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THE EFFECTS OF TAX AVOIDANCE ON FIRM CASH HOLDING

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Abstract

U.S. firms are holding increasingly larger amount of cash than they used to, which evokes a great attention on the determinants of corporate cash holdings. However, existing literatures seldom explain cash holdings based on tax incentive faced by firms to hold cash. For U.S. multinationals, they are easier to shift income to their foreign affiliates located in low tax jurisdiction and hold them into cash abroad. Triggered by this, my paper focuses on the listed firms generally and starts to put on linkage between increasingly larger magnitude of cash holdings and recently aggressive of tax avoidance activities and develops hypothesis that cash holdings is positively associated with tax avoidance. Nevertheless, two hypotheses are further developed in regarding to the influence of industry competition and quality of corporate governance on the issue. Using a sample of U.S. listed firms from the period 1993–2011, I first provide evidence that cash holdings of a firm is positively associated with tax avoidance. Second, I find that tight competition of a certain industry will lead to large amount of firm cash holdings. Third, the positive relation between tax avoidance and firm cash holdings is more pronounced in firms with positive book-tax difference, which implies potential issues in such firms with poor governed managerial mechanism.

Keywords: cash holdings, tax avoidance, competition, corporate governance

Table of Contents

1. Introduction 1
2. Literature review 3
2.1 Firm cash holdings and corporate governance 3
2.2 Tax avoidance and corporate governance 4
2.3 Strategic tax saving behavior and tax sheltering 5
2.4 Definition of tax avoidance 7
3. Hypotheses development 8
3.1 Tax avoidance and firm cash holdings 9
3.1.1 Agency problems in listed firm with highly diffused ownership structure 9
3.1.2 Managerial incentives for firm cash holdings 10
3.2 Industry competition and firm cash holdings 11
3.3 Effect of corporate governance 11
4. Research design 12
4.1 Model development 12
4.2 Variable description 13
4.2.1 Cash holdings 13
4.2.2 Tax avoidance 14
4.2.3 Industry competition 16
4.2.4 Control variables 16
4.3 Data selection 17
4.3.1 Reasons for choosing 1993 as a start year 18
4.3.2 Data filtering 18
5. Empirical analyses 19
5.1 The relation between tax avoidance and firm cash holdings 19
5.1.1 Univariate tests on firm cash holdings for tax avoidance quartiles 19
5.1.2 Analyses on the impact of tax avoidance on firm cash holdings 21
5.2 Industry competition in determination of firm cash holdings. 24
5.3 Variation of association between tax avoidance and firm cash holdings 26
6. Conclusions 29
7. Reference 33