

The Study on Enactment of Accounting Standards and Tax Avoidance of Small- and Medium-sized Entities: Comparison analysis between listed SME and Non-SME

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Abstract: This study examine financial the determinants of tax avoidance in SME, which hold less tax burden due to various tax reduction and tax deduction clauses in exceptional tax legislation. We also empirically test whether there is differing degree of motive in tax avoidance between SME and non-SME. In addition, in the case of listed SME, we investigate the impact of going public on tax avoidance. We make a contribution in providing policy implications by inspecting whether SME have motive to avoid tax by comparing tax avoidance in SME and non-SME and outlining contemporary enactment of AS-SME, which is adopted to clarify and simplify accounting rules for SME.

Key words: AS-SME, Tax avoidance, SME

1 Introduction

Generally, voluntary effort to enhance management transparency in small SME is lacking as a result of less number of users of accounting information as well as low reporting obligations. Small SME lack capability to form accounting themselves and even if they have the capability, their focus is mainly on tax law including corporate tax and value-added-tax so their financial statements contain low external reliability. Recent K-IFRS takes account of practicality with regards to conglomerates; conversely, small SME confront difficulty comprehending and applying both previous general corporate accounting (K-GAAP) and IFRS. In order to mitigate this difficulty, for firms that have relatively small number of information user, lack accounting capability and are not refer to external audit, Accounting Standards for Small- and Medium-sized Entities (AS-SME) was enacted to allow the accountant to easily understand the accounting rules when making financial statements and provide useful information to information users' decision making. Tax avoidance is referred to as the state of a firm to either explicitly or implicitly lower tax burden. Therefore, when the taxing authority concludes tax avoidance as tax evasion rather than tax saving, the firm confronts direct cost burden which encompasses both the original tax before tax avoidance and additional tax. However, aside from the direct tax cost, indirect tax cost including social condemnation, loss of company reputation and image, drop in stock

price and decrease in sales can be more burdensome (Anderson and Frankle 1980; Richardson and Welker 2001; Dhaliwal et al. 2010; Andrews et al). It is safe to infer that unlike conglomerates, SME have relatively less tax burden since they are beneficiaries of tax reduction clause in exceptional tax legislation. Therefore we expect SME are less likely to be engaged in tax avoidance.

2 Literature Review

2.1 Literature review on SME

2.1.1 Literature review on accounting practices of SME

Hwang et al. (2009) investigate fundamental factors relevant to establishment of accounting standards for unlisted firm in three-folds. First, they acknowledge the introduction background of accounting standards for unlisted firms and the trajectory in establishing the standards. Secondly, they scrutinize the effectiveness of current standards by sampling the implementation of SME accounting provisions, the 14th issue of corporate accounting standards.

2.1.2 Literature Review on Tax Avoidance

Lee and Yoon (2011) empirically test the factors that influence tendency to avoid tax in firms in Korea and Indonesia. They find higher the tax rate, higher the predilection for tax avoidance in both countries. It is also reported that complexity of taxation law and restraint against tax avoidance mitigate this tendency to avoid tax. Furthermore, high prevalence of tax avoidance and inequity in tax lead to higher tendency in tax avoidance. The result regarding characteristics of SME show larger firm size, higher capital intensity, lower profitability and less experience in tax audit are all associated with stronger propensity toward tax avoidance.

3 Modelling Research

3.1 Establishment of hypotheses

3.1.1 Tax avoidance in SME and non-SME

We conjecture SME to have relatively low tax burden with regards to tax avoidance since they are beneficiaries of various taxation subsidies and tax deduction or exemption. So their tendency to avoid tax is expected to be lower than that of non-SME. In the case of unlisted SME going public for external financing, they should

disclose financial information to the external stakeholders and cannot evade from various external auditing legislations in running business. For the fear of debasing firm's image or reputation, and subsequent drop in stock price and sales, they are expected to obviate from tax avoidance. We empirically test our expectations that can be arranged as whether there exists motive for SME to avoid tax compared to non-SME. Thus hypotheses are established as follows:

H1: SME will have lower level of tax avoidance compared to non-SME.

3.2 Measuring variables and establishment of model

3.2.1 Measurement of tax avoidance

This paper attempts to use BTD, which captures the difference between accounting profit before eliminating the effect of earnings manipulation and taxable income to proxy for tax avoidance for all listed firms. We also adopt the proxy proposed in Desai & Dharmapala (2006) that remove the effect of earnings manipulation in BTD and allows for more accurate measurement of tax avoidance.

$$BTD_{i,t} = \frac{(\text{accounting profit} - \text{taxable income})}{\text{total asset}} \quad (\text{Eq. 1})$$

3.2.2 Establishment of Model

Present paper attempts to identify the difference between SME and non-SME with regards to tax avoidance. We implement (Eq. 2) to analyze this difference using two proxies for tax avoidance, BTD and TS introduced above.

$$BTD_{i,t} (TS_{i,t}) = \alpha_0 + \alpha_1 SME_{i,t} + \alpha_2 SIZE_{i,t} + \alpha_3 ROA_{i,t} + \alpha_4 LEV_{i,t} + \alpha_5 CFO_{i,t} + \alpha_6 PPE_{i,t} + \alpha_7 RNDS_{i,t} + \alpha_8 GS_{i,t} + \alpha_9 ES_{i,t} + \sum YD + \sum IND + e_{i,t} \quad (\text{Eq.2})$$

3.3 Composition of sample

This paper select sample of 9,834 firms among listed firms on Korea Exchange from 2008 to 2013 excluding firms that meet the following criteria:

- Firms in financial industry or closing dates of those are December.
- Firms with capital encroachment or under supervision.
- Firms of which taxable income is unknown from footnotes of audited *statement*.
- Firms with unstructured KEJI index or those with uncollectable data.

4 Empirical Results

4.2 Regression Analysis

4.2.1 Regression of tax avoidance between SME and non-SME

<Table 1> demonstrate the empirical analysis result of whether tax avoidance is associated with being categorized as SME by discerning the year that the firm went public.

Table 1. Regression of tax avoidance on being SME

$$BT D_{i,t} (TS_{i,t}) = \alpha_0 + \alpha_1 SME_{i,t} + \alpha_2 SIZE_{i,t} + \alpha_3 ROA_{i,t} + \alpha_4 LEV_{i,t} + \alpha_5 CFO_{i,t} + \alpha_6 PPE_{i,t} + \alpha_7 RNDS_{i,t} + \alpha_8 GS_{i,t} + \alpha_9 ES_{i,t} + \Sigma YD + \Sigma IND + e_{i,t}$$

Variabl <i>e</i>	<i>In the year listed</i>				<i>total sample period</i>			
	<i>BT D</i>		<i>TS</i>		<i>BT D</i>		<i>TS</i>	
	<i>Coef</i> <i>f.</i>	<i>t(p-</i> <i>value)</i>	<i>Coef</i> <i>f.</i>	<i>t(p-</i> <i>value)</i>	<i>Coef</i> <i>f.</i>	<i>t(p-</i> <i>value)</i>	<i>Coef</i> <i>f.</i>	<i>t(p-</i> <i>value)</i>
<i>Interce</i> <i>pt</i>	- 0.13 6	- 3.419** *	- 0.10 5	- 3.518** *	- 0.18 4	-1.784*	- 0.13 3	-1.404
<i>SME</i>	0.06 2	2.976** *	0.06 5	4.101** *	0.01 3	1.036	0.00 2	0.214
<i>SIZE</i>	0.00 5	3.131** *	0.00 3	2.245**	0.00 7	1.711*	0.00 4	1.019
<i>ROA</i>	0.90 4	54.093* **	0.50 0	30.277* **	0.59 7	24.835* **	0.19 6	8.842** *
<i>LEV</i>	-	-	-	-	-	-1.807*	-	-1.131

	0.23 0	6.181** *	0.16 6	5.909** *	0.06 0		0.03 5	
<i>CFO</i>	0.58 7	14.257* **	0.68 2	21.953* **	0.15 6	5.453** *	0.65 8	25.046* **
<i>PPE</i>	- 0.02 9	- -0.976	- 0.01 4	- -0.639	0.02 4	0.772	0.00 5	0.182
<i>RNDS</i>	- 0.03 4	- 3.674** *	- 0.02 5	- 3.679** *	0.04 1	0.898	0.02 7	0.643
<i>GS</i>	0.01 4	3.285** *	0.01 3	2.990** *	0.00 7	6.630** *	0.00 7	7.392** *
<i>ES</i>	0.01 8	1.160	0.01 3	1.138	- 0.00 8	-0.489	- 0.01 0	-0.644
<i>YD</i>	<i>Included</i>		<i>Included</i>		<i>Included</i>		<i>Included</i>	
<i>N</i>	1,639		1,639		9,834		9,834	
<i>Adj. R²</i>	0.198		0.310		0.787		0.791	
<i>F-value</i>	46.963 (0.000)***		84.610 (0.000)***		130.632 (0.000)***		133.756 (0.000)***	

5 Conclusion

We figure that present study, which delve into AS-SME and tax avoidance of SME is duly conducted as there have been legislation of AS-SME and aids to facilitate listing of SME. This paper offers comprehensive understanding of AS-SME intended to easily and clearly form financial standards for small SME. Also analyses on

motivations of SME to avoid tax despite less tax burden from tax aids and benefits, are conducted to provide implications for SME supporting policy.

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