

The Impact of Tax Avoidance on Tax Risk: Does Good Corporate Governance Matter?

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Abstract

Tax avoidance is considered a complex issue because it has economic consequences. This study aims to determine how tax avoidance affects tax risk and how the role of corporate governance moderation variables. Data comes from the Indonesian Stock Exchange for financial reports of consumer goods companies during 2019-2023 using the purposive sampling method simple regression analysis and MRA were used to process the research data. The research results prove that tax avoidance has a significant negative impact on tax risk. The decrease in ETR as a proxy for tax avoidance will increase tax risk. In addition, the author found that in the future the effect of tax avoidance on tax risk will decrease if there is good corporate governance. This proves that tax avoidance is a risky deception for the Company in the future. Therefore, the outcome can offer managerial implications, namely encouraging shareholders and regulators to strengthen the corporate governance structure, to create public trust and protect stakeholder interests.

Keywords: *Tax Avoidance, Good Corporate Governance, Task Risk.*

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A. INTRODUCTION

Tax has important part for sustainability and development of the country, so that citizens are required to participate in paying taxes. According to Gunawan et al. (2022), taxes have a function for supporting economic growth and national development and are a strategic source of state finances. Meanwhile, from the company's perspective, taxes are costs that must be incurred and are considered a reduction in profit. The higher profit, the higher tax that company must be paid.

Through tax planning, companies can make tax payments more efficient legally or not (Frank et al., 2009). According to Handayani & Ibrani (2019), legal actions can be taken through weaknesses or loopholes in existing tax laws (tax avoidance). While illegal actions are carried out by violating tax laws (tax evasion). In 2021, Indonesian Minister of Finance stated that in consequence of based erosion and profit shifting, around IDR 3,360 trillion/year of global tax revenues could potentially be lost. This was done by using the issue of differences in corporate income tax rates and bank secrecy (CNN Indonesia, 2021). This is supported by data from datacenter.ortax.org (2022) which states that throughout 2021, the potential for tax fraud and avoidance risks increased because the level of financial information and corporate governance in Indonesia decreased. Based on a study entitled "Financial Secrecy Index 2022" by the Tax Justice Network, Indonesia is ranked 66th in 2022, having previously been ranked 79th in 2020. Tax Justice Network Chief Executive Alex Cobham said that tax evaders often take the benefit of the corporation's financial data governance and confidentiality. Based on the report, banking confidentiality, personal income tax data

and the degree of tax evasion secrecy are indicators that describe the decline in transparency in Indonesia.

According to Armstrong et.al (2015), tax avoidance has a big risk for companies. This means that the company wants high profits but also bears high risks (Choi & Park, 2022). This is because tax avoidance will increase investment returns but can reduce profitability and wealth distribution in the future (Chung et al., 2018). Tax risk is described as the risk that occurs because the Company avoids taxes (Neuman et al., 2013). Lin (2019) stated that the company's perspective will be influenced by tax risk. Based on the definition that has been described, this tax risk indicates tax uncertainty. This means that the Company's management fails to estimate the taxes to be paid. This will cause uncertainty in future cash flows. Therefore, the connection between tax risk and tax avoidance cannot be separated.

A prior study about tax avoidance's effect on tax risk has been held by Ghafoori & Rahmani (2017); Guenther et al., (2017) and Dyreng et al., (2008), Chung et al., (2018), and Choi & Park (2022). Research conducted by Ghafoori & Rahmani (2017) stated that if the quality of internal information is good, then ETR (tax avoidance proxy) can increase so that it can ultimately reduce tax risk. This statement is reinforced by Choi & Park (2022) who stated that tax risk will decrease because of increasing ETR, and vice versa. It can be minimized if the Company has good governance. Good corporate governance (GCG) is all efforts made by the Company to create a situation/condition where the relations between the stakeholders is conducive (Syafitri et al., 2019). Corporate governance will provide added value to shareholders in a sustainable manner. Appropriate managerial actions are needed to reduce tax risk. Managers must create deceptions to maximize profit and reduce the risk of tax avoidance. Therefore, corporate governance is chosen as moderation variable because tax avoidance practices contain risks that cannot be separated from manager's decision.

This study aims to determine the effect of tax avoidance on tax risk and how corporate governance moderates both. Therefore, audit quality is used as a measurement for corporate governance as suggested by Choi & Park's research (2022). According to DeAngelo & Masulis (1980), audit quality can regulate and direct manager behavior and prevent all forms of fraud. In addition, this research uses committee of audit, institutional ownership and independent commissioners as other measures of corporate governance so that it can provide new evidence regarding the effectiveness of GCG.

B. LITERATURE REVIEW

1. Agency Theory

According to Jensen & Meckling (1976), agency theory is an effort to separate the relationship between agent and principal. This is because agents will not always act in the interests of the company's owners. So according to Eisenhardt (1989), this will cause information asymmetry because management knows more about the company's daily information. However, financial reporting by management is not

information that is free from information asymmetry. Management has an interest in the incentives it receives which depend on after-tax profit (Crocker & Slemrod, 2005).

2. Tax Avoidance

Tax avoidance is defined as the transfer of wealth from companies to the state by reducing the tax burden (Kim et al., 2011; Hanlon & Heitzman, 2010). Hanlon and Heitzman see that tax avoidance actions are very broad, starting from the simplest action in the form of issuing interest-bearing bonds to aggressive actions such as not complying with tax regulations. The approach by Dyreng et al. (2008) is even broader where tax avoidance covers areas that are still gray to illegal areas.

3. Tax Risk

According to Nesbit et al. (2017), the definition of tax risk differs between disciplines because tax encompasses various aspects such as accounting, finance, economics and law. For example, they define tax risk as the result of tax avoidance. The risk is how much it can be known by the tax authorities. Meanwhile, financially, Drake et al. (2008) defines the risk that arises as the difference between the expected results from tax savings and the expected returns.

4. Corporate Governance

Pitria & Wijaya (2016) define corporate governance as a process and structure that is implemented to create and maximize company performance and value in a sustainable manner. Simply put, corporate governance is a management and control system of a company so that stakeholders are coordinated to achieve the company's goals and do not harm each other. Agency theory is the basis for the application of corporate governance where management as an agent has the responsibility to maximize shareholder profits and agents will receive compensation. According to Hidayanti (2013), the reason for the emergence of corporate governance is because of agency problems. The principal's problem is to ensure that the capital invested in the company is managed properly and used on profitable projects so that their profits are maximized. While managers act for their welfare. By implementing good corporate governance, it is expected to reduce information asymmetry, increase investor confidence, reduce conflicts of interest and cost of capital, and increase stakeholder support.

5. Tax avoidance and tax risk

Companies want to reach high profits even though they bear risks through tax avoidance (Choi & Park, 2022). Armstrong et al., (2015) again added that if a manager's personal interests are high, then he tends to do high tax avoidance. So, tax avoidance can increase excess investment returns but also can reduce profits and wealth distribution in the future (Chung et al., 2017). As a tax avoidance strategy, companies usually want a low effective tax rate so the tax charge can be shaven. In the future, the Company will bear the risk of uncertainty in the effective tax rate. To keep tax costs

low on a sustainable basis will of course be difficult. Because it will increase the volatility of tax rates as a measure of tax risk. In other words, there will be an increased possibility of being detected by the tax authorities. This incurs audit cost, additional tax costs, and sanctions/fines in the future (Choi & Park, 2022). Therefore, the hypothesis (H1) proposed is that tax avoidance have significant effect to tax risk.

6. Tax Avoidance; Corporate Governance, and Tax Risk

The influence of institutional ownership as one of the GCG proxies was analysed by Ghafoori and Rahmani (2017) on tax avoidance and tax risk. They concluded that if institutional ownership is greater, tax avoidance practices will decrease, and tax risk will be lower. If the level of institutional ownership is high, it will lower the level of tax avoidance practice due to tighter supervision (Destriwanti et al., 2022).

The role of independent commissioners can suppress extreme tax avoidance practices (Armstrong et.al, 2015). Goh et.al (2016) stated that the level of cost of capital and tax avoidance will decrease significantly if the company's corporate governance is in good condition. Independent commissioners can reduce the risks borne by the company (Choi & Park, 2022). In a study conducted by Krisnawati & Miftah (2019), it was shown that the negative effect that independent commissioners have on tax avoidance.

According to Choi & Park (2022), to avoid management fraud, an audit committee is needed to oversee the process of preparing financial reports. This is in accordance with the agency theory that the audit committee can supervise the company's activities and minimize conflict of agent. In this case, the company will be more open and responsible in preparing financial reports (Dewi & Jati, 2014). Meanwhile, according to Gaaya et al. (2017) Audit quality is defined as a mechanism to protect the company from managerial exploitation and all forms of fraud. Audits by the big four tend not to employ aggressive tax strategies (Lanis & Richardson, 2011). Based on this explanation, hypothesis (H2) suggested is that corporate governance can moderate tax avoidance and tax risk.

C. METHODS

Secondary data are financial reports of consumer goods companies in Indonesia during the 5-year observation period (2019-2023). This study consists of three main variables, namely tax risk, tax avoidance and GCG using independent commissioners, institutional ownership structure, audit quality and audit committees as proxies. Furthermore, size, leverage, pre-tax book income and operating cash flow are control variables that are used. Purposive sampling method with the criteria of companies that consistently publish annual reports and experience profits before and after tax.

Table 1. Variable Operationalization

Variable	Indicator	Measure	Prior Studies
Tax Avoidance*	CuETR	(Current Tax Expense)/(Pretax Income)	Drake et al. (2017); Choi & Park (2022)
Tax Risk**	ETRvol	Standard deviation of ETR in 5 years	Tanujaya (2020); Widyasari et al. (2021)
Audit Quality***	AQ	Number "2" if audited by Big 4 and "1" otherwise	Gaaya et al. (2017); Jihene & Moez (2019)
Audit Committee***	KA	Number of audit committee	Malinda et al. (2022)
Institutional Ownership***	KeI	Institutional Shares/Outstanding Shares	Ziana (2022)
Independent Comissioner***	KoI	(Number of Independent Commissioners)/(Total Commissioner)	Malinda et al. (2022)
Size	Size	Ln (Total Asset)	Guenther et al. (2017); Choi & Park (2022)
Leverage	Leve	(Total liability) / (Total Asset)	Guenther et al. (2017); Choi & Park (2022)
Pre-tax Book Income	PTBI	(Profit Before Tax)/(Total Asset)	Guenther et al. (2017); Choi & Park (2022)
Operating Cash Flow	CFO	(Operating Cash Flow)/(Total Asset)	Guenther et al. (2017); Choi & Park (2022)

Explanation: * - Independent Variable

** - Dependent Variable

*** - Moderating Variable

Source: Data Processed

Quantitative approach using simple regression analysis and MRA method was used in this study, resulting in the following formulation:

$$\text{ETR Vol} = \beta_0 + \beta_1 \text{ETR} + \beta_2 \text{SIZE} + \beta_3 \text{LEVE} + \beta_4 \text{PTBI} + e \quad \text{H1}$$

$$\text{ETR Vol} = \beta_0 + \beta_1 \text{ETR} + \beta_2 \text{SIZE} + \beta_3 \text{LEVE} + \beta_4 \text{PTBI} + \beta_5 \text{ETR} * \text{CGC}_{1,2,3} + e \quad \text{H2}$$

D. RESULTS AND DISCUSSION

Descriptive statistics of 200 samples are shown in table 2. Based on table 2, the coefficient of effective tax rate volatility (ETR_{vol}) as a tax risk measurement, showed a mean value of 0.39. Meanwhile, the mean value of effective tax rate (ETR) is 0.23. It can be interpreted that company make corporate income tax payments of around 23% of profit before tax. Furthermore, the descriptive analysis of corporate governance variables measured using 4 proxies: 1) structure of independent commissioners shows a mean value 0.41. This can be interpreted that on average, the companies that were the research samples has the composition of independent commissioner is 41% of the total commissioners. This may indicate that the company has complied with the provisions of the Financial Services Authority where the company must have at least 30% independent commissioners of all commissioners' members. 2) The Audit Committee (KA) which is the second proxy as a measurement of corporate governance shows mean value 30.15, this means that the company has complied with the provisions of the financial services authority to have an audit committee of at least three people. 3) The mean of audit quality (AQ) shows 0.16, This means that 16% of

companies are audited by big four public accountants and 84% are not. 4) Meanwhile, the average company sample in this study was 71% of its shares owned by bodies/institutions from the shares in circulation.

Table 2. Descriptive Statistic

Var	N	Minimum	Maximum	Mean	Std. Deviation
ETR	200	0,02686	0,95934	0,2378731	0,10325228
ETRvol	200	0,06169	444,403	0,3874358	0,59110289
KA	200	200	400	30.150.000	0,255148
QA	200	100	200	16.400.000	0,48120452
KeI	200	0,05098	690,792	0,7139386	0,49801193
KoI	200	0,14286	100	0,4122956	0,10804259
Size	200	1.361.995	3.080.366	217.862.022	573.425.122
Leve	200	0,02683	519,19	0,4459183	0,43530318
PTBI	200	0,00284	0,94137	0,1376012	0,1129205
CFO	200	0,00091	0,48716	0,1401832	0,9719908

Source: Data Processed

Based on table 3 above, the value of constant is -4.034. It means, if the tax avoidance variable (ETR) is considered constant or has a value of 0, the tax risk will decrease by 4.034 units. The regression coefficient of ETR is -0.445. It means an increase in tax avoidance of 1 will result in a decrease in tax risk of 0.445 and other variables are considered constant. This means that avoidance of tax has negative effect to tax risk. In addition, ETR has a t value of -3.096 with a significance level of 0.002. In addition, ETR has a t value of -3.096 with a significance level of 0.002. This is smaller than alpha (0.05). Then, t value (-3.096) is not between the t table (-1.65259 and 1.65259) so H1 is fulfilled and H0 is rejected. It means that tax avoidance has an effect to tax risk. Table 3 above also show the determination coefficient (R Square) 0.274 and the adjusted determination coefficient value (Adjusted R Square) 0.255. It means, 25.5% of the variation in tax risk can be defined by ETR (tax avoidance), leverage (LEVE), Company Size (SIZE), PTBI (pre-tax book income) and cash flow (CFO). While the rest (100% - 25.5% = 74.5%) are defined by other variables that do not exist in this research.

Table 3. Hypothesis Test 1

Var.	Coef.	t - value	Sig.
Cons.	-4,034	-5,787	0,000
ETR	-0,445	-3,096	0,002
Size	0,433	3,797	0,000
Leve	0,322	3,797	0,000
PTBI	-0,360	-5,313	0,000
CFO	-0,051	-0,801	0,424
N	200		
Adjusted R ²	0,255		
F-Test	12,548		

Explanation: Significant Level 5%

Source: Data Processed

Hypothesis test 2 on table 4 shows the effect of GCG in moderating ETR_{Vol} (tax risk) which is influenced by the tax avoidance variable (ETR). The value of constant is

-4.825. It means, if the value of other variables is 0 then the dependent variable (tax risk) is 4.825. The Adj. R-Square determination coefficient is 28.3%. It means, all variables in this research affects tax risk by 28.3%, the residual 71.7% is effected by other factors aren't explained in the research. The results of the suitability test analysis for testing hypothesis 2 show a good match. So, independent variables influence the dependent variable simultaneously.

Table. 4 Hypothesis Test 2

Var.	Coef.	t - value	Sig.
Cons.	-4.825	-6.318	0,000
ETR	-1.064	-1.991	0,048
Size	0,685	2.917	0,004
Leve	0,287	3.311	0,001
PTBI	-0,366	-5.420	0,000
CFO	-0,039	-.604	0,547
KA*ETR	-0,569	2,550	0,012
QA*ETR	-1,683	-4,088	0,000
KeI*ETR	-0,91	-0,296	0,767
KoI*ETR	-0,41	-0,73	0,942
N	200		
Adjusted R2	0,283		
F - Test	8,144		
Explanation: Significant Level 5%			

Source: Data Processed

Task Risk and Tax Avoidance

The influence between tax avoidance (ETR) and task risk (ETRvol) is explained by a simple regression analysis in table 3. Hypothesis 1 predicts that ETR and ETRvol will have negative and significant influence, since it hard for companies to choose sustainable tax avoidance strategy. Finally, the results support hypothesis 1. The ETR coefficient is -0.445 and represents a negative significant value at the 5% level.

This proves that if ETR increases, it will reduce ETRvol, or when ETR decreases, there is an increase in ETRvol. So, the increase of tax avoidance causes increases of tax risk. These findings support agency theory, where high tax avoidance will provide benefits to the Company, so that shareholder wealth will increase. This makes managers receive awards for their achievements. However, this action is temporary in nature where in the future the Company has risks and will be borne by shareholders. In addition, the findings in this research are parallel with positive accounting theory which tries to explain and predict the Company's accounting practices. It is shown that accounting information in the form of tax avoidance can be used as a prediction of corporation's future risks. This condition is very suitable with the purpose of making financial statements as a basis for decision making. The findings of this study support Ghafoori and Rahmani's research (2017); Goh et al. (2016) and Hasan et al. (2014). Nevertheless, my findings differ from Choi and Park

(2022) and Bauer and Klassen (2014) which states that tax avoidance has no effect on tax risk).

Tax Avoidance, Good Corporate Governance and Tax Risk

The influence between GCG on risk and tax avoidance is explained by table 4. The negative relationship between ETR and ETRvol will be low if the existing corporate governance structure is better. This is reflected in the proof of Hypothesis 1 which is in accordance with expectations, that there is negative significant relation between ETRvol and ETR. So, corporate governance (GCG) has an effect between tax avoidance and its risk.

The first analysis shows the results when the audit committee as moderating variable. The value of $ETR*KA$ is 0.569, which is positive and significant. These results can be interpreted as the uncertainty of company's tax rate due to tax avoidance cannot be pressured by the audit committee. This condition is because they have been controlled by management, because of the welfare that has been provided by management, so they lose their power to perform their functions in ensuring the Company's compliance with the norms that should be obeyed (Choi & Park, 2022). According to Hanum et.al (2013) these results also show that the committee of audit does not affect the company's management regarding the tax burden policy, which means that the company's effective tax rate is not determined by the audit committee. Thus, the number of audit committees does not ensure that the company will have a good effective tax rate value, and they cannot intervene to determine the Company's effective tax rate policy.

The second corporate governance moderation analysis using audit quality proxy as a measurement shows the $ETR*QA$ coefficient value is negative at -1.683 and significant. It means, Good corporate governance can reduce the uncertainty of the company's ETR in the future. This proves that quality of audit is an effective mechanism to control and supervision managers. Quality auditors can reduce the chances of managers taking actions that endanger the Company in the future by complying with tax regulations, because avoidance has a future risk for the Company. In addition, quality auditors are not interested in tax avoidance activities. Because this has the potential to damage the auditor's reputation, they will attempt to identify all these risky actions for the sake of their good name. The findings of this study are the same as Lanis & Richardson (2011); Gaaya et.al, (2017) and Jihene & Moez (2019) which show that quality of audit has a negative effect on risky actions in the future.

The third moderation analysis is institutional ownership. The interaction coefficient $ETR*KeI$ shows a figure of -0.091. It means institutional ownership has a negative effect on ETR (effective tax rate). Negative result indicates that institutional investors tend to invest safely by following the rules and laws set by the government. So that institutional investors tend to choose not to choose tax avoidance. The figure of 0.767 is a significance value that is greater than 5%. So, Institutional ownership isn't proven and doesn't have significant effect in moderating ETR on ETRvol. This means that the variable is less able to control the company directly, notably regarding tax

policy. Hanum et al (2013) stated that institutional investors do not have the ability to intervene in management in formulating strategy and operational activities like the company's effective tax rate.

The last moderation analysis is the composition of the independent of commissioner's structure. It shows a negative ETR*KoI coefficient value (-0.041). This negative result indicates that the presence of commissioners independent can reduce risky actions taken by managers. because they are authorized to make sure supervision of management in operations, the implementation of the company's strategy and accountability runs well. However, the significance value of this variable is greater than 5% (0.942), meaning that this variable has not been proven to be significant towards ETR. Hilmi et.al, (2017) stated that the insignificant influence of independent commissioners indicates that the company is not yet effective because it does not carry out the role of supervision of proper management it only acts as fulfilment of requirements in government regulations. Hanum et.al (2013) added that a larger proportion of independent commissioners does not ensure to company effectiveness. Independent commissioners act as a third party whose position is neutral between the government and management and plays an active role in determining independent management policies. So, the investors will've more confidence to management.

These findings support agency theory, which states that to minimize or suppress the agency costs borne by the principal, there must be a monitoring cost which is the cost that must be borne by the principal to supervise the behavior of managers.

E. CONCLUSION

This study found that when tax avoidance is high it will increase tax risk. This condition shows that the risks faced by companies when tax avoidance increases are the possibility of higher tax payments, conducting a corporate tax audit and fines/sanctions from the tax authority. Besides that, tax avoidance is a temporary method and cannot be used by the company continuously in the future. In other words, tax avoidance is a high-risk investment alternative. Therefore, the study of tax avoidance and its risks must be carried out through various approaches. From this study we also know that corporate governance can control the risk of tax avoidance in the future. Therefore, with optimal management regulation and supervision, it is hoped that the effects of tax avoidance on risk will be reduced. Because tax avoidance is riskful strategics. The managerial implications of this research are encouraging shareholders and regulators to strengthen the implementation and structure of corporate governance, to protect stakeholder interests and create public trust.

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