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The Effect of Corporate Governance on Tax Avoidance with Profitability as Moderating Variable

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ABSTRACT

This study aimed to examine and analyze the effect of corporate governance on tax avoidance through profitability as a moderating variable. This research is positive research using deductive reasoning by suggesting a theory which is then tested on a research design. This study's population consists of firms listed in Indonesia Stock Exchange between 2017 and 2021. Sample was selected by using a purposive sampling method. Sample selection was made by using a purposive sampling method. The research results after testing 505 samples found that companies with good corporate governance rarely engage in tax avoidance. Finally, this study provides empirical evidence regarding what factors can reduce the level of tax avoidance in companies by implementing good corporate governance. In addition, the researcher suggests that further research consider conducting cross-country comparative research because tax avoidance is not only a problem for Indonesia but also a global problem.

Keywords: Corporate Governance, Profitability, Stakeholder Theory, Tax Avoidance, Tax Aggressiveness.

INTRODUCTION

Tax avoidance is a major issue in the world of taxation, business, and tax authorities because of its negative impact on various parties (Abdallah,2013). This research defines tax avoidance, referring to Lanis & Richardson (2012), who state that tax avoidance, tax aggressiveness, and tax management refer to the same meaning. Tax avoidance is an attempt by management or company to reduce the company's tax burden through tax planning, both legal and illegal.

The actions of companies trying to reduce the tax burden caused many losses for the state. One of them is not achieving the tax revenue target set by the government for 12 years. Tax Justice Network's places Indonesia in the fourth position in Asia as the country with the most losses due to tax avoidance practices. The loss caused by tax avoidance practices in Indonesia is estimated at Sixty-nine trillion rupiah. This amount consists of tax avoidance by corporations is sixty-eight trillion rupiah and one trillion rupiah from tax avoidance by individuals. This implies that Indonesia is missing out on large potential tax revenues, resulting in the eventual failure to achieve tax revenue targets.

According to Armstrong et al. (2013), one alternative to reduce tax avoidance practices is applying the principles of good corporate governance. The system and corporate governance strongly influence the fulfilment of tax obligations in the company. In the Governance Guidelines, Indonesia Financial Services Authority (2015) explains that to implement good governance, five aspects must be considered: First, the company's relationship with shareholders, the functions and roles of the board of commissioners and directors, stakeholder participation, and information disclosure. This is consistent with what has been described by stakeholder theory that good governance is influenced by the contributions of various stakeholders (Freeman, 1984). Kovermann & Velte (2019) stated that tax avoidance could be controlled by several aspects of governance such as board composition, ownership structure, audit, and pressure from stakeholders. Halioui et al. (2016) stated that the number of supervisory boards has a negative effect on tax avoidance, which means that a large number of supervisory board members will increase the supervisory function, and the level of tax avoidance in companies will be low.

Kovermann & Velte (2019) argue that different research results may be explained by the different financial conditions of each company. In this study, the moderating variable used is profitability. Profitability is expected to describe the financial condition of the company. Profitability is used because all company activities are inseparable from funding sources, namely profits earned and assets owned by the company.

LITERATURE REVIEW

Stakeholder Theory

The concept of stakeholder theory was first introduced by Freeman (1984), which states that companies must simultaneously try to fulfill owners, employees, unions, suppliers, and also customers interests so that the company can be successful. Stakeholder theory provides a broader view of corporate governance than agency theory. In agency theory, the governance process controls managers and other parties to act in the owners' interests. The governance process based on the concept of stakeholder theory has a different view that shifts the problems of agents and principals into team production problems. In addition, the form of governance issues based on stakeholder theory ensures effective negotiation, coordination, and conflict resolution to maximize and distribute mutual benefits between the stakeholders.

Freeman (1984) concludes that stakeholder theory offers a practical, efficient, effective, and ethical method for managing groups in a highly complex environment. Stakeholder theory plays an essential role in corporate governance and can help companies balance the benefits of various groups

Tax Avoidance
The OECD identifies tax evasion as a design carried out by taxpayers intending to reduce the tax burden and usually contrary to the law's intent that should be followed. According to Taylor & Richardson (2012), there are several forms of tax avoidance practice schemes that aim to reduce the company's tax burden, including thin capitalization, transfer pricing, income shifting, and tax haven utilization

Tax avoidance is a company's effort to lessen the corporation's actual tax rate by utilizing loopholes and grey areas in tax regulations through tax avoidance schemes, as stated by Taylor & Richardson (2012). This tax avoidance then causes significant losses to the state.

Corporate Governance
Corporate governance (CG) is referred as the structure and method to direct and control the company (Financial Services Authority, 2014). According to Monks et al. (2004), the notion of corporate governance is a system to regulate and control a company that can create added value for all stakeholders. The OECD (2015) provides a more detailed definition of CG:
"… a set of relationships between a company's management, its board, its shareholders and other stakeholders. CG also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined."

From these various definitions of CG, it can be concluded that there are important things to emphasize, CG is a set of rules applied in running a company to increase the value and sustainability of the company. According to Kovermann & Velte (2019), in its application, there are two CG mechanisms, namely internal and external mechanisms. The internal mechanism is related to the internal control in the company, such as the size and composition of the board of commissioners and the board of directors. An external mechanism is a control mechanism that utilizes all existing tools outside the company, be it economic, legal, or social, to control the running of the company in accordance with stockholder as well as other stakeholder wishes. These tools include a competitive capital market, complete legal and regulatory instruments, fair law enforcement, and audits of financial statements conducted by audit firm.

Tax Avoidance and Corporate Governance
Stakeholder theory reveals that the company does not only run because of the relationship between managers and shareholders but also because of the role of other stakeholders, whether financially bound or not (Freeman, 1984). Stakeholder theory also states that companies have a responsibility to consider all actions they take because they will impact stakeholders. CG is a system developed by the company to ensure that the company's activities are carried out in accordance with the interests of shareholders and stakeholders (Wogu, 2016). Companies with good governance will carry out operational activities carefully to avoid harming the stakeholders. Tax avoidance is one of the actions that can damage the company's reputation and potentially harm stakeholders.

The implementation of good governance is needed in order to prevent tax avoidance in a company. Jiménez-Agueira's research (2018) proves that good governance, namely high internal and external supervision within the company, results in a low level of tax avoidance. These results are supported by research conducted by Hoseini et al. (2019), which states that the governance mechanism such as the composition of the supervisory board, has a negative effect on the level of corporate tax avoidance.

RESEARCH METHOD

This study uses a positive approach as the basis for solving research problems. A positive approach is used to get the truth (reality) in the world and see things happen because of the law of cause and effect. This study aimed to examine the relationship of the independent variable to the dependent and the effect of the moderating variable on the relationship. The stages carried out in this research are collecting research samples, collecting data related to research variables, and then analyzing the data through statistical tests that aim to test the established hypotheses so that empirical evidence will be obtained. This study includes all companies listed on the IDX between 2017 and 2021. This study's sample will be drawn from the population using the method of purposive sampling with the following criteria:

1. They are not financial institutions and construction companies.
2. Financial reports from 2017-2021 and available on the company website or IDX website
3. Annual reports containing information about implementation of public company governance recommendation conducted by Indonesia Financial Authorization Services from 2017-2021 and available on the company website or IDX website.
4. The company did not experience a loss during the year of the observation period.

This study's definition of tax avoidance refers to Lanis & Richardson (2012a). Tax avoidance is the efforts made by company managers to reduce the tax burden paid through the tax planning process. Measurement of tax avoidance in this study will use Effective Tax Rate, which refers to research (Halioui et al., 2016; Lanis & Richardson, 2012a; Lin et al., 2017). The formula for the effective tax rate is:

$$ETR = \frac{tax\ expense}{pretax\ income}$$

According to Indonesia Financial Services Authority (2014b), CG is a structure and process to direct and control a company. In this study, the measurement of CG variables will refer to the circular letter of the Financial Services Authority number 32/SEOJK.04/2015 regarding the governance of public companies. The CG guidelines consist of 5 aspects, 8 principles, and 25 recommendation items. The recommendations given by OJK will be an indicator for measuring CG variables. The scores of each recommendation item that is compiled will be added up.

The profitability ratio indicates the effectiveness of a company's wealth management, and the profits generated by the company indicate it. According to research by Lanis & Richardson (2012a), Mahoney et al. (2013), and Buana & Wahyudin (2016), ROA (Return on Assets) will be used in this study to describe the profitability of a company and to measure the efficiency with which the company generates earnings by utilizing its own assets.

$$\mathrm{ROA} = \frac{\text{Earning After Tax}}{\text{Total Assets}}$$

This study employs multiple linear regression and Moderate Regression Analysis for its analysis. In this study, the addition of a moderating variable seeks to determine whether the variable will enhance or diminish the relationship between the independent variable and the dependent variable. The testable regression equation model is as follows:

TA= α+β1 CG+β2 CG*ROA+Ɛ,

Description:

β	: Regression Coefficient
α	: Constant

TA : Tax Avoidance
CG : Corporate Governance
ROA : Profitability
Ɛ : Error rate

RESULTS

The results of the descriptive statistics analysis of all research variables are presented in table 1. The total sample obtained from 2017-2021 is 515 samples. It is identified, based on Table 1, that the average is 0.2126. From this average, it can be concluded that most sample companies pay a tax burden of 21% of profit before tax. ETR has a standard deviation value of 0.050. This value is less than the mean, indicating that there is little variation between the minimum and maximum values during the observation period, namely 0,09 to 0,36.

Table 1. Descriptive statistics results (N=515)

	N	Min	Max	Mean	Std. Deviation
ETR	515	,09	,36	,2126	,05023
CG	515	12	25	22,09	2,835
ROA	515	,04	52,67	8,8205	8,34550

CG has a mean value of 22,09 in the sample companies with a standard deviation of 2,835. The smallest ROA value of the sample company is 12, and the largest ROA value is 25. The average value illustrates that most sample companies have met 22 of the 25 recommendations the Financial Services Authority suggested. The minimum CG score is 12, this shows that the company only implements 12 recommendations for Public Company Governance and the highest score is 25.

Profitability measured by calculating Return on Assets (ROA) has a minimum value of 0.04 while the maximum value of the sample company is 52,67. The mean owned by the sample companies is 8,8205, with a standard deviation of 8,3455.

Table 2. Regression results without moderation

Variable	B	Std. Error	Sig.
(Constant)	,138	,017	,000
CG	,003	,001	,000

Note: R^2 = 0.037, $p > 0.05$

Table 3. Regression results with moderation

Variable	B	Std. Error	Sig.
(Constant)	,138	,017	,000
CG	,003	,001	,000
CG*ROA	,001	,000	,001

Note: R^2 = 0.056, $p < 0.05$

DISCUSSION

Table 2 shows CG has a beta coefficient value of 0.003 with significance value of 0.000. These findings show that the sig value is less than 0.05, it could be indicated there is positive effect among CG and ETR. A high ETR illustrates the low level of tax avoidance, therefore it can be deduced that CG has a negative impact on the amount of tax avoidance. These results support Armstrong (2013), who states that implementing good governance can minimize tax avoidance in the company. This result also supports the stakeholder theory described by Freeman (1984), which states that CG that involves various stakeholders can resolve conflicts in a practical, efficient, effective, and ethical manner. Supervision from internal and external companies will certainly be more effective in preventing tax evasion. The results of this study are in line with previous research by Jiménez-Agueira (2018), Hoseini et al. (2019), and Kovermann (2019), which provides evidence that good CG can decrease the occurrence of tax avoidance.

Table 3 report that CG*ROA has a beta coefficient value of 0.001 with a significance value of 0.001. These findings indicate that the significance value is smaller than 0.05, so it can be concluded that profitability has a significant impact on positive effect on CG on ETR. A high ETR illustrates the low level of tax avoidance, so it can be concluded that profitability strengthens the negative influence of CG and has a negative effect on the level of tax avoidance. The implementation of good governance will maximize the supervisory function, and high profitability illustrates that the company has a reputation that must be maintained so that it will prevent the company from tax avoidance. Stakeholder theory expressed by Freeman (1984) states that companies have a responsibility to think about all actions that the company will take because it will impact stakeholders.

CONCLUSION

This study seeks to analyze and investigate the impact of CG on tax avoidance, as moderated by profitability. This study supports the claim that effective CG can reduce tax avoidance. Moreover, good governance that involves internal and external stakeholders can maximize the supervisory function, minimizing the possibility of tax avoidance.

The research has proven that profitability can strengthen the negative effect of CG on tax avoidance in the sample companies. Profitability describes the financial condition of the sample companies. High profitability indicates that the sample companies have sufficient financial resources to meet their tax obligations and are not aggressive towards their taxes. The researcher suggests that further researchers consider tax avoidance measurements that are not based on data from financial statements. Future research can also consider conducting cross-country research to compare the influence of CG implementation on tax avoidance between countries.

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DECLARATION OF CONFLICTING INTERESTS
The authors declare that they have no conflicts of interest or personal relationships that could appear to have influenced the research reported in this paper.

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