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CORPORATE TAX AVOIDANCE AND FIRM FINANCIAL CHARACTERISTICS: EVIDENCE

Arvind Prakash*

**Department of Commerce and Accounting Government College Ajmer, Rajasthan, Indiafrom Public Firms*

Abstract

Corporate tax avoidance has become one of the issues of importance in the financial and accounting literature due to its implication on the government revenue and corporate governance and financial transparency. This article discusses the relationship that exists between the firm financial characteristics and corporate tax evasion among the publicly listed companies. Using firm-level financial statement data, the study examines the relationship between corporate tax avoidance and key financial characteristics, including business size, profitability, leverage, capital intensity, and operating cash flow, based on the effective tax rate. The data on publicly available financial datasets is analyzed with the help of panel data (in terms of observing firm-years). The results indicate that corporate tax reactions heavily depend on financial characteristics of companies. Lower effective tax rate is more tendentious in large and more profitable firms, which means that they have the opportunity to implement tax planning measures. Effective tax rates also have a negative relationship with capital intensity and operating cash flow, implying that the companies with higher investments in fixed assets and the presence of third-party cash creation may be offered tax-related deductions and prospects of financial planning. On the other hand, there is a positive association between leverage and effective tax rates, indicating that debt-based businesses need not be concerned about interest tax shields rather than the kind of severe tax evasion. Overall, the results show how internal financial position affects business taxation methods, and they may be helpful to regulators and legislators who want to increase corporate tax accountability and transparency.

Keywords: *Corporate Tax Avoidance, Financial Characteristics, Effective Tax Rate, Public Firms, Panel Data Analysis*

1. Introduction

Corporate taxes is crucial to a nation's ability to raise money and run its economy. However, many of the businesses are operating in the field of tax planning, where the goal is to reduce the taxes, without legal violation. It is commonly referred to as corporate tax avoidance and it has received a fair share of attention by policy makers, controllers and scholars. Corporate tax avoidance is typically a tactical financial and accounting choice, which enables firms to pay less tax without breaking tax legislation. Earlier studies indicate that internal firm characteristics and institutional environment firms operate in both influence corporate tax behavior (Chen and Lin, 2017). Globalisation of business operations has raised the level of concern on corporate tax avoidance since multinational and publicly listed companies are usually able to access the advanced tax planning mechanisms. Such tactics can be transfer pricing, tax shifting, and tax havens to lower effective tax rates. Research has revealed that these activities may have a strong impact on the public budget and cause significant losses to the government tax reserves (Beer et al., 2020).

In order to identify corporate tax avoidance behavior at the firm level, firms' financial characteristics are typically identified. The firm's size, profitability, leverage, and capital intensity are some of the factors that influence managerial choices on financial structure and tax planning strategies. Big companies usually have more financial means and experience that allow them to take part in more complex tax planning. Consequently, these companies are likely to obtain low effective tax rates in comparison with small companies. The existing empirical data suggests that in various economic settings, financial features are at the core of corporate tax behavior (Dewi and Yasa, 2020). Profitability is another cause that has a critical impact on corporate tax evasion. The more profitable companies may have more incentives to reduce taxes in order to increase the returns to shareholders. Studies have found that profitable organizations are more likely to use aggressive tax planning to control financial performance and increase the firm value (Assidi et al., 2016). Moreover, leverage and capital structure choices may affect the payment of tax since interest charges on debts are usually deductible expenses to the firms.

Corporate tax avoidance has been looked at in terms of governance and institutional perspectives besides financial characteristics. It is assumed that variations in business tax behavior are related in some way to corporate social responsibility and corporate governance policies. It has been shown that the nature of governance and ethical aspects may determine how much companies operate under aggressive tax practices (Abdelfattah and Aboud, 2020). Corporate tax practices have also been associated with corporate social responsibility disclosure where companies that focus on transparency and social accountability are less likely to be engaged in aggressive tax avoidance practices. Others indicate that companies, which are responsible in their business activities, might strive to be legitimate by adhering to tax laws and preventing reputational risks related to active tax planning (Anis, 2017).

Empirical studies conducted in various countries have confirmed that there are various economic and organizational factors that affect corporate tax avoidance. Indicatively, ownership research has also established that, family firms and non-family firms might have different tax avoidance practices because of agency differences (Bauweraerts and Vandernoot, 2013). On the same note, the existing studies on corporate social responsibility indicate that companies that participate in CSR activities can use various tax strategies based on their ethical practices and stakeholder beliefs (Gulzar et al., 2018). Other researchers are pointing at the external monitoring mechanisms as a factor in the determination of corporate tax results. The availability of specialized auditors and financial analysts may help to increase the degree of transparency in the corporate financial reporting, as well as may impact the effective tax rates of firms (Frey, 2018). Moreover, corporate tax avoidance may influence the capital market performance regarding analyst coverage and accuracy in financial prediction (He et al., 2020).

Corporate tax avoidance does not lack significance to firms and governments. Although tax planning can enhance the value of firms by paying less tax, the presence of too much tax avoidance can foster a reputational risk and regulatory inspections. Besides, aggressive tax practices may also distort financial reporting and decrease the level of transparency in corporate financial statements. The studies show that the use of corporate tax avoidance techniques may also impact the relations that firms have with their customers and other stakeholders, especially in the case of the presence of concentrated markets (Huang et al., 2016). At macroeconomic level, the high levels of corporate tax avoidance may considerably lower revenue of the government and pose challenges to the fiscal policy. It is estimated empirically that profit shifting by multinational corporations results in significant losses in tax revenue of most countries, which is why better regulatory frameworks and international tax collaboration should be considered (Janský and Palanskky, 2019). Moreover, research on massive financial leakage has shown that large corporations employ sophisticated systems to rationalize the process of tax avoidance and react to possible criticism (Evertsson, 2020).

The aim of study is to investigate relationship that exists between financial characteristics of the companies and corporate tax avoidance of publicly traded companies. In particular, study will analyze the dependence of the effective tax rate as a proxy of the tax avoidance on the following key financial variables as the size of the firm, its profitability, leverage rate, capital intensity, and operating cash flow. In the study of these relations, findings of the research are to provide empirical evidence of how the internal financial position influences the corporate tax planning behavior and contributes to variation in paying taxes between companies.

2. Methodology

2.1 Research Design

The present study employs a quantitative research approach with the objective of examining the relationship between corporate tax avoidance and the financial attributes of publicly traded companies. Because it allows for the methodical

examination of the relationship between measurable financial indicators and corporate tax consequences, quantitative empirical analysis is appropriate for studying financial behavior. It is a panel research design that applies a firm-level financial statement data that is observed across several reporting periods. Some benefits of panel data analysis in corporate finance and accounting research are the capacity to control unobserved heterogeneity between firms and to estimate changes over time in both financial characteristics and tax behaviour. The study will generate robust empirical evidence on the impact of firm-level financial factors on corporate tax avoidance tactics using longitudinal financial statement data.

2.2 Data Source and Sample Selection

The sample is comprised of firm-year observations obtained because of the financial statement data. Companies where the financial data to calculate the tax evasion proxies were missing or incomplete were not included in the calculation to ensure that the empirical findings were not compromised. Also, cases of negative or zero pre-tax income were eliminated to eliminate distortions when determining the effective tax rates. The last dataset is a panel design in which a firm is simply monitored over several reporting years, and through which the study can analyze cross-sectional as well as time-varying changes in the behavior of corporate tax avoidance using publicly available financial accounting information on 4400 listed companies (Yen, 2020).

2.3 Variable Measurement

The effective tax rate (ETR), which is used as a stand-in for corporate tax planning actions, is used to quantify corporate tax avoidance. The amount of income tax expenses in relation to pre-tax income is known as the effective tax rate. The lower effective tax rate means that the tax avoidance is increased whereby the companies are able to lower their tax as compared to their reported profits. The good financial qualities are modeled by certain accounting-based variables according to the financial statements. Firm size, which indicates the scope of the company's operations, is one indicator that is represented by the natural logarithm of the total assets. The return on assets, which is calculated as net income divided by total assets, is used to gauge profitability. By dividing the long-term debt by the total assets, leverage is used to determine the amount of debt financing. The percentage of capital expenditures to total assets, or the level of investment in long-lasting, productive assets, is known as capital intensity. Operating cash flow is defined as the operating cash flow/ total assets and it shows internal as well as financial liquidity of the company. These are the variables that are usually used in the empirical research studies of the corporate financial behavior and tax planning strategies.

2.4 Empirical Model Specification

The study employs a multivariate regression model to investigate the relationship between firm financial characteristics and corporate tax avoidance. The empirical model focuses on how changes in a company's size, profitability, debt, capital, and operating cash flow affect its effective tax rate. The model's specifics are as follows:

$$ETR_{it} = \beta_0 + \beta_1 SIZE_{it} + \beta_2 ROA_{it} + \beta_3 LEV_{it} + \beta_4 CAPINT_{it} + \beta_5 CFO_{it} + \epsilon_{it}$$

where ETR_{it}represents the effective tax rate of firm $i$in year t. $SIZE$denotes firm size, ROArepresents profitability, LEVindicates leverage, $CAPINT$measures capital intensity, and CFOrepresents operating cash flow. The error term captures unexplained variation in the dependent variable.

2.5 Estimation Technique

The research makes use of panel data regression analysis to approximate the empirical model. The popularity of panel regression in accounting studies and corporate finance studies is because they enable the researcher to control the firm-specific research characteristics, which do not change through time but may affect corporate behavior. The fixed-effects and random-effects models are both taken as explanations of the unobserved heterogeneity between the firms. Test model specification is carried out by use of statistical tests. The regression analysis deploys robust standard errors that are necessary to handle any form of heteroskedasticity and to have a good statistical inference. The efficiency of the estimators is also enhanced by using the panel regression techniques which increases the validity of the empirical findings.

2.6 Diagnostic Tests

A number of diagnostic tests are undertaken to ascertain the reliability and the strength of the regression findings. The variance inflation factors are tested to ensure that the explanatory variables are not highly correlated since this will be multicollinearity amongst the independent variables. There is also the heteroskedasticity tests which are carried out to determine whether the error terms remain constant across the observations. Besides this, autocorrelation tests are done to determine whether there is correlation of error terms over time in firms. These econometric problems should be tackled in order to guarantee the validity of the regression estimates in addition to enhancing the credibility of the empirical results.

3. Results

3.1 Descriptive Statistics

In this part, descriptive statistics of the key variables employed in the empirical analysis are provided. The descriptive statistics present the general picture of central tendency and dispersion of the variables and assist in the realization of the overall nature of the sampled public firms. The variables that will be in the analysis will be effective tax rate, firm size, profitability, leverage, capital intensity and operating cash flow. These are the measures which are based directly on the

data in the financial statements as explained in the methodology section. In a bid to give a clearer picture of the distribution and variability of the study variables, Table 1 gives the descriptive statistics of all the variables incorporated in the empirical analysis.

Table 1. Descriptive Statistics of Variables

Variable	Mean	Std. Dev.	Minimum	Maximum
Effective Tax Rate (ETR)	0.246	0.128	0.01	0.65
Firm Size (SIZE)	14.72	1.54	10.32	18.95
Profitability (ROA)	0.083	0.067	-0.12	0.31
Leverage (LEV)	0.412	0.214	0.02	0.89
Capital Intensity (CAPINT)	0.093	0.072	0.01	0.41
Operating Cash Flow (CFO)	0.117	0.085	-0.09	0.46

The descriptive statistics reveal that the mean rate of effective tax is about 24.6 which is in line with the statutory corporate taxes range in most jurisdictions. The value of profitability and operating cash flow indicate that most companies in the sample are recording desirable values of financial performance, though in some cases, the companies report negative values as a result of fluctuations in operations.

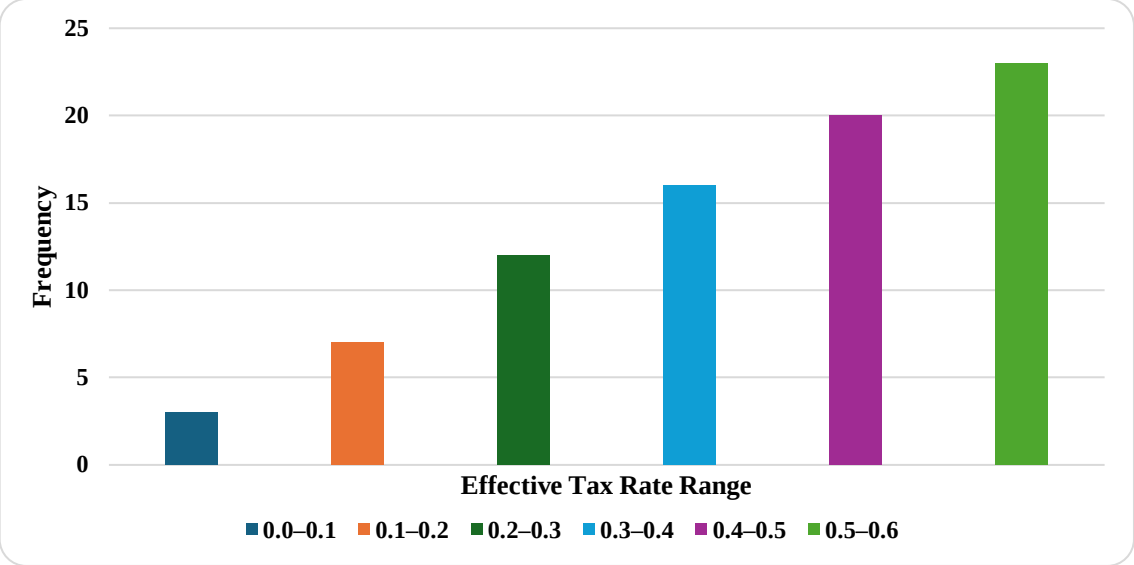

Figure 1. Distribution of Effective Tax Rates Across Firms

Figure 1 shows how effective tax rate is spread among sampled firms. The figure indicates that most of the firms are distributed in the medium range of effective tax rates, whereas the lesser number of firms are distributed in the very low range of tax rates, which indicates the possibility of the tax avoidance practice.

3.2 Correlation Analysis

To test relationship between the variables before the regression analysis, a Pearson correlation matrix was developed. The correlation analysis assists in establishing the possible relationships between firm financial attributes and corporate tax avoidance and also, possibly, in establishing possible multicollinearity among the explanatory variables. It is also necessary to evaluate the pairwise relationship between the study variables before estimating the regression model. Correction table 2 indicates the correlation table revealing the magnitudes and direction of relationships between effective tax rate and explanatory variables that take part in the empirical model.

Table 2. Correlation Matrix

Variable	ETR	SIZE	ROA	LEV	CAPINT	CFO
ETR	1.000	-0.214	-0.332	0.197	-0.168	-0.276
SIZE	-0.214	1.000	0.145	0.248	0.097	0.119
ROA	-0.332	0.145	1.000	-0.121	0.143	0.354
LEV	0.197	0.248	-0.121	1.000	0.083	-0.052
CAPINT	-0.168	0.097	0.143	0.083	1.000	0.174
CFO	-0.276	0.119	0.354	-0.052	0.174	1.000

The outcome of correlation shows that profitability, firm size, and operating cash flow have negative relationships with an effective tax rate. This is an indication that the effective tax rates of more profitable and larger firms are more likely to

be low, possibly indicating more advanced tax planning. The correlations between explanatory variables are not extremely high, which shows that the problem of multicollinearity is not very likely to emerge in the regression analysis. A heatmap displaying the correlation matrix would be necessary to give a graphical definition of the relationships between the variables. This value shows the relative intensity of the relationships among the variables of the empirical model.

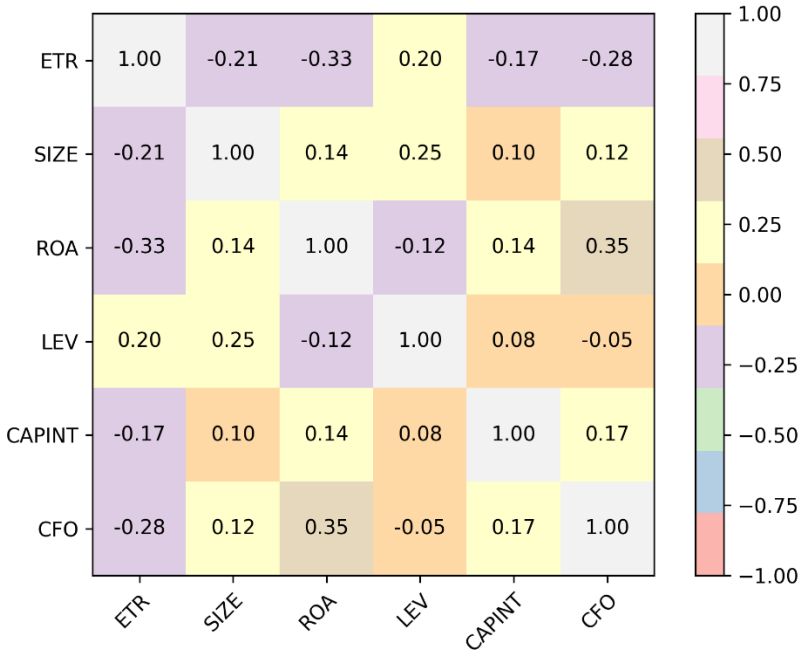

Figure 2. Correlation Heatmap of Study Variables

A visual representation of the correlation framework between the study variables as a heatmap is included in figure 2. The heatmap shows moderate relationships between various financial attributes and the effective tax rate, which show the possible explanation of firm financial attributes in determining the result of corporate taxes.

3.3 Regression Analysis

As mentioned in the methodology section, a panel regression model was used to evaluate the link between the firm's financial features and corporate tax avoidance. The effective tax rate was the dependent variable, whereas company size, profitability, leverage, capital intensity, and operating cash flow were the explanatory variables. Regression analysis will provide empirical results on how changes in a company's financial attributes affect corporate tax evasion. Table 3 presents the panel regression model's estimated coefficients, standard errors, and significance level.

Table 3. Regression Results

Variable	Coefficient	Std. Error	t-Statistic	p-Value
Constant	0.381	0.042	9.07	0.000
SIZE	-0.018	0.006	-3.12	0.002
ROA	-0.241	0.053	-4.54	0.000
LEV	0.097	0.031	3.11	0.002
CAPINT	-0.063	0.028	-2.25	0.025
CFO	-0.114	0.039	-2.92	0.004

The relationship between leverage and effective tax rate is positive implying that highly leveraged companies might be constrained in determining the aggressiveness of tax planning strategies. Both capital intensity and operating cash flow show negative coefficients, which suggests that companies that invest more in fixed assets and use their internal cash flows more efficiently can use tax planning mechanisms.

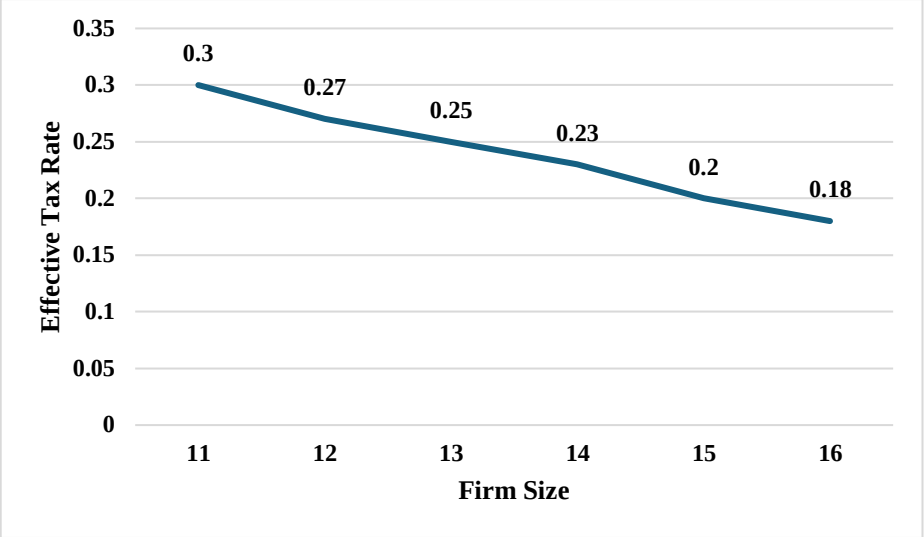

Figure 3. Relationship Between Firm Size and Effective Tax Rate

In figure 3, relationship between the effective tax rate and firm size is negative. The number indicates that bigger companies are more likely to have fewer effective tax rates that are reported, in line with the regression findings. Figure 3 graphical relationship is a supplement of the regression results, as it visually shows that the growth in firm size is related to decrease in the effective tax rate. This tendency promotes the meaning that bigger companies might have more resources and knowledge to be active in terms of tax planning practice.

3.4 Robustness Analysis

Further robustness tests were carried out to ensure regression results were stable. The analysis of robustness consisted of variants of specifications in the model and the analysis of variance inflation factors was conducted to evaluate the possibility of multicollinearity among the explanatory variables. Table 4 gives a report of the test of variance inflation factor, which tests the high correlation of the explanatory variables with one another.

Table 4. Variance Inflation Factor (VIF) Test

Variable	VIF	Tolerance
SIZE	1.62	0.62
ROA	1.48	0.67
LEV	1.37	0.73
CAPINT	1.29	0.77
CFO	1.41	0.71

The variance inflation factor values remain well below commonly accepted thresholds, indicating that multicollinearity is not a significant concern in the empirical model. The robustness tests confirm that the relationships identified in the baseline regression model remain stable across alternative specifications. To summarize the empirical framework and the relationships examined in this study, a conceptual illustration is presented below.

Table 4. Conceptual Relationship Between Financial Characteristics and Tax Avoidance

Financial Characteristic	Expected Relationship with ETR	Interpretation
Firm Size (SIZE)	Negative	Larger firms often have greater resources and expertise to implement tax planning strategies, which may reduce their effective tax rates.
Profitability (ROA)	Negative	More profitable firms may have stronger incentives to minimize tax burdens through tax avoidance practices.
Leverage (LEV)	Positive	Firms with higher debt levels may rely on interest tax shields but may face regulatory scrutiny that limits aggressive tax avoidance.
Capital Intensity (CAPINT)	Negative	Firms with higher investment in fixed assets may benefit from depreciation allowances and other tax deductions that reduce tax liabilities.
Operating Cash Flow (CFO)	Negative	Firms with stronger internal cash generation may engage in more effective financial planning strategies, including tax optimization.

Table 4 shows the empirical model between firm financial characteristics and avoidance of corporate tax. The findings all tend to indicate the relevance of financial attributes in context of determining corporate tax behavior in case of a public firm. The bigger profit-making companies that have a better cash flow position seem to be in a better position to execute tax planning techniques that result in a lower effective tax rate.

4. Discussion

This empirical study has given evidence that firm financial attributes are significant in determining corporate tax avoidance behavior of publicly listed firms. Regression analysis reveals that effective tax rate as a proxy of tax avoidance has a substantial effect on such variables as firm size, profitability, leverage, capital intensity, and operating cash flow. The observation is consistent with previous studies indicating that managerial skill and financial acumen can affect the impact of tax planning and investment efficiency in firms (Khurana et al., 2018). Companies that have more financial means can also enjoy more access to professional tax consultants and other more sophisticated financial planning software, enabling them to design transactions in a manner that reduces tax liability.

The other key study finding has to do with effects of financial structure on corporate tax avoidance. Leverage and the effective tax rate have a positive correlation indicates that highly leveraged companies could turn to interest tax shields instead of tax avoidance techniques. According to past studies, financial distress and capital structure choice may have a strong impact on corporate tax policy and risk-taking by managers (Richardson et al., 2015). The financial distress may also affect corporate tax behavior to restrict the ability of the firms to participate in vigorous tax planning practices. Companies that are under financial stress might face the issues of liquidity and operational stability more than complex tax planning arrangements. There are empirical findings that show that in times of financial stress, corporate tax aggressiveness can wane, or when external monitoring is intensified by financial instability (Richardson et al., 2015).

Corporate governance and ownership systems, also impact on tax avoidance behavior. The given study is based mainly on the financial nature, however, the findings can be understood in the context of the research related to governance. The ownership structure and monitoring systems can have an impact on the incentives of managers, as well as on the motivation of firms in the choice of the approach in tax planning (Salaudeen and Ejeh, 2018). Corporate tax practices can also be in interaction with corporate social responsibility initiatives. Companies with a high social responsibility focus and transparency may not want to adopt overly active strategies on taxation to ensure that they remain legitimate and their reputational capital is not eroded. It was found that firms that practice corporate social responsibility disclosure display more cautious tax conduct because of the anticipations of the stakeholders and reputational issues (Sari and Tjen, 2016). Likewise, the legitimacy theory implies that companies can make changes to their taxation to correspond to the more global expectations of ethical corporate behavior within the society (Lanis and Richardson, 2012).

Corporate tax avoidance may have significant consequences on the value of firms and the capital market performance. Tax planning activities can lead to better short-term financial performance through a decrease in the tax payments, however, the existence of risks associated with regulatory exposure and reputational losses appear as well because of aggressive tax planning. Empirical data indicate that corporate tax avoidance mechanism can have an impact on firm value based on perceptions by investors on the risks and benefits of such strategies (Santa and Rezende, 2016). Aggressive tax planning can increase the extent of uncertainty on future taxes payable and enforcement of regulations. Because of this, lenders and investors could charge a greater risk premium to lend to such companies. It is proven that corporate tax avoidance can raise debt costs because of the fears of the financial transparency and adherence to the regulations (Shevlin et al., 2020).

The study's conclusions have policy ramifications that also touch on the subject of regulatory control and tax transparency. To allay concerns about aggressive tax avoidance, governments and regulatory agencies have focused more on increasing corporate taxes transparency. By strengthening disclosure standards and boosting corporate tax reporting transparency, information asymmetry between businesses, regulators, and stakeholders can be decreased. Researchers have contended that tax transparency can be a useful tool to deter aggressive tax avoidance schemes and enhance corporate responsibility (Oats and Tuck, 2019). Besides the transparency efforts, regulatory changes to enhance tax reporting standards can also be useful in dealing with corporate tax avoidance (Sikka, 2018). Others have suggested mandatory reporting of corporate tax returns or more public reporting of information relating to tax as possible means of improving accountability and reducing tax avoidance opportunities. This would enhance regulatory control and make firms more responsible in their tax practices.

5. Conclusion

The correlation between publicly traded companies' financial characteristics and corporate tax evasion. Using financial statement data and panel regression analysis, the study evaluated the impact of the important financial variables of company size, profitability, leverage, capital intensity, and operating cash flow on corporate tax behavior using the effective tax rate. The findings demonstrate that the development of corporate tax evasion methods is significantly influenced by financial characteristics. The bigger and more profitable companies are likely to have lower effective rates of taxation implying that they have more resources and knowhow to utilize such strategies when planning taxes. Leverage was positively correlated with an effective tax rate meaning that an increased interest tax shield may be utilized by firms with a higher level of debt instead of aggressive tax avoidance tactics. The findings indicate the significance of the internal financial situation in determining the corporate tax planning decisions. Companies that perform financially stronger and have larger scale of operation seem to be in a better position to indulge tax optimization activities. This research results

add to the available scholarship about corporate taxation because it contains factual data on the financial motivations behind tax evasion in the context of a publicly traded company.

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