

# **THE EFFECT OF TAX AVOIDANCE ON FIRM VALUE: THE MEDIATING ROLE OF AGENCY COST AND MODERATING ROLE OF FAMILY OWNERSHIP**



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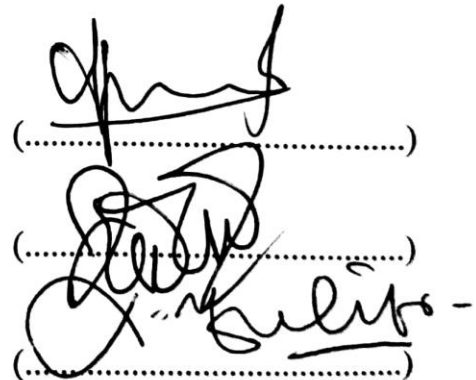
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## **DECLARATION OF ORIGINALITY**

I am, Amalia Intan Pratiwi, hereby declare that this thesis is real and accurate to be my own work, especially written for partial requirement to complete Undergraduate Program of Accounting, and has not been presented in any other occasion before. I bear full responsibility for my undergraduate thesis.

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## **MOTTO AND DEDICATION**

“You Only Fail When You Stop Trying”

**I dedicate this thesis for:**

My beloved parents

My beloved grandparents

My family

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## ABSTRACT

This study aims to investigate the effect of tax avoidance on firm value with the mediating role of agency cost and moderating role of family ownership. Firm value is measured with Tobin's Q, tax avoidance was measured with effective tax rate and agency cost was measured with asset turnover or sales to total asset ratio. This research adopted F-PEC index developed by Astrachan, Klein, & Smyrniotis (2002) to measure family ownership.

Population of this research were non financial firms listed on IDX. Samples were taken for the year 2012-2016 and was collected by purposive sampling method where researcher established some criteria to be the research data. Panel data analysis on Eviews 10 was used to test the research data.

This research find that tax avoidance significantly have positive effect on firm value. The results of this research prove that investor in Indonesia react positively to tax avoidance or do not consider tax avoidance practice as long as their interests are met. Furthermore, tax avoidance significantly have negative effect on agency cost, and agency cost significantly have negative effect on firm value. Tax avoidance negatively affects the agency costs because in doing tax avoidance, the agent strives to fulfill the principal's interests by providing higher after-tax profits, so that the interests of both parties are met and the conflicts and agency costs are likely to decrease. The path analysis result do not proven that tax avoidance have indirect effect on firm value through agency cost. Another finding is family ownership does not moderate the effect of tax avoidance on firm value. There are no different effect related to tax avoidance and firm value between low family ownership and high family ownership.

*Keywords: tax avoidance, firm value, agency cost, family ownership*

## ABSTRAK

Penelitian ini bertujuan untuk mengetahui pengaruh penghindaran pajak terhadap nilai perusahaan dengan peran mediasi biaya agensi dan moderasi peran kepemilikan keluarga. Nilai perusahaan diukur dengan Tobin Q, penghindaran pajak diukur dengan tarif pajak efektif dan biaya agensi diukur dengan perputaran aset atau penjualan ke rasio total sset. Penelitian ini mengadopsi indeks F-PEC yang dikembangkan oleh Astrachan, Klein, & Smyrnios (2002) untuk mengukur kepemilikan keluarga.

Populasi dalam penelitian ini adalah perusahaan non keuangan yang terdaftar di BEI. Sampel diambil untuk tahun 2012-2016 dan dikumpulkan dengan metode *purposive sampling* dimana peneliti menetapkan beberapa kriteria untuk dijadikan data penelitian. Analisis data panel pada Eviews 10 digunakan untuk menguji data penelitian.

Penelitian ini menunjukkan bahwa tax avoidance secara signifikan berpengaruh positif terhadap nilai perusahaan. Hasil penelitian ini membuktikan bahwa investor di Indonesia bereaksi positif terhadap penghindaran pajak atau tidak mempertimbangkan praktik penghindaran pajak selama kepentingannya terpenuhi. Lebih jauh lagi, penghindaran pajak secara signifikan memiliki efek negatif pada biaya agensi, dan biaya agensi secara signifikan memiliki efek negatif pada nilai perusahaan. Penghindaran pajak berpengaruh negatif terhadap biaya agensi karena dalam melakukan penghindaran pajak, agen tetap berusaha memenuhi kepentingan prinsipal dengan memberikan laba setelah pajak yang lebih tinggi, sehingga kepentingan kedua belah pihak terpenuhi dan konflik serta biaya agensi cenderung menurun. Hasil analisis jalur tidak membuktikan bahwa penghindaran pajak memiliki pengaruh tidak langsung terhadap nilai perusahaan melalui biaya agensi. Selain itu, kepemilikan keluarga tidak memoderasi pengaruh penghindaran pajak atas nilai perusahaan. Tidak ada efek yang berbeda terkait dengan penghindaran pajak dan nilai perusahaan antara kepemilikan keluarga yang rendah dan kepemilikan keluarga yang tinggi.

*Kata kunci: penghindaran pajak, nilai perusahaan, biaya agensi, kepemilikan keluarga*

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# **CHAPTER I**

## **INTRODUCTION**

This chapter consists of five sub-sections including background, problem formulation, research objectives, research contribution, and systematics writing. In the background section, explained the reasons why this study is conducted. The problem section describes the issues to be raised in the study. The research objective section explained the purpose of research. The research contribution section explained several contributions given by this research.

### **1.1 Background**

Tax amnesty has just been done in Indonesia last year. Tax amnesty is purposed to encourage tax evasion practitioners to report their assets and pay the tax on the next period. Therefore, tax amnesty as a policy or breakthroughs was implemented to encourage the assets transfer to Indonesian territory and to provide security guarantees for Indonesian citizens whose willing to transfer and disclose their assets. Tax amnesty is purposed on taxpayers who doing tax evasion. Beside tax evasion, there is another tax practice called tax avoidance, by minimizing tax burden in legal ways, such as by creating or adding research and development program to make the total expenditure is higher, the profit is lower and tax burden also lower since tax burden is determined by the fiscal profit. From those phenomena, comes a question why companies do tax avoidance. Then

come again a question, does the tax avoidance practices actually can give positive effect for the company, or it only gives negative effect?

From the government's point of view, tax avoidance and tax evasion practices reduce the ability of the government to collect taxes maximally. The government as a provider of infrastructure and various other facilities received little revenue compared to the amount that should be received. Government revenue is often unable to cover the need for greater development funds. As a result, the government raised tax collection and expanded its tax base. Ultimately, middle-class people will be affected by the burden of increasing tax expense.

Tax is the most important sector in our country. Based on statistic data from Badan Pusat Statistik (BPS), the biggest revenue is from tax. In 2010-2017, government revenue show that tax contribute for average 78% per year. Since the tax is being the biggest income, Indonesian government continues to push tax collection activities such as tax amnesty. Tax revenue also increasing year by year and show the government program to push tax collection is successfully implemented. The increase occurred due to the increase on the number of taxpayers and taxpayers compliance improvement.

Contradict the government, firms have another point of view. For them, tax is being an expense that could decrease the net income. So, several firms try to find the way to decrease their tax. In order to minimize the tax expense, managers perform tax management. Tax management is a management strategy to control, plan, and organize taxation aspects that can prosper the business value of the company while still implementing taxation obligations.

One of the strategies in tax management is tax avoidance. Tax avoidance is widely defined as the reduction in a firm's explicit tax liabilities (Dyreng, Hanlon, & Maydew, 2008 as cited in Chen, Hu, Wang, & Tang, 2014). Tax avoidance is the use of legal methods to modify an individual's financial situation to lower the amount of income tax owed through the regulatory loopholes. Tax avoidance is different from tax evasion. Tax evasion is an illegal practice of not paying taxes, by not reporting income or by not paying taxes owed.

Desai & Dharmapala, (2005) find that tax avoidance behavior by firms leads to increases the firm value. Tax avoidance is traditionally believed that corporate tax avoidance represents the wealth transfer from government to corporations and should enhance firm value. Firms do the tax avoidance as a way to minimize expense make increase the cash flow and thought that there is no other way to minimize the expense. Tax avoidance was initially considered beneficial until several researchers such as Chen, Hu, Wang, and Tang conducted the study about tax avoidance. According to Chen, Hu, Wang, & Tang (2014), tax avoidance is not costless. There are several possible impacts such as reputation loss, which cause stakeholders lose their trust in the company, and lower share prices. If the firm no longer trusted, it can slowly collapse.

Tax avoidance measures are positively and significantly associated with agency cost (Chen et al., 2014). Tax avoidance can give direct and indirect changes in current or future cash flows. For example, a direct change could increase cash flow through tax savings, while also being associated with higher agency costs that consist of reputation loss which based on agency theory are

classified as residual cost, and also there is implementation cost. Tax avoidance triggers an agency conflict because tax avoidance practice only give benefit for the agent and the principal's interest is harmed.

According to Jensen & Meckling (1976), a potential agency problem occurs when the manager's ownership of the firm's stock is less than one hundred percent. In the family firm, the agency conflict is lower because the manager also acts as owner. There is no or lower interest conflict between principal and agent, which will not significantly affect the stock price, and the saved cash flow by doing tax avoidance will lead to increase firm value.

This study is conducted because the prior research still give inconsistent results. Agency cost will be added as mediating variable to examine whether tax avoidance indirectly affects firm value through agency cost. Family ownership, as moderating variable will also be added to affect the strength of the relationship between the dependent and independent variable.

This study is according to the study conducted by Chen, Hu, Wang, & Tang, (2014) that find tax avoidance behavior reduces firm value and increases agency costs. The population of this study are non-financial firms listed on the Indonesian Stock Exchange during 2012-2016. The sample selection using purposive sampling to match the specified criteria. Based on the description above, then this research entitled **The Effect Of Tax Avoidance On Firm Value: The Mediating Role Of Agency Cost And Moderating Role Of Family Ownership (Evidence from Non-Financial Firms Listed in IDX 2012-2016).**

## 1.2 Problem Formulation

Research on the effect of tax avoidance on firm value is still give inconsistent findings. Several researchers find that tax avoidance can increase corporate value, but some argue otherwise. Desai & Dharmapala, (2005) find that tax avoidance is likely to increase value. Tax avoidance behavior provides corporations with more free cash flow either in the short run or in the long run, which directly increases firm value, and the tax avoidance itself will shift cash flows indirectly by influencing management decision making. Conversely, Chen et al., (2014) find that there is a negative relationship between tax avoidance and firm value. The complexity and ambiguity of tax avoidance allow managers to pipe the gains into themselves, which would reduce current and future cash flows. In addition, according to classic agency theory, the free cash flow deriving from tax avoidance would lead to the occurrence of company-paid consumption and the building of “personal empire”, which will shrink future cash flow and decrease firm value. Chen’s study is supported by Kiesewetter & Manthey (2017) which find that tax avoidance is not creating value (decrease the firm value). It seems possible that tax avoidance may not create value for various reasons. Managers tend to engage in tax management because it is believed to be their duty to maximise shareholder value. One reason why tax avoidance may not pay off is the well-functioning of law books and tax audits. Another reason is that it costs a lot of money to engage in tax avoidance. The fees paid to tax advisors, law firms and other professional advisors such as trustees and bankers can be substantial (Kiesewetter & Manthey, 2017).

Agency conflicts are the major problem arising from tax avoidance practices. Between firms and investors, they have their own point of view as well as conflicting opinions between one another. Firms consider tax avoidance behavior as a strategy to reduce their tax expense. From the investor's point of view, tax avoidance activities by managers can reduce the information content of financial statements that can reduce the value of the company (Balakrishnan and Guay, 2012). According to Desai & Dharmapala (2006), opportunistic managers can use tax avoidance to advance their own interests, creating conflicts between managers and shareholders regarding tax avoidance. This statement is supported by Chen et al., (2014), the study state that direct change caused by tax avoidance can increase free cash flow which also associated with higher agency cost.

The study regarding tax avoidance and firm value with family ownership as the moderating variable still not being a common topic in Indonesia. So, this study expects to find out more whether family ownership takes a role on tax avoidance practice and firm value on Indonesian companies. Therefore, this research was conducted to answer the questions as follows:

1. Does tax avoidance affect the firm value?
2. Does agency cost mediate the relationship between tax avoidance and firm value?
3. Does family ownership moderate the relationship between tax avoidance and firm value?

### **1.3 Research Objectives**

Based on the problem formulation above, the purpose of this study is as follows:

1. Analyze whether tax avoidance affects the firm value.
2. Analyze whether agency cost mediates the relationship between tax avoidance and firm value
3. Analyze whether family ownership moderates the relationship between tax avoidance and firm value.

### **1.4 Research Contributions**

This research is expected to deliver benefits for all parties, whether the benefits which available practically as well as theoretically, that is:

1. For academics, this research is expected to help further research, as empirical evidence and references and the development of theories especially related to tax avoidance, agency cost, family ownership, and firm value.
2. For accounting practitioners and regulators, this study is expected to give stakeholders an overview of tax avoidance and practices in Indonesia. This study is also expected to be a consideration for regulators on making decisions about rules and policies and to be a consideration for regulators to understand tax avoidance practices so as to improve existing regulatory loopholes.



## **1.5 Systematics Writing**

### **CHAPTER I: INTRODUCTION**

This chapter contains an explanation which attempts to give an overview of the description of the problem and the contents of the topic in this research. This chapter consists of the background of the research, problem formulation, research objectives, research contributions and writing systematic research.

### **CHAPTER II: LITERATURE REVIEW**

The chapter will describe the theories and explanatory material relating to the research topic, as well as previous research that is still relevant to the research topic. In this chapter is also contained by a framework that underlies the hypotheses to be tested in this research and explaining the variables that contained in this research included the independent variables, the dependent variable, mediating, and moderating variable.

### **CHAPTER III: RESEARCH METHODOLOGY**

This chapter describes the variables in the research operationally, determination and selection of the sample population, types and sources of data, data collection methods, data analysis methods and tools that used in this research.

### **CHAPTER IV: RESULTS AND DISCUSSION**

This chapter describes and explains the description of research objects, data analysis, interpretation of results and the argument or explanation for the results of existing research.

### **CHAPTER V: CONCLUSION**

This chapter contains the conclusion made by the authors of the research to answer all questions of research, the limitations of the study and suggestions for further research.