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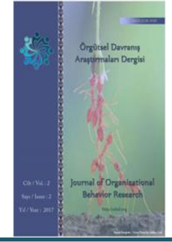

CULTURAL VALUES AND CORPORATE TAX AVOIDANCE: AN EMPIRICAL EVIDENCE FROM VIETNAM

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ABSTRACT

The present paper aims to examine the impact of cultural values on the corporate tax avoidance behavior of Vietnamese firms. Data is collected from over 6,000 firms over the period 1998-2018 and then analyzed by using the panel fixed-effect model. In general, the findings imply that firms that operate in high uncertainty avoidance cultures are less probable to be involved in corporate tax avoidance practice. This might be because high uncertainty avoidance cultures tend to be less competitive and are uncomfortable with ambiguity and inequality and thus, they are less probable to refrain from tax. In contrast, masculinity culture will lead to more tax avoidance behavior in firms. The feasible explanation is that masculine culture emphasizes competition and tends to engage in riskier and unethical activities which consequently lead to a higher probability of tax avoidance. This paper provides the first and unique empirical evidence about the role of cultural values in shaping firm tax avoidance behavior in Vietnam and thus, the findings of the study can draw policy implications for both shareholders and policy regulators.

Keywords: *Culture, Corporate tax avoidance, Firms, Vietnam, Hofstede.*

INTRODUCTION

Tax avoidance, broadly defined, applies to any tax-planning practices that businesses engage in to minimize the amount of tax paid to the government (Dyreng *et al.*, 2019). Since tax avoidance accounts for a significant portion of a company's overall cash outflows (Kovermann & Velte, 2019), all executives should expect to pay the least amount of corporate income taxes (Koester *et al.*, 2017; Lanis *et al.*, 2019). The common wisdom holds that this strategy will help shareholders maximize their wealth by reallocating capital from taxing authorities to corporate entities. Opponents of tax avoidance, on the other hand, are concerned that agency disputes between shareholders and managers within companies hurt tax avoidance benefits to shareholders. Given that tax avoidance accounts for a large portion of a firm's financial decisions, exploring the factors that affect tax avoidance is important in corporate finance research (Armstrong *et al.*, 2015).

Prior scholars suggest that tax analysis should be given more focus. Although the literature on this subject is new, it has been active for a few decades. For example, many studies (Atwood & Lewellen, 2019; Hoseini *et al.*, 2019; Lee *et al.*, 2020; Wen *et al.*, 2020) keep track of individual directors who have served on the boards of several companies and understand that top executive

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have an important role in deciding tax avoidance practices. Similarly, Koester *et al.* (2017) provide empirical evidence that higher-capability executives are more likely to use tax planning techniques. This is due to their in-depth knowledge of the firm's climate, which helps them to better recognize and exploit tax avoidance opportunities. According to Armstrong *et al.* (2015), the impact of corporate governance on tax avoidance is determined by the actual level of corporate tax avoidance. Firms with experienced and independent boards, in particular, improve tax avoidance at a low level because they can raise cash inflows with little risk. When the degree of tax avoidance is already high, however, the marginal cost of further tax avoidance will outweigh the marginal gain. As a result, boards will refrain from engaging in more aggressive tax preparation practices. According to McClure *et al.* (2018), businesses that pass tax credits on to shareholders for income tax paid are less likely to indulge in tax avoidance than companies that pay dividends without tax credits. Kovermann, and Velte (2019), show that companies with more centralized ownership and control participate in less active tax planning. These owner-managers are more likely to be risk-averse and therefore less able to take on risky projects, such as tax evasion (Rasooli *et al.*, 2019; Moghaddam & Dehkhodania, 2020).

The literature to date has also shown that corporate tax avoidance is determined by a lot of factors such as capital market pressure (Badertscher *et al.*, 2019); corporate social responsibility (Col *et al.*, 2019; López-González *et al.*, 2019; Wang *et al.*, 2020; Alsaadi, 2020); stock price reactions (Blaufus *et al.*, 2019); effective tax rate reconciliations (Drake *et al.*, 2020); managerial acquisitiveness (Gul *et al.*, 2020); asymmetric cost behavior (Xu & Zheng, 2020); tax uncertainty (Guenther *et al.*, 2019); tax transparency (Oats & Tuck, 2019), tax risk (Drake *et al.*, 2019) and corporate innovation (Li *et al.*, 2021). Moreover, the existing research have concentrated on several aspects of tax issues (Nguyen, 2019; Pham *et al.*, 2020) such as investigating how tax avoidance affect firm bankruptcy risk (Dhawan *et al.*, 2020); why not all firms engage in tax avoidance (Jacob *et al.*, 2021) as well as examining the channels, magnitudes and blind spots of the issue (Beer *et al.*, 2020), very little attention has been paid to national culture as an important determinants of corporate tax avoidance behavior.

The international business literature often defines culture as the obtained knowledge of people that explains the thinking and behaviors of people. Hofstede (1991) regards culture as the "collective programming of the mind which distinguishes the members of one group or category of people from another". More broadly, national culture refers to the beliefs, values, and norms that people learned from their childhood and can distinguish them from other groups of people (Hofstede, 1991). National culture is often known as a stable component of countries that do not necessarily change much across time and generations. National culture is embedded profoundly in everyday life, resistant to change, evolves from generation to generation, and invades most organizations in societies. According to institutional theory, corporate decisions and performance are greatly determined by the "common understandings of what is appropriate and, fundamentally, meaningful behavior" in the surrounding environment that they work in. In addition, these common understandings are known as the informal institutions, and national culture, as one of these informal institutions has motived and explained human behaviors that are compatible with the popular beliefs, values, norms, and practices in a nation (Licht *et al.*, 2007; Lewellyn, 2017). Some scholars have shown that national culture acts as a usual frame of reference or logic held by the members of a society and thus affects the performance of firms. Specifically, by driving a firm's desire of developing and maintaining its core capabilities,

national culture may lead to differences in the firm's strategy and efficiency (Yalcinkaya *et al.*, 2017).

Despite its pervasive nature, it would be surprising that the corporate literature seems to neglect the influence of national culture on a firm's business activities (except for the study of Chen *et al.*, 2021 to name a few). In addition, despite the large number of studies attempting to investigate factors that affect the practice of corporate tax avoidance, little attention has been paid to whether national culture could exert influences on companies' tax planning strategies. So, the present study intends to close this gap by investigating how national culture affects corporate tax avoidance among Vietnamese firms. As such this study choose Vietnam as the empirical setting since Vietnam is a typical developing country. Since the introduction of the reform policy known as Doi Moi in 1986, Vietnam has carried out massive economic reforms aiming at the establishment of an open and market-oriented economy. However, despite substantial effort from the government, corporate tax avoidance in Vietnam is still prevalent and remains an obstacle for regulators in this country. According to International transparency (2018), the country is still belonging to the low-transparency category and is one whose government commitment to ensure adequate support for courts and their personnel has weakened in recent years. Another reason is that although there are quite a lot of studies that have investigated the performance of firms in Vietnam, there is no study so far to focus on the impact of culture on the practice of corporate tax avoidance of Vietnamese firms.

Power distance, uncertainty avoidance, individualism, and masculinity are four cultural dimensions that are commonly used in literature to recognize cultural relativity as suggested by Hofstede (1991). Accordingly, while power distance and hesitancy avoidance are related to the structural and functional system of firms and thus the business model that firms wish to follow, the other two cultural dimensions are more associated with people themselves like how they will perform in a corporation instead of the corporations themselves. It has been found that a high level of individualism could increase the performance of affiliate firms in a collectivistic society and concluded that national culture does impact the performance of foreign firms operating in Greece. Broekhuizen *et al.* (2017) show that uncertainty avoidance has both positive and negative impacts on firm performance. Although these several studies include some cultural dimensions, such as individualism and hesitancy avoidance, the four cultural dimensions have not been given much attention, leaving studies on the role of national culture is largely neglected, partly because the difficulty of capturing and measuring culture has presented a major obstacle. This study can contribute to the economics and business literature in several aspects. First, this study provides empirical evidence about the role of national culture in shaping firm tax avoidance practice. Second, it can supplement an understanding of what drives firm tax planning strategies as well as an emphasis on the importance of values and norms in affecting firm behaviors. Third, by using a sample of 6468 FDI firms in Vietnam during the 20 years from 1998 to 2018, this research can contribute to the literature about the association between culture and corporate tax avoidance in an emerging country. The residue of the paper proceeds as follows. Section 2 presents the literature review, section 3 describes key variables of interest and sample overview; section 4 provides experimental results and section 5 is the conclusion.

Literature Review

Corporate Tax Avoidance

The investigation of the factors that influence corporate tax avoidance has grown in popularity over the last decade. Armstrong *et al.* (2015) investigated the effects of managerial stimulants on firm tax avoidance and found that comparatively high amounts of risk-taking equity can incentivize managers to participate in tax avoidance activities that go beyond what shareholders want. Furthermore, the authors show that at both high and low amounts of tax aggressiveness, there is a heterogeneous relationship between corporate governance and tax planning strategies. They also stress the possibility of positive net gains from risky tax avoidance investments up to a firm's optimum value. More experienced and autonomous boards, in particular, are encouraged to promote more tax planning at lower extents of tax avoidance, as this would increase cash inflows with low hazard. Highly experienced and autonomous boards are encouraged to support more tax preparation at a lower extent of tax avoidance, as this will raise cash inflows while posing a low hazard. Dividend imputation has a huge effect on corporate tax evasion. According to McClure *et al.* (2018), businesses that receive tax credits for income taxes paid are less likely to engage in tax avoidance practices, as shown by a higher average cash-effective tax rate, than companies that pay dividends without tax credits. The imputation of dividends has a major impact on firm tax avoidance. As mentioned by McClure *et al.* (2018), firms that earn tax credits for income taxes paid are less likely than companies that pay dividends without tax credits to participate in tax avoidance activities, as shown by a higher average cash effective tax rate.

According to Dyreng *et al.* (2010), top executives (i.e. CEO, CFO) have a major role in deciding the amount of tax avoidance. On the same note, Koester *et al.* (2017) give three additional explanations why companies with higher-ability executives can have a lower cash-effective tax rate (proxy used by the authors to capture tax avoidance). For instance, excellent managers would be able to make better aligned strategic decisions on tax planning techniques if they have a comprehensive understanding of their company's operating climate. Second, reducing cash outflows to taxing authorities is considered to be the most appropriate strategy for achieving lower cost structures since it has no negative impact on firm operations. Finally, it appeals to executives who can easily manage capital because reallocating tax benefits to company operations can theoretically produce a positive return on investment. Hoopes *et al.* (2012) analyzed the effect of Internal Revenue Service (IRS) monitoring on corporate tax evasion in the United States and found clear evidence that public corporations avoided less income tax when the IRS was more closely monitored. Furthermore, where firm-level governance is poor or tough external oversight by institutional shareholders is lacking, tax avoidance practices become more vulnerable to IRS audit rates. To maximize societal welfare, the authors suggest that instead of simply increasing IRS audit rates, authorities should carefully consider an optimal tax enforcement policy, such as encouraging taxpayer-IRS collaboration, requiring more corporate tax disclosure, or increasing penalties for those who engage in tax evasion.

In summary, recent research has centered on the agents that influence company tax avoidance. However, given the increasing importance of national culture in shaping firm behaviors and activities, studies on how it can affect corporate tax avoidance activities still receive little attention. As such, I attempt to shed light on the causal relationship between the two areas in this paper.

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National Culture

To define and measure national culture, many scholars around the world have built some frameworks and among them, the model of Hofstede (1991) is often known as the most comprehensive one. Accordingly, Hofstede has identified the most fundamental issues that all countries encounter, and by answering these questions, four cultural dimensions have been found including (1) Power distance defined as the degree to which people in a society agree on an acceptable level of power that is dispensed unequally; (2) Hesitancy avoidance which is the extent to which people in a community are annoyed with anxiety and uncertainty; (3) Individualism is defined as the preference for a loosely-knit social framework and is an opposite preference of collectivism that means a firmly woven social framework; and (4) Masculinity refers to the priority of success, assertiveness, and achievement and is against Femininity that reflects the preference for modesty, care, and relationships.

As pointed out by Hofstede (1991), these cultural dimensions can significantly affect not only each person but also the entire organization in different ways. Specifically, while both power distance and hesitancy avoidance affect the structural and functional framework of institutions and thus decide which type of business model an organization should be, both other two cultural dimensions influence the people themselves in organizations. The corporate literature has also documented that national culture can influence the firm performance in the way that a mismatch between the national culture of the affiliate and each job unit can decrease the business outcomes. Other scholars show that an increase in the performance of merging firms has been driven by a close distance of national culture but not the closeness among employees. Moreover, other works in the field of accounting and finance research have documented the critical role of cultural factors in the process of making decisions.

Specifically, these cultural values have shaped the institutional and legal framework where people and organizations operate and thus could directly affect firm behaviors and decisions. For example, as pointed out by Breuer and Salzmann (2011), since individualism is associated with people who are more optimistic and confident, it can positively affect a person's risk-taking behavior. Other scholars also found that business managers' decisions and activities are greatly determined by cultural values. In a broader context, cultural values are found to influence accounting transparency, corporate governance, judicial efficiency, and investor protection. For example, it has been shown that the differences in corporate governance are driven by the differences in cultural values across countries. The findings of Licht *et al.*'s (2007)'s work show that individualism and power distance are highly related to corporate governance. In addition, other scholars find that a more efficient judicial system and a more transparent accounting system are largely driven by cultural factors.

MATERIALS AND METHODS

Data and Sample Overview

As suggested by Hofstede (1991), culture can be measured by four cultural dimensions including power distance, individualism, masculinity, and uncertainty avoidance. Later, the fifth cultural dimension namely long-term versus short-term orientation that complements Hofstede's framework has been developed. Generally, the availability of these cultural dimensions takes place at a one-time point only, nevertheless, it is also argued that there might be substantial

stability in some social values such as failure, success, and belonging. The stable feature of culture can be explained by the claim that differences in values among societies are originated from history and drivers of socio-economic developments. However, in this study, I follow the highly influenced classifications of Hofstede and use four cultural dimensions that have extensively been used in national culture studies (Hofstede, 1991) that are power distance, individualism, masculine, and uncertainty avoidance. Accordingly, the cultural values data on power distance (PDI), masculinity (MAS), individualism (IDV), and uncertainty avoidance (UAI) are retrieved from Hofstede's VSM 2013 and Geert Hofstede website.

Concerning firm-specific characteristics, I control for firm size as suggested by Pasiouras and Gaganis (2013). In addition, I add in the model the market-to-book worthiness of properties ratio (MB) as suggested by some scholars (Villalonga & Amit, 2006). This ratio is calculated as the total of the equity market value plus the debt book value divided by the sum of the book value of equity and debt. According to these authors, the higher value of this ratio, the lower value appended to the properties, and the higher the value associated with development opportunities and more risk-taking. Previous studies (Hambrick & Mason, 1984) also indicate the relationship between age and gender of the managers and the performance of firms and thus I include these two variables into our model. The data on firm-specific characteristics is collected from the Vietnam Enterprises Survey (VES) conducted between 1992 and 2011. In addition, to control for macroeconomic factors, I add into the baseline model two country-specific variables including *GDP* and *INFLATION*. As suggested by some authors, firms can be more profitable in rapidly growing conditions and thus I include into the model the variable *GPD* which controls for economic growth and is measured as the annual GDP growth rate. Moreover, inflation has also been pointed out that may affect firm profitability by making firms' returns more volatile and as such, I add in the model the *INFLATION* variable that controls for the inflation rate and is measured by the annual change in the consumer price index.

With regards to the practice of tax avoidance, I use the cash-effective tax rate to calculate company tax avoidance, as recommended by Koester *et al.* (2017). Various measures of corporate tax avoidance have been used in previous studies, including book-tax disparities, the cash effective tax rate (Dyreng *et al.*, 2010; Koester *et al.*, 2017), and the GAAP effective tax rate (Dyreng *et al.*, 2010), among others. However, I assume that the cash-effective tax rate is the most appropriate measurement for the research. By accounting for tax benefits from timing discrepancies such as unpredictable tax positions and accelerated depreciation, I can examine both permanent and temporary tax deferral strategies (Koester *et al.*, 2017). Furthermore, adjustments in the calculation, such as the tax buffer or valuation allowance, have little effect on cash-effective tax rates. In addition, data to build other corporate tax avoidance measures is not completely available during the period studied in this study.

Next, **Table 1** presents the descriptive statistics, while **Table 2** shows the correlation matrix of all variables.

Table 1. Summary of Statistics

Variable	Obs	Mean	S.D	Min	Max
cash etr	6,468	0.310	0.060	0.146	0.401
pdi	6,468	61.879	14.588	0.000	104.000

idv	6,468	30.529	21.623	0.000	91.000
mas	6,468	52.097	19.591	0.000	110.000
uai	6,468	59.539	26.329	0.000	104.000
corr	6,468	2.920	0.823	1.380	5.465
inflation	6,468	5.463	4.624	0.000	30.000
firm_size	6,468	10.213	2.032	0.000	18.397
MB	6,468	10.174	8.602	4.592	16.410
age	6,468	47.462	9.413	22.000	80.000
gender	6,468	0.920	0.272	0.000	1.000
gdp	6,468	0.833	0.373	0.000	1.000

Table 2. Correlation Matrix

	cash etr	pdi	idv	mas	uai	inflation	size	MB	age	gender	gdp
cash etr	1										
pdi	0.343	1									
idv	0.062	-0.483	1								
mas	-0.381	-0.074	0.417	1							
uai	0.279	-0.328	0.107	0.310	1						
inflation	-0.301	-0.0279	0.006	0.003	0.015	1					
size	0.022	-0.001	-0.034	0.078	0.086	0.342	1				
MB	-0.410	-0.022	0.034	0.006	-0.007	-0.002	0.017	1			
age	0.165	-0.110	0.038	0.094	0.183	0.233	0.165	-0.003	1		
gender	-0.141	-0.065	0.059	0.105	0.152	0.019	0.089	0.001	0.145	1	
gdp	0.219	-0.041	0.093	0.046	0.015	0.005	0.081	0.007	-0.053	0.001	1

Model Specifications

To examine how national culture affects firm's tax avoidance behavior, I use the following model:

$$\text{CASH ETR}_{it} = \text{CULTURE}_{it} + \text{CONTROL_VARIABLES}_{it} + \pi + \delta + \varepsilon_{i,t} \quad (1)$$

The cash effective tax rate for a given firm i in year t (CASH ETR_{it}), which is calculated as cash taxes paid as a percentage of pretax book income before special products, is the dependent variable of interest. Lower levels of tax evasion are meant by a higher value of the effective tax rate (ETR). Various measures of corporate tax evasion have been used in previous research, including book-tax disparities, the cash-effective tax rate, and the GAAP effective tax rate. However, using the ETR as a proxy for tax avoidance is useful because it can represent long-

term book-tax differences while excluding the impact of short-term ones. It can also be used to capture the results of international activities for tax planning. Since it is difficult to collect reliable tax outcomes linked to book-tax discrepancies, I do not use them to suggest various degrees of tax avoidance. By accounting for tax benefits from timing discrepancies such as unpredictable tax positions and accelerated depreciation, I can examine both permanent and temporary tax deferral strategies (Koester *et al.*, 2017). Furthermore, adjustments in the calculation, such as the tax buffer or valuation allowance, have little effect on cash-effective tax rates. In contrast, the GAAP effective tax rate, which is determined by multiplying the current and deferred tax expenditure by pre-tax revenue, does not accurately reflect corporate tax avoidance. In many situations, the excess of accelerated depreciation often used for financial reporting for tax purposes helps minimize the firm's current tax liability but raises deferred tax liability as spending on plant and equipment slows, GAAP effective tax rate is less accurate in showing firms' tax avoidance strategies than cash effective tax rate. I require companies to have positive pre-tax revenue, income tax paid, and total income taxes, according to previous research (Koester *et al.*, 2017). To strengthen the understanding of the effective tax rate index, I have reset Cash ETR values greater than one to one. When taxes are paid to surpass pretax income, resulting in an effective tax rate greater than 100%, non-meaningful effective tax rates will occur (Dyreng *et al.* 2010).

The key explanatory variables are CULTURE represents the four cultural values: power distance (PDI), individualism (DIV), masculinity (MAS), and uncertainty avoidance (UAI) as mentioned in the previous section. I also include a broad set of control variables such as company size, company equity to turnover ratio, managers' age and gender, inflation, and economic growth (GDP growth rate. In addition, π and δ control for the unobserved province-specific and year fixed effect.

RESULTS AND DISCUSSION

Table 3 provides the findings of the impact of national culture on company tax avoidance. Columns (1)-(4) of **Table 3** report regressions of the CASH ETR variable on the four culture dimensions (PDI, IDV, MAS, UAI). Firstly, the estimated coefficient on MAS is significantly negative, implying that masculinity culture leads to an increase in tax avoidance. The feasible explanation is that masculine culture emphasizes competition, success, and are less sympathetic for the weak. In addition, masculine culture values ambitious and competitive individuals, especially males as argued by Vitell *et al.* (1993) so in this type of culture, companies are more likely to engage in riskier and unethical activities which consequently lead to a higher probability of tax avoidance. Specifically, this culture type has incentivized managers to adopt riskier plans including tax-avoiding activities. Besides, when there exists an information asymmetry between managers and shareholders concerning tax planning, managers belong to this cultural dimension are more likely to be easily facilitated to act at the expense of shareholders' wealth, resulting in a negative association between tax avoidance and firm value. In terms of uncertainty avoidance, the positive coefficient of UAI indicates an increase in the cash-effective tax rate, which connotes a decrease in corporate tax avoidance among firms having this cultural type. This is possible because high UAI cultures are less competitive and thus, firms having this cultural type are less likely to engage in risky activities, including the

practice of company tax avoidance since they are uncomfortable with ambiguity and inequality and due to the fear of losing their reputation and value. This finding is in line with some prior studies (Ashraf *et al.*, 2016).

The effects of power distance and uncertainty avoidance provide no consistent results since the coefficients on PDI and IDV are not statistically significant. I also find some evidence on firm characteristics and CEO characteristics as determinants of corporate tax avoidance. Specifically, I find that larger firms are more likely to avoid tax than a small firm. FIRM_AGE is positively related with cash etr, suggesting that older firms significantly decrease tax avoidance.

Table 3. National Culture and Corporate Tax Avoidance

	Dependent Variable: CASH ETR			
	(1)	(2)	(3)	(4)
PDI	0.009 (0.016)			
IDV		-0.004 (0.009)		
MAS			-0.019*** (0.011)	
UAI				0.011*** (0.008)
SIZE	-0.196*** (0.028)	-0.192*** (0.028)	-0.193*** (0.028)	-0.197*** (0.028)
INFLATION	0.134* (0.076)	0.129* (0.076)	0.134* (0.076)	0.121* (0.076)
MB	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)
AGE	0.306** (0.221)	0.275*** (0.223)	0.333 (0.230)	0.385* (0.229)
GENDER	-0.033 (0.150)	-0.045 (0.149)	-0.008 (0.150)	0.025 (0.154)
GDP	0.108 (0.117)	0.101 (0.117)	0.116 (0.119)	0.110 (0.118)
Industry dummies	YES	YES	YES	YES
Province dummies	YES	YES	YES	YES
R-square	0.19	0.19	0.20	0.20
No. Obs.	6468	6468	6468	6468
Note: *, **, and *** denotes significance at the 10%, 5%, and 1% level, respectively.				

Source: Author's work

CONCLUSION

This paper provides some of the first evidence on the role of national culture on the behavior of corporate tax avoidance among Vietnamese firms. In general, the findings imply that firms that

operate in high uncertainty avoidance cultures are less probable to be involved in corporate tax avoidance practice. This might be because high UAI cultures tend to avoid competition and because they are uncomfortable with ambiguity and inequality and thus, they are less probable to avoid tax. In contrast, masculinity culture will lead to more tax avoidance behavior in firms. This research therefore can draw policy implications for both firm shareholders and regulatory authorities when dealing with corporate tax avoidance.

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