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Reputational Costs as a Tax Avoidance Deterrent in Small to Medium Enterprises

Reputational concerns are considered a disincentive to tax avoidance. Prior literature examining tax avoidance in the context of large and listed firms attributes this relationship to the scrutiny to which large firms are subject. This begs the question if reputational concerns are a relevant tax avoidance deterrent in the setting of small to medium sized enterprises (SMEs) because SMEs have fewer stakeholders, lower disclosure requirements, and are subject to less media attention. Using survey data from Belgian SMEs, we find that SMEs with reputational concerns report an effective tax rate that is 8.57 percentage points higher than that of SMEs with low reputational concerns. We further examine which firm characteristics moderate the deterrent effect of reputational concerns on tax avoidance. We find that potential reputation damage is more important to the tax avoidance decision of firms with less financial freedom and firms with a higher need to maintain creditor relations. Finally, we document that reputational concerns act as a corporate tax avoidance deterrent against aggressive positions.

Key words: Reputation costs; Small to medium sized enterprises; Tax avoidance.

Reputational concerns are often put forward as an important disincentive for corporate tax avoidance (see Graham *et al.*, 2014; Hoopes *et al.*, 2018) since firms do not want to be perceived as not contributing their fair share to the economy (Bankman, 2004). The prior literature examining this relationship largely focuses on publicly listed firms because the tax behaviour of these firms is more observable to investors, stakeholders, and public authorities. The extent to which reputational concerns affect the tax behaviour of small to medium sized enterprises (SMEs) is less examined because of these firms' peculiar and opaque nature. This paper aims to fill this gap by studying how reputational concerns affect the tax strategy of SMEs.

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SMEs constitute 99% of all European firms and account for two-thirds of the total European turnover,[1] yet the tax behaviour of SMEs remains a largely under-explored subject. SMEs typically have fewer stakeholders, lower disclosure requirements, and receive less attention from the media (Beatty and Harris, 1999; Cloyd *et al*., 1996; Hall *et al*., 2004; Sen and Cowley, 2013), all of which permit SMEs to engage in more tax avoidance activities than their publicly listed counterparts. The potential to operate in such an opaque manner raises the question of whether reputational concerns are even a consideration in their tax planning strategy.

Reputational concerns can still be of importance, however, due to specific SME characteristics. First, while SMEs' tax payments are not as widely scrutinized by consumer groups as those from large visible firms, business clients are still incentivized to keep a close eye on the tax position of SMEs, and even distance themselves from tax aggressive firms. Tax authorities generally target tax avoidance schemes through supply chain agreements, such that business clients may attract unwanted attention from regulators if they are the client of a tax aggressive firm (Cen *et al*., 2017). This may even be aggravated as SMEs are characterized by a smaller and often localized client base (Quale, 2002; Sen and Cowley, 2013) such that they are more likely to lack resources to overcome potential tax avoidance-related client fallout (Buckley, 1989; Erramilli and D'Souza, 1993; Jenkins, 2006). Second, SMEs are often manager-owned, or financed by personal loans or loans of acquaintances, such that firm-related reputational costs are inherently linked to personal reputational costs (Badertscher *et al*., 2013; Cassar, 2011). Finally, SMEs can mitigate creditor distrust through the development of reputational capital as a signal of trustworthiness (Diamond, 1989), meaning damage to the reputational capital constitutes damage to the firm's financing options. Given the theoretical ambiguity, the purpose of this paper is to understand whether reputational concerns are relevant in a SME's tax planning strategy.

We employ a survey design to uncover information on the reputational concerns, tax avoidance efforts, and firm characteristics that are typically not available through public data, for 372 Belgian SMEs. We find that only a minority of SMEs express reputational concerns, which is consistent with the notion that SMEs face less scrutiny and have lower visibility. Yet, despite their low prevalence, reputational concerns still act as a sizable disincentive to tax avoidance. SMEs with reputational concerns report an effective tax rate that is 8.57 percentage points higher than that of firms without such concerns. Additionally, we find that financial freedom and the need to maintain creditor relations augment the importance of reputational concerns as a tax avoidance deterrent, yet personal ties between the firm and the management team do not appear to significantly moderate this relationship. These findings are robust to multiple model specifications. Lastly, we perform quantile regressions and examine tax aggressive behaviour. We document that reputational concerns

[1] This information is provided by the European Commission. More information on European SMEs can be found under the project 'Internal Market, Industry, Entrepreneurship and SMEs' at the European Commission's website: ec.europa.eu/growth/smes_en.

particularly act as a disincentive in the lower quantiles of the effective tax rate distribution and that customer-related reputational concerns significantly decrease the propensity of tax aggressiveness. These results indicate that reputational concerns are a deterrent to aggressive tax positions.

Our paper provides several contributions to the literature, the first of which is the study of tax avoidance in private firms, and in particular SMEs. Hanlon and Heitzman (2010, p 129) already argue that 'more work on privately held firms may be important beyond using them as a comparison group for publicly held firms. These firms have different ownership structures, different financial reporting incentives, and constitute a large portion of our economy'. We respond to this call because, to the best of our knowledge, we are the first to provide direct evidence concerning the importance of reputational concerns on the tax planning behaviour of small and medium enterprises.

Second, as indicated by Hoopes *et al.* (2018, p 146), 'empirical evidence on the reputational costs of tax avoidance is relatively scarce'. Our paper extends prior literature focusing on the public firm setting (Hanlon and Slemrod, 2009; Gallemore *et al.*, 2014), by studying reputational costs in the private realm. One exception herein is the study of Graham *et al.* (2014), which encompasses data on large private firms as well. The results of Graham *et al.* (2014), however, may not hold for SMEs, since the level of scrutiny faced by SMEs is generally much lower. Moreover, Graham *et al.*'s study paper surveyed the tax executives of larger private firms, which is a function that generally does not exist in SMEs. In fact, Everaert *et al.* (2007) show that most of the tax related planning by Belgian SMEs is outsourced, and the foremost reason for this outsourcing behaviour is to benefit from the access to expertise and specialized know-how of a service provider.[2]

Finally, our paper not only considers traditional measures of tax avoidance, such as effective tax rates, but also questions the SMEs about the exerted tax avoidance effort. As pointed out by Hanlon and Heitzman (2010, p 137), 'conforming tax avoidance, in which financial accounting income is reduced when the tax strategy is employed, is not captured by most measures' such as effective tax rates. We thus innovate by going beyond these non-conforming measures and study the degree to which firms exert effort in achieving their tax results (i.e., the exerted tax strategy).

RELATED LITERATURE AND EMPIRICAL PREDICTION

Reputational Concerns and Tax Avoidance

While corporate tax avoidance brings about a cash benefit for the firm, this behaviour is accompanied by (potential) costs. First, given that tax avoidance results in lost tax revenues for authorities, tax avoidant firms may be exposed to a substantial penalty

[2] Our survey confirms this behaviour as only 11.48% of the surveyed firms indicate that they have an internal function related to the preparation of the tax return. Of the surveyed firms, 80.67% reported that they seek the aid of an external advisor when preparing their tax return. We checked whether employing an external advisor affects our conclusions, but untabulated results show similar conclusions to those reported in the study.

from the tax administration (Hoopes *et al.*, 2012; Hanlon *et al.*, 2014). Second, some clients condone tax avoidance practices and therefore decrease their purchases from these firms, which may hurt turnover (Antonetti and Anesa, 2017; Sen and Cowley, 2013). Third, avoiding taxes is generally the result of costly expert advice because specific structures must be implemented and monitored (Scholes *et al.*, 2009). Finally, tax planning may result in higher non-tax costs, such as those arising from managers' hidden actions. Managers may very well engage in rent-extracting behaviour (i.e., non-value maximizing activities at the expense of shareholders) such as an increase in perk consumptions and related party transactions (Desai and Dharmapala 2006; Scholes *et al.*, 2009). Altogether, the tax accounting literature concludes that a firm will only employ a tax avoidance strategy when the marginal benefits exceed the marginal costs (Hanlon and Heitzman, 2010).

One stream of literature aimed at identifying determinants of tax avoidance focuses on how reputational concerns can act as an important deterrent (Graham *et al.*, 2014). Firms do not want to receive negative media attention, nor do they wish to alienate potential suppliers, clients, creditors, and investors by being perceived as not contributing their fair share to society (Bankman, 2004). Hoopes *et al.* (2018) show that several large Australian firms actively aim to avoid public tax disclosures and argue that consumer backlash serves as a principal reason. By relying on survey data, Graham *et al.* (2014) demonstrate the importance of potential reputational damage as a deterring factor for corporate tax avoidance. More specifically, they find that about 69% of corporate tax executives consider reputational costs as a dominant factor in the decision whether to adopt a tax planning strategy. Although their findings indicate that public firms attach more value to reputational concerns when avoiding tax planning strategies compared to private firms, they point out that over half of the responding large private firms (58.9%) are still concerned about reputational consequences.

Prior literature also documents the existence of reputation indifferent firms. In an effort to document the reputation effect of tax avoidance, Gallemore *et al.* (2014) study the impact of public scrutiny concerning tax shelters of 113 firms. However, the authors find no evidence of a reputation effect on CEO and CFO turnover, auditor turnover, lost sales, advertising costs, and media attention. Hanlon and Slemrod (2009) examine the market reaction to the news of firms engaging in tax shelters in 109 instances. The study reports only a small negative market reaction, or even a positive market reaction for firms that were not considered to be tax avoiding *ex post.* Both studies attribute the lack of clear negative reputation effects to a self-selection bias in the research design. If reputation concerns deter firms from engaging in tax strategies accompanied by negative reputation effects, it is likely that the observed firms are simply indifferent to reputation concerns.

Research as to why some firms remain indifferent to reputational concerns when determining their tax avoidance strategy is scarce. Hanlon and Slemrod (2009) document that firms active in retail are more likely to experience negative market reactions to the news of tax sheltering, indicating that retail firms face more consumer backlash. Using survey data, Graham *et al.* (2014) find that larger firms and firms with more analyst following rate reputation concerns as a more important disincentive for a tax avoidance strategy. Altogether, these findings

highlight that the level of scrutiny affects the effectiveness of reputational concerns as a tax avoidance deterrent.

Reputational Concerns and Tax Avoidance in a SME Setting

If the importance of reputational concerns in a firm's tax planning is solely driven by scrutiny (see Graham *et al.*, 2014), reputational concerns would be less important to the tax decisions of SMEs as these firms face less scrutiny on a variety of dimensions (Sen and Cowley, 2013). SMEs typically have a more concentrated ownership structure compared to larger private firms, limiting the amount of scrutiny from minority shareholders (Badertscher *et al.*, 2013; Steijvers and Niskanen, 2014). Minority shareholders are thought to be vigilant about tax planning strategies as tax complexity can be exploited to mask the rent extraction of managers and controlling shareholders vis-à-vis other shareholders (Desai and Dharmapala, 2006; Chen *et al.*, 2010; Badertscher *et al.*, 2013; Steijvers and Niskanen, 2014). As concentrated ownership lowers concerns about rent extraction through incentive alignment, there is less scrutiny concerning tax planning from shareholders.

Moreover, the disclosure requirements for SMEs are less stringent (Berger and Udell, 1998; Cabral and Mata, 2003). This opaqueness obstructs stakeholders' ability to clearly grasp a firm's tax position. As such, the heightened level of information asymmetry in SMEs diminishes the threat of reputational concerns surrounding tax avoidance. In addition, SMEs endure less monitoring due to a lower number of stakeholders (Sen and Cowley, 2013). For example, SMEs tend to have fewer creditors than larger firms (Berger and Udell, 1998) as their opaque nature creates limited access to external financing (Diamond, 1989), thereby increasing their reliance on internally generated funds. This independence consequently limits the number of external parties that would monitor a firm's behaviour. Altogether, reputational concerns regarding tax avoidance may be trivial in SMEs, such that there is no significant relationship between reputational concerns and tax avoidance. Therefore, we specify the following null hypothesis:

H1: There is no relationship between reputational costs and the tax planning strategy of SMEs.

Yet, other SME characteristics may still render reputational concerns important. First, reputation damage can cause customer fall out. While SMEs' tax payments are not as widely scrutinized by consumers groups as those from large visible firms, business clients, in particular, are incentivized to keep a close eye on their supplier's tax position and even distance themselves from tax aggressive firms. This is because business clients may attract unwanted attention from tax authorities by remaining a client of a tax aggressive firm that is targeted by authorities because of its supply chain agreements (Cen *et al.*, 2017). Since SMEs are characterized by a smaller and often localized client base (Quale, 2002; Sen and Cowley, 2013; Antonetti and Anesa, 2017), reputational damage may have a significant impact on the SMEs' gains. Moreover, SMEs are often regarded as

resource constrained because of their scarcity concerning expertise and capital (Buckley, 1989; Erramilli and D'Souza, 1993; Jenkins, 2006). Consequently, SMEs may lack the means to overcome customer fall out. Due to the potential threat to firm survival, SMEs are incentivized to incorporate reputational concerns into their tax planning.

Second, reputational capital is essential to maintaining creditor relations. As mentioned before, SMEs have limited access to external financing as creditors are wary of their opaque nature (Berger and Udell, 1998). Due to their higher operational risk and limited ability to provide collateral security, SMEs are considered risky borrowers (Cabral and Mata, 2003). Information asymmetry is therefore a particular barrier to creditor relations in the SME setting as creditors are subsequently unable to gauge the firm's risk of default. Yet, reputational capital can be used to offset some of the creditors' distrust as reputational capital signals trustworthiness and security (Diamond, 1989). Damage to reputational capital will therefore also damage the firm's financing options, thereby providing SMEs with an incentive to take up reputational concerns in their tax planning.

Third, there is a high manager-owner overlap in SMEs (see Steijvers and Niskanen, 2014), which lowers the tolerance for risky tax strategies. Prior literature argues that managers exploit tax complexity to mask rent extraction from shareholders and may even engage in tax aggressive strategies to obtain personal benefits (Desai and Dharmapala, 2006; Badertscher *et al*., 2013). However, manager-owner overlap resolves this behaviour through incentive alignment. Aggressive tax strategies, which include strategies accompanied by reputation damage, will now also damage the long-term interest of the manager. Consequently, manager-owner overlap leads to firms taking on less tax risk (Badertscher *et al*., 2013). As SMEs exhibit a high percentage of manager-owner overlap, reputational concerns are more likely to be taken up in their tax planning.

Finally, the SME's management can be personally motivated to act as a good steward. Prior research documents that a portion of SME financing stems from manager-owner loans and loans from family and friends (Bates, 1997; Cassar and Holmes, 2003). Because of the management's personal connection to such investors, the responsible use of assets is favoured over risky and opportunistic behaviour (Cassar, 2011). Hence, we define an alternative hypothesis stating that reputational concerns play a role in SMEs' tax planning strategy:

H2: There is a negative relationship between reputational costs and the tax planning strategy of SMEs.

RESEARCH DESIGN

In this section, we give an overview of the Belgian setting, the research design, the variables used, and the sample information.

The Belgian Setting

This study uses Belgian data to test how reputational concerns impact corporate tax avoidance in SMEs. The 2018 Belgian SME environment— the financial year for our survey—is largely representative of that of other EU countries since (i) these firms are the most prevalent type of enterprise (99% of all Belgian firms are SMEs), (ii) the financial statement regulation is harmonized through the European Single Market's EU Directives, and (iii) tax rules generally follow the OECD proposed structures that are adopted within the EU (OECD, 2011). Yet there are some unique characteristics that are important to this study.

First, many Belgian SMEs engage in business-to-business transactions (see FOD Economie, 2020; Dhyne *et al.*, 2015), which implies that many of the SMEs' clients are other business that typically have a better understanding of tax avoiding strategies than regular consumers. This is particularly important since, unlike in other EU countries, all firms (including SMEs and even micro firms) need to report their financial statements to the National Bank of Belgium and these are subsequently made available freely through an online portal. As such, businesses can gauge the financial performance of their suppliers and business clients, as well as their competitors. Therefore, the SMEs tax position is far more visible relative to other EU SMEs.

Second, tax audits have decreased considerably over time due to a shortage of tax auditors. In 2017, 14% of firms received a tax audit, which is only a third of the performed audits in 2014 (De Smet, 2017). There thus exists a lower risk of tax audit consequences and stakeholders learning about hidden tax liabilities as a result.

Third, the Belgian government allows certain remuneration schemes in SMEs that shift the tax burden from proprietors to the firm. This entails a firm documenting disallowed expenses regarding these remunerations, but proprietors will receive (partial) tax exemptions on these amounts in their personal income taxes. For example, as of tax year 2015, Belgian SMEs can allocate part or all of their accounting profit to a 'liquidation reserve'. This reserve needs to be booked on an unavailable equity account (which cannot serve as basis for any distribution or remuneration) and will be subject to a separate 10% tax (which is not deductible). This additional 10% corporate tax is registered as a disallowed expense. No additional taxation (withholding or personal tax) will be due provided this reserve is maintained until liquidation and hence distributed as a liquidation bonus. Proprietors can distribute these reserves even after five years at a reduced personal income tax rate. Given this considerable increase in tax expense, stakeholders are less likely to notice other tax avoiding strategies as the decrease in the taxable base may be offset by the increase in the disallowed expenses.[3]

[3] Note that the due to the presence of the liquidation reserve, the effective tax rates are likely to be higher than the statutory tax rates. In our sample, we observe an average effective tax rate of about 26% and a statutory tax rate of 22%. When correcting our effective tax rates for the presence of liquidation reserves and disallowed expenses, the effective tax rate becomes 20.3%. Correcting for this liquidation reserve does not significantly alter our findings. Results (untabulated) are available upon request.

Finally, there was a change in the statutory tax rate that occurred in tax year 2018, which coincides with the year of this study. Belgian firms were taxed in 2017 at 33.99% (24.25% lowest rate), but 29.58% (20.40% lowest rate) in 2018. Prior literature shows that during such tax shifts, firms accelerate tax deductions in the higher tax rate year and postpone tax increases to the lower tax rate year (Guenther, 1994; Andries *et al.*, 2017). Given that 2018 is the lower tax rate year, it is likely that the tax expense documents more (less) taxable base increasing (decreasing) items than usual.

Design

To find evidence of the relationship between reputational concerns and tax planning in SMEs, we construct the following model (Table 1 provides an overview of all variables):

$$\begin{aligned} Y = {} & \alpha + \beta_1 \,\mathrm{REPUTATION} + \gamma_1 \,\mathrm{STR} + \gamma_2 \,\mathrm{NOL} + \gamma_3 \,\mathrm{LOG\,ASSETS} + \gamma_4 \,\mathrm{ROA} \\ & + \gamma_5 \,\mathrm{PPE} + \gamma_6 \,\mathrm{INTANGIBLES} + \gamma_7 \,\mathrm{LEVERAGE} + \gamma_8 \,\mathrm{CASH} + \gamma_9 \,\mathrm{FAMILY} \\ & + \gamma_{10} \,\mathrm{TENURE} + \gamma_{11} \,\mathrm{BOARD} + \theta \,\mathrm{INDUSTRY} + \varepsilon, \end{aligned} \tag{1}$$

where Y represents the dependent variables that capture the firm's tax planning. We proxy a firm's tax planning in two distinct ways. First, we focus on the GAAP effective tax rate (*ETR*), computed as the ratio between the firm's tax expense and its earnings before taxes (see Chen *et al.*, 2010; Steijvers and Niskanen, 2014). In a sensitivity check, we also employ a binary variable to indicate tax aggressive firms (*TAXAG*), which takes on the value of one if the firm is considered to be tax aggressive, zero otherwise. A firm is seen as tax aggressive when the sector-adjusted effective tax rate belongs to the lowest 10% (Hanlon and Heitzman, 2010). Although the effective tax rate is a popular measure in tax research, it fails to capture the firm's strategy regarding tax planning, but rather captures the outcome of tax strategies (Hanlon and Heitzman, 2010). to identify the exuded tax planning effort, we use an alternative dependent variable (*EFFORT*) based on a five-point Likert scale to the question whether 'The firm aims to minimize its tax expense' in our sensitivity checks.

The main independent variable of interest (*REPUTATION*) is proxied by either the total reputational concerns (*REPUTATION1*) or the client-oriented reputational concerns (*REPUTATION2*). These variables are measured using a five-point Likert scale on whether 'Potential reputation damage is a disincentive concerning minimizing tax expenses' and whether 'The firm's clients react negatively to firms reporting a low tax expense', respectively. The first question is similar to that posed in Graham *et al.* (2014). However, the latter variable is added to account specifically for client-oriented reputational concerns, because SMEs tend to rely heavily on a limited number of customers (Quale, 2002; Sen and Cowley, 2013), such that they are more sensitive to the potential loss of a client compared to larger firms.

We further include several control variables in the model, which have been shown to affect corporate tax avoidance (see Steijvers and Niskanen, 2014). We

TABLE 1

DEFINITION OF VARIABLES

Variable	Definition
Dependent variable	
ETR	Ratio of the tax expense to accounting profit before taxes.
TAXAG	Dichotomous variable indicating whether the firm is tax aggressive. Equals 1 if the firm's sector-adjusted effective tax rates belongs to the lowest 10^{th} quantile, 0 otherwise.
EFFORT	Likert scale ranging from 1 (strongly disagree) to 5 (strongly agree) on the statement: 'The firm aims to minimize its tax expense (excluding tax evasion strategies)'.
Test variables	
REPUTATION1	Likert scale ranging from 1 (strongly disagree) to 5 (strongly agree) on the statement: 'Potential reputation damage is a disincentive concerning minimizing tax expenses (through non-tax evasion strategies)'.
REPUTATION2	Likert scale ranging from 1 (strongly disagree) to 5 (strongly agree) on the statement: 'The firm's clients react negatively to firms reporting a low tax expense'.
Control variables	
STR	Applicable statutory tax rate bracket.
NOL	Dichotomous variable indicating whether the firm has experienced historical losses. Equals 1 if the firm reported an accounting loss before taxes in the previous financial year or reported historical losses on the balance sheet of the previous financial year, 0 otherwise.
LOG ASSETS	Logarithm of total assets.
ROA	Return on Assets is calculated as the ratio of EBIT to total assets.
PPE	Ratio of property, plant and equipment to lagged total assets.
INTANGIBLES	Ratio of intangibles to lagged total assets.
LEVERAGE	Ratio of outstanding long-term debt to lagged total assets.
CASH	Ratio of lagged cash and cash equivalents to lagged total assets.
FAMILY	Dichotomous variable indicating whether the firm is a family firm. Equals 1 if at least 50% of all shares are under the control of a family, 0 otherwise.
TENURE	Average board tenure on the board of directors.
BOARD	Number of board members on the board of directors.
Other variables	
EPONYMOUS	Dichotomous variable indicating whether the firm is an eponymous firm. Equals 1 if the firm name encompasses at least one of the surnames of the firm's board members or management, 0 otherwise.
AGE	Firm age calculated as the difference between the year 2018 and the founding date.
GENERATION1	Dichotomous variable indicating whether the firm has at least one first-generation manager. Equals 1 if at least one firm manager has been managing the firm since its founding date, 0 otherwise.
FAMILY SHARE	Ratio of the controlling family firm's shares to all shares. A controlling family's share is defined as all the shares owned by family members, which encompasses the majority of all the shares.
MINORITY	Dichotomous variable indicating whether a family firm has minority shareholders equals 1 if there are minority shareholders in the family firm, 0 otherwise.
FULL FAMILY	Dichotomous variable indicating whether a firm is under complete control of one family. Equals 1 if the controlling family firm's shares equal 100%, 0 otherwise.
REMUN	Dichotomous variable indicating whether a firm has a liquidation reserve on the balance sheet. Equals 1 if there is a liquidation reserve on the balance sheet, 0 otherwise.

(Continues)

TABLE 1

CONTINUED

Variable	Definition
COMPLEXITY	Likert scale ranging from 1 (strongly disagree) to 5 (strongly agree) on the statement: 'The firm experiences trouble navigating the tax rules'.
COMPLIANCE	Likert scale ranging from 1 (strongly disagree) to 5 (strongly agree) on the statement: 'The firm aims to maximize its tax compliance'.

start by controlling for the applicable statutory tax rate bracket (*STR*). The typical statutory tax rate in 2018 is 29.58%. However, some SMEs receive a favourable statutory tax rate of 20.40% up to €100,000 of their taxable base. We also construct a binary variable (*NOL*), taking the value of one when the firm reported either an historical loss in the balance sheet, or an accounting loss before taxes in the previous financial year, zero otherwise. As such, we control for the presence of tax loss carryforwards that offset the taxable base. Since prior studies argue that larger firms tend to be more complex, reducing the costs of tax avoidance (see Rego, 2003), we include firm size as the logarithm of the total assets (*LOG ASSETS*). We control for the firm's profitability by including the return on assets (*ROA*), calculated as earnings before interest and taxes, scaled by the total assets of the firm (Steijvers and Niskanen, 2014). In addition, we include *PPE*, which captures fixed assets intensity and is measured as plant, property, and equipment divided by lagged total assets (see Steijvers and Niskanen, 2014), while *INTANGIBLES* captures the intensity of intangible assets (measured as the intangible assets divided by lagged total assets). Furthermore, since prior literature proposes that the level of firm debt is positively associated with tax avoidance (Richardson *et al.*, 2016), we include the firm's leverage (*LEVERAGE*) computed as the ratio of long-term debt relative to the firm's lagged total assets. A firm's cash holdings level is also expected to influence tax planning behaviour. Prior research documents that firms with higher levels of cash need to engage in tax avoidance to increase their cash holding level through generated cash tax savings (Edwards *et al.*, 2016). Therefore, we take up the ratio of the firm's cash and cash equivalents relative to total assets (*CASH*). We also control for the firm's ownership structure. Firms with concentrated ownership, such as family firms, are thought to avoid more taxes because controlling owners reap more benefits from cash tax savings (Hanlon and Heitzman, 2010). As such, we construct a dichotomous variable (*FAMILY*), which takes the value of '1', if at least 50% of all shares are under the control of a family, and zero otherwise (Chen *et al.*, 2010; Steijvers and Niskanen, 2014). We also control for the level of corporate governance through the average board tenure (*TENURE*) and board size[4]

[4] We only identify unique individuals on the board. In many cases, another firm is listed as a board member but is represented by an individual already listed as a board member. As such, we only count one true individual member.

(*BOARD*) as firms with more sophisticated governance are less tax aggressive (Richardson *et al*., 2016). Directors with a longer board tenure are associated with more risk aversion, thereby limiting opportunistic tax avoidance (Beasley, 1996; Donoher *et al*., 2007). In addition, longer tenure is associated with entrenchment, making the board less knowledgeable on ever evolving tax matters (Golden and Zajac, 2001). A larger board of directors allows for more diversity and knowledge on the board (Beasley, 1996). Finally, we include industry fixed effects to control for industry-level variation.

Sample Selection

Prior to sending the survey, we first imposed several restrictions to attain our research population. First, as our survey was conducted in Dutch, only limited liability firms reporting annual statements in Dutch were selected. Second, the unconsolidated financial statements needed to encompass a fiscal year of 12 months ending in December to ensure that all firms were adhering to the same tax regime. Third, we exclude financial firms, insurance firms, and holding companies, as well as government firms, because the financial statement information and financing needs differ substantially from those of commercial and industrial firms. Finally, we drop loss-making firms in order to compute the effective tax rate (Hanlon and Heitzman 2010). Table 2 provides an overview of the selection procedure.

A total of 10,923 Belgian SMEs were contacted through e-mail with an electronic survey, of which 587 (5.37%) responded. The survey ran from March to April 2019, with one reminder. The e-mail was accompanied by information on the purpose of the survey and requested respondents to be familiar with the firm's tax planning. Financial statement information was collected from the Belfirst database, and firms with missing information were dropped, which resulted in a final sample of 372 Belgian SMEs.[5]

To control whether our sample is representative for the broader population and does not suffer from selection bias, we collected archival data on the firm size and the tax expenses of the contacted firms (N = 10,923). The final sample used in our analyses was compared with the remaining population using Kolmogorov–Smirnov two-sample tests. We find no significant difference between the value of total assets ($p = 0.12$) and the effective tax rate ($p = 0.42$) of both groups. We also examine the comparability of the late responders (see, Kanuk and Berenson, 1975) by distinguishing between respondents from the first survey wave (N = 217) and respondents following the reminder (N = 155). Untabulated results show no significant differences between the two groups. In addition, we test for common method bias (e.g., Podsakoff *et al*., 2003), by performing an unrotated factor analysis involving this study's variables. Six factors with an eigenvalue larger than one are identified, with the largest factor accounting for 16.21% of the total variance. Hence, common method bias is unlikely in our study.

Table 2 further presents our sample distribution per industry as well as that of the effective tax rates. Overall, we find that our sample corresponds well to the

[5] Respondents had the option to indicate 'I do not know / no opinion' on questions regarding reputational concerns. This is the main reason observations are classified as missing information.

TABLE 2

SELECTION PROCEDURE

Selection procedure				
Contact details on SMEs reporting financial statements in Dutch			24,377	
- Non-limited liability firms	1,053			
- Closing date not ending in December	5,661			
- Financial statements unequal to 12 months	1,684			
- Financial institutions, government institutions, and NPOs	786			
- Firms with an accounting loss before taxes	4,270			
= Research population			10,923	
- Non-responsive firms	10,336			
= Responsive firms			587	
- Firms with missing information	115			
= Final sample			372	
Industry percentages	**Population**	**Sample**	**Difference**	**Significance**
Manufacturing	11.71	17.20	–5,49	**
Construction	15.55	9.95	5,60	**
Wholesale and retail trade	33.51	32.26	1,25	
Transportation and storage	4.23	5.65	–1,42	
Accommodation and food service activities	3.45	4.03	–0,58	
Information and communication	4.71	3.76	0,95	
Professional, scientific, and technical activities	13.4	14.78	–1,38	
Administrative and support service activities	5.90	6.45	–0,55	
Others	7.54	5.91	1,63	
Industry Effective Tax Rates (ETR)	**Population**	**Sample**	**Difference**	**Significance**
Manufacturing	0.24	0.32	0.08	*
Construction	0.24	0.20	0.04	
Wholesale and retail trade	0.27	0.30	–0.03	
Transportation and storage	0.27	0.26	0.01	
Accommodation and food service activities	0.21	0.19	0.02	
Information and communication	0.22	0.25	–0.03	
Professional, scientific, and technical activities	0.29	0.25	0.04	
Administrative and support service activities	0.29	0.28	0.01	
Others	0.27	0.32	–0.05	

* and ** denote statistical significance (two-tailed) at the 10% and 5% levels, respectively. Industry categories are defined using the European NACEBEL classification. Primary activities codes are used to allocate SMEs to their respective category.

general Belgian population with regards to industry distribution. The only significant differences can be observed in the manufacturing and construction industries. With regards to the effective tax rates per industry in our sample we find no statistically significant differences between our sample and the broader population, with the sole exception of the manufacturing industry, where the firms in our sample report a higher effective tax rate.[6]

[6] When leaving out the industries 'Manufacturing' and 'Construction', our conclusions remain unchanged. Results (untabulated) are available upon request.

RESULTS

Descriptive Statistics

The summary statistics of our dependent, independent, and control variables are reported in Table 3. In terms of our dependent variables, we find that the effective tax rate (*ETR*) is about 26% on average. Most firms in our sample acknowledge that they actively aim to minimize their tax expense (*EFFORT*). That is, about 85% of our sample either 'agrees' or 'strongly agrees'.

In terms of our independent variables of interest, a minority of firms (7.53%) indicate that potential reputation damage is a disincentive with regards to minimizing tax expenses (*REPUTATION1*). These lower concerns are in line with the premise that (i) SMEs are exposed to less reputational costs vis-à-vis larger firms, and/or (ii) there are few concerns in the Belgian SME setting in 2018 about reputational damage from a firm's tax position. Client-related reputation concerns (*REPUTATION2*) tend to be slightly more prevalent in our sample. Of the firms in our sample, 14.25% indicate that their clients react negatively to tax avoiding firms.

The average applicable statutory tax rate (*STR*) is 22.2%[7]. In addition, the average firm in our sample is profitable (*ROA*) and holds about 14.2% in long-term debt (*LEVERAGE*). More than 87% of firms are designated as family firms (*FAMILY*). Board tenure (*TENURE*) ranges between 0 to 46 years, where the average (median) board tenure equates to 14.40 (14) years.

In Table 4, we report the Pearson correlation amongst the different variables. We find that *ETR* is positively associated with the two different measures of reputational concerns (*REPUTATION1* and *REPUTATION2*). Furthermore, there is a negative correlation between the reputational variables and the exerted tax planning effort (*EFFORT*). Among the control variables, we find no extreme correlations.

Main Results

Table 5 reports the main results concerning the relationship between reputational concerns and corporate tax avoidance. There is a significantly positive association between both measures of reputational concerns and the effective tax rate. This indicates that reputational concerns act as a disincentive to tax avoidance, consistent with H2. Even though the prior descriptive results indicate that reputational concerns are not very prevalent in SMEs, they still constitute a substantial disincentive in a firm's level of tax avoidance when present. This effect is economically sizeable. On average, firms indicating high reputational concerns (*REPUTATION1*) are associated with an effective tax rate that is 8.57 percentage

[7] The average effective tax rate is higher than the average statutory tax rate. This can be attributed to SMEs using a liquidation reserve and other remunerations that create disallowed expenses. Correcting for liquidation reserves and other disallowed expenses effects stemming solely from remuneration, the adjusted average effective tax rate (standard deviation) becomes 0.203 (0.178). The adjusted value is lower than that of the statutory tax rate, indicating tax avoidance indeed occurs in our sample when omitting tax burden shifts from proprietors to firms.

TABLE 3

DESCRIPTIVE STATISTICS

	N	Mean	S. D.	Min	25%	Median	75%	Max
Dependent variables								
ETR	372	0.263	0.195	0.000	0.094	0.284	0.351	0.952
TAXAG	372	0.099	—	0.000	0.000	0.000	0.000	1.000
EFFORT	366	4.281	0.790	1.000	4.000	4.000	5.000	5.000
Test variables								
REPUTATION1	372	2.358	0.874	1.000	2.000	2.000	3.000	5.000
REPUTATION2	372	2.742	0.877	1.000	2.000	3.000	3.000	5.000
Control variables								
STR	372	0.222	0.028	0.204	0.204	0.204	0.242	0.296
NOL	372	0.148	—	0.000	0.000	0.000	0.000	1.000
LOG ASSETS	372	13.582	1.296	8.795	12.688	13.699	14.485	16.716
ROA	372	0.116	0.123	–0.212	0.036	0.080	0.158	0.610
PPE	372	0.285	0.258	0.000	0.071	0.213	0.446	1.308
INTANGIBLES	372	0.009	0.069	0.000	0.000	0.000	0.000	0.956
LEVERAGE	372	0.142	0.200	0.000	0.000	0.049	0.218	1.029
CASH	372	0.247	0.233	0.000	0.052	0.182	0.387	0.987
FAMILY	372	0.866	—	0.000	1.000	1.000	1.000	1.000
TENURE	372	14.40	8.43	0.000	8.000	14.000	19.000	46.000
BOARD	372	1.774	0.861	1.000	1.000	2.000	2.000	6.000
Other variables								
AGE	372	29.599	12.297	14.000	21.000	27.000	34.000	104.000
GENERATION1	372	0.387	—	0.000	0.000	0.000	1.000	1.000
FAMILY SHARE	372	0.817	0.374	0.000	1.000	1.000	1.000	1.000
MINORITY	372	0.099	—	0.000	0.000	0.000	0.000	1.000
FULL FAMILY	372	0.767	—	0.000	1.000	1.000	1.000	1.000
EPONYMOUS	372	0.320	—	0.000	0.000	0.000	1.000	1.000
REMUN	372	0.743	—	0.000	0.000	1.000	1.000	1.000
COMPLEXITY	362	3.061	1.007	1.000	2.000	3.000	4.000	5.000
COMPLIANCE	365	3.995	0.822	1.000	3.000	4.000	5.000	5.000

All variables are defined in Table 1.

points higher than that of firms with low reputational concerns ($p = 0.030$).[8] In a similar manner, client-oriented reputational concerns (*REPUTATION2*) form a significant deterrent, rejecting H1 once more in favour of H2. Firms indicating client concerns are associated with an effective tax rate that is 7.43 percentage points higher than that of firms with low client concerns ($p = 0.006$).[9]

As for the control variables, tax loss carryforwards are significantly associated with a lower effective tax rate. SMEs experiencing higher profitability are associated with higher levels of tax avoidance. These firms work more efficiently with their resources, suggesting that they work in a similar efficient way

[8] Measured as binary variable indicating one when potential reputation damage is seen as a disincentive to tax avoidance (*REPUTATION1* > 3), zero otherwise. With 95% certainty, the estimated economic size of these reputational concerns ranges between 0.8–16.29 percentage points.

[9] Measured as binary variable indicating one when a firm's clients are expected to react negatively to tax avoiding firms (*REPUTATION2* > 3), zero otherwise. With 95% certainty, the economic size of client reputational concerns ranges between 2.1 and 12.67 percentage points.

TABLE 4

CORRELATION TABLE REGARDING THE MAIN MODEL

	1	2	3	4	5	6	7	8	9	10	11	12	13
(1) ETR	1.00												
(2) EFFORT	–0.05	1.00											
(3) REPUTATION1	0.09*	–0.14***	1.00										
(4) REPUTATION2	0.13***	–0.12**	0.51***	1.00									
(5) STR	–0.06	–0.09*	0.07	0.01	1.00								
(6) LOG ASSETS	0.01	–0.10**	–0.03	–0.07	0.58***	1.00							
(7) ROA	–0.08*	0.05	0.07	0.06	0.27***	–0.25***	1.00						
(8) PPE	–0.14***	0.03	–0.01	–0.04	–0.07	0.09*	–0.04	1.00					
(9) INTANGIBLES	–0.01	–0.07	–0.01	–0.02	–0.05	0.01	–0.05	–0.09*	1.00				
(10) LEVERAGE	–0.15***	0.03	0.01	–0.10**	–0.08	0.07	–0.07	0.66***	–0.05	1.00			
(11) CASH	0.08*	0.02	–0.01	0.06	0.01	–0.14***	0.07	–0.31***	–0.05	–0.31***	1.00		
(12) TENURE	0.10*	–0.01	–0.04	0.05	–0.17***	–0.19***	–0.01	0.04	–0.06	–0.01	0.08	1.00	
(13) BOARD	–0.01	–0.04	–0.03	–0.03	0.16***	0.31***	–0.17***	–0.06	0.08*	–0.05	–0.01	–0.27***	1.00

All variables are defined in Table 1. *, **, and *** denote statistical significance (two-tailed) at the 10%, 5%, and 1% levels, respectively.

TABLE 5

MAIN RESULTS

	ETR	ETR
	(1)	(2)
Test variables		
REPUTATION1	**0.025****	
	(0.012)	
REPUTATION2		**0.026****
		(0.012)
Control variables		
STR	–0.399	–0.351
	(0.481)	(0.474)
NOL	**–0.107*****	**–0.110*****
	(0.033)	(0.033)
LOG ASSETS	0.005	0.005
	(0.012)	(0.012)
ROA	**–0.171***	**–0.167***
	(0.094)	(0.094)
PPE	–0.055	–0.062
	(0.054)	(0.053)
INTANGIBLES	–0.112	–0.109
	(0.119)	(0.127)
LEVERAGE	–0.106	–0.086
	(0.075)	(0.073)
CASH	0.010	0.007
	(0.044)	(0.044)
FAMILY	**–0.056***	**–0.054***
	(0.029)	(0.029)
TENURE	**0.002****	**0.002****
	(0.001)	(0.001)
BOARD	–0.005	–0.005
	(0.013)	(0.013)
(Intercept)	**0.351****	**0.337****
	(0.138)	(0.137)
Industry effects	Yes	Yes
N	372	372
F-value	3.84	4.24
Sig. F-value	<0.001	<0.001
R^2	13.92	14.25
Adjusted R^2	9.53	9.88
VIF	2.06	2.05

The dependent variable is the effective tax rate (*ETR*). All variables are defined in Table 1. Robust standard error values are reported in parentheses. *, **, and *** denote statistical significance (two-tailed) at the 10%, 5%, and 1% levels, respectively.

concerning tax items. In addition, more profitable firms have more financial means to hire external tax expertise. Family firms are associated with more tax avoidance, as evidenced by a lower effective tax rate. It should be noted that, at first glance, this result contradicts findings from prior literature that family firms engage in less tax avoidance (Seijvers and Niskanen, 2014). Prior research generally attributes the lower level of tax avoidance to the higher level of

reputational costs in family firms. Conversely, other studies document that the concentrated ownership in family firms drives tax avoidance behaviour (Sánchez-Marín *et al.*, 2016; Kovermann and Wendt, 2019). As such, the indicator variable that controls for whether the firm is a family firm likely captures both a reputational effect as well as a concentrated ownership effect. Our research design allows us to control for reputational effects separately, such that we are able to isolate the effect of concentrated ownership on tax avoidance. The significantly negative association of *FAMILY* disappears when rerunning our analysis without controlling for *REPUTATION*, indicating the relevance of separating the underlying effects. Lastly, the presence of longer board tenure is associated with a lower effective tax rate, which is in line with entrenchment effects.

As a robustness check, we rerun the analyses while leaving out firms with a neutral outlook on the reputational concerns (N = 242/184). Untabulated results confirm our prior conclusions.

Moderating Firm Characteristics

This section explores how SME characteristics moderate the relationship between reputational concerns and effective tax rates.

Significance of financial freedom Tax avoidance bears some level of risk for firms. For instance, firms face potential penalties from the tax authority if the firm's tax avoidance schemes are improper (Hoopes *et al.*, 2012; Hanlon *et al.*, 2014). In addition, prior literature showcases that clients condoning tax avoidance will decrease their purchases from a tax avoiding firm (Antonetti and Anesa, 2017), which hurts turnover and subsequent financial prosperity (Sen and Cowley, 2013).[10] These costs are arguably more dire in firms that lack financial freedom as opposed to firms with a larger financial buffer. We test this notion by examining whether a lack of financial freedom to overcome the potential negative (financial) consequences of tax avoidance influences the extent to which reputational concerns constitute a disincentive to corporate tax avoidance.

First, we relate a low degree of financial freedom to firms with cash constraints. On hand available cash can be used as an internal financing source (Myers and Majluf, 1984; Opler *et al.* 1999; Bigelli and Sánchez-Vidal, 2012; Orens and Reheul, 2013). Moreover, higher levels of cash holdings also mean that the firm is less dependent on operational outcomes or external capital for financing purposes (Opler *et al.*, 1999). As cash constraints increase, reputation damage can hinder the firm's ability to replenish their cash position. Hence, we split the sample based on firm's level of cash and cash equivalents (*CASH*). A firm belongs to the group with high (low) cash available, if the firm's level of cash and cash

[10] Financial constraints reduce the firms' hiring capacity, innovativeness and viability (Eisenhardt and Martin, 2000; Andries and Czarnitzki, 2014). For instance, the 2019 Survey on the Access to Finance of Enterprises report provided by the European Central Bank (see, https://www.ecb.europa.eu/stats/ecb_surveys/safe/html/all-releases.en.html)documents how euro area SMEs spend acquired capital. In net terms, 16% of all SMEs increased their fixed assets, 7% increased working capital and 12% increased the number of employees.

equivalents exceeds (is below or equal to) the median firm's level of cash and cash equivalents. These results are reported in Table 6, columns 1–4. The results of the multivariate analyses suggest a significantly positive association between reputational concerns and the effective tax rate, only in the case where cash means are low. The results are robust to splitting up the sample based on the average level of cash and cash equivalents in our sample.

Second, we also relate a low degree of financial freedom to firms with lower working capital levels. Working capital management revolves around the management of a firm's current assets and current liabilities (Deloof, 2003). As such, working capital management is often regarded as the management of short-term firm financing for day-to-day business activities. A higher working capital entails that the firm is less dependent on operational outcomes or external capital for financing purposes (Opler *et al.*, 1999). We therefore split our sample based on firm's ratio of working capital to total assets[11]. A firm belongs to the group with a high (low) working capital, if the firm's ratio of working capital to total assets exceeds (is below or equal to) that of the median firm within a sector. These results are reported in Table 6, columns 5–8. Again, we report a significantly positive association between reputational concerns and the effective tax rate, only in the case where working capital is deemed low. The results are robust to splitting up the sample based on the ratio of working capital to total assets.

Altogether, these results suggest that reputational concerns act as a disincentive in an SME's tax planning when the firm experiences less financial freedom. We attribute this finding to SMEs being conservative in their (tax) risk-taking when firms do not possess a financial buffer to bear the potential consequences.

Significance of creditor relations Next, we examine whether creditor relations augment the disincentive of reputational concerns on corporate tax avoidance. Reputational capital is an important resource for SMEs because it can act as a signal to resolve information asymmetry between the SME and its creditors. Since SMEs disclose less information (Beatty and Harris, 1999), trade partners and banks are less willing to cooperate with these firms or will demand higher transaction costs due to the uncertainty regarding firm (credit) risk (Diamond, 1989; Sakai *et al.*, 2010). As higher reputational capital signals more trustworthiness, doubts concerning the firm are mitigated. Consequently, reputational capital facilitates external relations. This also introduces the notion that reputational concerns will act as a larger disincentive to corporate tax avoidance in firms aiming to safeguard their creditor relations. Reputational capital has been proven to be an important facilitator of external financing for SMEs (Diamond, 1989; Sakai *et al.*, 2010), such that highly leveraged SMEs will have a higher reputation capital to sustain. Harm to the reputation capital

[11] While the sector-adjusted ratio of working capital to total assets exhibits a strong correlation (48.24%) with the sector-adjusted level of cash and cash equivalents, the overlap between the subsamples of high financial freedom is limited to 68.27%. As such, there are substantial differences in the firms included in these distinct subsamples.

TABLE 6

REPUTATIONAL CONCERNS AND FINANCIAL FREEDOM

	ETR	ETR	ETR	ETR	ETR	ETR	ETR	ETR
	HIGH CASH	LOW CASH	HIGH CASH	LOW CASH	HIGH WC	LOW WC	HIGH WC	LOW WC
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Test variables								
REPUTATION1	0.010	**0.041***			0.007	**0.049****		
	(0.014)	(0.022)			(0.015)	(0.019)		
REPUTATION2			0.012	**0.038***			0.002	**0.053*****
			(0.015)	(0.021)			(0.016)	(0.019)
Control variables								
STR	–0.571	–0.277	–0.513	–0.320	–0.434	0.094	–0.408	0.213
	(0.673)	(0.723)	(0.649)	(0.722)	(0.758)	(0.695)	(0.752)	(0.685)
NOL	–0.075	**–0.131*****	–0.074	**–0.138*****	–0.037	**–0.144*****	–0.039	**–0.151*****
	(0.049)	(0.047)	(0.049)	(0.046)	(0.055)	(0.046)	(0.055)	(0.043)
LOG ASSETS	0.023	–0.004	0.022	–0.003	0.025	–0.017	0.024	–0.014
	(0.020)	(0.018)	(0.020)	(0.018)	(0.022)	(0.016)	(0.022)	(0.015)
ROA	–0.110	**–0.268***	–0.107	**–0.270***	–0.004	**–0.473*****	–0.001	**–0.471*****
	(0.119)	(0.160)	(0.119)	(0.162)	(0.130)	(0.140)	(0.132)	(0.133)
PPE	–0.106	–0.040	–0.110	–0.050	–0.119	–0.043	–0.121	–0.054
	(0.072)	(0.071)	(0.071)	(0.071)	(0.104)	(0.071)	(0.103)	(0.071)
INTANGIBLES	–0.163	–0.133	–0.174	–0.103	–0.245	–0.169	–0.273	–0.157
	(0.266)	(0.109)	(0.267)	(0.114)	(0.633)	(0.118)	(0.624)	(0.130)
LEVERAGE	**–0.222****	–0.095	**–0.210****	–0.071	–0.047	–0.146	–0.044	–0.115
	(0.089)	(0.100)	(0.088)	(0.096)	(0.102)	(0.110)	(0.103)	(0.103)
CASH					0.047	0.098	0.047	0.076
					(0.062)	(0.090)	(0.062)	(0.087)
FAMILY	**–0.076****	–0.046	**–0.076****	–0.036	–0.032	**–0.067***	–0.029	**–0.074***
	(0.032)	(0.052)	(0.032)	(0.051)	(0.036)	(0.040)	(0.035)	(0.039)
TENURE	0.002	0.002	0.002	0.002	**0.002***	0.002	**0.002***	0.002
	(0.001)	(0.002)	(0.001)	(0.002)	(0.001)	(0.001)	(0.001)	(0.001)
BOARD	**–0.027***	–0.003	**–0.027***	–0.003	**–0.029***	0.002	**–0.029***	0.003
	(0.015)	(0.019)	(0.015)	(0.019)	(0.016)	(0.002)	(0.016)	(0.018)

(Continues)

TABLE 6

CONTINUED

	ETR	ETR	ETR	ETR	ETR	ETR	ETR	ETR
	HIGH CASH	LOW CASH	HIGH CASH	LOW CASH	HIGH WC	LOW WC	HIGH WC	LOW WC
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
(Intercept)	**0.363***	0.360	**0.356***	0.344	0.088	**0.563*****	0.097	**0.483****
	(0.185)	(0.222)	(0.187)	(0.222)	(0.230)	(0.198)	(0.227)	(0.195)
Industry effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	186	186	186	186	186	186	186	186
F-value	2.93	2.50	3.27	2.73	0.96	4.17	0.96	4.81
Sig. F-value	<0.001	0.001	<0.001	<0.001	0.512	<0.001	0.510	<0.001
R^2	19.69	16.74	19.91	16.67	7.54	31.06	7.45	31.95
Adjusted R^2	11.62	8.56	11.77	8.17	-3.67	22.70	-3.77	23.71
VIF	2.45	1.93	2.44	1.92	2.04	2.08	2/04	2.08

The dependent variable is the effective tax rate (*ETR*). All variables are defined in Table 1. Robust standard error values are reported in parentheses. *, **, and *** denote statistical significance (two-tailed) at the 10%, 5%, and 1% levels, respectively. A firm belongs to the HIGH (LOW) CASH subsample if the firm's cash holding level (*CASH*) exceeds (is below or equal to) the cash holding level of the median firm in the full sample. A firm belongs to the HIGH (LOW) WC subsample if the firm's ratio of working capital to total assets exceeds (is below or equal to) the ratio of working capital to total assets of the median firm in the full sample.

will constitute limitations on external financing, prompting firms to weigh potential reputation damage more heavily in their decision-making process.

Conversely, this begs the question whether creditors dislike tax avoidance. Creditors have large pre-defined claims on the profit (Platikanova, 2017). Firms engaging in tax avoidance could therefore be favoured by creditors because tax avoidance creates a direct cash income (Edwards *et al.*, 2016), which could offset the firm's debt position. However, corporate tax avoidance also brings about more risk, such as exposure to the tax authorities and an increase in operational complexity (Balakrishnan *et al.*, 2019), which increases the demand for monitoring (Desai and Dharmapala, 2006). It is therefore not surprising that creditors are more inclined to extend debt with shorter maturity to tax avoiding firms as a way to periodically monitor the borrower's tax position (Platikanova, 2017). In addition, consumers are known to dislike tax avoiding firms and will adjust their consumer behaviour accordingly (Quale, 2002; Sen and Cowley, 2013; Austin and Wilson, 2017), which endangers the firm's ability to pay creditors back. Given these concerns, it is likely that potential reputation damage stemming from tax avoidance is thought to be greater in highly leveraged firms. Therefore, we test whether the effect of reputational concerns on corporate tax avoidance is moderated by the firm's level of creditor dependency. Table 7, columns 1–4 report the results for leverage-based split samples. A firm belongs to the group with a high (low) creditor dependency if the firm's leverage (*LEVERAGE*) exceeds (is below or equal to) the leverage of the median firm in our sample. Table 7 indicates the existence of a significant positive association between reputational concerns and the effective tax rate when creditor dependency is high. We attribute this finding to a firm's need to fulfill cash claim obligations as the negative fall out from tax avoidance will hinder the firm's ability to meet creditor future cash flow claims and the firm's wish to safeguard its reputation capital with creditors. Note that these results are robust to splitting up the sample based on the average level of leverage in our sample.

Next, we relate a firm's reputational capital with creditors to firm age (Petersen and Rajan, 1994; Chittenden *et al.*, 1996; Hall *et al.*, 2004; Hyytinen and Pajarinen, 2007). Reputational capital increases by age as firms are able to provide more historical evidence of financial and operational performance which facilitates lending (Diamond, 1989; Boot *et al.*, 1993). Moreover, poorly performing firms are expected to default and exit the market (Sakai *et al.*, 2010). Eurostat[12] reports that only 57.51% of Belgian enterprises survived the first five years of business in 2018. Older firms can therefore be considered as less risky in the eyes of creditors. Hence, the importance of reputational concerns with creditors as a disincentive might be moderated by firm age. Table 7, columns 5–8 report the results for age-based split samples.[13] A firm belongs to the older group if the firm's age exceeds

[12] These statistics are reported at ec.europa.eu/eurostat/data/database under 'Business demography by size class (from 2004 onwards, NACE Rev. 2)' or code 'bd_9bd_sz_cl_r2'.

[13] While firm age is correlated (–3.28%) with the leverage ratio, the overlap between the subsamples of high creditor dependency is limited to 54.97%. This again leaves us with substantial differences in the firms included in the subsample analyses.

TABLE 7

REPUTATIONAL CONCERNS AND CREDITOR RELATIONS

	ETR	ETR	ETR	ETR	ETR	ETR	ETR	ETR
	HIGH LEV	LOW LEV	HIGH LEV	LOW LEV	OLDER	YOUNGER	OLDER	YOUNGER
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Test variables								
REPUTATION1	**0.042****	0.009			**0.043****	0.015		
	(0.019)	(0.015)			(0.019)	(0.016)		
REPUTATION2			**0.032***	0.015			**0.038***	0.006
			(0.018)	(0.016)			(0.021)	(0.017)
Control variables								
STR	–0.375	–0.270	–0.204	–0.322	–0.795	0.494	–0.784	0.571
	(0.651)	(0.703)	(0.647)	(0.684)	(0.693)	(0.679)	(0.676)	(0.672)
NOL	**–0.089****	**–0.133****	**–0.089****	**–0.135****	**–0.117****	**–0.102****	**–0.112****	**–0.107****
	(0.040)	(0.054)	(0.041)	(0.053)	(0.051)	(0.044)	(0.052)	(0.043)
LOG ASSETS	0.011	0.011	0.008	0.012	0.018	–0.012	0.021	–0.014
	(0.017)	(0.018)	(0.016)	(0.018)	(0.018)	(0.017)	(0.017)	(0.017)
ROA	**–0.286***	–0.106	**–0.303****	–0.099	–0.065	**–0.321****	–0.018	**–0.327****
	(0.154)	(0.116)	(0.148)	(0.116)	(0.142)	(0.134)	(0.144)	(0.135)
PPE	**–0.209*****	0.049	**–0.209*****	0.041	–0.055	–0.058	–0.071	–0.057
	(0.058)	(0.099)	(0.059)	(0.095)	(0.089)	(0.065)	(0.088)	(0.065)
INTANGIBLES	–0.213	**–0.311*****	–0.190	**–0.327*****	–0.144	1.342	–0.125	1.291
	(0.162)	(0.101)	(0.164)	(0.098)	(0.095)	(0.857)	(0.115)	(0.885)
LEVERAGE					0.004	**–0.228****	0.022	**–0.225****
					(0.104)	(0.100)	(0.103)	(0.098)
CASH	–0.072	0.052	–0.087	0.050	0.060	–0.045	0.038	–0.045
	(0.078)	(0.056)	(0.076)	(0.056)	(0.070)	(0.055)	(0.076)	(0.055)
FAMILY	**–0.147*****	0.015	**–0.143*****	0.014	–0.067	–0.049	–0.059	–0.048
	(0.040)	(0.035)	(0.039)	(0.035)	(0.047)	(0.039)	(0.046)	(0.039)
TENURE	**0.004****	0.002	**0.003****	0.002	**0.003****	**0.004****	**0.002****	**0.004****
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.002)	(0.001)	(0.002)
BOARD	**–0.038****	0.021	**–0.036****	0.019	–0.002	–0.001	–0.001	–0.003
	(0.015)	(0.021)	(0.016)	(0.021)	(0.021)	(0.019)	(0.020)	(0.020)

(Continues)

TABLE 7

CONTINUED

	ETR	ETR	ETR	ETR	ETR	ETR	ETR	ETR
	HIGH LEV	LOW LEV	HIGH LEV	LOW LEV	OLDER	YOUNGER	OLDER	YOUNGER
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
(Intercept)	**0.503****	–0.045	**0.521*****	–0.055	0.175	**0.456****	0.133	**0.496****
	(0.195)	(0.201)	(0.196)	(0.196)	(0.193)	(0.201)	(0.198)	(0.190)
Industry effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	186	186	186	186	181	191	181	191
F-value	4.80	4.85	5.06	5.30	2.81	3.58	3.14	3.75
Sig. F-value	<0.001	<0.001	<0.001	<0.001	<0.001	<0.001	<0.001	<0.001
R^2	28.37	13.41	28.11	13.96	17.75	21.88	17.70	21.63
Adjusted R^2	23.11	4.56	22.73	5.10	8.61	13.70	8.55	13.43
VIF	1.86	2.47	1.87	2.46	1.96	2.32	1.95	2.32

The dependent variable is the effective tax rate (*ETR*). All variables are defined in Table 1. Robust standard error values are reported in parentheses. *, **, and *** denote statistical significance (two-tailed) at the 10%, 5%, and 1% levels, respectively. A firm belongs to the HIGH (LOW) LEV subsample if the firm's leverage (*LEVERAGE*) exceeds (is below or equal to) the leverage of the median firm in the full sample. A firm belongs to the OLDER (YOUNGER) subsample if the firm's age exceeds (is below or equal to) the natural logarithm of the median firm age in the full sample.

(is below or equal to) the median firm age in our sample. Firm age is hereby calculated as the difference between the year 2018 (i.e., the year of interest) and the firm's founding date (*AGE*). Table 7 reports a significant positive association between reputational concerns and the effective tax rate when the firm is older. We attribute this finding to a higher cost of reputation damage to the firm's reputational capital as older firms have built up more reputational capital.[14]

Overall, the combined findings indicate that maintaining a firm's reputational capital towards its creditors amplifies the importance of reputational concerns as a disincentive for tax avoidance.

Significance of personal incentives Next, we investigate whether personal incentives moderate the relationship between reputational concerns and tax avoidance. We proxy this by looking at the setting of family firms, eponymous firms, and monetary incentives associated with the liquidation reserve.

As SMEs are characterized by a highly centralized management structure and manager-owner overlap, firm decisions can be strongly influenced by individuals' personal values and intuitions (Sen and Cowley, 2013). In this spirit, prior literature argues that family owners often have a deep emotional investment in their companies (Bubolz, 2001) as their family's fortune, personal satisfaction, and even public reputation are tied to the business (Ward, 2004). The firm's management is thus expected to take corporate decisions that meet the family's affective needs, such as identity, the ability to exercise family influence, and perpetuating the family dynasty (De Massis *et al.*, 2014; Gómez-Mejía *et al.*, 2007). Hence, it is possible that family business leaders will have a greater tolerance of threats to financial welfare to protect the firm's reputation, since it is a direct reflection of the family and its manager. Table 8, columns 1–2 show the results for the moderating effect of family ownership on the relationship between reputational concerns and tax avoidance. The moderating effect is measured through an interaction between *REPUTATION* and *FAMILY*.[15] However, we find no evidence of a significant interaction term suggesting that reputational concerns weigh more heavily in the tax planning strategy for family firms.

In a robustness check, *FAMILY* is replaced by the controlling family's share percentage (*FAMILY SHARE*). Untabulated results show similar results. We further check whether there is a difference between family firms with minority shareholders (*MINORITY*) and family firms with full family ownership (*FULL FAMILY*). Family firms without minority shareholders have more freedom to incorporate personal damages into their decision making (see, also, Steijvers and

[14] It is possible that these results are driven by generational effects pertaining to management characteristics. As such, we perform our analyses once more while also including a control for first-generation managers (*GENERATION1*). Untabulated results confirm our prior findings, indicating that our results are robust to generational effects.

[15] A rather unbalanced percentage of firms in our sample are family firms (about 87%). This results in subsamples with low numbers of observations, which ultimately reduces the degrees of freedom and thus impedes the power of a linear regression method performed with subsamples. Consequently, we use interaction variables and refrain from using subsamples.

TABLE 8

REPUTATIONAL CONCERNS AND PERSONAL INCENTIVES

	ETR	ETR	ETR	ETR	ETR	ETR
	(1)	(2)	(3)	(4)	(5)	(6)
Test variables						
REPUTATION1	**0.025****		**0.024****		0.001	0.015
	(0.012)		(0.012)		(0.018)	(0.018)
REPUTATION2		**0.026****		**0.025****		
		(0.012)		(0.012)		
REPUTATION X FAMILY	0.008	0.006				
	(0.035)	(0.032)				
REPUTATION X EPONYMOUS			–0.015	–0.036		
			(0.023)	(0.024)		
REPUTATION X REMUN					0.027	0.011
					(0.023)	(0.023)
Control variables						
EPONYMOUS			–0.028	–0.028		
			(0.020)	(0.020)		
REMUN					–0.016	0.015
					(0.058)	(0.068)
STR	–0.393	–0.347	–0.404	–0.359	–0.382	–0.350
	(0.483)	(0.476)	(0.487)	(0.479)	(0.483)	(0.477)
NOL	**–0.107*****	**–0.110*****	**–0.108*****	**–0.110*****	**–0.108*****	**–0.112*****
	(0.033)	(0.033)	(0.033)	(0.033)	(0.034)	(0.033)
LOG ASSETS	0.005	0.005	0.006	0.005	0.008	0.008
	(0.012)	(0.012)	(0.012)	(0.012)	(0.013)	(0.012)
ROA	**–0.171***	**–0.168***	**–0.178***	**–0.176***	–0.145	–0.145
	(0.095)	(0.094)	(0.095)	(0.094)	(0.092)	(0.092)
PPE	–0.055	–0.062	–0.051	–0.059	–0.042	–0.049
	(0.054)	(0.053)	(0.054)	(0.053)	(0.054)	(0.054)
INTANGIBLES	–0.110	–0.111	–0.121	–0.114	–0.109	–0.100
	(0.120)	(0.128)	(0.120)	(0.130)	(0.111)	(0.118)
LEVERAGE	–0.105	–0.085	–0.105	–0.083	–0.118	–0.096
	(0.074)	(0.072)	(0.074)	(0.071)	(0.075)	(0.073)
CASH	0.010	0.007	0.015	0.025	0.013	0.013
	(0.044)	(0.044)	(0.044)	(0.044)	(0.045)	(0.044)
FAMILY	**–0.054***	**–0.053***	**–0.049***	**–0.049***	**–0.054***	**–0.052***
	(0.028)	(0.028)	(0.029)	(0.029)	(0.028)	(0.028)
TENURE	**0.002****	**0.002****	**0.003****	**0.002****	**0.002****	**0.002****
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
BOARD	–0.005	–0.006	–0.004	–0.003	–0.006	–0.006
	(0.013)	(0.013)	(0.013)	(0.013)	(0.013)	(0.013)
(Intercept)	**0.351****	**0.338****	**0.350****	**0.341****	**0.322****	**0.282***
	(0.138)	(0.137)	(0.137)	(0.135)	(0.146)	(0.146)
Industry effects	Yes	Yes	Yes	Yes	Yes	Yes
N	372	372	372	372	372	372
F-value	3.66	4.05	3.54	4.22	4.08	4.56
Sig. F-value	<0.001	<0.001	<0.001	<0.001	<0.001	<0.001
R^2	13.93	14.26	14.37	15.18	16.72	16.69
Adjusted R^2	9.29	9.63	9.49	10.34	11.47	11.44
VIF	2.02	2.01	1.98	1.98	1.92	1.92

The dependent variable is the effective tax rate (*ETR*). All variables are defined in Table 1. Robust standard error values are reported in parentheses. *, **, and *** denote statistical significance (two-tailed) at the 10%, 5%, and 1% levels, respectively.

Niskanen, 2014). Yet, untabulated results again show no significant effect of being a family firm on the relationship between reputational costs and tax avoidance. Note that the descriptive statistics in Table 3 regarding these additional variables indicate that the vast majority of family firms in our sample are characterized by full family ownership. The absence of a significant effect may be driven by the homogenous nature of our sample and/or the lack of minority shareholders.

Similar to family firms, eponymous firms are expected to face heightened reputational costs. Eponymous firms are named after the shareholder and/or management. Naming the firm with someone's surname can be a useful tool to signal quality to the outside world, and therefore acts similarly to a brand (McDevitt, 2014), allowing the firms' founders to signal their competence (Belenzon *et al.*, 2017), while engendering an identity with which customers can become familiar (see Gallucci *et al.*, 2015). It is possible that firms' actions are influenced by a desire to safeguard the affiliated surname. Prior literature already points out that eponymous firms outperform their non-eponymous counterparts because of more customer-oriented and socially responsible actions. These actions are considered the result of the owner's desire to protect their surname (Kashmiri and Mahajan, 2010). As such, reputational concerns might weigh heavier in the tax planning of eponymous firms than non-eponymous firms. *EPONYMOUS* is a binary variable indicating one if the firm name encompasses at least one of the surnames of the firm's board members or management, zero otherwise[16]. The moderation is measured as an interaction between *REPUTATION* and *EPONYMOUS*.[17] Table 8, columns 3–4 report the results. We find no significant coefficient loading on the interaction term between either measure of reputational concerns and the dichotomous variable *EPONYMOUS*.

Lastly, we examine if monetary incentives, such as the existence of liquidation reserves, moderate the relationship between reputational concerns and corporate tax avoidance. The liquidation reserve allows proprietors to circumvent or decrease their withholding tax in at least five years into the future by paying an additional corporate tax expense of 10% of the reserved amount when the reserve is created this year. If the reserves are used to offset firm losses in the future when the reserves have not yet been paid out, the proprietor loses their financial advantage as Belgian law does not allow proprietors to recoup the prepaid corporate tax expense. Ergo, consequences of reputation damage due to tax avoidance threaten the proprietor's future payout (and thus create a monetary incentive to avoid potential firm losses). We take up a binary variable *REMUN* that takes on the value of one when a firm has a liquidation reserve, zero otherwise. The summary statistics of Table 3 report that around 70% of our

[16] We only examine full (sur)names. Hence, firms with a name agglomeration of owners are not considered eponymous firms.

[17] As with the variable *FAMILY*, again a rather unbalanced percentage of firms in our sample are eponymous (32%). This results in subsamples with low numbers of observations, which ultimately reduces the degrees of freedom and thus impedes the power of a linear regression method performed with subsamples. Consequently, we use interaction variables and refrain from using subsamples.

sample has such reserves on the balance sheet. In order to measure whether these monetary incentives moderate the effect of reputational concerns on tax avoidance, we take up the interaction variable *REPUTATION* × *REMUN*. Table 8, columns 5–6 show no significant moderation of these monetary incentives on the relationship between reputational concerns and corporate tax avoidance.

Altogether, while we cannot conclude that heightened personal reputational ties with the firm exert a significant effect on the relation between reputational concerns and tax planning behaviour, this analysis suffers from two important limitations. First, our paper employs a rather small sample size, such that the lack of statistical significance may be an artefact stemming from a lack of degrees of freedom. Second, while we have attempted to measure personal ties using three distinct proxies, it remains important to note that personal ties are by their very nature difficult to approximate. As such, the combination of these issues makes it difficult to confidently exclude their moderating impact.

Distribution Analyses of the Effective Tax Rate

This section examines whether reputational concerns act as a corporate tax avoidance deterrent in general or whether this is limited to aggressive tax positions, in two ways. First, we employ quantile regressions. General regression methods, such as the previously used ordinary least square regressions focus solely on the central tendency of the distribution, which does not allow for the possibility that the impact of reputational concerns can be different for different levels of corporate tax avoidance. Given that the distribution of the effective tax rates imply different levels of scrutiny—higher effective tax rates are likely to draw less attention from stakeholders compared to lower effective tax rates—the role of reputational concerns may differ. We estimate our model on five quantiles: the 10^{th}, 25^{th}, 50^{th}, 75^{th}, and 90^{th} quantiles. Table 9, columns 1–5 (6–10) show the quantile regressions for *REPUTATION1* (*REPUTATION2*). We find that significant positive associations between reputational concerns and effective tax rates occur in the 10^{th} and 25^{th} quantiles for both reputational concern measures. These findings suggest that reputational concerns mainly disincentivize lower bound effective tax rates, which are typically associated with aggressive tax positions.

Second, we examine if reputational concerns are associated with more or less tax aggressive firms, which are defined as those firms with the 10% lowest sector-adjusted effective tax rates (Hanlon and Heitzman, 2010). We create the binary variable *TAXAG* taking the value of one if the firm is tax aggressive according to this definition, zero otherwise. Next, we rerun equation (1) using a logit specification. Table 9, columns 11–12 show that more client-related reputational concerns (*REPUTATION*) are significantly less associated with tax aggressive firms.

Overall, these regressions suggest that reputational concerns mainly deter aggressive tax avoidance positions.

TABLE 9

DISTRIBUTION ANALYSES OF THE EFFECTIVE TAX RATE

	ETR	ETR	ETR	ETR	ETR
	QUANTILE	QUANTILE	QUANTILE	QUANTILE	QUANTILE
	10	25	50	75	90
	(1)	(2)	(3)	(4)	(5)
REPUTATION1	**0.013***	**0.025****	0.014	0.012	0.019
	(0.008)	(0.012)	(0.009)	(0.014)	(0.032)
Controls	Yes	Yes	Yes	Yes	Yes
Industry effects	Yes	Yes	Yes	Yes	Yes
N	372	372	372	372	372
WLS-value	18.52	36.92	48.30	42.55	25.34
	ETR	ETR	ETR	ETR	ETR
	QUANTILE	QUANTILE	QUANTILE	QUANTILE	QUANTILE
	10	25	50	75	90
	(6)	(7)	(8)	(9)	(10)
REPUTATION2	**0.030*****	**0.028****	0.006	0.011	0.015
	(0.010)	(0.012)	(0.010)	(0.011)	(0.034)
Controls	Yes	Yes	Yes	Yes	Yes
Industry effects	Yes	Yes	Yes	Yes	Yes
N	372	372	372	372	372
WLS-value	18.27	36.60	48.45	42.61	25.33
	TAXAG	TAXAG			
	FULL SAMPLE	FULL SAMPLE			
	(11)	(12)			
REPUTATION1	–0.278				
	(0.214)				
REPUTATION2		**–0.051****			
		(0.214)			
Controls	Yes	Yes			
Industry effects	Yes	Yes			
N	372	372			
χ^2-value	30.95	35.21			
Sig. χ^2-value	<0.001	<0.001			

The dependent variables are the effective tax rate (*ETR*) and tax aggressive firms (*TAXAG*). All variables are defined in Table 1. Robust standard error values are reported in parentheses. *, **, and *** denote statistical significance (two-tailed) at the 10%, 5%, and 1% levels, respectively. Columns 1–10 are performed using quantile regressions. Columns 11 and 12 are performed using logit regressions.

Tax Avoidance Effort

Thus far, the results obtained in our paper make use of the effective tax rate, which captures the *ex post* outcome of the firm's tax planning but not the extent to

which the firm actively engages in tax planning (Hanlon and Heitzman, 2010). Therefore, we repeat prior analyses using a measure of tax avoidance effort (*EFFORT*) obtained through survey responses. This measure entails the firm response on a five-point Likert scale to the statement whether 'The firm aims to minimize its tax expenses'. A higher value indicates greater effort to lower tax expenses. Table 10 reports the results of our previous analyses using the new dependent variable.

Table 10, columns 1–2 show a negative and significant relationship between reputational concerns and tax avoidance effort, once again confirming H_a and rejecting H1. This is consistent with our empirical prediction that a firm reduces its effort to obtain cash tax savings when reputational concerns are higher. Table 10, columns 3–6 (7–10) shows the relationship between reputational concerns (*REPUTATION*) and tax avoidance effort (*EFFORT*) in subsamples based on the firm's cash level (ratio of working capital to total assets). We conclude that reputational concerns are associated with significantly less tax avoidance effort in firms with lower financial freedom. In Table 9, columns 11–14 (15–18), we split our samples based on creditor dependency (firm age) to study the moderating impact of reputational capital. Once more, we find that both measures of reputational concerns are negatively associated with tax avoidance effort only in the sample of highly leveraged SMEs and older SMEs. Consistent with our previous findings, untabulated results show no significant moderating impact of family firms (*FAMILY*) or eponymous firms (*EPONYMOUS*) on the relationship between reputational concerns and exerted tax avoidance. Overall, these findings are similar to our previous conclusions using the effective tax rate as our dependent variable.

It should be noted that the *EFFORT* variable may also capture a firm's tax planning need and not solely the effort made to avoid taxes. For example, the change in the Belgian statutory tax rate may have led some firms to revise their overall tax structures. In this case, these firms would have a higher tax planning need, reporting a higher value of *EFFORT* than firms that did not reshape their tax structure, even though these firms may have retained their prior level of tax avoidance. To ensure that our results pertain to the effort made to avoid tax and not perceived tax planning need, we rerun our prior analyses while including two additional controls: *COMPLEXITY* and *COMPLIANCE*. The variable *COMPLEXITY* is the firm response on a five-point Likert scale to the statement whether 'The firm experiences trouble navigating the tax rules'. We argue that this measure is related to the complexity of the SME's tax environment. A higher value should therefore be linked to a higher tax planning need. The variable *COMPLIANCE* is the firm's response on a five-point Likert scale to the statement whether 'The firm aims to maximize tax compliance'. Similar to the *EFFORT* variable, a firm engaging in more tax planning overall should indicate a higher response for this question. Untabulated results show that our results remain unchanged when controlling for overall tax planning need. The control variables *COMPLEXITY* and *COMPLIANCE* show significant positive effects on *EFFORT* (both $p < 0.05$), which is in line with the notion that a higher tax

TABLE 10

TAX AVOIDANCE EFFORT MEASURE

	EFFORT	EFFORT
	FULL SAMPLE	FULL SAMPLE
	(1)	(2)
REPUTATION1	**–0.122****	
	(0.056)	
REPUTATION2		**–0.112***
		(0.059)
Controls	Yes	Yes
Industry effects	Yes	Yes
N	366	366
F-value	2.17	1.89
Sig. F-value	0.004	0.016
VIF	2.04	2.04

	EFFORT	EFFORT	EFFORT	EFFORT	EFFORT	EFFORT	EFFORT	EFFORT
	HIGH CASH	LOW CASH	HIGH CASH	LOW CASH	HIGH WC	LOW WC	HIGH WC	LOW WC
	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
REPUTATION1	–0.103	**–0.172****			–0.081	**–0.164****		
	(0.080)	(0.085)			(0.086)	(0.079)		
REPUTATION2			–0.128	–0.100			–0.134	–0.068
			(0.096)	(0.080)			(0.089)	(0.091)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	185	181	185	181	186	180	186	180
F-value	2.25	1.72	2.21	1.24	1.71	2.21	1.66	1.75
Sig. F-value	0.005	0.044	0.005	0.235	0.036	0.004	0.044	0.031
VIF	2.47	1.95	2.46	1.94	2.04	2.08	2.04	2.07

	EFFORT	EFFORT	EFFORT	EFFORT	EFFORT	EFFORT	EFFORT	EFFORT
	HIGH LEV	LOW LEV	HIGH LEV	LOW LEV	OLDER	YOUNGER	OLDER	YOUNGER
	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)
REPUTATION1	**–0.298***** (0.066)	0.019 (0.084)			**–0.162**** (0.076)	–0.104 (0.084)		
REPUTATION2			**–0.137*** (0.076)	–0.089 (0.093)			**–0.182**** (0.074)	–0.050 (0.090)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	183	183	183	183	177	189	177	189
F-value	2.90	1.90	1.81	1.93	3.04	1.02	2.76	0.93
Sig. F-value	<0.001	0.022	0.029	0.019	<0.001	0.437	<0.001	0.539
VIF	1.83	2.51	1.84	2.50	1.94	2.32	1.94	2.31

The dependent variable is the tax avoidance effort based on a five-point Likert scale (*EFFORT*). All variables are defined in Table 1. Robust standard error values are reported in parentheses. *, **, and *** denote statistical significance (two-tailed) at the 10%, 5%, and 1% levels, respectively. A firm belongs to the HIGH (LOW) CASH subsample if the firm's cash holding level (*CASH*) exceeds (is below or equal to) the cash holding level of the median firm in the full sample. A firm belongs to the HIGH (LOW) WC subsample if the firm's ratio of working capital to total assets exceeds (is below or equal to) the ratio of working capital to total assets of the median firm in the full sample. A firm belongs to the HIGH (LOW) LEV subsample if the firm's leverage (*LEVERAGE*) exceeds (is below or equal to) the leverage of the median firm in the full sample. A firm belongs to the OLDER (YOUNGER) subsample if the firm's age exceeds (is below or equal to) the natural logarithm of the median firm age in the full sample.

planning need leads to more (perceived) planning surrounding the minimization of tax expenses.

CONCLUSION

Because SMEs are characterized by lower levels of public scrutiny, it is *ex ante* unclear whether reputational costs play a significant role in their tax avoidance strategies. Using survey data from 372 Belgian SMEs, we uncover that reputational concerns are significantly associated with higher effective tax rates. While only a minority of SMEs report reputational concerns, such concerns significantly deter SMEs from engaging in tax avoiding behaviour.

We next study firm characteristics that may moderate this relationship. We find that reputational concerns act as a stronger disincentive to corporate tax avoidance when firms have less financial freedom (approximated by the levels of cash and cash equivalents as well as their working capital position), and when they have creditor relations to maintain (approximated through firm leverage and firm age). However, we find no support for personal incentives (approximated through family firms, eponymous firms, and monetary incentives) moderating the relationship between reputational concerns and corporate tax avoidance. Results from quantile regressions and a logit model indicate that reputational concerns mainly act as a deterrent to aggressive tax avoidance positions.

Altogether, our findings extend the existing literature on how reputational concerns affect a firm's tax planning by showing that reputational concerns can still matter in a setting where firms face less scrutiny. Furthermore, we contribute by pointing out that firm characteristics moderate this relationship. Understanding of which reputational concerns act as an inherent control mechanism in relation to firms' tax avoidance is also of importance to practitioners. Many tax administrations across the globe employ a risk-based tax audit approach for which the impact of these audits is dependent on the audit selection strategy (OECD, 2011). Our findings aid in understanding which taxpayers' tax audits will be more effective.

Although this paper provides novel and direct insights into the extent to which SMEs engage in corporate tax avoidance, our study is still subject to certain limitations. First, while this paper focuses on general reputational concerns (and client-oriented reputational concerns), there are many other forms in which such concerns can manifest themselves. Future research can expand on this study by examining the myriad specific and fine-grained types of reputational concerns. Moreover, an interesting avenue of future research could answer several follow-up questions pertaining to these different tax-related concerns. For example, how does the aim to develop a positive relationship with the tax administration or tax morale drive these concerns? Second, we cannot confirm or reject the notion that personal incentives moderate the relationship between reputational concerns and corporate tax avoidance. This may be due to our sample size or to the homogeneity of our firm sample relating to personal incentives. For example,

the vast majority of family firms in our sample are fully family owned and consequently lack monitoring by minority shareholders. Future research can explore the role of personal incentives as a moderator further by examining more heterogeneous firm structures. Third, future research can also re-examine this relationship internationally. While Belgium is representative of other EU countries in terms of its accounting practices and fiscal rulings, our findings may not be generalizable to settings with less transparency regarding tax expenses, such as the US where SMEs do not have to publicly disclose their financial statements. Finally, an interesting avenue for future research would be to repeat this analysis over a longer time period. This would allow us to increase our understanding of how the institutional environment affects our findings. For instance, do changes in the statutory tax rates or government efforts to battle tax avoidance alter the role reputational concerns play in firms' tax strategy?

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