
SARBANES OXLEY ACT AND TAXATION: A STUDY OF THE EFFECTS ON THE TAX AGGRESSIVENESS OF BRAZILIAN FIRMS

Antonio Lopo Martinez ¹
Alexandre Castro Ribeiro ²
Bruno Funchal ³

▪ Artigo recebido em: 28/11/2017 ▪ Artigo aceito em: 15/06/2019 ▪▪ Segunda versão aceita em: 12/07/2019

ABSTRACT

This paper investigates the effects of the Sarbanes-Oxley Act (SOX) on the tax aggressiveness of Brazilian firms that issued American Depositary Receipts (ADRs), in the period between 2004 and 2012. The aim was to investigate whether the improvement of internal controls promoted by the adoption of SOX would have any impact on the propensity to be more tax aggressive. In an environment of better internal controls, we would have more reliable information, restricting more abusive tax practices. We measured tax aggressiveness according to the effective tax rate (ETR), long-run cash effective tax rate (CASH ETR) and the difference between book income and taxable income (BTD). We compared listed Brazilian firms with ADRs (treatment group) in comparison with their peer firms only listed in Brazil, or issuers of lower level ADRs not subject to SOX (control group). The results indicate that the implementation of more stringent internal controls does not inhibit the aggressive tax practices of Brazilian firms. This study contributes to the literature on long-run tax avoidance causes and internal controls disclosures in developing countries. This research is relevant by providing some clues, in a sophisticated informational environment, the effects of a substantial improvement of internal controls would have in the tax behavior of public companies. Identifying whether, for these Brazilian companies with stock trading in the US, there would be significant modifications, after the adoption of the SOX.

Keywords: Sarbanes Oxley Act; tax aggressiveness; internal controls.

LEI SARBANES OXLEY E TRIBUTAÇÃO: UM ESTUDO DOS EFEITOS SOBRE A AGRESSIVIDADE TRIBUTÁRIA DAS FIRMAS BRASILEIRAS

¹ Doutorando em Direito, Universidade de Coimbra / Universidad de Salamanca, Visiting Researcher na Georgetown University Law Center. 600 New Jersey Ave NW, Washington, DC, antoniolopomartinez@gmail.com. Tel +1 202 662-9000.

² Mestre em Contabilidade pela Fucape Business School. . Contador da LBH Brasi. Av. Fernando Ferrari 1358 IBoa Vista, Vitória/ES., alexandre.castro@lbhbrasil.com.br . + 55 27 4009-4444.

³ Doutor em Economia FGV Rio, Professor titular da Fucape Business School, Av. Fernando Ferrari 1358. Boa Vista, Vitória/ES. bruno@fucape.br. + 55 27 4009-4444.

RESUMO

Este artigo investiga os efeitos da lei Sarbanes-Oxley (SOX) sobre a agressividade tributária das firmas brasileiras que emitiram American Depositary Receipts (ADRs), no período entre 2004 e 2012. O objetivo foi investigar se a melhoria dos controles internos promovidos pela adoção do SOX teria qualquer impacto sobre a propensão a ser mais agressivo. Em um ambiente de melhores controles internos, teríamos informações mais confiáveis, restringindo práticas fiscais mais abusivas. Medimos a agressividade tributária de acordo com a alíquota efetiva de imposto (ETR), a taxa efetiva de imposto em dinheiro de longa duração (CASH ETR) e a diferença entre a renda contábil e o rendimento tributável (BTD). Comparamos as empresas brasileiras listadas com ADRs (grupo de tratamento) em comparação com suas firmas de peer listadas apenas no Brasil, ou emissores de ADRs de nível inferior não sujeitos a SOX (grupo controle). Os resultados indicam que a implementação de controles internos mais rigorosos não inibe as práticas fiscais agressivas das firmas brasileiras. Este estudo contribui para a literatura sobre causas de agressividade tributária de longo prazo e divulgações de controles internos nos países em desenvolvimento. Esta pesquisa é relevante, fornecendo algumas pistas, em um ambiente informativo sofisticado, dos efeitos de uma melhoria substancial dos controles internos teriam no comportamento tributário das empresas públicas. Identificando se, para essas empresas brasileiras com negociação de ações nos EUA, haveria modificações significativas, após a adoção do SOX.

Palavras-chave: Lei Sarbanes Oxley; agressividade tributária; controles internos.

SARBANES OXLEY LEY Y TRIBUTACIÓN: UN ESTUDIO DE LOS EFECTOS SOBRE LA AGRESIVIDAD FISCAL DE LAS EMPRESAS BRASILEÑAS

RESUMEN

Este documento investiga los efectos de la Ley Sarbanes-Oxley (SOX) en la agresividad fiscal de las empresas brasileñas que emitieron Recibos Depositarios Americanos (ADRs), en el período comprendido entre 2004 y 2012. El objetivo era investigar si la mejora de los controles internos promovidos por la adopción de SOX tendría algún impacto en la propensión a ser más agresiva fiscalmente. En un entorno de mejores controles internos, tendríamos información más fiable, restringiendo prácticas fiscales más abusivas. Medimos la agresividad fiscal de acuerdo con la tasa de impuesto efectiva (ETR), la tasa de impuesto efectiva a largo plazo (CASH ETR) y la diferencia entre los lucros contables y los lucros imponibles (BTD). Comparamos las empresas brasileñas cotizadas con las ADR (grupo de tratamiento) en comparación con sus empresas pares que solo cotizan en Brasil, o emissores de ADR de menor nivel que no están sujetos a SOX (grupo de control). Los resultados indican que la aplicación de controles internos más estrictos no inibe las prácticas fiscales agresivas de las empresas brasileñas. Este estudio contribuye a la literatura sobre las causas de la evasión fiscal a largo plazo y las divulgaciones de controles internos en los países en desarrollo. Esta

investigación es relevante proporcionando algunas pistas, en un entorno informativo sofisticado, los efectos de una mejora sustancial de los controles internos tendrían en el comportamiento fiscal de las empresas públicas. Identificar si, para estas empresas brasileñas con negociación de acciones en los Estados Unidos, habría modificaciones significativas, después de la adopción del SOX.

Palabras clave: Sarbanes Oxley Act; agresividad fiscal; controles internos.

1 INTRODUCTION

Tax governance is associated with good tax management practices, involving lawful tax planning, or legitimate tax avoidance, achieved through a set of management procedures with the objective of improving control and revising procedures to reduce tax expenses without raising the risk of being audited, as well as to increase the transparency, trustworthiness and reliability of the financial statements (Martinez, 2017).

The tax aggressiveness is a topic of increasing interest in accounting literature, with a view to highlighting in recent years faced with a combination of political and economic factors, which have driven the focus of interest to corporate decisions, particularly as Tax (Guenther, Matsunaga & Willians, 2017).

The theme of tax governance has gained greater importance with the movement toward improved overall corporate governance practices after the fraud scandals that emerged in the United States in the early 2000s (especially Enron and WorldCom). The unexpected bankruptcies of these two companies as well as the former's auditor, Arthur Andersen, revealed severe governance problems and acted as sparkplugs to pressure regulators and lawmakers into establishing stricter rules. Chief among these was the Sarbanes-Oxley Act. While the combination of this law and more rigorous regulatory rules has brought many benefits (Holmstrom & Kaplan, 2003), it also has imposed added costs (Engel, Hayes & Wang, 2007). The main cost is for compliance with the more stringent rules on internal controls and auditing, while the improved corporate governance has brought several direct and indirect benefits (Funchal & Monte-Mor, 2011).

Therefore, we aim to analyze the potential effect of the Sarbanes Oxley Act on Brazilian firms' tax management practices. Two specific situations motivated this aim. First, SOX is a rigorous corporate governance mechanism, and second, Brazil's tax system is very complex, and the weight of taxes on the cost structure of firms and the business environment, in general, is considered very high.

The purpose was to investigate whether the improvement of internal controls promoted by the adoption of SOX would have any impact on the propensity to be more tax aggressive. In an environment of better internal controls, we would have more reliable information, restricting more abusive tax practices.

Another aspect that demands the existence of adequate internal controls is related to the legality of its actions because, while a manager can act according to his interests, it can act now in the best interest of shareholders (agency problem). There are several objectives for the internal control system: the pursuit of efficiency, through the guaranteed achievement of results through the fulfillment of plans, goals, and budgets; The safety and quality of information;

protection of reputation and avoid illegal acts, such as to incur in tax evasion. So, it is a reason to investigate if a substantial improvement in internal control has an impact on tax aggressiveness.

This leads to a question: Could the Sarbanes Oxley Act influence the tax management of Brazilian firms that are subject to its rules (because of issuing level 2 or 3 ADRs)?

Just as in the case of corporate governance, better tax management or governance practices aim to improve the transparency of information supplied to stockholders and the market, with the difference being that the focus is on tax information, which necessarily includes accounting data. Therefore, tax governance is a sub-category of corporate governance, and SOX, by establishing more rigorous overall governance rules, could have impacted tax management.

In this context, we aim to look for empirical evidence of a relationship between SOX and tax management by Brazilian firms. For this purpose, we compared listed Brazilian firms with level 2 or 3 ADRs (treatment group) in comparison with their peer firms only listed in Brazil, or issuers of lower level ADRs not subject to SOX (control group). We also analyzed the two groups of firms separately in the period before and after the inclusion of Section 404 in the Act, which made it mandatory for foreign companies in 2006.

We measured tax aggressiveness with three tax avoidance metrics commonly used in the literature (e.g., Hanlon & Heitzman, 2010): the effective tax rate (ETR), long-run cash effective tax rate (CASH ETR) and book-tax differences (BTD).

This research is relevant because it offers some clues, in a sophisticated informational environment, the effects of a substantial improvement of internal controls would have in the tax behavior of public companies. It is identifying whether, for these Brazilian companies with stock shares traded in the US, there would be significant modifications, after the adoption of the SOX.

The rest of the paper will discuss the literature on this topic. After this it will be presented the methodology, following by the analyses de results and discussion. Finally, the conclusion is presented.

2 REVIEW OF THE LITERATURE

According to Zingales et al. (2010), the large and numerous corporate fraud scandals that occurred in the United States shortly after the turn of the century prompted Congress to enact the Sarbanes-Oxley Act (SOX). As argued by Zhao and Zeibart (2015), SOX is the most significant reform of corporate law in the history of the United States, with the primary objective of protecting investors by improving the precision and reliability of the financial information disclosed by listed corporations. One of these mechanisms is the requirement to create internal committees to assure better independence of external auditing and more accountability of directors and officers for the financial information disclosed, thus enhancing transparency.

2.1 SOX, Corporate Governance and Tax Aggressiveness

The various rules of SOX apply to listed not only American firms but also to foreign companies that issue ADRs. This applies to foreign companies is established

in Section 404 of the law, applicable as of 2006. The importance of Section 404 is that it sets the bar higher regarding financial disclosures and internal management controls, to assure better efficacy of these controls and more independence of the audit process, thus making financial data more reliable (Bryen & Lilien, 2005).

Since the objective of this paper is to investigate the effects of SOX on the tax aggressiveness of Brazilian firms, it is first necessary to understand the relationship of SOX with corporate governance and tax aggressiveness. According to Funchal and Monte-Mor (2016), the Sarbanes-Oxley Act, also known as the "Company Accounting Reform and Investor Protection Act," imposed stricter rules on executive compensation and accountability, internal controls, and punishment of fraud, besides strengthening monitoring by shareholders. These changes induced more conservative behavior by managers, mitigating negligent behavior and moral hazard, such as by inhibiting risky investment decisions with the primary aim of increasing personal gains. This greater conservatism also reduces the propensity of manipulating the financial statements, and consequently, the numbers revealed to the market and indirectly has an influence on stock prices (Sundvik, 2017).

Further according to Funchal and Mont-Mor (2016), the law includes various provisions intended to improve monitoring by the board of directors, primarily to increase the power, responsibility and independence of the audit committee (it is charged with hiring the independent auditors, and it must be formed of at least three directors who meet the law's independence requirements). These stricter monitoring requirements reduce the chances of moral hazard problems and opportunistic behavior.

Finally, SOX increased the potential liability of the officers, by imposing severe criminal penalties on the CEO and CFO for misconduct, thus inducing less opportunistic behavior by managers, raising the "cost of wrongdoing." In short, the requirements imposed by SOX induce an improvement in corporate governance (Henry, Massel & Towery, 2016)

According to Correia and Amaral (2006), there is no single universal definition of corporate governance, although virtually all scholars of the theme consider good governance fundamental for companies to act in line with the interests of their shareholders, mainly the financial interests.

About tax aggressiveness, Machado (2011) states that the aim of tax management is, through legal forms, to reduce the tax burden of companies, to improve their performance and market value. Desai and Dharmapala (2006) describe tax management as a mechanism for legal transfer of resources from the government to companies by lowering the tax bill. In this same line of reasoning, Bankman (1999), Graham and Tucker (2006) and Wilson (2009) state that tax management is an activity that creates value for shareholders.

Therefore, the connection between corporate governance and tax aggressiveness is the common objective of increasing the firm's value, by maximizing its performance. Hanlon and Slemrod (2007) corroborate this affirmation because the lower the tax burden, the more profits there will be to distribute to stockholders and the more valuable their shares will be. However, some studies have found evidence that managers often use opportunistic artifices to minimize the tax burden, i.e., they behave too aggressively.

Desai and Dharmarpala (2008) discuss how corporate governance and tax management mechanisms can interact to the detriment of firms. The basic

intuition in this respect is that the search for efficient tax management can encourage the adoption of complex and obscure structures that contribute to opportunistic behavior in pursuit of interests that do not favor those of shareholders. As in other situations of potentially conflicting interests, the agency problem applies here (Watts & Zimmerman, 1986; Fields, Lyz & Vicent, 2001; Shackelford & Shelvin, 2001).

Some studies have found evidence of a relationship between corporate governance and tax aggressiveness. For instance, Desai, Dyck, and Zingales (2007) analyzed the interaction between the tax burden and corporate governance, finding that the characteristics of a tax system affect the extraction of private benefits by members of the company. Further, according to them, a higher tax burden indicates worse governance and increases the probability that managers will divert income into their pockets. On the other hand, despite the increase in the tax burden, stronger tax enforcement by the government can reduce the chance for diversion of funds within the firm, and by doing so increase the market value. The system of corporate governance affects the level of taxable income. When corporate governance is ineffective (or when it is easy to divert income), an increase in the tax rate can lead to a reduction in taxable income. The above authors tested this prediction in a panel of countries. According to the model, they identified that an increase in the corporate tax rate has a lower impact on tax revenues when corporate governance is weak.

Wilson (2009) examined whether the use of tax havens is associated with effective tax planning that generates wealth for shareholders, or whether tax havens are used by managers to extract wealth from the company. The results indicated that firms that use tax sheltering together with strong corporate governance present positive abnormal return performance, while firms that use tax havens with weak corporate governance exhibit significantly lower abnormal returns. The findings also indicated that tax sheltering is a tool for wealth creation in well-governed firms, while the benefit of tax sheltering is attenuated in firms with weak governance.

Desai and Dharmapala (2009) tested alternative theories of tax avoidance using unexplained differences between income reported to the capital market and tax authorities. Their results indicated that the effect of tax avoidance on firm value is a function of corporate governance and that tax avoidance when combined with good governance practices increases firm value. Crocker and Slemrod (2005) examined tax planning practices together with the agency theory developed by Jensen and Meckling in 1976 and concluded that the penalties imposed on firms' CFO are more efficient in reducing tax evasion than those imposed on shareholders.

According to Owens (2008), questions of taxation and corporate governance are connected in various contexts. One set of issues is how to assure that taxation concerns do not encourage behavior that is contrary to the company's or stockholders' interests. Another set of questions is how to guarantee transparency and quality of decisions in the tax area, and how to ensure that management, shareholders and other stakeholders are aware of the stakes involved in managing taxes. For him, corporate governance depends on financial and tax rules and the institutional environment, and the evidence indicates a correlation between corporate governance and taxation.

Numerous business and accounting processes influence tax planning throughout an organization, which are often a source of internal control deficiencies. Therefore, performing tax services exposes the provider to areas outside of the tax function that impacts internal controls. This communication between the tax and audit partners allows the audit team to bring their expertise to bear earlier than if they only performed the financial statement and internal control audits. (De Simone, Ege & Stomberg, 2015).

Following Gallemore and Labro (2015) the role of the internal information environment in supporting more favorable tax outcomes. Information on tax planning decisions is based on the risk aspect from the tax avoidance measure, a requirement to define what it means to present tax aggressiveness.

Minnick and Noga (2010) analyzed how corporate governance influence long-term tax management as well as firms' profits. The results suggested that good corporate governance improves performance and firm value using tax management.

The papers mentioned above aimed to identify the existence or not of a correlation between corporate governance and taxation. Evaluating the relationship with the use of various mechanisms of corporate governance and on various aspects, such as the agency problem and conflict of interest, tax evasion, tax avoidance, the existence of tax havens, the nature, and environment of corporate governance, maximization of financial results and increase of firm value through tax management. All the authors aimed to contribute to the literature by shedding light on whether good corporate governance brings benefits from the tax standpoint (Bauer, 2016).

Investigating the consequence of new internal controls from the Sarbanes Oxley Act, influenced the tax aggressiveness of Brazilian firms is what makes this paper *sui generis*. The Brazilian setting is of particular interest due to the country's fragile institutional structure and low level of investor protection, combined with a heavy tax burden and complex and in many aspects unfair tax system. To do this, we compare Brazilian firms listed only in Brazil (on the B³) or issuers of level 1 or Rule 144-A ADRs and firms listed in Brazil that also issue level 2 or 3 ADRs. Hence, some brief explanation of this type of security is in order.

JP Morgan created the first depositary receipt (DR) in 1927 for the English retail chain store company Selfridges. The idea was that increasing globalization and the appetite of investors for diversification had created a favorable climate for such a program, enabling firms to broaden their base of investors and sources of capital. Although depositary receipt programs can be structured in a variety of ways, there are two basic options:

- i) American Depositary Receipts (ADRs), which allow international firms to access the capital market in the United States; and
- ii) Global Depositary Receipts (GDRs), which enable firms to tap sources of capital from the United States and other markets (typically in Europe).

There are four ADR levels: those that can only be placed privately with qualified institutional investors (Rule 144); those that can only be traded in over-the-counter markets (level 1, or OTC facility); those that are listed for exchange trading (level 2, or listing facility); and those involving floating a new public offering (level 3, or offering facility). Issuers of ADRs at levels 2 and 3 are subject to the SOX rules, meaning they must have higher levels of corporate governance.

2.2 Internal Controls and Taxation

Before SOX little attention was paid to tax internal controls, by the firm or its auditors. Following SOX, however, internal tax controls received significant attention within the firm. Disclosed issues within the tax function are highly frequent in SOX reports. Gleason et al. (2017) document that over one-third of SOX reports included in Audit Analytics identify tax-related Internal control Weakness. Despite their common nature and ongoing importance, analysis of tax-related internal control weaknesses is sparse within the academic literature.

Equally, important and under-studied are the implications of these frequent tax-related Internal controls. Gleason et al. (2017) investigate the implications for earnings quality. They report that in the year before disclosing a tax-related to internal control weakness, firms are more likely to reduce their ETR from the third to the fourth quarter to meet or beat earnings benchmarks relative to firms without such weak internal controls.

Gleason et al. (2017) are silent on the implications of tax-related weak internal controls for tax avoidance. Furthermore, although SOX focuses on financial controls, tax reporting is correct only when compliance is accurate, tax positions are appropriate, and book-tax differences are reconciled. Internal controls represent the governance mechanism that acts to align the interests of managers and shareholders.

If a firm does not invest in an adequate internal control system, all else equal, manager-shareholder alignment is weaker. However, the direction of the association between internal control weaknesses and tax avoidance, ex-ante, is unclear. Weak controls could fail to meet tax avoidance objectives, whereby tax avoidance would be lower.

In the following part is presented the methodology used to solve the main question in this research.

3 METHODOLOGY

Our sample, obtained from the Economática database, consists of 469 firms listed on the B3 between 2004 and 2012, with a total of 3,093 firm-year observations. We excluded financial institutions from the sample because they have different governance requirements and accounting rules. We divided the firms between those with and without ADRs and between those required and not required to follow the rules of the Sarbanes Oxley Act.

We used three metrics to measure tax management (aggressiveness): effective tax rate (ETR), long-run cash effective tax rate (CASH ETR) and book-tax differences (BTD), as proposed for the analysis of corporate tax avoidance by Hanlon and Heitzman (2010). According to Minnick and Noga (2010), ETR is a good measure of tax management because, as the name suggests, it measures the actual tax rate paid by companies.

In turn, Dyreng, Hanlon, and Maydew (2008) argued that CASH ETR is a better proxy to measure right tax planning over the long run because it considers not only the actual taxes paid in the current year but also the effects of deferred taxes or tax credits in future years.

Hanlon and Heitzman (2010) define book-tax differences (BTD) as the difference between book or accounting income and taxable income. This

difference can arise because the taxable income is subject to different rules than accounting income so that companies can legitimately report different values.

Another relevant aspect of BTM, according to Tang et al. (2010) is its ability to measure the quality of profits, due to its ability to serve as a proxy for opportunistic management behavior. In other words, BTM can be used as a metric both of earnings management and tax management. For this reason, Halon and Heitzman (2010) claim it is one of the most important themes in the literature.

Chart 1: Metrics and calculations

Metrics	Calculation	Objective
Effective Tax Rate – ETR	$ETR = \text{Tax expenses} / \text{EBIT}$	Captures the ratio of tax expenses to pretax earnings.
Cash Effective Tax Rate – CASH ETR	$CASH ETR = \frac{\sum \text{Tax Expenses}}{\sum \text{EBIT}}$	Captures the long-term effective tax rate (every three years during nine years)
Book-Tax Differences – BTM	$BTM = \text{EBIT} - \text{Taxable Income}$	Captures the difference between book income (pretax earnings) and taxable income.

Note: Taxable income is calculated as the ratio between tax expenses and the nominal corporate tax rate (34%).

We divided our sample into two groups, the treatment group (issuers of level 2 and 3 ADRs, which are subject to the SOX rules), and the control group (issuers of level 1 and Rule 144-A ADRs and firms without ADRs, which are not subject to SOX).

Table 1: Frequency of firms regarding ADRs

	Frequency	Percentage
ADR levels 2 and 3	260	8.40%
144-A ADRs	382	12.35%
Non-issuers	2,451	79.24%
Total	3,093	100%

Source: Prepared by the authors.

The hypotheses tested here are:

- H_0 . a – The SOX has no relationship with the effective tax rate.
- H_0 . b – The SOX has no relationship with the long-run cash effective tax rate.
- H_0 . c – The SOX has no relationship with the difference between book-taxable income.

The corresponding models are mathematically described as:

$$ETR_{it} = \alpha_{it} + \varphi_t + \beta adr_{it} + \delta_1 adr. sox + \delta_2 pl_{it} + \delta_3 roa_{it} + \delta_4 rec_{it} + \delta_5 at_{it} + \varepsilon_{it} \quad (1)$$

$$CASH ETR_{it} = \alpha_{it} + \varphi_t + \beta adr_{it} + \delta_1 adr. sox + \delta_2 pl_{it} + \delta_3 roa_{it} + \delta_4 rec_{it} + \delta_5 at_{it} + \varepsilon_{it} \quad (2)$$

$$BTM_{it} = \alpha_{it} + \varphi_t + \beta adr_{it} + \delta_1 adr. sox + \delta_2 pl_{it} + \delta_3 roa_{it} + \delta_4 rec_{it} + \delta_5 at_{it} + \varepsilon_{it} \quad (3)$$

Where:

- ETR = effective tax rate, the dependent variable of the model;
- CASH ETR = long-run effective tax rate, the dependent variable of the model;
- BTM = the difference between book income and taxable income, the dependent variable of the model;
- α_i = the fixed effect estimated for each company independent of time;
- $adr_{it} = 1$ if the company issued ADRs in period t and zero otherwise;

- $SOX_t = 1$ after 2007 and zero otherwise.

To observe the shock, we took into consideration Section 404 of SOX, which covers the requirement for reports on internal controls and also made SOX mandatory for foreign companies with securities traded on exchanges in the United States starting in 2006. Therefore, the experiment considering SOX starts in 2006.

We used the following control variables in the model:

bv = book value of equity;

roa = return on assets;

rev = gross revenue;

ta = value of total assets;

ϵ = error term.

4 RESULTS

This section investigates the correlation between ETR, CASH ETR and BTD on the one hand and the effectiveness of SOX on the other.

Table 2: Results of the tests – ETR

Number of observations	3090			
F(451, 2608)	0.000			
Prob > F	0.000			
R ²	0.1447			
Standard error	27.977			
ETR-tax	Coeff.	Standard error.	T	P>t
ADR.SOX	-2.11539	1.678039	-1.26	0.208
ADR	0.763594	1.827992	0.42	0.676
BE	3.07E-09	1.21E-08	0.25	0.8
Total revenue	-2.47E-09	2.45E-08	-0.1	0.92
ROA	7.98E-06	3.21E-05	0.25	0.804
Total assets	-1.79E-09	5.02E-09	-0.36	0.721

Table 3: Results of the tests – CASH ETR

Number of observations	1059			
F(361, 616)	0.000			
Prob > F	0.000			
R ²	0.3441			
Standard error	61.314			
CashETR-tax	Coeff.	Standard error	t	P>t
ADR.SOX	5.701953	5.386748	1.06	0.29
ADR	3.327536	3.119968	1.07	0.287
BE	-5.19E-08	6.47E-08	-0.8	0.423
Total revenue	9.30E-08	1.43E-07	0.65	0.516
ROA	3.64E-05	0.000164	0.22	0.824
Total assets	1.67E-08	1.91E-08	0.87	0.382

Table 4: Results of the tests – BTD

Number of observations	3091			
F(361, 616)	0.000			
Prob > F	0.000			
R ²	0.6657			
Standard error	64.000			
Btd-tax	Coeff.	Standard error	T	P>t
ADR.SOX	185575.8	204211.7	0.91	0.364
ADR	-91364.96	51765.26	-1.76	0.078
BE	0.0087374	0.033168	0.26	0.792
Total revenue	-0.016223	0.023368	-0.69	0.488
ROA	4.829284	2.335846	2.07	0.039
Total assets	0.021045	0.020426	1.03	0.303

The results of Tables 2, 3 and 4 for the models with the inclusion of SOX, aiming to observe an exogenous shock in corporate governance levels, indicate that the relations between issuance of level 2 or 3 ADRs (representing a higher level of corporate governance) and the tax aggressiveness measures ETR, CASH ETR and BTD are not statistically significant. Therefore, even though there is a causality effect of the impact of SOX on the firms studied, there is no evidence that the enhanced corporate governance required by the Act influenced the tax aggressiveness of Brazilian firms according to the tax management metrics applied in the model. In short, the model proposed here points to no statistically significant effect of SOX on these three tax management metrics.

These results run counter to the theory proposed by most authors in the literature, as summarized here. A possible explanation for this is that most of the firms in the sample that were subject to SOX were listed for trading in premium segments of the B³ that require stronger governance. They already had better tax governance than their peers not subject to SOX (of which a much smaller percentage were listed for trading in the enhanced governance segments). Another is that perhaps the tax management metrics applied here are independent of whether firms have a high level of corporate governance.

To confirm the results of the model, we also performed a robustness test. The sample used in this test was taken from the databases of the magazine *Exame Melhores e Maiores* and of FIPECAFI. That sample contained 246 companies that disclosed consolidated statements of value added (SVAs) in the period from 2005 to 2009. This sample included both listed and unlisted firms, unlike the primary sample, which only contained publicly traded companies.

Just as in the first sample, we divided the firms between that subject and not subject to the Sarbanes Oxley Act and excluded financial institutions. In this test, we used a new metric to measure tax management, the amount of taxes paid as indicated in the SVA.

According to Law 11,638/2007, the SVA became a mandatory statement for listed companies starting in 2008, although many firms both listed and unlisted, started publishing this statement beforehand (the purpose of the law was to bring Brazilian accounting standards into convergence with IASB, by amending the Law

of Corporations). The objective of this statement is to demonstrate how companies' activities contribute to the economic and social development of the regions where they operate, by disclosing the wealth generated and its allocation. For our purposes, the information of interest is the allocation of taxes paid to the municipal, state and federal governments, which enables measurement of the tax burden.

Chart 2: Metric and calculation of the robustness test.

Metric	Calculation	Objective
SVA – Statement of Value Added	SVA = Value added paid to society in the form of taxes / Total value added	To capture the total tax burden of each firm.

Table 5: Frequency of firms regarding ADRs

	Frequency	Percentage
ADR levels 2 or 3	84	12%
Rule 144-A ADRs	98	13%
Non-issuers	548	75%
Total	730	100%

Source: Prepared by the authors

The null hypothesis tested in the robustness test is:

H_0 – The Sarbanes Oxley Act does not have any relationship with the allocation of value added to society in the form of taxes.

The following equation can describe the corresponding model:

$$DVA_{it} = \alpha_{it} + \varphi_t + \beta adr_{it} + \delta_1 adr. sox + \delta_2 pl_{it} + \delta_3 roa_{it} + \delta_4 rev_{it} + \varepsilon_{it} \quad (4)$$

Where:

- SVA = the dependent variable of the model: the percentage of value added from payment of taxes concerning the total distribution of value added;
- adr_{it} = 1 if firm i issued ADRs in period t and zero otherwise;
- SOX_t = 1 after 2007 and zero otherwise.

As before, to observe the shock we considered Section 404 of SOX, which covers the requirement for reports on internal controls and also made SOX mandatory for foreign companies with securities traded on exchanges in the United States starting in 2006. Therefore, the experiment considering SOX starts in 2006.

The control variables were the same as those used in the previous tests:

bv = book value of equity;

roa = return on assets;

rev = gross revenue;

ta = value of total assets;

ϵ = error term, for which we assumed mean zero and constant variance among the units examined.

In this section, we present the correlation between the value added to society in the form of taxes and the application of SOX to Brazilian firms.

Table 6: Results of the tests – SVA

Number of observations	725			
F(229,490)	5.10			
Prob > F	0.000			
R ²	0, 1342			
Standard error	17,870			
Dva-tax	Coeff.	Standard error	T	P>t
SOX-ADR 2,3	-0.3901890	0.0520808	-0.75	0.454
BE	1.23E-08	6.25E-09	1.96	0.05
Total assets	-5.70E-09	3.69E-09	-1.54	0.124
Total revenue	-1.97E-09	3.92E-09	-0.5	0.616
ROA	-0. 7120841	0. 0766562	-9.29	0

According to the results in Table 6, from testing the model with the inclusion of SOX to observe an exogenous shock on the firms' governance levels, the relationship between issuing level 2 or 3 ADRs (representing enhanced governance) and the dependent variable of tax management (SVA) is not statistically significant. Therefore, once again no causality effect of SOX on the companies studied here can be detected, meaning no evidence being subject to SOX influenced the tax aggressiveness of firms, represented by the tax payments revealed in the SVA.

To summarize, the model proposed here indicates that the relationship between the Sarbanes-Oxley Act and the measure of tax aggressiveness proposed in this robustness test is not statistically significant. A possible explanation for this finding is that the sample was drawn from the 500 largest firms in Brazil, which may have already had good tax governance and internal controls so that SOX did not have a sufficiently significant effect.

5 CONCLUSIONS

The primary objective of this article was to verify the existence of a relationship between subjection of listed Brazilian firms to the rules of the Sarbanes Oxley Act, meaning higher corporate governance levels, and the firms' tax aggressiveness. For this purpose, we applied a regression model with the dependent variables ETR, CASH ETR and BTD, and independent dummy variables to indicate groups of firms affected and not affected by SOX, along with the control variables total assets, total revenue, the book value of equity and return on assets.

The primary justification for this study is the high tax burden in Brazil and the country's complex and in many respects unfair tax legislation. Another justification is the weak institutional structure in Brazil, with weak investor protection, providing an excellent setting to investigate whether firms with high governance levels obtain benefits from a tax standpoint because of higher information quality regarding their tax and accounting results, a feature directly linked to the quality of earnings. In the final analysis, this investigation sheds light on to what extent better corporate governance enhances the creation of value for shareholders through tax management.

The aim was to investigate whether the improvement of internal controls promoted by the adoption of SOX would have any impact on the propensity to be more tax aggressive. In an environment of better internal controls, we would have more reliable information, restricting more abusive tax practices.

The results point to a weak relationship between subsection to SOX because of issuance of level 2 or 3 ADRs and the tax aggressiveness metrics employed. In other words, we did not find evidence of an influence on tax aggressiveness, measured by the metrics ETR, CASH-ETR, and BTM, of having good practices of corporate governance.

To confirm these results, we also applied a robustness test, using as a metric of tax management the amount of taxes reported by firms in the statement of value added (SVA). The results of this robustness test confirmed the results of the significant test, also showing no statistically significant relationship between subject to SOX and allocation of added value to society in the form of tax payments.

This might have occurred because the sample in the primary test was composed of publicly traded companies, and most of those subject to SOX (by issuing level 2 and 3 ADRs) were listed in premium governance segments of the B3, while in the case of the robustness test, the firms were drawn from among the 500 largest in Brazil. In both cases, the sample concerning firms subject to SOX was perhaps biased toward firms with good overall governance and tax governance, so that the additional effect of SOX was not sufficiently significant.

These results (both the main ones and those of the robustness test) run contrary to the generally accepted theory. A possible explanation is that the quality of tax management, as measured by the effective tax rate, the long-run cash effective tax rate, book-tax differences and allocation of added value to tax payments, is independent of having better corporate governance.

These results are of course limited to the firms studied, here and the unique features of the Brazilian institutional landscape regarding accounting rules and tax laws, so it is not possible to generalize the results to other groups of companies or other settings. Finally, it is not possible to conclude that having better governance by being subject to SOX influences tax management because the results presented do not prove this hypothesis.

In practical terms, there is no way to affirm that the existence of better internal controls resulting from the rules in the Sarbanes-Oxley Act would alter the tax aggressiveness profile of the sampled firms in the years studied. To sum up, despite the strong empirical evidence that better internal controls improve the quality of accounting results, these rules alone did not appear to have a significant effect in reducing the tax aggressiveness of the firms during the period studied. Firms with better and more sophisticated internal controls do not seem to be significantly likely to be less aggressive in their tax management.

REFERENCES

- Bankman, J. (1999) The new market in corporate tax shelters. *Tax Notes* 83: 1775-1794.
- Bauer, A. M. (2016) Tax Avoidance and the Implications of Weak Internal Controls. *Contemporary Accounting Research*, 33(2), 449–486.

- Correia, L. F. & Amaral, H.F. (2006) Reflexão das funções da governança corporativa. *Revista de Gestão USP*, São Paulo, 13(1): 43-55.
- Crocker, K. & Slemrod, J. (2005) Corporate tax evasion with agency costs. *Journal of Public Economics*, 89(9-10): 1593-1610.
- Desai, A., Dyck, A., & Zingales, L. (2007) Theft and taxes. *Journal of Financial Economics*, 84(3): 591-623.
- Desai, M. & Daharmapala, D. (2006). Corporate tax avoidance and high-powered incentives. *Journal of Financial Economics*, 79(1): 145-179.
- Desai, M. A. & Dharmapala, D. (2008) Tax and Corporate Governance: An Economic Approach. In: SCHÖN, W. (Ed.). *Tax and Corporate Governance*. Berlin, Heidelberg: Springer Berlin Heidelberg, v. 3p. 13-30.
- Desai, M. A. & Daharmapala, D. (2009) Corporate tax avoidance and firm value. *Review of Economics and Statistics*, 91(3): 537-546.
- De Simone, L., Ege, M. S., & Stomberg, B. (2015) Internal control quality: the role of auditor-provided tax services. *The Accounting Review*, v. 90, n. 4, p. 1469-1496.
- Dyck A., Morse A. & Zingales L. (2010) Who blows the whistle on corporate fraud? *The Journal of Finance*, 65(6): 2213-2253.
- Dyreg, S., Hanlon, M., & Maydew, E. (2008) Long-run corporate tax avoidance. *The Accounting Review*, 8(1): 61-82.
- Engel, E., Hayes, R. M., & Wang, X. (2007) The Sarbanes-Oxley Act and firms' going-private decisions. *Journal of Accounting and Economics*, 44(1/2): 116-1145.
- Fields, T. D., Lys, T. Z., & Vicent, L. (2001) Empirical research on accounting choice. *Journal of Accounting & Economics*, 31(1-3): 255-307.
- Funchal, B. & Monte-Mor, D. S. (2016) Corporate Governance and Credit Access in Brazil: The Sarbanes-Oxley Act as a Natural Experiment: Corporate Governance and Credit Access. *Corporate Governance: An International Review*, v. 24, n. 5, p. 528-547.
- Gallemore, J. & Labro, E. (2015) The importance of the internal information environment for tax avoidance. *Journal of Accounting and Economics*, v. 60, n. 1, p. 149-167.
- Gleason, C. A., Pincus, M., & Rego, S. O. (2017) Material Weaknesses in Tax-Related Internal Controls and Last Chance Earnings Management. *The Journal of the American Taxation Association*. v. 39, No. 1, pp. 25-44.
- Graham, J. & Tucker, A. (2006) Tax shelters and corporate debt policy. *Journal of Financial Economics*, 81(3): 563-594.
- Guenther, D. A., Matsunaga, S. R., & Williams, B. M. (2017) Is Tax Avoidance Related to Firm Risk? *The Accounting Review*, 92(1), 115-136.
- Hanlon, M. & Heitzman, S. A. (2010) Review of tax research. *Journal of Accounting and Economics*, 50(2/3): 127-178.
- Hanlon, M., Heitzman, S., & Slemrod, J. (2007) What does tax aggressiveness signal? Evidence from stock price reactions to news about tax aggressiveness. *SSRN Working Paper*, University of Michigan.

- Henry, E., Massel, N., & Towery E. (2016) Increased Tax Disclosures and Corporate Tax Avoidance. *National Tax Journal*, v. 69, n. 4, p. 809–830.
- Holmstrom, B. & Kabvean, S. N. (2003) The State of U.S corporate governance: What's right and what's wrong? *Journal of Applied Corporate Finance*, 15(3): 8-13. 2003.
- Machado, A. P. (2011) A verdadeira alíquota dos tributos incidentes sobre os lucros das empresas brasileiras. In: ENANPAD, 35., Rio de Janeiro (RJ). *Anais...* Rio de Janeiro: ANPAD.
- Martinez, A. L. (2017) Agressividade Tributária: um survey da literatura. *Revista de Educação e Pesquisa em Contabilidade*. V. 11, Edição Especial, p. 108-126.
- Minnick, K. & Noga, T. (2010) Do corporate governance characteristics influence tax management? *Journal of Corporate Finance*, 16(5): 703-718. 2010.
- Morgan J. P. (2013) *Find Out About ADR's*. *adr.com*, Available at <https://www.adr.com/Education/AboutDRs>, 2013.
- Owens, J. P. (2008) Good corporate governance: the tax dimension. *Tax and Corporate. MPI Studies on Intellectual Property, Competition and Tax Law*, 3: 9-12, 2008. Available at http://link.springer.com/chapter/10.1007%2F978-3-540-77276-7_2.
- SARBANES OXLEY ACT (2009) A guide to the Sarbanes-Oxley Act, Available at <http://www.soxlaw.com/>.
- Shackelford, D. A.; Shevlin, T. (2001) Empirical tax research in accounting. *Journal of Accounting and Economics*, 31(1-3): 321-387.
- Sundvik, D. (2017) Book-tax conformity and earnings management in response to tax rate cuts. *Journal of International Accounting, Auditing and Taxation*, 28, 31–42.
- Tang, T. & Michael, F. (2010) Can book tax differences capture earnings management? empirical evidence from China. *The International Journal of Accounting*.
- Watts, R. & Zimmerman J. (1986) *Positive Accounting Theory*. New Jersey: Prentice-Hall.
- Wilson, R. (2009) An examination of corporate tax shelter participants. *The Accounting Review*, 84(3): 969-999. 2009.
- Zhao, Q. & Ziebart, D. A. (2015) SOX and bondholders' reliance on monitors. *Research in Accounting Regulation*, v. 27, n. 2, p. 129–137.