REVISTA AMBIENTE CONTÁBIL
Universidade Federal do Rio Grande do Norte
ISSN 2176-9036
Vol. 18, n. 1, Jan./Jun., 2026
Sítios: https://periodicos.ufrn.br/index.php/ambiente
http://www.atena.org.br/revista/ojs-2.2.3-06/index.php/Ambiente
Article received in: February, 19th, 2025. Reviewed by pairs in: April, 01th, 2025. Reformulated in: April, 30th, 2025. Evaluated by the system double blind review.

DOI: 10.21680/2176-9036.2026v18n1ID42507

The impact of independent auditors' tax consulting services on tax litigation

Consultoría tributaria de auditores independientes y su impacto en litigios tributarios

Consultoria tributária de auditores independentes e seu impacto em litígios fiscais

Authors

Antonio Lopo Martinez
PhD in Accounting (FEA-USP), Researcher of the Instituto Jurídico da Universidade de Coimbra, Faculdade de Direito - 3004-528 Coimbra, Portugal. Identifiers (ID):
ORCID: https://orcid.org/0000-0001-9624-7646
Research Gate: https://www.researchgate.net/profile/Antonio_Martinez14
Lattes: http://lattes.cnpq.br/7735660007039816
E-mail: almartinez@fd.uc.pt

Marielza Santos do Nascimento
PhD in Accounting (FUCAPE), Professor of the Federal University of Alagoas. Address: Campus A. C. Simões - Av. Lourival Melo Mota, s/n – Tabuleiro do Martins 57072-900 Maceió, AL, Brazil. Identifiers (ID):
ORCID: https://orcid.org/0000-0002-4604-6667
Research Gate: https://www.researchgate.net/profile/Marielza-Nascimento
Lattes: https://lattes.cnpq.br/5371742296439545
E-mail: marielza1@hotmail.com

Luis Paulo Guimarães dos Santos
PhD in Controlling and Accounting (FEA-USP), Associated Professor of the Department of Accounting of the Federal University of Bahia. Address: Rua Augusto Viana, s/n 40110-060 Salvador, BA, Brazil. Identifiers (ID):
ORCID: https://orcid.org/0000-0001-9986-8237
Lattes: http://lattes.cnpq.br/0000-0001-9986-8237
E-mail: lupa@ufba.br

Silvio Hiroshi Nakao
Tenured Professor (Livre-Docente) at the University of São Paulo (USP-RP), Associate Professor of the Departament of Accounting of FEA-RP/USP. Address: Avenida Bandeirantes, 3900 – Vila Monte Alegre 14040-905 Ribeirão Preto, SP, Brazil. Identifiers (ID):
ORCID: https://orcid.org/ 0000-0002-0830-0214
Lattes: http://lattes.cnpq.br/3032618801971599
E-mail: shnakao@usp.br

Aline Mendonça de Andrade
Master in Accounting from the Federal University of Bahia, Court of Auditors of the State of Bahia. Address: 3ª Avenida, 460 – CAB 41745-002 Salvador, BA, Brazil. Identifiers (ID):
ORCID: https://orcid.org/0000-0002-4247-6205
Lattes: http://lattes.cnpq.br/8387804614051494
Email: fisio.alinemend@hotmail.com

Abstract

Purpose: This study aims to determine the impact of tax consulting services provided by independent auditors on the incidence of tax litigation among Brazilian companies listed on B3. The research investigates whether increased investment in auditing and tax consulting services is associated with a higher likelihood of legal disputes.

Methodology: An empirical analysis was conducted using a balanced panel dataset comprising 416 observations from 2017 to 2020. We used multiple linear regression models, as well as descriptive statistics and Pearson correlation analysis. In addition, the study held constant several important variables, including the return on equity (ROE), indebtedness, and firm size, to isolate the impact of tax consulting expenditures on tax litigation outcomes.

Results: It shows a highly positive relationship between higher spending on auditing and on tax consulting services and the incidence of tax litigation. More specifically, firms that invest more in these services face more tax-related legal disputes. These findings suggest that, while tax consulting may provide strategic and compliance-related benefits, it also increases exposure to litigation risks.

Contributions of the Study: This article addresses an important theoretical gap in the literature by establishing a direct connection between the provision of tax consulting services by independent auditors' and enhanced legal exposure. At a methodological level, the use of panel data econometric models increases both the precision and robusteness of the analysis, offering deeper insights into the driversof tax litigation. The research contributes to academic literature in accounting, auditing, and corporate governance, while providing practical implications for regulators and corporate managers aiming to balance the strategic benefits related to tax consulting with effective risk mitigation.

Keywords: Tax Litigation; Audit Services; Tax Consulting Services; Corporate Governance.

Resumen

Objetivo: El estudio tiene como objetivo determinar el impacto de los servicios de asesoría fiscal prestados por auditores independientes en el aumento de la incidencia de litigios fiscales en empresas brasileñas que cotizan en B3 . La investigación analiza el impacto de una mayor inversión en servicios de auditoría y consultoría tributaria sobre la probabilidad de que se produzcan disputas legales.

Metodología: Este estudio incluyó tanto aspectos empiristas como interpretativos y se basó en un panel de análisis equilibrado que consta de 416 observaciones desde el año 2017 al 2020. Se implementaron modelos econométricos tales como regresión lineal múltiple, así como análisis descriptivo y correlacional de Pearson. Asimismo, se controlaron otros factores críticos de la industria, por ejemplo, ROE, apalancamiento, tamaño para aislar la relación existente entre los desembolsos en servicios de consultoría tributaria y los resultados en materia de litigios.

Resultados: Tras analizar los datos, se encontró una relación positiva y significativa entre los gastos en auditoría y consultoría tributaria y los litigios en esta área. Así, las empresas que registraron mayores inversiones en ambos conceptos mostraron un número mayor de litigios en temas tributarios. Por ello, se determina que, si bien la consultoría tributaria otorga beneficios evidentes en términos estratégicos y de cumplimiento, también representa un factor de riesgo.

Contribuciones del Estudio: Esta investigación contribuye a la literatura académica al cubrir una brecha teórica importante y unir directamente la prestación de servicios de consultoría tributaria por parte de auditores independientes con el riesgo legal. Asimismo, la metodología aplicada, con modelado de datos de panel, mejora la precisión del análisis, lo que permite identificar de mejor forma los motivadores de los conflictos legales. Finalmente, este estudio aporta a la comprensión de los efectos de la consultoría tributaria en la contabilidad, auditoría y gobernanza corporativa y alinea las prioridades de las partes interesadas.

Palabras clave: Litigios Tributarios; Servicios de Auditoría; Consultoría Tributaria; Gobernanza Corporativa

Resumo

Objetivo: O estudo tem como objetivo determinar o impacto dos serviços de consultoria tributária prestados por auditores independentes no aumento da incidência de litígios tributários em empresas brasileiras listadas na B3. A pesquisa investiga o impacto de um maior investimento em serviços de auditoria e consultoria tributária sobre a probabilidade de ocorrência de disputas legais.

Metodologia: Foi realizada uma investigação empírica utilizando um painel balanceado composto por 416 observações no período de 2017 a 2020. Foram aplicados modelos de regressão linear múltipla, complementados por estatísticas descritivas e análise de correlação de Pearson. O estudo também controlou variáveis-chave, como retorno sobre o patrimônio (ROE), endividamento e tamanho da empresa, a fim de isolar o efeito dos gastos com consultoria tributária sobre os resultados dos litígios tributários.

Resultados: Os resultados revelam uma associação positiva e significativa entre o aumento dos gastos com serviços de auditoria e consultoria tributária e uma maior ocorrência de litígios tributários. Especificamente, empresas que investem de forma mais expressiva nesses serviços tendem a enfrentar um maior número de disputas legais relacionadas a questões tributárias. Esses achados ressaltam que, embora a consultoria tributária possa oferecer benefícios estratégicos e de conformidade, ela também aumenta a exposição aos riscos judiciais.

Contribuições do Estudo: Esta pesquisa preenche uma importante lacuna teórica ao vincular explicitamente a prestação de serviços de consultoria tributária por auditores independentes a um aumento do risco legal. Do ponto de vista metodológico, o uso de modelos econométricos em dados de painel aprimora a precisão da análise, fornecendo compreensão valiosa dos determinantes dos litígios tributários. O estudo enriquece a literatura acadêmica nas áreas de contabilidade, auditoria e governança corporativa, além de oferecer implicações práticas para reguladores e gestores corporativos que buscam equilibrar os benefícios estratégicos da consultoria tributária com a mitigação dos riscos.

Palavras-chave: Litígios Tributários; Serviços de Auditoria; Consultoria Tributária; Governança Corporativa.

1. Introduction

Independent auditors often provide tax consulting services, sparking debates about potential conflicts of interest and their impact on companies' tax compliance. Dhiyaulhaq and Fadjarenie (2023) observed that combining audit and tax consulting roles may lead to ethical leniency and increase the risk of tax evasion. In response to these concerns, tax authorities worldwide have strengthened regulatory compliance requirements and enhanced transparency in tax reporting. For instance, the Sarbanes-Oxley Act underscores the importance of clearly distinguishing between permissible and impermissible services, as noted by Obeng-Nyarko (2023).

Several studies suggest that directors with substantial experience in tax matters play a key role in shaping corporate tax strategies. Lanis and Richardson (2012), Khaola and Moez (2019), Kovermann and Velte (2019), and Wang and Yao (2021) argue that such executives often employ strategies that tread a fine line between legitimate tax avoidance and unlawful evasion. While hiring tax planning experts can legally reduce tax burdens, aligning with sound corporate governance and ethical standards (McGuire *et al.*, 2019), the literature also raises important cautions. For example, McGuire *et al.* (2012) warn that even without deliberate intent, these practices can lead to more aggressive tax strategies and elevate the risk of tax litigation.

In Brazil, this scenario is exacerbated by the complexity of the tax system and the high incidence of tax litigation. Baldivieso (2022) and Lopo Martinez (2022) describe a chronic mismatch between taxpayers and tax authorities, marked by deep mistrust and frequent disagreements over tax returns and the accuracy of financial reporting. Almeida (2018) and Cavalcante (2021) suggest that this adversarial environment can be mitigated through more transparent practices and collaborative strategies between taxpayers and the state. However, the structural complexity of the Brazilian tax system continues to fuel disputes.

The board of directors also plays a significant role in shaping tax strategies. Barros and Sarmento (2020), analyzing companies listed on the London Stock Exchange from 2002 to 2015, found that a higher frequency of board meetings is associated with lower effective tax rates. Conversely, greater board member attendance correlates with higher tax burdens, suggesting that internal board dynamics may influence aggressive tax behavior. These findings imply that more resilient and focused board oversight can help curb opportunistic practices and reduce the likelihood of managerial engagement in tax evasion.

Furthermore, Mukoffi *et al.* (2022) stress the need to clearly separate independent audit services from tax consulting. Such separation is vital for ensuring audit quality and maintaining the credibility of financial reports. A distinct division between these functions is required to prevent conflicts of interest that could compromise the integrity of corporate financial disclosures.

Against this backdrop, the study raises the following research question: **Do tax consulting services provided by independent auditors increase the incidence of tax litigation?**

This study is especially relevant given the complexity of Brazil's tax system and the high volume of tax litigation. By examining this relationship, it addresses a gap in the literature regarding the effects of tax consulting by independent auditors, contributing to discussions on corporate governance, regulatory frameworks, and ethical business practices.

The study aims to determine whether tax consulting services offered by independent auditors are associated with a higher incidence of tax litigation among companies listed on the Brazilian stock exchange (B3).

A quantitative panel study was conducted using multiple regression analysis on a dataset comprising 416 observations of B3-listed companies from 2017 to 2020. The results suggest that higher relative spending on tax consulting positively correlates with the incidence of tax litigation. This research enhances understanding by linking tax consulting services to legal risk, providing insights into auditor performance and its implications for corporate governance.

2. Theoretical Framework

2.1 Tax planning and litigation: Challenges and strategies

The complexity of the Brazilian tax system, marked by ambiguous regulations and frequent legislative changes, poses significant challenges for companies striving to maintain tax compliance. In this context, tax planning emerges as a crucial tool for legally and strategically optimizing the tax burden.

Effective tax planning must align with current legislation, avoid distortions of facts, and ensure transparency in fulfilling tax obligations (Biazus & Orlandi, 2016). Although it plays a key role in enhancing profitability, caution is warranted due to the uncertainties inherent in the tax environment (Xavier, 2016). When well-structured, tax planning can serve as a protective mechanism and help resolve tax-related disputes (Chaves, 2014).

However, tax planning outcomes do not always meet expectations and may generate costs that outweigh anticipated savings or even result in adverse effects (Martinez & Reinders, 2018). The tax legislation often leaves room for doubt and multiple interpretations, while the enforcement system can add further layers of uncertainty (Martinez & Oliveira, 2019). Thus, it is essential for taxpayers to fully understand legal procedures and provide adequate defenses to prevent the rejection of legitimate claims.

In highly complex and litigious environments, aggressive tax planning strategies can trigger unintended consequences such as unexpected payment obligations, heightened regulatory scrutiny, tax assessments, and increased legal disputes (Flamini *et al.*, 2021). To mitigate these risks, corporate directors adopt strategies to legally minimize tax liabilities and litigation, including manipulating the tax base and applying appropriate tax rates (Granda, 2021). Shareholders, in turn, view effective legal tax planning as a means to enhance profitability, though they acknowledge the importance of striking a balance to avoid potential litigation (Mukherjee, 2020).

Furthermore, shareholders often engage external firms that specialize in insuring risks unrelated to the company's core activities. These firms assume legal liabilities arising from tax litigation and help protect the integrity of financial statements (Cao & Narayanamoorthy, 2014). The preparation of financial reports must strictly adhere to established accounting standards to ensure transparency and reduce the likelihood of future disputes and regulatory investigations (Mota, Brandão, & Ponte, 2016).

The growth of tax litigation in Brazil can be attributed to legislative complexity, high tax burdens, inequitable installment schemes, and outdated progressive tax brackets (Oliveira, 2020). Federal authorities play a crucial role in overseeing these legal proceedings, determining taxpayer liability for the principal amounts owed, as well as interest, fines, and attorneys' fees.

2.2 The impact of the Sarbanes-Oxley Act (SOX) on audit services and tax litigation

The enactment of the Sarbanes-Oxley Act (SOX) in the United States in July 2002 represented a significant legislative response to corporate scandals that had undermined investor confidence. SOX established strict standards for the accounting profession, aiming to enhance auditing practices and strengthen companies' internal controls (Krishnan & Visvanathan, 2007).

In the Brazilian context, studies suggest that auditors generally act diligently to ensure compliance with regulatory requirements, highlighting the importance of accounting reports in promoting transparency in financial information (Bédard & Paquette, 2021). SOX has positively influenced the accounting profession by encouraging more rigorous and transparent practices.

The legislation introduced several measures to improve the audit process and address issues related to internal controls and the accuracy of financial records. These include prohibiting certain non-audit services by auditors to their clients, mandatory pre-approval of the auditor's engagement by the client's audit committee, and a stronger relationship between independent auditors and audit committees (Silva & Robles Junior, 2008).

Research indicates that SOX enhanced oversight of the accounting profession, added credibility to financial statements, and led to an increase in audit fees. Moreover, it reinforced the importance of separating audit and tax consulting services to avoid conflicts of interest and to preserve audit quality (Silva & Robles Junior, 2008).

SOX also significantly impacted Brazilian companies with shares traded on U.S. stock exchanges, prompting adjustments to internal audit procedures and investments in stronger internal controls. These changes aim to ensure the transparency and reliability of financial disclosures, reduce tax litigation, and strengthen corporate governance (Silva & Machado, 2008).

Accurate accounting and financial reporting play a critical role in ensuring reliability and transparency, particularly in efforts to avoid tax litigation. International research, such as studies conducted in China, supports this view. Key factors contributing to increased tax litigation include a heavy tax burden, complex legislation, the accumulation of tax liabilities, and the lack of oversight in financial transactions (Zhang *et al.*, 2022).

2.3 The impact of tax litigation on financial reporting and auditor behavior

Tax litigation can significantly impact companies' financial reporting, particularly regarding the recognition of provisions and contingent liabilities, as outlined by the Accounting Pronouncements Committee (CPC) 25 (equivalent to IAS 37). Santos (2022) demonstrates how unresolved tax disputes between taxpayers and tax authorities can lead to additional financial obligations, including interest, fines, and attorneys' fees, which directly affect the financial position of audited companies.

In this context, Maksymov *et al.* (2023) emphasize the need for auditors to adopt a more cautious and meticulous approach when performing their procedures, particularly in assessing risks related to tax litigation across various levels of government. The complexity and variability of tax laws demand that auditors have a thorough understanding of the factors contributing to such disputes, highlighting the significance of thoroughly analyzing both the services provided and the information disclosed in financial reports.

2.4 The relationship between tax consulting services and tax litigation

The provision of tax consulting services by independent auditors encompasses activities such as tax planning, advice on tax compliance, support in tax litigation, and the structuring of transactions with tax implications. While these services can add value to companies, they also raise concerns regarding auditor independence and potential conflicts of interest.

Cook *et al.* (2020) argue that engaging multiple service providers tends to reduce tax evasion, as new consultants lack the familiarity with a client's tax data that regular auditors may have, limiting the potential for aggressive tax planning.

Putri and Woro (2022) suggest that partnerships with external auditors may yield both positive and negative outcomes for sales growth in the tax sector. Their findings indicate a direct relationship between sales growth and tax collection, with no observed discrepancies among state-owned firms, thus reinforcing the link between tax compliance and state ownership.

Studies by Jaffar *et al.* (2021) highlight the growing relevance of aggressive tax planning in recent years, drawing increased scrutiny from tax authorities. Many firms have adopted increasingly bold strategies to reduce their tax burdens, leveraging aggressive planning mechanisms despite the complexity of prevailing tax laws.

Jaffar *et al.* (2021) also examined the moderating effects of non-audit service fees on various factors, including firm size, profitability, leverage, capital and inventory intensity, financial distress, and ownership ethnicity. Their analysis used control variables such as debt, return on equity, and firm size. It yielded positive associations, particularly regarding auditing services, asset audits, rendered services, logarithm of services, and firm size.

Al-Qadasi *et al.* (2023) found that firms employing specialized auditors are less likely to engage in real earnings management (REM). However, this negative association is weaker than the one linked to auditor independence, suggesting that economic ties between the auditor and client can compromise independence and, consequently, audit quality.

Tepalagul and Lin (2015) discuss how financial relationships between clients and audit firms, particularly fee dependence, can impair auditor independence and negatively affect key professional attributes. When independence is compromised, auditors are less likely to report irregularities, undermining the reliability and credibility of the audit.

Independent auditors' involvement in tax services often extends to participation in tax disputes (Ling, 2023). To address potential conflicts of interest, the Public Company Accounting Oversight Board (PCAOB) imposed a ban on the provision of certain non-audit services – particularly tax services – to audit clients, as mandated by the Sarbanes-Oxley Act (SOX). These restrictions include enhanced oversight and monitoring of tax consulting practices within audit firms.

Ling (2023) observes that under strict PCAOB oversight, there has been a shift toward more aggressive tax planning practices characterized by fewer financial restatements and greater reliance on permanent tax differences. Nonetheless, as Keyser (2023) notes, regulatory bodies may sometimes prioritize industry interests over the public interest, raising questions about the effectiveness of regulatory safeguards.

The engagement of independent auditors in tax consulting services may influence firms' likelihood of facing tax litigation, especially when such services support aggressive tax planning strategies (Jaffar *et al.*, 2021). Conversely, external auditors may enhance tax compliance (Putri & Woro, 2022). Auditor independence is a moderating factor in the effectiveness of specialized auditors in mitigating earnings management (Al-Qadasi *et al.*, 2023), while the calibration of the audit process positively impacts firm value (Tepalagul & Lin, 2015).

Lamoreaux *et al.* (2023) emphasize that audit quality depends on the ability of key organizational actors to establish connections with leading audit firms. These individuals tend to perceive higher audit quality after bringing in new audit teams for their respective organizations.

Finally, Gunawan *et al.* (2021) investigated the influence of independent boards of commissioners, audit committees, and audit quality on tax evasion. Their findings reveal that, although the mining sector contributes significantly to the economy, its tax contribution remains disproportionately low. Both partial board independence and audit quality influenced the incidence of tax evasion significantly.

2.5 The impact of the Big Four on tax litigation and service quality

The quality of services provided by the Big Four, i.e., the four largest global audit firms, is positively associated with their size. As these firms expand, they increase service turnover and foster higher levels of professional specialization (Francis & Yu, 2009). These authors also emphasize that larger firms tend to be more assertive in communicating their findings to clients.

Khurana and Raman (2004) investigated whether the perceived audit quality of the Big Four is influenced more by litigation exposure or reputational concerns. Their findings suggest that, in the United States, audits conducted by Big Four firms are associated with a lower ex-ante cost of equity for audited companies. This indicates that litigation risk, rather than reputation, primarily drives perceptions of audit quality.

Chyz *et al.* (2021) highlight a positive relationship between audit services and tax planning, noting that companies engaging more experienced and efficient audit firms benefit from reduced tax risk. Such engagements assist firms in developing risk mitigation strategies to address tax-related challenges and minimize financial exposure.

Seetharaman *et al.* (2002) explored the relationship between audit fees and litigation risk without differentiating between Big Four and smaller audit firms. They conclude that auditors should emphasize transparency and adopt strategic measures to minimize litigation risk, especially in contexts where average litigation levels are high relative to expectations.

Garcia-Blandon *et al.* (2021) argue that international evidence, particularly from Spain and the United States, points to a positive association between audit firm services and tax evasion, especially when audit firms also provide litigation or other non-audit services. Given the regulatory prohibitions on combining audit and certain tax services for the same client, such overlaps may facilitate aggressive tax practices and, consequently, increase tax evasion.

Larcker and Richardson (2004) support the link between information discovery and tax avoidance, where audit firms help clients legally reduce their tax burden. However, when firms provide services beyond the scope of an audit, even if in only a small number of cases, this can lead to unintended consequences.

Given the Big Four's commitment to reducing litigation risks through high-quality service, similar outcomes might be expected in Brazil's jurisdiction, such as a decline in tax-related litigation. To support the arguments presented in the theoretical framework and to explore possible explanations for the issue under study, the following hypotheses were formulated:

Hypothesis 1 (H1): Companies that use tax consulting services provided by independent auditors are more likely to engage in tax litigation.

Rationale: While high-quality audits may reduce tax risks, the simultaneous provision of tax consulting services by the same firm may encourage more aggressive tax strategies, thus increasing the likelihood of litigation. The literature indicates that such dual roles can undermine auditor independence and heighten conflicts of interest (Garcia-Blandon *et al.*, 2021).

Hypothesis 2 (H2): The ratio of tax services to a firm's total assets is positively associated with the incidence of tax litigation.

Rationale: A higher proportion of tax services suggests deeper auditor involvement in a firm's tax affairs, which may lead to high-risk tax avoidance strategies and an increased probability of disputes with tax authorities (Larcker & Richardson, 2004).

Hypothesis 3 (H3): The ratio of tax services to audit fees is positively associated with the incidence of tax litigation.

Rationale: Seetharaman *et al.* (2002) examined the relationship between audit fees and litigation risk, emphasizing the importance of maintaining auditor independence. A greater share of revenue derived from tax services may compromise this independence, thereby elevating the risk of litigation.

3. Methodology

This study uses a quantitative approach to analyze the relationship between independent auditors' provision of tax consulting services, including activities such as tax planning, advice on tax compliance, support in tax litigation, and structuring of transactions with tax implications, and the incidence of tax litigation. The analysis is conducted through multiple linear regression with panel data, using information from B3-listed companies between 2017 and 2020.

3.1 Data Collection and Processing

Financial data were obtained from the Economatica© database, including information on audit expenses, tax services, total assets, liabilities, and financial indicators. Information on tax litigation was extracted from the companies' financial statements, specifically from the explanatory notes that detail provisions for tax contingencies and contingent tax liabilities.

The initial sample comprised 401 non-financial B3-listed companies. Sixty-one companies from the financial sector were excluded due to their specific characteristics, and 14 companies had no sector information. After the treatment of missing data and inconsistencies, the final sample consisted of 326 companies, totaling 416 observations over the four years analyzed.

Data cleaning procedures included checking for consistency between databases, treating outliers through winsorization, and cross-validating information with official sources when necessary. In addition, multicollinearity (VIF) and heteroscedasticity tests were performed to ensure the robustness of the model.

3.2 Empirical model

To test the hypotheses formulated, the following multiple linear regression model with fixed effects for companies and years was estimated:

$$TaxLITIG_{i,t} = \beta_0 + \beta_1 Audit\_Exp_{\,i,t} + \beta_2 ROE_{\,i,t} + \beta_3 Indeb_{i,t} + \beta_4 Size_{\,i,t} + \text{Firm} + \text{Year} + \varepsilon_{i,t} \quad \textbf{(1)}$$

Where:

- TaxLITIG: Proportion of tax litigation of company *i* in year *t.*
- *Audit_Exp:* Independent variable representing audit and tax consulting services, detailed in section 3.3.
- ROE: Return on equity of company *i* in year *t.*
- Indeb: Debt ratio of company *i* in year *t.*
- Size: Size of company *i* in year *t*, measured by the natural logarithm of total assets.
- $Year_t$: Fixed effects to control for specific variations of each year.
- ε_{it} - Random error term.

Firm and year fixed effects were included in the model to control for unobservable characteristics specific to each firm and each period that could influence the results. Although their coefficients are not presented in the results tables for conciseness, their inclusion is essential to ensure the robustness of the estimates (Martinez & Reinders, 2018; Xavier *et al.*, 2022; Lopo Martinez *et al.*, 2023).

3.3 Dependent variable

The variable $TaxLITIG_{i,t}$ was used as an assessment tool to measure the level of involvement in tax litigation, indicating the extent to which companies engage in tax litigation and are prepared to respond to sanctions due to risks (Lopo Martinez *et al.*, 2024; Donelson *et al.*, 2022).

This specific examination explored the correlation between the company's engagement in reducing taxes payable, which leads to tax evasion, and an increase in the prevalence of conflicts. The domain of tax litigation encompasses the sum of potential tax provisions and contingent tax liabilities divided by the company's total assets (Wenwu *et al.*, 2023). Tax litigation is a strategy employed by financial organizations (Edward *et al.*, 2016; Martinez, 2017).

$$TaxLITIG_{i,t} = \frac{(Tax\ Provision_{\ t} + \ Contingent\ Tax\ Liabilities_{\ t})}{Total\ Assets_{\ t}} \quad \textbf{(2)}$$

3.4 Independent variable

The main independent variable, $Audit\_Exp_{i,t}$ is represented by four proxies that capture different aspects of audit and tax consulting services:

- LOG_AUDIT: Natural logarithm of total expenses with audit, tax services, and others.
- AUDIT_TA: Total expenses with audit, tax services, and others divided by total assets.
- LOG_SERV: Natural logarithm of total expenses with tax services.
- SERV_TA: Total expenses with tax services divided by total assets.

3.5 Control variables

The control variables included in the model are:

- ROE (Return on Equity): A profitability indicator calculated by dividing net income by equity.
- Indeb (Indebtedness): Ratio of total liabilities (current and non-current) to total assets.
- Size (Company size): Natural logarithm of total assets.

3.6 Statistical Procedures

Before estimating the model, descriptive statistics and correlation matrices were generated to understand the characteristics of the data. Four multiple linear regression models were then estimated to test hypotheses H1, H2, and H3, as detailed in the Results section. The models were built incrementally to assess the coefficients' stability and the results' robustness.

Table 1
Description of the variables used in the model

Variable	Type	Description	Formula	Expected Sign	Reference
TaxLITIG	Dependent	Tax litigation ratio	(Tax Provisions + Contingent Tax Liabilities) / Total Assets	-	Wenwu *et al.* (2023)
LOG_AUDIT	Independent	Natural logarithm of total audit and tax services expenses	ln(Audit Expenses + Tax Services)	+	Donelson *et al.* (2022)
AUDIT_TA	Independent	Total audit and tax services expenses to total assets	(Audit Expenses + Tax Services) / Total Assets	+	Donelson *et al.* (2022)
LOG_SERV	Independent	Natural logarithm of tax services expenses	ln(Tax Services Expenses)	+	Garcia-Blandon *et al.* (2021)
SERV_TA	Independent	Tax services expenses to total assets	Tax Services Expenses / Total Assets	+	Garcia-Blandon *et al.* (2021)
ROE	Control	Return on equity	Net Income / Equity	-	Xavier *et al.* (2022)
Indeb	Control	Debt ratio	(Current Liabilities + Non-Current Liabilities) / Total Assets	+	Bastos & Nakamura (2009)
Size	Control	Firm size	ln(Total Assets)	-	Wang *et al.* (2020)

Source: *research data.*

4. Results and Analysis

4.1 Descriptive statistics

Table 2 presents descriptive statistics of the variables used in the research, including tax litigation (TaxLITIG), audit costs (LOG_AUDIT and AUDIT_TA), tax service costs (LOG_SERV and SERV_TA), return on equity (ROE), debt (Indeb), and company size (SIZE).

Table 2
Descriptive statistics of the variables analyzed

Variable	Obs.	Mean	Standard deviation	Minimum	Maximum	P25	P50	P75
TasxLITIG	416	0.0699	0.0840	0.0001	0.4078	0.0142	0.0372	0.0955
LOG_AUDIT	416	6.9203	1.3107	3.7612	10.1206	6.0479	6.8161	7.7571
AUDIT_TA	416	0.3035	0.3522	0.0101	1.9699	0.0963	0.1769	0.3778

LOG_SERV	416	2.0237	4.5005	0.0000	14.2659	0.0000	0.0000	0.0000
SERV_TA	416	0.0029	0.0097	0.0000	0.0579	0.0000	0.0000	0.0000
ROE	416	11.9633	12.8720	-16.2979	72.6374	3.4985	10.9596	16.6900
Indeb	416	0.5584	0.2189	0.0993	1.3821	0.4508	0.5729	0.7022
SIZE	416	8.6427	1.6482	4.4955	13.0776	7.4820	8.6741	9.7556

Note: TaxLITIG is calculated as (tax provisions + contingent tax liabilities) divided by total assets. LOG_AUDIT and AUDIT_TA represent audit expenses; LOG_SERV and SERV_TA represent tax service expenses; ROE is return on equity; Indeb indicates debt, and SIZE refers to company size.
Source: *Research data.*

Tax Litigation (TaxLITIG): Table 2 shows an average litigation rate of 6.99% among B3-listed companies, as reflected by the LITIG variable. This rate is relatively low compared to the weak litigation outcomes reported by Krishnan and Krishnan (1997) and is notably below the average litigation rate of 12.78% documented by Lopo Martinez *et al.* (2024), representing a difference of approximately 5.79 percentage points in relation to total assets. The standard deviation of 8.40% suggests moderate variability around the mean. The observed range, from a minimum of 0.01% to a maximum of 40.78%, indicates that while some companies face minimal litigation, others encounter considerably higher levels. Approximately 75% of cases present litigation rates below 9.55%, consistent with Mukoffi *et al.*'s (2022) conclusions regarding the quality and transparency of tax information.

LOG_AUDIT (Logarithm of Audit Expenses): The mean value of 6.92 represents the natural logarithm of total audit expenses. This figure reflects considerable variation in audit spending across firms, as noted by Francis *et al.* (2009).

AUDIT_TA (Audit Expenses / Total Assets): The mean audit expense ratio of 30.35% indicates that, on average, audit expenses account for a substantial proportion of total assets. The high standard deviation of 35.22% suggests significant variability, which may reflect differences in the quality of audit services and their role in minimizing tax disputes and supporting firms' financial stability, in line with Khurana *et al.* (2004).

LOG_SERV (Logarithm of Tax Service Expenses): The mean value of 2.0237, accompanied by a notably high standard deviation of 4.5005, reveals substantial dispersion in tax service expenses across firms. Zero-value prevalence suggests that many companies incur little to no expenditure on tax services. According to Al-Qadasi *et al.* (2023) and Jaffar *et al.* (2021), this may be linked to the degree of auditor independence and its influence on the effectiveness of specialized auditors in managing tax outcomes and litigation exposure.

SERV_TA (Tax Services Expense / Total Assets): A mean of just 0.29% indicates that tax service expenses represent a small fraction of total assets, which supports the principles of transparency and reliable financial disclosure, as discussed by Lopo Martinez (2022).

Control Variables: Return on equity (ROE) has a mean of 11.9633%, indicating strong returns from the management of both equity and borrowed capital, as reported by Xavier *et al.* (2022). The standard deviation of 12.8720% suggests significant variability in profitability among firms.

4.2 Correlation matrix

The Pearson correlation matrix in Table 3 provides a comprehensive view of the associations between the variables investigated and the incidence of tax litigation (TaxLITIG).

Table 3
Pearson correlation matrix

Variables	LITIG	LOG_AUDIT	AUDIT_TA	LOG_SERV	SERV_TA	ROE	Indeb.	*Size*
LITIG	1							
LOG_AUDIT	0.2397***	1						
AUDIT_TA	0.0383	-0.0580	1					
LOG_SERV	0.1382***	0.3312***	-0.1095**	1				
SERV_TA	0.0534	0.1822***	0.0457	0.6912***	1			
ROE	-0.1001**	0.0480	-0.1530***	0.0481	0.0730	1		
Indeb.	0.2279***	0.1835***	-0.0031	-0.0019	0.0041	0.0370	1	
Size	0.2008***	0.7363***	-0.5825***	0.3222***	0.0782	0.0873*	0.2185***	1

Note. *** $p < 0.01$; ** $p < 0.05$; * $p < 0.10$.
Source: *Research data.*

The initial analysis reveals a moderate and statistically significant positive correlation between tax litigations and total audit expenses (LOG_AUDIT, r = 0.2397, p < 0.01). This result suggests that greater investment in audit services is associated with a higher incidence of tax litigation, corroborating previous studies indicating that companies with directors experienced in tax matters tend to adopt more aggressive tax strategies (Lanis & Richardson, 2012; Khaola & Moez, 2019; Kovermann & Velte, 2019; Wang & Yao, 2021). In contrast, the correlation between tax litigation and the AUDIT_TA variable, which measures audit expenses as a proportion of total assets, was weak and not statistically significant (r = 0.0383). This suggests that the relative level of audit spending, in proportion to company size, does not directly influence exposure to tax litigation.

There is also a moderate, positive, and statistically significant correlation between spending on tax services (LOG_SERV) and tax litigation (r = 0.1382, p < 0.01), reinforcing the idea that higher investments in outsourced tax consulting services are associated with a greater likelihood of tax litigation. Furthermore, the strong positive correlation between LOG_SERV and SERV_TA (r = 0.6912, p < 0.01) confirms this relationship, clearly indicating that companies allocating a greater proportion of resources to tax services are more likely to adopt aggressive tax strategies, potentially increasing the incidence of tax litigation, consistent with Nascimento (2020).

Another noteworthy finding is the moderate positive correlation between indebtedness (Indeb) and tax litigation (r = 0.2279, p < 0.01). This result suggests that more heavily indebted companies are more exposed to tax litigation, possibly due to increased regulatory scrutiny and a greater reliance on aggressive tax planning to meet financial obligations. Similarly, company size (Size) also showed a significant positive correlation with tax litigation (r = 0.2008, p < 0.01), indicating that larger firms may be more susceptible to such disputes, likely due to their operational complexity and higher visibility to tax authorities, as noted by Garcia-Blandon *et al.* (2021).

In addition, company size (Size) demonstrated a strong positive correlation with total audit expenses (LOG_AUDIT, r = 0.7363, p < 0.01), reinforcing the idea that larger companies incur higher absolute audit costs, likely reflecting more complex operational and regulatory requirements, as discussed by Chyz *et al.* (2021). Conversely, a strong negative correlation was found between AUDIT_TA and company size (r = -0.5825, p < 0.01), suggesting that, relative to total assets, larger firms spend proportionally less on auditing, possibly due to economies of scale that reduce per-unit audit costs.

Finally, return on equity (ROE) exhibited weak correlations with all other variables, including audit and tax service expenses. This indicates that while financial performance is economically important, it has limited direct influence on audit and tax consulting expenditures or on the incidence of tax litigation.

Overall, these results offer important insights into the interplay of financial, operational, and regulatory factors in the companies analyzed. In particular, they highlight the relevance of tax consulting and auditing services as potential determinants of tax litigation. However, it is important to stress that these correlations do not imply causality, and other factors not included in the analysis may also play a significant role.

4.3 Multiple linear regression analysis on tax litigation

Four multiple linear regression models were estimated to test the hypotheses (Table 4). Each model examines different combinations of independent variables related to audit and tax consulting services, along with control variables, to assess their impact on the incidence of tax litigation (TaxLITIG).

Table 4
Multiple linear regressions

Variable	Model (1)	Model (2)	TaxLITIG Model (3)	Model (4)
LOG_AUDIT	**0.0119*** **	-	-	-
AUDIT_TA	-	**0.0446*** **	-	-
LOG_SERV	-	-	**0.0018** **	-
SERV_TA	-	-	-	0.4193
ROE	**-0.0007*** **	**-0.0067** **	**-0.0008*** **	**-0.0008*** **
Indeb.	**0.0733*** **	**0.0655*** **	**0.7799*** **	**0.0753*** **
Size	0.0016	**0.0143*** **	**0.0069*** **	**0.0084*** **
CONST.	**-0.0604*** **	**-0.0978*** **	-0.0289	**-0.0381* **
Obs.	416	416	416	416
F Value	**12.26*** **	**13.07*** **	**11.39*** **	**10.54*** **
R-squared	0.1066	0.1042	0.1000	0.0930
Prob>F	0.0000	0.0000	0.0000	0.0000

Note. *** $p < 0.01$; ** $p < 0.05$; * $p < 0.10$..
Source: *Research data.*

The results presented confirm the main hypothesis (H1). Models 1, 2, and 3 demonstrate that higher corporate spending on auditing (LOG_AUDIT, AUDIT_TA) and tax consulting (LOG_SERV) is significantly associated with a higher incidence of tax litigation. Hypothesis H2 was partially supported, as the relative proportion of spending on tax services to total assets (SERV_TA) showed a positive but statistically non-significant relationship in the full model (Model 4).

Among the control variables, return on equity (ROE) consistently showed a negative effect across all models. This suggests that more profitable companies tend to experience fewer tax litigation, likely due to more conservative tax management practices. In contrast, indebtedness (Indeb) yielded significantly positive coefficients in all models, indicating that more indebted firms are more exposed to tax litigation, potentially due to higher financial and regulatory risk. Firm size (Size), which was significant in Models 2, 3, and 4, further supports the notion that larger firms are more frequently involved in tax litigation, possibly as a result of their greater operational complexity and heightened regulatory scrutiny.

Taken together, these results strongly suggest that expenditures on tax consulting increase firms' exposure to tax litigation, and that profitability, debt levels, and firm size consistently moderate this effect. A detailed discussion of these findings in relation to the existing literature is presented in the following section.

4.4 Discussion of the results

The results indicate that hiring tax consulting services from independent auditors is positively associated with a higher incidence of tax litigation. This finding provides robust empirical support for the study's main hypothesis (H1) and aligns with concerns raised in previous research. For instance, Dhiyaulhaq and Fadjarenie (2023) emphasize that combining audit and tax consulting functions can create ethical ambiguity, potentially increasing litigation risks due to incentives for adopting aggressive tax strategies. Our findings reinforce this perspective by demonstrating that companies with higher proportional spending on tax services tend to face more tax litigation.

These results corroborate the findings of Lanis and Richardson (2012), Khaola and Moez (2019), and Kovermann and Velte (2019), who argue that directors with extensive tax knowledge may inadvertently encourage aggressive tax planning. While such aggressiveness may reduce immediate tax liabilities, it can heighten exposure to regulatory scrutiny and legal challenges, particularly in stricter regulatory environments, as discussed by Obeng-Nyarko (2023).

The analysis also reveals that the relationship between tax consulting and tax litigation is sensitive to the measurement method employed. Although the models showed statistically significant associations when using the ratio of tax service expenses to total assets, it is important to recognize that this metric presents an inherent limitation. Specifically, the use of fees classified as tax services, extracted directly from corporate financial statements, constitutes an imperfect proxy that may not fully capture the scope or nature of the services provided. Consequently, the results should be interpreted with caution.

Moreover, the literature does not offer a clear consensus regarding the effects of the proportion of tax consulting fees relative to total fees paid to auditors. Jaffar *et al.* (2021) highlight ambiguities in this area, underscoring the need for more nuanced approaches in future research to understand this complex relationship better.

Another important consideration is that the relationships identified in this study are correlational rather than causal. As noted by McGuire *et al.* (2012) and Ling (2023), unobserved factors, such as changes in corporate governance practices, specific industry characteristics, or external regulatory pressures, may also directly influence litigation risk. Thus, our findings should be interpreted within the bounds of these methodological limitations.

From a practical standpoint, these results serve as a warning to companies and their audit committees to carefully weigh the potential trade-offs between tax optimization through consulting services and the increased risk of tax litigation. For regulators and policymakers, our findings highlight the importance of establishing clear and rigorous guidelines regarding the joint provision of audit and tax consulting services in order to mitigate potential conflicts of interest.

This study advances the literature by explicitly examining the intersection between independent auditing and tax consulting, emphasizing the legal implications of their interaction. In doing so, it contributes meaningfully to the accounting literature, particularly by shedding light on the practical and legal consequences of independent auditors providing tax consulting services. This subject remains underexplored, especially in the Brazilian context.

Finally, companies are advised to carefully balance the financial benefits of tax avoidance strategies against the heightened risk of conflict with tax authorities. This finding emphasizes the need for more refined and strategic approaches to corporate governance and risk management, supporting more informed and responsible organizational decision-making.

5. Conclusions

We conclude that, for the companies analyzed, tax consulting services provided by independent auditors are associated with an increase in the incidence of tax litigation**.** The empirical analysis of Brazilian companies listed on the B3 stock exchange from 2017 to 2020 revealed that higher spending on outsourced tax consulting services from audit firms coincided with significantly higher levels of tax litigation.

Regarding the formulated hypotheses, the empirical results confirmed **Hypothesis 1 (H1)**, showing that companies investing more in outsourced tax consulting are more likely to face tax litigation. **Hypothesis 2 (H2)** was also confirmed, although with a more limited effect: a higher proportion of tax service expenses relative to total assets contributed to a slight increase in the incidence of tax disputes. In contrast, **Hypothesis 3 (H3)**, which posited a positive relationship between the relative weight of tax services compared to total audit fees and an increase in tax litigation, did not receive robust statistical support. This indicates that this specific variable did not significantly influence the companies analyzed.

This study contributes to the literature by offering unprecedented empirical evidence on the relationship between tax consulting services provided by independent auditors and the occurrence of tax litigation in an emerging economy like Brazil. Unlike previous research, which often examines auditing or tax planning in isolation, our integrative approach highlights the trade-offs involved in the dual role of auditors as tax consultants, thereby advancing the understanding of the legal and ethical implications of this relationship.

From a practical perspective, the results suggest that managers and audit committees should carefully assess the balance between the financial benefits of tax avoidance achieved through tax consulting and the increased risk of conflict with tax authorities. For regulators and policymakers, the findings highlight the urgent need for clearer and stricter guidelines on the simultaneous provision of audit and tax consulting services to mitigate potential conflicts of interest and safeguard auditor independence.

As a limitation, this research was restricted to large Brazilian companies over a relatively short time span (four years), which may limit the generalizability of the results to broader contexts. Moreover, audit fees classified as tax services represent an imperfect proxy, as they depend on how companies report these amounts and may not fully capture the nature or scope of the tax services rendered.

Another important consideration is the observational nature of this study, which precludes the establishment of a direct causal relationship between tax consulting services and tax litigation. It is also necessary to account for potential unobserved factors, such as specific corporate governance practices and varying levels of regulatory pressure. Future research should consider using alternative financial performance indicators, such as ROI or EBITDA, to assess the robustness and generalizability of the findings.

We recommend that future studies explore longer periods, include other international markets, or adopt complementary methodologies, such as qualitative research or more robust longitudinal models, to better identify causal mechanisms and deepen the understanding of this topic.

This study enriches the ongoing debate on auditor independence and tax consulting by empirically demonstrating the trade-offs involved and providing valuable insights for academic, professional, and regulatory communities.

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