Tax Aggressiveness in Private Family Firms: An Agency Perspective

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Accounting research is one of the earliest business disciplines and family business is the dominant form of business organization across the world. Yet, accounting practices in family firms have been rarely studied. Addressing a part of this knowledge gap, the authors examined in this paper, the tax aggressiveness of privately held family firms. They defined the firm's tax aggressiveness as *"downward management of taxable income through tax planning activities."* The study was based on the survey data collected from 600 small and medium enterprises operating in Finland. This summary succinctly presents the findings of the study and its practical implications.

Tax Aggressiveness: The Phenomenon

Minimizing tax payments by aggressively adopting tax planning and tax-avoiding practices have been a rising phenomenon among businesses across the world. These tax-planning measures may be legal or sometimes may even lie on the boundaries of legality, which may invite penal action. Tax aggressiveness decisions pose agency problems because by adopting aggressive measures CEOs can continue to extract the benefits of control at the cost of other shareholders. For instance, CEOs can minimize tax outflow by artificially inflating expenses like executive salaries, perquisites or others. However, later the firm may have to incur huge costs for such tax aggressiveness, for example, penalties imposed by regulators when such masked transactions come to the fore in future accounting periods. In addition to monetary losses to the firm, it may also lead to loss of reputation (to both the firm and the owner family). Though public firms are known to have exercised tax aggressiveness, this study seeks to probe whether the phenomenon applies to the privately owned family firms.

Tax Aggressiveness in Privately Owned Family Business

Traditionally, privately owned and managed family firms are known to have low agency costs because of the family members' altruistic behaviour. However, even a partial separation of ownership from management may lead to information asymmetry and misalignment of interests of owners and managers. In these conditions the CEO (more so if he/ she is a non-owner) may act in self-interest and engage in tax aggressive behaviour against the interest of the owner family. It is here that the close involvement of the family is likely to ensure that tax related decision is not only based on financial gains but also takes into account the fallout on the family's socioemotional wealth. For instance, the family members would be averse to loss of reputation if the firm were to be penalized for unfair tax-practices. Therefore, the authors suggest that private family firms are likely to exhibit lower level of tax aggressive behaviour.

The authors also posit that if the CEO has a large ownership stake in the firm, he/ she is likely to exhibit a lower level of tax aggressive behaviour. In addition, if the board of directors is small and has some active outside members, it is likely to keep the tax aggressive behaviour of the CEO in check.

Key Findings

The statistical analysis of five years' effective tax rate and other financial and non-financial data collected from 600 small and mid-sized enterprises from Finland supported the authors' main hypothesis. Private family firms were found to be less tax aggressive than private non-family firms. However, no support was found to indicate that CEO ownership influenced the firm's tax aggressiveness. Most importantly, the role of external board member turned out to be significant in checking the CEO's tax-aggressive behaviour.

Practical Implications

The findings of the study had significant practical implications for privately held family businesses. Though private family firms can take pride in the fact that they do not indulge in tax-aggressive behaviour to the extent that their non-family peers do, it is important that they remain ever vigilant on that front.

They may appoint a non-owner CEO (viz. an outside professional) but keep a small and effective board to monitor the CEO's tax-aggressive decisions. Bringing external experts on the board is always advisable. The outside members add to the monitoring efforts of the family owners and keep a check on CEO's tax aggressive decisions.

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