

TAX AGGRESSIVENESS: POLITICAL COST THEORY OR POLITICAL POWER THEORY?

EFOSA EHIMA

Faculty of Management Sciences, University of Benin, Benin City, Nigeria
efosa.ehima@uniben.edu

NOSA OHONBA

Faculty of Management Sciences, University of Benin, Benin City, Nigeria
nosa.ohonba@uniben.edu

Abstract

The study reviewed empirical literature on tax aggressiveness: focusing on the theories of political cost and political power to determine which of these theories drove tax aggressiveness more.

Employing a library research methodology, the study discovered that prior findings on tax aggressiveness and political power produced mixed outcomes due to the absence of known proxies, making the results non-comparable. Conversely, political cost being measurable, allowed for comparison across studies and periods.

The study recommends that firms should exercise caution when employing tax aggressive practices so as to avoid crossing into tax evasion. The study calls for more empirical research to be carried out particularly as it relates to political power and tax aggressiveness to provide clearer insights.

Keywords: Tax Aggressiveness, Political Cost Theory, Political Power Theory

JEL classification:: H22, H26

1. INTRODUCTION

Tax expense constitutes a noteworthy financial burden for a company, leading to a decrease in either income or cash flow over a specific period. It signifies the fiscal obligation that the company must settle with the government. Nevertheless, in order to present more favorable financial results, companies implement various approaches that align with the legal framework of tax regulations to diminish their tax burdens. These approaches, also referred to as tax aggressiveness, encompass strategies such as tax minimization, tax planning, or tax avoidance. Although tax aggressiveness abides by the law, tax evasion does not.. Tax aggressiveness involves using legal strategies to reduce tax expense, whereas tax evasion involves employing unethical and unlawful practices to avoid paying tax. Therefore, firms must remain within the law when engaging in aggressive tax practices or they are faced with

reputational risk and sanctioned by the tax authorities. Tax aggressiveness is seen as a value maximizing activity for shareholders because it is done legally and within the opportunities available in tax legislation, and as such the current value of companies' taxes is minimized thereby boosting performance which results in a high market value (Desai & Dharmapala, 2009).

The determinants of tax aggressiveness, such as firm size, profitability, leverage, and firm age, have been subject to scrutiny. These determinants collectively fall under the category of firm characteristics. The primary metric often used to gauge tax aggressiveness is the Effective Tax Rate (ETR), which delineates the correlation between total tax expenses and pre-tax income. Various researchers, including Chen et al. (2010), have utilized the ETR, adapting it to enhance the precision of measuring tax aggressiveness. Notable modifications to the ETR include the current ETR, reflecting the link between current tax expenses and pre-tax income, and the long run cash ETR, assessing cash tax expense in relation to pre-tax income. Another metric employed in existing literature to assess tax aggressiveness is the Book Tax Difference (BTD), focusing on the variance between taxable incomes and accounting income. Each of these metrics presents advantages and drawbacks in capturing firms' tax aggressive tendencies.

Two theories endeavor to elucidate the rationale behind firms' involvement in tax aggressive behaviors: political cost theory and political power theory, with a focus on firm size. The political cost theory posits that profitable and sizable firms, under public and political scrutiny, might manipulate their figures to showcase reduced ETRs (Watts & Zimmerman, 1986). Ideally, large and profitable firms should exhibit elevated ETRs. Nevertheless, in a bid to mitigate their political costs (tax liabilities), they resort to tax aggressive strategies to diminish their tax obligations, thus boosting their post-tax profits. Conversely, the political power theory suggests that firms wielding substantial political influence can impact their tax liabilities (Malinda et al., 2022; Siegfried, 1972). This is attributed to their capacity to shape tax regulations or bargain their tax responsibilities. Consequently, this theory posits a positive correlation between sizable, profitable firms and tax aggressiveness.

The broad objective of this paper is to discuss and find out which theory explains the tax aggressive practices of firms in relation to their size. The methodology employed in the study is library research methodology. Past empirical studies were reviewed to determine which theory was more prevalent as regards tax aggressiveness. Proxies used for political cost was derived from literatures reviewed and they include firm size, profitability and leverage. However, there is a lack of data on political power as it relates to ETR and tax aggressiveness from empirical review, this is likely due to the fact that measuring political power for firms is challenging and there is limited proxies that can be used. The rest of the paper reviews the concept of tax aggressiveness, including its determinants and measurement, and reviews empirical literature to discover what theory really drives the aggressive tax behavior of firms.

2.1 THE CONCEPT OF TAX AGGRESSIVENESS

Tax aggressiveness has been defined by numerous scholars and is correlated with various terms like tax planning, tax sheltering, tax avoidance, and tax management in academic literature (Chen et al., 2010). According to Hanlon & Heitzman (2010), the term tax aggressiveness frequently denotes tax avoidance which is a component of tax planning. For the purposes of this investigation, tax aggressiveness is to be regarded as synonymous with the mentioned terms, with detailed definitions provided for each. Tax aggressiveness is perceived as a mechanism for maximizing wealth by transferring it from the government to the shareholders of a company (Kim et al., 2011). Several scholars have characterized tax aggressiveness as tax planning actions employed by corporations to diminish tax payments (Chen, et al., 2010). They elaborated that it involves the strategic behaviour of corporate bodies, influenced by the nature of tax planning they undertake to minimize tax revenues, which can be viewed as tax management. Apriyanti and Arifin (2021) contended that tax aggressiveness is a strategy for decreasing tax obligations. Effective tax planning aims to reduce taxes within legal boundaries, taking advantage of after-tax returns. Hanlon and Heitzman (2010) defined tax aggressiveness by examining the conduct of tax planning from a more assertive perspective. According to their definition, tax aggressiveness encompasses a set of tax planning tactics, ranging from legally minimizing explicit taxes to practices like noncompliance, evasion, aggressiveness, and sheltering.

Mughal and Akram (2012) suggested that tax avoidance can be described as taxpayers' efforts to explore various avenues to minimize their tax liability to the lowest possible extent or eliminate it entirely without violating regulations. Tax avoidance encompasses any transaction that impacts a company's tax burden, including legitimate activities with tax advantages, lobbying efforts to reduce a company's tax burden, and actions pursued solely to evade taxes. Tax planning denotes the strategies employed by corporations to cut down on tax payments through assertive tax avoidance measures and tax planning activities (Chen et al., 2010). Fundamentally, the objective of tax aggressiveness is to enrich shareholders by reducing tax burdens, thereby boosting revenue, as evidenced in a study by Nwaobia and Jayeoba (2016), where they argued that tax aggressive behaviors are geared towards minimizing tax liabilities, resulting in increased after-tax returns and a favorable impact on a firm's cash flow.

Tax aggressiveness involves utilizing the tax legal framework to minimize tax payments while ensuring full disclosure of material information to tax authorities (Desai & Dharmapala, 2006). The legality of tax aggressiveness depends on management's actions in reducing tax liability, which can range from legal to illegal. Legal tax aggressiveness adheres to the law, whereas illegal tax evasion involves illicit methods to lower taxes owed. Determining the legality of a company's tax decisions is the responsibility of tax authorities, as the line between legal and illegal practices is often blurred (Lee et al., 2015). Distinguishing between illegal tax aggressiveness and legal tax evasion is challenging. In this context, tax

aggressiveness refers to strategic actions within legal boundaries aimed at reducing a firm's tax obligations.

2.1.1 DETERMINANTS OF TAX AGGRESSIVENESS

Several metrics have been utilized in academic literature to ascertain the level of tax aggressiveness displayed by firms. However, preeminent among these metrics are firm characteristics. Firm characteristics encompass specific operational and financial metrics or attributes that influence both external and internal decisions within firms. These characteristics are routinely assessed in connection to various aspects of a firm such as corporate social responsibility disclosure, firm value, financial performance, assets disclosure, as well as intangible assets, with the aim of determining their impact on shareholders' wealth (Ogbeide, 2017). In this research, the focus will be on discussing the key determinants of tax aggressiveness in relation to firm characteristics, firm size, leverage, profitability, and firm age, with particular emphasis on firm size, which holds a pivotal role in the theory of political cost and political power.

The magnitude (size) of a firm is among the key firm characteristics that is likely to impact tax avoidance, often measured by the Effective Tax Rate (ETR). While there are various methodologies for gauging firm size, the prevalent approach is based on the total assets held. This characteristic has been extensively explored in scholarly works, with most studies on effective tax rates incorporating it as a parameter possessing predictive capability over ETRs (Yahaya & Yusuf, 2020). Nevertheless, the correlation between firm size and ETRs may vary. Research by Minnick and Noga (2010) revealed that firm size positively affects tax avoidance when GAAP ETR is used as the metric, but exerts no significant impact when cash ETR is employed. As per Hoi et al. (2013), the advantageous position of large firms in terms of political and economic influence renders them more inclined towards aggressive tax avoidance strategies.

Brigham and Houston (2013) argue that profitability ratios serve as a gauge of a firm's overall efficiency. These ratios typically reflect earnings derived from the firm's assets, capital employed, sales levels, earnings per share, and net worth over a specific timeframe. Profitability ratios are indicative of a firm's earning capacity and are viewed as measures of its success, oversight, and expansion. Given that corporate profitability stands as a pivotal indicator of firm performance, companies with higher pre-tax profits are more inclined to engage in tax reduction strategies compared to those with lower pre-tax earnings (Rego, 2003). This inclination arises from the fact that higher pre-tax profits translate to higher tax payments. Conversely, Manzon and Plesko (2002) contend that profitable firms can leverage tax exemptions, deductions, and credits more efficiently, resulting in greater disparities between book and tax figures for the firm.

Leverage is another indicator that has been stressed in tax avoidance or aggression research. Leverage is the degree to which a company has been financed through debt from external or outside sources. Leverage can be financial or operating. Financial leverage is the use of external funds that causes the firm to carry

the burden of a fixed rate of interest, whereas operating leverage is the use of assets that forces the company to face fixed costs like depreciation. Interest on loan payments is tax deductible for leveraged enterprises. Leverage serves as a tax shelter for such businesses. This can encourage them to engage in aggressive tax practices. The duration of a company's existence is referred to as its firm age. It is calculated as the total number of years the company has existed. According to Pratama (2017), business age could refer to either managerial or incorporation age. According to Scott (2003), older enterprises have larger businesses and hence face greater reputational risk. Firms will tend to manage risk by selecting behaviors that do not increase risk. On the other side, their age may provide them with enough experience to participate in tax avoidance.

2.1.2. MEASUREMENT AND MEASURES OF TAX AGGRESSIVENESS

There are several measurements authors have adopted when examining tax aggressiveness. These measures can be categorized into three. One is the Effective Tax Rate (ETR), which is chief amongst the measurement. ETR is commonly used because it gives an estimate of the effectiveness of firms' tax planning activities (Phillips, 2003). Effective tax rate (ETR) is the relationship between pre-tax income and total tax expenses (Aliani & Zarai, 2012). Several variants of ETR have been used to measure TA in literature. They include: Accounting ETR, Long-run cash ETR and Current ETR.

In the United States (US), Accounting ETR is also known as Generally Accepted Accounting Principles (GAAP) ETR. It is the reported ETR based on the financial statements. It calculates the cumulative proportion of the accounting income payable as taxes by dividing the entire tax expenses by the accounting income before tax. Thus, it assesses tax avoidance or aggressiveness in relation to accounting earnings. Chen et al. (2010) used this measure to capture tax aggression among 1003 enterprises and explain the association between family ownership and tax evasion. Armstrong et al. (2012) also utilized it to investigate the influence of tax directors on tax avoidance. Although accounting ETR as a metric of tax avoidance is commonly used, it does have drawbacks. To begin, accounting ETR can only capture non-conforming tax avoidance because it is measured in respect to accounting earnings.

Second, it shows tax deferral methods based on aggregate tax expenses. Current ETR is determined by adding the current-year tax expense to the overall accounting income before tax. It represents a firm's tax deferral methods by comparing current income tax to total tax expense, which gives it an edge over accounting ETR. Current ETR only covers nonconforming tax evasion, albeit it does represent corporations' deferral techniques. Furthermore, both accounting and current ETR suffer from the same limitation: they cannot reveal long-term tax avoidance. Long-run cash ETR is the percentage of cash taxes paid in relation to accounting income before tax. The use of cash taxes paid rather than tax expense helps to reduce the impact of elements like valuation allowance and tax cushions

(Dyreng et al., 2008). Minnick and Noga (2010) further claim that cash tax measured ETR accounts for the tax benefits of employee stock options, whereas accounting ETR does not. Aside from this advantage, long-run cash ETR employs tax information for numerous years, i.e. 3-10 years (Hanlon & Heitzman, 2010), which helps to reduce volatility between years. The second category includes the book-tax difference (BTD) measure proposed by Manzon and Plesko (2001) and the residual book-tax difference measure proposed by Desai and Dharmapala (2006). This type of tax evasion method focuses on the magnitude of the difference between taxable and accounting income (book-tax gap). The book-to-tax difference is the difference between book and taxable income (Manzon & Plesko, 2001; Wilson, 2009). Book income is pre-tax income minus minority interest, whereas taxable income is calculated by subtracting total exemptions and deductions from gross total income (Lee et al., 2015). Although the reasons of BTD are numerous and typically classed as temporary and permanent disparities, the size of the differences suggests the possibility of tax evasion tactics (Kim et al., 2011). There are two types of BTG measurements used to detect tax aggression or avoidance: residual book-tax gap and total book-tax gap. One significant hurdle to estimating the entire book-tax difference is the absence of taxable income in a company's public records (Lee et al., 2015). Another problem is that tax shelters are not considered. A tax shelter is any technique used by taxpayers to minimize their taxable income with no legitimate business purpose (Lee et al., 2015).

Finally, the third group includes a variety of methods, including tax shelters. Wilson (2009) devised a method for identifying businesses that participate in tax avoidance. In the analysis, he used the profiles of US firms accused of exploiting tax shelters. This metric is useful for estimating tax avoidance practices. Armstrong et al. (2012) employed these measures in their research. While this metric is useful for detecting tax evasion, its development is prone to selection biases (Hanlon & Heitzman, 2010), which are caused by the sample of accused businesses involved. While not all tax evaders are detected, many businesses dodge taxes without using tax shelters.

2.2 THE CONCEPTS OF POLITICAL COST THEORY AND POLITICAL POWER THEORY

The political cost theory, initially proposed by Watts and Zimmerman (1986), posits that politicians can impact a company's wealth redistribution through subsidies, taxes, regulations, and other means. Political costs refer to the financial burdens imposed on a company by external parties, such as the government. Notably, the magnitude of political costs varies depending on a company's size. The political cost theory features two main arguments: larger firms are subject to more governmental regulations and public scrutiny, which encourages them to adopt socially responsible behavior and align their actions with societal expectations.

Numerous studies support these arguments, suggesting a positive correlation between firm size and ETR (earnings per share) and between firm performance and ETR. Simply put, larger firms tend to report higher ETRs, and more profitable firms

are less likely to engage in aggressive tax practices. However, the political cost theory suggests that companies under political scrutiny, usually larger firms, may adopt strategies to reduce the likelihood of adverse cash flow resulting from the scrutiny. This means that political costs are a function of reported profits, leading companies to implement tax aggressiveness strategies to manage their earnings (Watts and Zimmerman 1990).

For the purpose of profitability, it is expected that large firms would adjust their behavior and actions to meet the social environment's expectations. Therefore, companies with high profitability should have higher ETRs. However, the Political Cost Theory suggests that profitable firms tend to postpone their income to future periods to avoid political costs. This is because high profits attract public and political attention, leading to increased political costs. The strength and weakness of this theory lie in the realism of its assumptions. Large and profitable companies know that reporting higher ETRs and paying more taxes is inevitable. To avoid this, they may engage in income-decreasing activities to report lower earnings and pay fewer taxes. For instance, foreign competition could lead to a decline in profitability, but affected firms may protect their imports by influencing the political process. One way to do this is by adopting accounting policies that decrease income to convince the government that their profits are falling. This theory overlooks the fact that smaller or less profitable firms may also engage in tax-aggressive practices to reduce their ETR and pay less in taxes, regardless of less political scrutiny. Additionally, profitable and large firms have the means to engage in corporate social responsibility, which can attract political favors, leading to lower political costs for these firms.

Siegfried in 1972 proposed the political power theory, positing that larger firms possess more political power than smaller ones, indicating a negative relationship between firm size and ETR. Consequently, larger firms can utilize their power and resources to negotiate their tax burden and influence legislation in their favor (e.g., lobbying activities), resulting in lower ETRs for larger firms compared to smaller ones (Nicodème, 2007; Siegfried, 1972). This theory predicts a positive relationship between firm performance, size, and tax aggressiveness. The clear advantage of the political power theory is that it has been demonstrated over time that larger corporations have the ability to influence legislation in their favor, which allows them to negotiate their tax obligations. Furthermore, these large corporations tend to create monopolies, where a single firm generates the majority of revenue within an industry. In such cases, the government is more likely to provide special favors, such as additional funding or tax breaks, to ensure the industry's continued profitability.

2.3 TAX AGGRESSIVENESS AND POLITICAL COST

Is the political cost hypothesis correct in terms of tax aggressiveness? Are firms likely to manipulate earnings to reduce political costs? For the purpose of this study, firm size, profitability and leverage will be used as proxies for political cost. These proxies will be reviewed alongside ETR which is our measure for tax

aggressiveness. Numerous studies have been carried out on the impact of firm size, profitability and leverage on the effective tax rate (ETR). For instance, from earliest studies, Zimmerman (1983) observes a positive association between ETRs and firm size. On the other hand, (Shevlin & Porter, 1992; Stickney & McGee, 1982) found no relationship between ETRs and firm size, while Porcano (1986) observed a negative relationship.

In Olhoft (1999), data were obtained from Compustat for the years 1990 to 1997, both U.S. multinational and U.S. domestic firms. The study examined which variables were important for enterprises that avoided more income tax, resulting in lower effective tax rates (ETR, defined in this study as the ratio of current income tax expense to pre-tax accounting income). With income constant, larger firms pay more tax on their total net sales than smaller firms. However, higher-income enterprises pay less tax than lower-income firms. Thus, more income is connected with income tax avoidance, although huge firm size is not. Multinational enterprises have a higher negative association between income and ETRs, implying that they pay less tax per dollar of income than local firms in the United States.

Rohaya et al. (2008) asserted that there was a positive relationship existed between firm size and return on assets to both measures of ETR used in their study. Wang et al. (2014) examined the ETR of listed companies in China and considered the causes of differences in ETR in the various sector of the China economy by adopting two measures of ETR (GAAP and CASH ETRs). The findings from their study showed that firm size was positively related to GAAP ETR but not positively related to CASH ETR, while Leverage was positively related to both measures of ETR. Noor et al. (2010) undertook a study with a sample of 294 large Malaysian companies (1470 firm age) between the years 2000 to 2004. They discovered that trading and services, real estate, and construction enterprises had higher ETRs, but lower ETRs were related with firms with bigger fixed asset investments, highly leveraged organizations, and firms with substantial international activities. Richardson and Lanis, (2007) and Dyreng et al. (2008) in their study found a negative relationship between size and cash ETR in their study. This is similar to the result of Davidson and Heany (2012) who in respect to political cost theory, examined ETR and firm size in Australia. Their findings indicated a non-linear link between ETR and firm size. In other words, more prosperous and larger businesses are more likely to engage in tax avoidance to report lower earnings and pay lower taxes. In another study also carried out on the Chinese economy by Liu and Cao (2007) they did not find any significant relationship between firm size and ETR while leverage had a negative impact on ETR. The reason for these contradictory results could be definitional. For example, Liu and Cao define ETR as tax expenses minus deferred tax provisions divided by earnings before interest and tax; thus, Nicodeme's (2001) assertion that different definitions of ETR produce different results appears to have played out here.

Kim and Im (2017) while studying the effect and determinants of small - and medium-sized entities practicing tax avoidance opined that profitability influences

tax avoidance of SMEs. Their result was also in line with that of Moreno et al. (2017), where a positive relationship was said to exist between profitability and tax avoidance. Rani et al. (2018) investigated the effect of profitability, size and leverage on tax avoidance. The study focuses on 49 manufacturing companies listed on the Indonesia Stock Exchange over a five-year period (2012-2016), with samples obtained using cluster random sampling. They discovered that earnings and size had a considerable negative effect on tax avoidance, whereas leverage had a positive effect. Wang et al. (2021) investigated the relationship between political costs and corporate tax avoidance with evidence from Sin firms. In their study, sin firms are firms that operate in sin industries (alcohol, gaming, tobacco and firearms). In their opinion, such firms should be at a higher risk of incurring political costs because of the nature of their services. Their data corroborated their theory, revealing that sin firms avoid taxes less than non-sin firms by employing uncertain and riskier techniques.

From the various studies evaluated, the association between firm size and ETR is unclear because some studies demonstrated a positive relationship, some a negative one, and some showed no relationship. However, the majority of studies found a positive correlation between business size and ETR. This implies that firm size has little bearing on tax aggression. In other words, larger enterprises are less likely to manipulate their earnings to report lower earnings and thus lower ETRs. This assumption is consistent with the second point of the political cost hypothesis, which states that because larger enterprises are under inspection, they seek to act in ways that are socially acceptable. Moreover, there is a stronger negative correlation between profitability and ETR. This means that corporations with higher earnings are more likely to engage in tax avoidance methods. Ideally, the bigger the profitability, the greater the ETR. However, the negative association exists because organizations with higher earnings place a greater emphasis on tax preparation and financial management operations.

When it comes to leverage, lower ETRs are associated with more leveraged firms. This is because firm leverage, as measured by total liability/total asset, can influence the effective tax rate because interest is deductible (Liu & Cao, 2007; Noor et al., 2008). As a result, there will be a strong positive association between leverage and tax aggressiveness, as enterprises with high leverage are more likely to engage in tax aggressive methods.

2.4 TAX AGGRESSIVENESS AND POLITICAL POWER

Anggraini and Wirdajor (2020) conducted an examination into the influence of political associations on tax evasion within manufacturing firms listed on the Indonesia Stock Exchange. Their analysis encompassed 62 companies spanning the period from 2014 to 2018, yielding a dataset of 310 observations. The findings indicate a statistically significant positive relationship between the political connections of directors and their inclination towards tax avoidance strategies. This suggests that directors who have ties to political entities are more inclined to adopt measures aimed at lessening the tax burden of the company. Particularly noteworthy

is the pronounced impact observed in smaller enterprises, where directors with political affiliations possess greater sway over tax-related decisions compared to their counterparts in larger organizations. Conversely, the research revealed that the political leanings of the board of commissioners do not exert a substantial influence on overall tax avoidance behaviors. Nevertheless, in the context of larger corporations, the political affiliations of the board of commissioners demonstrate a more pronounced effect on tax evasion compared to their counterparts in smaller entities. This disparity can be attributed to the enhanced resources and sophisticated governance structures typically found in larger firms. The study elucidates the positive correlation between directors' political connections and tax evasion by highlighting factors such as increased access to tax-related information, the capacity to influence tax policies or secure favorable terms, and a reduced likelihood of facing enforcement actions. The differential impact observed based on the size of the company underscores the unique dynamics at play between large and small enterprises. In smaller firms, where decision-making processes are more centralized, the influence of directors is magnified, whereas in larger corporations, the political affiliations of the board take on greater significance due to the imperative for comprehensive strategic planning. This study underscores the pivotal role that political ties assume in shaping tax avoidance behaviors, with outcomes varying contingent upon the size of the firm and the specific political affiliations embedded within its governance framework.

Wu et al. (2012) conducted a study on all non-financial public companies listed in China's A-share market over a nine (9) year period spanning from 1998 to 2006 to analyze the impact of state ownership, tax status, and firm size on Effective Tax Rates (ETR). The research revealed that privately controlled firms exhibited a higher ETR compared to state-controlled firms, suggesting that the latter possess greater political influence which can affect their ETRs. Mills et al. (2013) utilized ETR as an indicator of a firm's political expenses and explored how a firm's political sensitivity and political power collectively influence these expenses. Their findings indicated that companies dependent on government contracts tend to report elevated ETRs due to heightened political sensitivity; however, the association between political sensitivity and ETR weakens with an increase in a firm's political power, leading to the deduction that certain firms possess adequate political power to mitigate tax-related political expenses.

Zhang and Kim (2016) scrutinized the relationship between firms' political affiliations and their tendency towards aggressive tax strategies. Through an examination of diverse corporate political engagements such as the appointment of connected board members, lobbying efforts, and contributions to campaigns, it was discovered that politically affiliated firms demonstrate greater tax aggressiveness owing to reduced anticipated costs of tax compliance, diminished pressures from the capital market for transparency, superior comprehension of tax regulations and enforcement modifications, and enhanced risk-taking capacities derived from their political connections. In their exploration of tax aggressiveness and politically linked companies, Zaitul et al (2019) established that politically connected firms exhibit

superior profitability compared to non-connected firms, while experiencing lower leverage. The scarcity of information regarding tax aggressiveness concerning political power can be attributed to the intricate nature of measuring political power for companies, coupled with the limited availability of suitable proxies for such assessments.

3. EXPLANATION OF THE TAX AGGRESSIVENESS AND POLITICAL COST OR POLITICAL POWER HYPOTHESES

From the review of empirical literature, it's observed that companies under political and public scrutiny will employ various strategies to influence their ETRs. However, large corporations, on the other hand, are less likely to engage in tax evasion simply because of their size. The factors under political cost that significantly drives tax aggressiveness are profitability and leverage. Firms' earning high profit seek to reduce political scrutiny and their political cost. Hence they will most time engage in tax aggressiveness practices to report lower ETR. In contrast, highly leveraged enterprises exploit their leverage as a tax shield to minimize their ETR. Since interest is tax deductible, these firms may adopt strategies that make them rely more on debt for funding, thereby continuing to shift profits to other periods and pay less tax.

When it comes to political power, it is observed that State controlled firms can influence their ETRs more effectively due to their level of political power, and lower political sensitivity. Additionally, larger private firms with lower political sensitivity can also influence their ETRs, but they do so differently. Politically connected companies, regardless of their size, may report higher profits, and use less leverage because their political connections provide them with advantages such as lower expected costs of tax enforcement, better information regarding tax law changes, and greater risk-taking abilities (Malinda et al., 2022).

However, it is challenging to draw definite conclusion as to which theory has the most impact on tax aggressiveness. For one, tax aggressiveness and political cost has received serious empirical considerations in extant literature even though some have not been foreclosed and as such remains inconclusive, as some studies report a positive relationship, others a negative relationship, and yet others a mixed relationship. Additionally, as it relates to political power, the proxies used in empirical studies varies. The political power theory theorizes that big firms because of their resources may be able to negotiate their tax burden, or influence legislations. Take for instance, the finding on state-controlled firms having more political power than private controlled firms. Just because they are state controlled firms, doesn't make them large or more profitable than private firms. More so, political connection for a firm, doesn't automatically translate to it being a large firm. In addition, as stated earlier, there is limited proxy for political power, and the different studies examined, used different proxies. Hence results cannot be compared with each other.

4. CONCLUSION AND RECOMMENDATIONS

When conducted in compliance with legal regulations, tax aggressiveness is considered permissible; however, it is essential to acknowledge that such behavior contradicts the underlying purpose of tax legislation, which is to guarantee the generation of adequate funds to support public services. The primary aim of this study was to examine whether the tax aggressive conduct exhibited by corporations could be attributed to either political cost theory or political power theory. Predominantly, extant literature has been mainly hinged on political cost hypothesis, because the proxies for political cost is measurable, and can be compared over studies and over periods; however some other works have used political power to investigate the issues of tax aggressiveness thus mixed findings were revealed because different proxies were used for political power hypotheses and hence their result could not be compared and remained inconclusive. Therefore, from extant literature, the paper discovered that political cost theory explains that firms engage in tax aggressive activities in order to decrease their tax burden and declare favorable earnings. This point of view is also seen in the recent study of Belz et al. (2019), whose findings revealed that the political cost theory determined firm size in relation to ETR.

This paper also urges for more empirical research on political power theory and tax aggressiveness to clearly determine which theory had the most influence on tax aggressiveness. Until then, managers of large, profitable, high-leveraged and politically connected firms must apply caution when employing tax aggressive strategies, so as not to cross the line into tax evasion. More so, the study recommends that there should be one proxy on political power in order to ensure that empirical studies carried out on political power and tax aggressiveness can be compared with each other across companies and years.

REFERENCES

- Aliani, K., & Zarai, A. (2012). The board of directors and the corporate tax planning: Empirical evidence from Tunisia. *International Journal of Accounting and Financial Reporting*, 2(2), 142 -156. <https://doi.org/10.5296/ijafjr.v2i2.2525>
- Anggraini, Y., & Widarjo, W. (2020). Political connection, institutional ownership and tax aggressiveness in Indonesia. *European Journal of Business and Management Research*, 5(5).
- Apriyanti, H. W., & Arifin, M. (2021). Tax aggressiveness determinants. *Journal of Islami Accounting and Finance Research–Vol*, 3(1) 24-52.
- Armstrong, C. S., Blouin, J. L., & Larcker, D.F. (2012). The incentives for tax planning. *Journal of Accounting and Economics*, 53(1-2), 391-411. <https://doi.org/10.1016/j.jacceco.2011.04.001>
- Belz, T., Hagen, D. V., & Steffens, C. (2019). Taxes and firm size: Political cost or political power?. *Journal of Accounting Literature*, 42(1), 1-28.

- Brigham, E. F., & Houston, J. F. (2013). *Fundamentals of financial management*. South-Western Cengage Learning.
- Chen, S., Chen, X., Cheng, Q. & Shevlin, T. (2010). Are family firms more tax aggressive than non-family firms? *Journal of Financial Economics*, 95 (1), 41 - 61. <https://doi.org/10.1016/j.jfineco.2009.02.003>
- Davidson, S., & Heaney, R. (2012). Effective tax rates and the political cost hypothesis: A re-evaluation of Australian evidence. *Australian Tax Forum*.
- Desai, M. A., & Dharmapala, D. (2006). Corporate tax avoidance and high-powered incentives. *Journal of Financial Economics*, 79(1), 145-179. <https://doi.org/10.1016/j.jfineco.2005.02.002>
- Desai M. A., & Dharmapala, D. (2009). Corporate tax avoidance and firm value. *Review of Economics and Statistics*, 91(3), 537-546.
- Dyreng, S., Hanlon, M., & Maydew, E. (2008). Long-run corporate tax avoidance. *The Accounting Review*, 83, 61-82. <https://doi.org/10.2308/accr.2008.83.1.61>
- Hanlon, M., & Heitzman, S. (2010). A review of tax research. *Journal of Accounting and Economics* 50(2-3), 127-178. <http://dx.doi.org/10.1016/j.jacceco.2010.09.002>
- Hoi, C., Wu, Q., & Zhang, H. (2013). Is corporate social responsibility (CSR) associated with tax avoidance? Evidence from irresponsible CSR activities. *The Accounting Review* 88, 2025–2059. <https://doi.org/10.2308/accr-50544>
- Kim, J. B., Li, B., & Zhang, L. (2011). Corporate tax avoidance and stock price crash risk: Firm-level analysis. *Journal of Financial Economics*, 100(3), 639-662. <https://doi.org/10.1016/j.jfineco.2010.07.007>
- Kim, C., & Zhang, L. (2016). Corporate political connections and tax aggressiveness. *Contemporary Accounting Research*, 33(1), 78-114.
- Kim, J. H., & Im, C. C. (2017). The study on the effect and determinants of small-and medium-sized entities conducting tax avoidance. *Journal of Applied Business Research*, 33(2), 375-390. <https://doi.org/10.19030/jabr.v33i2.9911>
- Lanis, R., & Richardson, G. (2011). The effect of board of director composition on corporate tax aggressiveness. *Journal of Accounting and Public Policy*, 30(1), 50-70. <http://dx.doi.org/10.1016/j.jaccpubpol.2010.09.003>
- Lee, N., & Swenson, C. (2012). Are multinational corporate tax rules as important as tax rates? *The International Journal of Accounting* 47(2), 155-167.
- Lee, B.B., Dobiyanski, A., & Minton, S. (2015). Theories and empirical proxies for corporate tax avoidance. *Journal of Applied Business and Economics*, 17(3), 21 – 33. <https://www.proquest.com/scholarly-journals/theories-empirical-proxies-corporate-tax/docview/1727644636/se-2?accountid=201395>
- Liu, X., & Cao, S. (2007). Determinants of corporate effective tax rates. *The Chinese Economy* 40, 49–67. <https://doi.org/10.2753/CES1097-1475400603>
- Malinda, K. P., Sintha, L., Munandar, A., & Bertuah, E. (2022). The Influence of Political Connections, and Good Corporate Governance on Tax

- Aggressiveness. *American International Journal of Business Management (AIJBM)*, 5(4), 106-110.
- Manzon, G.B., & Plesko, J.A. (2001). The relation between financial and tax reporting measures of income. *Tax Law Review*, 55, 739-756.
- Mills, L., Nutter, S., & Schwab, C. (2013). The effect of political sensitivity and bargaining power on taxes: Evidence from federal contractors. *The Accounting Review* 88, 977–1005. <https://doi.org/10.2308/ACCR-50368>
- Minnick, K., & Noga, T. (2010). Do corporate governance characteristics influence tax management? *Journal of Corporate Finance* 16(5), 703-718.
- Moreno R. J., González, R. M. R., & Samper, M. (2017). Determinants of the effective tax rate in the tourism sector: A dynamic panel data model. *Tourism & Management Studies*, 13(3), 31-38. <https://doi.org/10.18089/tms.2017.13304>
- Mughal, M and Akram, M (2012), Reasons of tax avoidance and tax evasion: Reflections from Pakistan, *Journal of Economics and Behavioral Studies*, 4(2), 217-222.
- Nicodème, G. (2007). Do larges [sic] companies have lower effective corporate tax rates? A European survey. *Working Paper (Centre Emile Bernheim Working Paper 07/001)*.
- Noor, R., Fadzillah, & Mastuki, N. (2010). Corporate tax planning: A study on corporate effective tax rates of Malaysian listed companies. *International Journal of Trade, Economics and Finance*, 1, 189–193. <http://dx.doi.org/10.7763/IJTEF.2010.V1.34>
- Nwaobia, A. N., Jaycoba, N. & Olajumoke. (2016). Tax planning and firms' liquidity. *Journal of Business Management*, 2(1), 1 – 22.
- Ogbeide, S. O. (2017). Firm characteristics and tax aggressiveness of listed firms in Nigeria: Empirical evidence. *International Journal of Academic Research in Public Policy and Governance*, 4(1), 556-569.
- Ogbeide, S. O., & Iyafekhe, C. (2018). Empirical assessment of tax aggressiveness of listed firms in Nigeria. *International Accounting and Taxation Research Group*, 2(3), 13–29. <http://dx.doi.org/10.14710/jab.v9i2.30512>
- Olhoft, S. L. (1999). *Tax avoidance activities of United States multinational corporations*. University of Michigan.
- Phillips, J. (2003). Corporate tax planning effectiveness: The role of compensation based incentives. *The Accounting Review*, 78(3), 847-874. <https://doi.org/10.2308/accr.2003.78.3.847>
- Pratama, A. (2017). Company characteristics, corporate governance and aggressive tax avoidance practice: A study of Indonesian companies. *Review of Integrative Business and Economic Research*, 6(4), 70 – 81.
- Porcano, T. (1986). Corporate tax rates: Progressive, proportional, or regressive. *The Journal of the American Taxation Association*, 17 – 31.

- Rania, S., Susetyob, D., & Fuadahc, L. L. (2018). The effects of the corporate's characteristics on tax avoidance moderated by earnings management (Indonesian Evidence). *Journal of Accounting, Finance and Auditing Studies*, 4(3), 149-169.
- Rego, S. (2003). Tax avoidance activities of U.S. multinational corporations. *Contemporary Accounting Research*, 20(4), 805–833. <https://doi.org/10.1506/VANN-B7UB-GMFA-9E6W>
- Richardson, G., & Lanis, R. (2007). Determinants of the variability in corporate effective tax rates and tax reform: Evidence from Australia. *Journal of Accounting and Public Policy*, 26, 689 – 704. Richardson, G., & Lanis, R. (2008). Corporate effective tax rates and tax reform: Evidence spanning Australia's Ralph Review of Business Taxation Reform. *Australian Tax Forum*, 23, 109 – 123.
- Rohaya, N.M., Mastuki, N., & Bardai, B. (2008). Corporate effective tax rates: A study of Malaysian public listed companies. *Malaysian Accounting Review*, 7(1), 1-20.
- Scott, William R. 2003. *Financial Accounting Theory*. Third Edition. Canada: Prentice-Hall
- Shevlin, T., & Porter, S. (1992). The corporate tax comeback in 1987: Some further evidence. *The Journal of the American Taxation Association*, 14, 58–79.
- Siegfried, J. (1972). The relationship between economic structure and the effect of political influence: Empirical evidence from the corporation income tax program. *Ph.D. dissertation (University of Wisconsin)*, reported in *Stickney and McGee (1982)*.
- Slemrod, J. (2004). The economics of corporate tax selfishness. *National Tax Journal*, 57, 877–99. <https://doi.org/10.17310/ntj.2004.4.06>
- Stickney, C., & McGee, V. (1982). Effective corporate tax rates: The effect of size, capital intensity, leverage, and other factors. *Journal of Accounting and Public Policy*, 1, 125-152. [https://doi.org/10.1016/S0278-4254\(82\)80004-5](https://doi.org/10.1016/S0278-4254(82)80004-5)
- Wang, C., Wilson, R. J., Zhang, S., & Zou, H. (2021). Political costs and corporate tax avoidance: evidence from sin firms. <https://ssrn.com/abstract=3034635>
- Watts, R., & Zimmerman, J. (1986). Positive accounting theory. *Journal of Accountancy*. Prentice Hall Incorporation. SSRN. <https://ssrn.com/abstract=928677>
- Watts, R. L., & Zimmerman, J. L. (1990). Positive accounting theory: A ten year perspective. *The Accounting Review*, 65, 131–156.
- Wilson, R. (2009). An examination of corporate tax shelter participants. *The Accounting Review*, 84, (3), 969-999. <https://doi.org/10.2308/accr.2009.84.3.969>
- Wu, L., Wang, Y., Luo, W., & Gillis, P. (2012). State ownership, tax status and size effect on effective tax rate in China. *Accounting and Business Research*, 42(2), 97-114. <https://doi.org/10.1080/00014788.2012.628208>

- Yahaya, K. A., & Yusuf, K. (2020). Impact of company characteristics on aggressive tax avoidance in Nigerian listed insurance companies. *Jurnal Administrasi Bisnis*, 9, 2, 101-111. <https://doi.org/10.14710/jab.v9i2.30512>
- Zaitul, Z., Elfiswandi, E., & Ilona, D. (2019). Board of commissioners involvement and shareholder's wealth. *International Journal of Recent Technology and Engineering* 8(2 Special Issue 9), 484-490.
- Zimmerman, J. (1983). Taxes and firm size. *Journal of Accounting and Economics*, 5, 119-149. [https://doi.org/10.1016/0165-4101\(83\)90008-3](https://doi.org/10.1016/0165-4101(83)90008-3)