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Actual controllers with foreign residency rights and corporate tax avoidance: Evidence from private listed companies in China

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Highlights

- Actual controllers with foreign residency rights increase corporate tax avoidance.
- They do so under high tax collection intensity, low media attention, concurrent executive positions, and indirect shareholding.
- Actual controllers with foreign residency rights increase information asymmetry and financing constraints.

Abstract

Optronic Sciences LLC, Ex. 2035
BOE Technology Group Co., Ltd. v. Optronic Sciences LLC IPR2024-01130
Page 1 of 8

This study empirically tests the effect of actual controllers with foreign residency rights on corporate tax avoidance using a sample of A-share private listed companies in Shanghai and Shenzhen from 2013 to 2022. The results show that actual controllers with foreign residency rights increase corporate tax avoidance. Specifically, this occurs only under conditions of high tax collection intensity, low media attention, concurrent executive positions, and indirect shareholding. Further research shows that actual controllers with foreign residency rights increase the enterprise's information asymmetry and financing constraints.

Introduction

With economic globalization, the global flow of human capital has become increasingly frequent. In China, globalization has expanded the phenomenon of actual controllers of Chinese private enterprises having foreign residency rights. The actual controller refers to the natural person, legal person, or other organization that controls the company's behavior through investment relations, agreements, or other arrangements.[1] When the actual controller of an enterprise is a natural person with the right of residence in another country, they can live in that country at any time in a legal capacity, thereby facilitating the enterprise's overseas investment. Some entrepreneurs who engage in illegal behavior avoid legal punishment by moving abroad when they expect their illegal behavior to be exposed or have been exposed. Foreign residency rights have become a haven for lawbreakers to avoid legal punishment, making it difficult for governments to implement legal punishment measures. For example, Changxing Lai, the former chair of the Xiamen Yuanhua Group, fled to Canada in 1999 after committing illegal acts and was deported to China by Canadian law enforcement only 12 years later. Therefore, the public and capital market regard actual controllers with foreign residency rights as a risk, and this topic has attracted extensive academic attention.

On the one hand, the actual controller's foreign residency rights have a speculation effect. Foreign residency rights allow actual controllers to evade legal sanctions for their illegal behavior, intensifying their opportunistic behavior and leading to more violations and related transactions by enterprises. On the other hand, the actual controller's foreign residency rights have a supervision effect. Foreign residency rights cause concerns for other stakeholders, and thus, the company must optimize its internal control and supervision system to hedge public distrust caused by speculation. Given the combined effect of speculation and supervision, whether actual controllers with foreign residency rights adopt aggressive strategies owing to the speculation effect or adopt conservative strategies owing to the supervision effect when making tax decisions is worthy of an in-depth discussion.

Optronic Sciences LLC, Ex. 2035
BOE Technology Group Co., Ltd. v. Optronic Sciences LLC IPR2024-01130
Page 2 of 8

Using a sample of Chinese A-share private listed companies in Shanghai and Shenzhen from 2013 to 2022, this study empirically tests the effect of actual controllers with foreign residency rights on corporate tax avoidance. Chinese private listed companies refer to listed companies whose actual controllers are natural persons or other private enterprises within China. This study focuses on Chinese A-share private listed companies for the following reasons. First, the attribute of overseas residence rights is applicable only to natural persons, and only private listed companies may have natural persons as controlling shareholders. Second, state-owned listed enterprises are controlled by the government and do not have actual controllers in the category of natural persons. According to the information disclosure system of listed companies in China, when a listed company has an actual controller, it must disclose whether the controller has the right of overseas residence in the annual report. Thus, based on our research objectives, using private listed companies as research samples is the most appropriate choice.

The contributions of this study are as follows. First, it offers new theoretical explanations and empirical evidence for corporate tax avoidance. This study analyzes the factors influencing corporate tax avoidance from the perspective of an actual controller with foreign residency rights. This is an essential supplement to the literature on actual controllers' characteristics and corporate decision-making. Second, this study enriches research on the financial consequences of actual controllers with foreign residency rights. The literature has reached different conclusions on positive and negative impacts, and the findings of this study support the negative impact of foreign residency rights on corporate tax behavior decision-making.

This study analyzes the relationship between actual controllers with foreign residency rights and corporate tax avoidance in Chinese private listed companies from a rare research perspective (Hanlon and Heitzman, 2010). While tax avoidance is not illegal in theory, it might not conform to the legislative spirit of tax law. In practice, the tax avoidance behavior of enterprises may border on illegality. Aggressive tax avoidance by enterprises may trigger regulatory review by tax authorities, such as tax inspection and special tax adjustment. A sound legal environment affects the tax avoidance decisions of actual controllers by increasing the cost of violation and the deterrence of supervision. China's political and economic systems differ significantly from those of other countries, especially in terms of tax policy and market regulation.

With the increasing internationalization of Chinese enterprises, the problem of actual controllers with foreign residency rights has become increasingly prominent, making this study of unique practical value. This study finds that actual controllers with foreign residency rights can increase corporate tax avoidance, which has important implications for the governance of multinational corporations in other countries. When formulating the tax regulation policy for multinational

Optronic Sciences LLC, Ex. 2035
BOE Technology Group Co., Ltd. v. Optronic Sciences LLC IPR2024-01130
Page 3 of 8

corporations, the government should pay attention to actual controllers with foreign residency rights, strengthen international tax cooperation, and improve enterprises' tax compliance. Multinational companies should also examine possible loopholes in their governance structures to prevent corporate tax compliance risks caused by the personal factors of actual controllers.

The remainder of the paper is organized as follows. Section 2 reviews the literature. Section 3 outlines the theoretical analysis and research hypothesis. Section 4 details the sample selection and research design. Section 5 presents the analysis of the empirical results. Section 6 discusses the heterogeneity test. Section 7 conducts further research. Finally, Section 8 presents the conclusions and implications.

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Section snippets

The financial consequences of actual controllers with foreign residency rights

Actual controllers with foreign residency rights of private listed companies have been an important issue in the corporate governance field in recent years. The literature primarily focuses on the relationship between actual controllers' foreign residency rights and risk-taking, green innovation, and audit opinion. Studies on the financial consequences of actual controllers with foreign residency rights have not reached consistent conclusions. Views diverge along two main lines. The first group …

Theoretical analysis and research hypothesis

Actual controllers of enterprises often have solid financial strength. They may apply for foreign residency rights in other countries for their children's education and the pursuit of a higher quality of life. Some actual controllers with illegal and criminal intentions have planned and obtained foreign residency rights for themselves and their families in advance for precautionary reasons. Therefore, when actual controllers adopt illegal and criminal behaviors, this right gives them a “safe

Optronic Sciences LLC, Ex. 2035
BOE Technology Group Co., Ltd. v. Optronic Sciences LLC IPR2024-01130
Page 4 of 8

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Sample selection

We use China's A-share private listed companies in Shanghai and Shenzhen from 2013 to 2022 as the research sample. The data are obtained from the China Stock Market & Accounting Research (CSMAR) and Wind databases. To ensure the reliability of the research conclusions, the following samples are eliminated: listed companies in the financial industry, companies with missing variable data, companies with special treatment, and companies with less than five years of data. In China's capital …

Descriptive statistics

Table 2 reports the descriptive statistical results of the variables. The average value of *Taxrate_Diff* is 0.002, indicating that the effective tax rate of the sample companies is lower than the applicable statutory tax rate and there are tax avoidance activities. The value is consistent with previous studies (Wen et al., 2024; Wen et al., 2020). The minimum value of *Taxrate_Diff* is −0.213, and the maximum value is 0.146, indicating that the degree of tax avoidance of different private listed …

Heterogeneity analysis based on the tax collection intensity

With different tax collection intensities, the effect of actual controllers with foreign residency rights on corporate tax avoidance also differs. In regions with a low tax collection intensity, enterprises face a relatively weak tax collection environment; thus, actual controllers do not need to make tax avoidance decisions based on whether they have foreign residency rights. However, enterprises face stricter tax collection in regions with a high tax collection intensity. When actual …

The impact of actual controllers with foreign residency rights on information asymmetry

Information asymmetry exists between enterprises and their external stakeholders. According to Chen and Lin (2017) and Kerr (2019), corporate information asymmetry increases corporate tax avoidance. Information asymmetry makes it difficult for external stakeholders to identify unconventional transactions, interpret information, and supervise external affairs. This provides opportunities and information advantage for corporate tax avoidance. Therefore, we further study the impact of actual …

Optronic Sciences LLC, Ex. 2035
BOE Technology Group Co., Ltd. v. Optronic Sciences LLC IPR2024-01130
Page 5 of 8

Conclusions and implications

Using A-share private listed companies in Shanghai and Shenzhen from 2013 to 2022 as the research sample, this study systematically examines the impact of actual controllers with foreign residency rights on corporate tax avoidance. We find that the acquisition of foreign residency rights by actual controllers of private listed companies significantly increases corporate tax avoidance. In addition, we find that the actual controllers with foreign residency rights increase corporate tax avoidance …

CRediT authorship contribution statement

Xiaozhen Pan: Conceptualization, Methodology, Validation, Resources, Writing – review & editing, Supervision, Project administration, Funding acquisition. **Sabahati Aimaiti:** Conceptualization, Methodology, Software, Formal analysis, Investigation, Data curation, Writing – original draft. …

Declaration of competing interest

None. …

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Optronic Sciences LLC, Ex. 2035
BOE Technology Group Co., Ltd. v. Optronic Sciences LLC IPR2024-01130
Page 6 of 8

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Optronic Sciences LLC, Ex. 2035
BOE Technology Group Co., Ltd. v. Optronic Sciences LLC IPR2024-01130
Page 7 of 8

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Optronic Sciences LLC, Ex. 2035
BOE Technology Group Co., Ltd. v. Optronic Sciences LLC IPR2024-01130
Page 8 of 8