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CORPORATE TAX AVOIDANCE IN THE PAST DECADE: CANADIAN EVIDENCE

Abstract:

This study examines firms' tax avoidance in the past decade in Canada. Why do firms change their tax avoidance in recent years? First, regulations were implemented on tax avoidance. For instance, G20 Base Erosion and Profit Shifting Project is to create global framework to fight against income shifting across countries by multinational corporations. Meanwhile, there are requirements for increasing disclosure of tax information. For example, the Australian legislature passed a bill in 2013 requiring a disclosure of taxable income for foreign firms and domestic listed firms. Later, the same requirement was applied to domestic private firms. In the U.S., starting 2010, IRS required a statement on uncertain tax position for firms with total assets of $10M or more. Canadian government recently proposes mandatory disclosures such as detailed transactions with foreign entities, country-by-country reporting for multinational corporations, etc. Second, negative media coverage of tax sheltering and public pressure toward tax avoidance in recent years increased the risk of reputational damages for firms engaging in tax avoidance. However, industry concentration and lack of competition result in some firms becoming larger and lager. Large firms generally have an advantage in arranging tax avoidance transactions. Moreover, firms in financial constraints either because of the pandemic or some environmental damages were eager to pursue cash flows. In which case, tax savings from tax avoidance become more appealing.

Since tax avoidance generally can not be directly observed, prior studies use multiple proxies to measure tax avoidance, for example, accounting effective tax rate, cash effective rate, book-tax-difference, unrecognized tax benefits, tax sheltering, etc. Using the Canadian public companies covering the period from 2012 through 2021, and collecting data from Compustat, this study finds that (1) firms reduced their effective tax rates including annual and five-year accounting and cash effective tax rates. This reduction in effective tax rates is not due to the reduction of profit; (2) there was no significant change of either the permanent or the total book-tax-difference; and (3) the COVID-19 pandemic reduced two effective tax rates but has no effects on other tax avoidance measures.

Keywords:

tax avoidance, effective tax rate, book-tax-difference, profitability

JEL Classification: G00, M41, H00