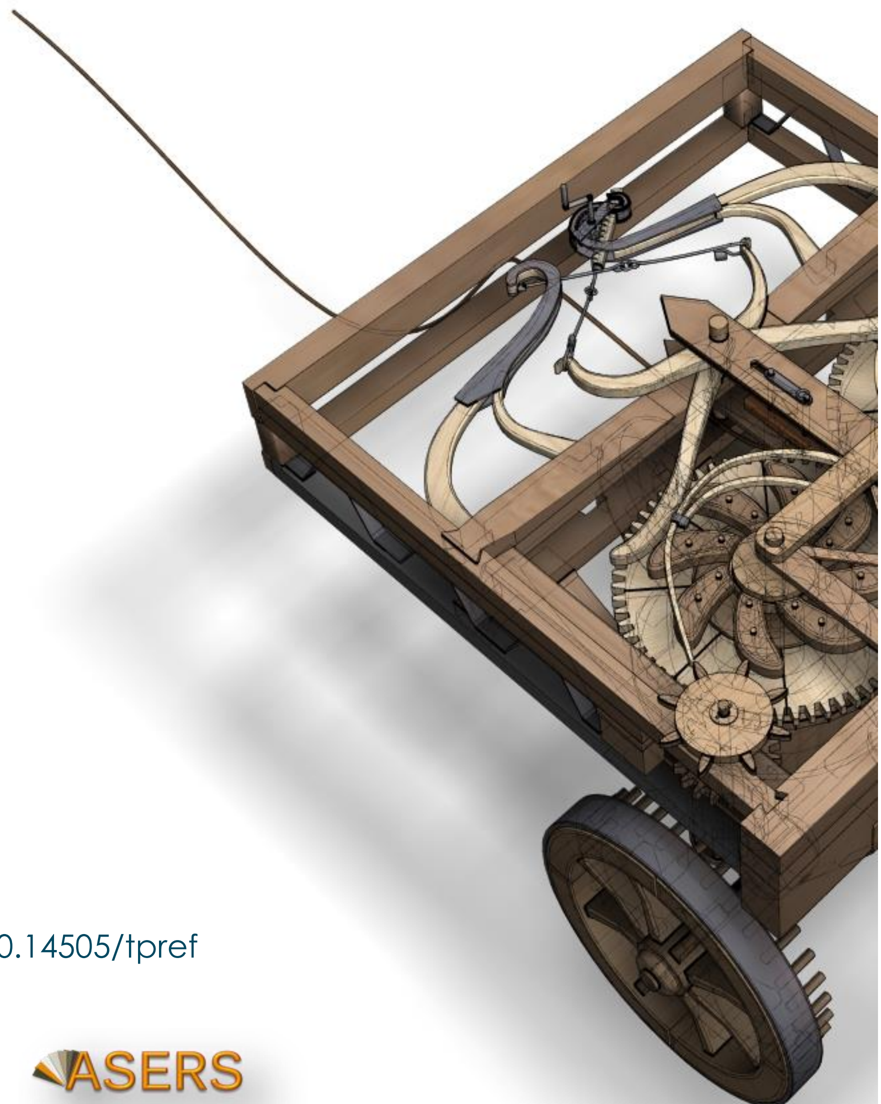
Theoretical and Practical Research in Economic Fields



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Theoretical and Practical Research in Economic Fields

Many economists today are concerned by the proliferation of journals and the concomitant labyrinth of research to be conquered in order to reach the specific information they require. To combat this tendency, **Theoretical and Practical Research in Economic Fields** has been conceived and designed outside the realm of the traditional economics journal. It consists of concise communications that provide a means of rapid and efficient dissemination of new results, models, and methods in all fields of economic research.

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Tax Avoidance by Public Firms: Unveiling the Overlooked Economic Consequences

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Abstract: The existing literature on tax avoidance of listed firms is rich in research results. Moreover, many tax avoidance studies are closely related to research themes. Still, there are large differences in conclusions and a lack of systematic exploration of their findings and the theoretical mechanisms behind them. In particular, the U.S. and China are rich in research on tax avoidance, and many issues of tax avoidance are viewed differently. Therefore, it is necessary to carry out a systematic review to clarify further the theoretical ideas on the influencing factors and economic consequences of tax avoidance.

This study conducts a statistical analysis of 172 empirical studies examining the factors influencing corporate tax avoidance and its economic consequences, including 97 studies on influencing factors and 75 on economic outcomes. Given the close interrelation between these factors and economic consequences, this paper systematically reviews the economic consequences of tax avoidance, building on the research of influencing factors. This approach aims to provide readers with a more comprehensive understanding of the determinants and economic implications of tax avoidance under agency theory.

Similar topics are categorized and organized, and related studies' theories and conclusions are summarized to facilitate a systematic understanding of the progress of tax avoidance research.

The literature related to this study was obtained by searching for a summary of the recent empirical literature on the factors influencing firm tax avoidance and economic consequences on ScienceDirect, EBSCO, SSRN, Zhiwang, and Baidu Academic. The study is divided into the possible risks arising from tax avoidance, which are discussed mainly from the perspective of tax agency theory, tax risk, accounting information risk, reputation risk, and financial risk.

Tax avoidance is an important and complex issue related to the quality development of firms and the coordination of the interests of various parties, such as the government, shareholders, and managers. This study finds that conclusions based on different systems, perspectives, study designs, and samples may not lead to the same conclusions. This study is dedicated to systematizing the literature on tax avoidance, understanding the various research perspectives, and comparing them. This study contributes to a systematic understanding of the content and perspectives of tax avoidance research. In addition, it provides direction for further work on high-quality firm tax avoidance in the future.

Keywords: tax avoidance; influencing factors; economic consequences.

JEL classification: H26; H00.

Introduction

Tax avoidance is the act of a firm taking various possible measures aimed at reducing its tax burden (Hanlon and Heitzman, 2010). The existing facts and evidence indicate that firms' tax avoidance is common and that firms may

engage in tax avoidance under their circumstances. For example, the United States is the largest developed country in the world. Tax differences in U.S. public firms have increased yearly (Manzon and Plesko, 2001; Lennox *et al.* 2012) and more than tenfold over the decade (Boynton *et al.* 2005). The increase in tax differences may result from the increasing aggressiveness of firm tax avoidance (Mills, 1998; Wilson, 2009; Blaylock *et al.* 2011). The Internal Revenue Service (IRS) and the U.S. Department of Commerce's Bureau of Economic Analysis (BEA) estimate the percentage of firm tax evasion to be over 10% through extensive checks. China is the largest developing country in the world, and tax evasion is more severe in Chinese-listed firms compared to other countries (Cai and Liu, 2009; Lin *et al.* 2017). According to the Ministry of Public Security and the State Administration of Taxation, as many as 22,800 cases of tax-related crimes were investigated by the Ministry of Public Security in 2018 alone, involving an amount of 560 billion yuan. This study finds that the studies related to tax avoidance fit their respective institutional contexts regarding influencing factors, but the conclusions are the same. However, the conclusions differ significantly in terms of economic consequences.

Research on the factors influencing tax avoidance is rich and most developed in the context of the respective systems. For example, when exploring how managers' characteristics affect firm tax avoidance, the Western literature is more often based on general managers' characteristics, such as gender (*e.g.*, Francis *et al.* 2014), or local Western contexts, such as political beliefs (*e.g.*, Francis *et al.* 2016). On the other hand, the literature related to tax avoidance in China is more often explored based on China-specific contextual models, such as the reform of the tax system (*e.g.*, Wang *et al.* 2009), the reform of mixed ownership of state-owned enterprises (*e.g.*, Wang *et al.* 2021), and the reform of reverse mixed ownership (*e.g.*, Zhai *et al.* 2021). Unlike the studies on the impact factors of tax avoidance, there are more differences in the economic consequences of tax avoidance. In particular, is tax avoidance more controversial regarding whether it raises risks? However, the prominent features of the lack of a systematic framework for tax avoidance research, the complexity of tax avoidance measurement, and the dichotomy between theoretical and empirical evidence have greatly reduced the value of tax avoidance theory and practice. This study provides an integrated overview of the existing tax avoidance literature. It helps understand what previous authors have focused on in tax avoidance research and their main views and disagreements. It is helpful for systematically constructing a theoretical framework for tax avoidance.

This study makes three main possible contributions. First, this study systematically organizes the theory and evidence of the economic consequences of tax avoidance and improves the study of the economic consequences of tax avoidance. The existing theories on the economic consequences of tax avoidance can be summarized in two: classical economic theory and tax agency theory. The former suggests that tax avoidance allows firms to gain tax savings and thus reduce firm costs. The latter demonstrates that tax avoidance becomes a means for insiders to extract rent from outsiders, resulting in a loss of firm wealth. Existing empirical studies partially support both theories but lack a holistic approach. This study attempts to explore the two theories and evidence provided systematically.

Second, this study enriches the research related to tax avoidance and provides a valuable reference for the future development of tax avoidance. Tax avoidance is influenced by the firm's motivation and external stakeholders, so how to coordinate the interests of all parties to coordinate the cost of tax avoidance and tax saving benefits and achieve high-quality tax avoidance is an essential issue for firms to consider. This study provides theoretical and practical support for future high-quality tax avoidance through a systematic theoretical review.

Third, building upon Ge *et al.* (2024) research on the determinants of tax avoidance, this paper explores the economic consequences of tax avoidance within the framework of agency theory. This study not only enhances the reader's comprehension of the multifaceted factors influencing tax avoidance but also fosters a deeper understanding and familiarity with the overarching perspective of tax avoidance under agency theory.

1. Research Methodology

1.1. Literature Collection Methodology

Following the practice of Awan and Sroufe (2022), this study searches for studies related to firm tax avoidance from 1992 to 2024 by keywords, abstracts, and subject terms in leading academic websites such as ScienceDirect, EBSCO, SSRN, Zhiwang, and Baidu Academic. Furthermore, 172 empirical studies were obtained on the factors influencing firm tax avoidance and economic consequences. Among them are 97 papers on the influencing factors of tax avoidance（Ge *et al.* 2024）and 75 papers on the economic consequences of tax avoidance, shown in Figure 1.

After analyzing the final literature on the factors influencing firm tax avoidance, it was concluded that the research themes on the factors influencing firm tax avoidance focused on managers' characteristics, fundamental firm characteristics, and corporate governance. It can be found that early studies on influencing factors focused on essential characteristics, such as firm size, business strategy, and industry classification. However, the tax avoidance literature has recently incorporated corporate governance features to reduce agency conflicts. While the research themes are rich, there are limitations to the specific details. First, most studies on tax avoidance and potential conflicts between managers and shareholders based on principal-agent theory are premised on the first type of agency costs. They do not address the second type of agency costs. Second, the current field of research is less concerned with comparing different forms of taxation, mainly based on the institutional contexts of different countries. Third, most of the current literature's widely used tax avoidance measures originate from U.S. academia and cannot be used in other countries except for the effective tax rate and accounting-tax difference categories.

Figure 1. Tax avoidance economic consequences.

The analysis revealed several potential economic consequences of firm tax avoidance. These consequences may be direct, such as increasing cash flow, reducing the tax burden on the firm, and creating a range of risks, such as tax risk, reputational risk, and financial risk, or indirect, such as changing the firm's capital structure. With the integration of tax and social responsibility, it can be found that the economic consequences of tax avoidance have received increasing attention in recent years. Still, there are some unresolved issues. First, the relationship between the interests associated with tax avoidance and managers and shareholders can be complex. Understanding the internal dynamics of tax avoidance decisions may require more in-depth case studies or surveys in willing firms. Second, using the cash saved through tax shelters is subject to further exploration as to whether tax-sheltered firms use the additional cash to engage in more productive activities. Third, managers may not always make the best choices in allocating firm resources, and the possible impact of tax avoidance on managers' decisions has not been fully explored.

1.2. Theoretical and Research Framework

1.2.1. Theoretical Framework

Classical tax avoidance theory considers tax avoidance as a tax avoidance between the firm and the state, where tax avoidance causes tax base erosion for the state but helps tax-avoiding firms to reduce their tax burden (Hanlon and Heitzman, 2010). With the Enron financial fraud incident in the United States in the past three decades, Enron executives hid accounting fraud information with the help of tax avoidance. They tunneled small and medium shareholders with the help of tax avoidance. Russia rectified oil tax evasion to increase the firm's wealth. The theoretical community gradually reflected on two issues. First, who influences tax avoidance? Second, is tax avoidance beneficial to the shareholders of a firm? Tax avoidance agency theory points out information asymmetry between internal managers and external shareholders in tax avoidance. Managers use

the name of tax avoidance to extort shareholders and make the firm suffer losses. This theory has become the most popular research topic in tax avoidance.

Tax avoidance agency theory implies that the initiative of tax avoidance is in the hands of the information-advantaged managers, who strategically adopt tax avoidance measures according to the firm's situation and stakeholder requirements (Desai *et al.* 2006; Desai *et al.* 2007). Therefore, tax avoidance does not necessarily benefit the firm, but it benefits managers. Although the existing literature gives reasons for influencing tax avoidance, almost all of the existing literature examining the factors influencing tax avoidance lacks an analytical framework for what influences the extent of firm tax avoidance.

1.2.2. Research Framework

Based on the tax avoidance agency theory research framework, this study proposes a three-factor model that affects tax avoidance. That is, the decision maker avoids taxes (managerial characteristics), the intrinsic conditions and magnitude of the ability to avoid taxes (fundamental firm characteristics), and the pressure faced by the decision maker and other stakeholders of the firm (corporate governance). These frameworks help clarify the stakeholders and role-play in tax avoidance decisions.

In addition, in terms of the economic consequences of tax avoidance, this study has reviewed four aspects of tax avoidance risk: tax risk, accounting information risk, reputation risk, and financial risk, focusing on the debate of whether tax avoidance triggers agency risk in recent decades. These areas of tax avoidance risk are of most interest to theoretical research.

The above framework is the research framework for this study to examine the factors influencing tax avoidance and economic consequences.

2. A Review of the Economic Consequences of Tax Avoidance

Tax avoidance saves firm cash support and increases firm value while providing stakeholders with more information to facilitate decision-making (Hanlon *et al.* 2005; Lennox *et al.* 2012). However, tax agency theory suggests that tax avoidance may incur reduced transparency of accounting information, increased agency risk, and other risks. Thus, tax avoidance's economic consequences may be risky and beneficial.

On the one hand, firms with a high degree of tax avoidance can deteriorate the quality of firm accounting information and information opacity through complex tax planning and tax accounting (Dhaliwal *et al.* 2017; Chen *et al.* 2016; Bennedsen and Zeume, 2018). On the other hand, external investors and government regulators have difficulty obtaining effective information to monitor the behavior of firm insiders, which worsens the agency problem between firm insiders and outsiders (Jenson and Meckling, 1976) and increases firm risk.

On the other hand, tax avoidance brings incremental information, and rational outside investors and government regulators identify the various risks behind firms with high levels of tax avoidance and thus be more cautious. Therefore, managers pay more attention to managing firm risk to avoid suspicion from investors and external regulators (Erickson *et al.* 2004; Lennox *et al.* 2012). In conclusion, the existing literature is controversial and inconclusive regarding whether tax avoidance brings more benefits or risks.

Inefficient market theory, share price changes are considered a composite reflection of investors' information about the firm. An increase in the share price means that investors hold that information about the firm, which helps increase the firm's value. On the contrary, the information reduces the value of the firm. There are different views on whether tax avoidance affects the value of a firm. One view is that managers view tax avoidance as a by-product of maximizing firm value. The level of tax avoidance for the market results from the firm's maximization decision, and they benefit from that optimal tax decision. Therefore, the level of tax avoidance does not affect the firm's value.

Another view is that tax avoidance does not affect the firm's value if the information between investors and the firm is perfectly symmetric. Managers can consistently achieve optimal incentives (Hanlon and Heitzman, 2010). However, the reality is that there are extensive information asymmetries between firms and shareholders and incentive efficiency losses for managers and shareholders (Slemrod, 2004; Chen and Chu, 2005), leading to tax avoidance that may affect firm value.

However, the existing literature does not agree on the relationship between tax avoidance and firm value. For example, Katz *et al.* (2013), based on an agency theory framework, find that tax avoidance leads to a decrease in the firm's future profitability. In contrast, Blaylock (2012) finds a positive association between tax avoidance and future firm performance. There is also some evidence that corporate governance is an essential factor in the economic consequences of tax avoidance (Desai and Dharmapala, 2009). Desai *et al.* (2007) studied the widespread tax evasion and weak tax enforcement in the Russian oil industry during Yeltsin's presidency.

They find that enhanced tax enforcement efforts drive up firms' share prices and related industries with significant tax evasion and avoidance. When a firm is located in a country with a higher corruption index, increasing tax rates can lead to tax evasion. Hanlon and Slemrod (2009) find that a good or bad corporate governance environment affects investors' judgments about firm tax behavior based on U.S. listed firms. When the market learns of a firm's involvement in tax sheltering, the share price declines, while news of a firm with a better governance environment whose taxes are sure to lead to an increase in the share price.

Similarly, Zhang *et al.* (2015), based on a sample of Chinese listed firms, find that overall tax avoidance does not increase the cash holding value of a firm. Still, tax avoidance helps increase cash-holding value among firms with better corporate governance. Also, based on market research on investor reaction to firm tax avoidance news, Desai and Dharmapala (2009) find that overall tax avoidance does not reduce the overall firm value. Still, for firms with higher corporate governance, tax avoidance helps increase firm value.

Based on the above evidence, there is no consensus on the impact of tax avoidance on firm value, and conclusions are influenced by various factors, including the firm's corporate governance. The impact of taxation on the value of a firm is reflected in various aspects, and studies have explored different aspects of the impact of taxation with widely divergent conclusions. This study explores the perspectives relevant to international and China's economic consequences based on the existing literature to provide an objective theoretical basis for various empirical studies in the future. The literature on the economic consequences of tax avoidance involves 75 pieces of empirical literature, as detailed in Table 2.

Table 2. Summary of literature on the economic consequences of tax avoidance (75 papers)

Authors	Country	Findings
Panel A: Tax risk (11studies)		
Dyreng *et al.* (2019)	United States	Aggressive tax avoidance may increase tax uncertainty.
Ciconte *et al.* (2016)	United States	Uncertain tax benefits predict future tax cash outflows.
Saavedra (2018)	United States	Firms with higher tax exposure have higher financing costs.
Law and Mills (2015)	United States	Law and Mills (2015) find that firms with financing constraints have higher tax exposure and greater IRS audit adjustments.
Frischmann *et al.* (2008)	United States	The market reacts positively before and after the effective date of FIN 48, suggesting that investors can leverage the tax benefits of uncertainty in disclosure to obtain more information and mitigate firm agency problems.
Koester (2011)	United States	Firms with higher uncertainty tax benefits have higher share prices in the first two years that FIN48 is in effect.
Tong *et al.* (2016)	China	Firms with lower tax compliance rates may face more agency problems due to the final reduction in the efficiency of the firm's operations.
Song *et al.* (2019)	China	Tax risk reduces firm value and diminishes the firm's incremental value of tax avoidance.
Shi *et al.* (2019)	China	The authors do not find higher future tax volatility for firms with higher tax avoidance. Instead, they argue that firms adopt a stable and continuous tax strategy ex-ante so that tax avoidance does not dramatically increase the firm's tax risk.
Juan and José（2023）	Spain	Tax avoidance may, on the one hand, increase the firm's cash flow, yet on the other hand, it elevates agency costs, informational risk, and the risk of scrutiny by tax authorities, thereby indirectly affecting the cost of debt.
Mkadmi & Ali（2024）	UK	Tax avoidance activities may heighten a firm's tax risk, rendering it more predictable and susceptible to regulatory oversight by tax authorities and potentially impacting its tax compliance and reputation.
Panel B: Accounting information risk (21 studies)		
Hanlon (2005)	United States	Lower earnings persistence for firms with large tax differences.
Blaylock *et al.* (2012)	United States	Investors can identify the causes of accounting tax differences and adopt lower pricing for accounting tax differences resulting from earnings managers and higher pricing for large accounting tax differences resulting from tax avoidance.

Authors	Country	Findings
Dhaliwal *et al.* (2004)	United States	When firms are not expected to meet analysts' forecasts, managers use to meet analysts' forecasts by adjusting downward the tax accruals.
Frank *et al.* (2009)	United States	Firms with higher levels of tax avoidance have lower-quality accounting accruals, suggesting that firms with aggressive tax avoidance may have lower-quality accounting information.
Balakrishnan *et al.* (2011)	United States	Firms with aggressive tax avoidance have higher information asymmetry, greater earnings forecast errors, and lower information quality, suggesting that tax avoidance triggers deterioration in the quality of accounting information.
Hope and Thomas (2012)	United States	Multinational firms that are reluctant to report earnings distribution reports have lower effective tax rates, suggesting that firms that practice tax avoidance reduce the transparency of accounting information to avoid the attention of others.
Bonsall and Koharki (2017)	United States	Tax avoidance triggers increased opacity of accounting information, which leads to rating agency disagreement. Conversely, lower tax avoidance or more tax footnote information disclosure leads to convergence ratings.
Hanlon *et al.* (2005)	United States	Accounting earnings provide more information to the market than taxable income, but both income metrics provide incremental information to investors.
Hanlon *et al.* (2008)	United States	Firms with higher tax differences have higher information return content than those with lower tax differences.
Lennox *et al.* (2012)	United States	Firms with aggressive tax avoidance are less likely to commit accounting fraud, i.e., a negative relationship exists between tax avoidance and accounting fraud.
Blaylock *et al.* (2015)	United States	Firms with high congressional tax differences have lower levels of earnings managers.
Jiang (2013)	China	Strengthening tax collection and managers' efforts can help reduce firm tax avoidance and risk.
Che (2012)	China	Based on the accounting robustness perspective, firms with higher tax differences have lower accounting robustness.
Wang (2016)	China	Compared to low-tax firms, high-tax firms tend to use expensing to implement effective tax avoidance for R&D expenditures.
Zhao and Xu (2012)	China	Firms with lower tax rates use downward earnings managers to reduce their firm tax burden. As a result, tax-averse firms have lower-quality accounting information and a higher risk of litigation for auditors.
Tan and Bao (2015)	China	Firms with larger tax differences have higher audit fees.
Tan and Bao (2015)	China	Tax-averse firms have higher earnings persistence, suggesting that firms with aggressive tax avoidance have higher-quality accounting information.
Tang *et al.* (2022)	China	Tax avoidance increases the risk of deterioration in the quality of accounting information while increasing the level of standardization in tax enforcement, which can help curb the risk of deterioration in accounting information arising from tax avoidance.
Lü *et al.* (2023)	China	Tax avoidance exerts a direct influence on various operational and managerial decisions, thereby affecting the value relevance of earnings.
Cheng Xiaojing (2023)	China	Firms with a higher degree of tax avoidance may increase the quantity of information disclosure while diminishing its quality. Such practices, accompanied by heightened earnings management and moderated by agency costs, impact both the quality and quantity of disclosure, thereby exacerbating information asymmetry.
J.P. Sánchez-Ballesta and J. Yagüe (2023)	Spain	Tax avoidance may, on the one hand, enhance the firm's cash flow, yet on the other, it also heightens agency costs, information risk, and the likelihood of scrutiny by tax authorities, thereby indirectly impacting the cost of debt.

Authors	Country	Findings
Panel C: Reputational Risk (9 studies)		
Hanlon and Slemrod (2009)	United States	The reputation of firms with aggressive tax avoidance is severely damaged, reducing customers' willingness to buy and pay.
Hardeck and Hertl (2014)	Germany	The reputation of firms with aggressive tax avoidance is severely damaged, reducing customers' willingness to buy and pay.
Graham *et al.* (2014)	United States	Direct questioning of firm executives and finding that fear of damage to the firm's reputation is one of the main reasons for reluctance to seek higher tax avoidance.
Chyz and Gaertner (2018)	United States	Firms with lower tax avoidance than their peers have CEOs more likely to be forced to rotate.
Gallemore *et al.* (2014)	United States	The rotation rate of CEOs and CFOs of tax-sheltered firms is not significantly affected over the next three years compared to other firms, and tax-sheltered firms do not impact the firm's Forbes listing.
Lu *et al.* (2011)	China	Defensive strategy firms choose to have a low level of tax avoidance. Moreover, for well-known firms with a defensive strategy, concerns about the firm's reputation risk can reinforce a more cautious tax avoidance strategy.
Ma *et al.* (2019)	China	A significant negative relationship between tax avoidance and a firm reputation indicates that aggressive tax avoidance may damage a firm reputation.
Zhang *et al.* (2019)	China	Aggressive tax avoidance triggers uncertainty about a firm's future operations, and damage to reputation caused by tax avoidance may be an important cause.
Arnaud and Giordano (2024)	France	The study hypothesizes a positive correlation between tax disclosure and corporate reputational risk (RRs), suggesting that companies facing reputational risk are inclined to enhance tax disclosure to restore trust and reputation.
Panel D: Financial risk (34 studies)		
Crabtree and Maher (2009)	United States	Abnormal tax differences lead to analysts' concerns, and analysts downgrade the firm's debt rating accordingly.
Shevlin *et al.* (2013)	United States	The higher the degree of tax avoidance, the higher the interest rate on the firm's publicly offered securities.
Isin (2018)	United States	A positive correlation between tax avoidance and loan spreads in the syndicated loan market.
Guedhami and Pittman (2008)	United States	IRS reviews help better monitor firm tax behavior and thus reduce the interest rate on public bonds.
Kim *et al.* (2010)	Korea	Tax avoidance helps firms reduce bank lending rates and relax non-pricing terms.
Guenther *et al.* (2017)	United States	Tax avoidance does not lead to increased tax risk and further share-return volatility.
Desai *et al.* (2007)	United States	Tax avoidance increases the risk of shareholder short-selling and weakens the firm's value.
Goh *et al.* (2016)	United States	The higher the degree of firm tax avoidance, the lower the cost of equity capital.
Cook *et al.* (2017)	United States	There is no linear relationship between tax avoidance and the cost of equity capital. Too little or too much tax avoidance can increase a firm financing risk, increasing the cost of equity financing.
Desai and Dharmapala (2009)	United States	Overall, tax avoidance does not reduce the overall firm value. Still, tax avoidance contributes to increased firm value for firms with higher corporate governance.
Hines (1999)	United States	Raising the firm tax burden leads to decreased FDI and a significant out-migration of domestic firms.
Shackelford *et al.* (2007)	United States	Tax avoidance without increasing the cost of accounting information promotes firms to choose the region for investment.
Foley *et al.* (2007)	United States	Multinational firms with higher repatriation in-country tax rates have higher cash holdings.

Authors	Country	Findings
Xing (2018)	United States	Firms are holding less cash after-tax rate decreases based on the reduction in the domestic tax rate on repatriation by Japanese multinationals.
Hanlon *et al.* (2017)	United States	The higher the tax risk a firm discloses, the higher its cash holdings.
Dhaliwail *et al.* (2011)	United States	Tax avoidance negatively affects cash holdings. The higher the level of firm tax avoidance, the lower the value of cash holdings.
Liu and Yeh (2013)	China	Tax-averse aggressive firms are more likely to overinvest, which leads to a loss of efficiency in the firm's investment.
Ling and Zhu (2015)	China	The higher the degree of tax avoidance, the lower the efficiency of firm investment
Hu *et al.* (2017)	China	The authors investigate tax avoidance and bank credit supply and find that the higher the degree of firm tax avoidance, the lower the bank credit growth.
Fu and Liu (2016)	China	The higher the firm's tax avoidance, the higher the interest rate on bank borrowing, and the shorter the loan term. It suggests that tax avoidance increases a firm's borrowing risk and leads to higher financing costs.
Wang and Zhang (2017)	China	The higher the tax avoidance, the less efficient the firm's operations, as evidenced by higher overhead and total asset turnover ratios.
Ye and Liu (2014)	China	The higher the tax avoidance, the less efficient the firm's operations, as evidenced by higher overhead and total asset turnover ratios.
Wang *et al.* (2014)	China	Tax avoidance leads to higher on-the-job consumption and overinvestment, while effective corporate governance can mitigate the effects of tax avoidance.
Zhang *et al.* (2019)	China	Aggressive tax avoidance leads to greater firm risk, suggesting that the agency risk that may arise from tax avoidance affects the firm's future operating uncertainty.
Wang *et al.* (2015)	China	The relationship between tax avoidance and the cost of equity capital decreases and then increases, suggesting that the increase in agency costs significantly affects the firm's financing costs only when the level of tax avoidance is high.
Hu *et al.* (2017)	China	An increase in tax avoidance exacerbates firm overinvestment only when the firm has more capital, indicating increased agency costs.
Chen and Jia (2016)	China	Chinese firm tax avoidance increases the value of cash holdings, suggesting that firm tax avoidance is not about appropriating cash assets but reducing the firm tax burden.
Zhang *et al.* (2015)	China	Tax avoidance does not increase the value of cash holdings.
Zheng and Cao (2018)	China	Tax avoidance does not increase the firm's cash holding value, but tax avoidance can increase the firm's cash holding value for firms with low agency costs.
Wang *et al.* (2019)	China	Aggressive tax avoidance can make agency problems prominent and lead to excessive cash consumption by firm insiders. They find that tax avoidance reduces the level of cash holdings.
Zhou and Huang (2019)	China	The higher the degree of tax avoidance, the lower the firm's value.
Song *et al.* (2019)	China	Tax avoidance enhances firm value, while higher tax risk hurts the increase in firm value.
Cheng *et al.* (2016)	China	The impact of tax avoidance on firm value depends on the external economic policy environment.
Letdin *et al.*(2024)	United States	There exists a nonlinear relationship between tax avoidance and the cost of debt. At lower levels of tax avoidance, the relationship is negative, whereas at higher levels, tax avoidance is positively correlated with the cost of debt.

2.1 Tax Risk

Tax uncertainty is the magnitude of the probability that an adverse effect of tax authorities results in a loss of tax proceeds claimed by the firm (Dyreng *et al.* 2019). For example, aggressive tax avoidance may increase tax uncertainty and further impact firm risk (Guenther *et al.* 2017). In 2006, the FASB issued Interpretation No. 48 (FIN 48), which requires firms to disclose potential tax risks, known as Uncertain Tax Benefits (UTB). Dyreng *et al.* (2019) examine the correlation between tax avoidance and tax risk for U.S. listed firms using UTB as a proxy variable for tax risk and find that tax avoidance significantly increases contemporaneous tax risk and is more pronounced in the sample group with a higher likelihood of tax havens, asset transfer pricing. Subsequently, studies have explored in depth the impact of uncertainty on tax revenue generation. For example, Ciconte *et al.* (2016) examine the economic consequences of disclosing relevant tax avoidance risks based on enacting the FIN 48 interpretation. It was found that the enactment of FIN 48 can effectively predict the U.S. firm's tax cash outflows in the next three years, which has high information value and can reduce the uncertainty of future cash outflows caused by tax uncertainty. In addition, Saavedra (2018) finds that firms with higher tax exposure have higher financing costs. In addition, Law and Mills (2015) find that firms with financing constraints have higher tax exposure and greater IRS audit adjustments. It suggests that tax avoidance creates tax risks and that auditors are concerned about such risks, requiring firms to make more adjustments. However, the risk of uncertain tax benefits disclosed in the current period allows tax benefits to be retained and potentially recognized in the future, and in addition, uncertain tax benefits signal to the market that the firm is actively engaged in activities that reduce its tax burden and contribute to increased shareholder wealth. Consistent with this, Frischmann *et al.* (2008) find that the market reacts positively before and after the effective date of FIN 48, suggesting that investors can leverage the tax benefits of uncertainty in disclosure to obtain more information and mitigate firm agency problems. In addition, Koester (2011) finds that firms with higher uncertainty tax benefits have higher share prices in the first two years that FIN48 is in effect.

Unlike developed countries such as the United States, which require disclosure of tax risks, many emerging countries are concerned about tax risks but lack sufficient information. For example, most of China's research on tax risk has focused on indirect approaches, such as strengthening enforcement to reduce tax risk. Tong *et al.* (2016) find that reducing tax risk through enhanced enforcement improves firm operations' efficiency. Similarly, Song *et al.* (2019) find that tax avoidance can enhance firm value while tax risk can harm firm value. However, the findings vary widely based on similar thematic studies. Juan and José (2023) found that tax avoidance may lead to more stringent tax scrutiny and could incur heightened tax risk (Mkadmi and Ali, 2024). Shi *et al.* (2019) provide more direct evidence testing the correlation between tax avoidance and tax volatility risk. Shi *et al.* (2019) do not find higher future tax volatility for firms with higher tax avoidance. Instead, they argue that firms adopt a stable and continuous tax strategy ex-ante so that tax avoidance does not dramatically increase the firm's tax risk. However, increased tax exposure can lead to a firm's share price volatility.

2.2. Accounting Information Risk

Tax avoidance aggressiveness is accompanied by complex business processing and information asymmetry, decreasing the quality of accounting information of aggressive firms' tax avoidance, leading to increased accounting information risk (Desai *et al.* 2007; Bennedsen and Zeume, 2018). Therefore, large tax differences are a sign of firm tax avoidance and an essential indicator of earnings managers, a risk point to which investors must be alert (Hanlon, 2005). In line with this, Hanlon (2005) finds lower earnings persistence for firms with large tax differences. Further, Blaylock *et al.* (2011) distinguish between book-tax differences resulting from earnings managers and tax avoidance and find that investors can identify the causes of accounting tax differences and adopt lower pricing for accounting tax differences resulting from earnings managers and higher pricing for large accounting tax differences resulting from tax avoidance. In addition, tax avoidance generates income tax accrual, which affects the income statement. Although this tax-based accrual is not very large, some evidence links tax avoidance and earnings managers. For example, Dhaliwal *et al.* (2004) find that when firms are not expected to meet analysts' forecasts, managers use to meet analysts' forecasts by adjusting downward the tax accruals. Therefore, tax accrual information is the "last resort" to adjusting accounting accrual (Hanlon and Heitzman, 2010). In addition, Frank *et al.* (2009) find that firms with higher levels of tax avoidance have lower-quality accounting accruals, suggesting that firms with aggressive tax avoidance may have lower-quality accounting information.

Similarly, Balakrishnan *et al.* (2011) found that firms engaging in aggressive tax avoidance exhibit higher information asymmetry, greater earnings forecast errors, and diminished information quality. Consistent with these findings, within the framework of agency theory, it has been observed that higher levels of tax avoidance

lead to a reduction in the value relevance of earnings (Lü Jincheng and Zhang Weixi, 2023) and an increase in earnings management (Cheng Xiaojing, 2023). The evidence above suggests that tax avoidance precipitates a decline in the quality of accounting information.

In addition, based on a study of voluntary disclosure of earnings distribution reports, Hope and Thomas (2012) find that multinational firms that are reluctant to report earnings distribution reports have lower effective tax rates, suggesting that firms that practice tax avoidance reduce the transparency of accounting information to avoid the attention of others. Finally, based on evidence from rating agencies, Bonsall and Koharki (2017) find that tax avoidance triggers increased opacity of accounting information, which leads to rating agency disagreement. Conversely, lower tax avoidance or more tax footnote information disclosure leads to convergence ratings.

However, tax avoidance also brings incremental information, which provides relevant information for investors' decision-making and thus reduces the risk of accounting information. For example, accounting and taxable income are the results of measuring a firm's income under accounting and tax rules. They both have content that provides incremental information about a firm's current and future operating income and value (Hanlon and Heitzman, 2010). Hanlon *et al.* (2005) find that accounting earnings provide more information to the market than taxable income, but both income metrics provide incremental information to investors. The market can respond to relevant information, which shows a large surplus response coefficient. It shows that the information related to tax avoidance can deepen investors' understanding of the firm's financial information, optimize their decision-making behavior, and improve the quality of accounting information. In line with this, Hanlon *et al.* (2008) examine the effect of changes in tax laws on the quality of earnings information and find that firms with higher tax differences have higher information return content than firms with lower tax differences. This view suggests that the existence of tax differences helps investors to obtain adequate information. Some evidence suggests that firms with aggressive tax avoidance may have higher-quality accounting information. Lennox *et al.* (2012) argue that tax avoidance is informative and rational. Investors and government regulators scrutinize firms with aggressive tax avoidance. Hence, firms try to improve the quality of accounting information. Consistent with that view, they find that tax-averse aggressive firms are less likely to commit financial fraud. It is contrary to the conclusion of Frank *et al.* (2009) that tax avoidance reduces the quality of accounting information.

The reason is that their research perspectives are different. Frank *et al.* (2009) investigated the impact of tax avoidance on earnings managers. Earnings managers are relatively secretive, and the possibility of discovery and the cost of punishment after discovery is little. Therefore, listed firms avoid tax and manage earnings at the same time when making decisions to achieve the purpose of obtaining tax savings and hiding adverse information. However, Lennox *et al.* (2012) examine how tax avoidance affects accounting fraud, a severe financial information quality problem with extremely high costs once detected. The trade-off is that listed firms focus on sacrificing tax avoidance benefits to reduce external attention and suspicion of accounting fraud. In addition, firms with large accounting and tax differences help to convey information to outsiders, thus limiting firm earnings managers' practices. Consistent with this, Blaylock *et al.* (2015) find that firms with high congressional tax differences have lower levels of earnings managers.

More studies have been conducted on the relationship between tax avoidance and accounting information quality in emerging market countries. However, most of them are based on their own systems or tax reforms as a background to explore the relationship between tax avoidance and accounting information risk. For example, based on income tax reform as a background, Che (2012) shows that tax avoidance is negatively related to accounting conservatism, indicating that tax avoidance deteriorates the quality of accounting information. Wang (2016), using the tax incentives for R&D expenditures as a background, found that Chinese listed firms manipulate earnings to avoid taxes, indicating that tax avoidance raises accounting information risks.

Zhao and Xu (2012) find that firms with lower tax rates use downward earnings managers to reduce their firm tax burden. As a result, tax-averse firms have lower-quality accounting information and a higher risk of litigation for auditors. Consistent with this, Tan and Bao (2015) find that firms with larger tax differences have higher audit fees. In contrast, Tian *et al.* (2019) find that tax-averse firms have higher earnings persistence, suggesting that firms with aggressive tax avoidance have higher quality accounting information. Jiang (2013) suggests that improving tax enforcement can help introduce external governance and improve the quality of accounting information. Tang (2022) finds that tax enforcement helps reduce the risk of accounting information.

2.3. Reputation Risk

Aggressive tax avoidance often attracts media attention and scrutiny from tax regulators, resulting in high reputational costs. Hanlon and Slemrod (2009) find that share prices fall when the market is informed of tax

sheltering behavior. It suggests that aggressive tax avoidance triggers reputational costs for firms, leading to a decline in firm value. Based on the customer-based perspective, Hardeck and Hertl (2014) find that when the firm is involved in adverse reports of tax avoidance in the media, customers reduce their desire to buy goods, indicating that radical tax avoidance damages the reputation image of the firm in the minds of consumers, causing consumers to reduce their willingness to pay and punish firms that are radical tax avoidance. Arnaud and Giordano (2024) discovered that companies facing higher reputational risk are more inclined to enhance tax disclosure to restore trust and reputation. On the contrary, when firms are involved in responsible tax avoidance reports, consumers are more willing to buy company products. In addition, Graham *et al.* (2014) use direct questioning of firm executives and find that fear of damage to the firm's reputation is one of the main reasons for reluctance to seek higher tax avoidance.

However, not all evidence suggests that aggressive tax avoidance incurs reputational costs. In contrast, a firm implementing less tax avoidance can also create a reputational cost problem. For example, Chyz and Gaertner (2018) find that firms with lower tax avoidance than their peers have CEOs who are more likely to be forced to rotate. In addition, tax avoidance is legally adopted and generates after-tax cash flows. As a result, the firm does not incur reputational costs. Gallemore *et al.* (2014) investigated 118 firms reported by the media due to tax evasion. They found no evidence that the firm or its executives had incurred significant reputation costs because of being accused of engaging in tax avoidance activities. The firm's tax avoidance behavior did not decrease after the discovery of tax evasion. Second, no apparent resignations of CEO and CFO executives have occurred due to negative tax avoidance news. Finally, the market reacts negatively to news about tax shelters, but the impact of this negative news wears off after a few weeks. In short, tax avoidance does not result in negative reputational costs at the firm level.

Chinese studies have also researched whether tax avoidance raises reputational risk. Lu *et al.* (2011) examine the relationship between firm strategy type and tax avoidance degree. They find that defensive strategy firms choose to have a low level of tax avoidance. Moreover, for well-known firms with a defensive strategy, concerns about the firm's reputation risk can reinforce a more cautious tax avoidance strategy. Finally, Ma *et al.* (2019) directly investigate the correlation between tax avoidance and firm reputation and find a significant negative relationship between tax avoidance and firm reputation, indicating that aggressive tax avoidance may damage a firm reputation. Zhang *et al.* (2019) examine the relationship between tax avoidance and corporate risk. They find that aggressive tax avoidance triggers uncertainty about a firm's future operations and that damage to reputation caused by tax avoidance may be an essential cause.

2.4. Financial Risk

Tax avoidance can affect a firm's financial risk, which can be divided into financing, investment, and cash holding risk.

Bond and equity financing are the two most common external financing channels for listed firms. However, an increase in tax avoidance can affect creditors' evaluation of the firm, leading to an escalation of debt financing risk (Letdin *et al.* 2024). As a result, aggressive tax avoidance may lead to a risk transfer from shareholders to creditors, leading to an increased risk of defaulting on the firm's debt. Crabtree and Maher (2009) examine the impact of congressional tax differences and bond analyst rating classifications in line with this. High or low tax differences indicate a potential financial risk to the firm, increasing bond default risk. Therefore, firms with unusually high or low tax differences have a higher risk of default and lower ratings than other firms. In addition, Shevlin *et al.* (2013) find that the higher the degree of tax avoidance, the higher the interest rate on the firm's publicly offered securities, suggesting that investors are wary of tax-averse firm risk and demand a higher risk rate as compensation.

Further, Isin (2018) finds a positive correlation between tax avoidance and loan spreads in the syndicated loan market. The evidence above suggests that tax avoidance creates agency problems and accounting information risks, leading to lenders' concerns about firm risk. Although tax avoidance may raise issues such as agency risk and reduced information transparency, increased tax avoidance may help firms increase earnings and reduce the risk of default if external creditors access internal information and monitor the firm by setting debt terms (Lietz, 2013). Consistent with this, Guedhami and Pittman (2008) find that IRS reviews help better monitor firm tax behavior and thus reduce the interest rate on public bonds. Based on how the implementation of tax avoidance by Korean firms affects the pricing of bank debt, Lim (2011) finds that tax avoidance helps firms to save on tax costs, reduce cash expenses, mitigate financial risk and bankruptcy risk, and thus reduce the cost of corporate debt.

An increase in firm tax avoidance may also affect the concerns of the firm's shareholders, which in turn may lead to an increase in equity financing risk and reduce the firm's value. Kim *et al.* (2009) find that firms with higher levels of tax avoidance face higher risks of share price crashes. Guenther *et al.* (2017) argue that tax avoidance increases tax risk and further volatility in share return. However, the empirical results do not support the relevant conclusions. Guenther *et al.* (2017) find that tax avoidance does not necessarily lead to increased corporate risk because companies generally adopt moderate tax avoidance strategies rather than aggressive ones. Based on more comprehensive evidence, Desai *et al.* (2007) argue that tax avoidance is a cover for insiders to tunnel shareholders. They find that increasing the tax enforcement level increases the firm's share value. It suggests that tax avoidance increases the risk of shareholder short-selling and weakens the firm's value.

In contrast, other studies argue that tax avoidance can reduce the cost of equity financing and increase a firm's wealth by saving money. The evidence is that Goh *et al.* (2016) find that the higher the degree of firm tax avoidance, the lower the cost of equity capital, especially among firms with higher quality accounting information, stronger external monitoring, and stronger tax-saving value-added effects. Further, Cook *et al.* (2017) find no linear relationship between tax avoidance and the cost of equity capital. Too little or too much tax avoidance can increase a firm financing risk, increasing the cost of equity financing. Based on more comprehensive evidence, Desai and Dharmapala (2009) find that overall tax avoidance does not reduce the overall firm value. Still, tax avoidance contributes to increased firm value for firms with higher corporate governance.

Tax avoidance may also influence the choice of location and foreign direct investment (FDI). For example, Hines (1999) finds that raising the firm tax burden leads to a decrease in FDI and a significant out-migration of domestic firms. Shackelford *et al.* (2007) find that tax avoidance without increasing the cost of accounting information promotes firms to choose the region for investment.

Cash is a firm's most liquid asset, and how it invests its cash is influenced by many factors, with taxes being one possible influence. Taxes affect the actual investment behavior of firms through quantitative, timing, risk, and tax credit factors (Hanlon and Heitzman, 2010). For example, investing multinationals must pay tax on profits repatriated to their home countries, while profits that remain invested internationally are exempt from taxation. Therefore, for tax avoidance reasons, the firm keeps the profits offshore for further investment, resulting in a large amount of cash held by the firm. In line with this, Foley *et al.* (2007) find that multinational firms with higher repatriation in-country tax rates have higher cash holdings.

Conversely, Xing (2018) finds that firms holding smaller cash after-tax rates decrease based on the reduction in the domestic tax rate on repatriation by Japanese multinationals. However, the firm may also increase cash holdings to prevent tax risks. Hanlon *et al.* (2017) find that the higher the tax risk a firm discloses, the higher its cash holdings. It indicates that tax avoidance risk invites uncertainty about the firm's future cash flows, causing it to increase its cash holdings to address possible future financial risks.

However, there is also evidence that increased levels of tax avoidance may lead to lower firm cash holdings. For example, Dhaliwail *et al.* (2011), based on the agency theory framework, argues that increased tax avoidance helps managers tunnel the firm's wealth, leading to a decrease in the firm's cash holdings. Moreover, Dhaliwail *et al.* (2011) empirically show that tax avoidance negatively affects cash holdings. The higher the level of firm tax avoidance, the lower the value of cash holdings.

Emerging countries such as China are weaker in governance and more concerned about the economic consequences of tax avoidance. In particular, investment, financing, operations, cash holding and firm value, and financial risk are discussed. In addition, agency problems due to tax avoidance can worsen investment efficiency (Liu and Ye, 2013). Conversely, when tax enforcement is strengthened, investment efficiency is improved. These conclusions are based on the condition that tax avoidance leads to agency problems. Conversely, when agency problems are less severe, tax avoidance savings promote investment efficiency (Hu *et al.* 2017).

Tax avoidance may also affect firm finance risk. For example, existing Chinese studies find that tax avoidance leads to higher financing and credit costs in terms of firm credit financing (Fu, 2017), bank credit supply (Fu and Liu, 2016), and loan pricing and maturity (Hou *et al.* 2016; Wang and Zhang, 2017), respectively. Based on the equity financing perspective, moderate tax avoidance reduces financing risk, and only aggressive tax avoidance increases financing risk (cost of equity financing (Wang *et al.* 2015).

Tax avoidance may incur a loss of efficiency in a firm's operations. Therefore, tax avoidance's effectiveness depends on the manager's strategic objectives and the governance environment. When a manager's strategies are not for firm growth, tax avoidance can lead to the manager's laziness and overspending (Ye and Liu, 2014), resulting in lower firm cash holdings (Wang *et al.* 2019). A good governance environment helps to curb agency risk arising from tax avoidance (Wang *et al.* 2014; Wang *et al.* 2019; Hu *et al.* 2017).

Studies in China have explored how tax avoidance affects firm cash holdings' level and holding value. Due to agency risk, firm tax avoidance does not promote the growth of cash holding value (Zhang *et al.* 2015; Zheng and Cao, 2018), leading to increased uncertainty and firm risk (Zhang *et al.* 2019).

Tax avoidance may also affect the firm's overall value (Zhou and Huang, 2019). However, more studies consider that it depends on the extent of tax avoidance and the impact of the governance environment (Cheng *et al.* 2016; Song *et al.* 2019). Therefore, moderate tax avoidance and effective governance are key to managing risk and enhancing value.

In summary, emerging countries have been rich regarding the economic consequences of tax avoidance. Diversified research and increased focus on financial risk. Research themes are more integrated with localized elements, such as political affiliation (Li and Xu., 2013), tax enforcement flexibility (Ling and Zhu, 2015), and ownership system differences (Wu, 2009; Wang *et al.* 2010).

2.5 Summary of Economic Consequences of Tax Avoidance

Most studies on the economic consequences of tax avoidance are based on tax agency theory along the logical lines of firm tax avoidance - agency problem - tax avoidance risk to carry out empirical studies. That is when firms implement tax avoidance, complex tax shelters facilitate self-interested behavior by insiders, who can take the opportunity to hide unfavorable information or conceal self-interested behavior, leading to a corresponding rise in risk. However, even though empirical findings on tax avoidance risk are growing yearly, some empirical studies still do not support the tax agency theory. Therefore, further and more direct evidence is needed on whether tax avoidance raises risks, and which risks it raises.

3. Discussion and Future Research

This study summarizes three decades of empirical literature on tax avoidance's impact factors and economic consequences. Based on tax agency theory, a three-factor theoretical framework of the impact of tax avoidance and a four-consequence theoretical framework of tax avoidance are proposed. The three-factor theoretical framework of tax avoidance is based on the tripartite framework of managers, firms, and stakeholders to explore the following three issues: (1) Do managers' characteristics affect firm tax avoidance? (2) What characteristics of firms are more aggressive in tax avoidance? (3) Which stakeholders influence firm tax avoidance? The theoretical framework of the four consequences of tax avoidance revolves around whether tax avoidance raises tax risk, accounting information risk, reputation risk, and financial risk. The above theoretical framework can provide researchers with a systematic understanding of the factors and economic consequences of tax avoidance and has implications for researchers, managers, policymakers, and regulators.

First for the researcher: this study draws on tax agency theory to systematically organize the empirical research framework on the factors and economic consequences of tax avoidance, responding well to Halon and Heitzman's (2010) call for more research on tax agency issues and actively exploring who is influencing tax avoidance. This study is helpful for a systematic understanding of tax avoidance, its theoretical basis, and the focus of the debate.

Second, managers should coordinate their self-interest, the interests of shareholders, and the government's interests. Suppose the manager ignores the interests of other stakeholders. In that case, he may incur the attention of market and policy regulators (Lennox *et al.*,2012) and damage his reputation (Graham *et al.* 2014).

Finally, for policymakers: effective allocation of benefits according to accounting contracts, compliance with laws and regulations, and efficiency of firm operations are important objectives for policymakers (Jensen and Meckling, 1976), so whether accounting information risks (Frank *et al.* 2009) and firm financial risks (Liu and Ye, 2013; Lim, 2011) increase are the key detection directions.

In addition, this study is an essential reference for emerging countries such as China in achieving high-quality tax avoidance. The rapid economic development in emerging countries like China coincides with weak governance and lenient tax enforcement, making tax agency issues more concerning (Lin *et al.* 2018). There is an open debate in developed countries such as the United States about whether the tax agency problem is widespread. However, many studies have shown that tax avoidance does not increase risk (Blaylock, 2011; Guenther *et al.* 2017). Although a few studies in emerging countries such as China also point out that tax agency risk is conditional (Zhang *et al.*,2015; Hu *et al.* 2017), studies on tax agency issues have become more numerous in recent years and mostly tend to support the conclusion that tax avoidance triggers risk. For example, tax avoidance increases risk only in poorly governed firms. Among well-governed firms, tax avoidance does not increase risk and reduces firm risk (Hu *et al.* 2017). With the growing call for high-quality development in

emerging and new developing countries, optimizing governance structures, managing tax avoidance risks, and achieving a coordinated distribution of benefits among multiple parties is an inevitable path for other emerging economies such as China. This study provides a detailed theoretical overview of how to influence tax avoidance and what the consequences of tax avoidance are. It also provides a basis for subsequent firm management of tax avoidance risks and sustainable tax policies.

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Wunhong Su: Conceptualization, Validataion, Methodology, Writing – review and editing, Project administration, Supervision.
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Declaration of Competing Interest

The authors declare that they have no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper.

Declaration of Use of Generative AI and AI-Assisted Technologies

The authors declare that they have not used generative AI and AI-assisted technologies during the preparation of this work.

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