
Firm Characteristics and Corporate Tax Aggressiveness: A Synthesis of Literature

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ABSTRACT

Corporate tax aggressiveness, or the aggressive actions by companies to lower their tax burdens, is among the most popular topics in corporate taxation studies. The prevalence of corporate tax aggressiveness has caused substantial losses to countries and deprived millions of much needed public amenities. Therefore, it is crucial to understand the factors influencing corporate propensity to be tax aggressive, principally those that are intrinsic within the companies themselves. In response, this paper synthesizes existing published literature for elements affecting companies' propensity to be tax aggressive. It finds that among the firm characteristics, firm size, debt intensity, capital intensity, inventory intensity, growth rate, and profitability do have some impact on the level of corporate tax aggressiveness.

JEL Classification: H20; H25.

Keywords: Corporate Taxation; Tax Aggressiveness; Firm Characteristics.

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1. INTRODUCTION

There exist extensive studies on taxation covering a multitude of disciplines from accounting to economics, finance, and law¹. Among the most popular topic is corporate tax compliance, or the lack of it. Corporate tax aggressiveness has become a focal point in tax studies, and its impacts on the equality and efficiency of tax system necessitate a profound understanding, especially on its enormity and nature (Hanlon, & Heitzman, 2010). Insights into the extents, components, and outcomes of corporate tax aggressiveness are crucial as most countries critically depend on tax revenues to fund their societal and governmental duties³. Companies' aggressive practices to reduce their taxes, or their tax aggressiveness, have led to substantial losses for the countries implicated and consequently deprived millions who could have benefited from the much-needed public sustenances (Sikka, 2010). Therefore, it is essential especially for policymakers and tax authorities to understand what influences companies to be tax aggressive in order to prevent further loss which jeopardizes the society's wellbeing. Our aim herein is to synthesize the literature related to corporat tax aggressiveness in order to identify the factors which influence corporate tax aggressive tendency.

Of the various studies that have tried to ascertain and assess elements affecting corporate tax aggressiveness, their results have suggested that in general, firm characteristics play a central role in influencing corporate tax aggressiveness. In the next sections, this paper discusses in detail on how aspects of firm characteristics influence companies' tendency to be tax aggressive.

2. FIRM CHARACTERISTICS AND CORPORATE TAX AGGRESSIVENESS

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The impacts of firm characteristics on companies' tax aggressive tendency have always been a core research area. As these characteristics form the fundamental make-up of companies, they are essential in determining how the companies treat their taxes. Among the firm characteristics which influence corporate tax aggressiveness are firm size, debt intensity, capital intensity, inventory intensity, growth rate, and profitability.

2.1 Firm Size

There are two distinct views on how firm size influences corporate tax aggressiveness.

The first view obeys the political cost theory, which postulates that larger companies have to endure higher political costs as they are subject to the more stringent regulatory as well as public scrutiny. As large companies in general have to pay more taxes than smaller companies, the considerable attentions from the government and the public alike dampen the companies' opportunity to successfully engage in tax aggressive behaviors for fear of official sanctions and public backlashes⁶⁻⁸. Consequently, they are less tax aggressive than small companies. This situation has been statistically observed in several studies on companies from the developed and developing economies (Noor et al., 2010).

The second opinion meanwhile suggests that large companies possess much better prospect to successfully employ aggressive tax tactics. Owing to their size, large companies normally own considerable means which enable them to arrange their activities in order to achieve optimal savings on their typically substantial tax expense. Consequently, they have higher motivation and greater scope to be tax aggressive. Therefore, these companies are more tax aggressive as compared to small firms, which a number of studies had statistically observed (Richardson et al., 2013).

2.2 Debt Intensity

Debt intensity, or leverage, represents the usage of debt by a company to finance its assets. A highly leveraged company has significantly more debt than equity financing. As interest expense is one of the expenditures that are tax deductible, a company with substantial debt has higher tax deduction amounts, and hence lower taxes¹⁸. Meanwhile, dividend payouts for equity holders are not tax deductible, providing companies no tax deduction whatsoever. Consequently, tax aggressive companies tend to choose debt over equity financing as to gain from the tax-saving effects of interest expense. Studies had provided consistent empirical support on this reasoning (Lanis, & Richardson, 2015). This scenario is also well presented by Apple Inc.'s dividend financing decision in 2013. Instead of repatriating its foreign-sourced earnings back to the United States, Apple chose to borrow the amount needed. The decision has allowed it to save up to USD9.2 billion in taxes, and at the same time enabled it to enjoy the tax-saving effect from the ensuing interest it has incurred (Lanis, & Richardson, 2012).

2.3 Capital Intensity

Capital intensity refers to a company's degree of fixed assets investment. A capital intensive company invests more heavily in its fixed assets. In a similar vein as debt intensity, most studies concluded that capital intensity had significantly increased corporate tax aggressiveness level (Mahenthiran, & Kasipillai, 2012). Studies on Western companies had linked this situation to the higher accelerated depreciation tax deductions that companies with more fixed assets had been enjoying. Such tax advantage gives the companies the opportunity to organize their capital structure decisions into an efficient tax aggressive mechanism (Hoi et al., 2013). In contrast, studies on Malaysian companies had attributed their findings to capital allowances provided for plants and buildings that the companies had been using in their operations. In Malaysia, there is no tax deduction for depreciation expense as it is not a cash outflow. Thus, capital intensive companies are entitled to higher capital allowance claims, which further decrease their taxable income. Again, this tax benefit provides companies the opportunity to be tax aggressive through their capital investment structure (Graham et al., 2014).

2.4 Inventory Intensity

Inventory intensity refers to the level of inventory that a company maintains. An inventory intensive company constantly keeps a high level of inventory on hand for its operations. As a rule, inventories have no tax benefit; only expenses related to their purchases are eligible for tax deduction as part of the operational costs. Consequently, inventory possesses no tax shield effect as compared to fixed assets. Thus, studies had surmised that contrary to capital intensive companies, inventory intensive companies had been far less tax aggressive (Christensen, & Murphy, 2004).

2.5 Growth Rate

In general, the managers of a rapidly growing company are highly pressured to maintain an appearance of corporate stability, especially during periods of economic decline. Subsequently, there exists a greater compulsion for them to engage in non-compliant activities to project the image of financial stability, which very well may include aggressive tax measures. Since companies occupy a vital position in the national economic development, it is natural for governments to provide such growing companies with added and improved tax benefits to spur their expansions. As a result, these companies are better able to manipulate the incentives given and thus become more tax aggressive. Contrary to the above reasoning, growing companies typically perform well and as such are more profitable. Consequently, they attract more probing public scrutiny which restricts them from being tax aggressive (Jenkins, & Newell, 2013). There are mixed observations as to how the companies' growth rate affects their tax aggressiveness levels. A majority of the studies had found that there had been an insignificant relationship between corporate growth rate and the tax aggressiveness level. Nevertheless, several studies did find that companies with higher growth rate were significantly less tax aggressive. In contrast, Lanis and Richardson observed that companies with higher growth rate were significantly more tax aggressive, providing statistical support that these companies' managers were more easily succumbed to non-compliant activities, among them tax aggressive mechanisms (Lanis, & Richardson, 2015).

2.6 Profitability

Profitability has always been the key element in corporate tax aggressiveness studies. In harmony with the progressive tax structure, companies earning more profit have to pay more income taxes. Besides, by being profitable, these companies tend to draw more intense public scrutiny. It causes them to find it hard to be tax aggressive without facing harmful criticisms and injunctions from the public as well as the government. Several studies on Western companies had concurred with this argument (Hanlon, & Heitzman, 2010). On the other hand, profitable companies in Malaysia have been found to be more tax aggressive. Hoi et al., (2013) attributed to the profusion of tax subsidies under the Malaysian industrial policy. Subsequent studies supported their view and further suggested that these companies had been possessing sufficient resources to arrange their operations as to take advantage of all the tax incentives and measures available towards lowering their tax burdens (Richardson et al., 2013).

3. CONCLUSION

Indeed, tax revenues are a country's élan vital. Yet, globalization threatens the country's ability to fully attain its tax revenues, particularly its sizable corporate income taxes collection. Faster capital and operation flows across geographical borders and escalating "tax wars" among countries striving for foreign investments have put developing economies at risk of losing their corporate tax revenues. Their conditions are even more precarious as they are heavily reliant on corporate taxes, and they are powerless to raise their tax rates due to the ongoing fierce tax competitions. As it is an irrefutable fact that governments use their tax revenues to provide public goods and services, corporate tax payments are a perfect example of companies' commitment towards the betterment of society. Even with companies around the world professing their dedications towards the principles of corporate social responsibility (CSR), a majority of them still see taxes as an expense to be minimized, instead of as societal contributions. Such tax aggressive attitude causes countries involved to suffer huge revenue losses and disrupts the provisions of essential public amenities to the deprived citizens⁵. Therefore, it is highly imperative for us to understand the factors influencing corporate tax aggressiveness as it is a matter that affects all of us as citizens and taxpayers in the countries we reside.

Based on the review of literatures, this paper suggests for more empirical studies on the effects of firm characteristics on corporate tax aggressiveness level. As majority of these studies had used data up to 2010, this paper proposes for empirical studies to use more recent data to reflect the current state of corporate tax aggressiveness practice, especially during the ongoing period of economic instability. Furthermore, this paper also suggests for more studies on companies operating in developing economies such as Asian and African countries. These countries are most heavily dependent on their tax revenues, thus the results from future studies will be of help to their governments in forming proper and timely actions in curbing such losses. Besides, with the advent of CSR in today's business world, it is hard for a company to not proclaim its support towards fulfilling its social responsibility. In view of this, prospective studies should delve into how companies' involvements in CSR activities influence their tendency to be tax aggressive.

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APPENDIX

Table 1 . Summary of Empirical Studies Reviewed

Study	Sample and Period of Study	Methodology
[6]	Non-financial companies listed in Bursa Malaysia from 1993 to 2000.	Multivariate regression analysis.
[7]	Companies listed in Bursa Malaysia from 2000 to 2004.	Longitudinal analyses using pooled ordinary least square (OLS), fixed effects, and random effects techniques.
[9]	456 companies on the S&P500 in 2005 with data from 1996 to 2005.	Multivariate regression using system general method of moments (GMM) estimator.
[10]	Companies listed in Kuala Lumpur Stock Exchange (KLSE) (now known as Bursa Malaysia) from 1990 to 1999.	Multiple regression analysis.
[11]	Companies listed in KLSE (now known as Bursa Malaysia) from 1990 to 1999.	Longitudinal analysis using random effects technique.
[12]	Companies listed in the Main Market of Bursa Malaysia from 2005 to 2008.	Multivariate regression analysis.
[13]	Non-financial companies listed in the United States for each year from 1992 to 2009.	Longitudinal analysis using fixed effects technique.
[14]	Non-financial companies listed in the Main Market of Bursa Malaysia from 2007 to 2010.	Multivariate regression analysis.
[15]	203 public listed Australian firms from 2006 to 2009.	Logit regression analysis.
[16]	217 tax avoidant firm-year observations and 217 non-tax avoidant firm-year observations from KLD database from 2003 to 2009.	Logit regression analysis.
[21]	Public listed Australian companies in Aspect Financial Database with data from 1997 to 2003, with the exclusion of year 2000, being a transitional year for tax reform.	t-test on the coefficient sums and pooled cross-sectional OLS regression analysis.
[22]	408 public listed companies in Australia for financial year 2008/2009.	Tobit regression analysis.
[25]	Companies listed in Bursa Malaysia from 2006 to 2008.	Multiple regression and two-stage least square analyses.
[26]	U.S. public companies from 2003 to 2009.	Logit and OLS regression analyses.
[27]	Company-specific data in PACAP database for five countries, i.e. Hong Kong (1979 – 1992), Korea (1980 - 1992), Malaysia (1977 - 1992), Taiwan (1975 – 1992), and Thailand (1975 – 1992).	Time series analysis and multiple regression analysis.
[28]	A choice-based sample of 32 companies listed in Australian Stock Exchange of which 16 has been accused as tax aggressive by Australian Tax Office (ATO) from 2001 to 2006.	Logit regression analysis.
[29]	Survey responses from 595 corporate tax executives working in American companies.	Multivariate regression analysis.

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