

UNIVERSITI TEKNOLOGI MARA

**DETERMINANTS AND VALUE RELEVANCE
OF CORPORATE TAX PLANNING**

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Abstract

The goal of this research is to provide evidence on the pervasiveness of tax planning activities among the publicly-listed Malaysian firms during the new tax regime 2000-2004. The pervasiveness of these tax planning activities resulted from the provision of tax incentives and different rules in tax reporting and financial reporting which have a significant impact on corporate tax burdens, that is, corporate effective tax rates (ETRs). Using a micro backward-looking approach of a balanced panel data for 294 listed firms during the years 2000-2004, this study examines the impact of tax policy and dual reporting systems on corporate ETRs, the determinants of corporate ETRs, the variation of corporate ETRs from the statutory tax rate, the extent of gap between financial accounting income and taxable income (book-tax differences), and the value relevance of taxable income as an earnings quality indicator and performance measure.

The statistical results reveal that ETRs are significantly different among firms within and across sectors. The average industry ETR during the years 2000-2004 is 20.4% and average ETRs for all sectors fall below the statutory tax rate of 28%. The study observed that firms from industrial products, consumer products, infrastructure and hotel sectors face lower ETRs, while firms from trading and services, properties and construction face higher ETRs. The statistical results provide evidence that low ETRs are associated with highly leveraged firms, extensive investment in fixed assets, higher profitability and greater extent of international operations. However, the statistical results support the political cost theory, instead of political clout theory, which indicates that larger firms face higher ETRs. Further, the findings suggest that in tax planning strategies, firms utilize permanent and temporary differences to reduce their ETRs. The statistical results provide significant evidence that firms have benefitted from tax provisions such as exempt income, deductible expenses, specific tax incentives, business losses and capital allowance carry forwards tax reliefs and deferred tax which caused their ETRs to diverge from the statutory tax rate. As a result, firms report higher financial accounting income than taxable income. Additionally, the findings suggest that taxable income provides useful information about the quality of corporate earnings and firms' performance.

Hence, this study provides empirical evidence that tax planning activities are pervasive and has lowered corporate ETRs below the statutory tax rate during the years 2000-2004. In tax planning strategies, managers of firms opportunistically utilized tax incentives and adopt accounting policies which trade-off between financial reporting and tax reporting to maximize shareholders' wealth. In addition, aggressive tax planning activities and dual reporting systems had contributed to a large gap between financial accounting income and taxable income. Hence, the present study contributes to the accounting literature with respect to tax competition, accounting choice and value relevance of corporate tax planning. Finally, despite equity and neutrality principles of the present corporate tax system which are believed to have been distorted, this study concludes that tax competition does not lead corporate tax rates to race to the bottom.

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CHAPTER 1

INTRODUCTION

1.0 Overview

The goal of this study is to provide evidence about the tax planning activities of publicly-listed Malaysian firms during the new tax regime 2000 to 2004, where firms are subject to current year assessment and self-assessment tax systems. The tax planning activities that resulted from the provision of tax incentives (general and specific tax incentives) and different rules between financial reporting and tax reporting have a significant impact on corporate tax burdens. Thus, an examination of effective corporate tax burdens is important for understanding the impact of a tax policy on the cost of doing business. As income taxes represent one of the costs of doing business, corporate income tax rates may affect corporate financing and investment decisions. Hence, policymakers, practitioners and academics acknowledge the importance of tax policy in determining the inflow and outflow of capital and the economic growth of a country (Molloy, 1998; Plesko, 2003; Desai, Dyck and Zingales, 2003).

In this study, tax planning refers to legitimate activities undertaken by firms to manage their income and expenses with the objectives of eliminating, minimizing and deferring tax within the ambit of tax legislations (Singh and Teoh, 2002; Kasipillai, 2005; Choong, 2006). Thus, tax planning activities should have been carried out by firms legally to reduce their incidence of tax within the tax rules and regulations. In tax planning strategies, firms strategically utilize tax incentives and other tax provisions, as well as different rules between financial reporting and tax reporting to generate tax savings. Hence, tax planning activities undertaken by the sample firms in this study should have been reflected in their effective tax rates (ETRs), that is, a proxy for