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Prevalence of an Earnings Management Process Aimed at Reducing Corporation and Individuals Tax Liabilities

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Abstract:

Tax evasion and avoidance have plagued society for centuries. In response, tax authorities have been developing and implementing tax codes to combat this issue, which significantly impacts tax revenue. As a result, governments have struggled to provide essential public goods and services due to deficits in tax revenue. The objective of this study is to examine a selection of 30 research papers published between 2009 and 2025 that focus on tax evasion and avoidance. This review will highlight the prevalence of earnings management practices designed to minimize both corporate and individual tax burdens. The papers analyzed will serve as secondary data for the research. I will employ a Systematic Literature Review methodology to explore various themes such as transfer pricing, exploitation of loopholes in tax codes, illicit financial flows amongst many themes. The findings indicate that tax evasion and avoidance are widespread in many countries. This prevalence hampers governments' ability to provide vital infrastructure and education for their citizens. This research aims to offer valuable insights for management, auditors, and tax authorities, assisting them in identifying and addressing weaknesses in their internal controls and audit processes. Such insights will aid in the prevention and detection of tax avoidance and evasion practices.

Keywords:

Corporate Social Responsibility, Tax Evasion, Tax Avoidance, Business Ethics

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Introduction

'Major corporations increasingly produce brochures and reports containing promises of socially responsible conduct, but this has also been accompanied by large scale tax avoidance and evasion' (Sikka, 2010, p. 4). Taxpayers have been neglecting their social responsibility to pay taxes. Many have resorted to tax avoidance and evasion as strategies to reduce their tax liabilities. This behaviour has led tax authorities into a continuous cycle of improving tax codes, while offenders find new ways to exploit loopholes or bypass these new regulations. As a result, less fortunate members of society suffer the consequences of a lack of public goods and services due to the government's inability to collect sufficient tax revenue to afford social capital (Sikka, 2010).

It is essential for governments to collect adequate tax revenue to provide public goods and services, such as road infrastructure and security, which benefit both rich and poor citizens. Corporations often face a difficult situation; they issue annual financial statements of poor quality while simultaneously engaging in practices to minimize their tax liabilities—through tax avoidance and, in extreme cases, tax evasion. 'Thus they have economic incentives to increase profits even if that entails reducing the payment of taxes' (Sikka, 2010, p. 9).

Individuals and corporations participate in tax avoidance and evasion practices, which impede tax authorities from collecting revenue needed for public goods and services. This research aims critically analyze the process of earnings management employed to minimize corporate tax liabilities. This paper presents evidence of practices used by both individuals and corporations to avoid or evade taxes. The goal is to provide valuable insights for management, auditors, and tax authorities, helping them identify and address weaknesses in their internal controls and audit processes. This will aid in the prevention and detection of tax avoidance and evasion practices within their organizations. The research question addressed in this paper is: 'Is tax avoidance and evasion a widespread issue?'

The paper starts with a literature review, followed by the research methodology, and then presents the results and findings. It continues by outlining the ethical implications of the paper and concludes with a conclusion.

Methods and Data

A Systematic Literature Review (SLR) was conducted to analyze research papers on the topics of tax evasion and tax avoidance. A search was performed on Google Scholar to retrieve articles related to these subjects. Both tax evasion and tax avoidance are practices frequently employed by taxpayers as part of earnings management. The search terms used in Google Scholar were "tax evasion and avoidance." The search was filtered to include papers published between 2009 and 2025, ensuring a sufficient amount of data was gathered to draw valid conclusions.

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All retrieved papers were carefully reviewed to establish their relevance to the topic of earnings management practices aimed at reducing tax liability. The selected papers were included in the analysis based on whether they discussed instances of tax evasion and avoidance. These practices were categorized as follows:

- Tax avoidance
  - Related party transactions (Transfer pricing, profit sharing, or using low tax jurisdictions)
  - Using loopholes in the tax code or circumvention of the law
  - Following the letter of the law instead of the spirit of the law
- Tax evasion
  - Illicit financial flows
  - Political lobbying and corruption or bribing tax officials
  - Bank secrecy or hiding or underreporting information from tax authorities or falsifying invoices

The above categories highlight practices frequently employed by taxpayers to avoid and evade tax. These categories were established to facilitate the tallying of cited tax avoidance and evasion practices across different regions of the world, as highlighted in the works of various authors. The review ensured representation from at least five continents: Africa, Europe, North America, South America, and Asia. A total of thirty papers were selected, covering a period of 16 years from 2009 to 2025. Three of the thirty papers were excluded because they did not mention tax avoidance and evasion practices.

The methodology employed acts as a funnel or filter to include relevant papers while excluding those that are irrelevant. Each paper was assessed for its relevance to key themes, such as transfer pricing, exploiting loopholes in tax codes, illicit financial flows, adhering to the letter versus the spirit of the law, political lobbying, and hiding information from tax authorities. The papers were tallied based on the earnings management practices uncovered to reach a total occurrence of each practice in each category. This filtering process ensured that only pertinent papers were included in the review.

Results and Discussion

Below is a table that shows the tax evasion and avoidance practices found in the papers reviewed:

Tax Avoidance			**Tax Evasion**		
Related party transactions (Transfer	Exploiting loopholes in tax codes or	Following the letter of the law instead of	Political lobbying and corruption or	Illicit financial flows	Manipulating information (Bank secrecy

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pricing or profit shifting (Shifting emission tax credits and profit) or using low tax jurisdiction)	circumventing the tax law	the spirit of the law	bribing tax officials		or hiding income or underreporting information to tax authorities or falsifying/hiding invoices)
17	21	5	8	14	23

Table 1: Tax evasion and avoidance practices

Caption: Tax avoidance includes practices such related party transactions (17 mentions out of 30 papers), exploiting loopholes in the tax code (21 mentions out of 30 papers) and following the letter of the law instead of the spirit of the law (5 mentions out of 30 papers). Tax evasion includes practices such as political lobbying (8 mentions out of 30 papers), illicit financial flows (14 mentions out of 30 papers) and hiding information from tax authorities (23 mentions out of 30 papers).

Corporate Citizenship Versus Agency Problem (Theory)

Corporate Citizenship Theory

An organisation is an integral part of society; it has corporate citizenship status. This status confers rights and responsibilities on the organisation towards society and the natural environment on which society depends (Ramalho, 2016). Companies do not operate in isolation; they are part of the society in which they function and are expected to fulfil their responsibility as corporate citizens by paying taxes. Governments use taxes to provide goods and services to the poor citizens, making corporate social responsibility an important element of the equation. This is because if companies fulfil their social responsibility, they will willingly pay taxes, making tax collection easier for tax authorities (Vitor et al., 2025).

Agency Theory

Agency Theory, also known as the principal-agent problem, addresses situations where one party (the agent) makes decisions on behalf of another (the principal), often in contexts of asymmetric information. This theory, developed in the mid-20th century by economists Stephen Ross and Barry Mitnick, highlights the challenges that arise when the principal lacks the same level of information as the agent, leading to potential conflicts of interest and inefficiencies (Douglas, 2024). Managers are often perceived as manipulating financial statements to report improved performance in order to earn bonuses to the

detriment of all other stakeholders involved. Their manipulation may involve tax avoidance and evasion tactics. This occurs because the accounting in annual financial statements differs from tax calculations. Managers may report profits using certain accounting policies while showing losses for tax purposes. Taxes are seen as costs that should be reduced or avoided (Sikka, 2010).

There is a connection between tax avoidance and management practices. Management often engages in tax avoidance strategies to reduce taxable income. Additionally, they may pursue these strategies to create the appearance of better performance. (Luthfiatun Niswah & Afrizal Nilwan, 2024). Principals, governments, tax authorities, and the general public are all impacted by the actions of agents, as less or no tax is collected, resulting in reduced tax revenue for providing public goods and services. Principals experience an additional burden when their companies face closure due to non-compliance with tax legislation.

Ability-to-Pay Principle

Ability-to-Pay Principle suggests that taxation should be levied according to an individual's ability to pay (Adebisi & Gbegi, 2013). This theory is recognized as effective in motivating taxpayers to fulfill their tax obligations. The payment of taxes is seen as a deprivation to the taxpayer because he gives away money to the government which he would have used for his own personal use. However, there is no solid approach for the measurement of the equity of sacrifice in this theory, as it can be measured in absolute, proportional or marginal terms (Adebisi and Gbegi, 2013). Every taxpayer is expected to contribute a portion of their income to the government to facilitate the provision of public goods and services. This theory leaves no loopholes for taxpayers to exploit as a justification for their reluctance to pay taxes.

Tax Avoidance

This basically one of the major means through which persons fail to comply with their tax liability by arranging their finances and taxable profits in such a way to benefit from tax holidays, incentives and exemptions. It is a practice found mainly within the formal sector whereby these big companies and organization aim to pay less tax or no tax at all by taking advantage of the provisions of the law and various tax policies (Karibo, 2025). Yusuff et al. noted that tax avoidance, while legal, involves exploiting loopholes in tax legislation to pay less tax or no tax at all. 'Tax avoidance refers to the tactical employment of tax regulations, deductions, and loopholes to reduce tax commitments without infringing upon legal mandates' (Kumar Singh, 2025).

Khasawneh et al. discovered that tax avoidance negatively impacts FDI in public infrastructure sectors like utilities and transportation. Such tax avoidance not only highlight the need for changes in tax laws and regulations but also come at a significant cost. This cost detracts from funds that could otherwise

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be used to provide public goods essential for the survival of low-income citizens. We must acknowledge the critical role that social grants play in sustaining the livelihoods of the less fortunate members of society. Tax avoidance raises concerns over ethics (Kumar Singh, 2025).

Governments have enacted legislation, such as General Anti-Avoidance Rules, to reduce tax avoidance practices by individuals and companies (Kumar Singh, 2025).

Transfer Pricing

There seems to be a new norm among multinational corporations regarding their claims of social responsibility while simultaneously avoiding tax payments (Sikka, 2010). These corporations often engage in activities aimed at reducing their corporate tax liabilities, and in some cases, they manage to pay no corporate taxes at all.

'Global Witnes noted that the company was involved in the sale of bricks at low prices to its subsidiary in Singapore, Coaltrade Services International, which subsequently resold them at a higher price. Through this transaction, Global Witnes identified a potential reduction in tax payments of US$ 125,000,000 against the Indonesian government. In addition, Global Witnes also highlighted the role of tax haven countries that allow Adaro to reduce its tax burden by 14,000,000 US dollars annually' (Douglas, 2024). Companies often take extensive measures to avoid paying taxes, including shifting revenue to lower tax jurisdictions and tax havens. This revenue shifting leads to the involved companies paying reduced tax or no tax at all.

Five out of thirty scholarly papers reveal an intriguing yet concerning trend: taxpayers frequently adhere to the letter of the law, often at the expense of its underlying principles. This phenomenon, while less pervasive than other tax evasion and avoidance strategies, is noted in 16.67% of the reviewed papers. It highlights a troubling mindset where managers consciously choose to bypass the spirit of the law. The implications of this behavior are significant, as its prevalence raises alarms about potential future increases. To address this ethical dilemma, it is essential to introduce comprehensive ethics courses aimed at equipping taxpayers with the understanding and tools necessary to recognize and respect the spirit of tax regulations.

In a more alarming observation, transfer pricing and profit sharing are classified as common practices in seventeen out of the thirty papers, accounting for an overwhelming 56.67% of the total. These methods, while legally permissible forms of tax avoidance, ring alarm bells as they undermine tax authorities' capacity to gather the revenue essential for sustainable governance. It is imperative for tax authorities to develop robust regulations that effectively deter profit sharing and transfer pricing. Furthermore, a collaborative international effort is crucial; governments must ensure that transactions between related parties are conducted at arm's length and facilitate the sharing of information across jurisdictions to enhance oversight and accountability.

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Moreover, tax avoidance through the exploitation of loopholes within the tax code or through circumvention of the law is documented in twenty-one of the thirty papers, highlighting its alarming prevalence, appearing in a striking 70% of the papers. The reality is that no legislative framework can be entirely free of loopholes; there will always be gaps ripe for exploitation. The burden of ethical decision-making falls to taxpayers, who need a strong moral compass to guide them away from such unscrupulous practices, as exploiting loopholes is not only unethical but also morally indefensible. Relying on individuals to cultivate this moral awareness proves challenging, given the inherent tendency to prioritize personal gain. Therefore, tax lawmakers bear the responsibility of closing as many loopholes as possible. Additionally, companies should be encouraged to invest in ethics training and to inspire leaders within their organizations to act as responsible corporate citizens. True corporate citizenship means fulfilling their obligation to pay taxes, which enables governments to provide vital goods and services necessary for a thriving society.

Tax Evasion

Tax evasion is the intentional act of refusing to pay taxes by an individual or a company. It involves various actions or failures to act by a taxpayer aimed at not complying with tax laws or regulations. These actions may include underreporting income or deliberately omitting income fro

m taxable earnings, which is against the law. Such actions and inactions are illegal (Karibo, 2025). In accordance with Vitor, Souza and Martins Meurer, tax evasion occurs when a company or individual intentionally avoids or conceals documentation that would have been used by tax authorities to make tax assessment.

Yusuff et al. noted that tax evasion is an illegal activity aimed at reducing tax liability by underreporting taxable income or falsifying financial records. Tax authorities typically penalize tax evasion when discovered, but often this does not occur. Funds are usually spent on tax audits, technology and tax education to try and curb this scourge, but it prevails, nonetheless. Kumar Singh, n.d cited that tax evasion involves intentional misrepresentation, deceit, or concealment aimed at evading tax obligations, resulting in legal repercussions and harm to one's reputation. Tax codes are written to outline fines, imprisonment and assets seizure for fraudulent committed by taxpayers (Kumar Singh, n.d.).

The introduction of digital economy, the emergence of e-commerce platforms, technology-driven financial services (FinTech), and crypto assets has created substantial challenges for tax authorities in monitoring and taxing cross-border transactions (Astri Warih Anjarwi and Nurlita Sukma Alfandia, 2025). The struggle of tax authorities to monitor cross-border transactions creates opportunities for fraudsters.

Companies and individuals engage in fraudulent activities to evade taxes (Kumar Singh, n.d.). These activities push the less fortunate away from public goods and services, as governments end up with fewer funds to allocate to housing and social services.

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Eight out of thirty papers indicate that taxpayers engage in political lobbying, corruption, or bribing tax officials. While the prevalence of these tax avoidance tactics is not alarmingly high, their occurrence—cited in 26.67% of the reviewed papers—remains a cause for concern. It is particularly troubling that these practices involve tax evasion, meaning taxpayers deliberately engage in illegal activities to avoid paying taxes. Corruption and the bribery of tax officials are criminal offenses punishable by law. Therefore, companies and tax authorities must provide ethics training to raise awareness about corruption and bribery.

Illicit financial flows are reported as a common practice in fourteen out of the thirty papers, accounting for 46.67% of the authors who observed evidence of such flows. These illicit financial flows constitute tax evasion and, by nature, are criminal activities. This indicates that taxpayers are aware it is a crime to transfer money across borders yet still choose to do so. Consequently, governments must collaborate and share information about illicit financial flows to reduce their occurrence.

Hiding or underreporting income is the most prevalent tax evasion method, cited in twenty-three out of the thirty papers studied, representing 76.67% of the total. The frequency of these tax evasion and avoidance practices hinders tax authorities in collecting revenue, resulting in reduced funds available for public goods and services.

The statistics are derived from papers authored by researchers from various continents, representing numerous countries worldwide. It is assumed that these papers reflect the realities in many jurisdictions across the globe. All mentioned statistics span a period of sixteen years, from 2009 to 2025. Additionally, the systematic literature review revealed that three of the papers on tax evasion and tax avoidance did not discuss any of the identified practices. The review's findings indicate that corporations and individuals engage in practices such as transfer pricing, exploiting loopholes in tax codes, illicit financial flows, following the letter of the law rather than the spirit, political lobbying, and withholding information from tax authorities. As a result, it seems that corporations are not acting as good corporate citizens and are not fulfilling their tax obligations when they have the means to do so.

Conclusion

Tax evasion and avoidance are widespread issues globally, and the literature reveals just how significant their impact is on society. The consequences of tax evasion and avoidance can be seen in governments that consistently run budget deficits, leading them to rely on debt to cover their spending. In response, governments have been implementing strategies to minimize tax evasion and avoidance. Some of these strategies include modifying tax codes; however, perpetrators often exploit loopholes within these codes, creating a cycle of legislative changes followed by further exploitation.

This paper highlights the prevalence of earnings management aimed at reducing tax liability for both individuals and corporations. The information presented can assist management, tax authorities, and

auditors in identifying weaknesses in their internal controls and in implementing measures to reduce the risk of tax evasion and avoidance practices in their countries.

Below is a list of recommended solutions for consideration by management, tax authorities, and auditors:

1. Amending legislation to curb tax avoidance and evasion.
2. Raising awareness about tax legislation.
3. Utilizing artificial intelligence (AI) in tax administration.
4. Collaborating with tax authorities in other countries to combat tax avoidance and evasion.
5. Introducing tax audits.
6. Implementing tax amnesty programs for taxpayers with accounts and assets in tax havens.
7. Introducing tax evasion and avoidance fraud helpline

Theoretical Implications and Further Research

Additionally, further research is needed to understand why individuals responsible for corporate governance and executive duties may choose to avoid or evade taxes. The research will provide new knowledge to aid all stakeholders involved understand this phenomenon. This insight will enable universities and professional bodies to develop ethics training aimed at educating students and members about tax evasion and avoidance. Having targeted information on this phenomenon will make it possible for students and members of professional bodies to steer away from this scourge. Compliance with tax regulation will be greatly improved, and governments will have more funds to provide social capital.

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