Political Economy of Corporate Tax Behavior, Earnings Management, and Market Power in Emerging and Advanced Economies

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ABSTRACT

The interaction between corporate taxation, political influence, market structure, and firm-level financial reporting behavior has become one of the most contested domains in contemporary political economy and accounting research. As governments rely increasingly on corporate income taxation while multinational enterprises expand their ability to shift profits across borders, firms have developed increasingly sophisticated strategies to influence both the measurement of taxable income and the political environment in which taxation is determined. This study develops an integrated theoretical and empirical framework that explains how earnings management, tax planning, political connections, and market concentration jointly shape corporate tax outcomes. Drawing upon insights from accounting, economics, and political economy, the article conceptualizes corporate taxation not as a neutral administrative process but as an arena of strategic interaction between firms and the state, mediated by institutional structures, lobbying activity, and market power. The theoretical backbone of the analysis is rooted in classical models of tax compliance and evasion, particularly the deterrence framework articulated by Allingham and Sandmo (1972), which frames tax behavior as a rational response to enforcement probability and penalties. However, this framework is extended by incorporating modern theories of corporate governance and incentives, such as those articulated by Armstrong et al. (2012), which emphasize the internal motivations of managers and the role of compensation structures in shaping tax planning aggressiveness.

A central empirical and conceptual anchor of the study is the body of evidence on Malaysian firms, especially the demonstration that earnings management can be used strategically to influence tax policy and political outcomes (Adhikari, Derashid, and Zhang, 2005). This evidence reveals that corporate reporting behavior is not merely reactive to tax rules but can be proactively deployed to shape the future design and enforcement of those rules. By embedding this insight within a broader cross-national and sectoral context, the article develops a dynamic theory in which firms adjust their financial reporting, lobbying intensity, and organizational structures in response to both market competition and anticipated policy changes. The analysis further incorporates research on political connections and effective tax rates (Adhikari, Derashid, and Zhang, 2006), showing how firms that are embedded in political networks are able to translate accounting strategies into durable fiscal advantages.

The article also engages deeply with recent research on market concentration and the rise of superstar firms, which has documented the growing dominance of a small number of highly profitable, often multinational enterprises in both advanced and emerging economies (Autor et al., 2020; Affeldt et al., 2021; Bajgar et al., 2021). These firms, because of their size, intangible asset intensity, and global reach, possess unparalleled capacity to shift profits and to lobby for favorable tax treatment. The study argues that this concentration of economic power fundamentally alters the tax policy equilibrium, weakening the state's ability to tax capital effectively while increasing the burden on smaller, less mobile firms and on labor. By synthesizing these literatures, the article advances a unified framework that explains why corporate tax bases have eroded in many jurisdictions despite nominally stable statutory tax rates.

Methodologically, the study adopts a qualitative-quantitative synthesis grounded in longitudinal and comparative

reasoning. Rather than presenting new numerical estimates, it integrates findings from existing empirical studies with a detailed theoretical model of firm behavior. This approach allows for a nuanced interpretation of how earnings management, profit shifting, and political influence interact over time. The results demonstrate that firms facing intense product market competition and those operating in highly concentrated industries adopt markedly different tax strategies, a pattern consistent with evidence from China (Cai and Liu, 2009) and from European and global contexts (Buijink et al., 2002; Blouin and Robinson, 2019).

The discussion situates these findings within broader debates on fiscal capacity, inequality, and globalization. It argues that the erosion of the corporate tax base is not an inevitable byproduct of globalization but the outcome of strategic behavior by powerful firms operating within permissive institutional frameworks. The article concludes by outlining policy implications, including the need for greater transparency, coordination across tax jurisdictions, and reforms to corporate governance that align managerial incentives with social objectives. In doing so, it contributes to a deeper understanding of how corporate taxation, accounting practices, and market power jointly shape the distribution of economic resources in the contemporary global economy.

Keywords: Corporate taxation; Earnings management; Political connections; Market concentration; Profit shifting; Tax policy; Corporate governance.

INTRODUCTION

Corporate taxation occupies a paradoxical position in modern economies. On the one hand, it is widely regarded as an essential instrument for financing public goods, redistributing income, and maintaining the legitimacy of the state. On the other hand, it is increasingly viewed by firms as a cost to be minimized and, in some cases, as a strategic variable to be manipulated through financial reporting, organizational design, and political influence. This tension has been present since the earliest development of corporate income taxes, yet it has become far more acute in the contemporary era of globalization, financialization, and digitalization, in which capital is highly mobile, intangible assets dominate firm value, and political institutions struggle to keep pace with corporate innovation (Antràs and Yeaple, 2014; Autor et al., 2020). Within this environment, the behavior of firms with respect to taxation cannot be understood solely through the lens of statutory tax rates or compliance rules. Instead, it must be analyzed as part of a broader system of incentives, constraints, and strategic interactions that link markets, politics, and accounting practices, a perspective that has been emphasized in both the accounting and economics literatures (Andreoni et al., 1998; Armstrong et al., 2012).

One of the most compelling empirical demonstrations of this strategic perspective is found in the study of Malaysian firms by Adhikari, Derashid, and Zhang (2005), who show that earnings management is not only a tool for influencing investors or meeting contractual obligations but also a mechanism for shaping tax policy itself. By manipulating reported profits, firms can signal economic distress or success in ways that influence policymakers' perceptions of the corporate sector and, ultimately, the design and enforcement of tax rules. This finding challenges the traditional view that tax policy is an exogenous constraint on firms and instead suggests a

dynamic feedback loop in which corporate reporting behavior and fiscal policy co-evolve. Such a perspective resonates with broader theories of political economy, which have long argued that economic actors seek to shape the rules of the game in their favor through lobbying, political connections, and strategic communication (Adhikari et al., 2006; Arayavechkit et al., 2018).

The importance of this dynamic is magnified by the growing concentration of economic activity in the hands of a relatively small number of large, often multinational firms. Recent research has documented a dramatic rise in market concentration across a wide range of industries, both in Europe and globally, accompanied by a decline in the labor share of income and an increase in the profitability of so-called superstar firms (Affeldt et al., 2021; Autor et al., 2020; Bajgar et al., 2021). These firms are characterized not only by their scale but also by their reliance on intangible assets, complex organizational structures, and extensive political networks, all of which enhance their ability to engage in sophisticated tax planning and to influence regulatory outcomes. As a result, corporate taxation has become increasingly polarized: highly profitable and politically connected firms are often able to achieve remarkably low effective tax rates, while smaller, domestically oriented firms bear a disproportionate share of the tax burden (Buijink et al., 2002; Blouin and Robinson, 2019).

The theoretical foundation for analyzing such behavior can be traced back to the seminal model of Allingham and Sandmo (1972), which conceptualizes tax evasion as a rational choice under uncertainty, driven by the trade-off between the expected gains from underreporting and the expected costs of detection and punishment. While this model was originally developed to analyze individual behavior, its core insights have been widely applied to corporate taxation, particularly in the study of compliance and enforcement (Andreoni et al., 1998). However, as the

corporate tax environment has become more complex, it has become clear that the Allingham–Sandmo framework is insufficient on its own. Firms do not simply decide how much income to report given a fixed set of rules; they also invest in changing those rules through lobbying, in designing organizational forms that facilitate profit shifting, and in adopting accounting practices that blur the boundary between legitimate tax planning and aggressive avoidance (Blouin and Krull, 2014; Armstrong et al., 2012).

This expanded perspective is particularly relevant in the context of multinational enterprises, which operate across multiple tax jurisdictions and can exploit differences in tax rates, enforcement, and accounting standards to minimize their global tax liability. The literature on profit shifting and tax havens has shown that a substantial share of multinational profits is reported in low-tax jurisdictions that bear little relation to the location of real economic activity, a phenomenon that undermines the integrity of national tax bases and distorts measures of economic performance (Blouin and Robinson, 2019; Alstadsæter et al., 2022). At the same time, research on organizational form, such as the use of "check-the-box" rules in the United States, has demonstrated how legal and accounting choices can be used to arbitrage tax systems and to obscure the true distribution of profits (Blouin and Krull, 2014). Although these studies often focus on advanced economies, their implications are equally, if not more, important for emerging economies, where institutional capacity may be weaker and political connections more influential, as evidenced by the Malaysian experience documented by Adhikari et al. (2005, 2006).

Despite the richness of this literature, there remains a significant gap in our understanding of how earnings management, political influence, and market structure jointly shape corporate tax outcomes over time. Much of the existing research treats these phenomena in isolation: accounting studies focus on earnings management and effective tax rates, political economy studies examine lobbying and regulatory capture, and industrial organization studies analyze market concentration and competition. Yet in practice, these dimensions are deeply intertwined. Firms that operate in highly concentrated industries have greater resources to invest in both sophisticated accounting practices and political influence, while firms facing intense competition may have stronger incentives to engage in aggressive tax planning as a means of preserving margins (Cai and Liu, 2009; Baugh et al., 2018). The failure to integrate these perspectives has limited our ability to explain why corporate tax bases have eroded so persistently and why policy reforms have often failed to achieve their intended effects.

The present study seeks to address this gap by developing a comprehensive framework that links corporate earnings management, political connections, and market concentration to corporate tax behavior. By drawing on the empirical insights of Adhikari, Derashid, and Zhang (2005) and related studies, as well as on broader theories of tax compliance, corporate governance, and industrial organization, the article constructs a dynamic model in which firms strategically manage both their reported profits and their political relationships in response to market conditions and anticipated policy changes. This approach not only enriches our understanding of corporate tax behavior but also sheds light on broader questions of inequality, fiscal capacity, and the sustainability of modern welfare states in an era of globalized capital and concentrated economic power (Autor et al., 2020; Bighelli et al., 2022).

In pursuing this objective, the article adopts a methodological stance that emphasizes depth of interpretation over the presentation of new numerical estimates. By synthesizing and critically engaging with a wide range of empirical studies, it seeks to uncover the underlying mechanisms that drive observed patterns of tax avoidance, profit shifting, and effective tax rates across different institutional contexts. This approach is particularly well suited to the complexity of the subject matter, as it allows for a nuanced exploration of how firms adapt their strategies over time and how policymakers respond, often imperfectly, to these adaptations. In doing so, the study contributes to a growing body of research that views corporate taxation not as a static set of rules but as a dynamic and contested arena in which economic and political forces continually interact (Adhikari et al., 2006; Arayavechkit et al., 2018).

The remainder of the article develops this argument in detail. The methodological section elaborates the analytical framework and explains how insights from the diverse literatures cited above are integrated into a coherent model of corporate tax behavior. The results section presents a descriptive and interpretive synthesis of empirical findings, highlighting consistent patterns and tensions across different contexts. The discussion then situates these findings within broader theoretical debates and explores their implications for policy and future research. Throughout, the analysis is grounded in the recognition, articulated so clearly by Adhikari, Derashid, and Zhang (2005), that corporate earnings and taxes are not merely accounting outcomes but instruments of political and economic strategy.

METHODOLOGY

The methodological foundation of this study is built on the recognition that corporate tax behavior is a multidimensional phenomenon that cannot be adequately captured by any single empirical or theoretical approach. Instead of relying on a narrow econometric model or a single-country dataset, the analysis adopts a synthetic and interpretive methodology that integrates findings from accounting, economics, and political economy. This

approach is particularly appropriate given the complexity of the relationships under investigation, which involve not only observable outcomes such as effective tax rates and reported earnings but also less tangible factors such as political influence, lobbying intensity, and managerial incentives (Armstrong et al., 2012; Adhikari et al., 2006). By weaving together insights from diverse empirical contexts, the methodology seeks to uncover generalizable patterns and mechanisms that transcend individual institutional settings.

At the core of the methodological strategy is a comparative and longitudinal perspective inspired by the work of Adhikari, Derashid, and Zhang (2005), whose analysis of Malaysian firms demonstrated the importance of examining corporate behavior over time and in relation to evolving policy environments. Rather than treating earnings management and tax planning as static choices, this perspective emphasizes their dynamic nature: firms adjust their reporting strategies in anticipation of, and in response to, changes in tax policy, enforcement, and political conditions. This temporal dimension is crucial for understanding how short-term accounting decisions can have long-term political and fiscal consequences, a point that has been further elaborated in subsequent research on political connections and effective tax rates in Malaysia (Adhikari et al., 2006).

The methodological framework also draws on the deterrence model of tax compliance articulated by Allingham and Sandmo (1972), which provides a baseline for understanding how firms weigh the expected benefits and costs of tax avoidance. However, rather than applying this model mechanically, the study treats it as a conceptual starting point that must be enriched by incorporating insights about corporate governance, market competition, and political influence. For example, Armstrong et al. (2012) emphasize that managerial incentives, such as stock-based compensation and performance targets, play a critical role in shaping firms' appetite for tax planning. In highly competitive industries, where margins are thin and performance pressures intense, managers may be particularly inclined to pursue aggressive tax strategies, a pattern that has been empirically observed in the Chinese context by Cai and Liu (2009).

To integrate these diverse strands of research, the methodology employs what can be described as an interpretive meta-analysis. This involves systematically reviewing and comparing the findings of key studies in the literature, identifying points of convergence and divergence, and constructing a coherent narrative that explains observed patterns of corporate tax behavior. For instance, evidence from European countries shows that firms' domicile and organizational structure have a significant impact on their effective tax rates, reflecting both legal differences and opportunities for profit

shifting (Buijink et al., 2002; Blouin and Krull, 2014). At the same time, research on market concentration and superstar firms indicates that large, dominant firms are able to leverage their scale and political influence to secure favorable tax treatment, even in jurisdictions with ostensibly robust enforcement (Affeldt et al., 2021; Autor et al., 2020). By juxtaposing these findings with the Malaysian evidence on earnings management and political influence (Adhikari et al., 2005, 2006), the methodology seeks to uncover a set of common mechanisms that operate across different institutional environments.

An important aspect of this methodological approach is its attention to institutional context. Tax systems, accounting standards, and political structures vary widely across countries, and these differences shape both the opportunities and the constraints faced by firms. For example, the ability of multinational enterprises to shift profits depends not only on statutory tax rates but also on the availability of tax treaties, the treatment of intangibles, and the enforcement capacity of tax authorities (Antràs and Yeaple, 2014; Blouin and Robinson, 2019). Similarly, the effectiveness of political connections in securing tax benefits depends on the nature of political institutions, the prevalence of corruption, and the transparency of policymaking, factors that have been shown to be particularly salient in emerging economies such as Malaysia (Adhikari et al., 2006). By explicitly considering these contextual factors, the methodology avoids the pitfalls of overly abstract theorizing and grounds its conclusions in the realities of corporate and political practice.

The study also draws on insights from the literature on capital-based corporate tax benefits and lobbying, which highlights how firms invest resources in influencing tax policy in ways that create endogenous misallocation of capital (Arayavechkit et al., 2018). This perspective complements the earnings management literature by emphasizing that corporate strategies to reduce taxes are not limited to accounting manipulation or profit shifting but also include active efforts to shape the tax code itself. When combined with evidence on market concentration, this suggests a powerful feedback loop: firms that are already large and profitable have both the incentive and the ability to lobby for tax provisions that further entrench their advantages, thereby increasing concentration and eroding the tax base (Bajgar et al., 2021; Bighelli et al., 2022).

A further methodological consideration is the treatment of multinational versus domestic firms. The literature on international trade and multinational enterprises has shown that firms' decisions about where to locate production, intellectual property, and financing are deeply intertwined with tax considerations (Antràs and Yeaple, 2014). Studies of profit shifting and tax havens provide compelling evidence that multinational firms exploit these decisions to minimize their global tax liability, often in

ways that are opaque to tax authorities and the public (Blouin and Robinson, 2019; Alstadsæter et al., 2022). By incorporating these insights, the methodology recognizes that corporate tax behavior cannot be fully understood within the confines of a single jurisdiction, even when the primary empirical focus is on a particular country such as Malaysia.

In terms of limitations, the methodological approach adopted here necessarily relies on the quality and scope of the existing literature. While the studies cited provide rich and varied evidence, they also reflect the data availability and methodological choices of their authors, which may introduce biases or blind spots. For example, much of the research on earnings management and political connections focuses on publicly listed firms, potentially overlooking the behavior of privately held or smaller enterprises, which may face different incentives and constraints (Adhikari et al., 2005; Armstrong et al., 2012). Similarly, studies of market concentration and superstar firms often rely on aggregate or industry-level data, which may obscure heterogeneity among firms (Autor et al., 2020; Affeldt et al., 2021). The interpretive synthesis employed in this study seeks to mitigate these limitations by triangulating across multiple sources and by emphasizing mechanisms rather than precise quantitative magnitudes.

Another limitation arises from the inherently political nature of the subject matter. Corporate tax policy is shaped not only by economic considerations but also by ideological, electoral, and geopolitical factors that are difficult to model or measure. The Malaysian case studied by Adhikari et al. (2005, 2006) illustrates how political connections can profoundly influence tax outcomes, but the specific forms and channels of influence may differ in other contexts. The methodology therefore refrains from making overly deterministic claims and instead focuses on identifying patterns and tendencies that are likely to manifest, albeit in different forms, across a range of institutional settings.

Despite these limitations, the methodological approach adopted here offers a powerful lens for understanding the complex interplay between earnings management, political influence, and market structure in shaping corporate tax behavior. By integrating insights from diverse literatures and by grounding the analysis in well-established empirical findings, it provides a robust foundation for the interpretive and theoretical contributions developed in the subsequent sections. In particular, it allows for a nuanced exploration of how the strategic use of accounting information, as documented by Adhikari, Derashid, and Zhang (2005), interacts with broader economic and political forces to produce the observed patterns of tax avoidance, profit shifting, and fiscal inequality.

RESULTS

The synthesis of the existing empirical literature reveals a set of consistent and interrelated patterns that illuminate how corporate earnings management, political connections, and market concentration jointly shape corporate tax outcomes. One of the most striking results is the pervasive divergence between statutory corporate tax rates and the effective tax rates actually paid by firms, a divergence that is systematically related to firm size, market power, and political embeddedness (Buijink et al., 2002; Armstrong et al., 2012). Across a wide range of institutional contexts, firms with greater resources and more complex organizational structures are able to exploit both legal and political channels to reduce their tax liabilities, a pattern that is vividly illustrated by the Malaysian evidence presented by Adhikari, Derashid, and Zhang (2005).

In the Malaysian case, firms engaged in earnings management not merely to meet financial reporting objectives but to influence the policy environment itself. By smoothing or suppressing reported profits during periods of policy debate, firms could present themselves as struggling and thereby strengthen their case for tax relief or regulatory forbearance, while during periods of stability they could inflate earnings to enhance market valuation and managerial compensation (Adhikari et al., 2005). This strategic manipulation of accounting numbers was found to be particularly pronounced among firms with strong political connections, suggesting that the effectiveness of earnings management as a policy tool depends on access to decision-makers and the credibility of corporate narratives within the political arena (Adhikari et al., 2006). The result is a feedback loop in which political connections facilitate accounting manipulation, which in turn reinforces political influence by shaping policy outcomes in favor of connected firms.

A similar pattern emerges in other contexts, albeit through different mechanisms. In China, for example, Cai and Liu (2009) find that firms facing intense product market competition are more likely to engage in aggressive tax avoidance, using a combination of accounting practices and legal strategies to preserve profitability. This suggests that competition can act as a catalyst for tax avoidance, as firms seek to gain an edge over rivals by reducing their tax burden. However, the effect of competition is not uniform: in highly concentrated industries dominated by a few large players, the relationship between competition and tax avoidance is mediated by market power and political influence, with dominant firms often able to secure favorable treatment through lobbying and regulatory capture (Affeldt et al., 2021; Autor et al., 2020).

The literature on market concentration provides further insight into this dynamic. Studies of European and global markets have documented a substantial increase in concentration over recent decades, accompanied by rising profit margins and a growing share of income accruing to capital rather than labor (Bighelli et al., 2022; Bajgar et al.,

2021). These trends have important implications for corporate taxation, as highly concentrated industries tend to be populated by firms with the scale and sophistication needed to engage in complex tax planning and profit shifting. Evidence from multinational enterprises indicates that a significant portion of global profits is reported in low-tax jurisdictions, often through the strategic allocation of intangible assets and intra-firm transactions that are difficult for tax authorities to monitor (Blouin and Robinson, 2019; Alstadsæter et al., 2022). The result is that the tax base erodes even as corporate profitability increases, creating a growing disconnect between economic reality and fiscal outcomes.

Another important result concerns the role of organizational form and legal structure in facilitating tax avoidance. Research on the use of "check-the-box" rules and other hybrid entities shows that firms can exploit differences between tax and accounting systems to create situations in which income is effectively untaxed, either because it is not recognized in any jurisdiction or because it is offset by deductions in multiple jurisdictions (Blouin and Krull, 2014). These strategies are particularly attractive to multinational firms with complex corporate structures, and they contribute to the phenomenon of double counting or misallocation of profits across borders documented by Blouin and Robinson (2019). The Malaysian evidence on earnings management complements this literature by showing that even within a single jurisdiction, firms can use accounting discretion to shift the timing and recognition of income in ways that affect their tax liabilities and their political leverage (Adhikari et al., 2005).

The interaction between tax policy and industry structure is further highlighted by evidence from natural experiments such as the implementation of the "Amazon Tax" in the United States, which showed that changes in sales tax enforcement can reshape industry dynamics by affecting the relative costs of different business models (Baugh et al., 2018). Although this study focuses on sales taxes rather than corporate income taxes, its findings underscore the broader point that tax policy can have profound effects on competition and market structure, which in turn feed back into firms' tax planning strategies. When tax rules are designed or enforced in ways that favor large, online, or multinational firms, they can inadvertently accelerate concentration and erode the tax base, a pattern that resonates with the broader trends documented by Autor et al. (2020) and Affeldt et al. (2021).

The synthesis also reveals important heterogeneity across firms and jurisdictions. Not all firms engage in aggressive tax planning or earnings management to the same degree, and the effectiveness of these strategies depends on institutional factors such as enforcement capacity, transparency, and the prevalence of political connections (Andreoni et al., 1998; Adhikari et al., 2006). In jurisdictions with strong enforcement and limited corruption, the scope for overt manipulation may be more constrained, but even there, firms can exploit legal ambiguities and international tax arbitrage to reduce their liabilities (Buijink et al., 2002; Blouin and Robinson, 2019). In emerging economies with weaker institutions, the interplay between earnings management and political influence may be more direct and more consequential, as illustrated by the Malaysian case (Adhikari et al., 2005).

Taken together, these results paint a picture of corporate tax behavior as a complex and strategic phenomenon shaped by the interaction of market forces, institutional structures, and political power. Firms do not simply respond to tax rules; they actively shape them through a combination of accounting practices, organizational design, and lobbying. The extent to which they can do so depends on their size, market position, and political embeddedness, leading to systematic disparities in effective tax rates and a gradual erosion of the corporate tax base.

DISCUSSION

The patterns identified in the preceding analysis have profound implications for our understanding of corporate taxation, market dynamics, and the political economy of the modern state. At a theoretical level, they challenge the conventional dichotomy between tax compliance and tax evasion by revealing a continuum of strategies that range from aggressive but legal tax planning to outright manipulation of accounting information and political influence. The evidence from Malaysia, as articulated by Adhikari, Derashid, and Zhang (2005), is particularly illuminating in this regard, as it demonstrates that earnings management can serve as a bridge between these domains, allowing firms to translate accounting discretion into political leverage and, ultimately, into favorable tax outcomes.

From the perspective of the Allingham and Sandmo (1972) model, these findings suggest that the expected cost of noncompliance is not determined solely by the probability of detection and the severity of penalties but also by the firm's ability to shape the enforcement environment itself. Firms with strong political connections can reduce the likelihood of scrutiny or secure lenient treatment, effectively lowering the expected cost of aggressive tax behavior. This extension of the deterrence model aligns with the broader literature on regulatory capture and lobbying, which emphasizes that powerful economic actors can influence both the rules and their enforcement (Arayavechkit et al., 2018; Adhikari et al., 2006). As a result, the equilibrium level of tax compliance is endogenously determined by the distribution of political power and market structure, rather than being fixed by statutory law.

The rise of market concentration and superstar firms

further complicates this picture. Research by Autor et al. (2020) and Affeldt et al. (2021) shows that economic activity has become increasingly dominated by a small number of highly productive and profitable firms. These firms not only enjoy economies of scale and scope but also possess the resources and organizational sophistication needed to engage in complex tax planning and to lobby effectively. The interaction between concentration and tax avoidance creates a self-reinforcing dynamic: low effective tax rates increase after-tax profitability, which in turn enables further expansion and political influence, leading to even more favorable tax treatment. This dynamic helps explain why corporate tax revenues have stagnated or declined in many countries despite robust growth in corporate profits, a puzzle that has long troubled policymakers and scholars alike (Bighelli et al., 2022; Bajgar et al., 2021).

The literature on multinational enterprises and profit shifting adds another layer of complexity. By allocating profits to low-tax jurisdictions through transfer pricing, intellectual property arrangements, and intra-firm financing, multinational firms can dramatically reduce their global tax burden, often in ways that are legal but ethically and politically contentious (Antràs and Yeaple, 2014; Blouin and Robinson, 2019). The findings of Alstadsæter et al. (2022) on the impact of profit shifting on wages underscore the real economic consequences of these practices, as they can depress labor income and exacerbate inequality. When combined with the evidence on earnings management and political influence from Malaysia (Adhikari et al., 2005), this suggests that the distributional effects of corporate tax avoidance are not incidental but central to the functioning of modern capitalism.

A key theoretical implication of these findings is that corporate taxation must be understood as a site of contestation between the state and powerful firms, rather than as a technocratic exercise in revenue collection. Firms use accounting practices, organizational structures, and political connections to reshape the tax environment in their favor, while governments attempt, often with limited success, to close loopholes and enforce compliance. This perspective aligns with the political economy tradition, which views policy outcomes as the product of competing interests and power relations rather than as the neutral application of economic principles (Adhikari et al., 2006; Arayavechkit et al., 2018). It also resonates with the emerging literature on the fiscal consequences of market concentration, which highlights how the growing dominance of large firms undermines the tax base and the capacity of the state to provide public goods (Autor et al., 2020; Bighelli et al., 2022).

The Malaysian case provides a particularly rich illustration of these dynamics. As an emerging economy with a history of close ties between business and politics,

Malaysia offers a context in which the interplay between earnings management, political connections, and tax policy is especially visible (Adhikari et al., 2005; Adhikari et al., 2006). However, the mechanisms identified in this context are not unique to Malaysia. Similar patterns can be observed, albeit in different forms, in advanced economies, where lobbying, regulatory complexity, and the internationalization of business create ample opportunities for tax avoidance and policy influence (Buijink et al., 2002; Blouin and Krull, 2014). The cross-contextual consistency of these mechanisms suggests that they are rooted in fundamental features of corporate capitalism, rather than in idiosyncratic institutional arrangements.

At the same time, it is important to acknowledge the limits of this analysis. While the literature provides compelling evidence of the strategic behavior of firms, it also reveals significant variation in the effectiveness of tax enforcement and the outcomes of policy reforms. Some countries have been more successful than others in curbing aggressive tax planning, either through robust enforcement, international cooperation, or reforms to corporate governance and accounting standards (Andreoni et al., 1998; Armstrong et al., 2012). The challenge for future research is to identify the institutional configurations that are most effective in aligning corporate incentives with social objectives, a task that will require careful comparative analysis and a willingness to engage with the political dimensions of tax policy.

In this regard, the integration of earnings management into the analysis of tax policy, as pioneered by Adhikari, Derashid, and Zhang (2005), offers a promising avenue for further inquiry. By recognizing that financial reporting is not merely a reflection of economic reality but a strategic tool, scholars and policymakers can better understand how corporate narratives and numbers shape policy debates and outcomes. This insight is particularly relevant in an era of growing concern about inequality, fiscal sustainability, and the legitimacy of the tax system, issues that are inextricably linked to the behavior of large, powerful firms (Autor et al., 2020; Alstadsæter et al., 2022).

CONCLUSION

The analysis presented in this article demonstrates that corporate tax behavior is the product of a complex and dynamic interplay between earnings management, political influence, and market structure. Drawing on a rich body of empirical and theoretical research, including the seminal work of Adhikari, Derashid, and Zhang (2005) on Malaysian firms, it shows that firms do not merely adapt to tax rules but actively seek to shape them through accounting practices, organizational design, and lobbying. This strategic perspective helps explain why effective tax rates vary so widely across firms and why the corporate tax base has eroded in many countries despite rising profitability and market concentration.

By integrating insights from the literatures on tax compliance, corporate governance, multinational enterprises, and industrial organization, the study offers a unified framework for understanding these phenomena. It highlights the central role of market power and political connections in enabling firms to secure favorable tax treatment and underscores the importance of institutional context in shaping the effectiveness of tax enforcement. In doing so, it contributes to a deeper understanding of the political economy of corporate taxation and points to the need for reforms that address not only technical loopholes but also the underlying power imbalances that drive strategic tax behavior.

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