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THE RELATIONSHIP BETWEEN LEGAL TRADITIONS, FINANCIAL SYSTEMS AND TAX AVOIDANCE

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CH.1 INTRODUCTION

In recent years, tax avoidance has increasingly become a burning issue. As countries are already struggling with political and economic instability, negative competition on taxation matters is something they simply cannot afford. This problem has also resulted in increasing frustration among citizens who are burdened by high taxation, while large multinational corporations pay less than half of their required taxes by utilizing accounting techniques and legal loopholes, substantially reducing their final tax rates (*Tax Avoidance as an Ethical Issue for Business*, 2013). Uncollected taxes that could be utilized by governments to enhance the welfare of citizens by improving crucial institutions such as schools, hospitals, and other essential services (Szoke, 2016). It's not uncommon for companies like Google to disclose their annual financial reports and declare huge profits, only to pay minimal taxes in the end (Drucker, 2010).

The proposal of a unified global taxation system for large firms and multinational companies has been discussed as a solution to this issue for years. However, it has been proven difficult to achieve a consensus among countries on a minimum tax rate for corporations. Although recently the OECD organization came up with a regulation, it still needs to be implemented into the legislation of each country (OECD, 2023). Consequently, there is currently no rule in place that precisely tackles this issue, and it is then crucial to conduct further research on taxation to produce and implement more accurate and adequate laws.

As a matter of fact, it must be recognized that the discussion on taxation cannot be separated from legislation. In truth, the topic of taxation is intrinsically linked with the legal framework of a country. Taxation is governed by laws that naturally vary among nations. Thus, understanding the strengths and weaknesses of the legal systems can be a starting point to understand better the topic of taxation and mitigate the issue of tax avoidance. This holds particularly true if the different legislations in place around the world can be categorized into two main groups: common law and civil law, each with its distinct features and characteristics.

The former, also called Anglo-Saxon law, can be found in countries that were originally colonized by Great Britain, such as the United States, Canada, New Zealand, and South Africa. Common law is often described as "judge-made law" because it relies heavily on previous court decisions and precedent cases. As a matter of fact, judges have a significant degree of discretion in interpreting the law and applying it to specific cases. The result is a more flexible and adaptable legal system but which, at the same time, can also present a certain degree of inconsistency and unpredictability in the judicial outcomes.

In contrast, civil law, or code law, can be mainly found in territories conquered by the Roman Empire, such as Italy, Germany, France, and Spain, and is characterized by a set of written laws and rules that judges must apply directly to cases, leaving little room for interpretation. In other words, the case must adapt to the law rather than the other way round. This can result in a more predictable and stable legal system but, at the same time, it can also lead to inflexibility and difficulty in adapting to the constant evolution of society (Ergungor, 2002).

Then, under the umbrella of civil law, it is possible by looking at their commercial codes to further identify three sub-groups: French, German, and Scandinavian law. They share all common principles and functions of Roman law but present also some nuances that still allow to differentiate them (La Porta et al., 1998). However, in line with the majority of the literature and to maintain simplicity in my study, I will categorize countries only into common or civil law.

The notable differences between these two legal traditions have had a profound effect on the formation and evolution of economies among countries. This can be observed when examining legislative features such as shareholder protection, creditor protection, fraud punishment, fund raising, and the role of banks, all of which vary greatly between different legal environments. According to these differences, two main types of economy have emerged and can be identified: the market-based economy and the bank-based economy.

The former, which can be generally found in Anglo-Saxon countries such as the United States and the United Kingdom, is characterized by a well-developed stock market, extensive shareholder protection, and a limited role of banks. In particular, the market-based economy is driven by the active participation of individual investors and shareholders, who are provided with a range of legal defenses and safeguards which help to foster confidence and trust in the market as well as to ensure their interests are protected.

On the other hand, the bank-based system, as stated in the name, is heavily reliant on banks as the main source of finance and guarantees. Banks play a much more central role in the financial system than financial markets in providing finance to both businesses and individuals. Unlike the market-based economy, shareholder protection is typically less extensive in a bank-based economy, as investors rely more heavily on financial institutions to safeguard their investments. The bank-based system is more common among European countries like Germany, France, Spain, and Italy (Esposito et al., 2021; Xiao, 2011).

The economic framework is significant as it has important consequences for how companies are organized and function. Since this study primarily examines corporate tax avoidance, the financial system becomes a relevant factor that should be considered.

However, before proceeding further, it is crucial to outline the distinction between tax avoidance and tax evasion for the purpose of this paper. Although there is no single, definitive definition that precisely lists and distinguishes the practices of one from the other, it is important to note that they are conceptually distinct. Generally, tax avoidance refers to legal schemes used mostly by firms to reduce taxes owed, while tax evasion includes all those illegal practices that result in paying no taxes at all. They are defined similarly by the British government as follows:

> "*Tax evasion is always illegal. It is when people or businesses deliberately do not declare and account for the taxes that they owe. It includes the hidden economy, where people conceal their presence or taxable sources of income. Tax avoidance involves bending the rules of the tax system to gain a tax advantage that Parliament never intended. It often involves contrived, artificial*

transactions that serve little or no purpose other than to produce this advantage. It involves operating within the letter – but not the spirit – of the law." (Seely, 2023, p. 11)

Moreover, while catching tax evaders may involve implementing stricter controls and penalties, dealing with tax avoidance is more complex as it involves policies of different countries and the movement of money across borders.

Individuals tax avoidance is generally insignificant, but it can have a significant impact when carried out by corporations, particularly large multinational companies, who may owe millions in taxes (Fuest & Riedel, 2009).

Starbucks is an example of a company that legally avoids paying millions in taxes by using a pricing transfer method. This involves transferring earnings and costs between branches in different countries to take advantage of lower tax rates, minimizing the tax payments for the company (Theresia & Septriadi, 2018). Similarly, Amazon has been reported to shift a significant portion of its UK sales, £ 8.2 billion, to Luxembourg in 2019, which presents many tax incentives and exemptions, resulting in the UK government missing out on a significant tax revenue amount (Chapman, 2021).

Countries like Luxembourg, which offer lower tax rates to attract foreign firms, are known as tax havens and have been involved in several scandals with the "Panama papers" scandal being one of the most recent examples.

It is then clear that the issue of tax avoidance is complex and affects all countries. Many nations are in competition to attract foreign companies with tax incentives or low rates, which usually benefit these companies but result in reduced revenue for governments (Durnev et al., 2017; Rawlings, 2017a).

Hence, taxation plays a critical role in any economy and is governed by laws and regulations which are heavily influenced by the legal environment (legal tradition) of a country. However, legal systems not only influence the law, but also the economy's structure, which in turn can affect the incidence of tax avoidance. As a result, both the legal environment and the financial system of a country can potentially influence the magnitude of tax avoidance.

To better address the complexity of the variables under investigation, this paper will first explore the relationship between legal tradition and financial systems. Subsequently, it will examine separately how the legal tradition and the financial system of a country are related to the phenomenon of tax avoidance. Despite analyzing multiple aspects, the paper ultimately aims to answer a single research question: What is the relationship between legal tradition, financial system, and tax avoidance?

Through an analysis, reflection, and comparison of over 50 studies listed in the Appendix, obtained from the Thomas Reuter Web of Science and Google Scholar databases, the aim is to identify the relationship between these variables. In particular, the expectation is that countries following the common law tradition, with the

US and UK as leading examples, will exhibit a relationship with market-based economies and potentially display higher levels of tax avoidance.

This study aims to address a literature gap by examining the relationship between these three variables and promoting further research. In fact, existing studies in economic literature have explored the issue of tax avoidance in relation to the type of economy or legislation, as well as the characteristics of economies and legislations. However, this study seeks to contribute by specifically examining the interplay between legal tradition, financial systems, and tax avoidance, in one study and thus filling a specific research gap in the literature. Scholars like La Porta, Levine, Demirgüç-Kunt, and Shleifer for example have contributed significantly to this field. However, three distinct approaches can be identified in the literature in studying these variables.

One approach involves analyzing the differences and contrasts between various types of economies or legislations, typically by focusing on a few key variables of interest. For example, Cross (2007) offers a broad comparison of common law and civil law, highlighting their respective strengths and weaknesses. Differently, Bats et al. (2020) contrast the bank-based and market-based financial systems in terms of their impact on the systemic risk variable.

Another approach involves identifying and evaluating specific factors, such as investor rights or the number of fraud cases won in court, in order to relate legislation types to financial systems. La Porta et al. (2007) for example groups countries according to their legal origins and studies their legal evolution in relation to economic needs and real effects. Another interesting research conducted by Ergungor (2002), investigates the association between legal tradition and economy type through the level of creditor protection.

Finally, a third approach focuses on identifying and evaluating specific elements of laws or economies that are related to tax avoidance, such as country-level governance, regulation quality, or law enforcement levels, without necessarily establishing a clear relationship with macro-variables yet. As an example, Benkraiem et al.'s (2020) study identifies a relationship between tax avoidance and poor legal institutions.

Although previous research have analyzed several sub-variables falling under one of the three macro-variables considered, there is still a research gap in understanding the interrelationships between all three macro-variables. Surprisingly, no study has treated and related them in a single paper. Therefore, the purpose of this paper is to fill this gap by presenting the most relevant research findings on the three macro-variables, examining whether a relationship exists between them, and if so, determining how it looks like.

The paper is thus structured as follows: Chapter 2 offers a comprehensive theoretical overview of each variable, including its definition, characteristics, and factors contributing to variations within it. Chapter 3 outlines the methodology employed to gather and analyze the relevant literature. Chapter 4, the core of the study, presents the findings and evidence derived from the literature analysis. Lastly, Chapter 5 concludes the paper by summarizing the main findings and their implications.

CH.2 THEORETICAL CONCEPTS

2.1 Legal tradition

A crucial initial distinction to be made in the study of law is between legal tradition and the legal system. A legal system refers to the collection of operating legal institutions, procedures, and rules that govern a particular jurisdiction. For example, in the US, it exists a different legal system in each state. The term legal tradition instead doesn't focus on the mere structure of legal institutions, the procedure of applying law or the entities involved in its creation. Indeed, it delves into the deeply rooted historical attributes and values that shape the nature of law. It seeks to attain a comprehensive understanding of the cultural and social environment (societal context) within which the legal system functions. It looks at how laws affect society, the way citizens and the state interact, and why laws are made, enforced, and understood. It also considers the actors involved in these processes, and how they contributed to the broader cultural and historical influences that shaped the legal system. In essence, legal tradition provides insights into the culture and values that underpin a particular legal system and allows us to gain a deeper understanding of its relationship with society.

Therefore, the legal tradition is not the same as the legal system because it includes the wider cultural and historical background in which the legal system functions. It provides insights into the values and beliefs that guide the legal system and its relationship with society, shedding light on the broader cultural influences that have shaped it (Merryman & Pérez-Perdomo, 2007).

Merryman and other scholars view the legal tradition as a crucial set of attitudes towards law that is essential for analyzing legal systems, and even necessary for classifying them into distinct groups. According to this perspective, "tradition" is the shared foundation that underlies this embeddedness and serves as the primary criterion for defining and distinguishing these groups. This classification, based on tradition, is also commonly referred to as legal culture. Yet, the use of the term "tradition" doesn't necessarily mean that the past dominates the present, although history undoubtedly influences and limits various aspects of the law even today. Thus, Merryman's interpretation of tradition is mainly focused on the impact of law's origins on the present, rather than the simple historical aspects of the law (Duve, 2018).

According to the literature, there are two primary and distinct legal traditions: common law and civil law. In addition to these, several sub-traditions derived from civil law can be identified, including the French, German, Scandinavian, and Socialist (like China, Cuba, and Vietnam), which for simplicity will not be considered apart in this paper. There are also some hybrid legal systems that incorporate elements of both traditions, but typically one tradition predominates over the other. One characteristic aspect of legal traditions is that the laws of a few dominant "mother" countries have been transplanted in other countries, often through colonization and conquest. Then, over time, the ideologies, settings, and codes of these legal systems have been adapted, evolved, and modified to meet the local needs of the colonized populations. As a matter of fact, a country's legal system always reflects the cultural, political, and economic conditions of its local population.

Given that no two populations are identical, each country's legal and regulatory system is inherently distinct and cannot be perfectly identical to another. However, the foundational pillars of a country's legal structure have remained and persist still today and are sufficient to classify legal systems according to their legal tradition. (La Porta et al., 2007)

In particular, Joireman (2004) identifies two distinct approaches to comparing legal traditions: by analyzing their differing philosophies and origins, or by examining the practical differences in the rules and settings of their legal systems.

According to the former, civil law originated from the legal code of the Roman Empire and over time evolved into a system of statutes. Civil law was developed in response to the need for regulation in an expanding empire and was structured to define the rights and duties of citizens. It became an instrument for administering and expanding the empire, as well as regulating the behavior of its citizens.

Then, the most influent civil law, the French law, underwent significant changes during the French Revolution of the 18th century. By that time, the reputation of judges was poor because the king had been selling judgeships to wealthy French families who used their power to block progressive reforms and promote their own interests. Then, during the French Revolution, the power of judges to interpret the law was limited in the name of liberty and progress. Judges were thus relegated to the role of pure law appliers, with their prestige reduced to that of minor bureaucrats. The French civil law evolved in order to eliminate corruption in the judiciary, consolidate state power, and restrict the interference of courts with state affairs. After the French Revolution, was Napoleon to spread and impose the French legal code in the conquered lands like Italy, Spain, and Portugal, as well as in other colonies in Indochina and Oceania. In particular, Spain and Portugal played a significant role in disseminating the French civil law, given their history as former conquerors, especially in their South American colonies. As a result, the French legal code had a significant impact on the legal systems of many countries around the world and its influence is still present today (Beck et al., 2003).

Civil law systems outline the roles of individuals within the state and distinguish between the rights and responsibilities of citizens in the public and private realms. In civil law countries, the law is adapted to fit the specific case under investigation, with the judge's role being to only apply it. The main characteristic of civil law is therefore the fundamental conception that the state is superior and the role of the individual is to respect and conform to it (Joireman, 2004).

English common law, on the other hand, born to limit the influence of the government and to protect the private properties against it. “English common law developed because landed aristocrats and merchants wanted a system of law that would provide strong protections for property and contract rights, and limit the crown’s ability to interfere in markets” (Mahoney, 2001, p.504).

Common law originated before the Magna Carta of 1215 A.C., although the Magna Carta is often considered the first example of its use. Yet, the modern form of common law shaped in the unstable 16th and 17th centuries when the English Parliament challenged the authority of the kings. The Crown sought to reassert

feudal privileges and sell monopolies to raise revenue, while the Parliament, composed largely of landowners and merchants, sided with property owners in support of the courts. Ultimately, the courts prevailed, and the Crown's power was limited through the law, marking a significant milestone in the development of common law (Beck et al., 2003).

In summary, common law originated to safeguard the population from the authority of the monarchy, whereas civil law was established to allocate the duties and rights of citizens in relation to the government.

These differences in underlying philosophies and approaches to law between civil law and common law are then reflected in the distinct settings, functioning, and implementation of law. All elements on which the second approach of Joireman focus.

Firstly, the civil law system is based on a written code and is applied practically through an inquisitorial system. In this system, judges play a unique role in gathering evidence, organizing, conducting investigations, and questioning witnesses to reach a final sentence that should be as truthful as possible. To do this, civil law judges are specially trained to conduct such investigations, and the judge who leads the investigation is not the same one who presides over the hearings. Another key feature of the civil law system is the written nature of the process. Motions from both sides must be provided in written form to the judge, who analyzes them and replies in a written form as well. Witnesses testify before the judge and lawyers intermittently rather than one after another. The written record of the testimony is then presented at the trial if it occurs, although civil law cases rarely go to trial. As a matter of fact, the process moves to the trial only if the judge leading the investigation is convinced of the guilt and considers sufficient the evidence obtained. Trials are typically simple reviews of the written material collected by the judge, and the guilt and sentence are decided by a group of judges and assessors, rather than by a jury as in the common law system (even though jury trial can be used for criminal cases). Finally, the role of lawyers is also quite different in the two legal systems. In fact, in civil law, they are involved in the process only as advisors to their clients, rather than as active figures in the courtroom (common law).

On the contrary, common-law systems employ an adversarial system of justice. The goal is to reach a just outcome through a process of investigation, competition, and decision-making, in which the parties involved in the dispute confront each other in an oral contest with the expectation that the truth will ultimately be revealed. The plaintiff, defendant, and lawyers gather to present their case before a jury and an impartial judge, who serves as an arbiter of justice. Common law systems differ from civil law systems in four distinct ways. First, the judge in a common law system is an impartial arbiter and no longer has an active role in the gathering of evidence and investigation. Second, common law relies on oral tradition, while civil law relies on a written process. Then, in contrast to the sole advisory role of lawyers in civil law, the role of lawyers in common law systems is that of active participants in the courtroom. Finally, the role of jury in common law countries is essential compared to civil law countries where it is used mostly in criminal cases.

Hence, due to its emphasis on resolving disputes rather than applying law, common law relies heavily on legal precedent, which entails making judgments based on past decisions. While statutes and legal codes are also used in the process, judicial precedent always dominates the justification for a legal decision. Moreover, when there is no regulation for a case, the judge has two options: following a particular precedent according to the *principle of stare decisis* or creating a new precedent. Stare decisis plays a crucial role in providing a foundation for courts to generate new regulations. In contrast, civil law adheres to a stricter and more mechanical process for judges to interpret the law. Common law is thus better suited to enable the law to evolve gradually without abrupt changes. The expectation is that, as society changes, new precedents will be established while still providing a set of rules upon which citizens can rely in both their personal and business affairs (Cross, 2007; Joireman, 2004).

Because of these different philosophical and institutional approaches to the role and setting of law and courts, the influential paper by La Porta et al. (1998) came up with the theory of law and finance, which suggests that countries with civil law legal systems may have weaker private property rights protections, leading to lower levels of financial development compared to countries with common law legal systems.

2.2 Financial systems

The financial system is responsible for performing several critical functions in an economy. Its primary functions include mobilizing resources for investment, allocating investment funds to profitable projects, and ensuring that the funded investments are monitored efficiently. These functions are essential to promote economic growth and development since they facilitate the movement of funds from savers to borrowers and empower businesses to invest in productive activities. In other words, financial systems enable a better capital provision and allocation (Demirgüç-Kunt & Maksimovic, 2002; Uzunkaya, 2012).

Even more explicit is the definition provided by Sahoo (2014): "*it has been well recognized that the financial system in general performs four basic functions essential to economic development and growth, namely, mobilizing savings, allocating resources to productive uses, facilitating transactions and risk management, and exerting corporate control*."

Researchers have conducted extensive theoretical and empirical studies to examine how financial systems perform critical functions and two distinct types of economies have been identified: market-based and bank-based. This distinction arises from the different sources of finance in an economy, which can lead to a higher or lower presence of financial intermediaries. In a market-based economy, financial markets have a leading role since they are the main source of finance. Financial instruments in these markets tend to have higher liquidity and greater availability of information, allowing for quicker movement of capital to new companies. In contrast, a bank-based economy relies on financial intermediaries like banks to obtain finance. This happens because, due to a higher information asymmetry, the process of obtaining financial information is more complex and costly for individuals and companies, but not for banks. Therefore, banks can provide a higher level of security to creditors given their information advantage. Additionally, financial intermediaries provide

a more stable long-term financial support for companies and a higher level of control over their behavior and performance. For example, Vitols (2001) reported that in Germany and Japan, two bank-based countries, the banks accounted for 74 and 64 percent respectively of the total proportion of financial-system assets compared to the US banks, which accounted for only one quarter.

More in depth, it is possible to say that all the main differences between the two economies lie in how they address the agency problem and in particular the issues of information asymmetry, leading to monitoring costs (Transaction costs), and creditor security (Miah, 2015; Schmukler et al., 2000; Vitols, 2001).

2.3 Taxation

Taxes are the primary source of revenue for a country. However, governments face the challenge of implementing a taxation system that promotes economic growth through low tax rates while ensuring that the state receives enough revenue to perform its functions and provide high quality public services. Tax revenue is, therefore, a crucial element that contributes heavily to the welfare of a country and the wellbeing of its citizens. While aiming to design a tax system that is fair, simple, efficient, and elastic, the government must consider the behavior of taxpayers, which remains the ultimate main variable influencing the amount of tax revenue. As a matter of fact, even if a country's tax system is well-designed and fair, the government will still face problems if citizens are not willing to pay the taxes (Bikas & Bagdonaitė, 2020).

Taxation is commonly considered a classic public goods problem of free riding. While everyone benefits from the services and infrastructure provided by the state, taxpayers have incentives to minimize their tax payments and avoid the costs associated with taxation. The problem becomes particularly pronounced when considering multinational companies or international businesses since states are in a particularly weak position to enforce taxation. In an increasingly globalized market, governments face international competition to attract businesses and investments to boost their economies. They do so by providing high-value-added services and infrastructure and implementing low tax rate policies or offering discounts for foreign capital. On the other hand, multinational companies often play one jurisdiction against the other, seeking subsidies and tax holidays to decrease their tax payments. Governments face also the first-mover disadvantage since the free movement of capital allowed by integrated markets permits taxpayers to choose which taxes to pay in which country. Therefore, if a country increases the tax rate first, taxpayers (mainly companies) will likely try to find a way to avoid paying those taxes in that country, leaving it with even less tax revenue than before (Palan, 2020).

Oxfarm (2000) has argued that tax competition has resulted in countries, particularly developing ones, progressively reducing tax rates on foreign capital. While in the 1990s, these rates were typically around 30-35%, in 2000, most of the countries had a corporate tax rate lower than 20%. A 2023 report from the OECD has confirmed this trend. In particular, the report states that in 2000, over 60% of the 94 jurisdictions for which tax rate data are available had statutory tax rates equal to or greater than 30%, compared to less than 20% of jurisdictions in 2018 (OECD, 2023).

However, the development of modern corporation law was a gradual process that took place throughout the 19th century, with the United States leading the way. The first general corporation law was created in New York in 1823, but it only applied to manufacturing corporations. Other laws followed in the UK and US, liberalizing incorporations. A significant ruling occurred in 1886 with the Santa Clara v. Southern Pacific Railroad case, where the US Supreme Court declared corporations as "persons" for the first time. This was a pivotal moment in the concept of corporate responsibility, as it began to be recognized by courts.

Nevertheless, the further development of incorporation laws over time widened the gap between theory and reality. For instance, the state of New Jersey allowed corporate groups to own shares in other groups at the end of the 19th century. Other states such as Delaware and Vermont emulated these laws, which eventually spread worldwide. These new incorporation laws allowed for an acceleration in industrial concentration and the rapid growth of more complex businesses. Mergers and acquisitions, sub-holdings, subsidiaries, and affiliates enabled firms to expand in size quickly and reach enormous proportions.

Prior to the New Jersey decision, the law treated each corporate entity as separate and independent but centrally controlled and managed. However, after the Santa Clara case, a gap opened up as each corporate unit could be seen as a separate legal personality controlled by another legal entity located in a different jurisdiction. This distinction became the crux of the matter, which still allows companies to play with corporate taxation.

A relevant case is the Calcutta Jute Mills and Cesena Sulphur Mines case in 1876, where the English court ruled that to recognize corporate residency, one had to look at the management and financial affairs quarters, namely the heart and head of the company. Since these two companies did not have these quarters located in England, the court did not consider them resident in England and therefore not subject to British taxation (Couzin, 2002).

Another significant case occurred in 1929, creating the first loophole in corporate taxation. The British company Egyptian Delta Land and Investment Co. Ltd. was brought before the court to resolve the issue of the company's place of residence. In the final decision, judges ruled that the company, even though registered in England, was not liable for British taxation. This decision created a precedent that made Britain a sort of tax haven, allowing foreign companies to set up in the UK but not be considered UK residents under British law and thus enjoy some tax shields abroad.

The result of these developments was that legal entities could be located in one jurisdiction and subject to certain rules and regulations but controlled through majority shareholding by others located in another jurisdiction. These differences are still used by companies today. For example, Apple Inc. was found guilty of conducting tax avoidance schemes by the EU commission, as it transferred many rights over patents and trademarks to Irish non-tax resident entities that were subsidiaries registered in Ireland (Palan, 2020).

Cases such as this fall under the category of tax avoidance, which should be distinguished from tax evasion. Yet, there is no universally accepted definition for distinguishing all those practices considered tax avoidance

from those considered tax evasion. In fact, the former case involves the study of non-ethical practices, while the latter case involves the investigation of criminal activities. Fuest & Riedel (2009) propose a way to distinguish between the two. According to them, tax avoidance refers to all those techniques that take advantage of loopholes in the tax system to reduce tax liability, even if they go against the purpose of the law. On the other hand, tax evasion involves all those illegal methods and activities aimed at hiding or underreporting financial information to evade taxes. Such activities could include covering up, camouflaging, or voluntarily withholding or underreporting financial data. For example, if an individual fails to report income from financial assets held abroad, this would be considered tax evasion. However, income shifting by firms is more complex and could involve both tax avoidance and, more rarely, tax evasion. It is important to understand that the distinction between tax avoidance and tax evasion cannot be clearly defined, as it can vary depending on factors such as jurisdiction and specific characteristics of the company (Fuest & Riedel, 2009).

Individual tax compliance has been extensively studied in the literature, and several factors that can affect compliance behavior have been identified. Some of them are tax rates, the probability of detection and punishment, penalties, risk-aversion, and intrinsic motivation (e.g., a sense of civic duty). When it comes to corporations, many of the same factors that affect individual compliance also apply. However, there are additional issues that arise due to the separation of ownership and control (agency problems). In particular, shareholders, who are generally considered risk-neutral, expect managers to focus on profit maximization and thus also to minimize tax liabilities as much as possible. This separation of ownership and control means that managers may implement corporate tax plans that reflect the private interests of owners and, when linked to bonuses, also of managers themselves. For example, if managers are incentivized to increase profits due to a bonus scheme by reducing tax liabilities, they may engage in aggressive tax planning or even tax evasion (Hanlon and Heitzman, 2010).

Fuest & Riedel (2009) argue that numerous studies indicate that tax revenue losses, particularly in developing nations, arise from two channels: various forms of corporate profit shifting practices and trade price distortions, which decrease the tax base for corporate taxation, as well as offshore retention of domestic residents' wealth, leading to a reduction in the personal income tax base. However, no relevant tax avoidance methodology would be worthy without the existence of tax heavens.

A definition of a tax haven is provided by Rawlings (2017, p. 656): *"A tax haven, also known as an offshore financial center (OFC) or international financial center (IFC), is a jurisdiction (country, self-governing territory, federal state, or province with fiscal autonomy) that offers low or no direct taxation, strict confidentiality, anonymity and privacy provisions governing transactions, costs and capitalization, and a broad range of flexible and permissive company incorporation laws and policies characterized by comprehensive regulation in some areas (e.g., criminal penalties against unauthorized disclosure) and relaxed regulation in others (e.g., minimal or non-existent laws governing directorships)."*

Some examples of countries that are commonly considered tax havens include UK, the Netherlands, Luxembourg, Switzerland, Cayman Islands, and others (Gravelle, 2009). Tax havens are particularly appealing to wealthy individuals and corporations seeking to move their assets outside their home country in order to hide them from the government and tax authorities. This practice is not new, as evidence suggests Chinese merchants sought safe havens from imperial taxes and tributes over 3000 years ago, and French aristocrats began moving their deposits to Switzerland during the late 18th century to escape revolution.

However, it was only after WWII and the Bretton Woods agreement of 1944 that the number of tax havens began to grow exponentially. Advancements in technology, such as the telegraph, made it easier to move bank accounts through various countries and incentivized small, independent countries that were not part of the Bretton Woods agreement to participate in the international financial markets by offering high interest rates and secrecy. This trend continued throughout the 20th century, and by 1994, offshore funds were estimated to be equivalent to 20 percent of the total private worldwide stocks of wealth.

Tax havens offer a range of financial activities that facilitate the active investment of funds beyond simple bank deposits. Corporations exploit them, for example, to finance international operations such as joint ventures, mergers, and acquisitions. The most common technique used by corporations that make use of tax havens is transfer pricing or profit shifting, where subsidiaries are established in low-tax jurisdictions and goods and services are sold to them at low agreed prices, thereby reducing the income of the headquarters while realizing profits offshore (Rawlings, 2017b).

Originally, transfer pricing was intended to prevent the double taxation of multinational corporations. However, it was quickly exploited by firms to minimize their tax liabilities as much as possible. Due to the numerous methods and practices employed by companies to achieve this objective, measuring tax avoidance is a complex process. This complexity is evidence by the fact that there are more than 12 commonly utilized methods in the literature. These methods include the effective tax rate measure, which is obtained by dividing the estimated tax liability by the profit before tax, the book-tax difference, tax shelter firms, unrecognized tax benefits, and "abnormal" measures of tax avoidance, which are computed by regressing the total book-tax differences on total accruals. While most of these proxies capture the measure of book-tax differences in one way or another, it is important for a researcher to identify the most appropriate method for their research and understand the potential differences in the results (Hanlon and Heitzman, 2010).

The literature used for this study makes use of multiple different proxies to measure tax avoidance. Yet, because this paper doesn't run an empirical analysis nor is interested in the relatively small details related to the measurement of the variable tax avoidance, I am briefly reporting only the three most used methods.

The first is the Effective Tax Rate (ETR) method. It aims to evaluate the amount of taxes a company or individual pays relative to their taxable income. It is calculated by dividing the total tax income expense of a firm by a measure of before tax profits, or alternatively of cash flow. Therefore, ETR aims to capture the average rate of tax per dollar of income (or cash flow). A variation of this measure is the Long-run ETR, which is computed

as the sum of cash paid for income taxes scaled by the sum of pre-tax income over a period of ten years. The clear advantage of this option is the longer time frame of the measurement. Another common way to quantify tax avoidance is through book-tax differences. It requires researchers to first examine financial statement data and tax return information of companies, and then identify and quantify variations between book income and taxable income by considering items such as revenue recognition, expense deductions, depreciation methods, tax credits, and other factors that can impact the calculation of taxable income. Although it seems a straight methodology, documenting information about tax avoidance through book-tax differences is more challenging due to the difficulty in obtaining accurate tax outcomes. Finally, the Unrecognized Tax Benefits (UTB) is used as a proxy to measure the levels and or changes in UTB. It refers to potential tax benefits or savings that a company or individual believes they are entitled to, but that have not been recognized or recorded in their financial statements.

It is important to underline that all tax avoidance measurement methodologies have their own advantages and disadvantages. Due to the complexity of tax avoidance, which involves various financial aspects and tactics, there is no universally perfect method to quantify it by including all potential sources of tax avoidance (Hanlon and Heitzman, 2010).

CH.3 METHODOLOGY

As shown in Figure 1, the Thomas Reuters Web of Science (WoS) database had been a crucial tool for this systematic literature review, with additional support from the Google Scholar database. The WoS was selected for its suitability for academic research, as it only accepts, and uploads verified and relevant papers to its database. Furthermore, it offers useful filters to narrow down search results, reducing the number of articles to analyze from thousands to a manageable amount. However, the Google Scholar database was also selected to ensure the inclusion of relevant papers that might not be present in Web of Science. While Google Scholar provided millions of results, I limited my analysis to the first 20 results (two pages) ordered by relevance due to the lack of filters (except by year). In addition, Google Scholar was used to search for specific articles through snowballing methodology that were not available in the Web of Science database. Overall, Web of Science was the primary tool for our material research, while Google Scholar was used as a backup and to supplement our search results.

To conduct my literature search, I began by using the general keywords "financial systems" and "legal traditions" since these are two of the three variables under analysis in this study. To narrow down the results, I also made use of the "Economics" filter. Then, to increase the amount of literature, I first used the same two keywords to search for articles on the Google Scholar database. Next, by using again the Web of Science database and using synonyms of "legal tradition" as keywords, such as "legal systems" and "institutional environment" plus the term "cross-country" to limit the search to studies that cover multiple countries.

In the second part of my search, I focused on investigating the relationship with the tax avoidance variable. To begin, I used the core keywords "tax avoidance" and "legal environment". In subsequent searches, I continued to use "financial systems" and "cross-country" as keywords, as well as including additional relevant terms such as "rule of law" (a synonym for legal environment) and "common law" (a more specific term).

My exclusion criteria were fairly straightforward. I reviewed the abstract previews on both the Web of Science and Google Scholar to determine whether each paper was relevant to my study. I excluded papers that focused solely on one country (such as China or Germany), investigated only one variable (e.g., legal tradition or financial systems), focused on tax evasion instead of tax avoidance, or that already appeared in a previous search. I defined the latter “Duplicates”, and it is possible to know their number for each search by looking at the tables in Appendix. Whenever it wasn’t possible to download a relevant paper from either of the two databases, I simply searched for it on the web. A total of 51 papers have been downloaded for further analysis.

For the second level of my literature search, I utilized the snowballing methodology. Whenever I came across a citation that I considered relevant, I searched for it in the databases. If the citation was not available or not present, then I searched for it on the web. After identifying potential papers through my literature search, I reviewed the abstracts to determine whether they met the inclusion criteria for my study. Any papers that did not meet the criteria or were deemed irrelevant based on the abstract were excluded. This step was consistent with the exclusion criteria applied to the previous searches and produced an additional 22 papers (reported in the Appendix) for a more in-depth analysis.

Finally, as the last step, each downloaded paper was carefully analyzed. During this analysis, a few additional papers were excluded due to their excessive focus on the firm level, their emphasis on tax evasion, or because they were simple literature reviews. The only exception is the literature review of Cumming et al. (2017), which I considered useful and not a simple report of past research. As a result, a total of 57 papers were obtained, and they can be found catalogized according to the original search in the Appendix.

CH.4 RESULTS AND DISCUSSION

4.1 Relation between financial systems and legal tradition

Although there is general agreement in the literature in distinguishing between market-based and bank-based financial systems, the exact source of this difference is not clear. Some scholars have identified three potential factors that have contributed to the development of different financial systems, including economic backwardness, cultural biases and political factors, and institutional (legal) factors (Fohlin, 2014). These vary from country to country and interact in complex ways, making it difficult to isolate the influence of only one factor on them.

While the legal tradition is not the only factor contributing to the difference between financial systems, it certainly had a significant impact on the development of financial systems, and is still a key factor in the

enduring persistence of this diversity (Beck et al., 2003; Demirgüç-Kunt & Maksimovic, 2002; Graff, 2008; Levine, 2002). In fact, as reported by Uzunkaya (2012), non-financial institutions, especially the rule of law, play a crucial role in shaping financial systems.

By examining specific differentiating characteristics between the civil and common law, such as investor protection, level of law enforcement, and the degree of uncertainty avoidance within a country, it becomes possible to outline the relationship between a particular legal tradition and a specific type of financial system.

After reviewing all the literature considered in this study, two clear relationships emerged. Common law is correlated with more market-based economies and, consequently, civil law with bank-based ones. These are supported by the vast majority of the literature (Aggarwal & Goodell, 2009a; Beck et al., 2003; Demirgüç-Kunt & Levine, 1999; Emenalo et al., 2018; Fohlin, 2014; Porta et al., 2000; Troilo et al., 2019; Voghouei et al., 2013), and contradicted only by two studies (Aggarwal & Goodell, 2009b, 2010). However, concerns on the samples used by the latter can be raised. In fact, these studies focused exclusively on countries from a single continent, specifically European countries for the first one and Asian countries for the second one, rather than including countries from different continents. This naturally decreases their relevance.

Then, it is interesting to notice the unanimous agreement among the literature in associating common law with a higher level of investor protection and a stronger degree of law enforcement. A plausible theory explaining why variations in these factors significantly impact and shape a country's financial system is proposed by Ergungor (2002). According to the author, everything begins with one fundamental finding: common law courts are more effective in resolving conflicts compared to civil law courts. This disparity arises from the code-based nature of civil law, which makes it less adept at reaching equitable decisions in cases where contractual breaches occur in ways not explicitly addressed by existing laws. Conversely, common law systems possess greater flexibility in interpreting and developing laws through the establishment of legal precedents. Consequently, under common law, investors have a higher likelihood of receiving a fair judgment even in situations not explicitly covered by the law. Therefore, due to the relatively lower level of protection offered by civil law courts in such cases, banks have a primary role as loan lenders over individual investors. They assume the responsibility of managing the risk and exerting their influence on firms by collaborating closely with them and leveraging their position as contract enforcers by threatening to withhold their services. This theory is supported also by Oto-Peralías & Romero-Ávila's (2017) study, which concludes that legal systems that offer to creditors efficient regulations for reclaiming their finances, paired with a strong level of contract enforcement by courts, are associated with higher levels of stocks traded in the financial market and an improved access to credit. These findings are quite logical by assuming that individuals are more motivated to explore the opportunities offered by stock markets when there are laws and regulations in place that safeguard their investments and provide a means for recovering their funds in worst-case scenarios.

Ullah Khan et al.'s (2021) study delves even deeper into the investigation of the characteristics of a legal system that are associated with a greater development of financial markets. Drawing on the World Bank

Enterprise Survey and in line with the literature, the authors not only establish an inverse relationship between the level of creditor protection and law enforcement with banks' involvement but also highlight that borrowers are less discouraged from borrowing when the legal system demonstrates qualities such as speed, affordability, and simplified court proceedings. However, due to the stringent collateral requirements imposed by banks for borrowing funds, small firms unable to comply with these requirements will seek alternative sources of capital in the markets. Therefore, even if creditor protection alone may not directly contribute to the growth of stock markets, in cases where the level of protection provided by the law to creditors (lenders of finance) is the same, but banks impose specific requirements for accessing loans, borrowers will opt to acquire financing through markets. This preference ultimately drives the expansion of markets in terms of size and significance, consequently shaping the financial system of a country towards a market-based orientation.

The significant impact of creditor and investor protection on investor behavior also prompts a reflection on the economic concept of uncertainty avoidance. As a matter of fact, a population might be more inclined to borrow from banks rather than relying on market-based financing due to a lower perceived risk, even if comprehensive regulations are in place and it is more expensive.

Aggarwal & Goodell conducted several studies on this topic (2009, 2010, 2014, 2016), investigating the relationship between a population's uncertainty avoidance and the proportion of market-based finance in a country. They found that greater uncertainty avoidance is negatively correlated with market-based finance. This happens because countries that are more willing to accept ambiguity and thus more trusting also place greater emphasis on the law and regulations. The fact that countries with a common law legal system, such as the US, South Africa, and the UK, ranked higher in the 2016 study for example, confirms that common law provides greater investor protection and thus reduces the level of uncertainty avoidance. (Kwok & Tadesse, 2006)

Finally, in order to give completeness to this analysis, it is worth noting the significance of the only two studies in the literature examined that specifically focus on African countries. These studies, conducted by Emenalo et al. (2018) and Mutarindwa et al. (2021), are relevant because both determine that case law is negatively associated with banking development. Hence, they confirm that even in underdeveloped countries, which are often excluded or under-represented from studies due to data limitations, the relationship between common law (civil law) and market-based (bank-based) economy holds.

In conclusion, although legal tradition may not be the sole factor behind the financial systems diversification, it has obviously played and continues to play a significant role. While there may not be unanimity consensus on the strength of the link between common law and market-based financial systems and civil law and bank-based ones, according to our sample of literature, these relations exist and are supported by the majority of the studies. It emerges also that enforcement of law, investor and creditor protection, and uncertainty avoidance are the most influential variables studied. In particular, the literature suggests that investors feel more

secure and protected under common law since it deals with each case individually, seeking the truth, as opposed to civil law where individuals may be able to commit fraud and avoid punishment due to the lack of specific rules and the inability of judges to make independent decisions. Furthermore, common law countries are more willing to accept uncertainty compared to civil law ones.

Therefore, it can be stated that there is a relationship between common law and market-based economies, as initially expected.

4.2 Relationship between legal tradition and tax avoidance

Given the confident relationship established in the literature between common (civil) law tradition and market-based (bank-based) economies, I am now interested to explore the potential relationship between tax avoidance and the legal tradition of a country. The literature analysis reveals that even though there is no consensus regarding the relationship between common law and lower tax avoidance, the majority of the studies support this relation (Atwood et al., 2012; Benkraiem et al., 2020; Cui et al., 2021; Ma et al., 2020; Matsunaga et al., 2017; Salhi et al., 2019; Vito & Jacob, 2022), while only 3 research suggest the opposite (Kerr, 2019; Yuanita et al., 2020; Zeng, 2018, 2019). 3 instead of 4 because the two studies of Zeng are computed on the same sample and thus are correlated. Furthermore, most of the literature not directly cited before supports indirectly the nexus common law-lower tax avoidance.

As a matter of fact, some studies do not directly investigate the relationship between legal tradition and tax avoidance, but indeed relate the level of earnings management to the legal tradition. However, the study of Benkraiem et al. (2020) asserts that earnings management is positively correlated with increased tax avoidance, meaning that higher earnings quality is typically associated with lower levels of tax avoidance. This is reasonable, as earnings management involves the legal manipulation of financial statements to achieve various outcomes, ranging from increased sales to higher revenues, with the intention of obtaining bonuses. Thus, one of the objectives for managers is to reduce also taxable revenue or the amount of tax paid and, to realize it, they often employ earnings management techniques. Consequently, the more a firm is used to managing earnings and financial statements, the more likely it is to minimize tax payments and actively seek to avoid them. Hence, given this relationship, it has been possible to use earnings management as a proxy variable for tax avoidance and consider relevant those studies investigating earnings management too.

In order to ensure a clear explanation and linear presentation, I am going to examine the same three factors that were discussed in relation to legal tradition and financial system: degree of investor and creditor protection, level of law enforcement (tax enforcement), and uncertainty avoidance. Indeed, these variables are frequently examined in the studies concerning tax avoidance as well.

In the first place, the existing literature presents divergent views regarding the relationships between the level of investor and creditor protection with the degree of tax avoidance, even though a trend can be recognized. Six studies (Atwood et al., 2012; Han et al., 2010; Leuz et al., 2003; Ma et al., 2020; Tang, 2019; Vito & Jacob, 2022) indicate a negative association between a higher level of investor and creditor protection and

the magnitude of tax avoidance. Conversely, only two studies (Kovermann, 2018; Yuanita et al., 2020) establish a direct relationship between the two variables. Relating a higher degree of investor protection with a lower level of tax avoidance might be logical, as it is expectable that a higher transparency, supervision, and control over the management of the company would reduce tax avoidance practices. Nevertheless, it is also reasonable to assert a direct relationship between them, as a stronger creditor protection might make investors trust the company's management more, potentially encouraging them to pursue aggressive tax strategies to boost dividends for shareholders.

In the second place, the analyzed literature agrees on the inverse relationship between the level of law (tax) enforcement and the extent of tax avoidance. In fact, robust tax enforcement leads to increased tax revenue for the country (Kanagaretnam et al., 2018; Tang, 2019; Zeng, 2019). This is primarily due to the legal environment which encourages higher compliance rates and transparency (Kerr, 2019) through stringent controls, regulations, and penalties. These measures help prevent excessive manipulation of earnings and discourage borderline practices, thereby promoting a healthier, fairer, and more effective tax system. Therefore, considering that a higher level of law enforcement is typically associated with common law systems, it is reasonable to view this variable as providing evidence for the connection between common law and lower levels of tax avoidance.

Finally, although only supported by the single study of Han et al. (2010), a reflection on uncertainty avoidance has to be done. According to it, which analyzed a large sample of firms across 32 countries, a higher level of uncertainty avoidance is associated with lower levels of earnings management and, consequently, lower tax avoidance. In other words, countries that exhibit a greater aversion to uncertainty, previously identified as being bank-based, tend to demonstrate higher levels of tax compliance. This finding contradicts the results related to law enforcement and, to some extent, investor protection.

Yet, it must be underlined that the study indicates a very weak relationship between uncertainty avoidance and tax avoidance (-0.0013). Furthermore, concerns regarding the sample selection and composition, given the lack of a comprehensive list of countries considered and the substantial difference in the number of firms included for each country, can be raised.

In conclusion, the majority of the literature suggests that countries with a common law tradition are related to lower levels of tax avoidance. Moreover, it emerged from this analysis that exists a clear and straight relation between the level of law enforcement and investor protection with the extent of tax avoidance. This relationship is further confirmed by the study conducted by Durnev et al. (2017) on Offshore Financial Centers (OFCs). Despite having common law settings, OFCs are commonly chosen as tax havens due to their lower regulation quality regarding investor and creditor protection, as well as weak law enforcement.

4.3 Relationship between financial systems and tax avoidance

Finally, the relationship between the financial system and the level of tax avoidance must be investigated. Within the literature analyzed, three papers (Matsunaga et al., 2017; Oktavia et al., 2019; Tang, 2019) examined the correlation between the level of market development or the influence of banks on tax avoidance practices and found a negative relationship. On the other hand, two other papers (Leuz et al., 2003; Salhi et al., 2019) support a positive relationship. Moreover, some clarifications regarding these studies must be pointed out.

Firstly, the study conducted by Oktavia et al. (2019) associating a higher usage of financial derivates by firms, which indicates a more developed financial market, with a higher level of tax avoidance, focuses exclusively on Asian countries, which are predominantly categorized as bank-based economies. Therefore, it is not possible to generalize this relationship universally, and the results would have changed if market-based countries were included in the analysis (sample bias). Nevertheless, both Matsunaga et al. (2017) and Tang (2019) identify the same relationship. In particular, the former study highlights that tax avoidance tends to be higher in business group affiliated firms located in countries with developed financial markets. This can be attributed to the fact that the non-tax costs associated with tax avoidance are comparatively higher in underdeveloped market countries as opposed to developed market countries. Consequently, the business group ownership structure is able to strategically allocate resources to leverage favorable tax provisions. This relationship is empirically supported by Tang (2019), who demonstrates that tax avoidance practices are highly valued by investors in countries with developed markets. This finding is logical by assuming that the size of financial markets is directly related to the level of individualism and capitalism. Thus, in market-based developed countries, where lower tax payments result in higher dividends, investors are more inclined to endorse tax avoidance practices.

There are also concerns regarding the sample used in the study conducted by Salhi et al. (2019). This study focuses on a significant number of firms exclusively from the UK and France and argues that a greater presence and influence of banks leads to an increase in the level of tax avoidance. As a matter of fact, banks can be a motivating factor for firms to minimize the amount of tax paid in order to comply with debt agreements and avoid violations, as well as to reduce interest rates on loans in some cases. While the theoretical explanation seems reasonable, the empirical evidence presented in this study raises doubts about its relevance. However, Leuz et al. (2003) supports this relationship by relating larger financial markets with lower earnings management and, consequently, lower tax avoidance.

Yet, it is not possible to establish a relationship between the financial system and the level of tax avoidance. The available and relevant literature analyzing this relationship is insufficient, especially considering the sample issues that have been discussed. Moreover, the existing literature is almost evenly divided on whether a market-based economy is associated with a higher or lower degree of tax avoidance. Even from a theoretical

standpoint, there are valid arguments supporting both perspectives. Therefore, the analysis remains inconclusive.

CONCLUSIONS

Tax avoidance has become a growing problem for countries in recent years. Multinational companies are exploiting differences in tax laws between countries to pay significantly lower taxes. In light of this issue, the objective of this study was to investigate whether the level of tax avoidance is influenced by the legal tradition and the type of financial system of a country, while also examining the relationship between them. As a matter of fact, the topic of taxation is intrinsically linked to both the law and economy of a country. To conduct this study, a comprehensive sample of relevant literature has been used. I tried to include the most cited and significant studies on these variables. As a result, a total of 57 papers (listed in the Appendix) were examined. Based on theoretical understanding and the general knowledge that most of the big multinational companies are located in common law jurisdictions such as USA and UK, I was expecting an association between common law, market-based economies, and an elevated level of tax avoidance. However, only part of it has been found true.

In fact, the relationship between common law and market-based countries has been confirmed by most of the literature with a good level of confidence. In particular, the characteristics of common law seem to have had a strong impact on shaping the financial system of a country. Furthermore, the literature also suggests a strong relationship between common law and a lower level of tax avoidance. This finding was unexpected as it suggests that countries like the UK and USA are associated with lower levels of tax avoidance. In other words, the home country of the most valued companies and commonly recognized as important tax avoiders, such as Google, Amazon, and Facebook, is not related to a higher level of tax avoidance.

There can be multiple explanations for these findings. Firstly, it is possible that the overall relationship between common law countries and tax avoidance is negative, but the USA exhibits a high level of tax avoidance on its own. Then, it is evident that there is a greater overall availability of data for the USA in comparison to other countries. This observation leads to additional questions regarding how these sample differences were addressed by the researchers. Specifically, doubts regarding whether adjustments such as weighting were made to achieve a more balanced and homogeneous sample, thereby avoiding the overrepresentation (underrepresentation) of countries with more (less) data. Additionally, it is crucial to consider the potential impact of variations in the measurement of tax avoidance, as this factor can significantly influence the results.

Another possibility is that multinational companies, for financial purposes, are no longer considered American and are categorized under other countries, including civil-law ones. Therefore, it is possible that these companies have been assigned to different countries, which could explain the unexpected observed relation.

Lastly, the study examined the relationship between financial systems and the degree of tax avoidance. The available literature on this topic is significantly limited and shows an almost equal division regarding this

relationship, thus making the analysis inconclusive. Furthermore, the theoretical justifications supporting both perspectives are logically sound. Banks can either contribute to or discourage tax avoidance practices. Therefore, it is challenging to take a definitive position even from a conceptual standpoint. Overall, it can be inferred that legal tradition influences both the financial system and the level of tax avoidance, while the financial systems seem to have a reduced influence on both variables.

These findings hold significant implications for legislators and policymakers as they highlight the crucial role of a country's legal system in both the economy and the issue of tax avoidance. The identified relationships offer valuable guidance on structuring, developing, and implementing new laws. Specifically, key factors contributing to the association between common law and lower levels of tax avoidance include better investor and creditor protection, as well as stronger law enforcement compared to civil law. Consequently, suggestions to reduce tax avoidance in civil law countries can be derived from these elements. In particular, adopting a more flexible approach to law in civil law jurisdictions is a crucial starting point to foster trust in the justice system. Allowing judges to interpret the law more liberally enables them to deliver justice in cases that may not be explicitly addressed by statutes, instilling confidence in investors and creditors, and thus reinforcing both the level of law enforcement and investor protection.

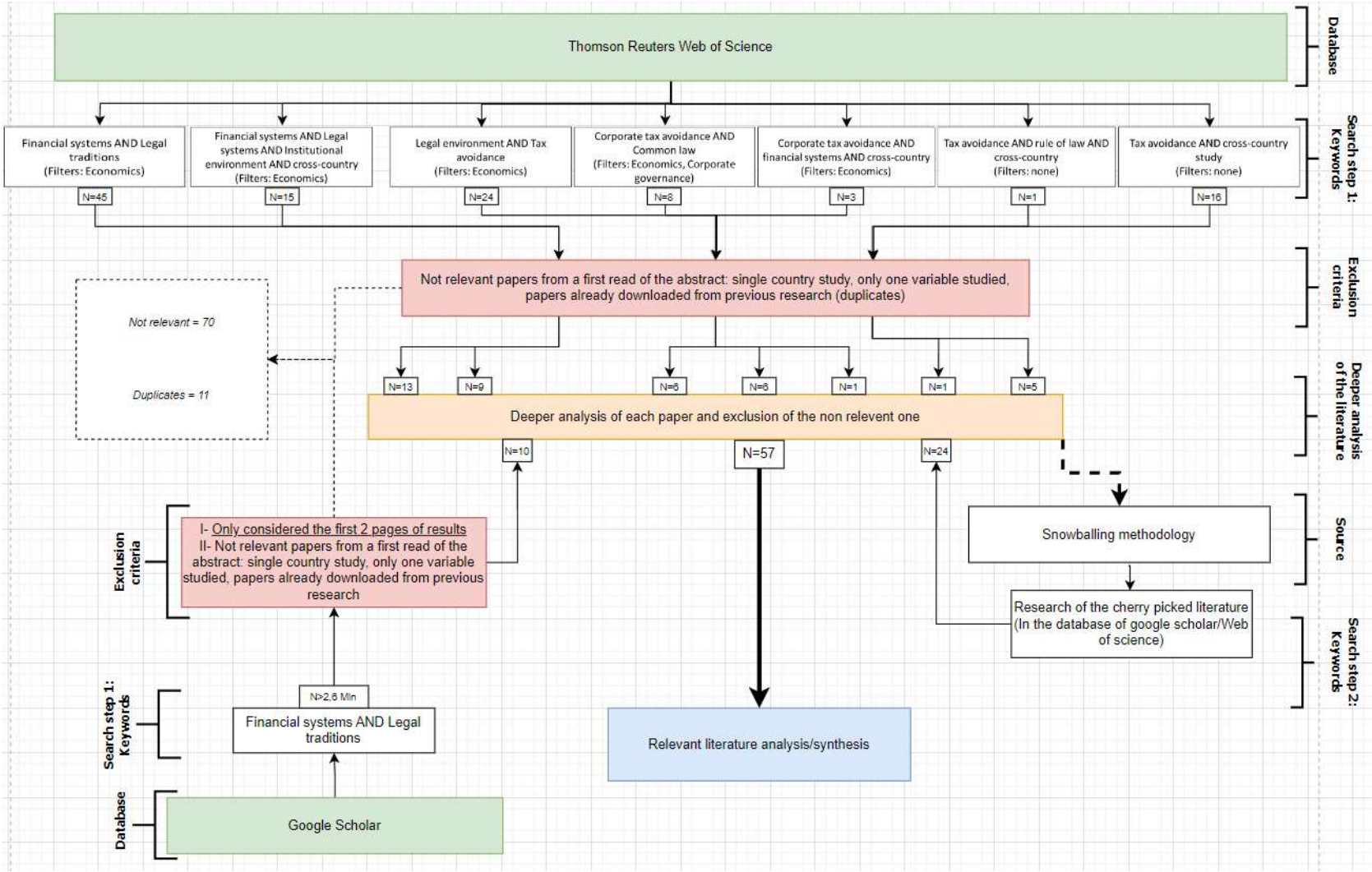
This research is not spotless and presents some limitations due to its reliance on evidence from other studies. First, the data and papers analyzed are not always recent and may date back 10 or 20 years. However, given the broad variables under consideration, this is not considered a serious issue that would affect the research findings since the legal and economic environment of a country cannot change substantially in a short period such as 20 years. Another limitation of this study is attributed to the numerous factors that can influence each variable. Despite the consistency in the variables analyzed across the literature, the impact of omitted variables must be taken into account. For example, different studies use different methods to measure the legal environment. Some studies rely on a comprehensive Rule of Law Index that considers multiple variables related to a country's legislation. On the other hand, other studies construct an index focusing only on specific variables like corruption and number of litigations.

Finally, it must be underlined that the research conducted on these variables is surprisingly limited considering their relevance. One of the reasons for this scarcity is the complex nature of these variables and the multitude of factors that can influence them. In particular, this complexity is particularly pronounced when examining tax avoidance and financial systems, as previously reported. Measuring tax avoidance, for instance, involves a wide range of methodologies, with more than 12 different approaches existing. Similarly, categorizing countries as market-based or bank-based economies is not a straightforward task too due to the presence of both elements in all countries, albeit in different proportions. Identifying the strength of banks or markets as a source of finance is not an easy task due to the multitude of different institutions involved. Nevertheless, I consider crucial further studies regarding these variables. Given the impossibility of identifying a single best measurement method and incorporating all relevant variables into the same study, I believe that

conducting numerous studies would enable us to average out the results and obtain a more comprehensive understanding.

APPENDIX

Figure 1, Literature sample map



FIRST PART RESEARCH LITERATURE

Database	Keywords	N° results	Exclusion criteria	**Not Relevant**	**Duplicates**	**Analysis 1**	**Analysis 2**
WoS	financial systems AND legal traditions + Economics filter	45	Not relevant papers from a first read of the abstract: single country study, only one variable studied, papers already down-loaded from previous research (duplicates)	32	0	13	11
Google scholar	Financial systems AND Legal traditions	2mln,600 Only first two pages (20 results)		8	2	10	9
WoS	Financial systems AND legal systems AND insti-tutional environment AND cross-country + Economics filter	15		6	0	9	6
TOT:		**= 80**		**= 46**	**= 2**	**= 32**	**= 26**

SECOND PART RESEARCH AND SNOWBALL METHODOLOGY LITERATURE

Database	Keywords	N° results	Exclusion criteria	**Not Relevant**	**Duplicates**	**Analysis 1**	**Analysis 2**
WoS	Legal environment AND Tax avoidance Filter: Economics	24	Not relevant papers from a first read of the abstract: single country study, only one variable studied, papers already downloaded from previous research (duplicates)	16	2	6	5
WoS	Corporate tax avoidance AND Common law Filters: Economics + Corporate governance	8		1	1	6	6
WoS	Corporate tax avoidance AND Financial systems AND Cross-country Filter: none	3		0	2	1	1
WoS	Tax avoidance AND Rule of law AND Cross-country Filter: none	1		0	0	1	0
WoS	Tax avoidance AND Cross-country study Filter: none	16		7	4	5	4
TOT:		**= 52**		**= 24**	**= 9**	**= 19**	**= 16**

Snowball method			22	15

LITERATURE SAMPLE ACCORDING TO THE SOURCES

Web of Science literature used (Analysis 2)	(Aggarwal & Goodell, 2009b, 2009a, 2010; Beck et al., 2003; Benkraiem et al., 2020; Bordo & Rousseau, 2006; Cotei et al., 2011; Cui et al., 2021; Das Gupta & Pathak, 2020; Durnev et al., 2017; Emenalo et al., 2018; Ergungor, 2002; Graff, 2008; Han et al., 2010; Hasan et al., 2022; Hoppe et al., 2021; Kanagaretnam et al., 2016, 2018; Kerr, 2019; Ma et al., 2020; Matsunaga et al., 2017; Mutarindwa et al., 2021; Oktavia et al., 2019; Salhi et al., 2019, 2020; Tang, 2019; Troilo et al., 2019; Ullah Khan et al., 2021; Vito & Jacob, 2022; Voghouei et al., 2013; Yuanita et al., 2020; Zeng, 2018, 2019)
Google scholar literature used (Analysis 2)	(Beck et al., 2003, 2004; Demirgüç-Kunt & Levine, 1999; Fohlin, 2014; Kwok & Tadesse, 2006; Levine, 1999, 2002; Oto-Peralías & Romero-Ávila, 2017; Woo-Cumings, 2006)
Snowball literature used	(Aggarwal & Goodell, 2014, 2016; Atwood et al., 2012; Batool & Jaffery, 2020; Cumming et al., 2017; Demirgüç-Kunt & Levine, 2001; Demirgüç-Kunt & Maksimovic, 2002; Kim & Zhang, 2016; La Porta et al., 1998, 2004; Leuz et al., 2003; Porta et al., 1997, 2000; Rajan & Zingales, 2003; Uzunkaya, 2012)

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