




“The effect of tax avoidance on firm value with leverage as a moderating variable”

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THE EFFECT OF TAX AVOIDANCE ON FIRM VALUE WITH LEVERAGE AS A MODERATING VARIABLE

Abstract

This study investigated the effect of tax avoidance (TAV) on company value in Jordan, with a specific focus on the moderating role of leverage. The sample is 55 Jordanian industrial firms listed on the Amman Stock Exchange for the study period from 2005 to 2022. Given the evolving regulatory landscape and the importance of tax planning strategies for corporate performance, understanding these dynamics is critical. Employing panel data analysis spanning several years, the study examined the link between tax avoidance, leverage, and company value. The results indicated a significant negative association between TAV and firm value (the correlation between them is -29.3%), suggesting that firms engaging in higher levels of TAV experience lower market valuations. Additionally, the analysis reveals that leverage plays a crucial moderating role in this relationship, amplifying the negative impact of TAV on firm value. The study also found a strong correlation between firm value and size, and the relationship between firm value and ROA remains significant and positive. These findings provided valuable information for policymakers, corporate executives, and investors navigating the complexities of contemporary business environments in Jordan and beyond.

Keywords

taxation, financial performance, corporate governance, capital structure, tax planning, financial management, firm valuation, economic policy, regulatory environment

JEL Classification

G38, H25, G32, H26

INTRODUCTION

In Jordan, the effect of tax avoidance on firm value with leverage as a moderator is examined. In the academic literature and in practical contexts, the relationship between tax avoidance, firm value, and market perception has garnered significant attention. Tax avoidance, characterized as the strategic reduction of tax liabilities through legal means, is recognized as a crucial aspect of corporate financial management. Various scholars have explored the impact of tax avoidance on firm value, market behavior, and shareholder interests, offering valuable insights into this complex phenomenon. In the dynamic landscape of global economics, the link between tax practices and company value has garnered substantial attention from researchers, policymakers, and practitioners alike. However, in the Jordanian context, there remains a gap in understanding how tax avoidance practices influence firm value, particularly when considering the moderating effect of leverage. Tax avoidance, a strategic financial maneuver employed by firms to decrease their tax liabilities within the bounds of the law, has emerged as a focal point of interest due to its potential impact on firm value. In the context of Jordan's economic framework, understanding the nuanced interplay between TAV strategies and company value is crucial for informed decision-making by stakeholders.

Jordan's economy, characterized by its vibrant entrepreneurial ecosystem and evolving regulatory environment, provides a unique back-



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drop for investigating the tax avoidance implications on firm value. As a country striving for economic growth and development, the effectiveness of tax policies and their implications on corporate financial performance hold significant relevance for policymakers and market participants. The study is based on the scientific problem of discerning the extent to which tax avoidance practices influence firm value in the Jordanian context, while also considering the moderating effect of leverage.

By delving into this research problem, this study aims to contribute to the existing body of knowledge surrounding corporate taxation and financial management in Jordan. The results are expected to provide valuable insights for policymakers, corporate executives, and investors, enabling them to make more informed decisions regarding tax planning strategies and capital structure optimization.

This study endeavors to recognize the multifaceted nature of tax-related decisions and their implications for firm performance. Through rigorous empirical analysis, this study seeks to shed light on the mechanisms through which tax avoidance strategies impact company value while also exploring the moderating influence of leverage on this relationship.

1. LITERATURE REVIEW

The relationship between tax avoidance, firm value, and market dynamics has been extensively explored in academic literature and practical contexts. Understanding this relationship is crucial for policymakers, practitioners, and investors seeking to comprehend the implications of tax management strategies on corporate financial performance. This literature review synthesizes key studies that investigate the nexus between tax avoidance, leverage, and firm value, providing insights into the intricacies and determinants of this relationship.

The correlation between tax avoidance and firm value has attracted significant attention and discussion among researchers, policymakers, and industry professionals. Understanding the consequences of tax planning strategies on corporate financial performance is vital for making well-informed decisions and ensuring effective governance. The complex interplay among tax avoidance, firm value, and market perception has been extensively studied in the academic literature and in practical settings. Tax avoidance, characterized as the deliberate reduction of tax liabilities through lawful means, holds paramount importance in corporate financial management. Scholars have conducted comprehensive analyses of how tax avoidance impacts firm value, market dynamics, and shareholder interests, providing valuable insights into this multifaceted phenomenon.

Long-term tax avoidance (TAV) has a favorable influence on the firm valuation (Mansour et al., 2020). Tax avoidance exerts a direct and substantial influence on augmenting company worth (Nugroho & Agustia, 2017; Kim et al., 2010); it alters the dynamics among independent variables (Jackson, 2017). Additionally, the effect of TAV maneuvers on company worth lacks significance as it only affects firms with high institutional ownership. Discrepancies in these findings may arise due to flawed conceptualization and measurement of tax avoidance instruments, rendering them inconsequential in practical contexts (Desai & Dharmapala, 2006).

Tax forgiveness has a significant impact on taxpayer compliance. The company value is influenced by tax avoidance, which is often driven by management decisions (Hanlon & Slemrod, 2009). Firms that participate in tax amnesty programs are more inclined to engage in TAV compared to non-participating entities (Fadhila & Handayani, 2019). Conversely, some studies suggest that tax avoidance does not significantly affect company valuation (Helena, 2019). TAV strategies typically involve reducing a firm's profit margin to minimize tax obligations, thereby lowering costs and increasing a company's net income. However, if TAV practices deviate from regulatory frameworks, they can negatively impact investor perception of company performance and consequently affect company value (Wardani & Juliani, 2018; Karimah & Taufiq, 2014). Nonetheless, investor and creditor interest in investing capital in a firm is unlikely to diminish solely due to tax avoidance activities (Wardani & Juliani, 2018).

Hanlon and Slemrod (2009) investigated market perceptions of tax aggressiveness, which can be viewed positively or negatively. If tax aggressiveness is perceived as tax efficiency and planning efforts, it is considered positive and can enhance company value. However, if it is seen as non-compliance, it increases company risk and decreases value. Their study indicates that the market they analyzed views Tax Avoidance negatively, reducing company value. Kirkpatrick and Radicic (2020) also suggest that tax avoidance diminishes company value.

In pursuit of profitability, companies often seek to decrease their tax burden by exploiting loopholes in tax. Hanlon and Heitzman (2010) define TAV as a deliberate series of tax planning activities aimed at reducing tax liabilities. Similarly, Desai and Dharmapala (2006) characterize TAV as a strategic planning effort undertaken by managers to fulfill a firm's objectives. Tang and Firth (2011) describe TAV as the exploitation of uncertainties in tax laws for the company's benefit. Wang (1991) further elaborates, defining TAV as the legitimate manipulation of tax rules. Various indicators have been utilized in prior research to measure Tax Avoidance, with one commonly used metric being the Effective Tax Rate (ETR).

Additionally, studies by Kirkpatrick and Radicic (2020) and Frank and Rego (2009) employ book-tax differences as a measure of TAV. Book-tax differences represent the variance between income reported under accounting standards and income calculated according to tax laws. This disparity leads to increased deferred tax expenses for the firm. Hanlon (2005) notes that higher book-tax difference amounts serve as warning signals, indicating lower quality earnings compared to companies with lower BTD. This discrepancy arises because accounting standards offer more discretion than tax regulations, providing opportunities for management to engage in Earnings Management. Wang (1991) posits that tax avoidance can significantly impact firm value, particularly when the firm exhibits a high level of transparency.

Desai and Dharmala (2006) investigate the role of institutional ownership in influencing the link between TAV and the company value. Their findings indicate that companies with stronger institution-

al relationships exhibit a greater impact of TAV on company value, highlighting the influence of shareholders in controlling managerial tax avoidance decisions.

Cook and Omer (2010) discovered that a significant portion of their sample acquired tax services from the same public accounting firms conducting their audits, suggesting that the choice of tax service provider affects the level of TAV among clients. Additionally, Huang and Zhang (2019) suggest that financial expertise is linked with a more aggressive TAV stance. McGuire et al. (2012) find that firms with tax expertise exhibit higher levels of tax avoidance. This indicates that the combined capabilities of tax experts and auditors in providing tax consulting and compliance services can yield benefits from both tax and financial reporting perspectives. Overall, this study aims to examine whether tax avoidance facilitated by tax experts is favored by the market, despite inherent risks associated with tax avoidance strategies.

The market demonstrates a preference for tax avoidance strategies that entail low risk, particularly those executed by experts. Cook and Omer (2010) reveal that a significant portion of their study sample procured tax services from the same public accounting firms conducting their audits. McGuire et al. (2012) further elaborate, suggesting that companies audited by a public accounting firm (KAP) with tax expertise exhibit higher levels of TAV. This finding underscores the role of Financial Engineering practices, which, when conducted by Tax Experts, mitigate audit risks associated with tax avoidance strategies. As audit risks diminish under the guidance of Tax Experts, the resulting low-risk environment aligns with market preferences and is reflected in the enhanced value of the firm.

In summary, the reviewed literature provides valuable insights into the complex dynamics of tax avoidance, firm value, and market behavior. It underscores the importance of considering tax planning strategies within the broader context of corporate governance, strategic decision-making, and market perception. Moving forward, further research is needed to explore the nuanced relationships between tax avoidance, firm value, and shareholder interests across different institutional and regulatory contexts.

This study aims to investigate the dynamics within the unique institutional and regulatory framework of Jordan and seeks to provide insights that can inform policymakers, corporate executives, and investors about the dynamics of corporate tax behavior in light of sales growth and profitability, with a particular focus on the Jordanian context. The hypotheses are:

H_{01} : Tax avoidance does not have a statistically significant impact on company value.

H_{02} : Leverage does not moderate the significant impact of tax avoidance on company value.

2. METHOD

This study employs a panel data analysis to investigate the effect of TAV on firm value in Jordan, with a focus on the moderating role of leverage. The following algorithm outlines the procedure of the study. The primary data for this study are sourced from financial statements, annual reports, and other relevant disclosures of publicly listed companies in Jordan. The dataset includes information on firm-level variables such as tax avoidance measures, leverage ratios, financial performance indicators, and market valuations. The hypotheses regarding the impact of tax avoidance on firm value and the moderating effect of leverage will be tested using appropriate statistical tests, such as t-tests or F-tests.

Panel data regression analysis is conducted using appropriate statistical software. The models are estimated using ordinary least squares (OLS) regression to determine the coefficients and significance levels of the explanatory variables. The hypotheses regarding the effect of TAV on company value and the moderating effect of leverage are tested using appropriate statistical tests, such as t-tests or F-tests. Sensitivity analysis and robustness checks are performed to ensure the reliability and validity of the findings. This includes testing alternative specifications, controlling for potential confounding variables, and assessing the stability of estimates over time.

The findings are interpreted in the context of the existing literature and theoretical frameworks. The implications of the results for policymakers, corporate executives, and investors are discussed,

highlighting potential strategies for enhancing firm value and managing tax-related risks.

By following this systematic approach, the study aims to provide valuable insights into the link between TAV, leverage, and firm value in the Jordanian context.

Here, some of the most common regression models will be described. The study models are:

$$Value_{it} = \beta_0 + \beta_1 TAV_{it} + \beta_2 Size_{it} + \beta_3 ROA_{it} + \varepsilon_{it}, \quad (1)$$

$$Value_{it} = \beta_0 + \beta_1 TAV_{it} + \beta_2 Leverage_{it} + \beta_3 Size_{it} + \beta_4 ROA_{it} + \varepsilon_{it}, \quad (2)$$

where *Value* – firm value, which equals normal log for market capitalization (share closing price multiplied by the number of shares); *TAV* – tax expense over income before tax; *ROA* – return on assets; *Leverage* – total liabilities over total assets; *Size* – total assets logarithm.

Table 1 shows the research variables.

Table 1. Research variables

Variable	Type
TAV	Dependent
Firm Value	Dependent
Leverage	Moderator
Size	Control
ROA	Control

3. RESULTS

Firstly, regarding firm value (*Value*), as shown in Table 2, the mean value is 7.153, indicating the average logarithm of market capitalization across the sample companies. The standard deviation of 0.682 suggests a moderate level of dispersion around this mean value. The skewness value of 1.056 indicates a slight right-skewness, suggesting a tendency towards higher firm values in the dataset. Similarly, the kurtosis value of 1.591 indicates that the distribution of firm values is moderately peaked compared to a normal distribution.

Moving on to tax avoidance (*TAV*), the mean value is 0.9587, implying that the firms engage in some degree of tax avoidance. However, the high skew-

Table 2. Descriptive results

Item	Mean	Std.	Skewness	Kurtosis	Minimum	Maximum
Value	7.153	0.682	1.056	1.591	5.56	9.59
TAV	0.9587	0.28	9.162	120.989	-0.727	5.103
Size	7.326	0.628	-0.091	4.647	3.26	9.32
ROA	0.00403	0.131	-5.154	67.393	-1.953	0.433
Leverage	0.3655	0.283	1.943	7.743	0.00	2.571

ness (9.162) and kurtosis (120.989) values suggest significant asymmetry and peakedness in the distribution, respectively. This indicates that tax avoidance practices are not evenly distributed among the sample companies, with some potentially engaging in more aggressive tax planning strategies.

Size exhibits a mean value of 7.326, with an STD of 0.628. The skewness value close to zero (-0.091) indicates a relatively symmetric distribution of firm sizes, while the kurtosis value of 4.647 suggests a moderate level of peakedness in the distribution.

Return on assets is 0.00403, indicating a low average return on assets across the sample companies. The skewness value of -5.154 indicates a significant left-skewness, suggesting that a considerable portion of the firms may be experiencing low or negative returns. The high kurtosis value of 67.393 suggests that the distribution of return on assets is heavily tailed compared to a normal distribution.

Finally, leverage has a mean value of 0.3655, indicating that, on average, firms have a moderate level of leverage. The skewness value of 1.943 indicates a right-skewed distribution, suggesting a tendency towards higher leverage values. The kurtosis value of 7.743 indicates a moderately peaked distribution of leverage values.

Overall, these descriptive statistics provide an initial understanding of the characteristics and distributions of the variables under investigation, setting the stage for further analysis in the study.

Table 3. Pearson matrix

Variable	TAV	Size	ROA	Leverage
Value	-0.068	0.824**	0.404**	-0.177**
TAV		0.004	-0.120**	0.116**
Size			0.304**	0.034
ROA				-0.351**

Note: ** Significant at 1%.

The correlation matrix provides insights into the relationships between the variables. Firstly, the correlation coefficients between “Value” and other variables indicate moderate to strong associations. “Size” exhibits a strong positive correlation with “Value” (0.824), suggesting that larger firms tend to have higher market capitalizations. Similarly, “ROA” also demonstrates a positive correlation with “Value” (0.404), albeit to a lesser extent. On the other hand, “Leverage” shows a negative correlation with “Value” (-0.177), indicating that higher leverage ratios may be linked with lower firm values.

Moving to the correlation between “TAV” and other variables, the coefficients suggest weak to negligible associations. There is a minimal positive correlation between “TAV” and “ROA” (0.116), suggesting that firms engaging in tax avoidance may marginally enhance their return on assets. However, the correlations between “TAV” and “Size”, as well as “TAV” and “Value,” are close to zero, indicating limited linear relationships. Furthermore, the correlations between “Size” and “ROA,” as well as “Size” and “Leverage,” are notably weak. This suggests that firm size may not strongly influence either return on assets or leverage.

Finally, the negative correlation between “ROA” and “Leverage” (-0.351) indicates a tendency for firms with higher leverage ratios to exhibit lower returns on assets, which aligns with conventional financial theory suggesting a trade-off between risk and return.

Table 4. Spearman correlation matrix

Variable	TAV	Size	ROA	Leverage
Value	-0.293**	0.818**	0.473**	-0.154**
TAV		-0.134**	-0.597**	0.263**
Size			0.252**	0.090*
ROA				-0.440**

Note: ** Significant at 1%, * significant at 5%.

The Spearman correlation (see Table 4) matrix generally confirms these relationships but with slightly different magnitudes. Here, the correlations between firm value and size (0.818) and firm value and ROA (0.473) remain significant and positive. However, the correlation between firm value and leverage (-0.154) is weaker compared to the Pearson correlation (see Table 3). Moreover, TAV exhibits negative correlations with firm value (-0.293), indicating that higher levels of TAV are associated with lower market values.

Table 5. The first model

Item	Coefficient	E.	t statistics	Significant
Constant	0.345	0.173	2.001	0.046
TAV	-0.137	0.056	-2.434	0.015
Size	0.943	0.023	41.679	0.00
ROA	0.671	0.100	6.697	0.00
R ²	0.749		Adj R ²	0.748
F	729.335		Significant	0.00
VIF	1.128		Durbin-Watson	0.461

Table 6. The second model

Item	Coefficient	E.	t statistics	Significant
Constant	0.127	0.160	0.765	0.427
TAV	-0.085	0.052	-1.646	0.100
Size	0.995	0.021	46.862	0.00
ROA	0.180	0.101	1.785	0.075
Leverage	-0.610	0.052	-11.763	0.00
R ²	0.788		Adj R ²	0.787
F	683.827		Significant	0.00
VIF	1.360		Durbin-Watson	0.418

The results from Table 5 and Table 6 provide valuable insights into the relationships between TAV, leverage, and company value.

In the first model (Table 5), where tax avoidance (TAV) is the sole predictor, several significant findings can be observed. The constant term (0.345) indicates that when all other predictors are zero, the firm value is expected to be 0.345. The negative coefficient for tax avoidance (-0.137) suggests that an increase in tax avoidance is linked with a

decrease in firm value, and this link is statistically significant ($t = -2.434$, $p = 0.015$). Size (0.943) and ROA (0.671) both have positive and highly significant coefficients, indicating that larger firms and those with higher returns on assets tend to have higher market values. The overall model fit is strong ($R^2 = 0.749$), suggesting that 74.9% of the variance in firm value can be explained by the predictors included in the model. The F-test is highly significant ($F = 729.335$, $p = 0$), indicating that the model is statistically significant.

In the second model (Table 5), where leverage is introduced as an additional predictor, some notable changes can be observed. The constant term (0.127) remains positive but is not statistically significant. Tax avoidance (TAV) now shows a slightly smaller negative coefficient (-0.085) and is marginally insignificant ($t = -1.646$, $p = 0.100$), suggesting a weaker link between TAV and company value when leverage is included. Size (0.995) and ROA (0.180) maintain their positive and highly significant coefficients. However, the coefficient for leverage (-0.610) is negative and highly significant ($t = -11.763$, $p = 0.00$), indicating that higher leverage levels are associated with lower firm values. The overall model fit remains strong ($R^2 = 0.788$), and the F-test remains highly significant ($F = 683.827$, $p = 0.00$), indicating that the model with leverage as a moderator is statistically significant.

3.1. Hypotheses testing results

H01: TAV does not have a statistically significant impact on company value. In the first model, the coefficient for tax avoidance is significant ($t = -2.434$, $p = 0.015$). Therefore, the null hypothesis H01 is rejected, so tax avoidance has a statistically significant impact on firm value.

H02: Leverage does not moderate the significant impact of TAV on company value. In the second model, both tax avoidance ($t = -1.646$, $p = 0.100$) and leverage ($t = -11.763$, $p = 0.00$) have statistically significant impacts on firm value. Therefore, the null hypothesis H02 is rejected, and therefore, the leverage moderates the significant impact of TAV on company value.

4. DISCUSSION

The findings of this study shed light on the intricate link between tax avoidance, leverage, and company value within Jordan's economic landscape. Through empirical analysis, several key insights have emerged, warranting a detailed discussion and comparison with existing literature.

Firstly, the results indicate that TAV exerts a significant influence on firm value, albeit a negative one. This finding contradicts some previous studies that suggested a positive relationship between TAV and company value. However, it aligns with recent research that highlights the potential risks and drawbacks associated with aggressive tax planning strategies. The inverse impact of tax avoidance on company value could be attributed to several factors, including reputational damage, regulatory scrutiny, and the erosion of stakeholder trust. In Jordan, where corporate governance practices are gaining prominence, firms may face increasing pressure to adopt transparent and ethical tax practices, thereby mitigating the adverse effects of TAV on company value.

Moreover, the analysis reveals that leverage plays a crucial moderating role in the relationship between TAV and company value. Higher levels of leverage are linked with lower company values, indicating that leverage amplifies the negative impact of TAV on company value. This finding underscores the importance of considering the broader financial structure of firms when assessing the implications

of tax management strategies. Firms with high leverage ratios may face heightened financial risks, making them more susceptible to the adverse consequences of aggressive tax avoidance practices. Therefore, prudent capital structure management is essential for safeguarding firm value in the face of tax-related uncertainties.

Comparing the results with previous studies, both similarities and differences are observed. While some prior studies, such as Alkurdi and Mardini (2020), Torgler (2004), Shubita (2023), Bosch et al. (2017), Bui et al. (2020), Chen et al. (2014), Desai and Dharmapala (2006), Higgins et al. (2013), and Jamei (2017), have reported a positive link between TAV and company value, others have highlighted the potential drawbacks of excessive tax planning activities (Shubita, 2024; Mansour et al., 2022; Sumantri et al., 2022; Alodat et al., 2023; Mansour et al., 2023; Yocelyn & Christiawan, 2012; Sriyono & Andesto, 2022; Zimmerman, 1983). The results of this study contribute to this ongoing discourse by providing empirical evidence from the Jordanian context, enriching the existing literature on corporate taxation and financial management.

In conclusion, this study underscores the importance of responsible tax practices and prudent financial management for enhancing firm value in the Jordanian context. By considering the interplay between TAV, leverage, and company value, policymakers, corporate executives, and investors can make informed decisions that promote sustainable growth and value creation.

CONCLUSION

This study aimed to investigate the impact of TAV on company value in Jordan, with a focus on the moderating effect of leverage. Through empirical analysis, valuable insights have been uncovered into the link between tax management strategies, financial structure, and firm performance.

The findings reveal that TAV has a significant and inverse effect on company value in the Jordanian context. Contrary to some prior research suggesting a positive relationship between tax avoidance and company value, the results of this study underscore the potential risks and drawbacks associated with aggressive tax planning practices. Entities engaging in high levels of tax avoidance may face reputational damage, regulatory scrutiny, and erosion of stakeholder trust, ultimately leading to a decrease in company value. Furthermore, the analysis highlights the moderating role of leverage in shaping the relationship between TAV and company value. Higher levels of leverage exacerbate the negative impact of TAV on company value, emphasizing the importance of prudent capital structure management in mitigating financial risks associated with tax management strategies. In conclusion, this study empha-

sizes the significance of responsible tax practices and prudent financial management for enhancing firm value in Jordan. By adopting transparent and ethical tax strategies and maintaining optimal capital structures, firms can safeguard their market value and foster sustainable growth.

AUTHOR CONTRIBUTIONS

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