*CASH_ETR*	*BTD*
WinP × Majority_Seats	-0.628*	-0.183***	0.387*	0.109***
	(0.338)	(0.065)	(0.204)	(0.036)
WinP	0.134	0.047	-0.192	-0.040
	(0.335)	(0.057)	(0.200)	(0.032)
Majority_Seats	0.009	0.007**	0.006	-0.001
	(0.016)	(0.004)	(0.013)	(0.003)
Controls	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm
Observations	2,282	2,022	2,717	2,030
Adj. R-sq	0.28	0.42	0.24	0.32

Panel C: Seniority

	1	2	3	4
	Financially Constrained Firms		***Financially Unconstrained Firms***	
	CASH_ETR	*BTD*	*CASH_ETR*	*BTD*
WinP × Seniority	-0.955**	-0.149**	0.382**	0.083**
	(0.413)	(0.060)	(0.194)	(0.037)
WinP	0.094	0.018	-0.087	-0.012
	(0.302)	(0.059)	(0.171)	(0.031)
Seniority	0.019	0.008**	-0.011	-0.004
	(0.020)	(0.004)	(0.016)	(0.003)
Controls	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm
Observations	2,282	2,022	2,717	2,030
Adj. R-sq	0.29	0.42	0.24	0.31

Table 11 The Role of Firm Importance

This table examines the role of firm importance in the effect of political connections on tax planning. Panel A uses *Top5_Donor*, an indicator variable equal to one if the firm is one of the top five donors by the amount for at least one of the winning candidates supported by the firm, and zero otherwise, to measure firm importance. Panel B uses *Donate10Pct*, an indicator variable that is equal to one if the firm's donation to at least one of the winning candidates is over 10 percent of the total donations received by that candidate, and zero otherwise, to measure firm importance. Panel C uses *Crucial_Industry_Emp*, an indicator variable equal to one if the firm's industry is one of the top three important industries in its headquarters state in terms of employment, and zero otherwise, to measure firm importance. Columns 1 and 2 present the results of financially constrained firms. Columns 3 and 4 present the results of financially unconstrained firms. Financial constraints are defined using the HP Index, with firms above the sample median in the pre-election year classified as constrained. *CASH_ETR* is calculated as the sum of total tax paid scaled by pretax income. We multiply *CASH_ETR* by -1 so that it is increasing in tax planning. *BTD* is book-tax differences scaled by lagged total assets. *WinP* is the number of winning candidates involved in a close election that a firm donated to prior to the election scaled by 100. Control variables including *SIZE, ROA, LEVERAGE, SGA, R_D, NOLCF, CHG_NOLCF, FOR_INCOME, LOSS,* and *STR* are defined in Appendix A. Robust standard errors clustered at the firm level are reported in the parentheses. ***, **, * indicate two-tailed significance at 1%, 5%, and 10%.

Panel A: Top5_Donor

	1	2	3	4
	Financially Constrained Firms		***Financially Unconstrained Firms***	
	CASH_ETR	*BTD*	*CASH_ETR*	*BTD*
WinP × Top5_Donor	-0.604*	-0.186**	0.381*	0.083**
	(0.320)	(0.073)	(0.199)	(0.040)
WinP	-0.090	0.024	0.048	0.014
	(0.296)	(0.056)	(0.145)	(0.028)
Top5_Donor	0.052**	0.011*	-0.035*	-0.010**
	(0.024)	(0.006)	(0.019)	(0.004)
Controls	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm
Observations	2,282	2,022	2,717	2,030
Adj. R-sq	0.28	0.42	0.24	0.31

Panel B: Donate10Pct

	1	2	3	4
	Financially Constrained Firms		***Financially Unconstrained Firms***	
	CASH_ETR	*BTD*	*CASH_ETR*	*BTD*
WinP × Donate10Pct	-1.027*	-0.154*	0.984***	0.131**
	(0.580)	(0.082)	(0.368)	(0.053)
WinP	-0.092	-0.011	0.072	0.025
	(0.229)	(0.047)	(0.134)	(0.026)
Donate10Pct	0.129***	0.008	-0.111**	-0.019***
	(0.039)	(0.009)	(0.049)	(0.007)
Controls	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm
Observations	2,282	2,022	2,717	2,030
Adj. R-sq	0.29	0.42	0.24	0.31

Panel C: Crucial_Industry_EMP

	1	2	3	4
	Financially Constrained Firms		***Financially Unconstrained Firms***	
	CASH_ETR	*BTD*	*CASH_ETR*	*BTD*
WinP × Crucial_Industry_EMP	-0.762*	-0.185*	0.472**	0.114***
	(0.406)	(0.102)	(0.220)	(0.039)
WinP	-0.103	0.005	0.031	-0.001
	(0.261)	(0.055)	(0.143)	(0.028)
Crucial_Industry_EMP	0.024	0.003	-0.016	-0.007*
	(0.025)	(0.006)	(0.021)	(0.004)
Controls	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm
Observations	2,282	2,022	2,717	2,030
Adj. R-sq	0.28	0.42	0.24	0.31

POLITICAL CONNECTIONS, FINANCIAL CONSTRAINTS, and CORPORATE TAXATION

ONLINE APPENDICES

Table OA1 Financial Performance and Investment Policies

Panel A presents results for financially constrained firms, and Panel B for financially unconstrained firms. Financial constraints are defined using the HP Index, with firms above the sample median in the pre-election year classified as constrained. The dependent variables include *PRETAX_MARGIN* (pre-tax income scaled by sales), *CAPEX* (capital expenditures scaled by lagged total assets), *RD_INTENSITY* (R&D expenditures scaled by sales), *MA_DUMMY* (indicator for firm-year with at least one merger or acquisition), and *MA_DEAL_VAL* (log of one plus the total value of M&A deals). *WinP* is the number of winning candidates involved in a close election that a firm donated to prior to the election scaled by 100. *LoseP* is the number of losing candidates involved in a close election that a firm donated to prior to the election scaled by 100. *TotalP* equals *WinP* minus *LoseP*. Control variables including *SIZE, ROA, LEVERAGE, SGA, R_D, NOLCF, CHG_NOLCF, FOR_INCOME, LOSS,* and *STR* are defined in Appendix A. Robust standard errors clustered at the firm level are reported in the parentheses. ***, **, * indicate two-tailed significance at 1%, 5% and 10%.

Panel A: Financially Constrained Firms

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
	PRETAX_MARGIN		*CAPEX*		*RD_INTENSITY*		*MA_DUMMY*		*MA_DEAL_VAL*	
TotalP	-0.085		-0.036		0.001		-0.417		-2.247	
	(0.241)		(0.052)		(0.015)		(0.541)		(2.738)	
WinP		-0.044		-0.021		0.009		-0.246		-0.909
		(0.230)		(0.054)		(0.017)		(0.582)		(3.057)
LoseP		0.201		0.077		0.022		0.925		6.230
		(0.297)		(0.082)		(0.018)		(0.751)		(4.026)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm	Firm	Firm	Firm	Firm	Firm	Firm
Observations	2,204	2,204	2,184	2,184	2,282	2,282	2,282	2,282	2,282	2,282
Adj. R-sq	0.48	0.48	0.65	0.65	0.96	0.96	0.24	0.24	0.28	0.28

Panel B: Financially Unconstrained Firms

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
	PRETAX_MARGIN		*CAPEX*		*RD_INTENSITY*		*MA_DUMMY*		*MA_DEAL_VAL*	
TotalP	-0.026		-0.003		0.007		-0.103		-0.311	
	(0.059)		(0.021)		(0.007)		(0.353)		(2.421)	
WinP		-0.021		-0.000		0.009		-0.128		-0.532
		(0.066)		(0.023)		(0.009)		(0.359)		(2.548)
LoseP		0.043		0.011		-0.001		0.020		-0.419
		(0.074)		(0.032)		(0.008)		(0.532)		(3.454)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm	Firm	Firm	Firm	Firm	Firm	Firm
Observations	2,668	2,668	2,632	2,632	2,717	2,717	2,717	2,717	2,717	2,717
Adj. R-sq	0.56	0.56	0.67	0.67	0.94	0.94	0.30	0.30	0.31	0.31

Table OA2 Tax Reform List Between 1980-2010

Reform Year	Major Act	Election Year	Brief Description	Corporate-related Change
1981	Economic Recovery Tax Act of 1981	1980	Reagan's landmark tax cut: reduced individual and corporate rates, reinstated investment tax credit, accelerated depreciation.	Yes
1982	Tax Equity and Fiscal Responsibility Act (TEFRA)	1980	Rolled back ERTA provisions, tightened depreciation and leasing rules, raised excises and minimum tax to reduce deficits.	No
1983	Social Security Amendments of 1983	1982	Raised payroll taxes, expanded coverage, taxed benefits, and delayed retirement age to restore Social Security solvency.	No
1984	Deficit Reduction Act	1982	Raised revenues through limits on tax shelters, leasing rules, bond/debt treatment, and insurance taxation to curb deficits.	Yes
1986	Tax Reform Act of 1986 (TRA86)	1984	Lowered corporate rates but broadened base (eliminated preferences). Structural change, not pure net cut.	Yes
1987	Omnibus Budget Reconciliation Act (OBRA87)	1986	Enacted for deficit reduction, it raised revenues mainly through corporate provisions such as limits on accounting methods, paid-leave reserves, and estate stock sales.	Yes
1990	Omnibus Budget Reconciliation Act (OBRA90)	1988	Raised high-income individual rates, excise increases, payroll expansion.	No/Small
1993	Omnibus Budget Reconciliation Act (OBRA93)	1992	Raised top marginal tax rates (personal & corporate); expanded AMT.	No

1997	Taxpayer Relief Act	1996	Introduced child and education tax credits and cut capital gains taxes as part of a balanced budget package.	No
1997	Balanced Budget Act of 1997	1996	Primarily reduced spending but also raised cigarette excise taxes in 2000 and 2002 to support deficit reduction.	No
2001	Economic Growth and Tax Relief Reconciliation Act (EGTRRA)	2000	Large personal tax cuts; some provisions indirectly touched businesses.	No
2002	Job Creation and Worker Assistance Act of 2002	2000	Temporary stimulus bill responding to 9/11 and recession, centered on bonus depreciation and other short-term tax relief to boost investment and jobs.	No
2003	Jobs and Growth Tax Relief Reconciliation Act (JGTRRA)	2002	Lowered dividend and capital gains taxes, bonus depreciation extension. Indirect effect on corporate sector.	Yes

Table OA3 Tax Reform Years

Panel A examines the effect of *TaxReformYear*, and Panel B focuses on *CorporateTaxChange*. Financial constraints are defined using the HP Index, with firms above the sample median in the pre-election year classified as constrained. *CASH_ETR* is calculated as the sum of total tax paid scaled by pretax income. We multiply *CASH_ETR* by -1 so that it is increasing in tax planning. *BTD* is book-tax differences scaled by lagged total assets. *TotalP* is the net number of winning minus losing candidates in close elections to whom the firm contributed prior to the election, scaled by 100. *TaxReformYear* equals one in years of major federal tax reforms (1980, 1982, 1984, 1986, 1988, 1992, 1996, 2000, 2002) and zero otherwise, following Romer and Romer (2010). *CorporateTaxChange* equals one in years with major business-oriented tax changes (1980, 1982, 1984, 1986, 2002) and zero otherwise, based on Mertens and Ravn (2013). Control variables include *SIZE, ROA, LEVERAGE, SGA, R_D, NOLCF, CHG_NOLCF, FOR_INCOME, LOSS*, and *STR*. All other variables are defined in Appendix A. Robust standard errors clustered at the firm level are reported in the parentheses. ***, **, * indicate two-tailed significance at 1%, 5% and 10%.

Panel A: Tax Reform Year

	(1)	(2)	(3)	(4)
	Financially Constrained Firms		***Financially Unconstrained Firms***	
	CASH_ETR	*BTD*	*CASH_ETR*	*BTD*
TotalP	-0.946***	-0.159**	0.386**	0.083***
	(0.321)	(0.064)	(0.176)	(0.031)
*TaxReformYear * TotalP*	0.361	0.090	-0.115	-0.016
	(0.566)	(0.101)	(0.262)	(0.050)
SIZE	-0.044***	-0.013***	-0.000	-0.011***
	(0.010)	(0.003)	(0.016)	(0.003)
ROA	0.221***	0.029	0.623***	0.030
	(0.077)	(0.018)	(0.100)	(0.021)
LEVERAGE	0.020	-0.007	0.008	-0.012**
	(0.035)	(0.007)	(0.043)	(0.006)
SGA	0.018	-0.014	-0.126**	-0.021
	(0.064)	(0.018)	(0.062)	(0.015)
R_D	-0.293	0.030	0.019	0.009
	(0.254)	(0.080)	(0.252)	(0.093)
NOLCF	0.087*	0.023*	-0.000	0.000
	(0.048)	(0.012)	(0.097)	(0.022)
CHG_NOLCF	-0.014	-0.058*	0.141	-0.064*
	(0.102)	(0.035)	(0.164)	(0.037)
FOR_INCOME	1.125***	0.069	-0.307	0.040
	(0.398)	(0.072)	(0.240)	(0.070)
LOSS	0.041**	0.009***	0.026	0.005*
	(0.017)	(0.003)	(0.017)	(0.003)
STR	-1.425	-0.278	0.587	0.086
	(0.927)	(0.213)	(0.555)	(0.181)
Year FE	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm
Observations	2,282	2,022	2,717	2,030
Adj. R-sq	0.29	0.42	0.24	0.31

Panel B: Corporate-oriented Tax Changes

	(1)	(2)	(3)	(4)
	Financially Constrained Firms		***Financially Unconstrained Firms***	
	CASH_ETR	*BTD*	*CASH_ETR*	*BTD*
TotalP	-0.897***	-0.160***	0.340**	0.073**
	(0.283)	(0.059)	(0.164)	(0.031)
*CorporateTaxChange * TotalP*	0.530	0.118	0.067	0.004
	(0.649)	(0.106)	(0.346)	(0.054)
SIZE	-0.043***	-0.013***	-0.000	-0.011***
	(0.010)	(0.003)	(0.016)	(0.003)
ROA	0.222***	0.029	0.623***	0.030
	(0.078)	(0.018)	(0.101)	(0.021)
LEVERAGE	0.020	-0.007	0.008	-0.012**
	(0.035)	(0.007)	(0.043)	(0.006)
SGA	0.020	-0.014	-0.127**	-0.021
	(0.063)	(0.018)	(0.062)	(0.015)
R_D	-0.295	0.029	0.022	0.009
	(0.254)	(0.080)	(0.251)	(0.093)
NOLCF	0.089*	0.023*	-0.001	0.001
	(0.048)	(0.012)	(0.097)	(0.022)
CHG_NOLCF	-0.017	-0.058*	0.141	-0.065*
	(0.102)	(0.035)	(0.164)	(0.038)
FOR_INCOME	1.126***	0.069	-0.304	0.040
	(0.400)	(0.072)	(0.240)	(0.070)
LOSS	0.041**	0.009***	0.026	0.005*
	(0.017)	(0.003)	(0.017)	(0.003)
STR	-1.409	-0.273	0.589	0.086
	(0.927)	(0.212)	(0.555)	(0.181)
Year FE	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm
Observations	2,282	2,022	2,717	2,030
Adj. R-sq	0.29	0.42	0.24	0.31

Table OA4 Impact of Firm Lifecycle

The table uses a matched sample in which each financially constrained firm is paired with a financially unconstrained counterpart from the same industry and of similar age (age difference ≤ two years). Columns (1)-(4) report the results for financially constrained firms. Columns (5)-(8) report the results for financially unconstrained firms. Financial constraints are defined using the HP Index, with firms above the sample median in the pre-election year classified as constrained. *CASH_ETR* is calculated as the sum of total tax paid scaled by pretax income. We multiply *CASH_ETR* by -1 so that it is increasing in tax planning. *BTD* is book-tax differences scaled by lagged total assets. *WinP* is the number of winning candidates involved in a close election that a firm donated to prior to the election scaled by 100. *LoseP* is the number of losing candidates involved in a close election that a firm donated to prior to the election scaled by 100. *TotalP* equals *WinP* minus *LoseP*. We divided these three variables by 100,000 to obtain sizeable coefficients. Control variables including *SIZE, ROA, LEVERAGE, SGA, R_D, NOLCF, CHG_NOLCF, FOR_INCOME, LOSS,* and *STR* are defined in Appendix A. Robust standard errors clustered at the firm level are reported in the parentheses. ***, **, * indicate two-tailed significance at 1%, 5% and 10%.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Financially Constrained Firms				***Financially Unconstrained Firms***			
	CASH_ETR		*BTD*		*CASH_ETR*		*BTD*	
TotalP	-0.971***		-0.161**		0.582**		0.118**	
	(0.309)		(0.063)		(0.257)		(0.052)	
WinP		-0.663*		-0.149*		0.499**		0.112**
		(0.353)		(0.079)		(0.240)		(0.051)
LoseP		1.441***		0.189**		-0.963**		-0.139*
		(0.472)		(0.076)		(0.459)		(0.079)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm	Firm	Firm	Firm	Firm
Observations	865	865	765	765	969	969	875	875
Adj. R-sq	0.39	0.39	0.53	0.53	0.44	0.44	0.51	0.51

Table OA5 Including Firms with Loss

This table reports results using the full sample that retains firms with negative pretax income (loss firms). Columns (1)-(4) report the results for financially constrained firms. Columns (5)-(8) report the results for financially unconstrained firms. Financial constraints are defined using the HP Index, with firms above the sample median in the pre-election year classified as constrained. *CASH_ETR* is calculated as the sum of total tax paid scaled by pretax income. We multiply *CASH_ETR* by -1 so that it is increasing in tax planning. *BTD* is book-tax differences scaled by lagged total assets. *WinP* is the number of winning candidates involved in a close election that a firm donated to prior to the election scaled by 100. *LoseP* is the number of losing candidates involved in a close election that a firm donated to prior to the election scaled by 100. *TotalP* equals *WinP* minus *LoseP*. We divided these three variables by 100,000 to obtain sizeable coefficients. Control variables including *SIZE, ROA, LEVERAGE, SGA, R_D, NOLCF, CHG_NOLCF, FOR_INCOME, LOSS,* and *STR* are defined in Appendix A. Robust standard errors clustered at the firm level are reported in the parentheses. ***, **, * indicate two-tailed significance at 1%, 5% and 10%.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Financially Constrained Firms				***Financially Unconstrained Firms***			
	CASH_ETR		*BTD*		*CASH_ETR*		*BTD*	
TotalP	-1.521***		-0.257**		0.663**		0.086**	
	(0.443)		(0.102)		(0.288)		(0.037)	
WinP		-1.590***		-0.280**		0.565*		0.085**
		(0.470)		(0.120)		(0.314)		(0.040)
LoseP		1.310**		0.193*		-0.981***		-0.090*
		(0.551)		(0.112)		(0.359)		(0.048)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm	Firm	Firm	Firm	Firm
Observations	2,668	2,668	2,771	2,771	2,881	2,881	2,317	2,317
Adj. R-sq	0.11	0.11	0.58	0.58	0.10	0.10	0.25	0.25

Table OA6 Donation-weighted Measures of Political Connections

This table examines the effect of political connections on corporate tax planning using donation-weighted measures of political connections. Columns (1)-(4) report the results for financially constrained firms. Columns (5)-(8) report the results for financially unconstrained firms. Financial constraints are defined using the HP Index, with firms above the sample median in the pre-election year classified as constrained. *CASH_ETR* is calculated as the sum of total tax paid scaled by pretax income. We multiply *CASH_ETR* by -1 so that it is increasing in tax planning. *BTD* is book-tax differences scaled by lagged total assets. *AmountWinP* is the number of winning candidates involved in a close election that a firm donated to prior to the election multiplied by the firm's contribution to the candidates. *AmountLoseP* is the number of losing candidates involved in a close election that a firm donated to prior to the election multiplied by the firm's contribution to the candidates. *AmountTotalP* is *AmountWinP* minus *AmountLoseP*. We divided these three variables by 100,000 to obtain sizeable coefficients. Control variables including *SIZE, ROA, LEVERAGE, SGA, R_D, NOLCF, CHG_NOLCF, FOR_INCOME, LOSS,* and *STR* are defined in Appendix A. Robust standard errors clustered at the firm level are reported in the parentheses. ***, **, * indicate two-tailed significance at 1%, 5% and 10%.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Financially Constrained Firms				***Financially Unconstrained Firms***			
	CASH_ETR		*BTD*		*CASH_ETR*		*BTD*	
AmountTotalP	-0.165**		-0.035***		0.053*		0.022***	
	(0.072)		(0.013)		(0.028)		(0.008)	
AmountWinP		-0.163*		-0.037**		0.055*		0.021**
		(0.085)		(0.014)		(0.031)		(0.009)
AmountLoseP		0.165**		0.031*		-0.052*		-0.023***
		(0.083)		(0.016)		(0.028)		(0.009)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm	Firm	Firm	Firm	Firm
Observations	2,282	2,282	2,022	2,022	2,717	2,717	2,030	2,030
Adj. R-sq	0.29	0.28	0.42	0.42	0.24	0.24	0.31	0.31

Table OA7 An Alternative Measure of Tax Planning

This table presents the regression results of using *TXPD_AT* as an alternative measure of tax planning. Columns (1) and (2) report the results using the full sample. Columns (3) and (4) report the results for financially constrained firms. Columns (5) and (6) report the results for financially unconstrained firms. Financial constraints are defined using the HP Index, with firms above the sample median in the pre-election year classified as constrained. *TXPD_AT* is calculated as the sum of total tax paid scaled by lagged total assets. We multiply *TXPD_AT* by -1 so that it is increasing in tax planning. *WinP* is the number of winning candidates involved in a close election that a firm donated to prior to the election scaled by 100. *LoseP* is the number of losing candidates involved in a close election that a firm donated to prior to the election scaled by 100. *TotalP* equals *WinP* minus *LoseP*. Control variables include *SIZE, ROA, LEVERAGE, SGA, R_D, NOLCF, CHG_NOLCF, FOR_INCOME, LOSS,* and *STR.* All variables are defined in Appendix A. Robust standard errors clustered at the firm level are reported in the parentheses. ***, **, * indicate two-tailed significance at 1%, 5% and 10%.

	(1)	(2)	(3)	(4)	(5)	(6)
	Full Sample		***Financially Constrained Firms***		***Financially Unconstrained Firms***	
	TXPD_AT		*TXPD_AT*		*TXPD_AT*	
TotalP	0.001		-0.059**		0.030***	
	(0.011)		(0.023)		(0.011)	
WinP		0.003		-0.056**		0.030***
		(0.011)		(0.024)		(0.012)
LoseP		0.004		0.067*		-0.030*
		(0.017)		(0.034)		(0.016)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm	Firm	Firm
Observations	4,999	4,999	2,282	2,282	2,717	2,717
Adj. R-sq	0.64	0.64	0.61	0.61	0.68	0.68

Table OA8 Special Elections

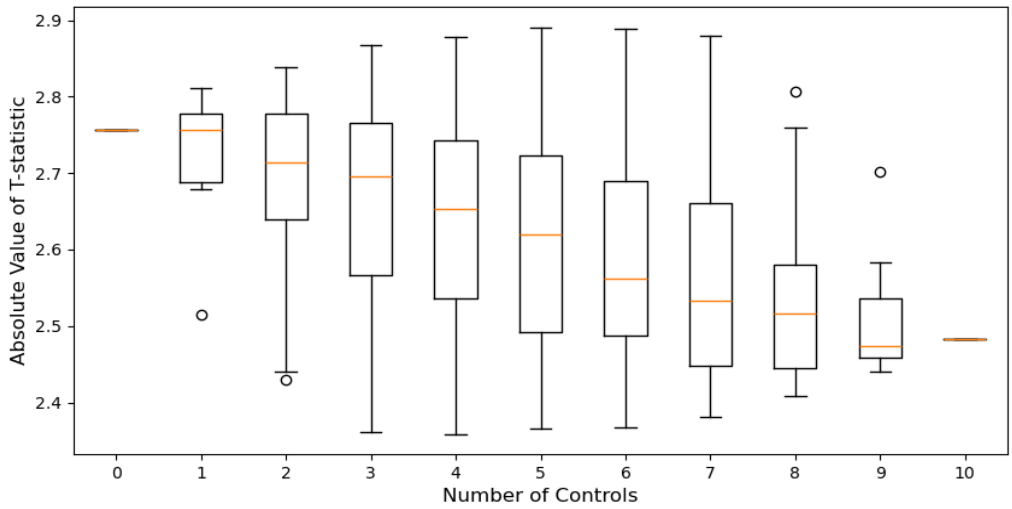
This table uses special elections to examine the effect of political connections on tax planning. Columns (1) and (2) present the regression results for financially constrained firms. Columns (3) and (4) present the regression results for financially unconstrained firms. Financial constraints are defined using the HP Index, with firms above the sample median in the pre-election year classified as constrained. *CASH_ETR* is calculated as the sum of total tax paid scaled by pretax income. We multiply *CASH_ETR* by -1 so that it is increasing in tax planning. *BTD* is book-tax differences scaled by lagged total assets. *Win* is a dummy variable that takes the value of one if the candidate to whom the firm donated won a close election, and zero otherwise. The estimation is performed using various polynomial functional forms, as suggested by Lee (2008). Robust standard errors clustered at the firm level are reported in the parentheses. ***, **, * indicate two-tailed significance at 1%, 5% and 10%.

	(1)	(2)	(3)	(4)
	Financially Constrained Firms		***Financially Unconstrained Firms***	
	CASH_ETR	*BTD*	*CASH_ETR*	*BTD*
Win	-0.104*	-0.019*	0.061*	0.026**
	(0.056)	(0.010)	(0.033)	(0.010)
Observations	271	313	454	331
Adj. R-sq	0.01	0.01	0.01	0.01
Functional Form	linear	linear	linear	linear
Win	-0.177**	-0.017*	0.062*	0.020**
	(0.069)	(0.010)	(0.036)	(0.009)
Observations	271	313	454	331
Adj. R-sq	0.02	0.00	0.00	0.00
Functional Form	quadratic	quadratic	quadratic	quadratic

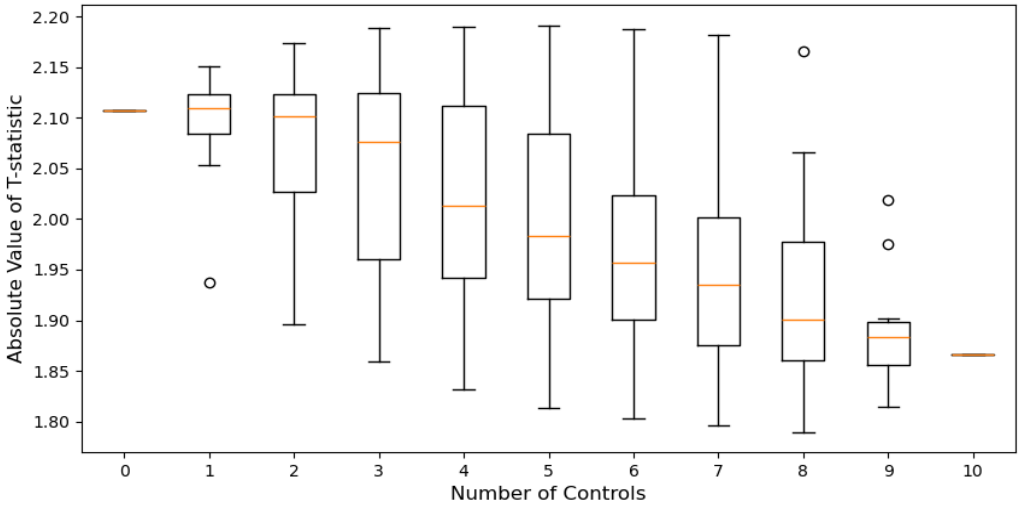
Figure OA1 P-Hacking Test

This figure presents p-hacking tests following Brodeur, Cook, and Heyes (2020). Panel A presents the regression results of tax planning on political connections for financially constrained firms. Panel B presents the regression tax planning on political connections for unconstrained firms. Financial constraints are defined using the HP Index, with firms above the sample median in the pre-election year classified as constrained. Both panels present the t-statistics for our main independent variable of interest by number of control variables, *TotalP*, when the dependent variables are *CASH_ETR* and *BTD*.

Panel A: Financially Constrained Firms

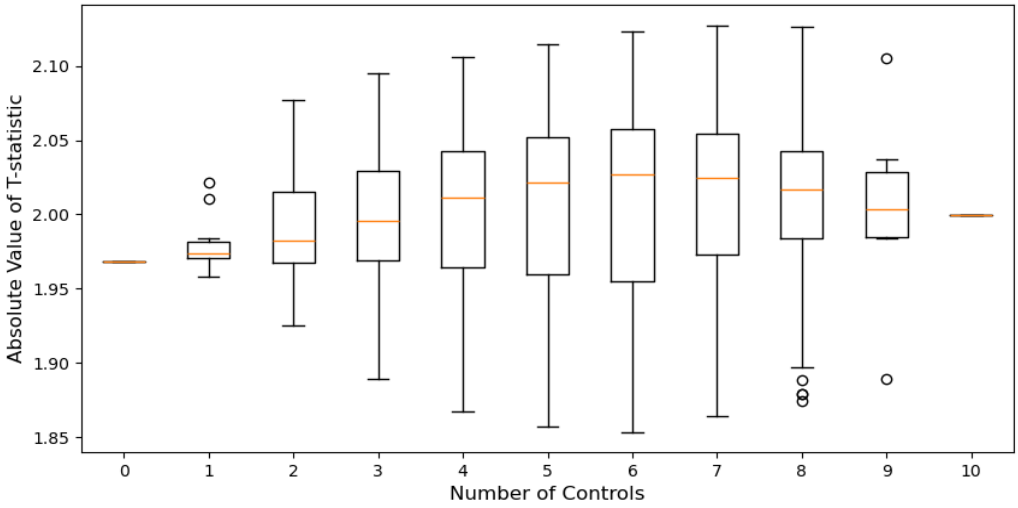


(a) *CASH_ETR*

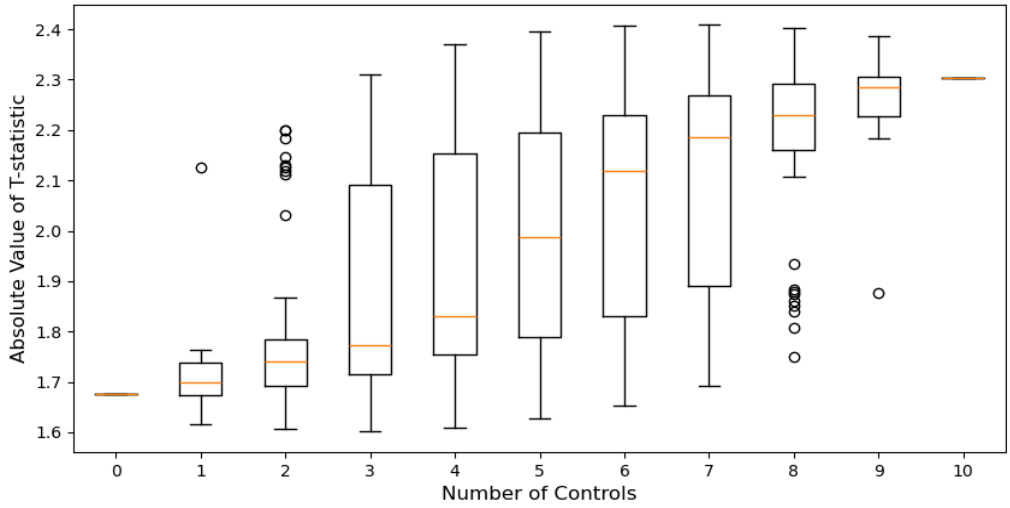


(b) BTD

Panel B: Financially Unconstrained Firms



(a) *CASH_ETR*



(b) BTD