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The Effect of Corporate Governance and Company Size on Tax Avoidance

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Abstract

Purpose - This study aims to examine the effect of corporate governance and company size on tax avoidance in manufacturing companies.

Methodology - The population includes all the manufacturing companies listed on the Indonesia Stock Exchange during 2017-2019 and the 288 companies used as samples were selected through the purposive sampling method. A regression model was used for analysis.

Findings - The results showed that institutional ownership, independent commissioners, and audit committee did not affect tax avoidance but managerial ownership and firm size have some influence. It was recommended that companies improve good governance by reducing their tax avoidance policies while other variables such as audit quality, executive character, liquidity, accounting conservatism, and capital intensity are suggested to be added to further studies related to tax avoidance.

Originality - The novelty of this study is examine all corporate governance mechanisms consist of institutional ownership, independent commissioner, audit committee, and managerial share ownership on tax avoidance.

1. Introduction

Tax is an important element in countries, especially developing ones, due to its function as a source of revenue. The optimization of this revenue by the state is, however, limited by the avoidance of companies to pay taxes due to its consideration as a burden on their profitability, therefore companies will try to pay as little tax as possible (Ginting, 2016).

This tax avoidance phenomenon was observed in Coca-Cola Indonesia Company with the company reported to have allegedly reduced its taxes as indicated by the underpayment of IDR 49.24 billion. The result of investigation by the Directorate General of Taxes showed that the company implemented tax avoidance measures associated with cost overruns such as the total of IDR 566.84 billion allocated to advertisements from 2002 to 2006 in addition to several others to ensure a decrease in taxable income (Kompas, 2014).

Tax avoidance is a legal aspect of tax planning which is usually implemented to reduce the tax burden on a company and is normally influenced by several factors such as corporate management or governance and company size. This concept is one of the important things required

to be considered by a finance company to optimize government efforts to obtain revenue through taxation. Tax avoidance is an effort often implemented by companies to minimize the tax burden because it is within the framework of the applicable tax regulations. Tax avoidance is legal but is not favored by the government and is observed to be reflected in the tax ratio of the Indonesian state which indicates the government's ability to collect tax revenues or absorb GDP from society through taxes. It is important to note that a higher tax ratio represents the high effectiveness of a country in relation to tax collection. The average tax ratio of Indonesia for the past six years is 12.14 percent and this implies the revenue obtained by the country from taxes is not optimal.

Tax avoidance practices are usually implemented by the management of a company to minimize tax obligations legally, so that companies tend to take various ways to reduce their tax burden (Diantari & Ulupui, 2016). Tax avoidance carried out by the company is of course through the policies taken by the company leaders themselves. It is a concept associated with the efforts of the company management to reduce legal tax debt but it usually put the company at the risk of penalties such as fines and a bad reputation. Moreover, the phenomenon can be classified as tax evasion when it exceeds a certain limit or violates applicable laws and regulations (Kalbuana, 2017).

Corporate governance is a corporate management systems that describes the relationship between different stakeholders having the responsibility to determine the performance of a company. The development of this concept was initiated in 1998 when Indonesia experienced a prolonged monetary crisis which was argued to be caused by weak corporate governance implemented by companies. Investors and the government shifted their focus to the principles of corporate governance afterward. Corporate governance is defined as a system and structure to regulate the relationship between management and owners irrespective of the number of shares owned. Corporate governance also functions to protects the investors from being affected by the different interests of the shareholders (principal) and the management (agents). The problems in corporate governance are associated with the separation between the ownership and control of a company. The board of commissioners who acts as an agent in a company is given the authority to manage the running of the company and make decisions on behalf of the owner, but the agent has different interests from the shareholders. It is indicate there are differences in the interest of the board of commissioners authorized to manage the affairs of the company and make decisions on behalf of the owners and interest of principal (Damayanti & Susanto, 2015). Implementation of corporate governance can be used in a company to oversee management performance including taxation to ensure it is legal. This concept is proxied by institutional ownership, independent commissioner, audit committee, and managerial ownership in this study. The findings from the previous study showed that companies with good corporate governance always have effective operational activities, including the formulation of tax policies, to ensure more efficient performance (Prasetyo & Pramuka, 2018), (Desai & Dharmapala, 2006), (Amstrong et al., 2015), (Dyreng et al., 2008), (Sadjiarto et al., 2020), (Mappadang, 2019). While (Hasibuan & Khomsiyah, 2019) found it has no effect on tax avoidance.

Institutional ownership is defined as the ownership of shares by an institution in other companies such as insurance, foreign organizations, or banks (Damayanti & Susanto, 2015). Institutional ownership can control management through the monitoring process effectively. According to Fadhila (2017), the ownership of higher shares by other institutions normally leads to a higher level of supervision to reduce tax avoidance actions by the management. Agency theory also states that managers certainly have more knowledge of the company and are required to provide the information to the owners but they sometimes convey asymmetric information due to conflict of interest, thereby, leading to an agency cost (Prasetyo & Pramuka, 2018). Agency

theory states the contractual relationship between the agent (management of a business) and the principal (business owner) such that the agents are required to perform certain tasks for the principal to obtain a particular reward (Kurniasih & Sari, 2013). An agency relationship is a contract between one or more people (employers or principals) that employ other people (agents) to perform several services and authorize them to make certain decisions. The theory shows there is information asymmetry between managers (agents) and shareholders (principals) due to the fact that managers have a better understanding of the company's internal information and prospects in the future than the shareholders and other stakeholders. The theory serves as the basis to understand the concept of corporate governance because the management and ownership of companies are increasingly being separated in the modern economy (Jensen & Meckling, 1976). This is usually conducted to ensure the owners have the maximum possible profit at the most efficient cost possible (Manhulae, 2016). There is, however, the need for corporate governance to reduce agency problems between owners and managers. This concept has the ability to control management through an effective monitoring process and is usually measured based on the percentage of the number of shares owned by the institution in relation to the total number of outstanding shares. This normally has further effects on the process of preparing financial statements and does not rule out accrualization in the interests of the management (Ginting, 2016). It has been previously reported that the ownership of more shares by institutions usually increases the tax avoidance effect due to the intervention of the institutional shareholders in the management activities to minimize the amount of corporate tax in order to increase their wealth (Prasetyo & Pramuka, 2018). Moreover, Alviyani (2016), Praditasari & Setyawan, (2017), Prasetyo & Pramuka, (2018), Alzoubi, E. S. S, (2016), (Waluyo & Doktoralina, 2016) showed the negative and significant effect of institutional ownership on tax avoidance while Cahyono (2016), Ginting (2016), Manhulae, (2016), Khan, M., Srinivasan, S & Tan, L, (2017), Kovermann & Velte, (2019) reported that it has positive and significant influence. While Jamie, (2017) found there is no significant relationship between institutional ownership on tax avoidance.

Another corporate governance with a possible effect on tax avoidance is the independent commissioner which is defined as a board of commissioners not affiliated with any other board of directors. They are usually appointed to oversee the management of the company and are responsible to shareholders. Based on Agency theory, the greater the number of independent commissioners in a company, the better the independent commissioners can fulfill their role in supervising the actions of management related to behavior opportunistic manager that might happen. It is stated in the regulation issued by the Jakarta Stock Exchange that at least 30% of the total number of commissioners in a company needs to be independent and this implies their presence is related to the number of commissioners in a company (Fadhila, 2017). They are expected to act independently towards preventing tax evasion as reported by Ginting (2016). It is, however, important to note that the shareholders, as the principal, normally want the manager, as the agent, to act according to their interests which is mainly related to the improvement in performance and cost-efficiency such as the reduction of the tax to increase their wealth (Alviyani, 2016). This signifies the existence of independent commissioners can hamper the interests of shareholders because they are required to minimize tax avoidance as much as possible (Alviyani, 2016). It is important to reiterate that (Van Der Pilos, 2017), (Aburajah et al., 2019), (Ogbeide & Obaretin, 2018), Alviyani (2016), (Amstrong et al., 2015), (Arianti, 2020), (Chukwu, Appah, et al., 2020), (Richardson & Taylor, 2013) and Diantari & Ulupui (2016) found a negative and significant influence of independent commissioner activities on tax avoidance. However, (Tarmidi et al., 2020), Ginting (2016), and Kurniasih & Sari (2013) discovered that independent commissioners do not have any effect on tax avoidance.

Another important factor related to corporate governance is the audit committee which usually consists of a minimum of three people charged with the responsibilities of overseeing corporate governance and financial reports. This committee is formed and is responsible to the board of commissioners. It is important to note that the committee also operates a monitoring mechanism to improve the audit function for external company reporting and assists the board of commissioners in supervising and providing recommendations on controls to prevent information asymmetry. The responsibility of the audit committee in corporate governance (CG) is to ensure the company is operating based on applicable laws, conducting its business ethically, and implementing effective supervision against conflicts of interest and fraud by company employees (Diantari & Ulupui, 2016). Moreover, Damayanti & Susanto (2015), Diantari & Ulupui (2016), Fadhila (2017), (Arismajayanti & Jati, 2017) showed that the audit committee has a negative and significant effect on tax avoidance while Alviyani (2016) and Praditasari & Setyawan, (2017) reported that it has no effect on tax avoidance. Meanwhile Tendean & Winnie, (2016) state that it has positive effect.

Managerial ownership is the proportion of shareholders actively participating in the decision-making processes of a company as directors and commissioners. It focuses on aligning the interests of the management and shareholders towards ensuring the managers are encouraged to increase performance and achieve prosperity for the shareholders (Fadhila, 2017). It is important to note that greater managerial share ownership usually increases the tendency of the management to be more active in increasing the interests of shareholders because it is also usually affected by the wrong decisions (Prasetyo & Pramuka, 2018). Previous studies by Fadhila (2017) and Sunarsih & Handayani (2017), (Bousaidi & Hamed, 2019) showed that managerial ownership has a negative and significant effect on tax avoidance while (Khan, M., Srinivasan, S & Tan, L, 2017) reported a positive influence but Kalbuana, (2017), Jamie, (2017), Manhulae (2016), and McGuire et al. (2014) stated that it does not have any impact.

Company size is a scale normally used to classify companies into large and small based on different indicators such as total assets, stock market value, average sales level, and total sales (Alviyani, 2016). A bigger company is usually associated with good prospects in a relatively long period and also indicates the attainment of maturity stage with positive cash flow. These companies are also relatively more stable and have a higher ability to generate more profits compared to small ones (Alviyani, 2016). It was discovered from Dermawan & Sukartha, (2014), Alviyani, (2016), Diantari & Ulupui, (2016), Chytis, E; S. Tasios & N. Gerantonis, (2018), Kasim & Natrah, (2019), (Waruwu & Kartikaningdyah, 2019) that company size has a positive and significant effect on tax avoidance while (Salawu & Adedeji, 2017), (Praditasari & Setyawan, 2017) and Kurniasih & Sari (2013) reported a negative and significant effect impact. WhilstYuniarwati et al., (2017), (Aliani & Zarai, 2012) state tat it does not have any impact.

The previous studies reviewed did not focus on the effect of all aspects of corporate governance on tax avoidance and this is the reason this present study is conducted to fill the gap. The novelty is to examine the influence of all corporate governance mechanisms including institutional ownership, independent commissioner, audit committee, and managerial share ownership on tax avoidance. Thus, this study is essential to research factors that influence tax avoidance in manufacturing companies listed on Indonesia Stock Exchange. Corporate and company size on tax avoidance is essential to investigate in Indonesia due to the lack of empirical evidence about these variables. The result can give suggestions and also information about tax avoidance for manufacturing companies especially. The implication is to investigate the corporate governance and size of firm in the role of tax avoidance. Another implication is the findings give a different result.

This study investigates the effect of corporate governance and company size on tax avoidance in manufacturing companies listed on the Indonesia Stock Exchange. This research aims to analyze the influence of corporate governance and company size on tax avoidance. Thus the hypotheses are as follow:

H1: Institutional ownership has a negative impact on tax avoidance.
H2: Independent commissioner has a negative impact on tax avoidance.
H3: Audit committee has a negative impact on tax avoidance.
H4: Managerial ownership has a negative effect on tax avoidance.
H5: Company size has a positive effect on tax avoidance.

2. Research Methods

2.1 Types and Sources of Data

This study was conducted quantitatively using secondary data collected through documentation. The collection method involved using data collected by other parties and the document used in this study include balance sheets as well as profit and loss financial statements of the companies analyzed. It is important to note that the population includes all the manufacturing companies listed on the Indonesia Stock Exchange in 2017-2019 but the samples used were selected through a purposive sampling technique with certain considerations. The financial statements used were obtained from the official IDX website.

2.2 Measurement

Tax avoidance is the method usually applied by taxpayers to legally take advantage of the gaps or grey areas contained in tax laws and regulations in order to reduce the amount of tax payable (Praditasari & Setyawan, 2017). Tax avoidance was proxied by the book-tax gap (BTG) which is the difference between profit before tax or commercial profit and taxable income or fiscal profit (Ginting, 2016); (Aronmwan & Okafor, 2019).

Institutional ownership is defined as the ownership of shares by an institution in other companies such as banks, insurance, investment organizations, or several others (Damayanti & Susanto, 2015). Moreover, institutional ownership was measured using the percentage of shares owned by an institution in relation to the total number of shares outstanding (Ginting, 2016),

An independent commissioner is not affiliated with any board of directors or boards and usually acts independently within a company to prevent tax evasion (Ginting, 2016). Independent commissioner was measured based on the percentage of independent commissioners among the total board of commissioners (Ginting, 2016).

The audit committee is a component of corporate governance required by the Indonesia Stock Exchange (IDX) to have at least three members in order to limit the action of companies' management towards minimizing profits for tax purposes. Audit committee was measured through the number of audit committee members (Praditasari & Setyawan, 2017),.

Managerial share ownership is the proportion of ordinary shares owned by the management actively involved in making decisions in a company. Managerial ownership was measured by the common shares owned by the management members actively involved in the decision-making of a company (Manhulae, 2016).

Company size is a scale of value normally used to classify a company into large or small based on different indicators such as total assets, stock market value, average sales level, and total

sales (Praditasari & Setyawan, 2017). Company size was measured based on Ln's total assets (Cahyono, 2016).

3. Results and Discussions

3.1 Descriptive Analysis

Descriptive statistics provide an overview or description of the data based on mean, standard deviation, maximum, and minimum using tax avoidance as the dependent variable while corporate governance consist of institutional ownership, independent commissioner, audit committee, managerial ownership and company size were used as independent variables.

Table 1. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
INST	217	.0000	10,686.0000	450,986175	816.0043430
KI	217	167.0000	2,000.0000	395,225806	152.0932331
KA	2 17	.0000	5.0000	3.000000	.5692750
MNJRL	217	.0000	246,331.0000	1,285.069124	16,741.3643007
SIZE	217	18,689.0000	35,803.0000	28,200,801843	2,201.7377675
BTG	217	5,682.0000	14,582.0000	11,063.294931	1,120.3992946
Valid N (listwise)	217				

Sources: Process Data

Table 1 shows that the average value of INST is 450.986175, the minimum was 0.0000, the maximum was 10,686.0000, and the standard deviation was 816.0043430 while the company with the smallest was Akasha Wira Internasional Tbk in 2015 and the highest was recorded in Hanjaya Mandala Sampoerna. Moreover, the average value for the Independent Commissioner variable was 395.225806, the minimum was 167.0000, the maximum was 2,000.00 and the standard deviation was 152.0932331 while the company with the smallest value was Unggul Indah Cahaya Tbk and the highest was Duta Pertiwi Nusantara Tbk. The mean value for KA was found to be 3.000000, the minimum was 0.000, the maximum was 5.00, and the standard deviation was 0.5692750 while the smallest value was recorded for Pelangi Indah Canindo Tbk and the highest for Malindo Feedmill Tbk. It was also discovered that the average MNJRL value was 1285.069124, the minimum was 0.0000, the maximum was 246.331.0000, and the standard deviation was 16,741.3643007 while the company with the smallest value was Unggul Indah Cahaya Tbk and the highest was found with Barito Pacific Tbk. Furthermore, the mean SIZE value was shown in the table to be 28,200.801843, the minimum was 18,689.0000, the maximum was 35,803.0000, and the standard deviation was 2,201.7377675 while the company with the smallest was Tembaga Mulia Semanan Tbk and the highest was Ultrajaya Milk Industry Tbk. The average value for the BTG was recorded to be 11,063.294931, the minimum was 18,689.0000, maximum value and standard deviation were 1,120.3992946 while the companies with the smallest value were Sido Muncul Tbk Herbal and Pharmaceutical Industry and the highest was found with Kalbe Farma Tbk.

This was followed by the normality test which was used to determine the distribution status of the residual data using skewness and kurtosis and the results are presented in the following Table 2.

Table 2. Normality Test

	Skewness		Kurtosis	
	Statistic	**Std. Error**	**Statistic**	**Std. Error**
Unstandardized Residual	.152	.165	.010	.329
Valid N (listwise)				

Sources: Process Data

The skewness and kurtosis values were calculated as follows:

$Zskew = x = \frac{0.152}{\sqrt{6}/217} = x = \frac{0.152}{0.165} = 0{,}921$ and $Zkurt = \frac{0.010}{0.329} = 0.030$

The normality value of the skewness was 0.921 < 1.96 and Kurtosis 0.030 < 1.98 and this means the processed data satisfy the assumption of normality. Moreover, the classical assumption test including the multicollinearity, autocorrelation, and heteroscedasticity was also conducted and the results are indicated as follows.

Table 3. Multicollinearity Test

	Collinearity Statistics	
Model	**Tolerance**	**VIF**
(Constant)		
INST	.992	1.008
KI	.984	1.016
KA	.985	1.015
MNJRL	.981	1.019
SIZE	.962	1.040

Dependent Variable: BTG

Sources: Process Data

The multicollinearity test showed that all variables have a tolerance value > 0.10 and a VIF value < 10 and this means there is no multicollinearity between the independent variables used in the regression model.

Table 4. Autocorrelation test

Model	Durbin-Watson
1	1.840

a. Predictors: (Constant), SIZE, INST, KI, KA, MNJRL
b. Dependent Variable: BTG

Sources: Process Data

The autocorrelation test showed that the value of DW was 1.840 and this was compared with Durbin Watson's value at 5% significance, a sample size of 217, and some independent variables of 5 (k = 5). The Durbin Watson value on the table, dl, is 1.732 while the du value is 1.825 and (4-du) is 4 – 1.825 = 2.175. This shows the calculated DW value is between the upper limit (du) and the lower limit (4-du) or du < dw < 4 – du as indicated by 1.825 <1.840 <2.175 and this means

there is no autocorrelation problem. Furthermore, the heteroscedasticity was tested using the Glejser test and the results are presented in Table 5.

Table 5. Heteroscedasticity test

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	T	Sig.
1	(Constant)	865.407	411.504		2.103	.037
	INST	-.033	.036	-.063	-.918	.360
	KI	.135	.195	.048	.692	.490
	KA	29.034	51.989	.038	.558	.577
	MNJRL	-.002	.002	-.085	-1.235	.218
	SIZE	-.019	.014	-.096	-1.383	.168
Dependent Variable: ABRS						

Sources: Process Data

The results showed that the sig value of INST was 0.360, KI was 0.490, KA was 0.577, MNJRL was 0.218, and SIZE was 0.168 which are all greater than 0.05, thereby, indicating the lack of heteroscedasticity in the regression model. This means the variables can be used in the model and this led to the further tests conducted on the hypotheses tests with the results presented in the following tables.

Table 6. Model test

Test the coefficient of determination					F test		
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Model	F	Sig
1	.827a	.684	.677	637.0041628	Regression	91.443	.000a
Predictors: (Constant), SIZE, INST, KI, KA, MNJRL							

Sources: Process Data

Table 6 shows the Adjust R-Square value was 0.677 and this means the INST, KI, KA, MNJRL, and SIZE variables can be used to explain the tax avoidance variable by 67.7% while the remaining 32.3% (100% - 67.7%) is associated with other variables outside the model. Moreover, the F-test showed that the independent variable has a significant effect on the dependent variable as indicated by the calculated F-value of 91.443 and a significant value of 0.000 <0.05.

Table 7. Regression model test

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	-30.144	607.242		-.050	.960
	INST	-.030	.053	-.022	-.570	.569
	KI	.137	.287	.019	.478	.633
	KA	47.607	76.719	.024	.621	.536
	MNJRL	-.016	.003	-.234	-6.003	.000
	SIZE	.388	.020	.762	19.309	.000
Dependent Variable: BTG						

Sources: Process Data

3.2 Discussion

The results showed that institutional ownership does not affect tax avoidance and this means the first hypothesis (H1) was rejected. This simply indicates the ownership of shares by institutions is not effective in ensuring the reduction of conflicts of interest within the management as well as the opportunities for tax avoidance. This finding further signifies that it is possible for institutional owners to care only about maximizing profit without any attention to the image of the company. Moreover, the proportion of institutional ownership was relatively small and this can be the reason for its ineffectiveness in influencing management's decision-making on corporate affairs. It is also important to note that institutional investors do not have the power to control a company because most of the management's decision-making is within the powers of the dominant or majority shareholders. This result is in line with the previous findings of Sunarsih & Handayani (2017) as well as Diantari & Ulupui (2016) that institutional ownership does not affect tax avoidance.

It was also discovered that independent commissioners do not have a significantly positive effect on tax avoidance and this led to the rejection of the second hypothesis (H2). This shows that the existence of independent commissioners does not have any influence on company policy to implement tax avoidance but is only present as compliance with the IDX regulations without performing any functions. This means the independent commissioners are not performing their supervisory roles up to the maximum level and this further indicates they are not working as expected in the corporate governance structure. This supports the previous findings of (Fadhila, 2017) that independent commissioners do not affect tax avoidance.

Another important finding is that the audit committee does not affect tax avoidance and this led to the rejection of the third hypothesis (H3). This shows that the presence of audit committees in the companies did not increase the level of supervision and this is associated with the limitation placed on the authority of the committee by the board of commissioners which further leads to the assistance the members provided in the tax evasion processes. It also indicates that the committee does not have the power to interfere in the tax rate policy of the company. This is observed to be in line with the findings of Sunarsih & Handayani (2017) and Cahyono (2016) that the presence of an audit committee did not affect tax avoidance.

The results showed that managerial ownership has a significant negative effect on tax avoidance and this led to the acceptance of the fourth hypothesis (H4). This means the share ownership by the management influences their activities in managing the affairs of the company and discourages tax evasion. This is associated with the prudence of the management in making decisions considering the fact that they have a stake in the business and the tendency not to allow any harmful effect on their shares. This is discovered to be in line with the findings of Fadhila (2017) as well as Sunarsih & Handayani (2017) that managerial ownership has a negative and significant effect on tax avoidance.

Another important observation is that the company size has a significant positive effect on tax avoidance and this means the fifth hypothesis (H5) was accepted. The companies with higher total assets were observed to have a higher tendency of avoiding tax legally due to their ability to regulate taxation through plans made towards ensuring optimal tax savings. They usually pay a small tax to have a smaller effective tax rate and this is in line with the findings of (Dermawan & Sukartha, 2014), (Alviyani, 2016), (Diantari & Ulupui, 2016), Chytis et al., (2018) that company size has a positive and significant effect on tax avoidance.

4. Conclusion

It was concluded in this study that institutional ownership does not affect tax avoidance due to the observation that the ownership of shares in a company by institutions does not lead to effective monitoring of the decision-making processes required to reduce opportunities for tax avoidance. The findings also showed that the existence of independent commissioners does not influence companies to implement tax avoidance and the presence of audit committees does not translate to increased supervision to reduce tax avoidance. Meanwhile, managerial ownership has a negative and significant effect on tax avoidance and this means the share owned by the management influences their activities in managing the affairs of the company towards discouraging tax evasion. Company size also has a positive and significant effect on tax avoidance and this means those with higher total assets have a higher tendency to avoid tax payment. These findings can be used by the tax directorate general to suppress tax avoidance by companies to ensure optimal collection of revenue by the government. It is important to note that the major limitation of this is the relatively small adjusted R-Square value and this means there several other variables outside the model that affect tax avoidance by companies. Therefore, it is recommended that further studies be conducted to (1) increase the area of research in order to provide a broader description of tax avoidance and (2) add other variables not been included in this model such as auditor reputation, financial performance, and leverage ratio.

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