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Political Status and Tax Haven Investment of Emerging Market Firms: Evidence from China

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Abstract

Tax haven investment has become an increasingly important topic in business ethics. Given the considerable tax haven investments from emerging market firms, understanding how home-country institutions shape their investments in tax havens is theoretically intriguing and practically crucial. By integrating resource dependence and institutional theories, we hypothesize the existence of a negative relationship between firms' home-country political status and tax haven investment. State-owned enterprises (SOEs) controlled by the central government dominate the political hierarchy. Compared with other types of enterprises, central SOEs receive the strongest institutional support and are the most prone to institutional oversight, thereby exhibiting the weakest tendency to invest in tax havens. This top group is followed by SOEs controlled by local governments, politically connected private firms, and private firms without political connections. These groups exhibit an increasing tendency to invest in overseas tax havens. The empirical analysis of Chinese listed firms during 2003–2013 supports our hypotheses. This research contributes to the business ethics literature by identifying institutional drivers of overseas tax haven investment by emerging market firms, thereby adding to the ethical debate on international tax avoidance.

Keywords Tax avoidance · Tax haven · Political status · Resource dependence theory · Institutional theory · Emerging market · China

Introduction

Recent years have witnessed the burgeoning investments of emerging market firms into tax havens (Akamah et al. 2018; Gokalp et al. 2017; Morck et al. 2008; OECD 2017). Tax havens refer to destinations attracting overseas capital through low tax rates (Dharmapala and Hines 2009; Fung et al. 2011; Gravelle 2009; Hines and Rice 1994). According to Angel Gurría, the Secretary-General of the Organisation for Economic Co-operation and Development (OECD), the loss of tax revenues among developing economies is estimated to be three times higher than the international financial aid they receive (Bearak 2016), as the governments of those economies have limited capability to tackle complicated tax haven activities (UNCTAD 2015, pp. 198–212). The OECD, G20, and the United Nations have taken or called for actions to tackle base erosion and profit shifting (BEPS), which aims to rebuild international tax transparency and restore fair competition ground (OECD 2018; United Nations 2016a, b).[1]

Due to the aforementioned severe tax losses worldwide, the potential antecedents of tax haven investment are worth exploring. To that end, our study examines how home-country institutions in emerging economies shape the corporate propensity to invest in overseas tax havens. We concentrate on one of the essential institutional factors, the political

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[1] The annual consequent corporate income tax loss is estimated to be roughly USD100–240 billion, which is equivalent to 4–10% of the global corporate income taxes (OECD 2017). In June 2018, 115 countries have joined the OECD/G20 multilateral coordination framework, representing 95% of global GDP (OECD 2018).

status of emerging market firms, and investigate its effect on tax avoidance behavior. Emerging economies typically follow a political hierarchical pattern in allocating key resources (Waldmeir and MacNamara 2010) to firms with various political statuses (i.e., relative importance in a political system). For example, state-owned enterprises (SOEs) receive more favorable treatments (e.g., preferential taxes) than private enterprises (Blau et al. 2013; Huang 2003). We argue that the discriminatory institutional environment in the home market motivates emerging market firms with low political status to invest in tax havens (Boisot and Meyer 2015; Buckley et al. 2015; Fung et al. 2011).

Integrating resource dependence and institutional theories, we explore why and how political hierarchy shapes tax haven investments from emerging market firms. Specifically, we expect private firms that lack political connections to have the strongest tendency to engage in tax haven investment because of the greatest power disadvantages compared to their competitors. Private firms are followed by politically connected private firms, SOEs administered by local governments, and SOEs supervised directly by the central government. We also hypothesize that the effects of the political status will be weakened when market liberalization increases in the subnational regions where focal firms are located. Empirical tests based on Chinese firms support our hypotheses.

Three primary contributions emerge from this study. First, we extend the boundaries of tax avoidance research by situating it in an emerging market context. This study is among the first attempts to examine the mechanisms through which the home country's political and institutional conditions drive tax haven investments. Second, this study enriches ongoing debates on the ethicality of international tax avoidance. It presents evidence from an emerging market that features strong government intervention and a heavy tax burden. Third, this work identifies how the heterogeneity among different firm types affects tax haven investment. Therefore, it enriches the institutional elements in the associated business ethics discussion. In terms of policies on curbing tax avoidance, the findings of this study suggest that researchers and policymakers move beyond the black-and-white mindset on tax haven investment. Instead, they need to look further at the home country's institutional and political inclusiveness.

Theoretical Background

International Tax Avoidance and Tax Haven Investment

Allured by lower overall global taxation and stronger competitiveness, multinational enterprises (MNEs) can employ various approaches to fulfill international tax avoidance objectives (Contractor 2016; Gravelle 2009). Deferral of foreign affiliate income serves as an obvious regulatory loophole. Certain countries, including the US, adopt the worldwide regime, which regards foreign incomes as taxable (Markle 2016). However, it allows MNEs to delay the liability on additional taxes until foreign earnings are repatriated back to the home country. The funds are put in tax havens for reinvestment (Klassen and Laplante 2012). Another common practice among firms is related to intra-MNE transactions. Some firms manipulate transfer price to redistribute profits within a business group (Gravelle 2009). The share of the intangible asset increases the propensity for tax avoidance because tax auditors have difficulty judging the reasonableness of transfer price (Dyreng and Lindsey 2009). Moreover, some MNEs use royalty payments as a tax-planning strategy. During the transfer of patents or brands within business groups, the licensor can charge royalties to other affiliates (Sikka 2016). Royalty payments are deductible, and thus would reduce the tax burden of the licensee in high-tax rate countries. Some firms support subsidiaries in high-tax rate countries to adopt a debt approach for earning stripping (Hines and Rice 1994). The low-taxed affiliates offer loans to those with higher tax rates, which would result in the reduction of the overall tax liabilities within MNEs (Grubert 1998). Parent overheads and costs allocation is also a huge concern for tax regulators (Al Karaawy and Al Baaj 2018). For example, human resources management expenditure occurs worldwide and logically has to be charged to each foreign affiliation. However, MNEs tend to allocate a larger slice to affiliates in high-tax rate countries. Shell companies with no economic activities act as a bridge for round-tripping and tax avoidance purposes too (Chari and Acikgoz 2016). A typical example is Chinese outbound investments, which returns to the mainland for preferential tax policies by utilizing the foreign identity. Finally, inversion occurs when MNEs shift the headquarters to low-tax rate countries (Gravelle 2009).

Tax haven investment, as a carrier of international tax avoidance, constitutes a considerable share of OFDI from emerging markets (Buckley et al. 2015). MNEs take advantage of the loose financial disclosure requirements of tax havens to reduce supervision from their home (Chari and Acikgoz 2016). According to the internalization theory of MNEs, emerging market firms internalize the benefits of tax haven investment and reduce their transaction costs, thereby achieving regulatory or institutional arbitrage (Boisot and Meyer 2015; Buckley et al. 2015). Tax havens have been subject to severe controversy and criticism among international organizations, politicians, and the media. Therefore, MNEs performing tax haven activities aggregate their geographic disclosure (Akamah et al. 2018).

International tax avoidance behavior is not unique to private firms from emerging markets. SOEs are also frequent users of this toolkit because they are increasingly becoming MNEs in the global marketplace. Approximately 56% of state-controlled MNEs come from developing and transitioning economies (UNCTAD 2011). Multinational SOEs employ various instruments, such as tax haven investment, to enhance their global competency (He et al. 2016a). SOEs need preferential taxation to counterbalance ideological resistance triggered by their political attributes (Meyer et al. 2014). Moreover, some home-country government agencies would silently approve tax avoidance and sacrifice short-term taxation for the long-term development of the state capitalism model in the global economy. For instance, China's "Belt and Road" initiative expects SOEs to act as leaders (Zhong 2017). Such an expectation propels the government to grant additional global tax-planning freedom among SOEs. Therefore, SOEs in the shipping industry, such as COSCO Shipping, have followed the international routine and registered many single-purpose vehicles in tax havens.

Political Status of Emerging Market Firms

During institutional transitions in emerging economies, firms are located in different positions in the domestic political hierarchy (Bhatt et al. 2018) as manifested by salient SOE privileges over private firms (Blau et al. 2013). Traditionally, SOEs have mostly contributed to fiscal revenues and served considerable public and social functions (Ralston et al. 2006). SOEs benefit from preferential access to financial capitals and favorable tax treatments. Therefore, they have been at the top of political hierarchy. Nonetheless, heterogeneous political status exists even among SOEs (Li et al. 2014). Central SOEs, which are directly supervised by the central/federal government, play crucial roles in nationwide strategic sectors, such as petroleum, electricity, and postal services. They function as the agents of the central government, acting directly on behalf of the state. By contrast, the local SOEs directly supervised by subnational governments serve the interests of the local government and society. While central SOEs are largely country-level policy instruments, local SOEs are primarily committed to local or regional social welfare (Boisot and Meyer 2015). The coexistence of central and local SOEs is widely observed in emerging economies, such as China, India, Indonesia, Malaysia, South Africa, and Vietnam (Li et al. 2014, p. 985). Local SOEs do not possess the same level of political status as central SOEs. Such a political hierarchy between local and central SOEs is evident in various aspects, such as preferential tax treatments, land use, and market access (Li et al. 2014).

Private firms also exhibit salient heterogeneity in their political status (Blau et al. 2013; Deng et al. 2018; Sun et al. 2015). Such firms usually face significant liability of privacy due to lack of legitimacy (Bhanji and Oxley 2013). Therefore, some private players strategically construct political connections to alleviate such a liability. First, political ties improve firms' political legitimacy. These ties help firms receive exclusive government endorsements and favorable treatments. Previous research has confirmed that politically connected firms acquire timely government bailouts, such as credits, during financial crisis (Blau et al. 2013; Faccio 2006; Khwaja and Mian 2005). Second, the government employs lax evaluation criteria for firms with political connections when reviewing merger proposals (Brockman et al. 2013). Third, the government may offer special tax deductions and loose regulation policies among politically connected firms, thereby reducing their tax burden (Adhikari et al. 2006; Wu et al. 2012, 2013). Private enterprises that lack political connections are situated at the bottom of the political hierarchy. These firms receive limited, if any, political and institutional support. However, they are not under close scrutiny by political actors because of their low status. Thus, they have more strategic discretion than other types of firms.

Resource Dependence Logic of OFDI

Resource dependence theory underlines the dependency of firms on their external environment, which refrains firms from making fully independent decisions (Pfeffer and Salancik 1978). Asymmetry exists when interdependency is unequally indispensable for both parties (Pfeffer and Salancik 1978). The extent to which an organization depends on an external actor is jointly determined by the value of resources (e.g., magnitude and criticality), discretion over resource usage, and alternative resources (Pfeffer and Salancik 1978). Actors who possess such resources can exert control over focal firms due to imbalanced power distribution. In emerging markets, the business–government exchanges usually exhibit imbalanced interdependency because of the relatively tight control of the government on strategic resources (Choudhury and Khanna 2014).

Pfeffer and Slancik (1978) identified a generic strategic response to power imbalance, namely, avoidance. By internationally diversifying resources via foreign direct investments, such as international mergers, acquisitions, or joint ventures, firms do not need to rely heavily on limited extant exchange partners in their home market, thereby alleviating power imbalance. OFDI is considered an effective avoidance strategy, particularly when firms are in disadvantageous position and heavily constrained by the domestic market in their home country (Boddewyn and Brewer 1994; Choudhury and Khanna 2014; Deng et al. 2018; Lu et al. 2014; Witt and Lewin 2007). However, the resource dependence

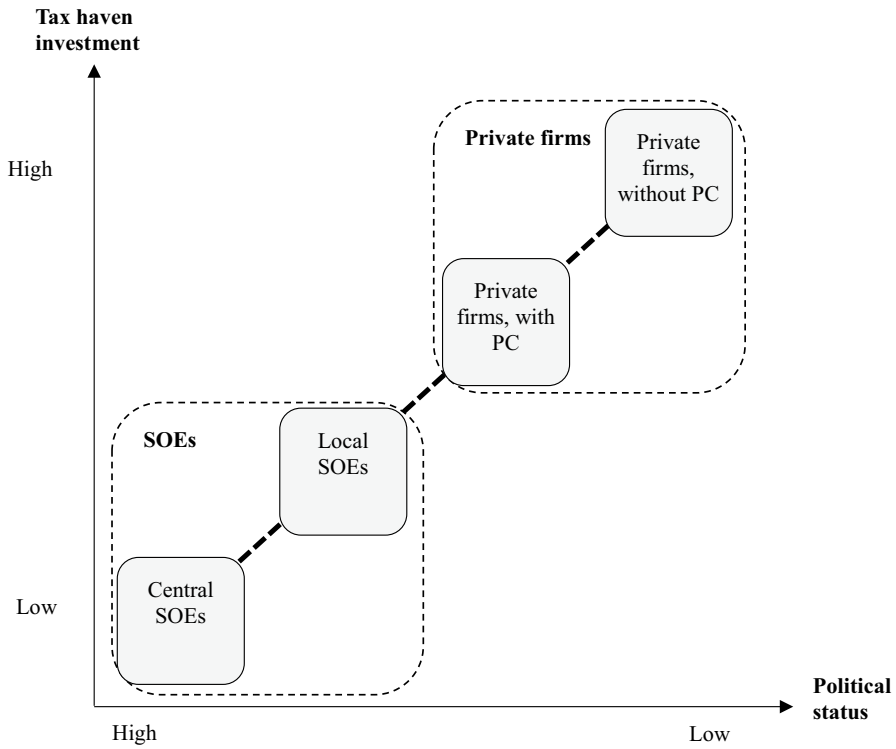

Fig. 1 Political status and tax haven investment. "PC" refers to "political connection"

Note: "PC" refers to "political connection".

antecedents of OFDI have not been examined fully from an institutional theory perspective.

Hypotheses

The political status of emerging market firms results in the different degrees of resource dependence and thus different commitments of tax haven investment (Fig. 1). We classify emerging market firms into four types, namely, (a) central SOEs, (b) local SOEs, (c) private firms with political connections, and (d) private firms without political connections. We initially compare tax haven investment between general SOEs and general private firms. Thereafter, we compare central SOEs with local SOEs and politically connected firms with unconnected firms.

SOEs Versus Private Firms

From the resource dependence and institutional perspectives, two forms of power interdependency play pivotal roles in determining the relationship between political hierarchy and tax haven investment.

First, heterogeneous interdependency exists between the state and firms at the different levels of political hierarchy. Emerging market firms operate in an environment with powerful state presence (Hoskisson et al. 2000). In such an environment, the state exerts strong control over legislation and regulations on almost all the major aspects of business activities, such as market access, land use, and bank loans. The state presence forms a power imbalance between firms and the government (Emerson 1962). Although SOEs have experienced the privatization reform since the late 1970s, they still serve as the agents of state capitalism, benefiting from an absolutely high political status in acquiring strategic resources (Li et al. 2014; Poncet et al. 2010), for example, preferential access to bank financing and industrial policies (Xu et al. 2013). Therefore, SOEs must repay the political favor by fulfilling their corporate social responsibilities and by being responsive to government calls (He et al. 2016a), such as tax revenue contribution.

SOEs must act as "role models" for other corporate citizens. Tax revenue is crucial for the government to operate in emerging markets, where they maintain powerful intervention. The state ensures the compliance of SOEs in tax contribution given that the government may directly dismiss top executives and appoint obedient ones to manage SOEs. Additionally, the OECD, G20, and United Nations are now continuing to focus on issues concerning BEPS (OECD 2018; United Nations 2016b). Thus, SOEs are less likely to conduct investments in tax havens for the sake of their home countries' international reputation. The Chinese government has been pursuing great leadership in

the global taxation coordination (State Administration of Taxation of China 2016). Since its first double tax treaty with Japan signed in 1983, China has signed treaties with 101 countries in 2015 to ensure tax transparency. China also signed taxation intelligence exchange agreements with ten tax jurisdictions[2] by 2010 (State Administration of Taxation of China 2018). SOEs face a dilemmatic situation in tax planning. On the one hand, the pressure from the State-owned Assets Supervision and Administration Commission to expand the global influence of state capitalism is mounting (Zhong 2017). Therefore, SOEs must adopt global tax planning to enhance their international competency. On the other hand, SOEs are refrained to do so by the global taxation commitment of the State Administration of Taxation. By contrast, private firms do not have to shoulder such strong political obligations in taxation. Hence, they have a greater degree of freedom to perform tax haven investment compared with other firms.

Second, the competitive interdependency between SOEs and private firms arises when firms provide similar products or share the same input market (Lu et al. 2014; Pfeffer and Salancik 1978). The government prioritizes the hierarchical allocations of resources among firms with different political statuses (Huang 2003). Hence, private firms are in a relatively disadvantageous position when competing for strategic resources (Lu et al. 2014). Given the environmental constraints in the home country, tax haven investment may be employed by firms as an avoidance strategy to diversify their sources of tax benefits (Choudhury and Khanna 2014; Lu et al. 2014; Witt and Lewin 2007).

In most cases, the marginal benefit exceeds the marginal costs involved in tax avoidance. Admittedly, international tax avoidance behavior involves various costs and potential risks, such as tax-consulting fees paid to the Big Four accounting firms (Marriage 2018), reputation damage caused by negative media coverage (Marriage 2017), and penalty for potentially illegal tax evasion in the tightened global tax coordination against the BEPS (OECD 2017; United Nations 2016b). Nonetheless, the economic benefit associated with tax haven investment is enormous, including the saved after-tax profits of tax haven investment and consequent financial advantages relative to their market competitors. Given the overwhelmingly higher net benefit perceived by the private firms vis-à-vis SOEs, as well as the institutional discrimination against private firms, the private firms will be more strongly motivated to invest in tax haven investment compared with SOEs.

Hypothesis 1a (H1a) Private firms exhibit higher commitments to tax haven investment than SOEs.

Central Versus Local SOEs

Central and local SOEs experience two forms of power interdependency, which leads to the heterogeneous degrees of tendency to engage in tax haven investment. First, the distinct levels of power interdependency between the state and SOEs serve as a motive for tax haven investment. Central SOEs are closely connected to the center of the political system and fulfill the political purposes for national interests, whereas local SOEs are administered by local governments to achieve local public objectives and generate local tax revenues (Boisot and Meyer 2015). Moreover, the appointment of top management teams in central SOEs is controlled by the central government, whereas that in local SOEs is controlled by the local government (Li et al. 2014). The central government treats the two types of SOEs differently due to their different sociopolitical functions. While central SOEs have easy access to the central government's policy and financial resources (e.g., large amount of loans from state-owned banks), they experience considerable pressures to fulfill social objectives, such as tax revenue contribution. The pressure transmitted from the State Administration of Taxation to the central SOEs will be immediate. Therefore, central SOEs must plan their taxation carefully to avoid apparent violation of the internationally agreed taxation treaties and reputation damage in the international community.

Unlike central SOEs, local SOEs are expected to contribute to the GDP growth and fiscal income of their local supervisory governments. The outcome of political tournaments among local government chiefs is based not only on their political conformity, but also on the performance of local economies (Lü and Landry 2014). Therefore, a delicate symbiotic relationship exists between the local government and local SOEs. Tax haven investment shrinks local taxation income. However, the reduced tax burden may stimulate additional investment and increased GDP growth, which may temporarily enhance the performance portfolio of local government officials (Liu et al. 2006). Moreover, the pressure from the international tax treaties could be substantially buffered due to the long oversight distance between the top of national taxation authority and locally supervised SOEs caused by administrative and fiscal decentralization (Li et al. 2014).

Second, the power imbalance between central and local SOEs stimulates the latter to resort to tax havens. As relatively autonomous economic entities, local SOEs are sheltered by their local governments in terms of their taxation obligation, priority in local market access, loans from local state-owned banks, preferential land use, and technological subsidies (Li et al. 2014, p. 990). However, the central

[2] They include Bahamas, British Virgin Islands, Isle of Man, Guernsey, Jersey, Bermuda, Argentina, Cayman Islands, San Marino, and Liechtenstein.

government offers additional privileges to central SOEs nationwide compared with local SOEs (Wang et al. 2012). These privileges include enormous bank loans, exponentially large infrastructure projects, and massive mergers and acquisitions of competitors facilitated by government intervention and coordination. The development of local SOEs outside the jurisdiction of their supervisory government is subject to strong competition from central SOEs and other local SOEs. In sum, the power imbalance imposed by the central SOEs strengthens local SOEs' commitment to conduct tax haven investment.

Hypothesis 1b (H1b) Local SOEs exhibit higher commitment to tax haven investment than central SOEs.

Politically Connected Private Firms Versus Unconnected Firms

First, politically connected firms depend on the government for special resources. This dependence obliges the private firms to pay relatively high taxes to the government. Private firms may strategically build political connections with the state to improve their political status (Poncet et al. 2010). Politically connected private firms possess easy access to policy information and political legitimacy, which brings key resources, such as fiscal subsidy and government bailouts (Faccio 2006). Moreover, politically connected firms receive tax benefits; thus, their effective tax rate is low (Adhikari et al. 2006; Wu et al. 2012). Politically connected private firms must shoulder substantial social responsibilities in the home market, such as fiscal revenue contribution. By contrast, unconnected firms do not benefit from the government's preferential treatments (Khwaja and Mian 2005); therefore, they experience a relatively high degree of freedom in tax planning.

Second, the competitive interdependency between the two types of private enterprises is also characterized as power imbalance. Politically connected private firms possess strong relationship-based capabilities to acquire access to home market resources and financial support (Lu et al. 2014; Wang et al. 2012). Well-established political networks serve as stepping stones to the power center, which improves firms' bargaining power and reduces environmental constraints (Mellahi et al. 2016; Sun et al. 2012). In terms of taxation, the government provides privileges to politically connected private firms as a compensation for undertaking certain public obligations. These privileges will strengthen the competitive power imbalance between connected and unconnected firms. Therefore, private firms that lack political connections will seek alternative strategies, such as international tax planning, to reduce their financial burden.

Hypothesis 1c (H1c) Unconnected private firms exhibit higher commitments to tax haven investment than politically connected private firms.

Moderating Role of Home Market Liberalization

Market liberalization is a scenario widely observed in emerging markets where the government opens the economic system to market power and private investors. Emerging markets exhibit salient variation across subnational regions (Ma et al. 2013; Sun et al. 2018). In Mexico, the time it takes to start a new business varies from 5 days in the most liberalized region to 48 days in the least liberalized region (World Bank 2016b, p. 23). During that privatization process, the allocation power of key resources, such as capital, land, and labor, will be shifted from the government to the private sector (Deng et al. 2017; Park et al. 2006). With reduced state intervention, the two types of resource interdependency between the government and competitors will be reduced.

First, market liberalization weakens the institutional dependency between the state and firms by reducing the government's control over key resources. In regions with abated state intervention, the government only has limited authority in policy manipulation (Li et al. 2014). SOEs should exit—to a great extent—from competitive sectors, such as textile and electronics, but stay in strategic sectors, such as aerospace technologies (Park et al. 2006). Along with market liberalization, the emergence and legitimation of private ownership challenge the ideological supremacy of SOEs (Xu et al. 2014). Therefore, the state provides reduced protection among SOEs in terms of market access and resource allocation. Consequently, the obligation of SOEs in liberalized subnational regions to pay full taxes to their home market governments to trade for a powerful political shelter will be reduced. Private firms in liberalized regions also find themselves in a friendly business environment; therefore, the role of non-market strategies in acquiring favorable political treatments is substantially weakened (Guillén 2000). The weak institutional dependency private firms on the state will drive them to formulate tax haven plans.

Second, the power imbalance among competitors will be alleviated when firms are in a relatively fair competitive environment with limited state intervention. During market liberalization, the state decentralizes responsibilities that previously belong to the government to ensure the efficiency and sustainability of the economy. A liberalized market offers a level-playing field to firms, regardless of ownership, to engage in business activities primarily based on their resource capabilities (Chinn and Ito 2006). A firm will be less discriminated in strategic resources and market entry. The competitive interdependency among firms with different political hierarchies will be weakened. Accordingly, the

power imbalance among firms will be relatively low. Therefore, firms with low political status exhibit low propensity in tax haven investment if they are located in regions with a high degree of market liberalization.

Hypothesis 2 (H2) Home market liberalization mitigates the relationship between political status and tax haven investment.

Empirical Design

Sample and Data

Our sample comprises indigenous Chinese publicly listed firms from 2003 to 2013. China is appropriate for investigating the influence of political hierarchy. The Chinese government still exercises strong control over the market, and private sectors face institutional discrimination unevenly across different subnational regions (Bhatt et al. 2018; Fan et al. 2007). In addition, China is the 12th economy with the highest overall corporate income tax burden (World Bank 2016a). OFDI flows increased after China joined the World Trade Organization in 2001. Thus, Chinese firms have gradually become capable of manipulating their global investment portfolio to minimize tax burden. The average host-country tax rate of Chinese OFDI gradually decreased from 42.6% in 2005 to 33.6% in 2013, as suggested by the data from the World Bank and Ministry of Commerce of China. We confine the research sample to indigenous Chinese firms and exclude those partially owned by foreign investors, since the latter possess natural advantages in tax manipulations in overseas markets. The start year of the sampling is appropriate given that Chinese private enterprises were prohibited from conducting OFDI prior to 2003 (Buckley et al. 2007). The aggregate OFDI value (912 billion USD) from Chinese investors from 2007 to 2016 was ranked third, next to the US (3180 billion USD) and Japan (1101 billion USD) (UNCTAD 2017). Nonetheless, as a newcomer to the international investment coordination, the Chinese government lacks experience in tackling tax haven activities, which leaves Chinese investors a de facto lax policy environment.

We merge firm-level data on listed firms from three primary sources. First, the OFDI dataset from the Ministry of Commerce of China provides the names of investing firms, year, and destinations. Second, we obtain the demographic and financial data of listed firms from the CSMAR database (Lu et al. 2014; Wu et al. 2012). Listed firms are subject to relatively close observation from investors and supervision from independent media (Kanagaretnam et al. 2018); therefore, they would carefully weigh the cost and benefits before making a strategic decision on tax haven investment. Third, we utilize WIND database to measure the political hierarchy among the firms. This dataset covers relatively complete resumes, especially the previous work experience of top executives and board members. The details of the variables will be discussed in the following section. We confine the sample firms to those with at least one OFDI during the sample period. The total size of our sample is 770 listed firms. We utilize these panel data to investigate the influence of the political hierarchy on tax haven investment.

Table 1 Distribution of Chinese OFDI projects to tax havens

Destination	Time, number (%)			
	2003–2008		2009–2013	
	Number	%	Number	%
Barbados	0	0	3	0.6
Bermuda	2	2.4	0	0
British Virgin Islands	5	5.9	18	3.5
Cayman Islands	2	2.4	2	0.4
Hong Kong	68	80	416	80.6
Luxembourg	0	0	6	1.2
Macau	4	4.7	6	1.2
Mauritius	0	0	3	0.6
Singapore	4	4.7	56	10.9
Switzerland	0	0	5	1
Vanuatu	0	0	1	0.2
Total	85	100	516	100

Dependent Variable

Following the literature, we posit that the OFDI in tax havens intends to reduce the global overall tax burdens (Dyreng and Lindsey 2009). We adopt a broad list of tax havens that is employed by Gravelle (2009) and Galaz et al. (2018). That list includes all tax havens in Hines et al. (1994) and OECD (2000), as well as Costa Rica, Mauritius and San Marino. By analyzing the OFDI dataset, we affirm that the number of tax haven investments accounts for 40% of all OFDI projects during the same period.[3] Hong Kong (80.5%), Singapore (10.0%), the British Virgin Islands (3.8%), and Macau (1.7%) are the top four destinations, accounting for 95% of the total number of tax haven investment projects from 2003 to 2013. Table 1 reports the distribution of Chinese OFDI projects among tax havens.

Bordering the Chinese Mainland, Hong Kong has been the most adjacent and important tax haven among Chinese

[3] All historical Chinese OFDI in tax havens accounted for nearly 78% of the value of all Chinese OFDI during 1980–2016. Hong Kong (57.5%), the Cayman Islands (7.7%), the British Virgin Islands (6.5%), and Singapore (2.5%) were the top four destinations (Ministry of Commerce of China 2017).

investors (Akamah et al. 2018; Dharmapala and Hines 2009; Fung et al. 2011; Hines and Rice 1994; Morck et al. 2008). Hong Kong was among the markets with the lowest corporate tax rates (ranked 22nd out of 264 markets) in the world during the sample period (2003–2013) (World Bank 2016b). Chinese investment to Hong Kong may primarily reap two types of tax benefits. First, Chinese firms may establish their global holding companies in Hong Kong. These firms may leverage Hong Kong as a springboard and engage in further investment to a third destination. Second, Chinese investors may leverage Hong Kong as a bridge for "round tripping" investments back to the Chinese Mainland market due to the favorable corporate income tax treatments to foreign and Hong Kong investors in the Chinese Mainland market (Buckley et al. 2015). Chinese firms choose Singapore and Macau because of geographic proximity and strong ethnical ties. The British Virgin Islands is preferred—particularly after China took over the administrative power of Hong Kong from the UK in 1997—because of its historical connections with Hong Kong (Sutherland and Ning 2011, p. 53).

We measure tax haven investment in two dimensions, namely, propensity and project number. *Tax haven propensity* is a dummy variable equal to 1 if an MNE invests in tax havens in a certain year; otherwise, it is equal to 0. *Tax haven project* measures the number of OFDI projects into tax havens given that MNEs may simultaneously conduct several investments in these locations.

Independent Variables

We measure the political status via a firm's distance to the central government. First, we consider *private firms* as a dummy variable. If the ultimate controller of a publicly listed company is not the state, then *private firms* takes the value of 1; otherwise, the value is 0. By contrast, we define a listed company as an SOE if its ultimate controller is the government (Meyer et al. 2014).

Second, we construct four independent variables, namely, *central SOEs, local SOEs, private firms with political connections*, and *private firms without political connections*, to identify clearly the heterogeneity inside the political hierarchy. The dummy variable of *central SOEs* equals 1 if a listed firm's largest shareholder is the central government; otherwise, it is equal to 0 (Lu et al. 2014). The dummy variable *local SOEs* takes the value of 1 if a firm is controlled by a provincial or municipal government agency; otherwise, it is equal to 0. We treat central SOEs as the base group. We also examine how the lower political statuses of the other firms, namely, local SOEs and private firms with or without political connections, propel them to engage in tax haven investment.

In accordance with prior studies (Faccio 2006; Fan et al. 2007), we define private firms as politically connected if the CEO or chairperson of the board once worked or currently works in province-level (or above) public administration agencies (Liang et al. 2014) or were once selected to be a member of province-level (or above) legislation body (Chizema et al. 2015). We exclude political ties below the provincial level because only higher political ties can impose effective influences on listed MNEs. We do not restrict the affiliation to a certain ministry, such as the Ministry of Commerce, because our sample contains various industries. Therefore, we utilize *private firms with political connections* as a dummy variable. This variable equals 1 if a private firm is politically connected; otherwise, it is equal to 0. Finally, the dummy variable *private firms without political connections* equals 1 if private firms have no relationship with the state; otherwise, it is equal to 0. Table 2 reports tax haven investment by different firm types, while Table 3 summarizes the dynamism exhibited in political connections. The descriptive statistics in Table 2 suggest that firms with higher political status exhibit higher tendency on tax haven investment than firms with low political status, thereby

Table 2 Firm type and tax haven investment

Firm type	Project number	Firm number	Share of projects (%)
Central SOEs	60	57	10.0
Local SOEs	252	305	41.9
Private firms with PC	136	191	22.6
Private firms without PC	153	217	25.5
Total	601	770	100

"PC" refers to "political connections." As long as a private firm has PC in a certain year during the sample period, we categorize it as private firms with PC

Table 3 Dynamism in the political status of private firms

Year	Firms with PC	Firms without PC	Firms losing PC	Firms gaining PC
2003	25	17	0	0
2004	37	25	1	0
2005	45	33	2	3
2006	56	36	0	3
2007	78	84	2	1
2008	99	125	5	1
2009	119	162	2	6
2010	139	195	2	4
2011	152	214	2	5
2012	156	232	8	4
2013	167	241	3	7

There are firms newly listed and delisted every year

seemingly debunking H1. Nonetheless, whether H1 is supported shall be determined by rigorous regression analyses, where disturbing factors, such as firm size and age, shall be fully controlled.

Moderating and Control Variables

We utilize the index of Fan et al. (2011) to denote regional-level market liberalization. This index has five pillars, namely, (a) abatement of state intervention in the economy, (b) private firm legitimation, (c) reduction of local protection, (d) law enforcement in factor and final product markets, and (e) protection of intellectual properties. The index is updated annually and has been used in various business studies (Sun et al. 2016).

We introduce firm, industry, and region-level control variables to investigate main effects and eliminate disturbances from other factors (Jones and Temouri 2016). We include *earnings per share*, which denotes the current net income divided by the weighted average current outstanding common stock. *Firm size* is the logarithm of the total assets, and *firm age* refers to the time gap since the firm is founded. Large-sized MNEs possess substantial organizational slacks to conduct OFDI projects (Dowell and Killaly 2009). We use the leverage level to measure a firm's financial condition. Generally, highly levered firms will be restricted substantially by creditors when conducting OFDI projects because these companies bear high financial risks (Zou and Adams 2008). We measure *financial leverage* as the ratio of the total debts to the total assets and *operating leverage* as the net fixed assets divided by the total assets (Saunders et al. 1990). We measure *board size* as the number of board members. *Independent board* refers to the share of independent board members in the board of directors. We also include *extant no-haven* to measure the number of historical OFDI investment projects to none tax havens. The more non-haven equity a firm possesses, the more likely the firm will seek tax avoidance to reduce its global tax burden and enhance international competency.

Firms that are registered in different regions could be exposed to heterogeneous peer pressure to invest abroad; therefore, we use *province* to capture the geographic factor (Wu et al. 2012). The variable *province* equals 1 if the headquarters are located in eastern or coastal regions and 0 if otherwise (Chang and Xu 2008). We employ dummy variables to control for industry-specific disturbance. There are four industries, namely, energy and public utility (11.9%), real estate (9.4%), manufacturing (74.8%), and commerce (3.9%). The government exercises distinct power over firms in different industries. OFDI projects in energy and public utility industries are usually dominated by SOEs due to the strategic value of these sectors.

Statistical Model

First, we adopt a probit model (Bliss 1934) to verify the determinants of tax haven propensity provided that the dependent variable (*tax haven propensity*) is a dichotomous one.

$$\begin{aligned}\text{P (tax haven propensity} = 1) \; = {} & \alpha_1 + \alpha_2 * \text{political status} \\ & + \alpha_3 * \text{market liberalization} \\ & + \alpha_4 * \text{political status} \\ & * \text{market liberalization} \\ & + \beta_1 * \mathbf{control_1} + \varepsilon_1,\end{aligned}$$

where *political status* may be measured by one of the two variable options, to wit: (a) private firms, with SOEs as the reference group and (b) local SOEs and private firms with and without political connections, with central SOEs as the reference group. ***Control*** collectively denotes a vector of control variables, as specified earlier.

Second, we employ the Tobit model to examine the effects on *tax haven project*. The parent firms do not conduct tax haven investment annually. Thus, the ordinary least squares regression estimator will cause biased estimates of the slope coefficient and the intercept (Tobin 1958). The Tobit model is specified as follows:

$$\begin{aligned}Y* = {} & \lambda_1 + \lambda_2 * \text{political status} + \lambda_3 * \text{market liberalization} \\ & + \lambda_4 * \text{political status} * \text{market liberalization} \\ & + \beta_2 * \mathbf{control}_2 + \varepsilon_2,\end{aligned}$$

$$Y = \max(0, Y^*),$$

where Y denotes *tax haven project* and Y^* is a latent variable. We cluster each firm to control for immeasurable time-invariant factors, such as the risk-taking culture. We also lag all independent variables by 1 year.

Empirical Findings

Baseline Results

Almost all correlation coefficients among independent variables in Table 4 are lower than 0.3. The variance inflation factors of all independent variables are lower than 5, manifesting no concern with regard to multicollinearity. In the sample, 59.6% of firm-year observations are dominated by the state, while 21.3% have political connections. This finding is consistent with the overall distribution of listed firms in China (Li et al. 2014; Sun et al. 2016; Wu et al. 2013). The average values of *tax haven propensity* and *tax haven project* are relatively low.

Table 4 Descriptive statistics and correlation coefficients

Variables	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
1. Tax haven propensity	1.000																
2. Tax haven project	0.939	1.000															
3. Private firms	0.030	0.026	1.000														
4. Central SOEs	0.030	0.031	− 0.079	1.000													
5. Local SOEs	− 0.004	− 0.007	− 0.807	− 0.540	1.000												
6. Private firms with PC	− 0.005	− 0.011	0.555	− 0.019	− 0.056	1.000											
7. Private firms without PC	0.030	0.029	0.558	− 0.086	− 0.451	− 0.380	1.000										
8. Private share	0.098	0.090	0.253	− 0.158	0.059	0.100	0.180	1.000									
9. Earnings per share	0.020	0.024	0.027	− 0.013	− 0.002	− 0.019	0.044	0.041	1.000								
10. Firm size	0.099	0.105	− 0.256	0.388	− 0.178	− 0.087	− 0.199	− 0.163	0.215	1.000							
11. Firm age	0.067	0.063	− 0.086	− 0.091	0.050	− 0.024	− 0.125	0.236	0.017	0.196	1.000						
12. Operating leverage	− 0.030	− 0.030	− 0.089	0.100	− 0.061	0.025	− 0.125	− 0.181	− 0.137	0.176	− 0.027	1.000					
13. Financial leverage	− 0.052	− 0.005	0.009	0.068	− 0.047	0.024	− 0.013	− 0.011	− 0.052	− 0.096	0.025	− 0.017	1.000				
14. Board size	− 0.031	− 0.027	− 0.160	0.077	− 0.028	− 0.018	− 0.160	− 0.241	0.058	0.279	− 0.020	0.191	0.000	1.000			
15. Independent board	0.064	0.066	0.041	0.161	− 0.100	− 0.007	0.051	0.092	− 0.005	0.121	− 0.020	− 0.035	− 0.006	− 0.346	1.000		
16. Extant no-haven	0.070	0.091	0.024	0.049	− 0.079	− 0.022	− 0.025	0.046	0.019	0.192	0.068	− 0.071	− 0.002	0.098	0.075	1.000	
7. Market liberalization	0.078	0.076	0.035	0.046	0.038	0.006	0.097	0.262	0.078	0.050	0.011	− 0.122	− 0.018	− 0.098	0.125	0.204	1.000
Mean	0.096	0.103	0.402	0.091	0.506	0.213	0.189	0.849	0.400	21.977	10.547	0.284	0.665	9.280	0.365	0.723	8.505
S.D	0.294	0.337	0.490	0.337	0.500	0.409	0.392	0.233	0.623	1.441	5.264	0.191	12.356	1.942	0.057	3.142	2.124

$N = 4455$

Correlation coefficients > |0.03|, significant at $p < 0.05$

Table 5 Effects of political hierarchy on tax haven propensity and project (dummy independent variables to measure political hierarchy)

D.V. (model)	0–1 Tax haven propensity (probit)				Tax haven project (Tobit)			
Model #	1	2	3	4	5	6	7	8
Earnings per share	− 0.025	− 0.030	− 0.034	− 0.135	− 0.043	− 0.051	− 0.060	− 0.290
	(0.055)	(0.053)	(0.054)	(0.108)	(0.105)	(0.104)	(0.104)	(0.246)
Firm size	0.150***	0.155***	0.183***	0.140***	0.287***	0.321***	0.348***	0.283***
	(0.024)	(0.025)	(0.026)	(0.043)	(0.048)	(0.048)	(0.051)	(0.109)
Firm age	0.017***	0.018***	0.019***	0.004	0.032***	0.036***	0.036***	0.009
	(0.006)	(0.006)	(0.006)	(0.013)	(0.011)	(0.011)	(0.011)	(0.028)
Operating leverage	− 0.266*	− 0.231	− 0.149	− 0.047	− 0.521*	− 0.434	− 0.287	− 0.091
	(0.155)	(0.156)	(0.158)	(0.283)	(0.304)	(0.304)	(0.307)	(0.631)
Financial leverage	− 0.277*	− 0.231	− 0.099	− 0.318	− 0.526*	− 0.218	− 0.192	− 0.684
	(0.147)	(0.146)	(0.133)	(0.285)	(0.290)	(0.277)	(0.278)	(0.658)
Board size	− 0.042**	− 0.038**	− 0.033**	− 0.012	− 0.082**	− 0.065**	− 0.065**	− 0.023
	(0.016)	(0.017)	(0.017)	(0.028)	(0.032)	(0.032)	(0.032)	(0.063)
Independent board	0.974**	0.970**	0.978**	2.432***	1.870*	1.770*	1.869*	4.829**
	(0.481)	(0.487)	(0.488)	(0.851)	(0.958)	(0.958)	(0.955)	(2.161)
Extant no-haven	0.013**	0.011*	0.012**	0.017*	0.022**	0.021*	0.020*	0.032
	(0.006)	(0.006)	(0.006)	(0.010)	(0.011)	(0.011)	(0.011)	(0.019)
H1: private firms		0.157***		2.012***		0.634***		4.010**
		(0.057)		(0.678)		(0.126)		(1.888)
		[0.025]***		[0.440]**		[0.063]***		[0.169]**
		⟨0.009⟩		⟨0.196⟩		⟨0.013⟩		⟨0.081⟩
H1: local SOEs			0.205*				0.405**	
			(0.109)				(0.201)	
			[0.026]**				[0.040]**	
			⟨0.013⟩				⟨0.020⟩	
H1: private firms with political connections			0.453***				0.864***	
			(0.128)				(0.238)	
			[0.069]***				[0.086]***	
			⟨0.018⟩				⟨0.024⟩	
H1: private firms without political connections			0.638***				1.211***	
			(0.134)				(0.248)	
			[0.109]***				[0.121]***	
			⟨0.022⟩				⟨0.025⟩	
Market liberalization				0.251***				0.516***
				(0.068)				(0.182)
H2: private firms * Market liberalization				− 0.215***				− 0.426**
				(0.070)				(0.196)
				[− 0.019]***				[− 0.018]**
				⟨0.007⟩				⟨0.008⟩
Constant	− 4.393***	− 4.697***	− 5.558***	− 7.584***	− 8.401***	− 9.693***	− 10.539***	− 23.257
	(0.624)	(0.633)	(0.689)	(1.067)	(1.274)	(1.308)	(1.393)	(450.493)
Province dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Log Likelihood	− 1370.507***	− 1348.525***	− 1353.643***	− 328.592***	− 1801.285***	− 1788.293***	− 1784.096***	− 413.645***

$N = 4455$ for models 1, 2, 3, 5, 6 and 7. $N = 2160$ for models 4 and 8

Robust standard errors in parentheses are obtained after controlling for clustering on each firm

Marginal effect coefficients in square brackets, standard errors of marginal effect coefficients in arrow brackets

*$p < 0.1$, **$p < 0.05$, ***$p < 0.01$

Table 5 reports the regression results. The logit models are non-linear models that we cannot utilize the coefficients to interpret the effects of independent variables; therefore, we calculate the marginal effect coefficients of the variables on political hierarchy at their mean values. Marginal effects are reported in square brackets and their standard errors in arrow brackets. We use the coefficient of *private firms* in model 2 to present the economic magnitude of the estimates. The marginal effect coefficient (0.025) suggests that a private firm averagely exhibits 0.025 (2.5%) higher propensity in conduct tax haven investment compared with an SOE.

We further examine the influence of the nuanced political hierarchy on tax haven investment by utilizing central SOEs as the reference group (in model 3). The marginal effect coefficients of *local SOEs, private firms with political connections*, and *private firms without political connections* are all significantly positive. In addition, we utilize *t* tests (two-tailed) to compare the marginal effect coefficients of the four types of firms. Estimated coefficients are significantly different, which indicates that we can make a sequence directly by comparing coefficient values. The coefficient of *local SOEs* is the lowest, which connotes that private firms demonstrate high commitments to OFDI in tax havens. When investigating the heterogeneity within privately owned firms, the estimated coefficient of private firms without political connections is larger than that of politically connected private firms. This provides further evidence that political ties will reduce the propensity of tax haven investment. In sum, the results in models 2 and 3 support H1a, H1b, and H1c. We also calculate the marginal effect coefficients of the interaction term. The coefficients are consistently negative, thereby lending support to H2.

We then employ an alternative measurement to capture firms' tax haven behavior, specifically *tax haven project*, to test H1. Table 5 exhibits the results for models 5–8. The marginal effect coefficients of political hierarchy in models 6–8 are significantly positive, thereby supporting the main hypotheses. We normalize the *tax haven project* and have obtained consistent estimates. We run the Poisson and negative binomial models for *tax haven project* and garner consistent estimates. Therefore, we can conclude that firms with the distinct levels of political hierarchy have hierarchical attitudes toward tax haven behavior.

The estimated coefficients and the marginal effect coefficients of market liberalization as control variables in models 4 and 8 are statistically significant and positive, indicating that liberalization stimulates firms' OFDI. This result is in line with the findings in the literature (Gokalp et al. 2017). On the contrary, the estimated marginal effect coefficients of the interaction term with private firms are negative, which supports H2.

Robustness Tests

We conduct four sets of analysis to test the robustness of the findings.[4] First, we apply an alternative way to measure the political hierarchy (Sun et al. 2015), specifically *private share*, which is calculated as one minus the equity share owned by the state (Cui and Jiang 2012; Liang et al. 2014). Accordingly, the higher the *private share* is, the more distant the firms will be from the center of political gravity. We also analyze the private shares that are in possession of the four types of firms. We determine that the central SOEs own the lowest private equity share, followed by local SOEs and private firms with and without political connections. Thus, we conclude that this alternative measurement is consistent with the one adopted in Tables 5, and Table 6 in Appendix reports the new results. The marginal effect coefficients of *private share* in models 2, 3, 5, and 6 are positive with the 1% significance level, which indicates that firms' private ownership and its associated political discrimination trigger tax haven investment. The marginal effect coefficients estimated at either mean or median value are consistent with the main effects. The inclusion of the moderator generates constant results. The complementary analysis accordingly corroborates the baseline results. For SOEs, private ownership assists to counterbalance the power of the state and stimulates the SOEs to focus more on their goals on profit maximization than on the goals of the state (He et al. 2016b). We test the relationship between the private ownership (%) and tax haven investment with the samples of SOEs, central SOEs, and local SOEs, respectively, and have obtained positive coefficients in all models, which are consistent with the finding in the literature.

Second, we exclude Hong Kong as a tax heaven in our sample, as it provides not only tax benefits, but also channels to facilitate firms to be listed in a different destination (Buckley et al. 2015). However, determining whether an overseas subsidiary is disguised as a shell company simply by examining its claimed scope of business in its voluntarily disclosed information is deemed impossible (Allred et al. 2017; Contractor 2016). We drop all observations on firms that have only invested in Hong Kong, and the new results generally support the hypotheses (see Table 7 in Appendix). The only exception is H1c. The results may suggest that politically unconnected private firms lack sufficient resources to further invest in tax havens other than the neighboring destination (i.e., Hong Kong). We also included Netherlands as a tax haven, and have obtained consistent results.

Third, we test the moderating effect of extant OFDI investment. The tax haven motives will be abated if firms have

[4] Some auxiliary empirical results not reported for brevity, but they are available upon request.

established subsidiaries in tax havens. Particularly, emerging market firms that have engaged in OFDI in tax havens encounter relatively low perceived power imbalance when bargaining with the home-country government. Thus, their new investments will not be much geared toward tax havens. The extant subsidiaries in tax havens also weaken the power imbalance among competitors and thus decrease their impetus to engage in new tax haven investments. The robustness test (in Appendix Table 8) suggests that the extant investments in tax havens, which serve as the alternative sources of preferential tax treatments, mitigate the main effects.

Finally, we examine an assumption underlying our research design, that is, investing in tax havens effectively reduces tax burdens from the home country. We employ *effective tax rate* to denote firms' overall tax burden (Col and Patel 2018), which is calculated as the ratio of the actual tax burden to the actual taxation object. In addition, we utilize the capital intensity and the inventory intensity to control for factors that may influence effective tax rate. The former refers to the share of fixed assets to the total assets, while the latter is the ratio of inventories to the total assets. We corroborate that the average value of the nominal tax rate (21.0%) is higher than that of the effective tax rate (18.1%), providing evidence on tax avoidance. We further test the relationship between the OFDI in tax havens and the effective tax rate of the entire sample and illustrate the results in Appendix Table 9. The coefficient of *extant tax haven investment* is significantly negative, which implies the effectiveness of tax haven investment.

Discussion

Theoretical Contributions

This study makes three contributions to the business ethics literature on tax avoidance. First, this research enriches the prior literature by investigating tax haven investment from the perspective of the political status and exploring the underlying institutional and resource dependence mechanisms. Previous studies have mainly delved into developed market firms and examined social capital and independent media as the antecedents of tax haven investment (Hasan et al. 2017; Kanagaretnam et al. 2018). Our findings highlight the relevance of institutional and political factors in shaping emerging market MNEs' tax haven activities (Morck et al. 2008). This study is vital for future business ethics research given that a considerable share of OFDI from emerging economies has been allocated to tax havens (Buckley et al. 2015). The integration of resource dependence and institutional theories may offer novel angles to examine tax haven investment from emerging markets.

Second, this study augments the ongoing debate on the ethicality of tax avoidance (e.g., OECD 2017; Payne and Raiborn 2018; United Nations 2016b), with evidence from emerging markets featuring strong government intervention, institutional imperfection, high transaction costs, and heavy tax burdens (Boisot and Meyer 2015; Buckley et al. 2015). Politically discriminated firms from emerging markets are propelled to flee the unfavorable home market environment and seek tax burden relief and significant survival opportunities (Sutherland and Ning 2011). An assumption that underpins the ethics discussion regarding tax avoidance is that the government collects taxes to provide high-quality public services (Bearak 2016). This strong assumption may be applicable to developed economies, where their governments are been under scrutiny by the general public (Kanagaretnam et al. 2018). In this sense, paying taxes to the government is a justified corporate social responsibility. Nonetheless, the governments with emerging markets usually collect severely high taxes to maintain their strong intervention (World Bank 2016b), which generally causes distortion in the market (Park et al. 2006). The findings of this study affirm that the radar of the ethical debate regarding tax haven investment from emerging markets should expand beyond firms per se and further incorporate the institutional and political factors.

Third, the present study identifies how the heterogeneity among different firm types affects tax haven investment, thereby enriching the institutional elements in the associated business ethics discussion. According to the conventional wisdom, SOEs have a higher degree of institutional support in their home markets compared with their private counterparts; hence, they should have very limited freedom and motives of tax haven investment. Nonetheless, emerging market governments tacitly approve their SOEs to employ international tax-planning tactics amid the intensified global competition featured with state capitalism for them to possibly infiltrate the global markets and exert influences. Among SOEs, central SOEs may restrain themselves more than local SOEs. The central ones are subject to relatively strong constraint from the taxation agencies in the central government, given the ambitious pursuit of emerging market governments for the leadership in the international taxation coordination (State Administration of Taxation of China 2016).

Managerial Implications

First, in the context of state capitalism in emerging markets, the state directs various policies to support the private firms that maintain good connections with the state. Such politically connected firms may seemingly benefit from their privileged positions at the home market; however, their business activities, such as tax planning, are subject to institutional pressure. The ideological discrimination against private firms either induces them to develop political ties or forces them to engage in controversial tax haven investment.

Second, emerging market SOEs are confronted by institutional constraints in the protective state capitalism and are increasingly taking the headlines of business press. For instance, more than 80 SOEs from China alone are included in the list of Fortune Global 500 in 2018. Nonetheless, these SOEs generate their revenues mainly from their home markets, where they benefit from strong political shelters. SOEs do not also have considerable freedom in planning taxes due to their high dependence on the government, which is the reason for SOEs' barely admirable financial performance in international markets in addition to their generally low efficiency because of industrial monopoly.

Policy Implications

Policymakers in emerging markets should focus on tax policy because of its substantial influence on the capital flows of firms. Policymakers should not only supervise and prevent the illegal tax evasion behavior of private firms but also pay due attention to creating a fair and inclusive institutional environment for all market participants. We also advise emerging market governments to watch closely the tax-planning activities of the SOEs. Preventing potentially illegal asset transfer and pecuniary income of corrupt officials and SOE executives is critical, despite the necessity for some SOEs to leverage legal tax haven activities to enhance their global competitiveness. Central or federal governments of emerging markets should also have strong supervision on central and local SOEs to ensure the SOEs abide by the international commitments of their governments. Finally, the ongoing global OECD coordination framework to prevent BEPS may offer policy guidance in investigating and preventing damaging tax evasion. Certain countries, like Luxembourg and Andorra, have liberalized banking secrecy by implementing the automatic exchange of tax information for financial accounts because of the publication of tax haven lists. Additionally, the mandatory rules of transfer pricing recommended by BEPS, such as aligning transfer pricing outcomes with value creation and providing country-by-country documentation, have resulted in increased participant attention on this issue. The BEPS strengthens government regulations on preferential tax treatments by a forum of harmful tax practices. Although the recent anti-globalization events may cause barriers for BEPS, the complementary policies on tax treaties supported by non-governmental organizations, such as the Tax Justice Network, would help to address BEPS.

Limitations and Directions for Future Research

As our study considerably contributes to the extant literature, the interpretation of the findings is still subject to three limitations, which concomitantly signals directions worthy of further exploration. First, we only examine indigenous publicly traded firms due to data constraints. The comparison between publicly and non-publicly traded firms would be interesting because the latter incur weaker oversights from the government, media, and general public (Kanagaretnam et al. 2018). Second, foreign subsidiaries and indigenous firms with foreign equity ownership have been dropped from the sample. Foreign subsidiaries in emerging markets have different motives and experience of tax avoidance (Marriage 2017). The market competition and cooperation between foreign subsidiaries and indigenous firms in the context of tax avoidance has great research potential. The tax incentives provided to high-technology foreign subsidiaries to stimulate indigenous firms' tax haven investment are also worth exploring. Third, the ultimate destination of tax haven investment is ambiguous due to data constraint. Given the sophisticated capital flows among different tax havens, examining the further "outward-journey" investment would be helpful (Sutherland and Ning 2011). Additionally, certain subnational regions can achieve tax-avoiding foreign investments although the country as an entity is not in the tax haven list, such as Delaware in US, which needs further discussion.

Conclusion

Overseas investment into tax havens is a widely observed phenomenon especially in emerging markets firms (Morck et al. 2008). Nonetheless, extant literature neglects home-country institutional contingencies when studying the antecedents of such tax haven investment. By integrating resource dependence and institutional theories, the current research builds a novel conceptual model on how political status affects the tax haven investment of emerging market firms. The research findings indicate domestic privileges offered by the government alleviate international tax avoidance. The study has strong ethical relevance to other emerging markets. The emerging markets are rapidly integrating into the globalized economy and witnessing massive yet uneven market liberalization, with a variety of firm ownership forms coexisting in the political systems. Various firms possess different political statuses and inevitably exhibit heterogeneous motives and tendencies of tax haven investment. To help store a fair international market order and constrain the liberty of emerging market firms in tax haven investment, not just international coordination but also domestic political reforms are important.

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Compliance with Ethical Standards

Conflict of interest The authors declare that they have no conflict of interest.

Ethical Approval This article does not contain any studies with human participants or animals performed by any of the authors.

Appendix

See Tables 6, 7, 8, and 9.

Table 6 Effects of political hierarchy on tax haven propensity and project (private share to measure political hierarchy)

Dependent variable	Tax haven propensity (0, 1)			Tax haven project		
Model type	Probit			Tobit		
Model #	1	2	3	4	5	6
Earnings per share	− 0.025	− 0.033	− 0.149	− 0.043	− 0.059	− 0.299
	(0.052)	(0.051)	(0.124)	(0.097)	(0.095)	(0.233)
Firm size	0.150***	0.159***	0.175***	0.287***	0.302***	0.349***
	(0.023)	(0.023)	(0.044)	(0.043)	(0.043)	(0.084)
Firm age	0.017***	0.006	− 0.006	0.032***	0.012	− 0.001
	(0.005)	(0.005)	(0.012)	(0.010)	(0.010)	(0.024)
Operating leverage	− 0.266*	− 0.193	0.049	− 0.521*	− 0.389	− 0.288
	(0.143)	(0.145)	(0.258)	(0.271)	(0.271)	(0.494)
Financial leverage	− 0.277**	− 0.222	− 0.262	− 0.526**	− 0.421*	− 0.409
	(0.136)	(0.135)	(0.285)	(0.255)	(0.251)	(0.540)
Board size	− 0.042***	-0.028*	0.004	− 0.082***	− 0.054*	0.013
	(0.015)	(0.015)	(0.028)	(0.029)	(0.029)	(0.058)
Independent board	0.974**	0.882*	2.476***	1.870**	1.690**	4.855***
	(0.453)	(0.458)	(0.889)	(0.847)	(0.844)	(1.771)
Extant no-haven	0.013***	0.011***	0.015***	0.022***	0.017***	0.024***
	(0.004)	(0.003)	(0.005)	(0.007)	(0.006)	(0.009)
H1: private share		0.864***	0.904***		1.633***	1.662***
		(0.146)	(0.260)		(0.276)	(0.499)
		[0.141]***	[0.081]***		[0.163]***	[0.070]***
		⟨0.024⟩	⟨0.024⟩		⟨0.028⟩	⟨0.022⟩
Market liberalization			0.136**			0.255**
			(0.060)			(0.126)
H2: Private share * Market liberalization			− 0.195*			− 0.450**
			(0.113)			(0.229)
			[− 0.018]*			[− 0.019]**
			⟨0.010⟩			⟨0.010⟩
Constant	− 4.393***	− 5.422***	− 7.976***	− 8.401***	− 10.240***	− 16.893***
	(0.503)	(0.537)	(1.100)	(0.964)	(1.019)	(2.181)
Province dummies	Yes	Yes	Yes	Yes	Yes	Yes
Industry dummies	Yes	Yes	Yes	Yes	Yes	Yes
Log Likelihood	− 1370.507***	− 1351.579***	− 325.059***	− 1801.285***	− 1781.734***	− 412.928***

$N = 4455$ for models 1, 2, 4 and 5. $N = 2160$ for models 3 and 6

Robust standard errors in parentheses are obtained after controlling for clustering on each firm

Marginal effect coefficients in square brackets, standard errors of marginal effect coefficients in arrow brackets

*$p < 0.1$, **$p < 0.05$, ***$p < 0.01$

Table 7 Effects of political hierarchy on tax haven propensity and project (Hong Kong excluded)

Dependent variable	Tax haven propensity (0, 1)				Tax haven project			
Model type	Probit				Tobit			
Model #	1	2	3	4	5	6	7	8
Earnings per share	0.032	0.030	0.015	-0.081	0.296	0.288	0.227	0.043
	(0.083)	(0.083)	(0.083)	(0.163)	(0.382)	(0.384)	(0.382)	(0.785)
Firm size	0.145***	0.160***	0.198***	0.149**	0.617***	0.675***	0.837***	0.602**
	(0.037)	(0.038)	(0.043)	(0.066)	(0.161)	(0.166)	(0.184)	(0.276)
Firm age	0.009	0.010	0.007	− 0.020	0.038	0.042	0.029	− 0.096
	(0.009)	(0.009)	(0.010)	(0.023)	(0.041)	(0.041)	(0.044)	(0.102)
Operating leverage	− 0.243	− 0.204	− 0.064	− 0.228	− 1.256	− 1.093	− 0.527	− 1.096
	(0.258)	(0.262)	(0.260)	(0.454)	(1.149)	(1.166)	(1.138)	(2.015)
Financial leverage	− 0.399	− 0.273	− 0.341	− 0.229	− 1.687	− 1.145	− 1.476	− 0.651
	(0.266)	(0.271)	(0.275)	(0.575)	(1.180)	(1.184)	(1.196)	(2.503)
Board size	− 0.027	− 0.019	− 0.022	− 0.015	− 0.102	− 0.068	− 0.080	− 0.019
	(0.027)	(0.027)	(0.027)	(0.042)	(0.128)	(0.129)	(0.127)	(0.193)
Independent board	1.706**	1.692**	1.844***	3.826***	9.148***	9.098***	9.740***	17.453***
	(0.715)	(0.727)	(0.715)	(1.224)	(3.482)	(3.526)	(3.488)	(5.998)
Extant no-haven	0.018***	0.018***	0.017***	0.025**	0.105***	0.105***	0.101***	0.119**
	(0.006)	(0.006)	(0.007)	(0.011)	(0.031)	(0.031)	(0.031)	(0.049)
H1: Private firms		0.244**		2.890***		1.023**		12.872***
		(0.110)		(0.993)		(0.483)		(4.562)
		[0.021]**		[0.166]***		[0.043]**		[0.300]***
		⟨0.010⟩		⟨0.061⟩		⟨0.021⟩		⟨0.117⟩
H1: Local SOEs			0.423**				1.766**	
			(0.178)				(0.792)	
			[0.037]**				[0.075]**	
			⟨0.016⟩				⟨0.034⟩	
H1: private firms with political connections			0.628***				2.651***	
			(0.211)				(0.930)	
			[0.054]***				[0.112]***	
			⟨0.019⟩				⟨0.040⟩	
H1: private firms without political connections			0.658***				2.682***	
			(0.225)				(0.967)	
			[0.057]***				[0.114]***	
			⟨0.020⟩				⟨0.042⟩	
Market liberalization				0.234*				0.926*
				(0.122)				(0.522)
H2: private firms * Market liberalization				− 0.293***				− 1.308***
				(0.100)				(0.466)
				[− 0.017]***				[− 0.030]**
				⟨0.006⟩				⟨0.012⟩
Constant	− 4.973***	− 5.547***	− 6.692***	− 8.695***	− 22.318***	− 24.685***	− 29.444***	− 37.292***
	(0.719)	(0.781)	(0.927)	(1.517)	(3.313)	(3.561)	(4.151)	(6.965)
Province dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Log Likelihood	− 470.670***	− 468.445***	− 465.622***	− 129.658***	− 683.820***	− 681.868***	− 679.403***	− 187.310***

$N = 2801$ for models 1, 2, 3, 5, 6 and 7. $N = 1150$ for models 4 and 8

Robust standard errors in parentheses are obtained after controlling for clustering on each firm

Marginal effect coefficients in square brackets, standard errors of marginal effect coefficients in arrow brackets

*$p < 0.1$, **$p < 0.05$, ***$p < 0.01$

Table 8 Moderating effect of extant tax haven investment

Dependent variable	Tax haven propensity (0, 1)	Tax haven project
Model type	Probit	Tobit
Model #	1	2
Earnings per share	− 0.095*	− 0.153
	(0.050)	(0.106)
Firm size	0.184***	0.360***
	(0.024)	(0.050)
Firm age	0.022***	0.046***
	(0.006)	(0.011)
Operating leverage	− 0.232	− 0.371
	(0.150)	(0.306)
Financial leverage	− 0.225	− 0.320
	(0.139)	(0.289)
Board size	− 0.037**	− 0.078**
	(0.017)	(0.033)
Independent board	0.615	1.463
	(0.496)	(0.972)
Extant no-haven	0.025***	0.052***
	(0.008)	(0.013)
H1: Private firms	0.373***	0.620***
	(0.065)	(0.129)
	[0.062]***	[0.064]***
	⟨0.011⟩	⟨0.014⟩
Extant tax haven investment	− 0.293***	− 0.648***
	(0.068)	(0.104)
H2: private firms * extant tax haven investment	− 0.244*	− 0.368*
	(0.141)	(0.207)
	[− 0.041]*	[− 0.038]*
	⟨0.024⟩	⟨0.021⟩
Constant	− 5.340***	− 10.124***
	(0.528)	(1.332)
Province dummies	Yes	Yes
Industry dummies	Yes	Yes
Log Likelihood	− 1275.682 ***	− 1656.491***

$N = 4455$

Robust standard errors in parentheses are obtained after controlling for clustering on each firm

Marginal effect coefficients in square brackets, standard errors of marginal effect coefficients in arrow brackets

*$p < 0.1$, **$p < 0.05$, ***$p < 0.01$

Table 9 Effects of foreign investments into tax havens on effective tax rate

Model #	1
Extant tax haven investment	− 0.020*
	(0.012)
ROA	0.014*
	(0.008)
Firm size	0.018***
	(0.006)
Firm age	0.005***
	(0.002)
Operating leverage	0.041
	(0.098)
Financial leverage	− 0.001*
	(0.001)
Capital intensity	− 0.120
	(0.092)
Inventory intensity	0.077
	(0.061)
After 2007	− 0.049***
	(0.018)
Constant	− 0.300*
	(0.173)
Province dummies	Yes
Industry dummies	Yes
Log Likelihood	− 2332.488***

$N = 4455$

Robust standard errors in parentheses are obtained after controlling for clustering on each firm

*$p < 0.1$, **$p < 0.05$, ***$p < 0.01$

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