Decomposing Book–Tax Differences: Evidence On Temporary And Permanent Components And Earnings Management In An Emerging Market

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Abstract

Prior research commonly relies on aggregate book–tax differences (BTDs) as a proxy for earnings management. However, this approach implicitly assumes that all BTD components reflect similar underlying economic behaviors, potentially masking important differences between temporary and permanent BTDs. This study addresses this limitation by examining whether temporary and permanent BTDs exhibit distinct associations with accrual-based earnings management. Drawing on agency theory and positive accounting theory, we argue that these components capture different managerial incentives and reporting behaviors, thereby leading to differential relationships with earnings management.

Using a sample of non-financial firms listed on the Stock Exchange of Thailand over the period 2015–2024, this study employed firm fixed-effects panel regressions to investigate the association between BTD components and absolute discretionary accruals, as measured by the Modified Jones Model with ROA control. Temporary and permanent BTDs were scaled by beginning total assets, and standard errors were clustered at the firm level to address heteroskedasticity. The empirical findings revealed that permanent BTDs were positively and significantly associated with earnings management, whereas temporary BTDs exhibited no significant relationship. These findings suggest that permanent accounting–tax differences may capture structural features or persistent reporting choices that are more closely related to earnings management behavior, while temporary differences do not necessarily reflect discretionary accrual manipulation. Overall, the findings highlight the importance of disaggregating BTDs to enhance their interpretability and avoid misleading inferences drawn from aggregate measures. This study contributes to the literature by providing evidence that the economic content of BTDs varies across components and by offering a more nuanced understanding of how accounting–tax disparities relate to earnings management.

Keywords: *Book–Tax Differences (BTD), Temporary BTD, Permanent BTD, Earnings Management, Discretionary Accruals, Emerging Market*

1. Introduction and Literature Review

In the context of contemporary financial reporting, the increasing complexity of business structures, together with the continuous development of accounting standards, has led to a growing divergence between accounting earnings reported to shareholders and taxable income used as the base for corporate income tax calculated under statutory rules. This divergence, commonly referred to as book–tax differences (BTDs), has attracted substantial attention from researchers, regulators, and financial statement users, as it raises concerns regarding the transparency and economic substance of reported earnings. Since the 1990s, empirical evidence has documented a persistent increase in the magnitude of BTDs across jurisdictions, prompting questions about whether reported accounting earnings faithfully reflect firms' underlying economic performance (Hanlon & Heitzman, 2010). From an economic perspective, BTDs arise from the inherent nature of a dual reporting system with fundamentally different objectives. Financial accounting is designed to provide decision-useful information to investors by emphasizing relevance and faithful representation under the accrual basis, whereas tax accounting primarily aims to raise government revenue and promote tax equity through more prescriptive and rule-based standards. These structural differences create opportunities for managers to exercise discretion in financial reporting, potentially engaging in earnings management (EM) to

present more favorable accounting outcomes without a corresponding increase in current tax liabilities (Desai & Dharmapala, 2006).

From a theoretical perspective, Agency Theory and Positive Accounting Theory provide a useful framework for understanding the relationship between BTDs and earnings management. Agency Theory posits that managers, acting in their own interests, may exploit information asymmetry to engage in opportunistic reporting when monitoring is imperfect (Jensen & Meckling, 1976). Positive Accounting Theory further suggests that managers select accounting methods to maximize their utility under contractual and political constraints (Watts & Zimmerman, 1986). Within this framework, accounting–tax differences provide a channel through which managerial discretion can be exercised. Importantly, different components of BTDs may reflect different forms of discretion. Temporary differences, which are expected to reverse, may be more transparent and subject to external monitoring. In contrast, permanent differences are less likely to reverse and may embed more persistent reporting strategies, making them potentially more difficult for external users to detect.

Prior empirical research has largely examined earnings management as a determinant of BTDs, treating BTDs as an outcome of managerial behavior. For example, Phillips, Pincus, and Rego (2003) showed that firms engaging in earnings management exhibited larger book–tax differences, while Frank et al. (2009) documented a positive association between aggressive financial reporting and tax aggressiveness. Although these studies provide important insights, they implicitly assume a unidirectional relationship from earnings management to BTDs. This perspective overlooks the possibility that BTDs themselves may contain information about underlying reporting behavior. Emerging evidence suggests that BTDs were associated with earnings persistence and future performance, indicating that they may have informational value beyond being mere outcomes (Hanlon, 2005; Weber, 2009). Another key limitation in the existing literature is the predominant reliance on aggregate BTD measures. Aggregate BTD combines different sources of accounting–tax divergence, including discretionary accruals, tax planning strategies, and structural differences between accounting standards and tax regulations. As a result, treating BTD as a single summary measure may obscure important heterogeneity and lead to mixed empirical findings (Hanlon & Heitzman, 2010; Evers, Meier, & Spengel, 2017). To address this issue, recent studies suggest that decomposing BTD into its components—particularly temporary and permanent differences—can provide a more nuanced understanding of its economic meaning (Jackson, 2015; Blaylock, Gaertner, & Shevlin, 2012). Empirical evidence across diverse institutional settings consistently shows that decomposed BTDs provide richer and more precise information than aggregate measures. In particular, temporary BTDs are found to be more strongly associated with future pretax earnings changes, earnings persistence, and discretionary accrual behavior, while permanent BTDs are more closely related to tax expense dynamics and tax aggressiveness (Jackson, 2015; Addeh, 2016). Comparative studies further demonstrate that models incorporating decomposed BTDs outperform those relying solely on aggregate BTDs in explaining earnings quality, persistence, and reporting risk, especially in emerging markets where institutional monitoring and enforcement may be weaker (Chartady et al., 2023). Systematic reviews and meta-analytic evidence reinforce this conclusion, emphasizing that the informational content of BTDs is highly sensitive to measurement choices and that decomposition is essential for avoiding overly generalized interpretations of managerial opportunism (Evers et al., 2017). Taken together, the literature suggests that decomposing BTDs is not merely a methodological refinement, but a necessary step for uncovering the distinct channels through which accounting discretion and tax considerations jointly shape reported earnings. This study builds on this insight by explicitly examining the differential association between temporary and permanent BTDs and earnings management, thereby contributing to a more nuanced understanding of the economic meaning of book–tax differences.

In emerging markets such as Thailand, the issue of book–tax differences is particularly salient due to the institutional environment in which financial reporting and taxation coexist. Firms listed on the Stock Exchange of Thailand (SET) operate under Thai Financial Reporting Standards (TFRS), which are largely aligned with International Financial Reporting Standards (IFRS), while corporate income taxation is governed

by the Revenue Code, which emphasizes legal form, tax compliance, and revenue collection. This coexistence of IFRS-based financial reporting and rule-based tax regulations creates structural conditions conducive to accounting–tax divergence and managerial discretion. Prior empirical studies using Thai firm-level data provide consistent evidence that earnings management is a salient issue among firms listed on SET. Specifically, research documents that managers of Thai listed firms engaged in accrual-based earnings management in response to capital market incentives, debt contracting considerations, and regulatory pressures (Charoenwong & Jiraporn, 2009). Moreover, the prevalence of concentrated ownership structures and relatively weaker external monitoring mechanisms in Thailand has been shown to amplify managerial discretion in financial reporting, thereby increasing the scope for earnings manipulation (Claessens, Djankov, Fan, & Lang, 2002). Collectively, these institutional characteristics suggest that accounting discretion plays an important role in shaping reported earnings outcomes in the Thai capital market. Moreover, international studies that include Thailand as part of multi-country samples indicated that the magnitude and implications of book–tax differences vary systematically with institutional settings. For example, Atwood, Drake, and Myers (2010) showed that differences in book–tax conformity across countries, including Thailand, were associated with variations in earnings persistence and the informativeness of reported earnings. Their findings imply that book–tax differences in Thailand may embed distinct economic meanings relative to those observed in more developed capital markets. Despite this growing body of evidence, relatively limited research explicitly examines how different components of book–tax differences—temporary versus permanent—relate to earnings management behavior in the Thai context. Most existing studies rely on aggregate measures or focus on earnings management without directly linking it to the accounting–tax gap.

Against this backdrop, the present study examines whether the components of BTDs are differentially associated with earnings management. By decomposing BTDs into temporary BTDs (TemBTDs) and permanent BTDs (PerBTDs), this study aims to provide a more nuanced understanding of how accounting–tax differences relate to managerial reporting behavior. Specifically, the study investigates whether TemBTDs and PerBTDs exhibit distinct relationships with discretionary accrual-based earnings management. In doing so, this study seeks to clarify the economic meaning of BTD components and to demonstrate why reliance on aggregate BTD measures may mask important differences in underlying reporting incentives. In summary, this study goes beyond documenting an association between book–tax differences and earnings management by demonstrating that the economic meaning of BTDs critically depends on their underlying components.

2. Objectives of the Study

The primary objective of this study is to investigate whether decomposing book–tax differences (BTDs) into temporary and permanent components provides incremental insights into accrual-based earnings management beyond aggregate BTD measures.

3. Details

3.1 Population and Sample

This study employed a quantitative research approach using secondary data. The population consisted of firms listed on the Stock Exchange of Thailand (SET) for the period between 2015–2024. The sample was selected using purposive sampling by excluding financial firms, firms with fiscal years not ending on December 31, firms not continuously listed during the study period, and firms with incomplete data. The final sample comprised390 firms, yielding 3,900 firm-year observations.

3.2 Data Sources and Data Collection

Financial data were obtained from the LSEG (Refinitiv) database and firms' annual reports. The data included information necessary for measuring earnings management, book–tax differences, and control variables used in the empirical analysis.

3.3 Variable Measurement

Earnings management was proxied by accrual-based measures using discretionary accruals estimated from the Modified Jones Model with ROA control (Kothari et al., 2005). This approach is widely regarded as a benchmark in the earnings management literature, as it adjusts for firm performance and mitigates performance-related bias in accrual estimation. Compared to earlier models, the inclusion of ROA helps reduce the likelihood of misclassifying normal accruals as discretionary components. To capture the magnitude of managerial discretion regardless of direction, this study focuses on the level of earnings management rather than its directional intent (income-increasing or income-decreasing). Accordingly, the absolute value of discretionary accruals was used as the proxy for accrual-based earnings management. The main independent variables were temporary book–tax differences (TemBTD) and permanent book–tax differences (PerBTD)which were scaled by beginning total assets to ensure comparability across firms.

Various control variables were included to account for firm characteristics that may influence earnings management. These variables included firm size (SIZE), to capture political cost and monitoring effects; leverage (LEV), to reflect debt-related incentives for earnings management; cash holdings (CASH_H), to account for financial flexibility; and sales growth (SaleGrow) controls, to show the firm's performance and growth opportunities. These variables are commonly used in accounting literature and are expected to mitigate omitted variable bias.

4. Results

4.1 Descriptive Statistics

Table 1 shows the descriptive statistics for the main variables used in the analysis. The mean value of absolute discretionary accruals (absDA) was 0.069, with a median of 0.047, indicating a moderate level of earnings management across the sample. These magnitudes are comparable to those reported in prior earnings management studies using performance-matched accrual models (Kothari et al., 2005; Hanlon, 2005). The distribution of absDA exhibited moderate dispersion, reflecting substantial firm-level heterogeneity in discretionary reporting behavior. Regarding book–tax differences, temporary and permanent components displayed distinct distributional characteristics. Temporary BTDs exhibited a mean close to zero (0.008) and a relatively narrow interquartile range, suggesting that timing-related accounting–tax differences are generally small and less dispersed across firms. Likewise, the permanent BTDs also exhibited a mean close to zero but showed greater variation relative to temporary differences, as reflected in higher dispersion across percentiles. This pattern suggests that accounting–tax differences in the sample are more likely driven by persistent structural factors—such as tax incentives or permanent exclusions—rather than short-term timing adjustments; this result is also consistent with prior evidence that not all BTDs reflect discretionary behavior (Phillips et al., 2003; Blaylock et al., 2012). Firm-level control variables indicated that the sample consists of relatively large firms with moderate leverage and cash holdings. Sales growth displayed substantial variability, reflecting heterogeneous growth opportunities across firms. Overall, the descriptive statistics highlight meaningful cross-sectional variation in both earnings management and the components of book–tax differences, providing a suitable setting to examine their differential associations in the subsequent regression analysis.

Table 1 Descriptive Statistics (N = 3900)

	min	p25	mean	p50	p75	max	sd
Earnings Management:							
absDA	0.001	0.021	0.069	0.047	0.088	0.457	0.076
BTDs:							
TemBTD	-0.360	-0.046	0.008	-0.010	0.044	0.609	0.129
PerBTD	-0.395	-0.026	-0.001	0.005	0.035	0.215	0.081
ToBTD	-0.553	-0.061	0.007	-0.001	0.071	0.59	0.155
Controls:							
SIZE	13.013	14.615	15.694	15.457	16.485	20.249	1.537
LEV	0.000	0.067	0.265	0.252	0.433	0.715	0.205
CASH_H	0.000	0.020	0.080	0.049	0.102	0.497	0.092
SaleGrow	-0.643	-0.093	0.073	0.025	0.154	2.301	0.372

4.2 Correlation analysis

Table 2 presents the Pearson correlation coefficients among the main variables. Overall, the correlation matrix indicated moderate associations, suggesting no severe multicollinearity concerns. Absolute discretionary accruals (absDA) exhibited a small but statistically significant negative correlation with temporary book–tax differences, while the correlation with permanent book–tax differences was weak and statistically insignificant. These associations provide preliminary insights into how different components of book–tax differences are related to earnings management, although they should be interpreted with caution.

Firm size was negatively correlated with absDA, indicating that larger firms tend to exhibit lower levels of discretionary accruals. Cash holdings and sales growth showed positive correlations with absDA, suggesting that firms with higher liquidity and growth opportunities are associated with greater discretionary accrual activity. Leverage was not significantly correlated with absDA. With respect to the independent variables, temporary and permanent book–tax differences were not strongly correlated with each other, supporting the view that they capture distinct aspects of accounting–tax disparities. In addition, the variance inflation factor analysis suggests that multicollinearity is not a concern in the empirical models.

4.3 Regression Analysis

To test the hypotheses, this study estimates firm fixed-effects panel regressions[1] with year fixed effects, as specified in Equation (1). The dependent variable was absolute discretionary accruals, serving as a proxy for earnings management. The key independent variables were temporary and permanent book–tax differences, while firm size, leverage, cash holdings, and sales growth were included as control variables. Standard errors were clustered at the firm level.

[1] To formally assess the appropriateness of the model specification, Hausman's (1978) test was conducted to compare the fixed-effects and random-effects estimators. The results of the test reject the null hypothesis that the random-effects estimator is consistent, indicating that firm-specific effects are correlated with the explanatory variables. Accordingly, the fixed-effects model is preferred.

$$absDA_{i,t} = \alpha + \beta_1 TemBTD_{i,t} + \beta_2 PerBTD_{i,t} + \beta_3 SIZE_{i,t} + \beta_4 LEV_{i,t} + \beta_5 CASH\_H_{i,t} + \beta_6 SALE\_GR_{i,t} + \mu_i + \pi_t + \varepsilon_{i,t} (1)$$

Where:

$absDA_{i,t}$	=	Absolute discretionary accruals of firm *i* in year *t*, used as a proxy for earnings management.
$TemBTD_{i,t}$	=	Temporary book–tax differences of firm *i* in year *t*, measured as temporary differences between accounting income and taxable income, scaled by beginning total assets.
$PerBTD_{i,t}$	=	Permanent book–tax differences of firm *i* in year *t*, measured as permanent differences between accounting income and taxable income, scaled by beginning total assets.
$SIZE_{i,t}$	=	Firm size, measured as the natural logarithm of total assets of firm *i* in year *t*.
$LEV_{i,t}$	=	Leverage, measured as total liabilities divided by total assets of firm *i* in year *t*.
$CASH\_H_{i,t}$	=	Cash holdings, measured as cash and cash equivalents divided by total assets of firm *i* in year *t*.
$SALE\_GR_{i,t}$	=	Sales growth, measured as the annual percentage change in net sales of firm *i* from year *t−1* to year *t*.
μ_i	=	Firm fixed effects, capturing unobserved, time-invariant firm characteristics such as business model, reporting culture, or ownership structure.
π_t	=	Year fixed effects, controlling for common macroeconomic conditions, regulatory changes, and time-specific shocks affecting all firms in year *t*.
$\varepsilon_{i,t}$	=	Error term.

Note: All continuous variables were winsorized at the 1st and 99th percentiles to mitigate the influence of extreme observations.

Table 2 Correlation analysis

	absDA	TemBTD	PerBTD	ToBTD	SIZE	LEV	CASH_H	Sale_GR
absDA	1.000							
TemBTD	-0.052**	1.000						
PerBTD	-0.016	0.000	1.000					
ToBTD	-0.057***	0.824***	0.551***	1.000				
SIZE	-0.103***	0.114***	0.079***	0.142***	1.000			
LEV	0.001	-0.032*	-0.079***	-0.070***	0.446***	1.000		
CASH_H	0.068***	-0.130***	-0.023	-0.121***	-0.173***	-0.280***	1.000	
Sale_GR	0.073***	0.062***	0.241***	0.182***	0.045**	0.047**	-0.021	1.000
N	3900							

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

Table 3 shows the baseline fixed-effects regression results, examining the association between book–tax differences and discretionary earnings management. Model 1 employed decomposed book–tax differences, while Model 2 used the aggregate measure. In Model 1, the coefficient on temporary book–tax

differences (TemBTD) was negative but statistically insignificant (coef. = −0.005, p > 0.10), indicating no detectable association between timing-related accounting–tax differences and earnings management. In contrast, permanent book–tax differences (PerBTD) exhibited a positive and statistically significant association with earnings management (coef. = 0.035, p < 0.05), suggesting that firms with larger permanent accounting–tax differences tend to engage in higher levels of discretionary accruals. Although the coefficient appeared small in magnitude, it is economically meaningful given that the variables were scaled by total assets and discretionary accruals were typically small in absolute terms. To facilitate the economic interpretation of the regression results, Figure 1 plots the mean absolute discretionary accruals across quartiles of permanent book–tax differences.

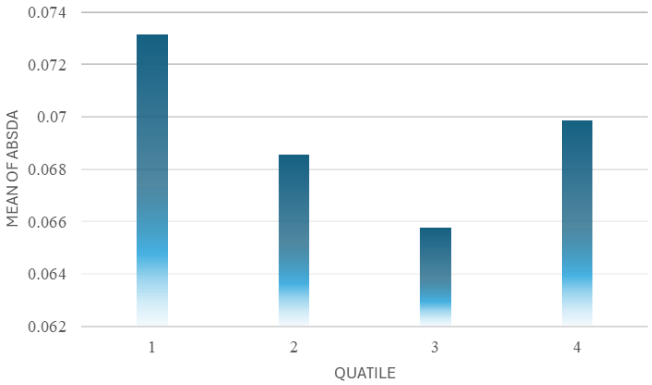

Figure 1. Mean Absolute Discretionary Accruals by Permanent Book–Tax Difference Quartiles

Table 3 Regression Analysis

	AbsDA	**AbsDA**
	Model 1 Decomposed BTD	Model 2 Aggregate BTD
Key measures of BTD:		
TemBTD	-0.005	
	(0.021)	
PerBTD	0.035**	
	(0.017)	
Additional measure of BTD:		
ToBTD		0.017
		(0.013)
Control Variables:		
SIZE	-0.015**	-0.015**
	(0.007)	(0.007)
LEV	-0.001	-0.001
	(0.017)	(0.017)
CASH_H	0.004	0.004
	(0.023)	(0.023)
Sale_GR	0.008	0.009*
	(0.005)	(0.005)

Constant	0.299***	0.306***
	(0.109)	(0.107)
adj. R^2	0.008	0.007
F	1.703	1.462
N	3869	3869

Standard errors in parentheses
* p<0.1, ** p<0.05, *** p<0.01

Figure 1 is constructed by grouping firms into quartiles based on permanent book–tax differences and plotting the mean absolute discretionary accruals for each group. It provides an intuitive illustration of the regression results by showing that earnings management intensity differs across levels of permanent book–tax differences. Although the pattern is not strictly monotonic, firms with extreme levels of PerBTD—both low and high—exhibited higher mean discretionary accruals than firms in the middle quartiles. This visual evidence suggests that PerBTD was systematically related to earnings management, and this is consistent with the positive association documented in the regression analysis.

In Model 2, where the decomposed measures were replaced with aggregate book–tax differences (ToBTD), the coefficient on aggregate BTDs was positive but statistically insignificant (coef. = 0.017, $p > 0.10$). This result indicates that using an aggregate BTD measure masks the underlying heterogeneity across components and fails to capture the differential relationship observed in the decomposed specification. Together, these results highlight the importance of decomposing book–tax differences to enhance their economic interpretability.

Regarding control variables, firm size was negatively and significantly associated with earnings management in both models (coef. = −0.015, $p < 0.05$), suggesting that larger firms exhibit lower discretionary accrual activity. Sales growth was positively related to earnings management and was marginally significant in the aggregate BTD model (coef. = 0.009, $p < 0.10$). Leverage and cash holdings did not display statistically significant associations with earnings management across specifications.

To further assess whether the effects of temporary and permanent book–tax differences differ statistically, a Wald test was conducted. The test failed to reject the null hypothesis that the coefficients on TemBTD and PerBTD are equal ($F = 2.54$, $p = 0.111$). While the difference in coefficients was not statistically significant, the regression results consistently show that only permanent book–tax differences were significantly associated with earnings management, underscoring their greater relevance in explaining discretionary reporting behavior. However, the relatively low adjusted R^2 is consistent with prior studies on accrual-based earnings management, where discretionary accruals were subject to substantial estimation error and were inherently noisy, reflecting both discretionary and nondiscretionary components (Dechow et al., 1995; McNichols, 2002; Dechow & Dichev, 2002). In addition, prior research highlighted that discretionary accrual measures were closely related to firm performance, necessitating performance adjustments such as the Kothari et al. (2005) model, further indicating the limited explanatory power of these proxies.

4.4 Discussion

This study investigates the relationship between book–tax differences and earnings management by decomposing total book–tax differences into their temporary and permanent components. The empirical evidence yields several important insights. First, permanent book–tax differences (PerBTD) exhibited a positive and statistically significant association with earnings management, whereas temporary book–tax differences (TemBTD) did not show a significant relationship. Second, when book–tax differences were measured in aggregate form, the association with earnings management became statistically insignificant, indicating that aggregation obscures economically meaningful heterogeneity across components.

The finding that PerBTD was positively associated with discretionary accruals is particularly noteworthy, as it contrasts with the conventional view that temporary differences are more closely linked to accrual-based earnings management due to their timing-related nature. One plausible interpretation is that PerBTD captures more persistent reporting strategies rather than short-term timing discretion. Prior studies

emphasize that book–tax differences represent an aggregate construct combining heterogeneous sources, including tax planning activities, financial reporting choices, and structural divergences between accounting and tax rules (Hanlon, 2005; Desai & Dharmapala, 2006; Hanlon & Heitzman, 2010). In this context, permanent differences—such as non-deductible expenses, tax-exempt income, and long-term tax incentives—may systematically reflect managerial reporting behavior that unfolds over longer horizons, thereby exhibiting a stronger association with earnings management. This interpretation is consistent with evidence suggesting that aggressive financial reporting and tax-related strategies often coexist as part of broader managerial incentives rather than isolated or transitory actions. Frank, Lynch, and Rego (2009), for example, documented that firms engaging in aggressive financial reporting were also more likely to pursue aggressive tax strategies, implying that permanent accounting–tax differences may embed sustained opportunistic behavior rather than purely mechanical tax effects. Similarly, Wilson (2009) postulated that certain tax-related strategies were persistent in nature and closely linked to managerial discretion, lending further support to the view that PerBTDs convey economically meaningful information about reporting incentives. In contrast, the absence of a significant association between TemBTD and earnings management suggests that timing-related accounting–tax differences do not necessarily translate into higher discretionary accruals in the Thai setting. This finding aligns with arguments that not all accounting discretion embedded in temporary differences is opportunistic. Temporary differences may arise from legitimate accrual processes, regulatory constraints, or enforcement mechanisms that limit managers' ability to exploit short-term timing adjustments (Phillips et al., 2003; Blaylock et al., 2012). As such, TemBTDs may capture accounting–tax mismatches that are largely mechanical or reversible, rather than reflecting sustained managerial manipulation of reported earnings. An additional implication of these findings is that book–tax differences, particularly permanent components, may function as informative signals of underlying earnings management behavior. Rather than being viewed solely as outcomes of managerial actions, BTDs can provide observable indicators that help infer the presence of accrual-based earnings management. This perspective complements prior literature that predominantly treats earnings management as a determinant of BTDs, and suggests that disaggregated BTD measures may have predictive or signaling value in identifying firms with higher levels of managerial discretion.

From an agency perspective, these findings highlight an important distinction between the two components of book–tax differences. While temporary differences are expected to reverse over time and may therefore be more transparent to external monitors, permanent differences are less likely to reverse and may be more difficult for investors, auditors, and regulators to disentangle. This lower reversibility and transparency potentially make permanent differences a more effective channel for sustained earnings management behavior. Consequently, PerBTDs may better reflect managerial discretion exercised within the accounting–tax interface when agency conflicts are present. Importantly, the comparison between decomposed and aggregate specifications underscores a key methodological implication of this study. The insignificant coefficient on aggregate book–tax differences mirrors prior evidence that reliance on a single BTD measure may mask the underlying economic mechanisms linking accounting–tax gaps to financial reporting outcomes (Hanlon & Heitzman, 2010). In contrast, decomposing BTDs allows for a clearer interpretation of how distinct components relate to earnings management, reinforcing calls to move beyond aggregate proxies when examining opportunistic reporting behavior. Taken together, these findings are broadly consistent with the predictions of Agency Theory and Positive Accounting Theory, which posit that managers exploit discretion embedded in accounting and tax systems when incentives and institutional conditions permit (Jensen & Meckling, 1976; Watts & Zimmerman, 1986). In the context of firms listed on the Stock Exchange of Thailand, permanent accounting–tax differences appear to be more informative about earnings management behavior than temporary differences. This evidence highlights the importance of institutional settings in shaping the economic meaning of book–tax differences and suggests that researchers and practitioners should exercise caution when interpreting aggregate BTD measures. More broadly, the results underscore the value of decomposing accounting–tax gaps to better understand the channels through which managerial discretion manifests in reported earnings.

5. Contributions

This study makes several contributions to accounting literature. First, it contributes to the book–tax differences literature by demonstrating that the economic meaning of BTDs critically depends on their underlying components. While prior studies frequently employ aggregate BTD measures, this study provides evidence that such aggregation may mask heterogeneous effects and lead to inconclusive inferences regarding earnings management behavior (Hanlon, 2005; Hanlon & Heitzman, 2010).

Second, the study extends the earnings management literature by showing that permanent book–tax differences, rather than temporary differences, are more strongly associated with discretionary accruals. This finding challenges the conventional emphasis on timing-related differences and suggests that long-term reporting strategies embedded in permanent differences warrant greater attention, particularly in emerging market settings.

Third, this study extends prior literature by proposing that book–tax differences—particularly their permanent components—can serve as informative signals of underlying earnings management behavior. This perspective shifts the role of BTDs from being treated solely as outcomes of managerial actions to observable indicators that may help identify firms with higher levels of reporting discretion.

Fourth, this study provides novel evidence from an emerging market setting. Unlike developed markets, Thailand is characterized by distinct institutional features, including IFRS-based financial reporting, rule-based taxation, and concentrated ownership structures. These features may influence the way accounting–tax differences are generated and interpreted. By providing evidence from this context, the study enhances the external validity of the BTD literature and responds to calls for more international evidence (Atwood et al., 2010).

Finally, the findings have practical implications for investors, regulators, and standard setters. The findings suggest that users of financial statements should exercise caution when interpreting aggregate book–tax differences and consider the underlying components to better assess earnings quality. In particular, permanent differences may warrant closer scrutiny as potential indicators of sustained earnings management behavior. For regulators and standard setters, the study highlights the importance of understanding how institutional features and reporting incentives interact to influence managerial behavior.

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