

# The Relationship between Cash Tax Savings and Reputation Risk in the Stock Exchange of Selected Countries in the Persian Gulf Region<sup>1</sup>

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Research Paper

## INTRODUCTION

Tax avoidance has been described as "activities that reduce the tax of profitable investments to aggressive strategies" (Dyrenge, Hanlon, and Maydew, 2019) and "activities that generate cash tax savings." and provide financial reporting benefits". (Hutchens, Rego, and Williams, 2020). The activities related to cash tax saving (avoidance), despite creating benefits for companies, they can create problems for the governments and finally cause issues in the government's planning; Because this issue leads to paying less tax by companies.

While the evidence shows that there is a wide variety of ways and methods of tax avoidance among companies, the question is why some companies engage in tax avoidance eagerly while others seem to avoid it.

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Reputational costs are often considered an important factor that limits tax avoidance activities.(Gallemore, Maydew and Thornock, 2014).

Hanlon and Heitzman (2010), in their tax sector research, called for research on the following questions: “Why do some firms avoid taxes more than others? How do investors, creditors, and consumers perceive corporate tax avoidance?...These are interesting questions that can be studied" (137, 146).

This research can answer the research request about reputation costs.

Therefore, the research question can be raised as follows; Can decisions about cash tax savings be affected by reputational risk (costs)?

## **MATERIALS AND METHOD**

The statistical population of the research is all the companies listed on the stock exchange of the Persian Gulf countries, including Iran, Qatar, Oman, Kuwait, and Saudi Arabia from 2014 to 2015. Some variables require data during  $t_5$ - and  $t_1$ -years; The information was collected during the years (2010-2021). which have the following conditions:

1. During the research period, they are available on the stock exchange of the selected countries of the Persian Gulf region and they have not changed the financial year;
2. Due to the different nature of the major activities of investment companies and other financial intermediaries, these items have been omitted;
3. The information required to conduct the research is disclosed in the explanatory notes attached to the financial statements;
4. Have a net profit during the mentioned years.

Initially, the data of 165 companies (1485 company-year observations) were collected. Still, by applying the above restrictions, the number of 119 companies (833 company-year observations) from the total number of companies admitted to the stock exchange of the selected countries in this region was studied as a sample.

To measure the reputation risk (independent variable) of these companies the ranking of companies by the Industrial Management Organization in Iran and the ranking of companies in Arab countries was used by the prestigious magazine Forbes. The cash tax savings (dependent variable) were measured through the effective cash tax rate and the effect of reputation risk on it was investigated through a regression model.

## **RESULTS**

Hypothesis was examined at the 95% confidence level. It showed a significant relationship between cash tax savings and reputation risk (cost). It is concluded that some companies when using strategies for tax avoidance, pay attention to the costs caused by damage to the company's reputation and avoid it or become less involved in tax avoidance.

## **DISCUSSION**

Businesses that have very high credit, can face a higher risk of responsibility. If they cannot meet all the expectations of the interested groups, the trust of the company will decrease and it will have a bad effect on the reputation of the company. Reputation affects various social situations, especially those who are the main actors in decision-making or are obliged to make decisions (Bromley, 2000). So, identifying the risk of reputation and minimizing it is a priority problem in controlling this risk.

Examining the variables of the research showed that the top companies located in the Persian Gulf have shown lower cash tax savings than other companies located in this region.

In similar research, for example, Ismailzadeh, Scafi Assal, Nazimi (2016), corporate management of reputational risk on tax minimization and stock price reaction, and Gallemore, Maydew, and Thornock (2014), reputational costs of tax avoidance have studied. Each of these researches is a confirmation of the existence of reputational risk arising from issues related to tax planning by managers.

A few researches have been done in the field of risk and costs of reputation related to issues such as taxes; this study can lead to the expansion and

enrichment of this topic and the development of research literature in this sector. In addition, it should attract the attention of researchers and managers in the tax section.

**Keywords:** Reputation Risk, Persian Gulf Countries, Cash Tax Savings.

**JEL Classification:** G41, H26.

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