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Executive Incentive and Corporate Tax Avoidance: Review and Prospects

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Abstract— *Corporate tax avoidance has always been a hot issue studied by scholars. As a profit-making organization, the company regards the maximization of corporate value as its primary goal, and has been motivated to implement various measures to reduce the outflow of economic benefits since the emergence of taxation. The modern tax system is in the process of constantly updating and improving. In recent years, the "tax reduction and fee reduction" and the preferential income tax policies have undoubtedly brought "benefits" to enterprises, but at the same time, they have also brought some potential threats to the national tax revenue. Tax avoidance decision as a strategic decision of a company is a direct manifestation of the motivation and behavior of corporate executives. The evaluation of tax avoidance benefits and risks by executives directly affects the degree of corporate tax avoidance. Therefore, from the perspective of executive incentives, this paper first elaborates the existing research on executive incentives and corporate tax avoidance, then reviews the literature on the two and their interaction, and finally makes comments on them, in order to provide some ideas for future research on executive incentives and corporate tax avoidance.*

Keywords— *Executive Incentives; CorporateTax Avoidance; Corporate Governance; Corporate Value.*

I. INTRODUCTION

Under the background of the socialist market economy, taxation, as one of the important sources of national fiscal revenue, not only affects the efficiency of resource allocation, but is also an important cash outflow of the company. Tax avoidance is beneficial to increase retained earnings, promote the company to participate in market competition more effectively, and form strategic advantages to consolidate market position. The modern taxation system is in the process of continuous updating and improvement. The "tax reduction and fee reduction" and preferential income tax policies implemented in recent years have undoubtedly brought "benefits" to enterprises and gave them many choices in financial treatment, but at the same time, it also brings some potential threats to the national tax revenue: companies may use the incompleteness of the tax law rules to conduct radical tax planning, harming the interests of the country and the collective. Naturally, the issue of tax avoidance has become a research hotspot in the fields of corporate financial accounting and public finance. Tax avoidance decision as a strategic decision of a company is a direct manifestation of the motivation and behavior of corporate executives. The evaluation of tax avoidance benefits and risks by executives directly affects the degree of corporate tax avoidance. Under the condition of separation of two rights, management compensation is considered to be one of the important corporate governance mechanisms that affect management decisions (Flor et al., 2005). In modern companies, how to design executive incentive mechanism so that the management can overcome moral hazard and adverse selection, and achieve the consistency with the interests of shareholders has become one of the most important issues concerned by the practical and academic circles (Wei L. and Minghui L., 2012).

Therefore, the following will review relevant domestic and foreign literature, analyze the current research status of executive incentives and corporate tax avoidance, in order to provide some ideas for future research in related fields.

II. LITERATURE REVIEW OF EXECUTIVE INCENTIVES AND CORPORATE TAX AVOIDANCE

(1) Current status of research on executive incentives

The separation of ownership and management rights in modern companies leads to information asymmetry between managers and shareholders, causing agency problems. Therefore, the executive incentive system is introduced into corporate governance to ease agency costs and stimulate the initiative and creativity of executives. Executive incentives include explicit and implicit incentives. In the existing literature, most studies are conducted from the perspective of explicit incentives, while a few literatures take implicit incentives into account in empirical studies, and the conclusions have not yet reached a unified conclusion.

Explicit incentives mainly focus on the research on company value, corporate innovation, social responsibility, and investment efficiency. Compensation performance rewards and equity incentives can be used as effective means to reduce agency problems (Inoue et al., 2013), which can reduce the bad behavior of senior management, strengthen internal control of the company, and use it for talent attraction and retention, and ultimately achieve the growth of corporate value. Meiqun Y. et al. (2018) studied a sample of listed companies in eight years since 2009 and found that, especially in technology-intensive industries, executive compensation incentives can significantly positively regulate the relationship between company innovation resource investment and corporate performance. Hong B et al. (2016) used the empirical study of contract compensation when executives signed a contract and found that corporate social responsibility performance rewards can encourage companies to carry out more social responsibility activities.

In terms of implicit incentives, Cai et al. (2011) found that for listed companies with poor corporate governance, corporate executives use more on-the-job consumption to satisfy their private interests. In this case, it will have a significant negative impact on corporate performance.

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Adithipyangkul et al. (2011) hold the opposite view, believing that on-the-job consumption can motivate management to improve efficiency and have a positive impact on company performance. Jianluan G. and Xiaotong J. (2021) made an empirical study from the perspective of the external supervision effect of analysts and found that the higher the analyst's attention to the enterprise, the more likely it is to restrain the on-the-job consumption level and excess on-the-job consumption level of executives. Yong D. and Lu Z. (2020) found that political promotion is more attractive to executives of state-owned enterprises than salary incentive based on their research on the background of Chinese system. In addition, some scholars investigated the application of executive compensation incentive mechanism under different competitive strategies (Cai C. et al., 2017), and the relationship between salary stickiness and corporate innovation efficiency and investment efficiency (Yue X. et al., 2018; Shuping Z. et al., 2020; Haifeng G. et al., 2021).

(2) Research status of corporate tax avoidance

Domestic and foreign scholars mainly study the impact on corporate tax avoidance from the direction of corporate basic characteristics, corporate governance characteristics, and regional characteristics variables and so on. In terms of the basic characteristics of a company, return on total assets, employment scale and corporate donation have a negative impact on the actual income tax rate (Kangtao Y. et al., 2018). When studying the relationship between company size and actual tax burden based on the background of developed countries, foreign scholars have drawn diametrically opposite views from the perspectives of the political cost hypothesis and the political power hypothesis. Guangjun S. and Jingxian Z. (2017) found that there was no significant relationship between enterprise size and overall effective tax rate based on China's special policy background. When the company's external financing level is high, more tax avoidance strategies will be implemented (Edwards et al., 2015; Law and Mills, 2015). The CEO's internal debt holdings will have a negative impact on the CEO's risk appetite, thereby reducing corporate tax avoidance activities (Sabrina et al., 2017). In terms of corporate governance characteristics, a better corporate governance mechanism can alleviate agency problems caused by aggressive tax avoidance to a certain extent (Armstrong et al., 2015). Xingzhe Y. and Xiangyi Z. (2020) studied for the first time from the perspective of increasing internal governance and easing financing constraints, and found that the higher the level of company stock liquidity, the less tax avoidance in the second year. Further distinguishing the nature of property rights, Bradshaw et al. (2018) found that the actual income tax rate of state-owned companies is generally higher, and the motivation for tax avoidance is relatively lower. Chinese scholars have also reached similar conclusions (Pan L. and Kaiqiang Z., 2020; Shengdao G., etc., 2019). In terms of regional characteristic variables, the tax collection and management system can help regulate the operation of listed companies and restrain the earnings manipulation behavior of agents, thereby reducing the degree of corporate tax avoidance (Dyreng et al., 2008). The stricter the regional taxation supervision, the more significant corporate tax evasion behavior will be curbed (Xing L. and Kangtao Y., 2014, Xiaojuan W., 2018).

Corporate tax avoidance has many results, either directly reducing expenses and increasing cash flow, or indirectly reducing corporate tax shield marginal profits (Graham and Tucker, 2006). Similarly, Chinese scholars have also found that tax avoidance can increase the value of cash holdings (Baohong Z. et al., 2018) and increase the value of enterprises (Xiaoke C. et al., 2016). However, some scholars, based on the tax avoidance agency view, believe that companies engaging in tax avoidance activities will increase internal agency costs (Kangtao Y. and Xing L., 2014), and will not increase corporate value. Only tax avoidance activities in companies with good governance will help increase corporate value (Desai et al., 2009; Zhaoguo Z. et al., 2015). In addition, tax avoidance activities will reduce information transparency (Desai et al., 2007; Balakrishnan et al., 2012; Donohoe et al., 2014), which in turn affects the amount of commercial credit financing a company can obtain (Jia F., 2017), and even reduces the company’s capital allocation efficiency (Jinzhi T. et al., 2015), have a negative impact on corporate investment efficiency (Ling Z. and Tingting Z., 2015).

(3) Research status of the relationship between executive incentives and corporate tax avoidance

Some scholars believe that executive incentives are positively related to corporate tax avoidance. Armstrong et al. (2015) found that executives who adopt equity incentives prefer risk more, and there is a positive correlation between equity incentives and tax avoidance. Rego and Wilson (2012), Graham et al. (2014), Powers et al. (2016) also reached similar conclusions. Domestic scholars Wei L. and Minghui L. (2012) were the first to study the relationship between management incentives and corporate tax avoidance. They believed that with the enhancement of management incentives, executives are willing to take greater risks in tax avoidance activities and reduce the actual tax burden of the company. Xudong Y. et al. (2019) found that the higher the shareholding ratio of executives, the lower the actual corporate tax burden and the greater the degree of tax avoidance. This relationship is more significant when the degree of industry competition is low. Based on the principal-agent theory and rent-seeking theory, Yishu W. et al. (2020) found that in non-state-owned enterprises, executive compensation and equity incentives have a significant positive impact on the degree of corporate tax avoidance. Some scholars also believe that there is a negative correlation between executive incentives and corporate tax avoidance. Jing L. and Jingjing Z. (2017) empirically found that increasing management's shareholding ratio can restrain management's rent-seeking motivation to a certain extent, alleviate agency conflicts, and reduce tax avoidance to a certain extent. In addition, Shuyu P. et al. (2017) found the nonlinear relationship between the two, and the fluctuation of tax rate makes the equity incentive and corporate tax avoidance present a "U-shaped" relationship. Armstrong et al. (2002) found that the relationship between tax director's salary incentives and tax avoidance presents different relationships due to different tax avoidance measures.

Some scholars have also begun to look at the entire tax avoidance distribution through quantile regression when studying the relationship between the two, paying special attention to the relatively extreme tail of the impact of executive incentives on tax avoidance. Armstrong (2015) found that under the premise of average distribution condition of tax avoidance degree, there was no significant relationship between corporate tax avoidance degree and various governance variables. However, quantile-based regression showed that corporate governance variables had significant influence on corporate tax avoidance when corporate tax avoidance level was more aggressive or lower. Hengxia D. and Suhua H. (2018) used quantile regression methods to find that when the level of corporate tax avoidance is weak, the stronger the intensity of executive equity incentives, the more obvious the company's tax avoidance behavior.

III. RESEARCH REVIEW AND FUTURE PROSPECTS

Through the review of relevant domestic and foreign literature on executive incentives and corporate tax avoidance, it can be found that current research on executive incentives is mainly based on executive explicit incentives, mostly at the company level, focusing on corporate value, corporate innovation, and earnings management. Research on corporate tax avoidance mainly focuses on its influencing factors and economic consequences, but a unified view has not yet been formed. Looking at the relevant research on executive incentives and corporate tax avoidance, it is not difficult to find that different scholars have reached inconsistent research conclusions based on different research specific conditions. This may be due to the complexity and opacity of corporate tax avoidance activities. Also, it is difficult to measure it, and the executive incentive effect itself is the result of a combination of multiple factors. In addition, most of the existing researches perform regression analysis from the variable conditional mean, and pay less attention to the entire tax avoidance distribution. In the future, further research can be done in this respect.

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