

RESEARCH ARTICLE

An Analysis of the Effects of Foreign Ownership on the Level of Tax Avoidance Across Philippine Publicly Listed Firms

Ailyn A. Shi, Francis R. Concepcion, Cheri Mae R. Laguinday, Trisha Amber T. Ong Hian Huy, and Angelo A. Unite
De La Salle University, Manila, Philippines
ailyn.shi@dlsu.edu.ph

Tax avoidance schemes used by firms to lessen their tax burden have long attracted widespread concern in the Philippines, where poor tax collection due to tax leakages has contributed to chronic fiscal deficits in the country. In this regard, corporate governance mechanisms, such as the firm's ownership structure, play a significant role in ensuring that management acts ethically and in the best interest of the firm's owners. In this study, we examine the effect of foreign ownership on corporate tax avoidance for non-financial firms listed in the Philippine Stock Exchange (PSE) from 2009 to 2015. Using three different measures of foreign ownership and two measures of corporate tax avoidance, our analysis of an unbalanced and dynamic panel dataset with the two-step system generalized method of moments (GMM) estimator yields some evidence of a significant and positive relationship between the degree of foreign participation in boards and corporate tax avoidance. Against this background, we argue that policymakers and regulators should carefully evaluate the costs and benefits of foreign participation in boards of companies, given the opportunity for corporate tax avoidance.

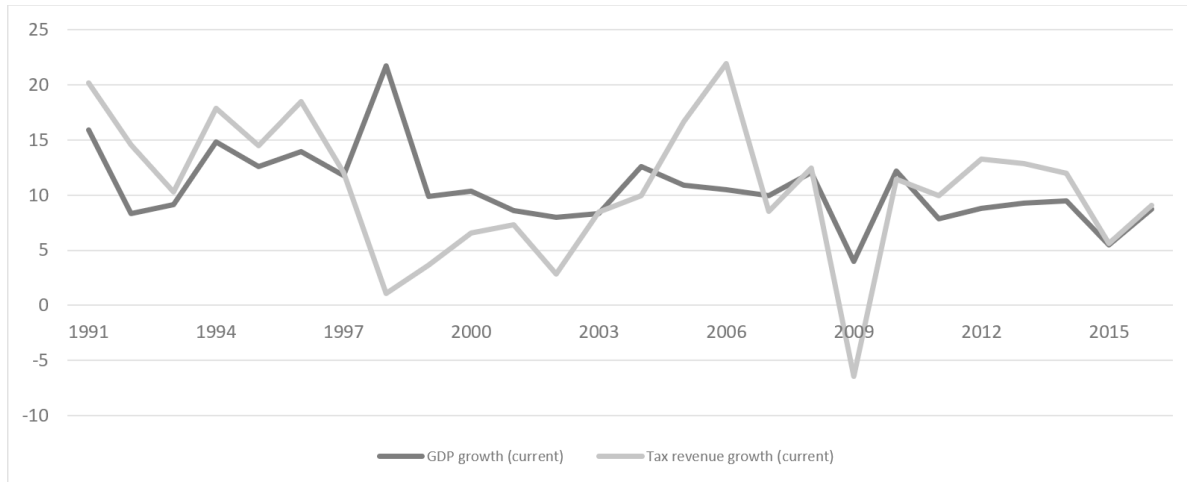
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“Tax revenues are the lifeblood of the democratic government and the social contract, but the majority of multinational businesses have been structured so as to enable tax avoidance in every jurisdiction in which they operate...” (Christensen & Murphy, 2004)

Prior to 2008, tax effort in the Philippines, computed as the ratio of government tax collection to

the country's Gross Domestic Product, was stagnant at an average of 13% annually due primarily to inefficiencies in tax collections and the complexity of the Philippine tax system (Diokno, 2008; Manasan, 2008). This had been a cause for concern, especially because about 87% of government revenues from 1981 to 2007 were obtained from taxes levied upon Filipinos (Diokno, 2008). In recent years, however, the country's



Source: databank.worldbank.org

Figure 1
GDP and Tax Revenue Growth Rate in the Philippines (1991-2016)

tax revenues have been growing at a faster rate than the Gross Domestic Product, which may have been due to unprecedented efforts by the national government. For example, the Tax Reform for Acceleration and Inclusion Act of 2017 boosted government revenues by approximately 19% in 2017 (Padin, 2018). Figure 1 shows the huge upswing in tax revenue collection in the Philippines post-financial crisis.

As taxes are collected by authorities for the welfare of the citizens, they are a means for firms to demonstrate their corporate and social responsibility (Salihu et al., 2015). However, corporations are theorized to act as profit-maximizing agents that prefer to lessen their liabilities; this may entice them to develop schemes that would lessen tax burdens. Such schemes entail either tax avoidance or tax evasion, which are similar in nature and objective of decreasing tax burdens. Tax avoidance involves the use of means either allowed by law or beyond the scope of the law for firms to minimize their liabilities, whereas tax evasion involves intentional non-payment of taxes through incomplete disclosure of earnings, overstatement of expenses, and fabrication of receipts, among others. Salihu et al. (2013) argued that such differences in legality may be difficult to discern because laws sometimes have grey areas on certain issues.

Recent evidence shows that managerial actions designed to minimize tax liabilities through aggressive tax schemes are rapidly becoming prevalent in both developed and developing countries.¹ Such schemes

have become more sophisticated in recent times. In the Philippines, the Bureau of Internal Revenue has uncovered tax avoidance schemes employed by at least 18 of the largest conglomerates in the country, which include intercompany transactions among related parties and the creation of fake suppliers so that the overall tax burden of the group is decreased. Their investigation indicated that these corporations tend to under-declare their taxable income by at least 30% (Gonzales, 2012). In 2012 alone, the Bureau of Internal Revenue (2012) reported that more than 52 cases have been filed under the Run After Tax Evaders (RATE) program of the country, with more than 135 cases still unfiled from January until November 2012.

To emphasize the value of tax compliance and adherence at the international level, the Common Reporting System through the Organization for Economic Cooperation and Development was initiated in 2014 to provide tax authorities instantaneous access to the taxpayers' offshore investments. However, the impending economic integration of the Association of Southeast Asian Nations (ASEAN) member countries may provide more opportunities for multinational corporations to shift income abroad and exploit possible tax havens. Such opportunities provided by conducive international trade environments suggest that greater foreign ownership and involvement within the firm may be associated with greater tax avoidance or evasion (Masahiro & Kanda, 2015).

Theoretically, this positive relationship between foreign ownership and tax avoidance contradicts the common perception that firms seek to establish legitimacy in society through compliance with standards set by “legitimizers” (Chan and Makino, 2007).² This means that firms will seek to attain legitimacy by abiding with tax laws and eschewing tax avoidance, which is considered costly to society and viewed as unethical and irresponsible (Hoi et al., 2013). Failure to comply with tax regulations would prompt a negative image of the firm that may possibly tarnish the company’s reputation. Therefore, foreign investors and directors have an incentive to promote tax regulation compliance, rather than tax avoidance, among management.

Although several studies (Kinney & Lawrence, 2000; Egger et al., 2010; Huizinga & Nicodème, 2006) reported the impact of foreign ownership on tax avoidance in the U.S. and European region, there is a dearth of similar studies in the context of developing markets. In particular, no such study has been done in the case of the Philippines, which remains an excellent site for foreign direct investments (Villar, 2018). Thus, this study augments the limited literature (Salihu et al., 2015; Yoo & Koh, 2014; Hasan et al., 2016; Tee et al., 2016) on the relationship between foreign ownership and corporate tax avoidance in the context of an emerging market. We examined this relationship by analyzing annual firm-level data for approximately 150 Philippine firms listed in the Philippine Stock Exchange (PSE) during the period 2009 to 2015. To control for size and industry effects on the relationship between foreign ownership and tax avoidance, we constructed size- and industry-adjusted tax avoidance measures, consistent with Balakrishnan et al. (2019). This allowed us to capture variations in tax avoidance within firms that have similar size-industry characteristics. In addition, we used long-run measures of tax avoidance that address the issue of reversals that plague short-run tax avoidance measures. We found some evidence that greater participation of foreign directors in the firm leads to greater corporate tax avoidance. Such finding should be interesting to policymakers who need to consider whether the benefits of greater foreign influence among boards of Philippine publicly listed firms outweigh the costs in the presence of tax avoidance.

Related Literature, Theoretical Framework, and Hypotheses Development

Tax avoidance involves the use of tax regimes, through means within or beyond the law, to one’s own advantage through the reduction of taxes payable (Yoo & Koh, 2014). The prevalence of tax avoidance may be due to the benefits that tax aggressiveness entails, such as tax savings and rent extraction at the expense of minority shareholders (Chen et al., 2010). However, such practices also entail potential costs for the firms, including penalties which may be imposed by the regulatory body should the firm’s actions be deemed illegal and the possible price discount that shareholders can impose (Chen et al., 2010). From management’s perspective, the benefits of tax avoidance may outweigh the costs, in which case corporate governance mechanisms, such as ownership structure, should be considered as factors that may help mitigate levels of tax avoidance.

Foreign Ownership (Ownership Structure) and Tax Avoidance

According to the agency theory, conflicts of interest may arise between foreign investors (the principal) and executive management (the agent) or between controlling and minority shareholders (both principals). On the one hand, principal-agent conflicts arise because managers will maximize their self-interest, thereby leading them to extract profits from the firm’s shareholders and act against shareholder interest. On the other hand, increased principal-principal conflicts, which are common among emerging economies, arise because firms’ control and ownership rights are concentrated in the hands of a large shareholder or controlling family. Excess control rights may enable the controlling shareholder or family to sell firm assets or direct cash flow to themselves or their subsidiaries at the expense of minority shareholders (Young et al., 2008).

Because share values can fluctuate due to such expropriation of minority shareholders, and because foreign investors also face information asymmetry, these investors are then motivated to intensely monitor managerial behavior (Yoo & Koh, 2014). Thus, according to the agency theory, foreign ownership can mitigate agency conflicts within firms. Although foreign ownership may not result in a transfer of controlling power, it can effectively challenge

controlling shareholders because foreign institutions can act as major shareholders with significant voting rights and can even elect foreign directors (Yoo & Koh, 2014). This implies that foreign investors can also impact corporate tax avoidance by suggesting corporate governance tax strategies, influencing company intrinsic values, and imposing interventions (Hasan et al., 2016). Moreover, because foreign ownership is relatively free from social connections that underpin principal-principal conflicts (Yoo & Koh, 2014), the election of foreign directors can help challenge controlling shareholders, particularly because the presence of these directors signals company commitment to resolving transparency issues. This can also help reduce tax avoidance within companies.

Consistent with the agency theory, Yoo and Koh (2014) studied Korean publicly listed firms and found that greater foreign ownership significantly decreases corporate tax avoidance. Furthermore, Hasan et al. (2016) found that foreign ownership is negatively related to corporate tax avoidance across 43 countries.

The legitimacy theory also posits a negative relationship between foreign ownership and tax avoidance. Companies desire to be viewed as legitimate and socially responsible members of society (Salihu et al., 2015). Therefore, they will opt to be tax-compliant, given that tax payments are considered an important means for firms to fulfill their civic responsibility, and any act leading to tax avoidance is considered social irresponsibility. However, despite foreign-

owned companies being deemed more legitimate and desirable because of more voluntary disclosures and better performances, Salihu et al. (2015) found that, contrary to the legitimacy theory, foreign ownership significantly increases corporate tax avoidance among publicly listed Malaysian firms included in the FTSE Bursa Malaysia Top 100 Index. This suggests that Malaysian firms with greater foreign ownership place more emphasis on the benefits of corporate tax avoidance than they do on organizational legitimacy.³

In contrast, Fuest and Hemmelgarn (2005) argued that there is a positive relationship between foreign ownership and corporate tax avoidance when corporate tax is viewed as a backstop to personal income tax, rather than a tax on economic rent, and when firm ownership is symmetrically distributed across all nations, and income shifting is ruled out. Egger et al. (2010) further asserted that foreign-owned firms, especially multinational firms, have more opportunities to take advantage of international tax rate differentials and special accounting standards and tax treatments in foreign countries that make profit and debt shifting more attractive for them. Such characteristic gives firms with greater foreign influence more tax advantages and opportunities for tax planning. Similarly, Salihu et al. (2015) argued that the presence of foreign directors represents the interests of the firm's headquarters in a foreign country. Due to this separation of ownership and control, firms with foreign directors face greater complexity in corporate taxation and may use this opportunity to divert income elsewhere.

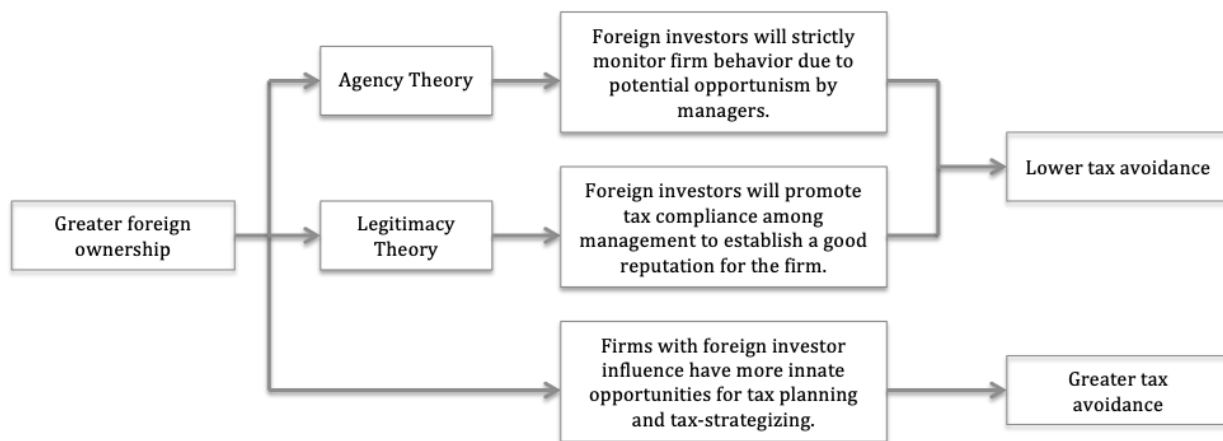


Figure 2

Theoretical Links Between Foreign Ownership and Tax Avoidance

Consistent with the above theories, Egger et al. (2010) examined the impact of foreign plant ownership on corporate tax avoidance among 31 European countries and found greater tax avoidance among firms located in high-tax foreign countries. Kinney and Lawrence (2000) also found that U.S. firms with substantial foreign ownership pay lower taxes than other U.S. firms.

Based on the preceding discussions, we hypothesize that:

H1: Foreign ownership is positively related to tax avoidance because of the tax-induced advantages and opportunities that foreign-owned firms have.

H2: Foreign ownership is negatively related to tax avoidance, according to the agency and legitimacy theories.

Figure 2 illustrates the theories underpinning the relationship between foreign ownership and corporate tax avoidance.

Methodology

Sample and Data Collection

Our initial sample consists of all firms in the Philippines whose common shares are traded in the PSE during the period 2009 to 2015. We then eliminated (i) observations for which data needed to calculate our tax avoidance variables are missing, (ii) financial and utility firms, as well as Philippine Economic Zone Authority (PEZA) firms, because regulations for these firms are likely to affect their tax avoidance opportunities,⁴ and (iii) observations for which there are missing data on the independent and control variables. Thus, our final sample consists of unbalanced panel datasets with around 599 to 643 firm-years each, depending on the tax avoidance and foreign ownership measure used.

Data used to construct our tax avoidance measures, customer concentration, and other accounting information-based, firm-level variables were obtained from the annual financial statements disclosed by the firms, whereas data used to measure board characteristics and the nationality of each member of the board of directors were hand-collected from the Annual Reports and Annual Corporate Governance Reports submitted by the firms to the PSE and the

Philippine Securities and Exchange Commission (SEC). Data used to construct our foreign ownership and family corporate group ownership measures were obtained from the firms' Public Ownership reports submitted to the PSE and the Foreign Ownership Level Reports prepared by and obtained from the PSE.

Variable Description

Dependent Variable: Tax Avoidance

The literature proposes several methods of measuring corporate tax avoidance, although each measure has its limitations and no well-accepted measure has yet evolved. This is because there is no clear consensus in the tax literature regarding the definition of tax avoidance and aggressiveness. Balakrishnan et al. (2019) observed that in general, most firms capitalize on ambiguities in the tax code to create and justify their tax planning schemes until such schemes eventually do not survive after being noticed and challenged by other firms, tax authorities, or by the court. In this regard, what counts as "tax avoidance" seems to be fluid and depends on how creative firms can get when capitalizing on weaknesses in the tax system. Given the lack of an encompassing definition of tax avoidance, Balakrishnan et al. (2019) argued that a firm's tax aggressiveness is best assessed by comparing it to other firms' tax aggressiveness. Firms employing tax planning schemes that are unusual relative to that of other similar firms are more likely to stand out as being tax avoidant and, thus, are more likely to exhibit tax aggressiveness of a greater and more prominent degree.

The Generally Accepted Accounting Principles (GAAP) and cash effective tax rates (ETRs) are among the most widely used measures of tax aggressiveness in the literature, yet Balakrishnan et al. (2019) argued that neither measure in its raw form gives a clear indication of the tax aggressiveness of a firm relative to its peers.⁵ For example, a pharmaceutical company might have lower GAAP and cash ETR relative to a distributor company, not because the former is more tax avoidant than the latter, but only because it enjoys greater R&D tax credits. Therefore, using GAAP and cash ETR in their raw forms does not necessarily indicate a firm's level of tax avoidance.

Therefore, similar to Balakrishnan et al. (2019), we constructed GAAP and cash ETR measures that benchmark against other firms with the same size and

industry characteristics. These measures rely upon the notion that firms that belong to the same industry and have the same size have similar tax planning opportunities. And among these firms with similar tax planning opportunities, those with lower tax liabilities (i.e., lower ETR values) may be considered more tax avoidant.

Moreover, to avoid reversals in tax avoidance measurements from year to year, we used the long-run (3-year) GAAP and cash ETR measures over the annual ETR measures. Dyreng et al. (2008) claimed that long-run ETR measures are less affected by accruals management than annual ETR measures because the period included captures the reversal of accruals. Thus, tax avoidance should be measured over multiple years, so that any volatility in its measurement caused by the timing differences between the treatments of certain items under financial and tax accounting will disappear (Salihu et al., 2013).⁶

We, therefore, constructed our 3-year GAAP ETR ($3YRGAAPETR$) and 3-year cash ETR ($3YRCASHETR$) variables, both of which proxy for a firm's tax burden. $3YRGAAPETR$ is computed as the sum of total tax expense from years $t-2$ to t , scaled by the sum of pre-tax income from years $t-2$ to t . On the other hand, $3YRCASHETR$ is calculated as the sum of total cash taxes paid from years $t-2$ to t , divided by the sum of pre-tax income from years $t-2$ to t . We report the results using both long-run GAAP and long-run cash ETR measures because the latter addresses the limitations of the former: due to its use of aggregate tax expenses, GAAP ETR measures will not reflect the firm's use of strategies for tax deferral, whereas cash ETR measures can capture forms of tax avoidance that use such deferral strategies.⁷ Moreover, Dyreng et al. (2008) and Minnick and Noga (2010) argued that the use of cash taxes paid, as opposed to total tax expense, helps to minimize the effect of items such as tax cushions and accounts for the benefits of employee stock options.

We then censored our $3YRGAAPETR$ and $3YRCASHETR$ variables to take values from only 0 to 1. Dyreng et al. (2008) argued that negative cash ETRs can arise when taxes paid are negative, which make for non-meaningful ETR values. Similarly, when taxes paid are so high as to exceed pre-tax income (i.e., ETR values above 1), the ETR values become difficult to interpret as well.

Finally, we adjusted and demeaned each firm's $3YRGAAPETR$ and $3YRCASHETR$ by the same period's

mean values of $3YRGAAPETR$ and $3YRCASHETR$ for the portfolio of firms in the same industry and size quintile, where size and industry are sorted independently, and size is proxied by the firm's total assets whereas the industry is based on the Philippine Stock Exchange (PSE) Industry Classification system.⁸ Thus, we calculated $3YRGAAPETR_{ADJ}$ as the mean size-industry matched $3YRGAAPETR$ less the firm's $3YRGAAPETR$. Similarly, we calculate $3YRCASHETR_{ADJ}$ as the mean size-industry matched $3YRCASHETR$ less the firm's $3YRCASHETR$. Higher $3YRGAAPETR_{ADJ}$ and $3YRCASHETR_{ADJ}$ values indicate that the firm pays more taxes relative to its size-industry peers, and so exhibits a lower level of tax avoidance.

Independent Variables

Foreign Ownership. Following Salihu et al. (2015), we considered three alternative measures of foreign ownership. The first is $FOR1$, which captures the extent of foreign ownership and is calculated as the proportion of outstanding common shares owned by foreign shareholders. The second is $FOR2$, which is a dichotomous variable that takes the value of 1 if foreign shareholders own more than 10% of a firm's outstanding common shares, and 0 otherwise.⁹ The third is $FOR3$, which captures the presence of foreign directors on the board and is calculated as the ratio of the number of foreign directors to the total number of directors on the board.¹⁰

Other Independent Variables. We controlled for firms that are part of a family corporate group since Yoo and Koh (2014) and Chen et al. (2010) found that family-owned firms exhibit less tax aggressive behavior. Following Chen et al. (2010), we used two alternative measures of family ownership. The first is $FAMI$, which is a dichotomous variable that takes the value of 1 if the proportion of shares owned by a family group or largest individual shareholder is more than 10%, and 0 otherwise. The second is $FAM2$, which describes the extent of family ownership and is calculated as the proportion of a firm's outstanding common shares owned by the corporate family group or largest individual shareholder.

Regarding customer concentration, Li and Zhang (2014) argued that firms engage in less tax avoidance to maintain their reputation and ensure the longevity of contracts with customers, although Huang et al. (2016) argued that firms with high customer concentration have

incentives to engage in more tax aggressive activities to reduce cash outflow arising from transactions with major customers. We measured customer concentration (*MC*) using a dichotomous variable that takes the value of 1 when a firm reports the existence of at least one major customer, and 0 otherwise.¹¹

We also controlled for other board characteristics shown in the literature to affect corporate tax avoidance. Following Khaoula and Ali (2012), we measured (a) board size (*BFSIZE*) as the natural logarithm of the total number of directors in the board and (b) board independence (*BIND*) as the ratio of the number of reported independent directors to the total number of directors in the board. Additional control variables include firm size (*FFSIZE*) proxied by the natural logarithm of the book value of total assets; firm age (*FAGE*) calculated as the natural logarithm of the number of years since the incorporation of the firm; firm performance proxied by Return on Assets (*ROA*), which is computed as the ratio of pre-tax earnings to the book value of total assets; leverage (*LEV*) computed as the ratio of long-term debt to total equity; and capital intensity (*CAPINT*) computed as the ratio of net property, plant, and equipment to the book value of total assets.

We also included a dichotomous variable (*LOSS*) equal to 1 if the firm's pre-tax income is negative in the current year, and 0 otherwise. Loss firms are posited to be more tax avoidant because they have both lower earnings quality and greater information asymmetry that is associated with more opaque financial reporting. However, it may also be the case that such firms appear to be tax aggressive, when, in fact, they merely have lower earnings to report (Balakrishnan et al., 2019). Henry and Sansing (2018) noted that loss firms should not be discarded from the sample because doing so induces an asymmetric treatment of income in loss years, which biases our tax avoidance measures.

Model Specification

We used regression analysis to analyze the effect of foreign ownership on corporate tax avoidance. Similar to the model proposed by Salihu et al. (2015), we incorporated foreign ownership into our model as an independent variable. We also included family ownership, customer concentration, board characteristics, and control variables as additional explanatory variables. Specifically, we estimated the regression equation

$$CTA_{it} = \beta_0 + \beta_1 CTA_{it-1} + \beta_2 FOR_{it} + \beta_3 MC_{it} + \beta_4 FAM_{it} + \delta' BCHAR_{it} + \theta' FCHAR_{it} + \beta_5 LOSS_{it} + \gamma' YEAR_t + \varepsilon_{it} \quad (1)$$

where CTA_{it} is our measure of corporate tax avoidance ($3YRGAAPETR_{ADJ}$ or $3YRCASHESTR_{ADJ}$), FOR_{it} is our measure of foreign ownership ($FOR1$, $FOR2$, or $FOR3$), MC_{it} is our measure of customer concentration, and FAM_{it} is our measure of family ownership ($FAM1$ or $FAM2$). $BCHAR$ is a vector of board characteristics ($BFSIZE$ and $BIND$), and $FCHAR$ is a vector of firm characteristics, including $FFSIZE$, $FAGE$, ROA , LEV , and $CAPINT$.¹² $LOSS$ is a binary dummy variable that captures the presence of loss years and ε_{it} is the random error term. We also included year dummy variables to control for any macroeconomic events that may vary over time.¹³ Similar to Salihu et al. (2015), we included the one-year lag of the dependent variable, CTA_{it-1} , as an additional explanatory variable to capture the dynamic effects present in corporate tax planning.

Model Estimation

Endogeneity issues—such as unobserved (individual effects) heterogeneity, reverse causality, and dynamic endogeneity—are concerns that need to be addressed in studies pertaining to corporate governance and taxation. Dynamic endogeneity arises because tax payment is a continuous process; this implies that corporate tax planning involves strategies that transcend a one-year plan (Salihu et al., 2015). Coincidentally, reverse causality arises because of the bidirectional relationship between tax avoidance and foreign ownership (Hasan et al., 2016). Although the literature suggests that foreign ownership has an effect on the level of tax avoidance practiced by firms (Yoo & Koh, 2014; Salihu et al., 2015; Hasan et al., 2016), foreign ownership can also be endogenous to the tax system faced by the firm. Huizinga and Nicodème (2006) argued that the existence of foreign tax credits and the discriminatory treatment of tax systems towards foreigners (i.e., special tax breaks) can affect the decision of foreign investors to retain their investments. Moreover, because foreign investors focus on the reputation of the firm, tax law compliance is one factor that they consider.

To address these issues, we estimated equation (1) using the two-step Blundell-Bond system generalized method of moments (GMM) estimator. The system

GMM technique entails the use of instruments found within the dataset to proxy for the endogenous variables. In this study, we used two lags of the independent variables as instruments, except for firm size, firm age, and capital intensity, all of which we treat as strictly exogenous variables. To test for the validity of the instrument set used in our estimations, we employed the Arellano-Bond first- and second-order autocorrelation tests and the Sargan-Hansen test of overidentifying restrictions. Failure to reject the null hypothesis that there is no second-order autocorrelation and that the model is correctly specified, respectively, implies that the moment conditions and instrument set used are valid. Lastly, we reported standard errors that have been corrected for within-firm serial correlation and heteroskedasticity.

Results and Discussion

Table 1 reports the mean, standard deviation, minimum, and maximum values of each variable used in this study across the entire sample period. Gebhart (2017) argued that ETR-based measures can be compared with the existing statutory tax rate to check whether there is an indication that tax avoidance is being practiced; such indication is present when the ETR-based measure obtained is lower than the statutory tax rate. We found that the mean values for *3YRGAAPETR* and *3YRCASHE*TR in our sample are 15.52% and 13.09%, respectively, whereas the statutory corporate tax rate in the Philippines is 30%. That the Philippine statutory tax rate is higher than our estimates of the long-run effective tax rates is indicative of the incidence of tax avoidance among firms listed in the PSE.

Table 1
Descriptive Statistics

	Mean	Std. Dev.	Min	Max
<i>Dependent Variable</i>				
<i>3-year GAAP ETR (3YRGAAPETR)</i>	0.1552	0.1593	0	1
<i>3-year Cash ETR (3YRCASHE</i> TR)	0.1309	0.1638	0	1
<i>Industry-and-size matched 3-year GAAP ETR (3YRGAAPETR_{ADJ})</i>	-0.0005	0.1426	-0.2986	0.8565
<i>Industry-and-size matched 3-year Cash ETR (3YRCASHE</i> TR _{ADJ})	0.0022	0.1474	-0.3555	0.8483
<i>Independent Variables</i>				
<i>Foreign Ownership 1 (FOR1)</i>	0.1720	0.2137	0	0.9403
<i>Foreign Ownership 2 (FOR2) (dummy variable)</i>	0.4672	--	--	--
<i>Foreign Ownership 3 (FOR3)</i>	0.0885	0.1506	0	0.7778
<i>Major Customer (MC) (dummy variable)</i>	0.1665	--	--	--
<i>Family Ownership 1 (FAM1) (dummy variable)</i>	0.8012	--	--	--
<i>Family Ownership 2 (FAM2)</i>	0.4582	0.2946	0	0.9995
<i>Board Independence (BIND)</i>	0.2630	0.0911	0	0.8182
<i>Board Size (BSIZE)</i>	9.1976	2.1414	5	15
<i>Firm Size (FSIZE) (in Php millions)</i>	46,300	132,000	0.75	1,250,000
<i>Firm Age (FAGE)</i>	42.4965	24.4023	2.8877	112.3867
<i>Firm Performance (ROA)</i>	0.0256	0.2491	-5.2988	0.6604
<i>Capital Intensity (CAPINT)</i>	0.2518	0.2511	0	0.9513
<i>Leverage (LEV)</i>	0.2948	0.6966	0	4.7945
<i>Loss Firms (LOSS) (dummy variable)</i>	0.2623	--	--	--

The standard deviations of our $3YRGAAPETR$ and $3YRCASHETR$ measures, 15.93% and 16.38% respectively, are not nearly as high as those of Balakrishnan et al. (2019), indicating that cross-sectional variation in our ETR measures for PSE-listed firms is not as substantial as that for U.S. listed firms.¹⁴ Our $3YRGAAPETR_{ADJ}$ and $3YRCASHETR_{ADJ}$ measures, which are size-industry adjusted measures,

also exhibited nearly as much cross-sectional variation as our unadjusted long-run ETRs (i.e., 14.26% and 14.74% respectively), although not as substantial as those of Balakrishnan et al. (2019).¹⁵ This indicates the presence of substantial variation as well among long-run ETRs within our size-industry groupings.

Moreover, we found that, on average, 17.20% of the common shares of a typical PSE-listed firm

Table 2

Regression Results Using the Industry-and-Size Matched 3-Year GAAP ETR ($3YRGAAPETR_{ADJ}$) as Dependent Variable

	PANEL A.1			PANEL A.2		
	FOR1 (1)	FOR2 (2)	FOR3 (3)	FOR1 (1)	FOR2 (2)	FOR3 (3)
Foreign Ownership	-0.1244 (0.1204)	0.0272 (0.0537)	-0.2195 (0.1615)	-0.1211 (0.1076)	0.0269 (0.0551)	-0.3578 ** (0.1530)
Major Customer (MC)	0.0204 (0.0487)	0.0318 (0.0461)	0.0298 (0.0414)	0.0466 (0.0540)	0.0607 (0.0508)	0.0662 (0.0470)
Family Ownership 1 (FAM1)	-0.0531 (0.0599)	-0.0522 (0.0635)	-0.0441 (0.0504)	--	--	--
Family Ownership 2 (FAM2)	--	--	--	-0.0214 (0.0862)	0.0177 (0.0874)	-0.0914 (0.0815)
Board Independence (BIND)	0.0182 (0.1644)	0.0242 (0.1339)	0.0874 (0.0891)	-0.0679 (0.1988)	-0.0517 (0.1634)	-0.0423 (0.1268)
Board Size (BSIZE)	0.0245 (0.0868)	-0.0044 (0.0876)	0.1100 * (0.0644)	-0.0096 (0.0896)	-0.0078 (0.0807)	0.1318 * (0.0674)
Firm Size (FSIZE)	-0.0090 (0.0070)	-0.0142 ** (0.0068)	-0.0080 (0.0055)	-0.0090 (0.0075)	-0.0161 * (0.0091)	-0.0054 (0.0061)
Firm Age (FAGE)	0.0076 (0.0183)	0.0139 (0.0197)	0.0015 (0.0152)	0.0196 (0.0173)	0.0222 (0.0172)	0.0043 (0.0144)
Firm Performance (ROA)	-0.0436 (0.0755)	0.0170 (0.0830)	0.0551 (0.0697)	-0.0788 (0.1009)	0.0116 (0.0615)	0.0050 (0.0501)
Leverage (LEV)	0.0256 (0.0236)	0.0329 (0.0249)	0.0200 (0.0228)	0.0263 (0.0276)	0.0266 (0.0295)	0.0150 (0.0190)
Capital Intensity (CAPINT)	0.0287 (0.0369)	0.0518 (0.0371)	-0.0016 (0.0279)	0.0349 (0.0403)	0.0598 (0.0391)	0.0039 (0.0356)
Loss Dummy (LOSS)	-0.1626 *** (0.0539)	-0.1490 *** (0.0570)	-0.0500 (0.0479)	-0.1788 *** (0.0615)	-0.1515 ** (0.0608)	-0.0585 (0.0378)
Lag (1) of $3YRGAAPETR_{ADJ}$	0.2741 *** (0.1003)	0.3208 *** (0.1096)	0.3095 *** (0.1136)	0.2609 *** (0.0979)	0.3147 *** (0.1063)	0.3080 *** (0.1149)
Hansen test of overidentifying restrictions <i>p</i> -value	0.478	0.599	0.334	0.505	0.698	0.544
AB Test for AR(1) <i>p</i> -value	0.050	0.047	0.047	0.049	0.046	0.052
AB Test for AR(2) <i>p</i> -value	0.946	0.897	0.620	0.990	0.886	0.629
Difference in Hansen tests of exogeneity of instrument subsets:						
GMM instruments for levels:						
Hansen test excluding group <i>p</i> -value	0.910	0.853	0.497	0.535	0.572	0.429
Difference (null H = exogenous) <i>p</i> -value	0.147	0.330	0.264	0.439	0.668	0.595
Instruments for IV-Style:						
Hansen test excluding group <i>p</i> -value	0.380	0.548	0.262	0.413	0.623	0.470
Difference (null H = exogenous) <i>p</i> -value	0.893	0.615	0.794	0.878	0.787	0.763
No. of observations	599	599	643	599	599	643
Year dummies	YES	YES	YES	YES	YES	YES

Coefficients are in bold; robust standard errors are in parentheses; *** 1% significance level, ** 5% significance level, * 10%

are owned by foreign investors, whereas 8.85% of the board is comprised of foreign directors. Using a 10% ownership threshold, we observed that foreign investors hold substantial ownership in nearly half (46.72%) of our sample firms. We also found that around 16.65% of our sample firms are reliant on at least one major customer. Moreover, using a 10% ownership threshold, approximately 80.12% of our sample firms are classified as family firms, whereas, on average, 45.82% of total outstanding shares are family-owned. In our sample, the board of a typical PSE-listed firm has around nine directors, 26.30% of which are independent. The average age of a typical firm is about 42 years, with an average size of Php 46.3 billion in total assets, an average return on assets of 2.56%, an average capital intensity of 25.18%, and a mean leverage ratio of 29.48%. Finally, 26.23% of our sample firm-years are reported loss years.

Table 2 reports the results of estimating equation (1) using the industry-and-size matched 3-year GAAPETR ($3YRGAAPETR_{ADJ}$) as the measure of tax avoidance. We found a negative and significant relationship between foreign ownership and $3YRGAAPETR_{ADJ}$ but only when $FOR3$ and $FAM2$ are used to measure foreign ownership and family ownership, respectively. This implies that firms with a greater presence of foreign directors exhibit higher levels of tax avoidance. Such finding is consistent with the theory that firms with foreign directors may tend to engage more in tax avoidance due to greater opportunities for tax planning that foreign influence brings. In this regard, firms place more emphasis on the benefits of corporate tax avoidance than they do on their costs.

Moreover, we found some evidence that $BFSIZE$ has a weakly significant and positive relationship with $3YRGAAPETR_{ADJ}$ when $FOR3$ is used to proxy for foreign ownership. This result suggests that firms with larger boards exhibit lower levels of tax avoidance, and is consistent with the idea proposed by Ribeiro et al. (2015) that larger boards tend to have more difficulty investing in tax-aggressive activities because they face more difficulty reaching a consensus. We also found that $FSIZE$ has a significant and negative effect on $3YRGAAPETR_{ADJ}$ when $FOR2$ is used to measure foreign ownership. This suggests that larger firms tend to engage in higher levels of tax avoidance, consistent with the political power theory, which posits that larger firms

have more resources available to manipulate political processes to lower tax burdens and engage in tax planning (Richardson & Lanis, 2007).

We also found $LOSS$ to have a significant and negative relationship with $3YRGAAPETR_{ADJ}$, suggesting that firms with negative pre-tax income levels tend to be more tax avoidant relative to profitable firms. This result is consistent with the idea that loss firms have greater incentives to avoid paying taxes because of their lower earnings quality. Lastly, we found that past $3YRGAAPETR_{ADJ}$, measured by the one-period lag of $3YRGAAPETR_{ADJ}$, has a significant and positive effect on current $3YRGAAPETR_{ADJ}$, regardless of the family ownership and foreign ownership measures used.

Table 3 reports the results of estimating equation (1) using the industry-and-size matched 3-year cash ETR ($3YRCASHETR_{ADJ}$) as the measure of tax avoidance. We found a negative and significant relationship between $FOR3$ and $3YRCASHETR_{ADJ}$, similar to our $3YRGAAPETR_{ADJ}$ results, for both family ownership measures used. Again, this implies that firms with more foreign directors exhibit higher levels of tax avoidance, consistent with the theory that greater foreign exposure and influence bring about more tax-induced opportunities to take advantage of. Moreover, similar to our $3YRGAAPETR_{ADJ}$ results, we found some evidence of a negative, albeit weakly significant, relationship between $LOSS$ and $3YRCASHETR_{ADJ}$, suggesting that firms with incurred losses are more tax-avoidant than profitable firms are.

In addition, we found a weakly significant yet positive relationship between $BIND$ and $3YRCASHETR_{ADJ}$, only when $FOR3$ and $FAMI$ are used as the ownership measures. This suggests that firms with more independent boards exhibit lower levels of tax avoidance, supporting the agency theory, which posits that independent directors act as effective monitors within the firm and decrease the level of tax avoidance pursued by management. We also found some weak evidence of a positive relationship between $CAPINT$ and $3YRCASHETR_{ADJ}$, indicating that firms with greater levels of capital intensity are less tax avoidant. Finally, we found past $3YRCASHETR_{ADJ}$, measured by the one-period lag of $3YRCASHETR_{ADJ}$, to have a significant positive effect on current $3YRCASHETR_{ADJ}$, regardless of the ownership measure used.¹⁶

Table 3Regression Results Using the Industry-and-Size Matched 3-Year Cash ETR ($3YRCASHETR_{ADJ}$) as Dependent Variable

	PANEL B.1			PANEL B.2		
	FOR1 (1)	FOR2 (2)	FOR3 (3)	FOR1 (1)	FOR2 (2)	FOR3 (3)
Foreign Ownership	-0.1171 (0.1101)	0.0181 (0.0494)	-0.3264 ** (0.1657)	-0.1093 (0.0951)	0.0283 (0.0385)	-0.3639 *** (0.1371)
Major Customer (MC)	0.0319 (0.0509)	0.0287 (0.0522)	0.0057 (0.0539)	0.0305 (0.0567)	0.0305 (0.0515)	0.0341 (0.0615)
Family Ownership 1 (FAM1)	-0.0027 (0.0378)	0.0033 (0.0549)	-0.0542 (0.0539)	--	--	--
Family Ownership 2 (FAM2)	--	--	--	0.0259 (0.0603)	0.0614 (0.0644)	-0.0268 (0.0638)
Board Independence (BIND)	0.1678 (0.1431)	0.0972 (0.1537)	0.2214 * (0.1182)	0.1456 (0.1488)	0.0840 (0.1229)	0.1236 (0.1459)
Board Size (BSIZE)	-0.0168 (0.0799)	0.0083 (0.0749)	-0.0251 (0.0969)	-0.0064 (0.0878)	-0.0077 (0.0699)	0.0198 (0.0681)
Firm Size (FSIZE)	0.0013 (0.0055)	-0.0062 (0.0072)	0.0059 (0.0047)	-0.0012 (0.0068)	-0.0099 (0.0081)	0.0051 (0.0052)
Firm Age (FAGE)	0.0200 (0.0131)	0.0107 (0.0120)	0.0090 (0.0156)	0.0165 (0.0117)	0.0113 (0.0127)	0.0097 (0.0150)
Firm Performance (ROA)	-0.1409 (0.1056)	-0.0791 (0.1014)	-0.0113 (0.0680)	-0.0913 (0.0842)	-0.0251 (0.0829)	-0.0626 (0.0762)
Leverage (LEV)	-0.0042 (0.0156)	0.0019 (0.0186)	-0.0232 (0.0204)	-0.0015 (0.0173)	0.0029 (0.0188)	-0.0188 (0.0141)
Capital Intensity (CAPINT)	0.0271 (0.0249)	0.0463 * (0.0264)	0.0210 (0.0304)	0.0177 (0.0249)	0.0493 * (0.0292)	0.0181 (0.0335)
Loss Dummy (LOSS)	-0.0763 (0.0530)	-0.0840 * (0.0494)	0.0014 (0.0641)	-0.0718 (0.0525)	-0.0702 * (0.0433)	-0.0100 (0.0502)
Lag (1) of $3YRCASHETR_{ADJ}$	0.5423 *** (0.1145)	0.5551 *** (0.1022)	0.4732 *** (0.0782)	0.4973 *** (0.1159)	0.5202 *** (0.1137)	0.4352 *** (0.0824)
Hansen test of overidentifying restrictions <i>p-value</i>	0.354	0.437	0.650	0.455	0.591	0.771
AB Test for AR(1) <i>p-value</i>	0.012	0.014	0.013	0.016	0.016	0.018
AB Test for AR(2) <i>p-value</i>	0.221	0.234	0.374	0.234	0.220	0.353
Difference in Hansen tests of exogeneity of instrument subsets:						
GMM instruments for levels:						
Hansen test excluding group <i>p-value</i>	0.385	0.164	0.785	0.380	0.194	0.642
Difference (null H = exogenous) <i>p-value</i>	0.369	0.707	0.418	0.522	0.872	0.722
Instruments for IV-Style:						
Hansen test excluding group <i>p-value</i>	0.256	0.351	0.581	0.347	0.530	0.703
Difference (null H = exogenous) <i>p-value</i>	0.961	0.797	0.738	0.980	0.681	0.820
No. of observations	599	599	643	599	599	643
Year dummies	YES	YES	YES	YES	YES	YES

Coefficients are in bold; robust standard errors are in parentheses; *** 1% significance level, ** 5% significance level, * 10% significance level

Conclusion and Policy Recommendations

Tax avoidance schemes have developed over the years and have become more complex, primarily due to the high tax rates and narrow tax base imposed in the Philippines. Such schemes may imply weaknesses

in corporate governance mechanisms and hinder the government from providing quality public service. The goal of this study was to empirically analyze the relationship between foreign ownership and corporate tax avoidance on the basis that a greater extent of foreign investors' interest will mitigate firm tax

avoidance because such investors have the incentive to monitor management effectively, in order to realize higher returns from their investments.

For our sample of Philippine firms, we analyzed the relationship between foreign ownership and corporate tax avoidance for the period 2009 to 2015. Foreign ownership is proxied by the proportion of shares held by foreign investors, the presence of substantial shareholding by foreign investors, and the proportion of foreign directors on the boards of firms. Corporate tax avoidance is proxied by the industry- and size-adjusted long-run accounting and long-run cash effective tax rate measures, both of which allow us to benchmark against the tax aggressiveness of other firms with the same size and industry characteristics. We also employ the two-step system GMM estimation technique that addresses concerns related to unobserved heterogeneity, dynamic endogeneity, and reverse causality in the data. Overall, we found some evidence that firms with greater presence of foreign directors tend to engage in more aggressive tax avoidance schemes. We also found evidence that (i) tax avoidance, measured by the industry-and-size adjusted long-run GAAP effective tax rate, is positively associated with firm size and loss firms, but negatively associated with board size, and (ii) both greater board independence and greater capital intensity levels are associated with lower tax avoidance, as measured by the industry-and-size adjusted long-run cash effective tax rate.

The implications of our study should be beneficial to policymakers who seek to identify the determinants of corporate tax avoidance. Given that we found some evidence of a significant, positive relationship between foreign influence in boards and corporate tax avoidance, policymakers should exercise diligent caution in their oversight when evaluating foreign participation in boards of companies on the basis that such participation can bring about much-needed expertise and diverse insights needed in firm decision-making. They need to carefully assess whether the benefits of such participation outweigh the costs, given the opportunity for greater tax avoidance.

NOTES

¹ See, for instance, the cases of Enron, WorldCom, Walmart, Apple, IBM, Pfizer, Samsung, and SouthGobi Resources.

² Legitimizers consist of governmental bodies, political groups, trade unions, communities, associated

corporations, employees, and customers (Lanis & Richardson, 2011).

³ The marginal benefits of tax aggressiveness or avoidance to shareholders include greater tax savings for the firm (Lanis & Richardson, 2011).

⁴ Unlike other industries, financial firms are subject to 5% corporate tax rate, according to Section 122 of the National Internal Revenue Code. On the other hand, PEZA-registered firms are entitled to tax incentives (i.e., income tax holidays). Thus, including these firms in our sample may create discrepancies and inconsistencies.

⁵ Effective tax rates (ETRs) are widely used as measures of tax avoidance. ETR is generally measured as the proportion of tax liability to pre-tax income, where tax liability is proxied by either income tax expense for GAAP ETR or cash taxes paid for cash ETR. Both GAAP and cash ETR measures capture the proportion of accounting income payable as taxes (Salihu et al., 2013) and, therefore, measure tax avoidance relative to accounting earnings. Higher ETR values indicate a greater amount of tax liability (proxied by either income tax expense or cash taxes paid) and, consequently, a lower level of tax avoidance.

⁶ In the tax avoidance literature, the long-run ETR measures are usually constructed using windows that vary anywhere from 3 to 16 years. In this study, we followed Balakrishnan et al. (2019) and constructed our long-run GAAP and long-run cash ETR measures using only a 3-year behind window, including the current year, due to the limited time period of our sample. Hanlon and Heitzman (2010) also noted that a 3-year period is the minimum suggested period for the computation of long-run ETR measures.

⁷ Dyreng et al. (2008) noted that much of tax avoidance involves deferring income for tax purposes relative to book purposes, which reduces current taxes but increases deferred taxes. Because GAAP ETRs use total tax expense, which includes both current and deferred taxes, they will not reflect tax avoidance that makes use of deferral strategies.

⁸ The Philippine Stock Exchange Industry Classification system classifies firms into six sectors: Financial, Holding Firms, Property, Services, Industrial, and Mining & Oil. We sorted our firms into only five sectors because our sample is comprised of purely non-financial firms. Given the five industries and the size quintiles, we sorted our firms into a total of 25 size-industry bins for each year.

⁹ Substantial shareholders own more than 10% of a class of equity security, according to Rule 38.5.2 of the 2015 Implementing Rules and Regulations of the Securities Regulation Code (Securities and Exchange Commission, 2015).

¹⁰ We classified directors with dual citizenship as Filipinos.

¹¹ A major customer refers to a single external customer who accounts for 10% or more of the total revenue of the entity (International Accounting Standards

Board, 2006). Based on the guidelines in IFRS 8: Operating Segments, firms are required to disclose this fact, the total revenues received from each major customer, and the identity of the operating segment that made the sales to the customer.

¹² We winsorized our leverage variable at the 1st and 99th percentiles to mitigate the effects of outliers.

¹³ We used 2015 as the base year.

¹⁴ The standard deviations of Balakrishnan et al.'s (2019) 3-year GAAP ETR and 3-year cash ETR measures for U.S. listed firms are 19.3% and 22.6%, respectively.

¹⁵ The standard deviations of Balakrishnan et al.'s (2019) size-industry matched 3-year GAAP and 3-year cash ETR measures for U.S. listed firms are 18.4% and 21.4% respectively.

¹⁶ As robustness checks, we also measured foreign ownership and family ownership using dummy variables equal to 1 if the foreigners (family corporate group or largest individual shareholder) own 20% or more of outstanding common shares, and 0 otherwise, and we find qualitatively similar results. We also estimated equation (1) using the widely used measures of tax avoidance including residual book-tax gap and the unadjusted and annual measures of GAAP ETR and cash ETR as the proxies for tax avoidance, and found a weakly significant and negative relationship between foreign ownership and tax avoidance only when *FOR3* and *FAM2* are used as the ownership measures and cash ETR as the tax avoidance measure. This result implies that firms with more foreign directors tend to have greater levels of tax avoidance, consistent with our main findings. These results are available from the authors upon request.

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