How Do Italian Private Companies Respond to a Reduction in the Corporate Standard Tax Rate? A Focus on the Ownership Gender Diversity Effect

Simone Poli

Department of Management, Università Politecnica delle Marche

Piazzale R. Martelli 8, Ancona 60121, Italy

Tel: 39-071-220-7258   E-mail: s.poli@univpm.it

Abstract

Cuts in the corporate standard tax rate can encourage companies to manage their earnings in order to save on taxes by shifting earnings from the fiscal year in which it is higher to the fiscal year in which it is lower. This phenomenon has been very little explored for private companies, despite their importance in many countries around the world. Moreover, no previous study has verified whether certain features of private companies' ownership structure may affect the aforementioned phenomenon. In order to contribute to filling this knowledge gap, this study aims to verify whether the gender of the owners has any impact. Focusing on Italian private companies, this study shows that they responded to the cut in the corporate standard tax rate that came into force in fiscal year 2017 by putting in place earnings management practices that shifted profits from FY 2016 to FY 2017. At the same time, it shows that the gender of owners has not had any impact on the phenomenon; in other words, Italian female-owned and male-owned private companies do not behave in statistically different ways.

1. Introduction

Cuts in the corporate standard tax rate can encourage companies to manage their earnings in order to save on taxes by shifting earnings from the fiscal year in which it is higher to the fiscal year in which it is lower (e.g. Scholes et al., 1992; Klassen et al., 1993; Guenther, 1994;

Maydew, 1997; Lopez et al., 1998; Roubi & Richardson, 1998; Lin et al., 2012; Watrin et al., 2012; Lin et al., 2014; Mattei, 2014a; Mattei, 2014b; Sundvik, 2016; Höglund & Sundvik, 2016; Sundvik, 2017a; Sundvik, 2017b; Sundvik, 2017c; Dobbins et al., 2018; Haga et al., 2019). In a recent review of the literature, Sundvik (2017a) found that this phenomenon has been underexplored in private companies, despite their importance in many countries around the world.

Among other aspects of this topic, no previous study has verified, for example, whether certain features of the ownership structure may affect the aforementioned phenomenon. In order to contribute to filling this knowledge gap, this study aims to verify whether the gender of the owners has any impact on the phenomenon.

The hypothesis that the gender of company owners can have an impact on the phenomenon under examination is suggested by the extant literature. According to numerous scholars, (e.g. Betz et al., 1989; Ruegger & King, 1992; Johnson & Powell, 1994; Khazanchi, 1995; Bernardi & Arnold, 1997; Eynon et al., 1997; Jianakoplos & Bernasek, 1998; Sunden & Surette, 1998; Barber & Odean, 2001; Olsen & Cox, 2001; Bliss & Potter, 2002; Dwyer et al., 2002; Graham et al., 2002; Watson & Robinson, 2003; Schubert, 2006; Watson & McNaughton, 2007), females are more risk averse and ethical than their male counterparts in different fields, including accounting and finance. Since earnings management practices can be perceived as risky and unethical (e.g., Healy & Wahlen, 1999; Roychowdhury, 2006) and since females have been found to be more risk averse and ethical than their male counterparts, the spread and intensity of the phenomenon under consideration may be influenced by gender.

The investigation has been carried out with reference to the case of Italian private companies. The Italian context appears to be particularly fruitful for the investigation because the Italian government has recently cut the corporate standard tax rate (it was lowered from 27.5% to 24%, starting from FY 2017).

The paper proceeds as follows. Section 2 develops the research hypotheses. Section 3 describes the research methodology. Section 4 shows the empirical results. Section 5 concludes and highlights the main contributions to the literature, the limitations of the study, and possible further research opportunities.

2. Research Hypotheses Development

2.1 The Relationship Between Private Companies and the Practice of Shifting Profits From the Fiscal Year in Which the Corporate Standard Tax Rate Is Higher to That in Which It Is Lower

Previous studies have amply documented that cuts in the corporate standard tax rate encourage companies to practice earnings management by shifting profits from the fiscal year in which it is higher to the fiscal year in which it is lower in order to save on taxes (e.g. Scholes et al., 1992; Klassen et al., 1993; Guenther, 1994; Maydew, 1997; Lopez et al., 1998; Roubi & Richardson, 1998; Lin et al., 2012; Watrin et al., 2012; Lin et al., 2014; Sundvik, 2016; Höglund & Sundvik, 2016; Sundvik, 2017a; Sundvik, 2017b; Sundvik, 2017c; Dobbins

et al., 2018; Haga et al., 2019). This phenomenon appears to be more frequent and intense in private companies than in public companies. There may be different reasons, including, for example, that private companies do not face as much market pressure or that they have fewer negative consequences if they report lower earnings.

As specifically concerns the Italian setting, Mattei (2014a) and Mattei (2014b) investigated the phenomenon under consideration with reference to a previous corporate standard tax rate cut (2008). They found that private companies shifted earnings from FY 2007 to FY 2008, thus managing their earnings.

With reference to the cut in the corporate standard tax rate implemented by the Italian government as of 2017 and in light of the findings of previous studies, the following research hypothesis is tested:

H_1: In Italy, private companies report significantly more negative current accruals before the tax rate cut than in other periods, all else being equal.

2.2 The Relationship Between the Gender of Owners and the Practice of Shifting Profit From the Fiscal Year in Which the Corporate Standard Tax Rate Is Higher to That in Which It Is Lower

Previous studies have compared females to males and found that women are more risk averse and less frequently overconfident in the field of accounting and finance (e.g. Jianakoplos & Bernasek, 1998; Sunden & Surette, 1998; Olsen & Cox, 2001; Dwyer et al., 2002; Graham et al., 2002; Watson & Robinson, 2003; Watson & McNaughton, 2007) and on financial matters in general (e.g. Johnson & Powell, 1994; Barber & Odean, 2001; Bliss & Potter, 2002; Schubert, 2006), more ethical in business contexts (e.g. Ruegger & King, 1992; Khazanchi, 1995; Eynon et al., 1997); they also behave less unethically in the work place to gain financial rewards (e.g. Bernardi & Arnold, 1997; Betz et al., 1989). Because earnings management practices are often perceived as risky and unethical behaviors (e.g. Healy & Wahlen, 1999; Roychowdhury, 2006), it can be seen how women may view such practices less favorably than men.

Previous studies that have investigated the relationship between gender diversity and earnings management have focused on the gender diversity in board of directors and have found that it constrains earnings management (e.g. Arun et al., 2015; Gavious et al., 2012; Gull et al., 2018; Krishnan & Parsons, 2008; Labelle et al., 2010; Srinidhi et al., 2011). However, they have neglected the gender diversity in ownership (Khlif & Achek, 2017).

With reference to Italian private companies, previous studies have not found that female ownership and the propensity to practice some forms of earnings management are negatively related. Rather, Poli (2017a) has found that the relationship between the incidence of female ownership and the magnitude of abnormal working capital accruals is quadratic, and Poli (2017b) has also found that female-owned and non female-owned companies have the same propensity to engage in "earnings minimisation" and "earnings change minimisation". These results suggest testing the following research hypothesis:

H_2: In Italy, in the context of private companies, female-owned companies do not report significantly less negative discretionary accruals than male-owned companies before the tax rate cut, all else being equal.

3. Research Methodology

3.1 Testing Sample

The research hypotheses posited above were tested on a sample of Italian private companies belonging to economic sectors other than the financial sector. The sample companies were extracted (on 12th July 2019) from the AIDA database containing the economic and financial data of all Italian private companies. The selection criteria are reported in Table 1, below.

Table 1. Selection criteria of sample companies

Selection criteria	Motivations
Limited liability companies	Companies required to prepare financial statements
Private (unlisted) companies, with ownership structure composed of only individuals	Companies related to research hypotheses
Active companies, with total shareholder equity > 0 and total revenues > € 1,000 for all the years	Excluding distressed and non-operating companies
Companies presenting financial statements prepared according to Italian legislation and generally accepted accounting principles, in the ordinary (not abbreviated) form (when, for two consecutive fiscal years, the company exceeds two of the following three parameters: total assets € 8,800,000; total revenues € 4,400,000; average number of employees: 50), for the maximum number of years (2009-2017)	Displaying homogeneity in terms of rules for preparing the financial statements (international accounting standards are rarely adopted by Italian private companies), and having all the data necessary to carry out the investigation

Of a total of 4,612 companies that met the selection criteria and reported complete and valid data, 302 companies were rejected because the economic sector to which they belong (based on the ATECO 2007 codes, the Italian system of economic sector classification) appeared under-represented (<30 companies). Therefore, 4,310 companies (corresponding to 8,620 firm-year observations) were used to carry out the investigation. To avoid the problem of outliers, the dependent variable and some of the control variables that derive from financial statement ratios (specifically, ROA and GROWTH) were winsorised at the level of the first

and ninety-ninth percentile.

3.2 Testing Methodology

The research hypothesis H1 has been tested through the OLS model that follows:

$$DCA = \beta_0 + \beta_1 PRETAXCUT + \sum_{i=2}^{n} \beta_i CV_i + \varepsilon \qquad (1)$$

where:

DCA	discretionary current accruals
PRETAXCUT	dummy variable assuming value 1 if the observation occurs in FY 2016 (before the corporate standard tax rate cut), and 0 otherwise
CV_i	control variables

As in previous studies (e.g. Lin et al., 2014; Mattei, 2014a), the hypothesis that companies have managed earnings by decreasing them in the fiscal year in which the tax rate is higher and increasing them in the fiscal year in which the tax rate becomes lower has been tested by introducing a dummy variable (PRETAXCUT) aiming to represent the two years in question. Research hypothesis H1 is confirmed if the regression coefficient of PRETAXCUT is found to be negative and statistically significant.

Research hypothesis H2 has been tested through the OLS model that follows:

$$DCA = \beta_0 + \beta_1 PRETAXCUT + \beta_2 FEMALE\_OWN + \beta_3 PRETAXCUT\_FEMALE\_OWN + \sum_{i=4}^{n} \beta_i CV_i + \varepsilon \quad (2)$$

where:

DCA	discretionary current accruals, as above
PRETAXCUT	dummy variable assuming value 1 if the observation occurs in FY 2016 (before the corporate standard tax rate cut), and 0 otherwise, as above
FEMALE_OWN	dummy variable assuming value 1 if the portion of capital held by female owners is greater than 0.50, value 0 if the portion of capital held by male owners is greater than 0.50
PRETAXCUT_FEMALE_OWN	interaction term between PRETAXCUT and FEMALE_OWN
CV_i	control variables, as above

Considering how FEMALE_OWN is measured, companies in which female owners and male owners hold the same portion of capital (0.50) were excluded from the analysis. However, it has been alternatively measured through a dummy variable assuming value 1 if the portion of

capital held by female owners is greater than 0.50, value 0 if the portion of capital held by male owners is equal to or less than 0.50. In this case, companies in which female owners and male owners hold the same portion of capital (0.50) were included in the analysis, and the relative observations are coded 0. Since the analysis has shown that the results are qualitatively the same using the two different variables, demonstrating that the results are not sensitive to the way in which the variable under examination is measured, the results that will be shown are those relating to the first variable described above.

As in previous studies (e.g. Lin et al., 2014; Mattei, 2014a), the hypothesis that one type of company has managed earnings (decreasing them in the fiscal year in which the tax rate is higher and increasing them in the fiscal year in which the tax rate becomes lower) more than another type of company has been tested by adding a dummy variable (FEMALE_OWN), aiming to indicate the two types of company, and the interaction term (PRETAXCUT_FEM_OWN) between this variable and the dummy variable (PRETAXCUT) aiming to indicate the two years to the previous regression model. Research hypothesis H2 is confirmed if the regression coefficient of PRETAXCUT_FEMALE_OWN is not statistically significant or is positive and statistically significant.

3.3 The Discretionary Current Accruals (DCA)

As in previous studies (e.g. Guenther, 1994; Lin et al., 2014; Mattei, 2014a; Roubi & Richardson, 1998), DCA were used to proxy earnings management. DCA are the differences between total current accruals (TCA) and non-discretionary current accruals (NDCA). With reference to Italian companies, TCA cannot be directly calculated as the difference between specific configurations of earnings and cash flows because Italian companies were not required to prepare a statement of cash flows until FY 2016. Consequently, they could only be calculated indirectly, using balance sheet data, and were approximated, as suggested by Poli (2017). Using the items on the balance sheets prepared by the sample companies according to Italian legislation, DCA are given by the algebraic sum of the changes in inventories (+), accounts receivable (with the exclusion of deferred tax asset) (+), accrued revenue and prepaid expenses (+), accounts payable (−), and accrued liabilities and deferred revenue (−). According to Poli (2017a: 15-16), "With regard to accounts payable, the financial reporting prepared in accordance with the Italian legislation does not report separately those involving parent companies, subsidiaries and associated companies. The items that report the amounts due to such companies include both accounts payable and financial debts, distinguishing them only according to the due time (before/after 12 months from the financial reporting date). […] only the portion of the item due within 12 months from the financial reporting date (assuming that the rest is represented by financial debts) is taken into account".

NDCA were calculated by means of the so-called "Modified Jones Model" (Dechow et al., 1995; Jones, 1991). Specifically, for each company included in the sample, the following procedure was adopted (Lin et al., 2014):

1. using the data for the six years between 2010 and 2015, the following regression model (1) was estimated:

$$\frac{CA}{ASSETS} = \beta_1 \frac{1}{ASSETS} + \beta_2 \frac{\Delta SALES - \Delta AR}{ASSETS} + \varepsilon \tag{3}$$

where:

CA: current accruals

ASSETS: total assets

SALES: sales

AR: account receivables

In literature, for the estimation of the regression model (3), a time period of six years is considered sufficient (e.g. Huguet & Gandia, 2016). This procedure assumes that, during the estimation period (2010-2015), there was no other factor that led companies to manipulate profits through DCA.

2. using the regression coefficients estimated in the previous model (3), NDCA referring to the years 2016 and 2017 were calculated as the differences between the reported current accruals and the expected current accruals as in the following equation (4):

$$DCA = \frac{CA}{ASSETS} - \left(\beta_1 \frac{1}{ASSETS} + \beta_2 \frac{\Delta SALES - \Delta AR}{ASSETS} \right) \tag{4}$$

where: DCA, CA, ASSETS, SALES, and AR are the same as above; β_1 and β_2 are the regression coefficient previously estimated

3.4 Control Variables

A set of variables was included to control for the influence of factors (for which the necessary data was available) that previous comparable studies have taken into consideration (e.g. Guenther, 1994; Lin et al., 2014; Mattei, 2014a), namely, size, indebtedness, profitability, growth, age, and economic sector. Their meanings and the way they were measured are reported in Table 2.

Table 2. Control variables

Variable	Meaning/Measurement
SIZE	*Firm size*, measured as the natural logarithm of total assets at the end of the previous fiscal year.
LEVERAGE	*Level of indebtedness*, measured as the ratio between debts of the current fiscal year and total assets at the end of the previous fiscal year.
ROA	*Firm profitability* (1), measured as the ratio between net income of the fiscal year and total assets at the end of the previous fiscal year.
LOSS	*Firm profitability* (2), measured by means of a dummy variable assuming value 1 if the observation has a negative net income, and 0 otherwise.

GROWTH	*Firm growth*, measured as the ratio between change in sales of fiscal year *t* (namely, the difference between sales in fiscal year *t* and sales in fiscal year *t-1*) and sales of fiscal year *t-1* of company *i*.
AGE	*Firm age*, measured as the natural logarithm of the number of fiscal years since the constitution of company *i*.
SECTOR	*Economic sector*, measured by means of a set of dummy variables based on the two-digit ATECO 2007 codes (the Italian system of classification of economic sectors). The base case is the economic sector that the highest number of companies belongs to.

4. Findings

Table 3, below, reports some descriptive statistics referring to the DCA levels of the sample companies. The behaviors displayed by the two types of companies is not different in terms of statistical significance. In fact, both female-owned and male-owned companies tended to report a negative DCA level in 2016 and a positive one in 2017. The difference between the DCA levels of the two types of companies is not statistically significant in 2016, nor is it so in 2017. The differences between the DCA levels of the two years and for both types of companies, instead, are statistically significant at the 1% level.

The results of the univariate analysis appear to be consistent with research hypothesis H1, according to which private companies would be inclined to shift profits from the year in which the tax rate is higher (2016) to the year in which the tax rate is lower (2017). Similarly, they appear to be consistent with research hypothesis H2, according to which female-owned companies would not be less inclined than their male-owned counterparts to shift profits from the year in which the tax rate is higher (2016) to the year in which the tax rate is lower (2017).

Table 3. Descriptive statistics and univariate analysis of DCA

Statistics	Before the rate cut (2016)			After the rate cut (2017)		
	Pooled	Female-owned companies	Male-owned companies	Pooled	Female-owned companies	Male-owned companies
Mean	-0.0071	-0.0096	-0.0067	0.0078	0.0084	0.0077
SD	0.1003	0.0988	0.1006	0.0957	0.0891	0.0957
Median	-0.0080	-0.0082	-0.0078	0.0083	0.0056	0.0083
Number	4,310	691	3,619	4,310	691	3,619

Note. [a] Verification of the statistical significance of the differences between means was not

carried out, due to the fact that the variables are not normally distributed. Verification of the statistical significance of the differences between medians, instead, was carried out through the determination of the Wilcoxon rank-sum test.

Table 4, below, reports the results of the regression analysis. The adjusted-R^2 is comparable to that of previous studies on temporal income shifting (e.g. Guenther, 1994; Lopez et al., 1998; Lin et al., 2014; Mattei, 2014a).

Table 4. Regression analysis results

Variables	Model 1 Coefficients (Robust Standard Errors[a])	Model 2 Coefficients (Robust Standard Errors[a])
Constant	-0.0206 (0.0271)	-0.0211 (0.0271)
PRETAXCUT	-0.0129* (0.0021)	-0.0122* (0.0023)
FEMALE_OWN		0.0030 (0.0037)
PRETAXCUT_FEMALE_OWN		-0.0041 (0.0054)
Control variables	Included	Included
Observations	8,620	8,620
F	6.84	6.61
Probability > F	0.0000	0.0000
adjusted-R^2	0.0447	0.0445

Note. Meaning and measurement of variables in Table 2. [a] Robust standard errors have been calculated to overcome the problem of the heteroscedasticity of regression residuals. The model does not show any collinearity problem: VIFs have been calculated, and all of them are under the limit of 10 proposed by literature (the highest is that of the interaction term). * refer to statistical significance at 1%.

With reference to model 1, the regression coefficient of PRETAXCUT is negative and statistically significant. This means that Italian private companies have reported significantly more negative discretionary current accruals in FY 2016 than in FY 2017. Thus, research hypothesis H1 is confirmed, consistent with the findings of previous studies (e.g. Watrin et al.,

2012; Lin et al., 2014; Mattei, 2014a; Mattei, 2014b; Sundvik, 2016; H öglund & Sundvik, 2016; Sundvik, 2017a; Sundvik, 2017b; Sundvik, 2017c; Dobbins et al., 2018; Haga et al., 2019).

With reference to model 2, the regression coefficient of PRETAXCUT remains negative and statistically significant, whereas that of PRETAXCUT_FEMALE_OWN is not statistically significant. This means that Italian private female-owned companies did not report significantly less negative discretionary current accruals in FY 2016 than they did in FY 2017 compared to male-owned companies. Thus, research hypothesis H2 is confirmed. These findings are consistent with those of previous studies that have investigated the relationship between the gender of owners and other earnings management practices in the context of Italian private companies (Poli, 2017a; Poli, 2017a).

Research hypothesis H2 was also tested in an alternative way.

The overall sample was divided into two sub-samples based on the predominant gender of the owners: sub-sample of female-owned companies and sub-sample of male-owned companies. In this case, only the independent variable PRETAX was included (in addition to the control variables previously considered). The results reported in Table 5, below, show that the regression coefficient of PRETAX is negative and statistically significant with reference to both sub-samples. In testing the difference between the two coefficients the results show that it is not statistically significant (p-value=0.4504). These results confirm those found previously.

Table 5. Female-owned companies versus male-owned companies

Variables	Female-owned companies	Male-owned companies
Constant	-0.0721	-0.0079
PRETAXCUT	-0.0163*	-0.0122*
Control variables	Included	Included
Observations	1,382	7,238
F	3.59	5.80
Probability > F	0.0000	0.0000
adjusted-R^2	0.0492	0.0434

Note. Meaning and measurement of variables in Table 2. [a] Robust standard errors have been calculated to overcome the problem of the heteroscedasticity of regression residuals. The model does not show any collinearity problem: VIFs have been calculated, and all of them

are under the limit of 10 proposed by literature. * refer to statistical significance at 1%.

The overall sample was divided into two sub-samples based on the year of reference: sub-sample for FY 2016 and sub-sample for FY 2017. In this case, only the independent variable FEMALE_OWN was included (in addition to the control variables previously considered). The results reported in Table 6, below, show that the regression coefficient of FEMALE_OWN is not statistically significant with reference to both sub-samples. The test for the difference between the two coefficients shows that it is not statistically significant (p-value=0.5185), confirming previous results.

Table 6. Before the tax rate cut (2016) versus after the tax rate cut (2017)

Variables	Before the tax rate cut (2016)	After the tax rate cut (2017)
Constant	-0.0187	-0.0344
FEMALE_OWN	-0.0008	0.0027
Control variables	Included	Included
Observations	4,310	4,310
F	3.67	4.24
Probability > F	0.0000	0.0000
adjusted-R^2	0.0374	0.0490

Note. Meaning and measurement of variables in Table 2. [a] Robust standard errors have been calculated to overcome the problem of the heteroscedasticity of regression residuals. The model does not show any collinearity problem: VIFs have been calculated, and all of them are under the limit of 10 proposed by literature.

5. Conclusions

The study has shown that Italian private companies responded to the cut in the corporate standard tax rate that came into force in FY 2017. They did so by adopting earnings management practices that shifted profits from FY 2016 to FY 2017, allowing companies to gain tax savings.

At the same time, the study has shown that the ownership gender did not have had an impact on the phenomenon. In other words, Italian female-owned and male-owned private companies did not behave in a statistically different way. This finding is the main contribution that this study adds to the extant literature. To the best of our knowledge, no previous study has investigated whether the gender of company owners impacts the spread and intensity of earnings management practices implemented by private companies in the

case of a cut in the corporate standard tax rate.

Due to country-level institutional differences, the findings of the study cannot be generalised to countries different from Italy. However, they constitute useful reference points for future comparative studies. In addition, they can help Italian public authorities understand the effects of cutting corporate standard tax rates, in terms of tax revenue.

Some limitations of the study should be noted. The first relates to the way in which earnings management practices have been measured; the use of a single measure does not permit a sensitivity analysis of the results with respect to the way of measuring earnings management. The second concerns the definition of female-owned companies; the ownership structure may be defined in a narrower or broader sense. The third concerns the companies included in the sample; having used a certain way of measuring DCA, only companies for which a lengthier data timeline was available were included in the sample, thus excluding younger companies. Future studies can delve into and overcome the aforementioned limitations.

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