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Tax Avoidance and Firm Value Relationship in the Listed Companies of Bangladesh: A Conceptual Overview

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***Abstract* - The aim of the present paper is to look at whether corporate tax avoidance (CTA) contributes to firm value in the perspective of Bangladeshi listed firms. Our conceptual assumption is that in presence of agency conflicts, corporate managers take on tax avoidance (TA) initiatives to extract their own benefits through taking advantage as of the loopholes of current tax laws. Further, CTA does not fulfill the ethical and social demands. Agency costs and social irresponsibility that produce from TA activities could adversely influence the firm value. It is also among the first paper focusing on the TA and firm value association in the perspective of Bangladeshi listed firms after the gradual decline of stock market index during the year 2019, whereas most of the adjacent South Asian countries' bourse has achieved gradual improve. However, the present paper aims to integrate relevant studies and theories to extend the intended potentials for limiting corporate tax avoidance to enhance the value of the listed companies in Bangladesh. This study has evaluated CTA behavior from a combination of agency theory and stakeholder theory standpoint rather than traditional sight of tax burden decreasing strategy. Moreover, as existing literature reveals inconsistent and less evidence that attempt to examine the consequence of CTA on firm value, the present paper proposes and shows an imperative proposition for potential empirical research.**

***Keywords* -** *Agency Theory, Corporate Tax Avoidance, Firm Value, Stakeholder Theory*

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I. Introduction

Corporate tax avoidance might represent "different thing to different people" due to lack of universal definition (Hanlon & Heitzman, 2010). The customary sight of CTA implies that tax avoidance initiatives ought to increase the firm value, while the agency viewpoint on CTA gives a further nuanced anticipation (Chen et al., 2014). However, tax avoidance is the planned attempt of a company to decrease its tax burden by using lawful or unlawful methods (Lee et al., 2015). Managers can make use of aggressiveness in taxes like a mask entirely for the gain of management (Luo & Wei, 2012). In addition, tax avoidance may complex and unclear, and may probably agree to opportunistic behavior of the managers (Minnick & Noga, 2010). Tax evasion is a sort of infringement of the law, whereas tax avoidance is the exercise of a legal vacuum, i.e. the formal misuse of the law where exemptions and incentives are permissible (Jamei, 2017). From the agency theory perspective, there remains opportunism in favor of management to be tax aggressive (Desai & Dharmapala, 2009a, 2009b).

Companies that take advantage of tax havens have no societal responsibility, along with the market has a negative response to these companies, and thus, the value of the companies go down (Hanlon & Heitzman, 2010). However, developing countries has smaller number of strong institutions and sources of financial support, and for that reason, they have a greater dependence on the tax revenues (Jenkins & Newell, 2013). Accordingly, deficiency in corporate tax revenue makes a momentous as well as probable irremediable loss towards society (Slemrod, 2004). Moreover, if business firms keep away from tax, it may possibly affect the public welfare initiatives to be taken on by the government. In social context, corporate taxes assist to finance public products (Freedman, 2003). Hence, a firm's tax antagonistic policies might have a miserable consequence on public (Freedman, 2003). Likewise, TA is regarded like a sustainability problem because tax revenue is an essential component of the working of the government and society, as well as firms have sense of duty to conform to morale along with communal demands of society (Bird & Davis-Nozemack, 2018). Therefore, in a social context, CTA could be regarded as irresponsible deeds (Erle, 2008).

Tax avoiding activities endow with earnings advantages and real cash flow benefits to the firm, however, potential costs related to tax avoidance actions like agency costs, tax audits, amended tax assessments and legal action might outweigh these advantages (Ying et al., 2017). In addition, firms perform tax aggressive actions in many ways, including failure of submitting returns, erroneous returns by influencing taxable profits, reporting untrue transactions, overstating expenses, and breaching the provisions of pertinent tax acts (Sharayri & Momani, 2009). Besides, superior governance, which is aided by the capital market by means of smooth flow of information, is feeble in Bangladesh (Rouf & Akhtaruddin, 2020). Furthermore, agency conflicts inside Asian nations are surrounded with a need of corporate clarity, which concur rent seeking along with insider trading (Claessens & Fan, 2002). Therefore, from the agency theory perspective, in Bangladesh, where there is a want for good governance, corporate managers may exercise tax avoidance strategy in support of extracting their own benefits and not intended for the benefit of investors, and thus, tax avoidance could negatively affect the firm value.

II. Problem Statement

Bangladesh's stock market carried on its nosedive posting a negative expansion all through the year 2019, whereas bourses in five other frontiers as well as emerging Asian countries recorded growth in the same period (Dhaka Tribune, 2020). Dhaka Stock Exchange Limited is the prime bourse of Bangladesh, and recorded 17.30% negative index return during the year 2019 (Dhaka Tribune, 2020). In the same period, the adjoining south Asian countries achieved positive index return, for instance, on Indian key index, SENSEX, was 14.70% followed by 10.70% of Pakistani KSE100, 8.10% of Vietnamese VNINDEX, 2.30% of Sri Lankan CSEALL and 1.00% of Thai SET (Dhaka Tribune, 2020). Market analysts and insiders accredited the yearlong go down in the stock market towards confidence crisis (Dhaka Tribune, 2020). Stock price movement synchronicity is uttered in emergent marketplaces, due to their comparatively tough obstructions with well-versed trading (Morck et al., 2000).

However, investors respond negatively when a company discloses information associated to tax aggressiveness (Hanlon & Slemrod, 2009). Agency theory approach, besides considering the merits of TA, thinks about the expenses associated with tax avoidance actions (Chen et al., 2015). Opaque tax avoidance initiatives could reduce the firm value through producing information asymmetries (Wahab & Holland, 2012). Firm value represents investors' view concerning the height of achievement of a firm which is usually linked with share prices (Djashan, 2019). The stakeholder approach seeks to meet necessitates of shareholders as well as other interested groups (Jamei, 2017), whereas, tax avoidance initiatives signal irresponsible behavior of a firm to government and society (Bird & Davis-Nozemack, 2018). Thus, corporate tax avoidance might one of the important factors which can adversely affect the stock market index return in Bangladesh. In brief, our present study is an initiative to evaluate whether corporate tax avoidance contributes as one of the causes of lower stock market index return in the context of an emerging economy like Bangladesh.

III. Literature Review

Tax avoidance consists of tax planning actions which are lawful or which could plummet into the grey region and deeds that are against the law (Chen et al., 2010). The agency theory viewpoint considers tax aggressiveness as an action designed to make scope for managerial opportunism wherein managers seek to enhance their personal utilities more willingly than generating wealth for shareholders because of the separation of ownership as of control (Khurana & Moser, 2009). Antagonistic tax planning gives excuses for managers to stage-manage income, hoard corporate private news and create financial statements complicated to external investors that enhance information inequality along with corporate opacity (Kim et al., 2011). In addition, tax avoidance actions increase agency costs and reduce the value of the firm, as well as investors reply negatively towards CTA performance, however, this pessimistic respond might be allayed via information clarity (Chen et al., 2014). Therefore, the complexity as well as unclearness of TA may defend managers who are involved with different types of opportunistic rent seeking actions, for instance income manipulation along with insider trading (Desai & Dharmapala, 2009b).

Complicated antagonistic tax planning may supply managers with instruments to conceal rent extraction as well as resource-diverting actions (Payne & Raiborn, 2018). If investors cannot completely realize the cost-benefit analysis, firm value might be reduced by the tax avoidance activities (Lee et al., 2015). There are two viewpoints in relation to the effect of TA on firm value, specifically, agency theory and the classical point of view (Akbari et al., 2019). In agency theory approach, advantages of TA are considered along with the non-financial costs involved with such initiatives together with time, labors and resources expend for tax avoidance strategies, for instance possibility of restatement of financial statements and possibility of legal action (Chen et al., 2015). Moreover, if shareholders see the behavior of tax avoidance like a way to conceal cash, a price fall would be enforced on the shares (Steijvers & Niskanen, 2014).

Contrarily, tax avoidance has positive relationship with firm value in the existence of strong executive monitoring (Chyz & White, 2014). The classical approach argues that for enhancing shareholders' wealth firms should not give up the resources which they carried as tax expenses (Akbari et al., 2019). Besides, tax avoidance activities of well monitored firms generate value for shareholders (Desai & Dharmapala, 2009b). Wang (2010) commented that shareholders put a price premium on TA, however, value premium declines while corporate clarity reduces. In addition, aggressive TA actions are linked to administrative penalty along with consequent reputation breakdown that as well reduces prospective cash flows as well as firm value (Chen et al., 2014). Similarly, TA has an effect on stock prices as it makes easy managerial rent seeking along with fearful information concealing (Kim et al., 2011).

The investigation regarding information content of TA recommends that corporate tax expenditure might be a signal in relation to company profitability (Chen et al., 2014). Moreover, a reduced amount of company-specific news is included into company share prices, and hence, price movement synchronicity could be enhanced (Feng et al., 2019). In addition, TA decreases information content of corporate tax payment (Ayers et al., 2009). Further, indirect consequences of TA comprise opaque corporate reporting (Balakrishnan et al., 2019), growing chances of income management (Desai, 2005) and increasing cost of investment (Lambert et al., 2007). However, Desai and Dharmapala (2009b) observed that overall consequence of CTA actions on firm value is not considerably different as of zero; though CTA comprises a wealth shift as of government to investors, agency problems flanked by managers and external investors enlarge the possibility of managerial diversion that is a reduction of firm value. Thus, current empirical evidence on TA to firm value is mixed. Further, the net impact of TA towards firm value is an experiential issue. The coming out of prime persuading issue depends on particular business operating surroundings as well as institutional setting (Chen et al., 2014).

IV. Research Gap

Very limited number of tax researches has found in the context of Bangladeshi listed companies. Furthermore, extant researches on corporate tax avoidance have shown inconclusive result regarding the linkage of TA with firm value. Some extant tax studies (e.g. Desai & Dharmapala, 2009b; Noor et al., 2009; Blaylock et al., 2012; Kiesewetter & Manthey, 2017; Akbari et al., 2019; Neifar & Utz, 2019) have found positive linkage of TA with firm value, whereas, some other studies (e.g. Chen et al., 2014; Chen et al., 2016; Li et al., 2016; Feng et al., 2019) have found negative linkage of TA with firm value. However, the empirical phase of the present paper would contribute to reach a conclusive idea on the linkage of TA with firm value. Moreover, it is also among the first paper that evaluates the association of TA with firm value from a combination of agency theory and stakeholder theory to the context of an emerging economy like Bangladesh. In summary, the empirical phase of the present study could fill the gap in the current tax avoidance literature through relating the tax avoidance with firm value in the context of an emerging economy like Bangladesh.

V. Research Question and Objective

The objective of this paper is to look at the connection of TA with firm value. In order to achieve the study objective, the research question of this paper is 'Is there any connection of TA with firm value?'

VI. Significance of the Study

The study provides conceptual evidence by extending the agency theory and stakeholder theory explanation in the context of an emerging economy like Bangladesh. Further, the study has made a way to realize how the agency theory and stakeholder theory can be applied to build up a theoretical framework to explain the linkage of TA with firm value. Besides, findings of the extant studies on the linkage of TA with firm value are inconsistent. Corporate managers could use the theoretical findings of this paper to better organize and direct their endeavors on corporate tax management. Moreover, the theoretical findings could be helpful to tax consultant as well as professional bodies who are linked with tax planning activities for the corporate bodies. It is also expected that the outcome of the study will encourage the interest and attention intended for future empirical research on CTA in the context of Bangladesh. In summary, a better understanding on the proposed research framework may help to maximize firm value as of restraining corporate tax avoidance.

VII. Underlying Theories

The tendency on the way to lesser tax expenses is further essential to the corporations which put into practice the division of proprietorship from management (Park, 2013). Moreover, the level of tax aggressiveness in companies could be determined by the character and level of agency conflicts, and therefore, investigation of an aggressive tax preference ought to be rooted in an agency point of view (Edwin & Victor, 2019). Agency theory elucidates the relationship linking the agent and principal regarding company’s any sort of transaction that generates agency costs (Cabello et al., 2019). Tax avoidance is a transaction as well and, consequently, gives increase to agency costs (Cabello et al., 2019). In addition, tax avoidance initiatives support opportunistic managerial actions (Desai & Dharmapala, 2006; Wilson, 2009; Wang et al., 2014). Opportunistic managers’ control accounting results by selecting accounting policies that facilitate them to maximize their wealth in addition to minimize tax burdens (Wilson, 2009). Hence, in agency theory perspective, tax avoidance has shareholders’ wealth-falling and stock price collapse risk increasing consequences (Neifar & Utz, 2019).

Stakeholder theory (Freeman, 1984) thinks about matters associated to morals and ethics in operating a business. Ethical accountability of a firm defends its stakeholders’ interest (Thomas & Tahir, 2019). Besides, stakeholder theory connects a business with its customers, suppliers, employees, shareholders, communities along with others who have an attention in the organization. Furthermore, stakeholder theory explains that a firm should produce value for all the stakeholders, not just shareholders. The basis of stakeholder theory is that in addition to shareholders, companies ought to pay attention toward other parts of the society owing to company growth along with their insightful impact on society (Jamei, 2017). On the one hand, firms’ emphasis their social responsibility, whereas, on the other hand, involve in tax avoidance strategies, and therefore, come out complex relations and situations whether tax avoidance strategies create value (Sikka, 2010).

VIII. Proposition Development

Tax avoidance decreases transparency, and thus, increases the jeopardy of the management taking benefit at the cost of firm’s resources, hence, firm value is negatively influenced in case of feeble corporate governance, that, in turn, could consent to managers to understate income (Desai & Dharmapala, 2006). Firms connecting in aggressive tax planning show evidence of comparatively high corporate opacity (Feng et al., 2019). The opaque temperament of stock market produces chances for managers utilizing tax avoidance as a mechanism to involve in rent seeking activities that harm shareholders’ value (Chen et al., 2016). Thus, TA has negative connection with firm value (Park et al., 2016). Similarly, Hanlon and Slemrod (2009) also found a negative response of the share price on information related to tax avoidance. Moreover, TA does not inevitably insert value to obscure companies compared with translucent counterparts because of additional agency costs (Chen et al., 2014).

The traditional motives of tax avoidance, for instance, enhancing shareholder value or making the best use of cash flows, are go together with the association of agency conflicts (Kiesewetter & Manthey, 2017). From agency theory perspective, costs of TA, for example investors’ hesitation subsequent to discharging its information, legal disgraces, being paid fines along with other associated costs, are more significant than advantages of tax avoidance actions (Akbari et al., 2019). In addition, agency theory considers advantages of TA, and the costs incurred with such actions together with time; endeavors and resources utilize for TA strategies, for example the possibility of financial statements’ amendment along with threat of lawsuit (Chen et al., 2015). Therefore, the significant negative direct link of tax avoidance with market value is consistent towards agency cost theory, along with its effects on managerial opportunistic rent seeking (Chen et al., 2016).

Stakeholder theory reveals that companies and societies are mutually dependent, and hence, companies should serve a broad social purpose than merely serving the shareholder welfares (Capasso et al., 2015).

However, tax avoidance disregards the ethical hope of the stakeholders as of the business. Moreover, when companies avoid taxes, they can make a public outcry that exposes the company to reactions as of politicians (Christensen et al., 2014). The presence of mistrust on the procedure of corporate reporting and disclosed financial news might discourage public to invest in a business, and therefore, it could impede the increase of market capitalization of a firm (Palepu & Healy, 2012). Thus, tax avoidance behavior indeed enhances future cash flow volatility by means of intensifying insecurity (Shevlin et al., 2019). Besides, tax revenue has a vast importance towards the government and society as it facilitates the working of the government and society (Kiesewetter & Manthey, 2017). Accordingly, reputational threats take place when tax avoidance practices are detected and released to the public (Christensen et al., 2014). Financial analysts as well as tax regulators also have recognized an enhancement in aggressive tax reporting with simultaneous increase in corporate accounting disgrace (Frank et al., 2004). Bird and Davis-Nozemack (2018) considered tax avoidance like a sustainability problem. On the basis of above discussion, and in the light of agency theory and stakeholder theory our presumption is that tax avoidance has negative association with firm value.

IX. Conclusion

Agency theory argues that managers might seek for additional financial advantages as agency costs from tax avoidance benefits. Besides, corporate tax avoidance might increase corporate social irresponsibility as it reduces the funding of government initiatives to execute public welfare activities, and it does not discharge the morale expectation of the stakeholders from the business. Thus, tax avoidance could decrease the stakeholders' confidence on the business. On the basis of agency theory, stakeholder theory and prior studies, our proposition is that tax avoidance has negative association with firm value, and thus, in empirical phase, the investigation could adopt a correlation study for examining the link between TA and firm value. Hence, the proposition of this paper might act as a guideline to managers and other practitioners for making an effective tax planning in order to derive maximum firm value. Furthermore, it is expected that the theoretical framework and proposition of the paper will be extended to an empirical phase in the context of an emerging economy like Bangladesh.

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