Targets of Convenience? Tax Monitoring as a Political Cost for Government Contractors

Davidson B. Gillette
East Carolina University

Ryan C. Polk*
Clemson University

Shane R. Stinson
The University of Alabama

*Corresponding Author

Davidson B. Gillette, Department of Accounting, School of Business, East Carolina University, Greenville, NC, USA; Ryan C. Polk, Department of Accountancy, The Wilbur O. and Ann Powers College of Business, Clemson University, Clemson, SC, USA; Shane R. Stinson, Culverhouse School of Accountancy, Culverhouse College of Business, The University of Alabama, Tuscaloosa, AL, USA

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Abstract: In this paper, we explore a hidden cost to receiving governmental contract revenues. While prior literature has focused on the many benefits of winning such contracts, we explore how they may also entail additional costs, such as greater regulatory scrutiny. As firms win more contract revenues, they become more visible to regulators and more constrained in their response options, together potentially making them "targets of convenience". We examine this possibility using data from the U.S. Government's System for Award Management to study the association between contractors' political visibility (level of contract revenues) and political vulnerability (percentage of firm revenues from contracts) with tax authority monitoring. Our results show that more visible and vulnerable contractors are subject to heightened monitoring from tax authorities, highlighting the trade-offs between political costs and benefits in securing contract revenues.

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I. SYNOPSIS AND INSIGHTS FOR PRACTICE AND POLICY

With contracts recently totaling over $750 billion in the United States, many companies perceive a substantial upside to working with and for the federal government (Government Accountability Office 2024). Prior research identifies several benefits associated with receiving such contracts, including more consistent revenue generation, lower cost of capital, and more efficient use of cash (e.g., Cohen and Li, 2016, 2020; Dhaliwal, Judd, Serfling, and Shaikh, 2016; Ngo and Susnjara, 2020). In contrast, this paper explores an underexamined cost of such contracts: additional regulatory monitoring (Watts and Zimmerman 1978). Although often lucrative, winning and retaining governmental contracts inherently raises contractors' prominence to regulatory agencies and constrains their ability to aggressively respond to scrutiny. These conditions, particularly as resources allocated to enforcement agencies continue to decline, may make contractors "targets of convenience" for regulators. As such, the financial and political benefits enjoyed by government contractors may come at the cost of greater scrutiny.

To study the relationship between higher contract-driven prominence to regulators and increased regulatory scrutiny, we examine the association between governmental contract revenues and tax authority monitoring. The political cost hypothesis (Watts and Zimmerman 1978) suggests that receiving government benefits, such as federal contracts, raises a firm's political prominence and heightens potential regulatory and public scrutiny and criticism. In turn, theory suggests that firms voluntarily curb their aggressive behavior in anticipation of this higher scrutiny. This prediction of firms preemptively curbing behavior has been the primary focus of existing research, including in the tax setting, where Mills, Nutter, and Schwab (2013) find that politically prominent firms engage in less tax avoidance.

In contrast, we examine the theory's underlying inference: that politically prominent firms, despite their incentives to preemptively curb aggressive behavior and maintain positive relationships with regulators, nonetheless receive more regulatory scrutiny. Surprisingly, this prediction has received little attention, potentially due to difficulties measuring regulator monitoring levels (Godsell 2024). However, we draw on recent studies that utilize financial statement disclosures to construct proxies for tax authority monitoring (Armstrong, Glaeser, and Hoopes 2025; Finley and Stekelberg 2022). We then examine the association of political prominence, in the form of political visibility and political vulnerability based on governmental contracts, with these measures of regulatory scrutiny.

Governmental contracting and tax oversight provide a unique context for examining the link between political prominence and regulatory scrutiny. These contracts not only increase a firm's overall salience to regulators but also impose tax-specific reporting requirements that directly connect contractors to tax authorities. For example, under Federal Acquisition Regulation §52.209-11, contractors must self-attest to compliance and file Form 8596, which discloses contracting agencies, contract numbers, terms, and total obligations. Since this filing adds no tax information beyond the corporate return, it increases prominence without signaling additional avoidance drivers, potentially leading to increased monitoring based on prominence rather than heightened expectations for non-compliance. Accordingly, after controlling for established determinants of tax authority scrutiny, this setting allows us to examine whether firms with greater political prominence face incrementally higher monitoring that appears unrelated to underlying tax behavior.

To examine the association between political prominence and political costs, we measure political prominence with two variables: political visibility and political vulnerability. Using the

U.S. Government's System for Award Management (SAM), political visibility is measured using proxies based on federal contract size, while political vulnerability is based on the proportion of firm revenues derived from contracts. These reflect how winning more government contracts inherently raises a firm's visibility with regulators and, by increasing the firm's reliance on contract revenues relative to other income sources, makes firms more vulnerable and defensive in the face of contract losses.

We measure tax authority scrutiny using two complementary disclosure-based proxies: (i) IRS Exposure, which captures firms' discussion of IRS oversight in their 10-Ks (Armstrong et al. 2025), and (ii) a UTB-based measure that reflects the relative amount of uncertain tax benefits (UTBs) settled versus those that lapse without examination (Finley and Stekelberg 2022). We find that firms that secure the largest government contracts face greater tax authority scrutiny, even after controlling for opportunities to avoid taxes. Further, we find that political vulnerability also garners additional monitoring. Notably, these results hold after controlling for firm size, a traditional proxy for political prominence (Watts and Zimmerman 1978). Overall, the results support the political cost hypothesis prediction that political benefits in the form of contracts also entail political costs in the form of scrutiny, particularly for the largest and most vulnerable contractors, indicative of such firms functioning as targets of convenience.

To supplement our primary findings, we perform a series of additional analyses. First, drawing on the Mills et al. (2013) concept that political visibility and political vulnerability may operate jointly, we combine our measures to create a proxy for overall political sensitivity. Using this joint variable, we find a positive association with our measures for tax oversight. Additionally, when interacting our proxies for political sensitivity and tax authority scrutiny, we find positive and significant associations with federal effective tax rates. Thus, our findings

complement the prior research by Mills et al. (2013), offering insight into the underlying forces that influence the outcomes they study. Finally, we run parallel tests using Armstrong et al. (2025)'s exposure measures for other, non-tax regulators. Interestingly, in contrast to our results for tax regulators, we find mostly directionally different associations among political visibility, political vulnerability, and regulatory oversight across these other regulators. This suggests that the IRS's focus may be unique among federal government agencies.

Our paper contributes to the academic literature by identifying an externally imposed political cost through heightened tax authority scrutiny. While the role of political costs in accounting has a long history (e.g., Jensen and Meckling 1978; Watts and Zimmerman 1978), prior research has primarily focused on internally imposed costs, particularly instances where firms preemptively alter behavior to reduce political vulnerabilities or avoid scrutiny (e.g., Ramanna and Roychowdhury 2010; Jung 2024; Mills et al. 2013). However, these studies do not examine the underlying inference of the theory, namely, whether prominence itself results in differential (and perhaps misplaced) enforcement. We extend this literature by presenting evidence that politically visible or vulnerable firms, as a result of winning government contracts, do face higher levels of tax authority scrutiny, an interesting result when considered in the context of previous evidence that government contractors are less tax aggressive (Mills et al., 2013). As such, our focus provides complementary evidence to earlier findings and documents a previously unmeasured external cost associated with public sector engagement.

We also contribute to public policy discussions around government contracting and tax enforcement policy. Increased IRS oversight imposes direct costs on firms by raising the burden of tax planning (e.g., Robinson, Sikes, and Weaver 2010) and reducing their willingness and ability to avoid taxes, reflecting politically driven constraints on tax behavior (e.g., Hoopes,

Mescall, and Pittman 2012; Kubick, Lynch, and Mayberry 2016). Therefore, as policymakers consider adjustments to enforcement policy, it is essential to promote equitable tax enforcement while incentivizing the efficient delivery of public services.

Additionally, our findings are particularly timely given recent cuts to the tax regulator workforce and enforcement budgets (Blatt 2025; McGhee 2025). This may result in resource-constrained tax authorities increasingly shifting limited resources to the audit of firms that are prominent, easily identifiable, or less likely to resist scrutiny. This is consistent with a concurrent working paper by Gardner, Polk, and Yazzie (2025), which documents that firms engaging with the IRS through Private Letter Rulings (PLRs), a process that requires significant transparency and cooperation, experience heightened enforcement. We further provide evidence that regulatory agencies select targets of convenience by showing that politically visible and important contractors face higher levels of tax monitoring. Collectively, these patterns raise broader policy concerns about whether audit selection adequately reflects underlying tax compliance risk.

II. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Government Contracts, Political Visibility, and Political Vulnerability

Firms and governments have a complex and interdependent relationship that influences company behavior, including accounting-related choices (Watts and Zimmerman 1978). For instance, government contracts provide direct wealth transfers, which corporations generally find desirable for their stability and relative profitability (e.g., Huang, Lobo, Wang, and Xie 2016).[1] Moreover, the indirect effects of such contracts may extend beyond their nominal amounts.

[1] In fiscal year 2023, the U.S. government dispensed more than $750 billion in contracts. These contracts support a wide range of activities, including both products and services, broadly split between defense agencies ($456 billion) and civilian agencies ($303 billion) (GAO 2024).

Cohen and Li (2016, 2020) find that major governmental suppliers have more stable operating cash flows and, correspondingly, can hold less non-productive cash in reserve. Similarly, research suggests that firms with greater governmental customer concentration benefit from a lower cost of equity capital (Dhaliwal et al. 2016) and a better internal information environment (Samuels 2021).

Despite the benefits of winning government contracts, they increase a firm's political prominence, elevating its exposure to governmental and public scrutiny (Mills et al. 2013).[2] This heightened exposure, in turn, raises the risk of more regulatory scrutiny and adverse governmental actions (Watts and Zimmerman 1978, 1990). In anticipation of this, contractors may act strategically to lower this perceived risk by proactively engaging in income-reducing behavior as a means of deflecting problematic attention from both regulators and the general public, a preemptive reaction that has previously received extensive study.

For example, Key (1997) finds that cable firms, operating under FCC oversight, report lower income during periods of congressional scrutiny, while Grace and Leverty (2010) show that insurers, made politically visible through rate regulation, manage earnings downward by adjusting discretionary reserves. Similarly, Ramanna and Roychowdhury (2010) find that companies engaging in politically controversial outsourcing of operations also use discretionary accruals to manipulate earnings downward and avoid more exposure. Finally, in a tax setting, Mills et al. (2013) find that the prominence afforded by government contracts encourages contracting firms to voluntarily pay more in taxes. Together, the prior literature reinforces that

[2] Such prominence may come from a variety of sources outside of government contracts. Early research focused on firm size as the primary driver of governmental attention and corresponding political risks. Watts and Zimmerman (1978, 115) note that "the magnitude of political costs is highly dependent on firm size. Even as a percentage of total assets or sales, we would not expect a firm with sales of $100 million to generate the same political costs (as a percentage of sales) as a firm with $10 billion of sales." In addition, prior research has examined a wide variety of contributors to increased visibility and political costs, including income (e.g., Grace and Leverty 2010; Jones 1991), social norm violations (e.g., Wang, Wilson, Zhang, and Zou 2022), and disclosure choices (e.g., Godsell 2022).

political prominence elevates perceived political costs and elicits strategic financial and tax reporting responses.

Although large government contracts raise a firm's political visibility, the extent to which a firm relies on those contracts also increases the firm's defensiveness to threats to those contracts, sometimes referred to as political vulnerability or importance. This reliance on government contract revenues may impact strategic decision-making to avoid controversies that could threaten these vital revenue sources and even the ability to continue as a going concern. For example, Boland and Godsell (2020) provide evidence that defense firms, heavily reliant on government contracts to stay in business, reduce reported income following exogenous increases in political costs. Relatedly, Jung (2024) and Jung and Yang (2024) find that politically connected firms anticipating elevated political risk engage in earnings smoothing to reduce visibility, particularly when reliant on government customers or subject to tax scrutiny. Overall, prior research demonstrates that political visibility reflects a firm's existing exposure to scrutiny, while political vulnerability captures how consequential negative implications of that scrutiny may be, together providing incentives to preemptively manage financial and tax reporting in anticipation of political costs. As both components represent aspects of a firm's political prominence, we examine both in their association with tax authority monitoring.

Tax Authority Scrutiny

As previously discussed, the importance of political prominence has led to multiple studies examining how firms anticipate increased politically driven regulatory oversight and, correspondingly, curb their own behavior. However, little attention has been paid to whether that anticipated regulatory scrutiny actually exists.[3] Thus, the question remains whether tax authorities respond to political visibility and vulnerability, as exhibited by major government contractors, when allocating enforcement resources. This choice of focus is particularly important given the IRS's shrinking budgets, reduced workforce, limited resources, and mounting case backlogs (e.g., Blatt 2025; McGhee 2025; Nessa, Schwab, Stomberg, and Towery 2020; Hoopes et al. 2012). Wrestling with limited resources, the rationale for choosing which firms to target becomes both more difficult and more important, potentially leading to an emphasis on "targets of convenience", which theory suggests would particularly include politically prominent firms.

However, this potential focus on governmental contractors raises important trade-offs for regulators. On one hand, given that political prominence in this context is predicated on contracting firms receiving substantial revenues from government sources, it is natural for tax authorities and other enforcement agencies to ensure those funds are put to proper use. As such, some degree of monitoring is both financially prudent and potentially face-saving in the event some form of misappropriation or non-compliance by government contractors is revealed. On the other hand, prior research suggests that politically visible or sensitive firms already have strong incentives to reduce tax aggressiveness and cooperate with regulators (e.g., Mills et al. 2013), given their need to maintain a positive relationship with the government. This raises the question

[3] An exception is Goodsell (2024) which finds that firm financial accounting disclosures are associated with general governmental regulator oversight.

of whether the symbiotic relationship between prominent government contactors and regulators warrants proportionately *less* direct enforcement action, allowing more of regulators' already scarce resources to instead be directed toward other firms that may be more aggressive without sufficient oversight and are less constrained by their reliance on government funds.

Nevertheless, government contractors may represent attractive audit targets to the extent revenue agents perceive them as more cooperative in the information gathering process associated with a tax examination and less resistant to any findings, no matter how conservative their initial tax reporting strategies may seem. This perceived administrative manageability, combined with the availability of collection mechanisms such as the Federal Payment Levy Program, may make examinations of these firms appear less resource-intensive at the margin. Faced with limited enforcement resources, tax authorities may *prioritize* enforcement actions, whether through increased audit likelihood or greater audit intensity, based on considerations of efficiency and manageability, in addition to any underlying compliance risk.

Further, theory suggests that under an increased workload, individuals select more manageable tasks (KC, Staats, Kouchaki, and Gino 2020). For example, Kubick, Lockhart, Mills, and Robinson (2017) find that the IRS is more likely to audit firms located near an IRS office, suggesting that audit selection and intensity are partially a product of logistical convenience and perceived audit difficulty. Together, these findings suggest that politically visible and vulnerable firms may face greater tax monitoring, not because they are more likely to engage in tax avoidance, but because they present a potentially more straightforward audit for resource-constrained revenue agents.

Overall, politically visible and vulnerable firms may receive differing levels of tax authority monitoring depending on how enforcement resources are directed. Although these

firms may exhibit lower tax risk due to their private incentives to preserve government contracts (e.g., Mills et al. 2013), their salience to regulators and perceived cooperativeness may still make them attractive enforcement targets. Given the conflicting nature of the prior literature and theory, we present our design in Figure 1 and state our hypotheses in the null form:

H1: There is no association between a firm's political visibility and the level of tax authority monitoring it faces.

H2: There is no association between a firm's political vulnerability and the level of tax authority monitoring it faces.

III. RESEARCH DESIGN

Data Sources and Sample Selection

To test our hypotheses, our sample begins with all firm-years in 2013, consistent with the first full year following the launch of the U.S. Government's System for Award Management (SAM), where we collect data regarding the annual amount of contract goods and services purchased and obligated by the U.S. federal government.[4] We restrict the sample to only firms with at least two government contracts within the sample period due to the potential inherent differences between contractors and non-contractors, as well as to rule out any effect from the small group of firms that only report one year with government contracts.[5] Next, we remove all contractor-years lacking control variables from the Compustat Fundamentals database. Consistent with prior literature, we remove firms in the utility and financial services industries and all contractor-years where our dependent variables are not available. This leaves a sample of 3,612 and 3,222 contractor-years for our two tax monitoring dependent variables.

[4] The data are provided on the governmental fiscal year of October 1 to September 30. Consistent with the prior literature, we assign the contract totals to the fiscal year ending September 30 to the same firm fiscal year. For example, an annual contract total for the federal government's fiscal year 2020 is assigned to firm-year 2020, even if the firm operates on a calendar year.

[5] In untabulated results, we relax this restriction and entropy balance on the first, second, and third moments. All results are directionally and statistically similar.

Empirical Design

Tax Authority Scrutiny

To capture tax regulatory scrutiny in our setting, we use two complementary measures that reflect the tax enforcement process. First, we use *IRS Exposure*, developed by Armstrong et al. (2025). *IRS Exposure* is a disclosure-based proxy that captures the extent to which firms discuss IRS oversight in their annual filings. Armstrong et al. (2025) construct the measure by analyzing 10-Ks, identifying sentences that reference the IRS alongside enforcement-related terms (e.g., audit, examination, investigation, compliance), and scaling the count by the total number of sentences in the filing.[6] Firms are required to disclose material risks and contingencies, including the potential consequences of tax examinations. Accordingly, higher *IRS Exposure* is consistent with a higher perceived likelihood or intensity of IRS scrutiny. To align this disclosure-based measure with the timing of tax return filings, typically occurring in October of the year following operations, and the three-year federal statute of limitations, we measure *IRS Exposure* as a three-year average over years t+2 through t+4.

Our second measure, *Tax Monitor*, follows Finley and Stekelberg (2022) and relies on UTB disclosures under ASC 740-10. Under ASC 740-10, firms must disclose their reserves for uncertain tax benefits (UTBs) that are not more than likely to be sustained upon tax authority examination. Further, they must disclose the amounts and causes of year-over-year increases and decreases in the UTB balance. UTB decreases are primarily driven by lapses and settlements, which represent different levels of tax enforcement. Decreases due to lapses in the statute of limitations suggest limited oversight, as tax positions deemed sufficiently uncertain to generate

[6] We thank the authors for making this data available.

UTBs nevertheless go unchallenged. In contrast, settlements indicate active engagement by tax authorities (Finley and Stekelberg 2022).

Following Finley and Stekelberg (2022), we measure *Tax Monitor* as the sum of UTBs released due to settlements with tax authorities less UTBs released due to the expiration of the statute of limitations from year t+1 to t+4, scaled by the UTB balance at the beginning of year t+1. Higher values of this measure indicate greater enforcement activity, reflecting that a greater proportion of UTBs are settled with tax authorities rather than allowed to expire. Lower values imply that more uncertain tax positions expire without challenge, suggesting a lack of scrutiny. Taken together, *IRS Exposure* and *Tax Monitor* capture tax regulator scrutiny from both firms' disclosed audit-related risk and the realized resolution of uncertain tax positions, with the former variables specifically focused on IRS-driven scrutiny and the latter reflecting both IRS and non-IRS tax monitoring.

Political Visibility and Political Vulnerability

Winning larger government contracts increases a firm's visibility, increasing its exposure to political oversight and regulatory scrutiny. Therefore, we proxy for political visibility using the size of awarded government contracts. Specifically, we use *Log Contract Visibility*, *Large Government Contractor*, and *High Visibility. Log Contract Visibility* is the log of the total government contracts awarded over a three-year period from t-2 to t. *Large Government Contractor* is an indicator variable coded one if the firm is awarded a three-year total of contract revenues above the industry-year median and zero otherwise. Finally, consistent with a break in the size of contracts at the ninth decile, we use the indicator variable *High Visibility*, coded one if

the firm's three-year total contract revenues are in the top two deciles by year and zero otherwise.[7]

Next, to proxy for political vulnerability, we measure each firm's reliance on government contract revenues to continue operating as a going concern. Specifically, we use *Contract Percentage*, measured as the three-year sum of government contract revenues scaled by total revenue over the same time period. Second, we use *High Reliance*, an indicator variable coded one if the firm has a *Contract Percentage* above the industry-year median and zero otherwise. Finally, following the break in the distribution of *Contract Percentage* at the top decile, we use *D10 Reliance*, an indicator variable coded one if the firm reports *Contract Percentage* in the top decile by year and zero otherwise.

Controls

Since other factors influence the level of tax authority attention, we include a series of control variables. We control for firm size (*Size*) and market value (*Market Value*), as larger firms are subject to higher audit rates (Hoopes, Mescall, and Pittman 2012). Notably, the inclusion of a firm size control variable is a conservative design choice, as size has traditionally served as a proxy for political visibility (e.g., Watts and Zimmerman 1978), though the reliance on that measure has garnered criticism in preference for more direct proxies (like the contract-based measures we utilize). Also, we include controls for existing levels of tax aggressiveness, including cash effective tax rates (*CETR*), open unrecognized tax benefits (*Open UTB*), and cash reserves (*Cash*), since more tax-aggressive firms are more likely to face higher levels of IRS scrutiny, and higher tax uncertainty is associated with higher levels of cash holdings (Hanlon,

[7] Mills et al. (2013) measure *High Visibility* as contract revenues in the top decile, where they identify a break in the amount of federal government contract revenues. With our broader sample as a product of the SAM database, we follow the authors by generating this variable at the break at the ninth decile.

Maydew, and Saavedra 2017). We include *Leverage* since debt may provide a tax shield (Graham 1996) and the opportunity to structure debt to optimize tax expense, potentially drawing additional scrutiny. We control for *Return on Assets* since more profitable firms may attract tax authority scrutiny, especially when using tax avoidance maneuvers (Maydew 1997; Mills 1998). We control for *Capital Intensity* and *Inventory Intensity* due to the availability of tax planning strategies related to inventory valuation, depreciation methods, and cost segregation studies, among others. *Research and Development Intensity* is included since the credit for increasing research activities under Section 41 of the Internal Revenue Code is consistently a high-priority examination item for the IRS (Cowx 2025).

Next, we include an indicator variable for the presence of foreign operations (*Foreign*), the scale of foreign operations (*Foreign Intensity*), and scaled intangible assets (*Intangibles*) to control for opportunities for income-shifting and related tax controversy (TIGTA 2016; IRS 2023). Due to the documented relationship between auditor-provided tax services (APTS) and tax authority monitoring, we control for *APTS* (Axelton, Inger, Mathis, and Sadler 2025; Rapley, Sapkota, and Stekelberg 2024). We also include a variable for the percentage of tax returns audited by the IRS by firm size and year (*PCT AUD)*, based on Finley and Stekelberg (2022), to control for the expected IRS audit rate based on size (Hoopes et al. 2012). This allows us to further concentrate on the tax authority monitoring driven by contracts, rather than firm characteristics. Consistent with the prior tax literature, we also control for the presence of a net operating loss (*NOL*) carryforward. Finally, we include industry[8] and year fixed effects to control for the influence of macroeconomic and political factors on tax authority decision-making, as

[8] Industry fixed effects are represented using two-digit SIC codes.

well as tax subsidies that may be both industry-specific and have complex qualification requirements. We define all variables in Appendix A.

Using the differing measures of tax authority monitoring, political visibility, and political vulnerability, we test our hypotheses using Model (1). A positive (negative) coefficient on B_1 is indicative of additional (less) scrutiny on politically visible or vulnerable government contractors when compared to other firms.

$$\textit{Tax Enforcement} = \beta_0 + \beta_1 * \textit{Political Visibility}\ (\textit{Political Vulnerability}) + \beta_j * \text{Controls} + \beta_k * \text{Fixed Effects} + \varepsilon \quad (1)$$

IV. RESULTS

Descriptive Statistics

Table 1 provides summary statistics. Within the sample, the average contractor earns over $400 million in government contracts over a three-year period, representing 2% of its total revenues over that time frame. Like Finley and Stekelberg (2022), we report a negative mean *Tax Monitor* (-0.094). Further, within the sample, 65.2% have foreign operations, and we find an average *Research and Development Intensity* of 10.5%, showing that many firms in the sample may be subject to additional tax authority scrutiny based on existing tax planning opportunities.

Next, we compare government contractors as their level of political visibility and political vulnerability increases. As illustrated in Figure 2, Panel A, we find a pattern that as firms move from the first quartile to the fourth quartile of *Contract Visibility*, firms report higher CETRs and Federal ETRs (FETR). Further, illustrated in Panel B, we find the opposite pattern among firms as they move from the least to most reliant on government contracts.

Main Analyses

Political Visibility and Tax Authority Scrutiny

We turn first to examine the association between political visibility and tax monitoring. While government contractors are generally less tax aggressive (Mills et al. 2013), their heightened visibility may still influence the intensity of tax authority scrutiny, presenting as a positive association between our variables of interest. We test this possibility and our first hypothesis by estimating Model (1).

We present the results in Table 2. Consistent with larger firms facing higher levels of IRS scrutiny (Hoopes et al. 2012; Watts and Zimmerman 1978), we find a consistent positive and significant relationship between size and our measures of tax authority monitoring. Additionally, consistent with the IRS's focus on the research and development credit under Internal Revenue Code (IRC) Section 41 (Cowx 2025), we find a consistent and significant relationship between *R&D Intensity* and *Tax Monitor*.

Next, we move to our primary tests of H1. Providing evidence to reject the null hypothesis, we find a consistent positive relationship between each proxy of political visibility and the three proxies for tax authority monitoring. Specifically, we find a positive and significant relationship between the continuous measure *Log Contract Visibility*, *IRS Exposure* (b=0.001, p<0.01), and *Tax Monitor* (b=0.004, p<0.01).[9] We find a similar relationship between *Large Government Contractor*, *IRS Exposure* (b=0.015, p<0.01), and *Tax Monitor* (b=0.051, p<0.01). These coefficients suggest that contractors above the industry-year median report an increase in *IRS Exposure* that is 19.7% higher than other contractors and settle 5.1% more open UTBs than are allowed to expire by the IRS, representing a difference of approximately $15.7 million.[10] Finally, we find a positive and significant relationship between *High Visibility* and our two

[9] All p-values are one-tailed.
[10] The difference in *IRS Exposure* is calculated as the coefficient (0.015) divided by the average *IRS Exposure* in the sample (0.076). Further, the average beginning balance of UTBs within the tested sample is $307.2 million. We estimate the $15.7 million value by multiplying the beginning balance by the coefficient (0.051).

proxies for IRS scrutiny (b=0.014, p<0.01; b=0.047, p<0.01). Together, the results provide evidence to reject H1, indicating that as government contractors increase their level of political visibility, they face higher levels of IRS scrutiny.

Political Vulnerability and Tax Authority Scrutiny

Building on the visibility results, we next test H2, which examines whether political vulnerability, defined as a firm's reliance on government contracts as a percentage of its overall revenues, influences tax authority monitoring. Reliance on federal contract revenues may reduce enforcement exposure if such firms are more compliant due to the high risk of losing their core revenue source. However, these firms may be viewed as targets of convenience by the IRS, given their perceived cooperativeness and exposure, as the need to defend valued contracts renders them more vulnerable and less reactive to scrutiny. To test this possibility and H2, we estimate Model (1) using our measures of political vulnerability.

As presented in Table 3, we find that greater reliance on government contract revenues is consistently associated with higher tax authority scrutiny. Specifically, we find a positive and significant relationship between *Contract Percentage*, *Tax Monitor* (b=0.319, p<0.05), and *IRS Exposure* (b=0.034, p<0.01). Further, we find a positive and significant relationship between *High Reliance* and *Tax Monitor* (b=0.220, p<0.01). Finally, we find a positive and significant relationship between *High Reliance* and both proxies for tax authority monitoring (b=0.016, p<0.01; b=0.055, p<0.01), suggesting that contractors above the industry-year median report an increase in *IRS Exposure* that is 21.1% higher than other contractors and settle 5.5% more open UTBs than are allowed to expire by the IRS, representing a difference of approximately $16.9

million.[11] These results provide evidence to reject the null in H2 and mirror the patterns observed for political visibility, indicating that within the universe of contractors, the firms most dependent on public funds are monitored more intensely.

Taken together, our results indicate that both political visibility and political vulnerability are associated with heightened tax authority scrutiny. These findings highlight an important implication for the political cost hypothesis in showing that government contracts provide political and economic benefits while also imposing external costs in the form of increased regulatory scrutiny. Overall, our results show that contractors often face additional tax authority monitoring not due to taking more aggressive tax positions, but instead because they are visible and easier to monitor, raising questions of fairness and efficiency.

V. ADDITIONAL ANALYSES

Political Sensitivity and Tax Authority Scrutiny

Having established that political visibility and political vulnerability are each associated with greater tax authority monitoring, we next consider whether these constructs operate jointly. This test maps directly to Mills et al. (2013), who define *Political Sensitivity* as the joint effect of (i) contracts being large enough to attract scrutiny (visibility) and (ii) contracts being important enough to motivate behavioral responses (vulnerability). In their setting, political sensitivity predicts firms' tax payments as a form of political cost. We extend their framework to the enforcement side of the relationship by examining whether the same joint construct that shapes contractor behavior also corresponds to how tax authorities allocate monitoring and resolve uncertain tax positions.

[11] The difference in *IRS Exposure* is calculated as the coefficient (0.016) divided by the average *IRS Exposure* in the sample (0.076). Further, the average beginning balance of UTBs within the tested sample is $307.2 million. We estimate the $16.9 million value by multiplying the beginning balance by the coefficient (0.055).

Conceptually, the mechanism described by Mills et al. (2013) can operate in either direction in our setting. On the one hand, contractors that are both highly visible and heavily reliant on public funds may be especially salient to regulators, making them attractive "targets of convenience" when resources are constrained. On the other hand, the same incentives emphasized by Mills et al. (2013), including protecting contract revenues by taking less aggressive tax positions, could make these firms appear less risky and therefore less likely to warrant incremental monitoring. Testing this joint relationship helps clarify whether tax authorities concentrate scrutiny on the most visible and reliant contractors as high-profile targets or instead shift attention elsewhere because politically sensitive contractors are perceived as lower-risk audit subjects.

To examine this joint relationship, we estimate Model (2).

$$\textit{Tax Enforcement} = \beta_0 + \beta_1 * \textit{Political Sensitivity} \text{ (or } \textit{Political Sensitivity 2}) + \beta_j * \textit{Controls} + \beta_k * \textit{Industry Fixed Effects} + \beta_l * \textit{Year Fixed Effects} + \varepsilon \quad (2)$$

In Model (2), *Political Sensitivity* is defined as the interaction of *High Visibility* and *Contract Percentage*, consistent with the construct in Mills et al. (2013). Further, to examine the impact of the continuous contract size, we measure *Political Sensitivity 2* as the interaction between *Log Contract Visibility* and *Contract Percentage*. As presented in Table 4, both *Political Sensitivity* and *Political Sensitivity 2* are positively and significantly associated with *IRS Exposure* and *Tax Monitor.* These findings indicate that IRS scrutiny rises with the prominence captured jointly by political visibility and vulnerability. Stated differently, the same combination of contract size and contract dependence that predicts higher tax-related political costs in Mills et al. (2013) is also associated with incrementally greater IRS scrutiny.

Impact of Enforcement on the Contractor-Tax Aggressiveness Relationship

Our results provide evidence that government contractors face higher IRS scrutiny, whether due to an increase in audit selection likelihood or, more likely, an increase in IRS audit intensity. These findings may also provide context for the conclusions in Mills et al. (2013), who document that politically sensitive contractors exhibit higher federal effective tax rates (*Federal ETR*s), consistent with incurring tax-related political costs to protect contract revenues. Accordingly, we examine whether our findings provide evidence for underlying mechanisms (i.e., greater tax authority oversight of contractors) that contribute to their findings.

To do so, we add the mean-centered value of *IRS Exposure* and its interaction with *Political Sensitivity* to Model (2) and replace the dependent variable with *Federal ETR*.[12] This specification is intended to test whether IRS scrutiny moderates the *Political Sensitivity-Federal ETR* relationship documented by Mills et al. (2013). By controlling directly for *IRS Exposure*, we hold constant the association between IRS scrutiny and *Federal ETR* and ensure that the interaction term captures whether scrutiny strengthens the association between *Political Sensitivity* and *Federal ETR*, rather than simply absorbing the direct effect of scrutiny itself. Under this approach, a positive interaction indicates that the *Political Sensitivity-Federal ETR* association is stronger when IRS scrutiny is above average.

As presented in Table 5, we find a positive and significant relationship between *Political Sensitivity* and *Federal ETR*. Similarly, when splitting the sample at 2009[13], we find a positive and significant association in both subsamples. However, we only find a positive and significant main effect between *Political Sensitivity* and *Federal ETR* in the pre-2009 subsample. That

[12] We mean-center *IRS Exposure* before constructing the interaction to reduce nonessential multicollinearity while also providing the closest empirical analog to the baseline Mills et al. (2013) specification. Further, since UTBs are not available until 2007, we use only *IRS Exposure* as the proxy for IRS scrutiny.

[13] We use 2009 as a natural breakpoint because the American Recovery and Reinvestment Act of 2009 (ARRA) substantially expanded federal spending implemented through contracting, while also increasing the visibility and oversight of that spending, which plausibly heightened contractors' political exposure and the salience of enforcement. The Digital Accountability and Transparency Act of 2014 included similar transparency provisions.

pattern is informative because Mills et al.'s sample covers 2002-2007, making the pre-2009 tests the most directly comparable to their setting. Accordingly, we view the pre-2009 evidence as the closest analog to Mills et al. (2013), while the positive interaction in both subsamples suggests that IRS scrutiny amplifies the *Political Sensitivity–Federal ETR* relation both within and beyond the period they study. Overall, this pattern suggests that a meaningful portion of the higher Federal ETRs documented in the contractor setting reflects elevated enforcement activity, rather than (or in addition to) purely voluntary tax conservatism. Accordingly, our monitoring results help reconcile our evidence with that of Mills et al. (2013) and extend their framework by directly examining the environment that contractors face.

Other Federal Government Agencies

Next, we examine whether the relation between contracting and agency exposure is similar outside the IRS setting. Therefore, we modify Models (1)-(3), replacing *IRS Scrutiny* with *DOL Exposure, DOJ Exposure,* and *SEC Exposure* (all from Armstrong et al. 2025), agency-level exposure measures that capture the extent to which firms discuss oversight by a given agency in their 10-Ks. As presented in Table 6, the pattern differs across agencies. *Log Contract Visibility* is negatively associated with *SEC Exposure* and *DOL Exposure* but positively associated with *DOJ Exposure*. *Contract Percentage* is negatively associated with *SEC Exposure* and *DOJ Exposure* and is not significantly related to *DOL Exposure*. Additionally, both *Political Sensitivity* and *Political Sensitivity 2* are negatively and statistically associated with all three agency outcomes. Taken together, these results suggest that contracting does not necessarily result in a uniform increase in exposure to federal agencies and may, in cases of the most visible contractors, result in lower exposure to agency enforcement. Instead, the consistent positive

exposure pattern appears unique to the IRS. We include this finding as an opportunity for future research to explore.

VI. CONCLUSION

While governmental contracts can provide substantial benefits, both financial and non-financial, to recipients, they also entail additional costs. Specifically, governmental contracts inherently raise a firm's prominence to governmental regulators. In this paper, we explore the relationship between political prominence and tax enforcement, providing empirical evidence for the negative consequences of higher prominence to governmental agencies. This assumption is a key, but largely unproven, foundation of the political cost hypothesis, which has a large and important role in the broader accounting literature.

Using a sample of government contract-years, we find that political prominence, as proxied by larger government contract revenues and greater reliance on such revenues, is consistently associated with heightened tax authority scrutiny. This relationship holds across multiple measures of political visibility, political vulnerability, and regulatory scrutiny, underscoring that prominence itself carries regulatory costs. In additional analyses, we find that visibility and vulnerability jointly shape monitoring, with attenuation at the highest levels by a consistently positive relationship overall. Taken together, these results demonstrate that government contractors face political costs in the form of increased tax authority monitoring. Importantly, we find this association despite prior evidence that contractors are less tax aggressive, suggesting that tax authorities scrutinize these firms not due to questionable tax positions, but because their prominence and accessibility make them convenient targets.

As with all research, our findings are subject to limitations. For example, we build on the prior literature around tax monitoring and enforcement, but note that, like all measures using

public data, it is potentially subject to noise. Additionally, given the limitations of public data, we can only provide evidence of increased enforcement against publicly traded government contractors. Future researchers with access to more comprehensive IRS audit data should investigate whether this relationship persists among smaller, private contractors. This research is particularly important given current federal government policies that favor minority-owned and women-owned businesses, ensuring that these businesses are not unfairly subject to additional costs associated with increased enforcement. Additionally, we note that different types of scrutiny beyond regulator monitoring may impact the preemptive avoidance of controversial behaviors.

Overall, we find evidence that the IRS adjusts its enforcement strategy in response to politically prominent government contractors. Notably, we find that tax authorities may single out such firms as targets of convenience based on their prominence rather than specific indications of tax aggressiveness. This contributes to theory, providing novel evidence for a key inference of the political cost hypothesis, but one that has received relatively little attention in the literature. For contractors, a better understanding of the political costs of government contracting may encourage greater investment in documentation, internal controls, and proactive compliance measures to mitigate the burden of increased tax authority monitoring. For policymakers, the findings suggest a need to reassess whether concentrating enforcement on prominent contractors is driven by convenience or actual evidence of problematic tax behavior. In summary, our results contribute to both theory and practice in examining a hidden cost within politically driven benefits.

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Figure 1: Research Summary Diagram

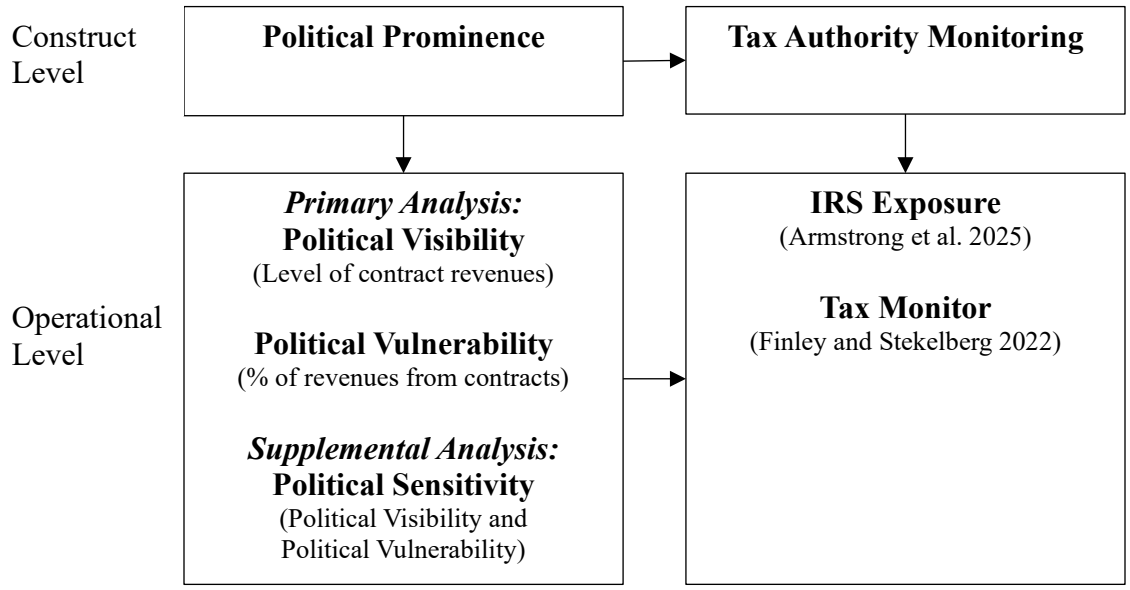
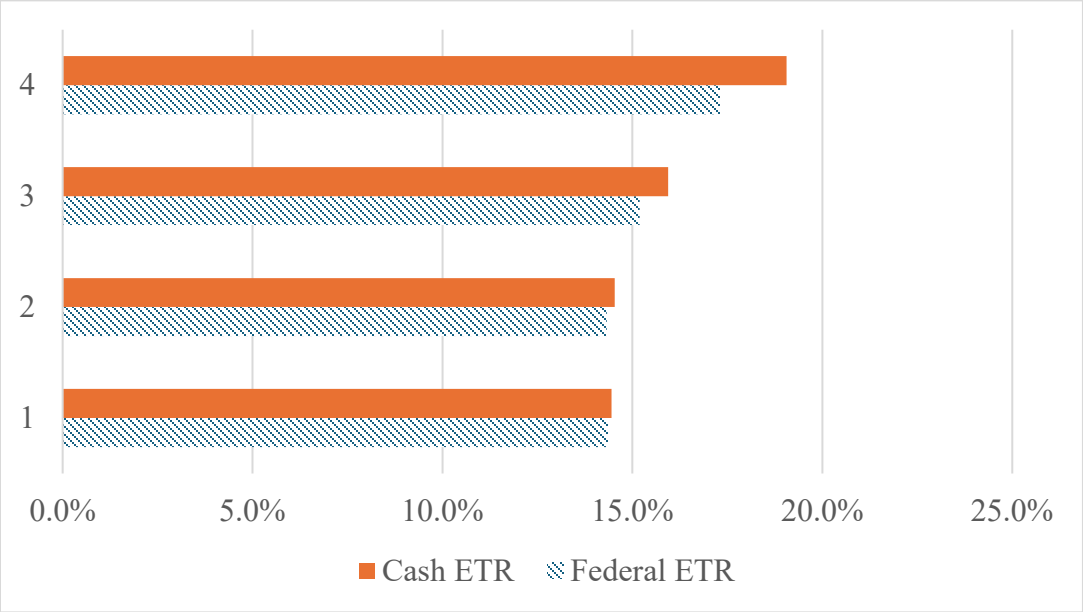


Figure 2. Reported tax rates by political visibility and political vulnerability
Panel A. Reported tax rates by contract visibility quartile



Panel B. Reported tax rates by contract vulnerability quartile

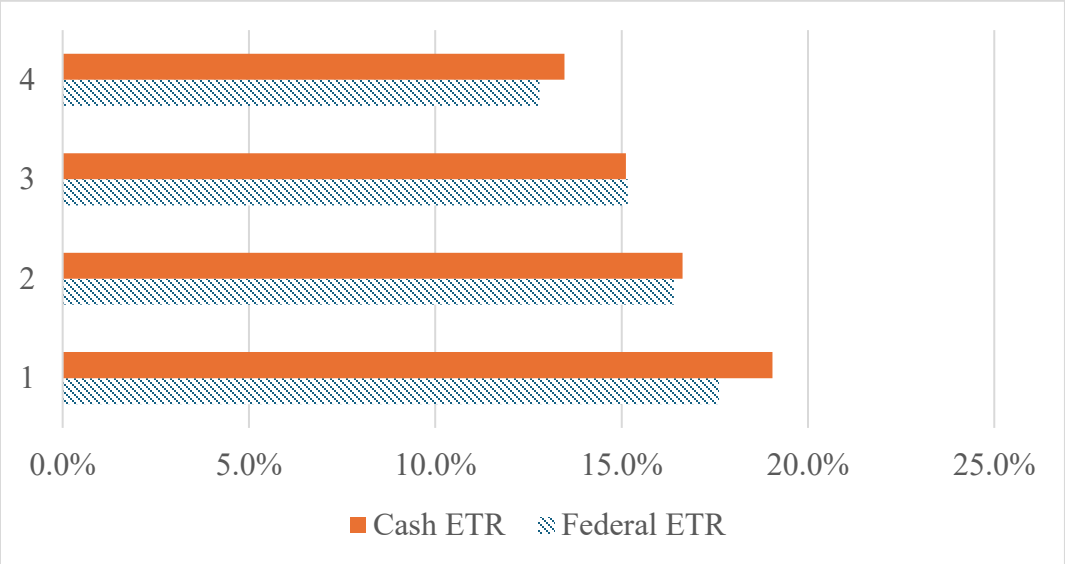


Figure 2, Panel A (Panel B), graphs comparative CETRs and Federal ETRs by *Log Contract Visibility* (*Contract Percentage*) quartile.

Table 1. Descriptive Statistics

Variable	*N*	*Mean*	*SD*	*p25*	*p50*	*p75*
Tax Monitoring Variables						
IRS Exposure	3612	0.076	0.090	0.000	0.050	0.109
Tax Monitor	3222	-0.094	0.478	-0.379	-0.006	0.104
Government Contractor Variables						
Log Contract Visibility	3612	9.110	7.828	0.000	12.317	15.677
Large Government Contractor	3612	0.593	0.491	0.000	1.000	1.000
High Visibility	3612	0.267	0.442	0.000	0.000	1.000
Contract Percentage	3612	0.017	0.086	0.000	0.000	0.003
High Reliance	3612	0.509	0.500	0.000	1.000	1.000
High Importance	3612	0.054	0.226	0.000	0.000	0.000
Control Variables						
CETR	3612	0.172	0.192	0.030	0.194	0.294
Size	3612	7.411	2.226	6.021	7.487	8.915
Market Value	3612	7.673	2.226	6.261	7.783	9.350
Leverage	3612	0.253	0.362	0.071	0.216	0.345
Capital Intensity	3612	0.190	0.171	0.074	0.127	0.246
Inventory Intensity	3612	0.106	0.109	0.014	0.080	0.157
R&D Intensity	3612	0.105	0.477	0.000	0.024	0.097
Intangibles	3612	0.426	0.357	0.101	0.360	0.689
ROA	3612	0.013	0.586	0.026	0.070	0.113
Foreign	3612	0.652	0.431	0.000	1.000	1.000
Foreign Intensity	3612	0.273	0.375	0.000	0.121	0.517
NOL	3612	0.791	0.406	1.000	1.000	1.000
APTS	3612	0.003	0.015	0.001	0.001	0.002
Cash	3612	0.180	0.168	0.052	0.133	0.252
Open UTB	3612	0.322	17.916	0.001	0.004	0.011
PCT AUDIT	3612	17.778	16.489	5.600	14.600	22.400

Table 1 presents summary sample statistics related to relevant variables used in the analysis of H1 and H2. The sample consists of 3,612 firm-year observations representing 588 government contractors. All data is from fiscal years 2013-2025. All variables are measured as the three-year average, except for *Tax Monitor*. *Tax Monitor* is winsorized between -1 and 1. *CETR* is winsorized between 0 and 1. All other continuous variables are winsorized at the 1st and 99th percentiles. Differences in the N are due to missing UTB variables necessary to calculate *Tax Monitor*. All variables are defined in Appendix A.

Table 2. Relationship between Political Visibility and IRS Scrutiny

VARIABLES	(1) IRS Exposure	(2) IRS Exposure	(3) IRS Exposure	(4) Tax Monitor	(5) Tax Monitor	(6) Tax Monitor
Log Contract Visibility	0.001***			0.004***		
	(0.000)			(0.001)		
High Visibility		0.014***			0.047***	
		(0.004)			(0.019)	
Large Government Contractor			0.015***			0.051***
			(0.003)			(0.017)
CETR	-0.002	-0.003	-0.002	-0.130***	-0.130***	-0.128***
	(0.007)	(0.007)	(0.007)	(0.048)	(0.048)	(0.048)
Size	0.010***	0.009***	0.010***	0.056***	0.054***	0.058***
	(0.002)	(0.002)	(0.002)	(0.014)	(0.014)	(0.014)
Market Value	-0.004**	-0.004***	-0.004**	-0.026***	-0.026***	-0.027***
	(0.002)	(0.002)	(0.002)	(0.010)	(0.011)	(0.010)
Leverage	0.004	0.004	0.004	-0.012	-0.012	-0.014
	(0.004)	(0.004)	(0.004)	(0.050)	(0.051)	(0.050)
Capital Intensity	-0.015	-0.010	-0.017	-0.099	-0.087	-0.103
	(0.015)	(0.015)	(0.015)	(0.095)	(0.096)	(0.096)
Inventory Intensity	-0.057***	-0.053***	-0.057***	-0.175*	-0.163	-0.178*
	(0.019)	(0.019)	(0.019)	(0.132)	(0.133)	(0.133)
R&D Intensity	0.000	0.000	0.000	0.047**	0.048**	0.047**
	(0.002)	(0.002)	(0.002)	(0.025)	(0.024)	(0.025)
Intangibles	0.004	0.006	0.004	0.036	0.044	0.035
	(0.008)	(0.008)	(0.008)	(0.042)	(0.042)	(0.042)
ROA	0.003	0.002	0.003	-0.167**	-0.180**	-0.168**
	(0.003)	(0.003)	(0.003)	(0.088)	(0.088)	(0.088)
Foreign	-0.009**	-0.010***	-0.009**	0.081***	0.077***	0.081***
	(0.004)	(0.004)	(0.004)	(0.024)	(0.025)	(0.024)
Foreign Intensity	0.020***	0.021***	0.020***	-0.049**	-0.047**	-0.050**
	(0.005)	(0.004)	(0.005)	(0.024)	(0.024)	(0.024)
NOL	0.004	0.005	0.004	0.031*	0.032*	0.031*
	(0.004)	(0.004)	(0.004)	(0.023)	(0.023)	(0.023)
APTS	0.122*	0.090	0.128**	-0.435	-0.729	-0.410
	(0.076)	(0.074)	(0.077)	(1.185)	(1.172)	(1.192)
Cash	-0.004	0.001	-0.004	0.217***	0.234***	0.214***
	(0.017)	(0.017)	(0.017)	(0.088)	(0.088)	(0.089)
Open UTB	0.000***	0.000***	0.000***	0.000	0.000	0.000
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
PCT AUDIT	0.001***	0.001***	0.001***	0.005***	0.005***	0.005***
	(0.000)	(0.000)	(0.000)	(0.001)	(0.001)	(0.001)
Constant	0.006	0.012	0.005	-0.505***	-0.481***	-0.508***
	(0.013)	(0.013)	(0.013)	(0.0765)	(0.077)	(0.077)
Industry Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Observations	3,612	3,612	3,612	3,222	3,222	3,222
Adjusted R-squared	21.5%	21.3%	21.4%	15.1%	14.9%	15.0%

***, **, * Represent statistical significance at $p < 0.01$, $p < 0.05$, and $p < 0.10$, one-tailed. Robust standard errors are presented in parentheses. Table 2 presents the results of estimating Model (1) to test H1. Columns (1)-(3) present OLS results on the variable *IRS Exposure*. Columns (4)-(6) present OLS

results on the variable *Tax Monitor*. A positive (negative) coefficient represents more (less) aggressive tax enforcement. The variables of interest are *Log Contract Visibility*, *High Visibility*, and *Large Government Contractor,* where a positive (negative) coefficient represents higher (lower) levels of IRS scrutiny. All variables are defined in Appendix A.

Table 3. Relationship between Political Vulnerability and IRS Scrutiny

VARIABLES	(1) IRS Exposure	(2) IRS Exposure	(3) IRS Exposure	(4) Tax Monitor	(5) Tax Monitor	(6) Tax Monitor
Contract Percentage	0.034***			0.319**		
	(0.013)			(0.155)		
D10 Reliance		0.006			0.220***	
		(0.005)			(0.051)	
High Reliance			0.016***			0.055***
			(0.003)			(0.017)
CETR	-0.002	-0.002	-0.001	-0.128***	-0.133***	-0.126***
	(0.007)	(0.007)	(0.007)	(0.048)	(0.049)	(0.048)
Size	0.010***	0.010***	0.010***	0.056***	0.056***	0.058***
	(0.002)	(0.002)	(0.002)	(0.014)	(0.014)	(0.014)
Market Value	-0.004**	-0.004**	-0.004**	-0.025***	-0.025***	-0.027***
	(0.002)	(0.002)	(0.002)	(0.011)	(0.010)	(0.010)
Leverage	0.006*	0.004	0.004	-0.012	0.003	-0.014
	(0.004)	(0.004)	(0.004)	(0.051)	(0.050)	(0.051)
Capital Intensity	-0.016	-0.014	-0.018	-0.114	-0.121	-0.109
	(0.015)	(0.015)	(0.015)	(0.097)	(0.096)	(0.096)
Inventory Intensity	-0.051***	-0.052***	-0.058***	-0.164	-0.141	-0.174*
	(0.019)	(0.019)	(0.019)	(0.133)	(0.132)	(0.133)
R&D Intensity	0.000	-0.001	0.000	0.047**	0.048**	0.046**
	(0.002)	(0.002)	(0.002)	(0.025)	(0.025)	(0.025)
Intangibles	0.005	0.006	0.003	0.038	0.035	0.034
	(0.008)	(0.008)	(0.008)	(0.042)	(0.041)	(0.042)
ROA	0.005**	0.002	0.003	-0.187**	-0.186**	-0.167**
	(0.003)	(0.003)	(0.003)	(0.088)	(0.088)	(0.088)
Foreign	-0.009**	-0.009**	-0.009***	0.082***	0.086***	0.078***
	(0.004)	(0.004)	(0.004)	(0.025)	(0.025)	(0.024)
Foreign Intensity	0.021***	0.021***	0.020***	-0.044**	-0.040**	-0.050**
	(0.005)	(0.005)	(0.005)	(0.024)	(0.024)	(0.024)
NOL	0.004	0.004	0.004	0.031*	0.030*	0.031*
	(0.004)	(0.004)	(0.004)	(0.023)	(0.023)	(0.023)
APTS	0.139**	0.104*	0.130**	-0.717	-0.602	-0.393
	(0.075)	(0.073)	(0.077)	(1.170)	(1.204)	(1.186)
Cash	0.000	0.001	-0.007	0.215***	0.217***	0.208***
	(0.017)	(0.017)	(0.017)	(0.090)	(0.089)	(0.089)
Open UTB	0.000*	0.000***	0.000***	0.000**	0.000**	0.000
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
PCT AUDIT	0.001***	0.001***	0.001***	0.005***	0.005***	0.005***
	(0.000)	(0.000)	(0.000)	(0.001)	(0.001)	(0.001)
Constant	0.010	0.011	0.005	-0.486***	-0.501***	-0.506***
	(0.013)	(0.013)	(0.013)	(0.077)	(0.077)	(0.077)
Industry Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Observations	3,612	3,612	3,612	3,222	3,222	3,222
Adjusted R-squared	20.9%	20.9%	21.6%	14.9%	15.5%	15.0%

***, **, * Represent statistical significance at $p < 0.01$, $p < 0.05$, and $p < 0.10$, one-tailed. Robust standard errors are presented in parentheses.

Table 3 presents the results of estimating Model (1) to test H2. Columns (1)-(3) present OLS results on the variable *IRS Exposure*. Columns (4)-(6) present OLS results on the variable *Tax Monitor*. The variables of interest are *Contract Percentage, D10 Reliance,* and *High Reliance,* where a positive (negative) coefficient represents higher (lower) levels of tax monitoring. All variables are defined in Appendix A.

Table 4. Joint effect of political visibility and political vulnerability on IRS scrutiny

VARIABLES	(1) IRS Exposure	(2) Tax Monitor	(3) IRS Exposure	(4) Tax Monitor
Political Sensitivity	0.025*	0.349**		
	(0.016)	(0.155)		
Political Sensitivity 2			0.002**	0.016**
			(0.001)	(0.008)
CETR	-0.002	-0.128***	-0.002	-0.128***
	(0.007)	(0.048)	(0.007)	(0.048)
Size	0.010***	0.056***	0.010***	0.056***
	(0.002)	(0.014)	(0.002)	(0.014)
Market Value	-0.004**	-0.025***	-0.004**	-0.025***
	(0.002)	(0.011)	(0.002)	(0.011)
Leverage	0.004	-0.012	0.005	-0.012
	(0.004)	(0.051)	(0.004)	(0.051)
Capital Intensity	-0.015	-0.115	-0.016	-0.114
	(0.015)	(0.097)	(0.015)	(0.097)
Inventory Intensity	-0.052***	-0.164	-0.051***	-0.164
	(0.019)	(0.133)	(0.019)	(0.133)
R&D Intensity	-0.001	0.048**	0.000	0.047**
	(0.002)	(0.025)	(0.002)	(0.025)
Intangibles	0.006	0.038	0.005	0.038
	(0.008)	(0.042)	(0.008)	(0.042)
ROA	0.002	-0.189**	0.004*	-0.188**
	(0.003)	(0.088)	(0.003)	(0.088)
Foreign	-0.009**	0.082***	-0.009**	0.082***
	(0.004)	(0.025)	(0.004)	(0.025)
Foreign Intensity	0.021***	-0.044**	0.021***	-0.044**
	(0.005)	(0.024)	(0.005)	(0.024)
NOL	0.004	0.031*	0.004	0.031*
	(0.004)	(0.023)	(0.004)	(0.023)
APTS	0.100*	-0.712	0.126**	-0.719
	(0.074)	(1.197)	(0.074)	(1.178)
Cash	0.000	0.216***	0.000	0.217***
	(0.017)	(0.0894)	(0.017)	(0.089)
Open UTB	0.000***	0.000	0.000***	0.000**
	(0.000)	(0.000)	(0.000)	(0.000)
PCT AUDIT	0.001***	0.005***	0.001***	0.005***
	(0.000)	(0.001)	(0.000)	(0.001)
Constant	0.011	-0.485***	0.011	-0.485***
	(0.013)	(0.077)	(0.013)	(0.077)
Industry Fixed Effects	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes
Observations	3,612	3,222	3,612	3,222
Adjusted R-squared	20.9%	14.9%	16.1%	14.7%

***, **, * Represent statistical significance at $p < 0.01$, $p < 0.05$, and $p < 0.10$, one-tailed. Robust standard errors are presented in parentheses.

Table 4 presents the results of estimating Model (2), which examines the potential moderating effect of the interaction between political visibility and political vulnerability. A positive (negative) coefficient represents higher (lower) levels of tax monitoring. All variables are defined in Appendix A.

Table 5. Reconciliation with Mills et al. (2013)

		Before 2009	After 2009
	(1)	(2)	(3)
VARIABLES	Federal ETR	Federal ETR	Federal ETR
Political Sensitivity	0.044*	0.089*	0.003
	(0.032)	(0.057)	(0.033)
Centered IRS Exposure	0.005	0.004	0.021
	(0.024)	(0.037)	(0.032)
Political Sensitivity * Centered IRS Exposure	1.185***	1.172**	0.985*
	(0.472)	(0.621)	(0.694)
Size	0.008***	0.009***	0.005***
	(0.002)	(0.002)	(0.002)
Leverage	-0.085***	-0.078***	-0.062***
	(0.015)	(0.019)	(0.017)
Capital Intensity	-0.085***	-0.005	-0.111***
	(0.020)	(0.027)	(0.025)
Inventory Intensity	0.041*	0.088**	0.074**
	(0.030)	(0.040)	(0.041)
R&D Intensity	0.013	0.231***	0.001
	(0.014)	(0.064)	(0.007)
Intangibles	0.033***	-0.003	0.042***
	(0.009)	(0.014)	(0.012)
ROA	0.152***	0.148***	0.191***
	(0.029)	(0.036)	(0.041)
Foreign	-0.046***	-0.049***	-0.037***
	(0.007)	(0.010)	(0.009)
Foreign Intensity	-0.101***	-0.119***	-0.099***
	(0.008)	(0.014)	(0.010)
NOL	-0.022***	-0.036***	-0.021***
	(0.005)	(0.007)	(0.006)
Constant	0.210***	0.210***	0.184***
	(0.013)	(0.018)	(0.017)
Industry Fixed Effects	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes
Observations	14,447	7,429	7,018
Adjusted R-squared	20.7%	12.7%	20.1%

***, **, * Represent statistical significance at $p < 0.01$, $p < 0.05$, and $p < 0.10$, one-tailed. Robust standard errors are presented in parentheses.

Table 6 presents the results of estimating Model (4). The variables of interest are *Political Sensitivity*, defined as the interaction between *High Visibility* and *Contract Percentage*, *Centered IRS Exposure*, and the interaction term. A positive (negative) coefficient represents higher (lower) Federal ETRs, related to lower (higher) levels of tax aggressiveness. All variables are defined in Appendix A.

Table 6. Political visibility, political vulnerability, and exposure to other federal government agencies

VARIABLES	(1) SEC Exposure	(2) DOJ Exposure	(3) DOL Exposure	(4) SEC Exposure	(5) DOJ Exposure	(6) DOL Exposure
Log Contract Visibility	-0.001**	0.001***	-0.019***			
	(0.001)	(0.000)	(0.006)			
Contract Percentage				-0.318***	-0.042***	-0.300
				(0.060)	(0.013)	(0.268)
CETR	0.0452**	-0.003	0.682***	0.0482**	-0.002	0.674***
	(0.0230)	(0.009)	(0.250)	(0.0230)	(0.009)	(0.250)
Size	-0.018**	0.009***	0.191***	-0.020***	0.009***	0.185***
	(0.009)	(0.003)	(0.063)	(0.008)	(0.003)	(0.063)
Market Value	0.018***	-0.001	0.067*	0.018***	-0.001	0.066*
	(0.006)	(0.003)	(0.047)	(0.006)	(0.003)	(0.047)
Leverage	0.045	0.001	0.002	0.023	-0.002	-0.014
	(0.0351)	(0.00374)	(0.128)	(0.0319)	(0.00393)	(0.135)
Capital Intensity	-0.262***	-0.0215	-0.903**	-0.244***	-0.019	-0.894**
	(0.0501)	(0.0235)	(0.466)	(0.0489)	(0.024)	(0.470)
Inventory Intensity	0.0975*	0.0261**	-2.743***	0.0818	0.027**	-2.848***
	(0.0643)	(0.0139)	(0.433)	(0.0641)	(0.014)	(0.438)
R&D Intensity	0.013	-0.008***	0.119**	0.009	-0.009***	0.134**
	(0.017)	(0.003)	(0.056)	(0.016)	(0.003)	(0.059)
Intangibles	-0.043**	0.015***	-1.068***	-0.040**	0.016***	-1.092***
	(0.024)	(0.005)	(0.217)	(0.024)	(0.005)	(0.218)
ROA	-0.076***	-0.003	-0.022	-0.108***	-0.008***	-0.032
	(0.029)	(0.002)	(0.072)	(0.025)	(0.003)	(0.084)
Foreign	-0.016	-0.034***	-0.062	-0.019	-0.034***	-0.053
	(0.015)	(0.00773)	(0.101)	(0.0154)	(0.008)	(0.102)
Foreign Intensity	-0.015	-0.003	-0.329***	-0.018	-0.003	-0.345***
	(0.015)	(0.00528)	(0.125)	(0.0146)	(0.00526)	(0.125)
NOL	-0.026**	-0.012**	-0.408***	-0.027**	-0.012**	-0.414***
	(0.013)	(0.006)	(0.145)	(0.013)	(0.006)	(0.147)
APTS	0.490	0.028	2.172**	0.161	-0.030	2.244**
	(0.838)	(0.0448)	(1.147)	(0.785)	(0.0453)	(1.265)
Cash	-0.113**	0.0175**	-1.951***	-0.102**	0.023**	-2.035***
	(0.0500)	(0.010)	(0.362)	(0.050)	(0.010)	(0.359)
Open UTB	0.000***	0.000	0.000	0.000	0.000***	0.000
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
PCT AUDIT	0.000	0.000	-0.023***	0.000	0.000	-0.022***
	(0.001)	(0.000)	(0.005)	(0.001)	(0.000)	(0.005)
Constant	0.488***	-0.004	0.971***	0.498***	0.001	0.883***
	(0.043)	(0.009)	(0.297)	(0.042)	(0.009)	(0.291)
Industry Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Observations	3,612	3,612	3,612	3,612	3,612	3,612
Adjusted R-squared	24.7%	30.8%	13.7%	25.2%	30.8%	13.4%

***, **, * Represent statistical significance at $p < 0.01$, $p < 0.05$, and $p < 0.10$, one-tailed. Robust standard errors are presented in parentheses.

Table 6 (continued). Political visibility, political vulnerability, and exposure to other federal government agencies

VARIABLES	(7) SEC Exposure	(8) DOJ Exposure	(9) DOL Exposure	(4) SEC Exposure	(5) DOJ Exposure	(6) DOL Exposure
Political Sensitivity	-0.170***	-0.048***	-0.455*			
	(0.052)	(0.015)	(0.278)			
Political Sensitivity 2				-0.015***	-0.022*	-0.002***
				(0.003)	(0.014)	(0.001)
CETR	0.046**	-0.002	0.674***	0.048**	0.675***	-0.002
	(0.023)	(0.009)	(0.249)	(0.023)	(0.250)	(0.009)
Size	-0.019**	0.009***	0.187***	-0.019**	0.186***	0.009***
	(0.009)	(0.003)	(0.063)	(0.009)	(0.063)	(0.003)
Market Value	0.044	0.001	0.004	0.018***	0.066*	-0.001
	(0.036)	(0.004)	(0.129)	(0.006)	(0.047)	(0.003)
Leverage	-0.258***	-0.020	-0.900**	0.030	-0.015	-0.001
	(0.050)	(0.023)	(0.466)	(0.033)	(0.133)	(0.004)
Capital Intensity	0.091*	0.029**	-2.841***	-0.247***	-0.889**	-0.019
	(0.064)	(0.014)	(0.437)	(0.049)	(0.469)	(0.024)
Inventory Intensity	0.013	-0.008***	0.137***	0.084*	-2.851***	0.028**
	(0.017)	(0.003)	(0.058)	(0.064)	(0.438)	(0.014)
R&D Intensity	-0.044**	0.016***	-1.092***	0.010	0.133**	-0.009***
	(0.024)	(0.005)	(0.219)	(0.016)	(0.058)	(0.003)
Intangibles	-0.075***	-0.003*	-0.001	-0.041**	-1.091***	0.016***
	(0.030)	(0.002)	(0.073)	(0.024)	(0.218)	(0.005)
ROA	-0.017	-0.034***	-0.054	-0.097***	-0.033	-0.007***
	(0.015)	(0.008)	(0.102)	(0.027)	(0.079)	(0.003)
Foreign	-0.017	-0.003	-0.347***	-0.018	-0.054	-0.034***
	(0.015)	(0.005)	(0.125)	(0.015)	(0.102)	(0.008)
Foreign Intensity	-0.026**	-0.012**	-0.412***	-0.018	-0.346***	-0.003
	(0.013)	(0.006)	(0.147)	(0.0146)	(0.125)	(0.005)
NOL	0.518	0.018	2.587**	-0.026**	-0.414***	-0.012**
	(0.846)	(0.043)	(1.197)	(0.013)	(0.147)	(0.006)
APTS	-0.109**	0.023***	-2.026***	0.276	2.225**	-0.020
	(0.050)	(0.010)	(0.359)	(0.802)	(1.237)	(0.044)
Cash	0.000***	0.000*	0.000	-0.105**	-2.030***	0.022**
	(0.000)	(0.000)	(0.000)	(0.050)	(0.359)	(0.010)
Open UTB	0.017***	-0.001	0.065*	0.000**	0.000	0.000***
	(0.006)	(0.003)	(0.047)	(0.000)	(0.000)	(0.000)
PCT AUDIT	0.000	0.000	-0.022***	0.000	-0.022***	0.000
	(0.001)	(0.000)	(0.005)	(0.001)	(0.005)	(0.000)
Constant	0.486***	0.000	0.879***	0.493***	0.884***	0.001
	(0.0423)	(0.009)	(0.289)	(0.042)	(0.291)	(0.009)
Industry Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Observations	3,612	3,612	3,612	3,612	3,612	3,612
Adjusted R-squared	24.8%	30.8%	13.4%	25.1%	13.4%	30.8%

***, **, * Represent statistical significance at $p < 0.01$, $p < 0.05$, and $p < 0.10$, one-tailed. Robust standard errors are presented in parentheses. Table 6 presents the results of estimating Model (1), replacing the dependent variable with exposure to the Department of Justice, Department of Labor, and the Securities and Exchange Commission. A positive (negative) coefficient represents higher (lower) levels of exposure to the given agency. All variables are defined in Appendix A.

Appendix A. Variable Definitions

Variable Name	Variable Definition	Data Source
Tax Monitoring		
IRS Exposure	A text-based measure from Armstrong et al. (2025) equal to the number of 10-K sentences that mention the IRS and an enforcement-related action term (for example, audit, examination, investigation, compliance), scaled by the total number of sentences in the 10-K.	See Armstrong et al. (2025)
Tax Monitor	Calculated as the sum of settlements with the tax authority (TXTUBSETTLE) net of decreases related to statute of limitations expirations (TXTUBSOFLIMIT) in years t−3 through t, scaled by the UTB balance at the beginning of year t−3 (TXTUBBEGIN)	Compustat; see Finley and Stekelberg (2022)
Political Visibility		
Log Contract Visibility	Log of the total government contracts awarded from year t-2 to t	SAM Database
Large Government Contractor	Indicator variable coded one if the firm is awarded a three-year total contract revenues above the industry-year median and zero otherwise	SAM Database
High Visibility	Indicator variable coded one if the firm is awarded a three-year sum of contract revenues in the top two deciles by year and zero otherwise	SAM Database
Political Vulnerability		
Contract Percentage	Three-year sum of total contract dollars, scaled by the three-year sum of revenues (REVT)	SAM Database and Compustat
High Reliance	Indicator variable coded one if *Contract Percentage* is above the industry-year median and zero otherwise	SAM Database
D10 Reliance	Indicator variable coded one if *Log Contract Percentage* is in the top decile by industry-year and zero otherwise	SAM Database
Control Variables		
Size	Three-year average of the log of total assets (AT)	Compustat
Market Value	Three-year average of a firm's market value (PRCC_F * CSHO)	Compustat
R&D Intensity	Three-year average of a firm's research and development expenditures, scaled by revenues (XRD/REVT)	Compustat
Capital Intensity	Three-year average of a firm's capital assets, scaled by total assets (PPEGT/AT)	Compustat
Inventory Intensity	Three-year average of a firm's total inventory, scaled by total assets (INVT/AT)	Compustat
Intangibles	Three-year average of a firm's total intangible assets, scaled by total assets (INTAN/AT)	Compustat

Leverage	Three-year average of a firm's total debt, scaled by total assets (DLTT/AT)	Compustat
NOL	Indicator variable coded one if a firm reports a net operating loss carryforward in any of the previous three years, and zero otherwise (TLCF)	Compustat
Return on Assets	Three-year average of a firm's total pretax income, scaled by total assets (PI/AT)	Compustat
Foreign	Indicator variable coded one if a firm reports foreign activity in the past three years, and zero otherwise	Compustat
Foreign Intensity	Three-year average of a firms total foreign pretax income, scaled by pretax income (PIFO / PI)	Compustat
APTS	Three-year average of total fees for auditor-provided tax services, scaled by total audit fees	Audit Analytics
Cash	Three-year average of cash, scaled by assets (CHE/AT)	Compustat
Open UTB	Three-year average of open UTBs, scaled by assets (TXTUBBEGIN – TXTUBPOSPDEC – TXTUBSETTLE – TXTUBSOFLIMIT) / AT	Compustat
PCT AUDIT	Percentage of tax returns audited by the IRS by size and year	IRS Data Book
CETR	Taxes paid (TXPD) scaled by pretax income (PI), winsorized between 0 and 1	Compustat
Variables for Additional Analyses		
Federal ETR	Three-year average of domestic tax expense, scaled by pretax income (TXFED/PI)	Compustat
Political Sensitivity	Combination of visibility and vulnerability constructs; measured as the interaction of *High Visibility* and *Contract Percentage*	SAM Database and Compustat; see Mills et al. (2013)
Political Sensitivity 2	Combination of visibility and vulnerability constructs; measured as the interaction of *Log Contract Visibility* and *Contract Percentage*	SAM Database and Compustat
Centered IRS Exposure	*IRS Exposure*, demeaned by the annual average for contractors	See Armstrong et al. (2025)
DOJ Exposure	A text-based measure from Armstrong et al. (2025) equal to the number of 10-K sentences that mention the Department of Justice and an enforcement-related action term, scaled by the total number of sentences in the 10-K.	See Armstrong et al. (2025)
DOL Exposure	A text-based measure from Armstrong et al. (2025) equal to the number of 10-K sentences that mention the Department of Labor and an enforcement-related action term, scaled by the total number of sentences in the 10-K.	See Armstrong et al. (2025)

SEC Exposure	A text-based measure from Armstrong et al. (2025) equal to the number of 10-K sentences that mention the Securities and Exchange Commission and an enforcement-related action term, scaled by the total number of sentences in the 10-K.	See Armstrong et al. (2025)