TAX AVOIDANCE AND EARNINGS QUALITY: EVIDENCE FROM VIETNAM

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Abstract: ***This study examines the conditional role of corporate tax avoidance in earnings persistence among non-financial listed firms in Vietnam. Earnings persistence is measured by the association between current pre-tax book income and one-year-ahead pre-tax income. Using panel data comprising 1,610 firm-year observations from 2019-2023, the analysis employs pooled OLS, fixed-effects, and FGLS estimations. The results indicate that current earnings exhibit substantial persistence; however, this association weakens when firms engage in higher levels of tax avoidance. Interaction terms between tax avoidance and current earnings are consistently negative and statistically significant, suggesting that tax avoidance does not directly affect future earnings but instead alters the dynamic mapping of earnings over time. Earnings decomposition further reveals that this weakening operates through both operating cash flows and accruals, with a more pronounced impact on accruals.***

• Keywords: *earnings persistence; tax avoidance; cash flows; accruals; Vietnam.*

Date of receipt: 27th Feb., 2026
Date of delivery revision: 07th Mar., 2026
Date of receipt revision: 17th Mar., 2026
Date of approval: 29th Mar., 2026
DOI: https://doi.org/10.71374/jfar.v26.i2.35

1. Introduction

Earnings persistence is a core attribute of earnings quality, indicating how much current earnings can be sustained into future accounting periods. This attribute plays a central role in firm valuation and investment decision-making, as earnings are informative only to the extent that they are repeatable and predictive of future cash flows (Hanlon, 2005). Consequently, identifying factors that weaken the association between current and future earnings has become a central focus of accounting and finance research.

Corporate tax avoidance has increasingly been viewed as an important conditioning factor in the association between current and future earnings. Although tax avoidance may generate short-term benefits through improved cash flows and higher after-tax earnings (Hanlon & Heitzman, 2010), it is also associated with greater managerial discretion, short-term accounting adjustments, and a higher risk of earnings reversals (Frankel & Litov, 2009). As a result, tax avoidance may weaken the linkage between current and future earnings.

Recent empirical evidence further indicates that the effect of tax avoidance on earnings quality is heterogeneous and channel-dependent. While some studies document short-term cash-flow benefits, others show that aggressive tax avoidance is associated with greater information uncertainty and lower earnings persistence over time (McGuire et al., 2013; Chen et al., 2024). However, evidence on how tax avoidance affects earnings persistence through the cash-flow and accrual components remains limited.

Addressing this gap, this study examines the conditioning role of corporate tax avoidance in earnings persistence, as measured by the association between current and one-year-ahead pre-tax book income. Earnings are further decomposed into operating cash flows and accruals to identify the channels through which tax avoidance affects earnings sustainability in an emerging-market setting such as Vietnam.

2. Theoretical background and hypothesis development

2.1. Earnings persistence and tax avoidance

Earnings persistence is the extent to which current earnings predict future earnings, thereby capturing a firm's ability to sustain operating performance over time (Schipper & Vincent, 2003). Although accounting earnings, particularly pre-tax earnings, are generally persistent, prior studies document substantial cross-firm variation in persistence that depends critically on earnings structure and the surrounding information environment (Sloan, 1996; Frankel & Litov, 2009).

In this context, firms' financial and tax-related behaviors may shape the association between current and future earnings. Empirical evidence indicates that corporate tax avoidance is often linked to greater managerial discretion and more accounting

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adjustments, thereby increasing the transitory component of reported earnings. Frankel and Litov (2009) show that firms engaging more aggressively in tax avoidance are also more likely to engage in earnings management, while Hanlon and Heitzman (2010) argue that tax avoidance increases information risk and the likelihood of earnings reversals. These findings imply that tax avoidance affects not only the level of reported earnings but also the dynamic linkage between current and future earnings.

Accordingly, when tax avoidance is accompanied by greater discretion and higher informational opacity, the mapping of current earnings into future earnings is expected to weaken. In this setting, tax avoidance acts as a conditioning factor that reduces earnings persistence rather than as a direct determinant of future earnings.

Hypothesis H1: Corporate tax avoidance weakens the association between current and future earnings.

2.2. Tax avoidance and the channels of earnings persistence

Accounting earnings can be decomposed into two fundamental components: operating cash flows and accruals. The seminal literature shows that cash flows are generally more persistent, whereas accruals are less persistent because of estimation errors and managerial discretion (Sloan, 1996; Richardson et al., 2006). Examining these components is therefore essential for identifying the channels through which tax avoidance affects earnings persistence.

From a theoretical perspective, tax avoidance may alter the earnings structure through both components. By shifting the timing of tax expense recognition, exploiting deferrals, or restructuring transactions, firms can generate transitory earnings effects that are primarily reflected in accruals. Accruals arising from such tax-related adjustments are more likely to reverse in subsequent periods, thereby weakening earnings persistence (Dechow & Dichev, 2002).

The effect of tax avoidance on operating cash flows is less direct yet still economically meaningful. When tax avoidance is linked to short-term operational decisions or heightened uncertainty about tax enforcement and compliance, the sustainability of future operating cash flows may decline. Empirical evidence shows that tax-aggressive firms exhibit greater cash-flow volatility and lower cash-flow predictability over time (Hanlon & Heitzman, 2010; Chen et al., 2024).

Taken together, these arguments suggest that tax avoidance weakens the association between current and future earnings across both earnings components. However, because accruals are more directly affected by managerial discretion and tax-related accounting adjustments, the attenuation of earnings persistence is expected to be more pronounced through the accrual channel than through operating cash flows.

Hypothesis H2: Corporate tax avoidance weakens the association between current and future earnings through both operating cash flows (PTCF) and accruals (PTACC).

3. Research design

3.1. Sample and data

The study uses a balanced panel of non-financial firms listed in Vietnam from 2019 to 2023, based on audited financial statements. Financial institutions are excluded due to their distinct reporting structures and regulatory environments. After removing observations with missing data and addressing outliers, the final sample comprises 1,610 firm-year observations.

3.2. Variable measurement

Earnings persistence is measured following Hanlon (2005) and Blaylock et al. (2012) using the association between current pre-tax book income (PTBIt) and one-year-ahead pre-tax book income ($PTBI_{i,t+1}$). Pre-tax income is scaled by total assets. To examine underlying mechanisms, earnings are decomposed into operating cash flows (PTCF) and accruals (PTACC), with PTACC defined as the difference between pre-tax income and operating cash flows.

Tax avoidance (TAXAD) is measured using a dummy variable for firms with relatively high levels of tax avoidance, allowing the analysis to focus on the conditioning role of tax avoidance in earnings persistence rather than its direct effect on future earnings. Control variables include firm size (FSIZE), financial leverage (LEV), asset tangibility (TANG), and firm age (OLDS), which account for heterogeneity in risk, asset structure, and firm life cycle.

3.3. Empirical models

To test Hypothesis H1, the following baseline persistence model is estimated:

$$PTBI_{i,t+1} = \beta_0 + \beta_1 PTBI_{i,t} + \beta_2 TAXAD_{i,t} + \beta_3 (TAXAD_{i,t} \times PTBI_{i,t}) + Controls_{i,t} + \varepsilon_{i,t}$$

The coefficient β3 captures the conditioning effect of tax avoidance on the association between current and future earnings.

To test Hypothesis H2, earnings are decomposed into cash-flow and accrual components:

$$PTBI_{i,t+1} = \beta_0 + \beta_1 PTCF_{i,t} + \beta_2 PTACC_{i,t} + \beta_3 TAXAD_{i,t} + \beta_4 (TAXAD_{i,t} \times PTCF_{i,t}) + \beta_5 (TAXAD_{i,t} \times PTACC_{i,t}) + Controls_{i,t} + \varepsilon_{i,t}$$

The interaction coefficients β4 and β5 identify the channels through which tax avoidance influences earnings persistence.

The study uses pooled OLS as a baseline estimator and fixed-effects models to control for unobserved firm-specific heterogeneity. Feasible generalized least squares (FGLS) is also applied to account for heteroskedasticity and serial correlation in the panel data. All specifications include year and industry fixed effects.

4. Results and discussion

4.1. Descriptive statistics and correlations

Descriptive statistics in Table 1 show that the tax avoidance indicator (TAXAD) has a mean of 0.1981, implying that approximately 19.8% of firm-year observations are classified as high-tax-avoidance firms.

Table 1. Descriptive statistics

Variable	N	Mean	Std. Dev.	Min	Max
$PTBI_{it+1}$	1,610	0.0580	0.0816	−0.1521	0.3732
$PTBI_t$	1,610	0.0635	0.0809	−0.1453	0.3856
PTCF	1,610	0.0563	0.1212	−0.2733	0.4250
PTACC	1,610	0.0068	0.1151	−0.3466	0.3376
TAXAD	1,610	0.1981	0.3987	0.0000	1.0000
FSIZE	1,610	12.0868	0.6822	10.5648	13.7537
LEV	1,610	0.4698	0.2295	0.0312	0.8975
TANG	1,610	0.1867	0.1984	0.0000	0.8628
OLDS	1,610	31.4534	14.5671	10.0000	96.0000

Notes: PTBIit+1 and PTBIt denote pre-tax book income in years t+1 and t, scaled by average total assets; PTCF is operating cash flows, scaled by average total assets; PTACC is accruals, defined as pre-tax book income minus operating cash flows, scaled by average total assets; TAXAD is a tax avoidance dummy based on the effective tax rate (ETR), equal to one if the gap between the statutory tax rate and the cash effective tax rate falls within the top 20% of the sample, and zero otherwise; FSIZE is the natural logarithm of total assets; LEV is total liabilities divided by total assets; TANG is tangible assets divided by total assets; OLDS is firm age, measured as the number of years since establishment.

Table 2 presents the correlation matrix. Current pre-tax earnings ($PTBI_t$) are strongly and positively correlated with one-year-ahead earnings ($PTBI_{i,t+1}$) (β = 0.735, p < 0.01), providing preliminary evidence of earnings persistence.

All variance inflation factors (VIFs) are below conventional thresholds, with a maximum of 3.32, indicating no serious multicollinearity concerns.

Table 2. Correlation matrix and variance inflation factors (VIFs)

Variable	$PTBI_{it+1}$	$PTBI_t$	PTCF	PTACC	TAXAD	FSIZE	LEV	TANG	OLDS	VIF
$PTBI_{it+1}$	1.000									-
$PTBI_t$	0.735***	1.000								1.68
PTCF	0.502***	0.411***	1.000							3.22
PTACC	−0.005	0.283***	−0.744***	1.000						3.32
TAXAD	0.083***	−0.046*	−0.001	−0.037	1.000					1.56
FSIZE	0.058**	0.068***	0.001	0.049**	0.017	1.000				1.20
LEV	−0.449***	−0.440***	−0.258***	−0.030	−0.116***	0.289***	1.000			1.45
TANG	0.064**	0.055**	0.259***	−0.243***	0.138***	0.112***	−0.104***	1.000		1.14
OLDS	0.033	0.039	0.069***	−0.043*	−0.074***	−0.063**	0.110***	0.065***	1.000	1.06

*Notes: This table reports Pearson correlation coefficients. VIF denotes the variance inflation factor for each explanatory variable. *, **, and *** indicate statistical significance at the 10%, 5%, and 1% levels, respectively.*

4.2. Regression analysis

Table 3 presents the baseline persistence regressions. Across all specifications, current pre-tax book income ($PTBI_t$) is positive and highly significant in explaining one-year-ahead pre-tax income, confirming earnings persistence in the sample. The estimated coefficient on $PTBI_t$ equals 0.750 (p < 0.01) under pooled OLS, 0.178 (p < 0.01) in the fixed-effects model, and 0.751 (p < 0.01) under FGLS.

More importantly, the interaction term between tax avoidance and current earnings (TAXAD × $PTBI_t$) is negative and statistically significant at the 1% level across all models. The interaction coefficients are −0.364 (p < 0.01) for OLS, −0.283 (p < 0.01) for fixed effects, and −0.288 (p < 0.01) for FGLS. These results indicate that the mapping from current to future earnings weakens significantly for firms with higher tax avoidance. Taken together, the evidence in Table 3 suggests that tax avoidance acts as a conditioning factor that attenuates earnings persistence, thereby supporting Hypothesis H1.

Table 3. The conditional role of tax avoidance in earnings persistence

Variables	Dependent variable: $PTBI_{it+1}$		
	OLS	FE	FGLS
$PTBI_t$	0.750*** (0.021)	0.178*** (0.031)	0.751*** (0.018)
TAXAD	0.041*** (0.004)	0.039*** (0.004)	0.025*** (0.002)
TAXAD × $PTBI_t$	−0.364*** (0.039)	−0.283*** (0.043)	−0.288*** (0.032)
FSIZE	0.009*** (0.002)	0.073*** (0.016)	0.006*** (0.001)
LEV	−0.056*** (0.007)	−0.143*** (0.020)	−0.035*** (0.004)
TANG	−0.005 (0.007)	−0.099*** (0.019)	−0.006 (0.004)
OLDS	0.000** (0.000)	−0.006*** (0.001)	0.000*** (0.000)
Constant	−0.084*** (0.024)	−0.557*** (0.178)	−0.052*** (0.013)
Year fixed effects	No	Yes	Yes
Industry fixed effects	No	Yes	Yes
Observations	1,610	1,610	1,610
R^2 / Wald χ^2	0.596	0.168 (within)	4,708.03
F / χ^2 test	F = 337.39***	F = 25.72***	χ^2 = 4,708.03***

*Notes: Robust standard errors are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.*

Table 4 extends the analysis by decomposing earnings into operating cash flows (PTCF) and accruals (PTACC). Across all specifications, both components show positive and statistically significant associations with future earnings. In the FGLS model, the estimated coefficients are 0.732 (p < 0.01) for PTCF and 0.633 (p < 0.01) for PTACC, indicating that both cash-flow and accrual components contribute to earnings persistence.

However, the interaction terms between tax avoidance and each earnings component are consistently negative and highly significant. Specifically, the

coefficients on TAXAD × PTCF are −0.306 ($p < 0.01$), −0.248 ($p < 0.01$), and −0.261 ($p < 0.01$) under OLS, fixed effects, and FGLS, respectively. Similarly, the coefficients on TAXAD × PTACC are −0.293 ($p < 0.01$), −0.216 ($p < 0.01$), and −0.258 ($p < 0.01$) across the three estimators. These results indicate that tax avoidance weakens earnings persistence through both cash-flow and accrual channels.

Although the direct coefficient on TAXAD is positive in the baseline specifications, reflecting short-term earnings benefits, the negative interaction effects indicate that these benefits are accompanied by a pronounced deterioration in earnings persistence. Overall, the evidence in Table 4 supports Hypothesis H2 and clarifies that the adverse implications of tax avoidance for earnings persistence operate through both components of earnings, with economically meaningful effects across estimation methods.

Table 4. Channels through which tax avoidance affects earnings persistence

Variables	Dependent variable: $PTBI_{it+1}$		
	OLS	FE	FGLS
PTCF	0.747*** (0.020)	0.249*** (0.030)	0.732*** (0.018)
PTACC	0.590*** (0.021)	0.125*** (0.028)	0.633*** (0.019)
TAXAD	0.038*** (0.004)	0.036*** (0.004)	0.025*** (0.003)
TAXAD × PTCF	−0.306*** (0.040)	−0.248*** (0.042)	−0.261*** (0.034)
TAXAD × PTACC	−0.293*** (0.038)	−0.216*** (0.040)	−0.258*** (0.033)
FSIZE	0.011*** (0.002)	0.088*** (0.015)	0.008*** (0.001)
LEV	−0.064*** (0.007)	−0.146*** (0.019)	−0.045*** (0.005)
TANG	−0.024*** (0.007)	−0.098*** (0.019)	−0.018*** (0.004)
OLDS	0.000*** (0.000)	−0.006*** (0.001)	0.000*** (0.000)
Constant	−0.100*** (0.024)	−0.759*** (0.174)	−0.070*** (0.014)
Year fixed effects	No	Yes	Yes
Industry fixed effects	No	Yes	Yes
Observations	1,610	1,610	1,610
R^2 / Wald χ^2	0.615	0.218 (within)	4,229.17
F / χ^2 test	F = 283.67***	F = 29.58***	χ^2 = 4,229·17***

*Notes: Robust standard errors are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.*

4.3. Discussion and conclusion

The empirical results indicate that tax avoidance serves as a conditioning factor that weakens earnings persistence. The interaction coefficients between TAXAD and current earnings (PTBI) are consistently negative and statistically significant across specifications, suggesting that when firms engage in tax avoidance, the persistence of current earnings into subsequent accounting periods declines markedly. This finding supports Hypothesis H1 and is consistent with the argument that tax avoidance increases the informational uncertainty of reported earnings, thereby reducing their predictive ability over time (Hanlon, 2005; Blaylock et al., 2012).

The earnings decomposition analysis further clarifies the underlying mechanism, as both interaction terms, TAXAD × PTCF and TAXAD × PTACC, are negative and statistically significant. This evidence indicates that the adverse effect of tax avoidance is not confined to the accrual channel, emphasized in foundational studies (Sloan, 1996; Dechow et al., 2010), but also extends to operating cash flows. Relative to prior evidence that primarily focuses on accruals (Hanlon, 2005; Blaylock et al., 2012), these findings suggest that the influence of tax avoidance on earnings dynamics is more pervasive, impairing multiple components of earnings simultaneously.

From a theoretical perspective, the results align with the view that tax avoidance reflects greater managerial discretion in allocating earnings and tax obligations over time. When tax avoidance is linked to complex transaction structures and a less transparent information environment, both cash flows and accruals become less stable, increasing the transitory components of earnings and jointly reducing earnings persistence, thereby supporting Hypothesis H2. In the Vietnamese context, where tax and accounting systems are still evolving and enforcement remains uneven, these findings underscore that tax avoidance should be interpreted not merely as tax optimization but also as a source of heightened information asymmetry and operational risk, which ultimately undermines the sustainability of earnings. Accordingly, this study contributes emerging-market evidence and highlights the importance of institutional context in interpreting the relationship between tax avoidance and earnings quality.

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