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The Effect of Internal Control on Corporate Tax Evasion

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Abstract. First, we will explore the basic reasons for the high-tax situation of a company in China's A-share market from 2003 to 2023 and how stock distribution influences these financial decisions. According to the data, the larger the positions held by the top ten shareholders, the more likely they are to employ high-level tax evasion methods. A typical result is that the transparency policy has had a slight dampening effect, and thus the head company has voluntarily reduced disclosure requirements to obscure the lack of information and conceal intentions of accounting fraud. Note that the outside world will also do this. The strong support from the government and regular investigative reports by news organizations have reduced this behaviour; thus, other types of restrictions may not be required by the masses or the courts. In short, based on this analysis, it is necessary to combine the outside supervision system with the internal governance system, such as modifying the board of directors, to strengthen the disclosure obligations and financial control of listed companies.

Keywords: Corporate tax avoidance, Ownership concentration, Information transparency, External monitoring

1. Introduction

To promote the company's development and boost shareholders' interests, it is necessary to strengthen financial autonomy by reducing debt [1]. However, the new types of money-laundering are also relatively easy to find. As for the effect of the new structure on the desire or reluctance to commit fraud in the first instance, there are many different views among scholars at present. Based on the above reasons, it can be concluded that a relatively dispersed ownership structure has strengthened the principal-agent problem. In light of this, the main group may use a series of accounting methods to hide the diversion of funds for their own gain. Alternatively, the system paradigm believes that when the main [2] beneficiary takes a considerable stake in the company, they will be more likely to pay attention to changes in the company's tax situation over time and avoid short-sightedness and excessive risk-taking in tax work [3]. Due to the above reasons, we need to know exactly how the strong dominance of Apex Asset affects corporate tax planning in China's equity market and what the actual operating mechanism is.

Many studies have shown that there are both circumstances and problems in this regard. The general effect of the mandatory directive to reduce the share of exact liquidity (RRR) and monetary subsidies for the ecological transition has been a decline in fiscal evasion [1]. Financial market

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deregulation [4] and constant media coverage have had a serious [2] institutional constraint on reducing tax evasion by way of joint supervision in outdoor areas.

The regional monitoring system focuses on the inspection of the board of directors and major creditors [5]; therefore, it can check the greed of management and restrain excessive accounting fraud to ensure that the harm is borne by the company, not by an individual. However, due to the existence of Type II principal-agent friction and the structure of leading managers' after-tax payouts, there are other problems. With an increase in the proportion of controlling shareholders' [3, 6, 7] shares in the company, the quantity of disclosure materials will decline; thus, it is possible to carry out complicated financial engineering to hide illegal acts that benefit the controlling shareholder [3]. The precise quantitative mechanisms of why there is such a tension have not been determined.

Based on a large database of listed state-owned enterprises in China's A-share market from 2003 to 2023, a two-way fixed-effects model will be used in this paper to study the relationship between high shareholder concentration and corporate tax evasion of the top ten shareholders. Though it is a robust positive correlation, our main achievement lies in identifying some intermediary paths. We know that open information is a necessary condition, so the leading professional investors have intentionally reduced the scope of disclosure and erected data walls to conceal their plans to siphon off profits. We will also establish one set of regulations. Based on our research, timely intervention by the state and long-term public opinion can curb the rise of such abnormal activities; thus, we should coordinate various forms of regulation and non-governmental participation. Based on the above observations, it is proposed that the authorities should enhance external supervision and construct a regular internal control system.

2. Theoretical analysis

The division of fiscal aid among the trustee and various groups of interest is mainly based on the regional management system, that is to say, managerial councils [4]. With the development of China's economy and society, the old state-shareholder conflict has begun to be replaced by a Type II principal-agent problem among top financiers and junior creditors. As a result of continued high concentration of stock ownership by the top ten shareholders, these powerful private holdings have increased their influence in the direction of the company's operations. At this time, the pursuit of strong financial efficiency is no longer about adding value to the company in the ordinary way; instead, it has become an instrumental way for powerful individuals to seize assets and protect their own special advantages.

Given their considerable influence, the leading parties often use the current tax system to shift wealth from the company. In short, they usually take the form of opaque related-party transactions and deliberate property restructurin [3]. Since the main provisions of the fiscal disclosure regulations are too general, responsible persons may be more prone to setting up an excessive number of links in the liquidity chain under the cover of normal accounting measures to divert funds from minority shareholders.

As the main shareholders use tunneling to evade taxes, they have been actively altering the financial statements of the company. The principal shareholders have decreased fiscal openness and formed an information wall in order to hide their private wealth, making it difficult for independent auditors and little investors [3] to obtain the necessary information. Based on the above statistics, we know that the availability of data is required. By reducing the standard of transparency on purpose, the unified governance team has hidden the actual reasons for its firm audit attitude and is protecting its own interests and those of others.

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3. Research design

3.1. Model specification

3.1.1. Sample selection and data sources

To build an empirical basis for this study, we will take the panel data of Chinese A-share listed companies from 2003 to 2023. The two reasons for selecting 2003 as the starting year are the stability of institutions and the precision of computation. The China Securities Regulatory Commission (CSRC) issued the Corporate Governance Standards for Listed Companies in 2002 at the level of regulations. Therefore, 2003 is the first complete accounting period in the stable framework, so it will be used as a benchmark to study the effects of governance structure and ownership on financial performance. At the same time, the demand for accuracy also rose. Before 2003, there were not many organised disclosures and dispersed monitoring indicators for the primary market. After 2003, the CSMAR database started to release organised and standardised data on the exact capital structure and major shareholders. To avoid adding errors from previous intervals to the basic conclusion, we will ignore them. We will extend the research period to include 2023 and add the recent market data that have been used in the construction of the conceptual framework and reflect the current state of corporate fiscal performance. In anticipation of various modifications at different times, the following sections will introduce consistency verification based on various chronological subdivisions.

Based on the traditional method of descriptive financial accounting research, we have expanded the initial CSMAR database by means of some careful exclusion parameters. Initially, we ignore entities that fall under the special regulations and accounting rules for the banking and insurance sectors. In addition, we do not include the annual data of companies marked as ST (Special Treatment) or PT (Preparation Transfer) because they have irregular fiscal difficulties that may affect the main assessment. Finally, all records that do not have information about the main, independent or controlling factors are deleted. Purification can generate a good pool of 41,237 enterprise-year entries that can represent the wide range of the manufacturing sector in the econometric model accurately and be protected from structural abnormalities in itself.

3.1.2. Variable definitions

The main index of the research is corporate-level tax aggressiveness, and it is based on the book-tax gap (BTG) framework constructed by Li [1]. An increase in the size of the difference between a company's reported accounting results and its official tax declaration is an increase in regulatory tax evasion. As for the main reason, concentrated ownership, we use the sum of the equity stake percentages of the first ten investors (Top10). Therefore, a relatively high Top-10 score indicates that the asset structure is more concentrated and control is relatively strong. An overall introduction to all the changes in the variables is shown in Table 1.

Table 1. Variable definitions

Variable Name	Symbol	Definition
Tax Avoidance	*BTD*	Book-Tax Difference ,the calculation is 100×（Total Pre-tax Profit－Taxable Income）/Total Assets

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Table 1. (contiued)

Ownership Concentration	*Top10*	Shares held by top ten shareholders/Total shares
Firm Size	*Size*	Natural logarithm of total assets
Leverage	*Lev*	Total liabilities/Total assets
Cash Flow Ratio	*Cashflow*	Net operating cash flow/Total assets
Inventory Intensity	*INV*	Net inventory/Total assets
Fixed Asset Intensity	*FIXED*	Net fixed assets/Total assets
Listing Age	*Listage*	(Current year - Year of listing) + 1

3.1.3. Model specification

To study how much an increase in the proportion of shares held by the top ten large shareholders affects corporate fiscal irregularities, the following is the main concept framework of this paper.

$$BTD_{i\ ,\ t} = \alpha + \beta_1 Top_{i\ ,\ t} + \beta_j Controls_{i\ ,\ t} + \varepsilon_{i\ ,\ t} \tag{1}$$

BTDi is used as the index for the amount of tax evasion in the company through the above system. Topi, the independent variable, is the sum of the equity of the top ten large shareholders. The control variables are different in each company, and ε_i,t is the residual error term. We will also add the enterprise level and time elements to the general overview. This way can solve the basic problems of the company's stable nature under prolonged economic fluctuations and ensure the reliability of our empirical results.

3.2. Empirical results and analysis

3.2.1. Descriptive statistics

Table 2 is a summary of the basic research indicators. Given that the mean BTD value is 0.2657, it can be seen from this that the claimed fiscal income exceeds the actual taxable duties by almost 0.27%. The standard deviation of 2.5859 for BTD shows that there are large differences in the tax avoidance strategies of the companies selected above. As for Top10, the median is 0.5996; that is, every leading top-ten enterprise controls about 60 per cent of the combined assets. The high concentration of equity in China's stock market is mainly due to a relatively large number of controlling shareholders. The quantity of the auxiliary governance factor is reasonable and has been observed by domestic and foreign scholars in previous studies.

Table 2. Description statistics

Variables	*Obs*	*Mean*	*Std. Dev.*	*P25*	*Median*	*P75*
BTD	41237	0.2657	2.5859	-1.0931	0.0775	1.4777
Top10	41237	0.5996	0.1497	0.4935	0.6125	0.7160

DOI: 10.54254/2754-1169/2026.BL35900

Table 2. (continued)

Size	41237	22.1119	1.2962	21.1648	21.9048	22.8389
Lev	41237	0.4099	0.1972	0.2504	0.4055	0.5595
Cashflow	41237	0.0552	0.0682	0.0161	0.0539	0.0950
INV	41237	0.1433	0.1276	0.0591	0.1130	0.1840
FIXED	41237	0.2179	0.1608	0.0923	0.1850	0.3083
ListAge	41237	1.9682	0.9394	1.3863	2.0794	2.7081

3.2.2. Baseline results

The results in Table 3 are presented in this section. In Column (1), the basic coefficient was calculated without any extra control factors; thus, the Top10 index has exhibited a positive trend and is still far from zero in the 1% range. As shown in Column (2), after adding all firm-specific indicators, the Top10 measure is 0.5496 and still meets the condition of analytical consistency within the 5% significance level. Thus, we have gathered some basic support for the main idea. It shows that enterprises with very concentrated ownership, especially those under the control of the top ten shareholders, tend to have a higher level of corporate tax evasion.

Table 3. Assessment of the effect of large shareholder's capital proportion on firm tax evasion

Variables	*BTD*	
	(1)	（2）
Top10	0.6340***	0.5496**
	(0.227)	(0.244)
Observations	41237	41237
R-squared	0.397	0.408
Controls	YES	YES
Firm FE	YES	YES
Year FE	YES	YES

Observation: The standard deviations or t-values are in brackets, and ***, **, and * indicate that they are at the 1%, 5%, and 10% significance levels, respectively. The reference will continue in all the following charts.

3.2.3. Robustness tests

(1) Alternative Measurement of the Dependent Variable To ensure the results are not sensitive to variable definitions, we re-estimate the model using RATE_diff as an alternative proxy for tax avoidance. RATE_diff is calculated as the difference between the firm's statutory income tax rate and its effective tax rate. Economically, a larger difference implies that actual tax payments fall significantly short of statutory requirements, indicating aggressive tax planning. Column (1) of Table 4 reports these results. The coefficient on Top10 remains positive and statistically significant

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at the 1% level, confirming that our primary conclusions do not depend on the specific tax avoidance metric.

(2) Alternative Measurement of the Independent Variable Next, we modify the measurement of the main independent variable. We replace the top ten shareholder ratio with a proxy for executive monetary incentives, calculated as the natural logarithm of executive shareholdings plus one. Column (2) of Table 4 presents this alternative regression. The coefficient on the incentive variable is significant at the 1% level. This specification provides additional evidence that internal governance characteristics robustly influence corporate tax behaviors, supporting the stability of our baseline model.

(3) Alternative Sample Period Finally, we consider potential biases from macroeconomic shocks, notably the COVID-19 pandemic. The pandemic significantly disrupted corporate operations and macro-level tax policies after 2019. To eliminate these confounding factors, we drop all observations from 2020 onward and re-run the baseline model on the pre-pandemic sample. The results in Table 5 show that the Top10 coefficient remains positive and significant at the 1% level. This confirms that the established relationship is stable and not driven by recent exogenous economic fluctuations.

Table 4. Robustness tests - alternative measures of key variables

Variables	*Alternative Dependent Variable* *RATE_diff* （1）	*Alternative Independent Variable* *BTD* （2）	*Alternative Sample Period* *BTD* （3）
Top10	0.0554***		0.9281***
	(0.011)		(0.283)
Monetary Incentives		0.2713***	
		(0.050)	
Observations	41237	39395	28375
R-squared	0.318	0.422	0.398
Controls	YES	YES	YES
Firm FE	YES	YES	YES
Year FE	YES	YES	YES

3.2.4. Moderating and mediating effects

(1) Mediating Effect Analysis

To study the reasons for this, we use the general model of three-stage mediation. In other words, the three stages of evaluation are as follows: First, verify the direct effect of the concentration of shareholders on tax evasion; Second, determine whether this concentration in equity significantly affects the proposed mediating variable, financial obfuscation; Finally, conduct a regression analysis to study tax evasion by taking both the main explanatory factors and the intervening variable together and distinguish between the direct and indirect effects.

Table 5 shows the results of the mediating assessment conducted in this paper. As shown in Column (2), the coefficient of Top10 is still negative at the 1% level, and thus an increase in

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stakeholder power may significantly weaken institutional quality. After adding the fairness indicator and the transparency measure to the end of the final model (Column 3), opacity is still statistically significant. Therefore, the value for Top10 is different from the initial base number shown in Column (1). A change in the main variable is consistent with the idea that informational asymmetry may also be a cause. Economically speaking, it means that the main investors will improve their financial flexibility by reducing the control of the company's day-to-day operations and also actively seek to maintain a vague accounting report environment.

Table 5. Results of mediation effect test

Variables	*BTD* (1)	(2)	*Opaque* (3)
Top10	0.5394**	0.8061***	0.0581***
	(0.2460)	(0.3122)	(0.0182)
Opaque		0.9062***	
		(0.2151)	
Observations	41237	27147	27147
R-squared	0.3327	0.3416	0.3948
Controls	YES	YES	YES
Firm FE	YES	YES	YES
Year FE	YES	YES	YES

(2) Moderating Effect Analysis

At present, research has begun to investigate how the outer supervisory framework, that is to say shareholder governance (Inst) and media attention (Media), moderates the main effect. Table 6 presents the above regression results. In Column (1), the interaction coefficient of Top10 with Inst is negative and statistically significant at the 5% level. It can be seen from the above that the proactive institutional stakeholders have reduced the risk of large shareholders taking advantage of the profit distribution plan under fiscal incentives. Column (2) also shows that the Media variable is significantly negatively associated with it at the 1% level. Therefore, it can be concluded that the combined supervisory system has reduced the economic cost of very dispersed ownership. Based on the above evidence, it can be concluded that there is strong external statutory pressure restricting the behaviour of the controlling shareholders.

Table 6. Results of the moderation test

Variables	*InstModeration* （1）	*MediaModeration* （2）
Top10	-0.6118	2.7506***
	(0.4075)	(0.5758)
Inst	0.0287***	

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Table 6. (contiued)

	(0.0057)	
Top10×Inst	-0.0152**	
	(0.0074)	
Media		0.4144***
		(0.0704)
Top10×Media		-0.4628***
		(0.1088)
Observations	37303	40066
R-squared	0.3600	0.3345
Controls	YES	YES
Firm FE	YES	YES
Year FE	YES	YES

4. Conclusions and implications

Based on the data of the Chinese A-share market from 2003 to 2023, this paper will investigate the links between strong control concentration and government corruption, as well as the reasons and countermeasures for such corruption. According to the results of this study, companies with a relatively larger share of capital tend to have a larger fluctuation in disclosed and calculable surplus of net income (BTD). Therefore, it can be concluded from the above results that the main shareholders are employing accounting measures to benefit themselves and harm the company.

Later studies have pointed out that the lack of available data is the reason. The main people have been less transparent about what ideas they are formulating and have concealed some fiscal activities to achieve this. Externally, there are also regulations for this. Through mediation, it can be found that the professional role and media attention have reduced the positive effect of stock concentration on financial risk-taking. External supervisors will raise the costs of people-oriented work and therefore restrict the freedom of action for the leading group of shareholders in the pursuit of their own interests.

The above empirical results offer some new ideas for supervising departments and boards of directors. Governance organisations should strengthen the level of information disclosure. As obscurity has been exploited to help the considerable tax evasion of investors, all related-party transactions and corporate tax plans must be transparently disclosed. Therefore, there will be less incentive for the main shareholders to hide their bad behaviour.

The commercial organisation is also to distribute the shares. Although the central government can make quick decisions, it may be influenced by the self-interest of those in power. In order to solve the aforementioned problems, the company should integrate all kinds of shareholders and establish a

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supervisory system. Reciprocal vigilant supervision by all groups of interest can restrict the fiscal-strategy for private interests of one powerful person and avoid serious management failure.

In addition, the mediation results above show that there is an external monitor. Supervisory organs should have the long-term interest groups involved in corporate governance. At the same time, there should be legal guarantees for the audit of fiscal reports. An eclectic outside management structure will reduce the concentration of insider shareholders and raise the performance standard of the company.

The first two are the reasons for this. First of all, the actual dataset is only for evaluating A-share companies based in Shanghai and Shenzhen, China. It does not include non-listed companies and other organisations in the special market for ChiNext and the STAR Market that have different administrative structures and constituent compositions. Based on the research, it should be confirmed that the results obtained in the previous analysis have general applicability. Although we have addressed the problem of endogeneity, the probability of reverse causality in the link between stock distribution and monetary outcomes has not been studied. In order to investigate the reasons for this, new Instrumental Variable (IV) or quasi-experimental methods can be used to assess the subsidiary company.

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