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Corporate Governance as a Determiner of Tax Avoidance: A Literature Review Study

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ABSTRACT
Tax avoidance is an act of legally reducing taxes or taking advantage of loopholes in tax laws. Some aspects of corporate governance that are often used in tax avoidance research are ETR, Incentives, company board composition, company ownership structure, Auditor Quality, and customers. This study uses a literature review research method using 34 articles related to tax avoidance and corporate governance starting from 2006 – 2022. More research on tax avoidance was carried out in 2018 with the aspect of governance that is most often researched is the structure of corporate ownership which is more many use agency theory as a basis for research. A low ETR reflects a low tax burden resulting from tax evasion. Empirical evidence suggests that an independent and strong board composition will have a negative impact on tax evasion. The company's ownership structure has an impact on the separation of ownership and control which can encourage tax evasion. The auditor's reputation is the most important thing that must be maintained by an auditor so that it is likely that the auditor is less tolerant of companies trying to avoid taxes committed by their clients. Customers can be used as a tax strategy that companies can use to avoid taxes.

INTRODUCTION

Tax is one element that is always a consideration for individual taxpayers and corporate taxpayers because taxes are considered a burden that must be paid. Corporate taxpayers will always try to reduce the tax burden they have to pay. One of the actions taken by corporate taxpayers in reducing the tax burden is by doing tax evasion. Tax avoidance is an action taken to reduce the tax burden by taking advantage of loopholes in the tax law, meaning that this action is carried out legally (Xynas, 2011).

Tax avoidance is still a phenomenon that occurs in the world. Tax avoidance is much discussed in the world of business and academia. In the academic world, tax avoidance is a topic that has been studied by academics, especially academics in the field of economics. Such as the tax evasion phenomenon that occurred in Indonesia in 2016 in 10 years the state lost nearly IDR 100 trillion in tax revenues originating from 2,000 PMA who claimed to have suffered losses but 1,900 PMA did not make any complaints, so this raised suspicions that several companies were committing tax avoidance (Media Indonesia, 2016).

Tax evasion by the company has several factors that influence it, one of which is in the interests of shareholders. When tax avoidance is carried out, it will increase cash flow and after-tax income (Austin & Wilson, 2017). Tax evasion involves companies retaining cash resources within the company that are supposed to be revenue for the government. These resources can increase the value of the company which also indirectly affects the interests of shareholders.

Research on tax avoidance that has been conducted by previous researchers tends to focus on firm-level factors that carry out tax evasion (Kovermann & Wendt, 2019; Shackelford & Shevlin, 2001). Recent

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research considers the effect of tax avoidance as one of the economic consequences that will differ between managers, companies and shareholders when viewed from an agency problem. Agency problems for shareholders are related to the separation between shareholders and managers which provides opportunities for managers to take advantage of tax avoidance for personal purposes that can harm the company.

Tax avoidance from the shareholder side is based on the interests of the shareholders involved in corporate governance (Timothy, 2010). Opportunities for tax avoidance are exploited to align the interests of shareholders and managers. Corporate governance and tax avoidance are frequent research topics. Several articles provide research results which suggest the relationship between corporate governance and tax avoidance as seen from management compensation, company board composition, company ownership structure, and auditing.

This research was conducted with the aim of reviewing previous literature that examined tax avoidance by companies. This research will provide an in-depth review of the literature that will link corporate governance with tax avoidance from the aspect of incentives between management and shareholders, composition of the company's board, company ownership structure, auditor quality, and stakeholder pressure.

METHODS

This study uses a comprehensive literature review approach to examine the relationship between corporate governance and tax evasion. This research uses previous literature from 2006 – 2022 so that there are 34 articles that discuss corporate governance with tax avoidance. Some articles only discuss one or more aspects of corporate governance such as ETR, incentives, shareholder roles, board composition, company ownership structure, auditors, and customers that can affect tax evasion.

RESULTS

This study is a comprehensive literature that takes data from previous articles on the relationship between corporate governance and tax avoidance. In recent years, research on tax avoidance has focused more on corporate governance. In empirical and academic studies tax avoidance is of great interest to research with governance as the main determinant of tax avoidance emerging as an autonomous research stream (Hanlon & Heitzman, 2010). This literature study summarizes the findings about the effect of corporate governance on tax avoidance by companies. In the observation of the literature which was carried out using 34 articles found starting from 2006 - 2022, there is a research composition as follows:

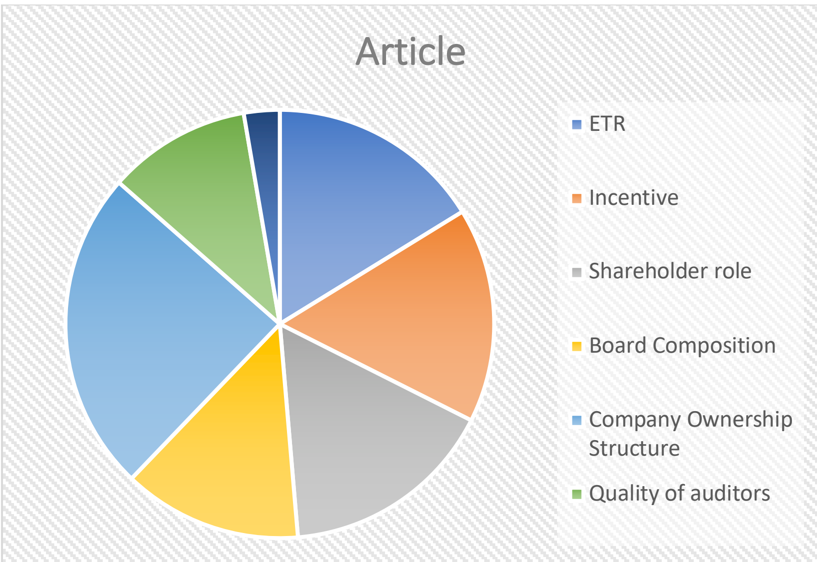

Figure 1. Article research results

Based on Figure 1, there are 6 articles that use ETR as a variable that influences tax evasion (Cook et al., 2020; Graham et al., 2014). A total of 6 articles use incentives and the role of shareholders as variables that influence tax evasion (Armstrong et al., 2012; Desai & Dharmapala, 2006; Graham et al., 2014; McGuire et al., 2012). A total of 7 articles using shareholder and board composition as variables that influence tax evasion (Allen et al., 2016; Armstrong et al., 2015; Hsieh et al., 2018; Hsu et al., 2018; Kubick & Lockhart, 2017; Lanis & Richardson, 2011; McClure et al., 2018). Meanwhile, the most widely used variable influencing tax evasion is ownership structure with 17 articles (Anissa et al., 2021; Badertscher et al., 2013; Bird & Karolyi, 2016; Bradshaw et al., 2019; Chen et al., 2010; Gaaya et al., 2017; Imen et al., 2022; Jost, 2019; Khan et al., 2017; McGuire et al., 2012; Nugraheni & Azlan Anuar, 2014; Richardson et al., 2016; Xin & Yuan, 2018). Moreover, there is 1 article that uses customers as a variable that affects tax evasion.

The research trend found in this literature study is to use the ownership structure variable as a variable that influences tax evasion. The ownership structure in the research used as an indicator is family ownership and non-family ownership. Based on the year of article publication examines tax avoidance and corporate governance, it can be seen as follows:

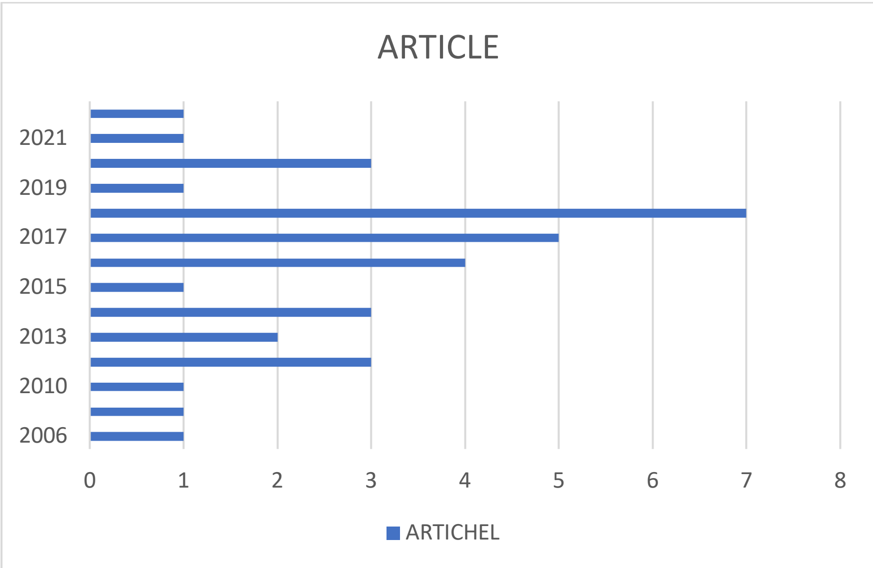

Figure 2. year of article publication

From the graph above it can be seen that the trend of research on tax avoidance was mostly published in 2018 by academic researchers who on average were published in reputable international journals with a range of quarties ranging from quartile 1 to quartile 4 used in this literature study. Theories commonly used in the several literature studies studied consist of agency theory, corporate governance theory, tax planning theory, behavioral theory, Hedging Activity Theory, Customer Theory, False Consensus Effect Theory, and Upper Echelon Theory. When viewed from the articles studied, the trends in the use of the most frequently used theory are as follows:

Figure 3. The Most Frequently Used Theory

From the Figure 3, it can be seen that the trend of tax avoidance research uses more agency theory and tax planning theory. Agency theory is a theory of separation of ownership and central control of all predictions arising from the consequences of tax avoidance (Badertscher et al., 2013). Tax avoidance will increase cash flow after tax, thereby creating risky investment opportunities for management (Armstrong et al., 2015). If tax evasion is detected by the tax examiner, it will increase tax obligations, fines, and the company's reputation will be damaged and at risk (Hanlon & Slemrod, 2009). Agency conflicts will be different for agents and participants. The principal will choose a high level of tax avoidance that will result in increased after-tax cash flow or a lower level of tax avoidance that will result in less risk for the company. Principal agency theory suggests that principals become risk neutral, this is because principals are assumed to store their wealth in highly diversified portfolios (Demski & Feltham, 1978). However, this does not apply to all shareholders. Shareholders who own a portion of the company's equity are expected to prefer to avoid risk because their wealth is concentrated in fewer companies (Shleifer & Vishny, 1986). Meanwhile, the agent will choose a higher level of tax avoidance because the agent will expect more incentives when doing tax avoidance.

Agents will choose the level that shareholders want as long as there are strong corporate governance mechanisms, such as exercising oversight and incentive alignment. With this corporate governance is a suggestion to ensure managers do not behave efficiently by allowing company resources to be subject to high taxes. With good corporate governance, it will suppress the behavior of agents or managers in tax evasion because managers will think more about the risks that will arise from this behavior, such as losing a job. Agents will choose the level that shareholders want as long as there are strong corporate governance mechanisms, such as exercising oversight and incentive alignment. With this corporate governance is a suggestion to ensure managers do not behave efficiently by allowing company resources to be subject to high taxes. With good corporate governance, it will suppress the behavior of agents or managers in tax evasion because managers will think more about the risks that will arise from this behavior, such as losing a job.

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In many tax avoidance studies proxied by the effective tax rate (ETR). A low ETR is assumed to reflect a low tax burden resulting from tax evasion. Low ETR here means lower rates than tax rates according to applicable tax laws (Blaylock et al., 2012). ETR can be calculated using the company's financial statements, this is the background for many studies using ETR.

Shareholders delegate supervisory and controlling functions and duties to the board of directors who choose to delegate some functions to agents or management as the company's internal agents. Internal agents of a company like this gain considerable control over the board because they have knowledge of what is going on within the company, which creates opportunities for these internal agents to do something in their personal interests. Minnick and Noga (2010) in their research did not find a direct relationship between boards and taxes. However, Lanis and Richardson (2011) put forward their findings in a study that companies with a higher independent board composition show lower tax evasion.

The ownership structure of the company based on agency theory is the location of the most important elements. The ownership structure aims to strengthen the position of shareholders through management oversight and control. Separation of ownership is a type of public company. Mills and Newberry (Mills & Newberry, 2001) in their research found that public companies have a larger Book Tax Differences (BTD) value compared to private companies, this indicates tax evasion. Badertscher et al. (2013) in their research suggested that companies with higher levels of managerial share ownership would avoid lower taxes than other companies. In other words, the separation of ownership and control can encourage tax avoidance.

Audit is one of the most important parts of the company's external control. The audit engagement component evaluates, discloses, measures, and discloses tax-related accounts in examining a company's annual financial statements. Tax evasion by the company will increase the risk of litigation for the auditor if the board of directors tries to hold the auditor responsible for taxes in the company's financial statements (Donohoe & Robert, 2014). The auditor's reputation will be damaged if the tax is canceled by the tax authorities and requires a restatement. The auditor's reputation is the most important thing that must be maintained by an auditor so that it is likely that the auditor is less tolerant of companies trying to avoid taxes committed by their clients.

One element that is also related to the company's tax strategy is the customer. This element is still very rarely used by previous researchers as an element that can be considered in tax avoidance. Customers are the company's business model related to tax strategy. The level of customer concentration can affect the company's operating performance, cash flow risk, and the company's financial policies and can affect the company's tax avoidance actions. Customer concentration leads to demand for more cash holdings and less financial volatility resulting in higher revenues. As a result of higher income, the company will try to carry out a good strategy related to taxes, because high income reflects a tax burden which will also be higher so that companies will do tax evasion. Tax evasion can affect a company's cash flow and cause financial difficulties resulting from temporary and permanent tax book differences. If the company chooses a risky business strategy, the company will rely on customers in its tax planning. Huang et al. (2016) in their research suggested that companies with tax strategies that depend on larger customers are more likely to engage in tax evasion. If the company chooses a risky business strategy, the company will rely on customers in its tax planning.

CONCLUSION

In recent years research on tax avoidance has focused more on corporate governance. Many aspects of corporate governance can be used as proxies and variables used to measure and assess tax avoidance by companies. Most studies use agency theory as the basic theory in research because it is considered a linking theory between the interests of principals and agents that can influence corporate governance with corporate tax avoidance.

With a lower ETR, the company has a lower level of tax evasion. Tax incentives can influence agents or managers to avoid taxes if they are not supported by a high board composition as supervisors in the company. The quality of a good auditor will reduce the level of corporate tax avoidance because an auditor will be more concerned with reputation as a good auditor so that the auditor is very intolerant of companies or their clients who commit tax evasion. Companies that prefer to use corporate strategies with high customer utilization will be more likely to do tax evasion.

In this literature study only considers tax avoidance through corporate governance. Subsequent research can conduct research by considering aspects of tax ethics, professional ethics, policy ethics, and national culture in tax avoidance.

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