



Determinants of Aggressive Corporate Tax Planning

Noor Emilina Mohd Nasir^{1*}, Najihah Marha Yaacob², Norfadzilah Rashid³, Siti Nurhazwani Kamarudin⁴

¹ Faculty of Accountancy, Universiti Teknologi MARA, Terengganu, Malaysia; nooremilina@uitm.edu.my;  0000-0002-5734-2189

² Faculty of Accountancy, Universiti Teknologi MARA, Terengganu, Malaysia; najihahm@uitm.edu.my;  0000-0001-5770-9916

³ Faculty of Accountancy, Universiti Sultan Zainal Abidin, Terengganu, Malaysia; nikmfadzilah@unisza.edu.my;  0000-0002-6678-1052

⁴ Faculty of Accountancy, Universiti Teknologi MARA, Selangor, Malaysia; hazwanikamarudin@uitm.edu.my;  0000-0002-3080-6094

* Correspondence: nooremilina@uitm.edu.my; +60179628655.

Abstract: Corporate tax plays a crucial role in attaining an economy's fiscal goals and stimulating economic growth. The context of the corporate world is rapidly expanding. As a result, it has an impact on how accounting is practiced. The role of managers is evolving away from planning the business operation toward implementing strategies in tax reporting to lower their tax burden. Since the aggressive corporate tax planning will harm the Malaysian economy, it has drawn much attention from the tax authorities, stakeholders and the public. Thus, ensuring the integrity of the financial reporting process and providing quality information to calculate tax liability is vital. Notwithstanding, from the agency theory perspective, the managers will deviate from their role to act in the best interest of the shareholders. As a result, several factors will affect managers' decisions in conducting effective corporate tax planning. Hence, this study's main aim is to discuss the determinants influencing corporate tax planning. Since tax liability represents the cost of operating a business and, thus, a significant impediment to maximizing wealth, effective tax planning is essential for companies. Nevertheless, companies need to ensure that their action in corporate tax planning abides by the law to avoid any penalties imposed by the tax authorities.

Keywords: corporate tax; corporate tax planning; agency theory; tax aggressiveness.



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1. INTRODUCTION

The taxation's purpose is to raise the amount of income collected and maximize the amount of public revenue, which serves as a financial instrument to govern the expansion of the economy as well as the growth of the nation. As a result, taxes are not only a vital mechanism for the equitable distribution of resources within a society but also an important source of revenue for the financing of public infrastructure. It contributes to fulfilling social demands through supporting public services, healthcare, and education. As the Ministry of Finance reported in Figure 1, more than 50% of the Federal Government's Revenue in 2021 comprised income tax revenue. Therefore, it is crucial to secure revenue collection from the taxpayers to sustain the government's source of income. However, tax collection is hindered by taxpayers' efforts to reduce their income tax burden. Tax planning can be achieved by using the government's tax incentives and other creative accounting strategies to manage their tax liability.

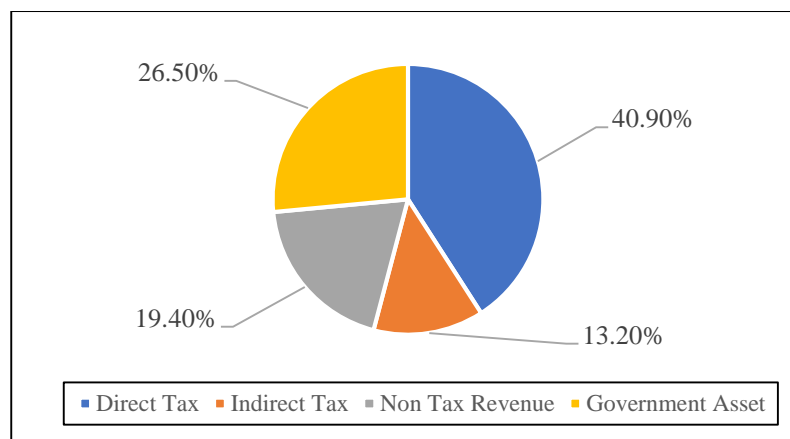


Figure 1. Federal Government’s Revenue in 2021 (Source: Ministry of Finance, Malaysia, 2021)

Tax planning is a key competitive technique for businesses. Businesses will develop strategies to reduce their taxable income as much as possible. However, aggressive corporate tax planning results in a significant loss of revenue for the government and negatively affects the development of economies (Amidu et al., 2019). Companies may engage in tax evasion and tax avoidance in tax planning strategies, depending on their level of aggressiveness (Hanlon & Heitzman, 2010). Thus, tax planning can be divided into two types: tax avoidance and tax evasion. Companies that participate in tax evasion by violating regulations tend to engage in more aggressive techniques, such as fraudulent financial reporting and criminal activity (Kourdoumpalou & Karagiorgos, 2012). In contrast, tax avoidance can be defined as a business strategy that exploits the applicable tax regulation loopholes and other legal measures to lower the amount of tax payable (Fitria, & Taufik, 2020). Thus, corporate tax planning can be conducted either legally or illegally, both ways with the same objectives to lower the tax burden.

A large body of research has examined numerous financial factors that influence the level of corporate tax planning. In determining the tax liability of the companies, accounting information reported in the financial statements will be adjusted according to the relevant tax rules. Thus, the financial transactions reported will be the value relevance in computing the tax payable to the companies. Hence, the main objective of this paper is to discuss the relevant financial variables that have a significant relationship towards corporate tax planning. The following is the structure of the paper: Section 2 presents a review of literature by previous scholars on the factors influencing corporate tax planning, focusing on the financial variables. Subsequently, a theoretical perspective on corporation tax planning is discussed. A conclusion concludes the text.

2. REVIEW OF DETERMINANTS OF CORPORATE TAX PLANNING

2.1 Leverage

The leverage ratio is commonly used to measure the percentage of long-term liabilities over the total assets of a company. Likewise, the leverage ratio refers to the assets' ability to finance their long-term liabilities in the capital market (Danielova & Sarkar, 2011). The leverage is important to determine the level of interest tax shield since the interest is tax-deductible. Interest expenses can be deducted from taxable income, which can result in tax savings and lessen the overall burden of tax liability. The level of the leverage ratio will be lesser with the absence of tax since there will be no deduction on interest expense. Companies with high levels of leverage have a greater capacity to evade taxes through

financial transactions. Similarly, the company that opts for debt financing will have a high leverage ratio and enjoy more tax benefits, hence less need to participate in tax planning activities. This strategy is supported by Hazir (2019), where tax aggressiveness is inversely associated with leverage. Additionally, the study by Bubanić and Šimović (2021) discovered an adverse effect of the leverage level on taxation activities in a company. Relatively, the leverage ratio may influence tax planning decisions depending on the cost and benefit associated with debt and equity financing, as it will affect a company's capital structure. Thus, a company must choose the optimal capital structure, which maximises its profitability and minimises its tax liability.

2.2 Capital Intensity

Capital intensity determines the percentage of non-current asset utilization, specifically the property, plant, and equipment used in running the company. Hence, the capital intensity ratio measures how much companies invest in total assets for production (Judzik & Sala, 2014). The cost related to property, plant, and equipment will affect the corporate tax planning as it will be eligible for the tax incentives and capital allowance offered by the government. Companies with a large portion of non-current assets may implement effective tax planning by using the incentives available to decrease the tax. As a result, companies are most likely to fully utilize the capital allowance available to reduce tax liability and thus associated with a low level of effective tax rate (Bubanić & Šimović, 2021). A study by Hazir (2019) on Turkish public listed companies revealed that tax liability is influenced by capital intensity. Thus, a company with a substantial number of non-current assets but a higher effective tax rate implies that it is inefficient in managing its capital to minimize the tax burden.

2.3 Government Ownership

Empirical evidence shows that ownership structure may affect corporate tax planning. Bashir and Zachariah (2020) define ownership structure as the percentage of shares held by the shareholders, which can be managers, foreigners, government, families, and institutions. The proportion of ownership structure may or may not mitigate the agency problem. In this context, government ownership may align the government's interest with corporate tax planning, consequently preventing the company from implementing aggressive tax planning strategies. Ying et al. (2017) discovered that government ownership significantly influences the level of tax aggressiveness among Chinese listed companies. Similarly, by using a sample of Malaysian public listed companies, Annuar et al. (2014) found that government ownership is associated with corporate tax planning. As a result, the company will have better monitoring of the tax planning strategies and reduce the chances of being involved in illegal activities. Thus, it indicates that ownership structure represents corporate governance procedures to curb tax avoidance strategies.

2.4 Financial Distress

Companies facing financial difficulties will be more likely to involve in aggressive tax planning. Based on previous studies, Altman Z Score was used to determine financial distress and predict corporate failure. Altman (1968) developed the first bankruptcy prediction models using univariate and multivariate approaches from US company data. The Altman model applied a combination of five different ratios: liquidity, profitability, leverage, solvency, and activity. The firms' Z-score is calculated using the formula and will be classified into three categories. Companies with a Z-score of greater than 2.99 falls into a "healthy firm" category. Those with a score of between 1.81 to 2.99 are in the "zone of ignorance" or "grey area". Finally, a score below 1.81 classifies the companies as "bankrupt firms" (Altman, 1968). Hence, the lower the company's Z-score, the higher the probability of a firm's bankruptcy. Nugroho (2020) examines financial distress's effect on tax aggressiveness among manufacturing companies listed on Indonesia Stock Exchange. The authors discovered that financial

distress positively correlates with the level of tax aggressiveness. In contrast, Richardson et al. (2015) investigated the influence of financial distress tax avoidance in Australia during the financial crisis. They found the same results where financial distress has a significant positive relationship with tax avoidance. Thus, it is evident that financial distress would serve as an indicator to influence corporate taxpayers in minimising their tax burden as they will have financial difficulties in satisfying their tax liabilities.

3. AGENCY THEORY AS THEORETICAL LENS

The literature examining corporate tax planning often emphasises the agency relationship between the managers and shareholders. Jensen and Meckling (1976) explained agency theory as “*a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf, which involves delegating some decision-making authority to the agent.*” The theory concerns the relationship between the agent and principal where the agent might act not in the principal’s best interest due to the information asymmetry between principals and agents. By having such insider information, the agents may be involved in business activities that give them economic benefits over their principals. Moreover, it requires agency costs to align their interest to minimise the conflict of interest between the principals and agents.

Under this theory, the shareholders believe that tax does not have significant value to their companies (Hoseini et al., 2018). Therefore, the agency theory may lead the managers to decide how the tax planning will be conducted. The companies’ strategic approach in tax planning is often classified under agency theory by minimising the tax burden to maximise the shareholders’ value since tax is seen as the operational cost to the companies, which lowers their cash flows. Therefore, managers will manage their tax planning to maximise profits and increase the shareholders’ value rather than benefit their customers and the public. However, one must observe the financial reporting practices to examine the level of corporate tax planning since the tax reporting need to be prepared based on the reported financial figures according to the Income Tax Act.

4. CONCLUSION

In general, companies have demonstrated some tax planning strategies to lower their tax liabilities. The study highlighted the determinants that influence the level of corporate tax planning, which enables important input to the tax authorities. It also provides red tape, which needs to be concentrated by the tax authorities in conducting the tax audit to hinder aggressive tax planning by companies. In addition, the prepares of the financial report, and the auditors should take necessary actions to ensure it portrays the true financial information of the companies.

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