The Impact of Ownership Structure, Independent Commissioners, Audit Committees, and Audit Quality on Tax Avoidance
An Empirical Study of Non-Financial Firms listed on the Indonesia Stock Exchange from 2013-2016

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Keywords: Audit Committees, Audit Quality, Foreign Ownership, Family Ownership, Government Ownership, Independent Commissioners, Tax Avoidance.

Abstract: This study aims to provide empirical evidence regarding the impact of family ownership, government ownership, foreign ownership, independent commissioners, audit committees and audit quality on tax avoidance. Tax avoidance is proxied by the Cash Effective Tax Rate (CETR), which is the ratio of cash tax paid to pre-tax income. The sample includes 568 non-financial firms listed on the Indonesia Stock Exchange between 2013 and 2016 and is determined by the purposive sampling method. The impacts of family ownership, government ownership, foreign ownership, independent commissioners, audit committees and audit quality on tax avoidance were analyzed using multiple linear regression analysis with the help of SPSS 21 software. Based on the results, it can be concluded that independent commissioners, audit committees and audit quality have no significant impact on tax avoidance; meanwhile, family ownership, government ownership, and foreign ownership have a significant impact on tax avoidance. This indicates that higher ownership of family, government, and foreign company will reduce tax avoidance practices.

SCIENCE AND TECHNOLOGY PUBLICATIONS

1 INTRODUCTION

Minnick and Noga (2010) stated that firm governance can affect how a firm manages taxes. Tax planning depends on the dynamics of firm governance within a firm (Winata, 2015). Tax planning is defined as the process of organizing a taxpayer's business in such a way that his tax payable, both income tax and other taxes, are in a minimum position, as long as this is made possible by the applicable laws and regulations (Mangoting, 2004). A well-structured firm governance mechanism in a given firm is directly related to its compliance with its tax obligations (Winata, 2015).

The Indonesian government is always trying to increase its tax revenue. However, as taxpayers, firms use tax as an income deduction factor. Accordingly, a firm will attempt to pay the smallest amount of tax possible in order to generate maximum profit. This difference of interests causes firm taxpayers to reduce the amount of their tax payments by means of tax avoidance. Taxpayers commit tax avoidance not solely because of a lack of intention to pay taxes, but also due to their motivation to obtain financial benefits.

The phenomenon of tax avoidance in Indonesia can be seen from the ratio of tax revenue. The tax ratio shows the government's ability to collect tax revenues or re-absorb GDP from the public by means of taxes; accordingly, the higher a country's tax ratio, the better its tax collection performance. Indonesia's tax ratios for the years 2010 to 2015 were 10.5%, 11.2%, 11.4%, 11.3%, 10.9%, and 10.8% respectively. There was an increase from 2010 to 2012, but then a subsequent decrease until 2015. While tax revenues themselves are increasing every year, Indonesia's tax ratio is relatively low compared to that of other developing countries. These results indicate that tax avoidance activities in Indonesia are widespread, meaning that the State tax revenue is still suboptimal.

Several major tax avoidance cases have been undertaken by the Indonesian Directorate General of Taxation, including Asian Agri, Bumi Resources, Adaro, Indosat, Indofood, Kaltim Prima Coal (KPC) and PT Airfast Indonesia (subsidiary PT Freeport

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Mc Moran) (Rusydi, 2014). In the case of PT Asian Agri Group, the taxpayer was suspected of storing his wealth in a tax haven. The high number of tax avoidance cases indicates that firm governance has not been adequately implemented by public firms in Indonesia. Moreover, the practice of tax avoidance within a firm indicates that the firm has bad firm governance (Desai and Dharmapala, 2006).

2 LITERATURE REVIEW AND HYPOTHESES

Tax avoidance is based on the agency theory, and the conflict that arises between managers and shareholders is the result of an aggressive tax planning strategy. Aggressive tax action can result in costs due to issues arising from agency problems. Shareholders act to reduce a firm's tax burden and maximize profit after tax in order to meet the firm's objectives; on the other hand, managers (agents) tend to behave opportunistically by maximizing their own interests. This can reduce the transparency of the firm and create a moral hazard. As revealed by Jensen and Meckling (1976), agency conflict arises due to the separation between ownership and control of the firm.

In this study, the implementation of firm governance will be examined through the mechanisms of ownership structures (family ownership, government ownership, and foreign ownership), independent commissioners, audit committees and audit quality. Hanlon and Heitzman (2010) argue that ownership structure is an important factor that can affect the degree of tax avoidance while Lanis and Richardson (2011) state that family members who occupy the board of directors are capable of encouraging management to take aggressive tax action. Both Martinez and Ramalho (2014) and Bauweraerts and Vandernoot (2013) state that family ownership positively affects tax avoidance. It can be concluded that the higher the degree of family ownership, the lower the tax avoidance rate of the firm.

In firms with government ownership, the potential for tax avoidance benefits seems to be higher than the costs associated with tax avoidance (Salihu et al., 2014). A study by Zhang and Han (2008) found that government ownership is positively and significantly related to firm tax avoidance. Moreover, DeBacker et al. (2015) state that foreign-owned firms in the United States whose owners are from countries with higher rates of corruption tend to commit more tax avoidance. Annuar et al. (2014) contend that foreign ownership affects the tax avoidance of Malaysian companies. However, Hasan et al. (2016) argue that foreign ownership has a negative effect on tax avoidance The relevant hypotheses to be tested are as follows:

H_{1a}: Family ownership has an impact on tax avoidance.

H_{1b}: Government ownership has an impact on tax avoidance.

H_{1c}: Foreign ownership has an impact on tax avoidance.

Fama and Jensen (1983) argue that the existence of independent commissioners will result in more effective board monitoring and restrict managerial opportunism. Richardson et al. (2013) examined the impact of board composition and tax aggressiveness and found that the addition of a large number of independent commissioners reduces the probability of aggressive tax planning. The existence of this independent board of commissioners may reduce agency problems related to the degree of tax aggressiveness (Armstrong et al., 2015). Independent commissioners have been found to have an effect on tax avoidance (Kantudu and Samaila (2015). The relevant hypothesis to be tested is as follows:

H_2: Independent commissioners have an impact on tax avoidance.

Richardson et al. (2013) state that if a firm has independent audit committees, it is less likely to engage in aggressive tax practices. Audit committees have proved to have a significant impact on tax avoidance, since if the number of audit committees is not in line with Indonesia Stock Exchange (IDX) regulations, it will improve management actions to minimize the firm's profit for tax purposes (Annisa and Kurniasih, 2012). The relevant hypothesis to be tested is as follows:

H_3: Audit Committees have an impact on tax avoidance.

The quality of auditors can also affect the aggressiveness of tax strategy (Kanagaretnam et al., 2016). Francis (2004) argues that the so-called 'Big Four' Public Accountant Firms on average, provide a higher quality audit report than non-Big Four KAPs. The higher audit fees charged by the Big Four can result in better audit quality through greater audit efforts and superior auditor expertise. According to Cai and Liu (2009), if the amount of tax to be paid is too high, a firm will be forced to commit tax avoidance. The more qualified the audit of a firm, the less likely a firm will be to manipulate

earnings for the benefit of taxation. The relevant hypothesis to be tested is as follows:

H_4: Audit quality has an impact on tax avoidance.

This study uses the control variables of firm size (size), profitability (ROA), and leverage. The use of firm size as a control variable is to control the effect of size on tax avoidance activities (Lanis and Richardson, 2011). Large firms are expected to reveal more information than small firms to reduce the problem of information asymmetry (Jensen and Meckling, 1976). The use of leverage as a control variable is based on the idea that firms with more debt tend to disclose more information. Saputra et al. (2016) state that profitability affects tax avoidance. Firms that earn profits are assumed not to commit tax avoidance because they are better able to manage their income and tax payments.

3 METHOD AND ANALYSIS

3.1 Sample Approach

This study employs a quantitative approach using secondary data in the form of financial statements. The populations are all non-financial firms listed on the Indonesia Stock Exchange (IDX) between 2013 and 2016. The data was collected by accumulating secondary data in the form of financial reports, which became the research sample. The sample was then selected based on predetermined criteria using purposive sampling, with 568 observations in total.

3.2 Operational Definitions

Family ownership (SHMKEL) is measured using the percentage of shares owned by the family as a proportion of total outstanding shares. The firm is said to have family ownership if the composition of family ownership is the largest and holds more than 20% of the outstanding shares and/or the CEO or the board of directors are family members (Villalonga and Amit, 2006). Government ownership (SHMPEM) is measured using the percentage of shares owned by the government as a proportion of total outstanding shares of the firm (Annuar et al., 2014). Foreign ownership (SHMASG) is measured using the percentage of total shares owned by foreign investors as a proportion of total outstanding shares of the firm (Al Farooque et al., 2007). Independent commissioners (KOMIND) are measured using the percentage of the number of independent commissioners as a proportion of the total number of members of the board of commissioners (Sari, 2014).

The Audit Committee variable (AUDIT) is defined by counting the number of audit committees excluding the independent commissioner as a proportion of the total number of audit committees of the firm (Swingly and Sukartha, 2015).

Audit quality measurement (AUDITOR) uses dummy variables, which are set at 1 if the firm is audited by a 'Big Four' KAP (i.e. Deloitte, PricewaterhouseCoopers (PWC), Ernst & Young (E&W), and KPMG), and set at 0 if the firm is audited by a KAP that is not a member of the Big Four (Saputra et al., 2016). Tax avoidance is measured using Cash Effective Tax Rate (CETR). CETR is defined as cash tax paid to pre-tax income. The Cash Effective Tax Rate is expected to be able to identify the aggressiveness of firm tax planning that is conducted using fixed differences as well as temporary differences (Chen et al., 2010). Firm size (SIZE) is the size of a firm calculated from the total logarithm of total assets owned by the firm (Annuar et al., 2014). The profitability is proxied using ROA, which is defined as pretax income to total assets (Richardson et al., 2013). Leverage (LEV) is measured by total debt to total assets (Annuar et al., 2014).

3.3 Analysis Technique

This study uses a multiple linear regression analysis method. The multiple linear regression equation in question is:

$$CETR = \alpha + \beta 1\ SHMKEL + \beta 2\ SHMPEM + \beta 3\ SHMASG + \beta 4\ KOMIND + \beta 5\ AUDIT + \beta 6\ AUDITOR + \beta 7\ SIZE + \beta 8\ ROA + \beta 9\ LEV + \beta 10 YD + \beta 11\ ID + e \quad (1)$$

The Industry Dummy variable (ID) is used to classify the types of industries in non-financial firms based on the industry sector classification set by the Indonesia Stock Exchange. According to Achmad (2012), Tjondro et al. (2016), and Butje and Tjondro (2015), the industrial sectors are assigned a value of 1 for related sector and a value of 0 for other. These sectors includes the mining sector, basic industries and chemical sectors, miscellaneous industry sectors, consumer goods industry sector, property sector, real estate, building construction, trade and services sector, and infrastructure, utilities, and transportation sectors. The Dummy Years variable (YD) consists of 3 'dummy years', in this case 2014, 2015 and 2016.

4 RESULTS AND DISCUSSION

4.1 Results

Descriptive statistical results are provided in Table 4.1. In addition, the total frequency for audit quality variables in this study amounted to 568; of these, non-Big Four KAP audits numbered 296 (52.1%), while Big Four KAP audits numbered 272 (47.9%).

This study uses multiple linear regression analysis with a significance level of 5%. Test results in Table 4.2 illustrate that the variables of family ownership, government ownership, and foreign ownership have an impact on tax avoidance, meaning that H1a, H1b, and H1c are supported. On the other hand, the independent commissioners, audit committees, and audit quality have no significant impact on tax avoidance, indicating that H2, H3, and H4 are not supported.

Table 1: Descriptive Statistics.

	N	Minimum	Maximum	Mean	Std. Deviation
CETR	568	.0001	.9810	.284615	.1674753
SHMKEL	568	.00	98.18	30.6774	30.83096
SHMPEM	568	.00	90.03	5.9152	18.37567
SHMASG	568	.00	97.98	20.2746	30.22556
KOMIND	568	.00	.83	.3926	.11001
AUDIT	568	.00	.80	.6460	.09964
Valid N (listwise)	568				

Table 2: Multiple Regression Analysis Results.

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	.078	.172		.452	.652		
	SHMKEL	.001	.000	.172	2.418	.016	.289	3.462
	SHMPEM	.002	.000	.214	4.086	.000	.534	1.874
	SHMASG	.002	.000	.275	3.743	.000	.271	3.688
	KOMIND	-.017	.061	-.011	-.276	.782	.897	1.114
	AUDIT	-.103	.069	-.061	-1.481	.139	.857	1.166
	AUDITOR	-.024	.016	-.070	-1.476	.140	.643	1.555
	SIZE	.010	.012	.040	.822	.411	.607	1.648
	ROA	-.271	.073	-.160	-3.715	.000	.792	1.263
	LEV	.168	.037	.188	4.515	.000	.838	1.193
	Year2014	-.015	.018	-.038	-.819	.413	.664	1.507
	Year2015	-.007	.018	-.019	-.392	.695	.654	1.528
	Year2016	-.032	.018	-.084	-1.755	.080	.645	1.549
	Agricultural	.143	.034	.186	4.264	.000	.771	1.297
	Mining	.184	.030	.268	6.195	.000	.781	1.281
	Basic_Chemical	.094	.024	.183	3.884	.000	.656	1.524
	Miscellaneous	.123	.028	.197	4.430	.000	.737	1.357
	Consumer_Goods	.069	.024	.149	2.891	.004	.548	1.825
	Infrastructure	-.026	.026	-.045	-1.023	.307	.739	1.352
	Trade	.072	.021	.177	3.398	.001	.538	1.858

4.2 Discussion

Firms with higher family ownership tend to avoid tax avoidance because these firms are more oriented towards protecting the firm's reputation so as to maintain its survival. Owners who are family members are willing to pay higher taxes in order to avoid the risk of fines, sanctions, and damage to the reputation of the firm. In short, given the fines and possible damage to the firm's reputation that can result from aggressive tax action, a family firm will tend to avoid tax avoidance practice (Chen et al., 2010). Family firms have an incentive to protect the firm's reputation because they generally regard the firm as a legacy to be passed on to the next generation (Casson, 1999).

These results are also consistent with research conducted by Chan et al. (2013) stating that firms with government ownership are less aggressive in tax strategy. The higher the level of government ownership, the more the firm will pay attention to the long-term consequences of an aggressive tax strategy. Zeng (2010) also believes that firms with government ownership exhibit lower tax avoidance.

Chibber and Majumdar (1999) stated that a higher number of foreign parties investing their shares in the firm will improve firm performance. The foreign party is generally considered to have good management, technology, innovation, expertise and marketing systems that can have a positive impact on the firm. However, firms with foreign ownership are usually more likely to encounter information asymmetry problems due to geographical and language barriers; therefore, firms with large foreign ownership will be compelled to report or disclose their firm information voluntarily and more widely, including information on taxation. Foreign ownership also has a higher concern for the firm's reputation, so that they prefer to minimize aggressive tax action (Rustiarini, 2011).

According to Darwis (2009), independent commissioners exist only to comply with the regulations of Capital Market and Financial Institution Supervisory Agency BAPEPAM. Independent commissioners do not perform their monitoring functions properly and do not use their independence to oversee the policies of the board of directors. Hardiningsih (2010) states that, based on the results of the Asian Development Bank survey, the major shareholder/s (controller/founders) play an important role, meaning that the board of commissioners are not independent and their oversight function (that should be the responsibility of the board members) is ineffective. Thus, there is no significant relationship between independent commissioners and tax avoidance due to the existence of affiliated parties within the firm affecting the independence level of independent commissioners. Moreover, the size of the independent board of directors is not a major determinant of the effectiveness of oversight of

corporate management. The effectiveness of the control mechanism depends on the value, norms, trust, and the role of the board of commissioners in the activity of imposing controls on management (Jennings, 2005).

In Indonesia, mandatory BAPEPAM regulations are currently in place. In fact, firms tend to form their main audit committees solely to meet these regulatory requirements and thus avoid punishment and sanction (Agustia, 2013). Consequently, the number of audit committee members present within the firm is set only to ensure compliance with BAPEPAM regulations, which require the audit committee to consist of at least 3 (three) persons from independent commissioners and external parties. Therefore, the performance of audit committees is less effective in developing and implementing oversight processes to minimize firm tax avoidance practices.

Audit quality does not have an impact on tax avoidance; this is due to improved audit quality in the Big Four KAPs as a consequence of the increasingly stringent BAPEPAM regulations, as well as the possibility of Big Four firms providing tax advisory services for audited firms to minimize the amount of tax payable legally. The results of this study are in accordance with Saputra et al. (2016) and Hartadinata and Tjaraka (2013), who also argue that audit quality does not affect tax avoidance.

Firm size also has no effect on tax avoidance. This may be due to the fact that tax avoidance efforts are made by both large and small firms in Indonesia. The results of this study are in accordance with Rusyidi (2014) and Cahyono et al. (2016), who also state that the size of the firm does not affect tax avoidance. In short, firm size is not a determinant of corporate tax avoidance; large and small firms alike will certainly be examined by the tax authorities in cases where they violate the provisions of taxation law, because paying taxes is a firm’s obligation.

According to Saputra et al., (2016) profitability affects tax avoidance. ROA is an indicator that reflects the firm's financial performance. A high value of ROA generated by a firm can categorize the firm's financial performance as good. Firms that earn profits are assumed not to commit tax avoidance because they are able to manage their income and tax payments. Suyanto and Supramono (2012) stated that as debt rises, taxable income becomes smaller because of tax incentives related to interest expense that result from larger debt. This brings up the implications of the increasing use of debt by firms. The Ozkan (2001) study provides evidence that leverage affects tax avoidance. Firms that have high tax payable will often choose to become indebted to reduce taxes.

Furthermore, the year of data collection has no impact on tax avoidance. The firm's opportunity to practice or eschew tax avoidance appears to be the same for each of the three years studied. However, the agricultural sector, mining sector, basic industry and chemical sector, miscellaneous industry sector, consumer goods industry sector, trade and service sectors do have an effect on tax avoidance. The results indicate that these sectors are more tax-conscious, or in other words, that their tax avoidance rate is low. Infrastructure, utilities, and transportation sectors were found to have no effect on tax avoidance. According to Butje and Tjondro (2015), each industry sector has different and unique characteristics. Each sector has its own policies, tax rates paid, different accounting assessments and disclosure patterns.

5 CONCLUSION

The ownership structures of family ownership, government ownership, and foreign ownership have been shown to affect tax avoidance. Firms with higher ownership structure tend not to avoid taxes because the owners are willing to pay higher taxes to avoid the risk of fines, sanctions, and damage to the reputation of the firm; in short, they assess a lack of perceived benefits for tax avoidance behavior. Independent commissioners, audit committee and audit quality have no impact on tax avoidance. This may be because the existence of independent commissioners and audit committees in the firm may be solely to ensure compliance with regulations established by BAPEPAM.

Audit quality does not affect tax avoidance due to increased audit quality in non-Big Four KAPs as a consequence of increasingly tight BAPEPAM regulations, as well as the possibility of Big Four KAPs providing tax advisory services for audited firms so as to minimize the amount of tax payable legally. Year of data collection proved to have no effect on tax avoidance; a given firm's opportunity to commit or avoid tax avoidance is the same across those three years. The agricultural sector, mining sector, basic industry and chemical sector, miscellaneous industry sector, consumer goods industry sector, trade and service sector have an impact on tax avoidance, indicating that these sector are more tax-conscious (or, in other words, that their tax avoidance rate is low). On the other hand, the infrastructure, utilities, and transportation sectors

proved to have no impact on tax avoidance. It can be concluded that each industry sector has different and unique characteristics; each sector has its own policies, tax rates paid, different accounting assessments and disclosure patterns.

On the subject of firms, they should enhance the performance of their independent commissioners and audit committees, as their function of overseeing firm management should be made effective and more improved. Regarding the government as a policymaker, it is necessary to consider formulating and introducing a statutory general anti-avoidance rule in Indonesia's tax law by taking lessons from other countries that have applied similar provisions. This is because the specific anti-avoidance rule in Article 18 of the Income Tax Law cannot yet cover all types of tax avoidance transactions given the increasing complexity of current tax avoidance schemes.

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