

## Corporate Governance and Its Effect on Tax Avoidance: Evidence from the Indonesia Stock Exchange

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### Article Info

#### Article history:

Have received 28/02/2025

Revised 06/03/2025

Accepted 10/03/2025

#### Keywords:

Corporate Governance,  
Board of Commissioners,  
Proportion of  
Independent  
Commissioners,  
Managerial Ownership,  
Institutional Ownership,  
Tax Avoidance

### ABSTRACT

This study aims to examine the effect of corporate governance mechanisms specifically the size of the board of commissioners, the proportion of independent commissioners, managerial ownership, and institutional ownership on tax avoidance. A quantitative approach with an explanatory research design was employed. The study focused on companies listed on the Indonesia Stock Exchange (IDX) during the period 2012–2016. Secondary data were obtained from annual financial reports published on the IDX website and the Indonesian Capital Market Directory. The population comprised all companies listed on the IDX between 2012 and 2016. A purposive sampling technique, based on non-probability sampling, was used to select the sample. Data were analyzed using regression analysis with SPSS version 24. The findings reveal that both the size of the board of commissioners and managerial ownership significantly influence tax avoidance, whereas the proportion of independent commissioners and institutional ownership have no significant effect.



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## INTRODUCTION

One of the industries that is currently growing rapidly in Indonesia is the logistics and transportation services business sector. This is indicated by market size data on transportation and logistics businesses from 2012 to 2016 which continues to increase with an average growth of 13.7% (<http://duniaindustri.com> 2017). This condition motivates company management to carry out tax management, so that tax costs become smaller but without violating applicable tax provisions (tax Avoidance). Efforts to minimize taxes that do not violate tax provisions are tax avoidance actions. This is legitimate because there are loopholes in the imperfection of tax provisions (Waluyo 13:2013).

Tax management can be done by one of them by conducting tax avoidance (tax evasion) where the company tries to reduce its tax burden in a legal way and does not conflict with tax regulations or can also be said to take advantage of weaknesses in applicable tax regulations. In addition to tax avoidance, tax management is also carried out through tax evasion, where tax evasion is illegal because it violates tax laws and regulations. There are factors that influence tax avoidance, namely corporate governance. One of the mechanisms of the corporate governance system is the establishment of a supervisory system carried out by the board of commissioners and the independent board of commissioners as part of corporate governance to supervise the company. The relationship between taxes and corporate governance has been studied extensively by several researchers, including research conducted by (Desai and Dharmapala, 2006). Based on the background above, this study aims to see how financial performance and corporate governance affect tax avoidance in logistics and transportation sector companies listed on the IDX for the period 2012-2016.

## LITERATURE REVIEW

### Agency Theory

The agency theory view sees the cause of potential conflicts that affect the quality of financial report information due to the separation between the principal and the agent. Agency theory is a

cooperative relationship between the principal (company owner) and the agent (company management), where the principal delegates authority to the agent to manage the company and make decisions (Jensen & Meckling, 1976).

For companies in the form of Limited Liability Companies (especially those listed on the capital market), there is often a separation between the company managers (management, also called agents) and the company owners (or shareholders, also called principals). In addition, for companies in the form of Limited Liability Companies (PT), the owner's liability is limited to the invested capital. This means that if the company goes bankrupt, the owner's own capital (equity) may be lost, but the owner's personal wealth does not bear the loss. Agency problems arise in two forms, namely between the company's owners (principals) and management (agents), and between shareholders and bondholders. Certain shareholders want managers to work with the aim of maximizing shareholder wealth. Conversely, corporate managers may act not to maximize shareholder wealth, but to maximize their own wealth.

### **Tax Avoidance**

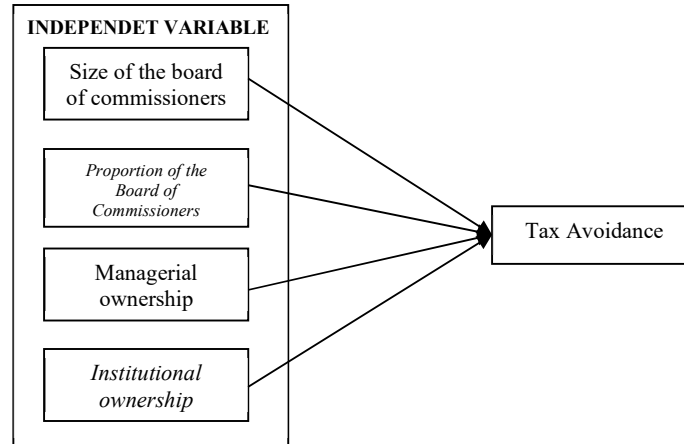
The company management's efforts to obtain the expected profit through the implementation of tax management, one of which is by conducting tax avoidance, namely reducing the amount of tax in a way that does not violate tax laws and regulations. Tax avoidance can also be interpreted as part of a tax management strategy that is not prohibited by tax regulations. Tax avoidance carried out unlawfully is tax evasion or can also be said to be tax avoidance, namely avoiding taxes that are not permitted in tax laws and regulations. Tax avoidance is an attempt to avoid taxes that is carried out legally and safely for taxpayers without conflicting with applicable tax provisions where the methods and techniques used tend to. From this understanding it can be concluded that tax avoidance is essentially a way to reduce the company's tax burden by exploiting weaknesses in applicable tax regulations, so that this method cannot be said to be unlawful.

### **Corporate Governance**

The definition of corporate governance according to the Organization for Economic Cooperation and Development (OECD, 2004) is a system used to direct and control a company's business activities. Corporate Governance regulates the division of duties, rights, and obligations of interested parties in the company, including shareholders, the board of directors, managers, and all non-shareholder stakeholders. From this definition, it can be concluded that corporate governance is essentially a system and set of regulations that govern the relationship between shareholders, the board of commissioners, and the board of directors so that the company's performance is carried out effectively, efficiently, transparently, and accountably in order to achieve organizational goals and avoid fraud in decision making.

In its development in Indonesia, in 1999 the National Committee for Corporate Governance Policy (KNKCG) was formed, which issued the first corporate governance guidelines in Indonesia. One of the objectives of implementing corporate governance is so that the company's financial reports produced by management are presented with the principles of accountability and transparency. To achieve the objectives of implementing corporate governance, a system and structure of duties and authorities of the board of commissioners and audit committee are formed so that corporate governance can run effectively and efficiently.

Based on BAPEPAM LK regulation Kep-134/BL/2006 concerning the obligation to submit financial reports for issuers or public companies, it is stated that in submitting reports, issuers are required to include reports on the implementation of the work of the board of commissioners and audit committee as part of the corporate governance report. The implementation of corporate governance is expected to minimize profit management practices in a company that can harm users of financial reports because the information contained in the financial reports becomes biased and cannot be accounted for.



**Figure 1. Conceptual Framework**

### Hypothesis:

H1: Size of the Board of Commissioners on Tax Avoidance

H2: Proportion of Independent Board of Commissioners on Tax Avoidance

H3: Managerial Ownership on Tax Avoidance

H4: Institutional Ownership on Tax Avoidance

### RESEARCH METHODS

This study uses a quantitative method with an explanatory research type. The explanatory research type is a study that aims to explain the causal relationship between one variable that affects another variable (Cooper & Schindler, 2011:141) through hypothesis testing. What is analyzed is the influence of corporate governance financial performance consisting of the size of the board of commissioners, the proportion of independent commissioners, managerial ownership and institutional ownership on tax avoidance. In this study, there is one independent variable, namely Corporate Governance, which influences the dependent variable, namely Tax Avoidance. The data used in this study are secondary data, namely data that is already available and obtained indirectly through intermediaries obtained and recorded by other parties. The secondary data used are in the form of financial reports sourced from the Indonesia Stock Exchange website or annual financial reports published by the Indonesian Capital Market Directory from 2012 to 2016 and other supporting materials. The population in this study are companies in Indonesia listed on the stock exchange. Sampling uses non-probability sampling techniques with purposive sampling methods, namely sampling techniques based on certain criteria. The analysis method used to test the hypothesis in this study is multiple regression, classical assumption test, and descriptive statistics are also used to provide an overview of the variables in this study. In addition, hypothesis testing is carried out, namely the t-statistic test and the simultaneous F-statistic test and the coefficient of determination to assess the feasibility of the regression model in this study. To conduct the test, the researcher used the SPSS program version 24.00.

### Hypothesis Testing

#### Partial Test Results (t-Test)

Partial hypothesis testing or t-test is conducted to determine the effect of corporate governance variables on the dependent variable (tax avoidance). The basis for decision making is based on the significance value, if the significance value is smaller than the 5% error rate ( $\text{sig.} < 0.05$ ) then  $H_0$  is rejected. The summary test results can be seen in Table 1 below.

**Table 1. Results of Partial Hypothesis Test (t-Test)**

1	Size of the Board of Commissioners	Positive	0.033	2,979	0.002	H1 Accepted
2	Proportion of Independent Commissioners	Positive	0.086	0.459	0.324	H2 Rejected
3	Managerial ownership	Positive	0.001	1,706	0.046	H3 Accepted
4	Institutional ownership	Positive	0.011	0.281	0.390	H4 Rejected

Based on the table above, it can be explained that from 1 hypothesis proposed, there is 1 hypothesis that is accepted.

### First Hypothesis (H1)

The First Hypothesis tests the effect of Corporate Governance on tax avoidance. In this case, Corporate Governance is measured through four measurements, namely the size of the board of commissioners, the proportion of the board of commissioners, managerial ownership, and institutional ownership. The hypothesis of each measurement is as follows. The hypothesis used is to determine whether the size of the board of commissioners has a negative effect on tax avoidance. Based on Table 1, the results of the hypothesis of the variable size of the board of commissioners on tax avoidance produce a beta coefficient value of 0.033 and a significance value of  $0.002 < 0.05$ . Thus,  $H_01$  is accepted and  $H_{a1}$  is accepted, meaning that it is proven that the size of the board of commissioners has no effect on tax avoidance.

### Second Hypothesis (H2)

The hypothesis proposed is to find out whether the proportion of independent board of commissioners has a negative effect on tax avoidance. The hypothesis proposed is as follows. Based on Table 1, the results of the hypothesis of the variable proportion of independent board of commissioners on tax avoidance produce a beta coefficient value of 0.086 and a significance value of  $0.324 > 0.05$ . Thus,  $H_02$  is accepted and  $H_{a2}$  is rejected, meaning that the proportion of independent board of commissioners does not affect tax avoidance.

### Third Hypothesis (H3)

The hypothesis proposed is to find out whether managerial ownership has a negative effect on tax avoidance. The hypothesis proposed is as follows. Based on Table 1, the results of the hypothesis of the managerial ownership variable on tax avoidance produce a beta coefficient value of 0.001 and a significance value of  $0.046 < 0.05$ . Thus,  $H_03$  is accepted and  $H_{a3}$  is accepted, meaning that managerial ownership has no effect on tax avoidance.

### Fourth Hypothesis (H4)

The hypothesis proposed is to find out whether Concentrated Ownership has a negative effect on tax avoidance. The hypothesis proposed is as follows. Based on Table 1, the results of the hypothesis of institutional ownership variables on tax avoidance produce a beta coefficient value of 0.011 and a significance value of  $0.390 > 0.05$ . Thus,  $H_04$  is accepted and  $H_{a4}$  is rejected, meaning that institutional ownership has no effect on tax avoidance.

### Discussion

The results of the study on logistics and transportation service companies listed on the IDX for the period 2012–2016 show that elements of Corporate Governance such as the size of the board of commissioners, the proportion of independent commissioners, managerial ownership, and institutional ownership do not have a significant effect on tax avoidance. This means that the hypothesis stating that corporate governance has an effect on tax avoidance practices is rejected.

Anggraeni (2011) stated that independent commissioners are one of the means to supervise management. Institutional ownership has an important meaning in a company, their existence is considered an effective monitoring mechanism in every decision taken by managers.

So it can be concluded that independent commissioners as supervisors provide encouragement to company management by supervising company management to generate profits based on applicable

provisions, because basically independent commissioners look more at the extent to which management complies with the rules in generating profits, one of which is complying with applicable tax provisions and minimizing aggressive tax actions carried out by the company.

However, several previous theories and studies have shown the importance of the role of the board of commissioners and independent commissioners in supervising management so that they do not act opportunistically. Independent commissioners in particular are considered capable of increasing the effectiveness of supervision and encouraging compliance with regulations, including tax regulations.

Institutional ownership is also considered capable of acting as a mechanism for management oversight. However, in the context of this study, this role has not been proven to have a significant influence on tax avoidance practices. In conclusion, although the theory supports the role of Corporate Governance in suppressing tax avoidance, empirical results in certain sectors do not show a significant influence in the period studied.

## **Conclusion and Suggestions**

### **Conclusion**

This study shows that in general corporate governance mechanisms such as the size of the board of commissioners, the proportion of independent commissioners, managerial ownership, and institutional ownership do not have a significant influence on tax avoidance practices in logistics and transportation companies in Indonesia during 2012–2016.

Only two factors board size and managerial ownership have a statistically significant effect, while the other two factors do not show a significant effect. This shows that although in theory corporate governance can help control corporate tax policy, its implementation in this sector is not strong enough to influence tax avoidance practices.

Thus, the role of supervision and transparency in corporate governance still needs to be strengthened so that the objective of tax efficiency remains within the permitted limits and in accordance with applicable provisions.

### **Suggestion**

Companies in the logistics and transportation sector are advised to further strengthen the implementation of corporate governance principles, especially in terms of the active role of the board of commissioners and independent commissioners in overseeing the company's tax policies. Training and increasing supervisory capacity can be concrete steps to achieve this. Companies need to improve the transparency of financial reporting and accountability for managerial decisions related to tax management. This is important to create a balance between tax efficiency and compliance with applicable provisions.

Regulators such as OJK and DJP can strengthen supervision of corporate governance implementation by setting more specific assessment indicators related to corporate tax policies, thus encouraging companies to focus not only on tax efficiency, but also on compliance and ethics. Further research is expected to add other relevant variables, such as managerial ethics, organizational culture, or external pressure from shareholders, to gain a more comprehensive understanding of the factors that influence tax avoidance.

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