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Abstract
The topic of book-tax differences（BTDs）has been discussed in resent years. Lev and Nissim（2004）find that the ratio of taxable income to book income predicts future earnings growth. Hanlon（2005）finds that large BTDs signal less persistence in book income. In addition, Revsine et al.（2005）argues that useful information for assessing the degree of conservatism in a firm’s portfolio of accounting choices can be extracted from the income tax footnote by comparing the ratio of pre-tax book income to taxable income. However, the relation between BTDs and financial statement conservatism has never been tested in an empirical setting in Taiwan. By examining how conservatism in book income and conservatism in taxable income varies with BTDs, we provide new insights into causes of BTDs. We also investigate the role of BTDs in indicating the persistence of earnings, accruals, and cash flows for one-period-ahead earnings.

We examine Taiwan’s listed companies for a sample period of 1995-2004. Based on regression model by Basu（1997）and Hanlon（2005）, our empirical results demonstrate:

1.The firm-years with positive BTDs exhibit less conservatism in book income.
2.The firm-years with negative BTDs exhibit more conservatism in book income.
3.The firm-years with negative BTDs have lower earnings persistence than firm-years with positive BTDs.
4.The firm-years with negative BTDs have less persistent of earnings, accruals, and cash flows.

Overall, our results provide further insights into the uses of BTDs for financial statement analysis. The findings are important to anyone who uses taxable income for valuation purpose, either alone or as a benchmark against book income, academics and regulators interested in causes of BTDs, policy-markers considering increasing disclosure of taxable income or aligning book income with taxable income, and academics who study proposed causes of conservatism.
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