



Does board of commissioners independence still relevant in tax avoidance monitoring?

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ABSTRACT

This study aims to examine does independence of the Board of Commissioner (BOC) is still relevant as a corporate governance mechanism regarding monitoring managers' activity, such as aggressive in financial reporting and tax avoidance during financial distress condition. The focus of this study is listed companies on the Indonesia Stock Exchange (IDX), particularly on Mining and Consumer Good Industry sector for period 2016 until 2018. Using multiple linear regression analysis, this study documents that Independency of board commissioner has significant effect on manager's activity in avoiding tax, however this study failed to document that independency moderates the effect of financial distress and financial reporting aggressiveness on tax avoidance. In addition, this study find that financial distress and financial re-orting aggressiveness positively affect tax avoidance. This study contributes on two ways, first, it adds empirical evidence regarding the relevancy of board of commissioner's independency as a measure of corporate governance mechanism to monitor managers' activities in avoiding tax. Second, it also adds evidence that independence is unable to moderates the effect of financial distress and financial reporting aggressiveness on tax avoidance activities performed by managers. In brief, this study implies that the independence of BoC, solely as a measure of corporate governance mechanism is less relevant in a current situation especially when the company facing financial distress conditions and managers' aggressiveness in financial reporting. Managers should more pay attention to the discretion of tax avoidance activities particularly when facing financial distress condition. The results also imply that regulatory bodies, for instance, Stock Exchange Supervisory Board under the Indonesian Financial Services Authority should reconsider or reformation the concept of independence of Board Commissioners.

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Introduction

Corporate governance has become crucial attention of business since Sarbanes Ox-ley's Act in 2002 released. Indonesia, as other emerging countries, has regulation regarding corporate governance mechanism with regard to mitigate effect of weak shareholders legal protection. Ariefiara & Utama (2018), Sun et al. (2014), Gani & Jermias (2006) has ex-plored that independency of board commissioner (BOC) contributes on effective monitoring mechanism of managers activities significantly. Meanwhile, other literatures showed that independency of BOC is insufficient to measure monitoring mechanism, therefore to be more effective, corporate governance should be measured using more than one indicator such as competencies, BOC activities, etc. (Ariefiara et al, 2020; Hermawan, 2011). This study investigates the relevancy of BOC's independencies on monitoring of managers activi-ty, particularly in avoiding tax and aggressive in financial reporting when company faces financial distress condition.

Tax revenue realization in State Budget (APBN) has increased from year to year, however, since 2013 from 2018 it below the target. From the table below, tax revenue target is increasing in 5 current years, yet the realization shows fluctuate. This fluctuation implies

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that tax compliance behavior among tax payer is remain questioned. Santoso & Rahayu (2019) stated that tax is a wealth transfer from private into public sector, and tax payer, in nature, presume that tax will decrease their wealth, also according to Eisenhardt (1989) hu-man is bounded rationality and self-interest, therefore tax payer is performing activities that could minimize their tax burden.

Table 1: Indonesian Tax Revenue Target and Realization 2013 – 2018(in Billion Rupiah)

Year	2013	2014	2015	2016	2017	2018
Realization	921,27	981,83	1.060,83	1.105,81	1.151,13	1.315,9
Target	995,21	1.072.37	1.294,26	1.355,20	1.283,56	1.424
Percentage	92,5%	91,5%	81,9%	81,59%	89,68%	92,4%

Source: Directorate General of Taxation Performance Report, CNBC Indonesia

Common phenomenon that still relevant nowadays is tax avoidance practice both by individual or enterprise tax payers, hence, analysis of tax avoidance behavior remain inter-esting to be explore further. Tax avoidance is a way to minimize tax burden by exploiting loopholes in taxation regulations. (Pohan, 2018 p. 11). In other words, tax avoidance is one of managers’ activities concerning to maximize income after tax by reducing income tax (Hanlon & Heitzman, 2010); (Chen, Chen, Cheng, & Shevlin, 2010).

The most recent phenomenon related to Tax Avoidance in Indonesia, particularly in Mining Industry sector is the case of PT Adaro Energy, Tbk through its subsidiary located in Singapore. The investigation reports on allegations of tax avoidance practices performed by Adaro Energy are published by the International NGO Global Witness (NGO in the scope of environmental issues), it indicates that Adaro shift its revenue and profits abroad. The in-come shifting of Adaro causes minimize tax payments to the Government of Indonesia. Ac-cording to this NGO, Adaro applied transfer pricing practice by selling its mining products at a relatively lower price to its subsidiary in Singapore, namely Coal trade Services Interna-tional, which is then resold at higher price. Global Witness has found the possibility of pay-ing less than the supposed tax of USD 125 million to the Republic of Indonesia. (Tirto.id, 2019).

Taylor & Richardson (2013) have examined corporate tax avoidance practices in Australia, the result shows that companies in Australia use several corporate tax avoidance practices to reduce their tax liability. They tend to use tax havens, transfer pricing, and capi-talization concurrently with the aim of maximizing international tax avoidance opportuni-ties.

Investigation about the relationship between Financial Distress and Tax Avoidance Practices has previously been established, for instance research by (Richardson, Taylor, & Lanis, 2015) who examined the impact of financial difficulties (known as GFC/Global Fi-nancial Crisis) on tax avoidance, particularly it effects on the relationship between financial hardship and tax avoidance. The result is financial difficulties have a significant positive re-lationship with tax avoidance, confirm with this, Hanna & Haryanto (2017) have found that financial difficulties faced by companies also positively affect tax avoidance. On contrary, research by (Valencia, 2019) showed the opposite result, that is Financial Distress has no effect on Tax Avoidance. Thus, previous studies on the effect of financial distress condition in tax avoid-ance behavior remains unclear and need to be explore further.

Managers’ activities in financial reporting has impact on tax avoidance, when man-ager aggressively in financial reporting it will cause aggressively in tax reporting as well (Shackelford & Shevlin, 2005; Suharti & Arieftiara, 2019; Frank et al., 2009; Yunistina & Tahar, 2017). These studies showed that there is a trade-off between income reported in the financial statements to the shareholders and to the tax authority. Shareholders demand max-imum income reported by managers on financial statement, on the other side it will cause maximum income for tax computation based as well, which is undesirable by shareholders. However, recent research shows that there is not always a trade off in financial reporting and tax reporting (Hanna and Haryanto (2017). (Frank, Lynch, & Rego, 2009) developed a study that comprehensively explains the relationship between tax aggressive actions and financial reporting aggressiveness. (Frank et al., 2009) found that companies with higher profits re-ported in their financial statements had a relatively small tax burden, which context in Unit-ed States. Frank et al (2009) measured tax avoidance with Book Tax Difference or the differ-ence between profit in financial statements and increasing taxable income. This further strengthens the argument that differences in financial accounting and taxation rules are able to provide opportunities for companies to manage larger book-based revenues and lower tax-able income in the same reporting period. From the explanation above, the relationship be-tween financial reporting aggressiveness and tax avoidance remain unclear, hence needs to be explored further.

As mentioned before, mainly in emerging countries, Corporate Governance is need to ascertain that managers’ activities are concerning align with shareholders’ interest. The mon-itoring mechanism from corporate governance system will mitigates potential risk/disadvantages rise from opportunistic behaviors of managers such as in financial report-ing aggressiveness and tax avoidance (Arieftiara et al., 2020; Suharti & Arieftiara, 2019; Armstrong et al., 2015). The ASEAN Corporate Governance Scorecard ranking obtained by Indonesia this year is getting better. This shows the improvement in Indonesian issuers in the ranks of public companies in ASEAN. The ACGS rating is corporate governance assessment of 100 stock-emittens with the largest market capitalization. Companies will be more com-ply to accounting principles and tax regulations if the corporate governance mechanism is well implemented, such as how the independency of Board of Commissioners. (www.invest.kontan.co.id).

Previous study documented that independent commissioners on the composition of the board of commissioners positively impact on tax avoidance activities (Lanis & Richard-son, 2011). However, this study focuses to investigate Does the BOC's independency as an indicator of corporate governance mechanism still relevance, primarily in monitors manag-ers' activities regarding financial reporting aggressiveness and tax avoidance when compa-nies facing financial distress condition? This study contributes on two ways, first, it adds empirical evidence regarding the relevancy of board of commissioner's independency as a measure of corporate governance mechanism to monitor managers' activities in avoiding tax. Second, it also adds evidence that independency unable to moderates the effect of finan-cial distress and financial reporting aggressiveness on tax avoidance activities performed by managers. In brief, this study implies that independency of BoC, solely as a measure of cor-porate governance mechanism is less relevant in current situation especially when company facing financial distress condition and managers' aggressiveness in financial reporting.

Literature Review

Theoretical and Conceptual Background

Board of commissioners' monitoring mechanism based on agency theory and signal theory

Agency theory, developed by Jensen and Meckling in 1976, explained that firm is consist nexus of contract which potential caused problem, namely Agency Problem between principal and agent. The difference in interests between those parties will cause Agency Cost beared by principals, therefore they should implement the monitoring mechanism toward agent. There are three models in Agency cost, first, monitoring cost, which is the cost that the principal incurs, which aims to observe and control all agent behavior in managing the company. The second is Bonding cost, which is the cost made by the principal to ensure that the actions of the agent are in the interests of the principal. The third is the residual cost, which is a cost that has been incurred but does not have an effect on what is wanted or it can also be called a decrease in the Principal's welfare (Jensen & Meckling, 1976).

The information asymmetry arises because the agent has more information than prin-cipal, and it used by agent to avoid tax in order to fulfill its interests (Scott, 2015). For ex-ample, to gain maximum after-tax compensation, which determined based on the financial performance condition in one period, so that the agent will make every effort mainly with purpose to maintain the company's good financial condition, in order to be compensated higher, hence the agent will avoid tax aggressively.

Signal Theory which developed by Ross (1977) stated that a company through man-agement as an agent has a "signal", which is company try to release significant information to interested parties, such as investors and business people. This signal emerges from the presence of information asymmetry within internal and external parties, the signal is the management's belief that qualitatively, that is completer and more reliable than the pub-lished version of financial reporting

Tax Avoidance

Tax Planning is one method of tax management, performed by managers to obtain optimum tax burden, with two ways, tax evasion and tax avoidance. Tax avoidance is man-agers activities to minimize tax burden and taxable income by exploit loopholes in the tax law, then it also called as legal activities and does not violate the law, meanwhile tax evasion is managers' effort to resistance tax payment illegally, by violating applicable laws and regu-lations, such as manipulating income statements, etc (Hanlon & Heitzman, 2010; Richard-son, 2015; Pohan, 2018; Santoso & Rahayu, 2019; Arieftiara et al., 2020). Even though tax planning is a legal action, managers should not aggressively in avoiding tax, since it will po-tentially cause tax penalties and can be harmful for the good image of the company (Yoonah, 2006).

According to Prebble et al., (2012), tax avoidance is different from tax evasion in the way of its method. Tax avoidance is arrangement of transactions that has tax favored by tak-ing advantage of the opportunities that exist in tax regulations and not against these regula-tions, meanwhile, tax evasion is an act which is performed intentionally in an illegal sense with the same objective to evade tax payment

Financial Distress

In general, bankruptcy is a condition in which a company unable to fulfill its obliga-tions which lead to legal process related to bankruptcy, either recovery or liquidation. Bank-ruptcy initially emerge from the financial condition then followed by the occurrence of legal process toward bankrupt. Disruption occurs in the company's business process in responding to internal and external conditions as a trigger of bankruptcy (Altman, 1968).

This study uses the terminology of financial distress based on previous studies where the definition of financial distress is a sign that can lead a company to bankruptcy (Altman, 1968). The measures of financial distress are also recognized as ratio to predict bankruptcy (Altman, 1968).

Financial Reporting Aggressiveness

Aggressiveness of Financial Reporting is defined as a managers' activity which pur-poses to increase net income by using several ways including earning management (Frank et al., 2009). Earnings management is a method of income and accruals recognition in accord-ance with accounting standards that also needs discretion from management to implement. Thus, managers could aggressively using their discretion regarding earning management by making an aggressive financial reporting.

Managers have various motivation of reporting the financial statement aggressively, such as to gain good impression from shareholders and to maintain higher stock prices. Financial reporting aggressiveness occurs when managers use their discretion in preparing financial reports and manipulate information in financial reports. According to definitions above, it can be concluded that the aggressiveness of financial reporting is related to earnings management activities, whether manipulative or not, in accordance with generally accepted accounting principles or not, in order to avoid various risks that can harm the company such as deteriorating reputation and decreasing prices (Suharti & Ariefiara, 2019).

Independency of Board of Commissioner

The Authority of Financial Services (OJK) has regulated the board of commissioners and board of directors of public companies under regulation number 33 of 2014. The responsibility and role of the board of commissioners is emphasized in the principle of GCG according to the "Organization for Economic Corporation and Development/OECD", namely the responsibility of the board, which means this principle emphasizes the importance of the function of the board of commissioners as an advisor to management in managing the company. The board of commissioners must treat all shareholders fairly and without discrimination. In addition, the board of commissioners also functions to manage conflicts of interest and maintain company transparency and accountability.

The composition of the board of commissioners is generally divided into independent and ordinary members. Independent commissioner is a commissioner who is generally independent, which means that he has no interest or affiliation in a company, such as share ownership or concurrent positions. According to OJK Regulation Number 33 / POJK.04 / 2014, the number of independent commissioners on the board of commissioners of a company or issuer is at least 30% of the total number of commissioners.

Hypothesis Development

Edwards et al. (2012) found that companies experiencing financial difficulties will encounter declined fund resources mainly from external parties, increased capital costs, and lower credit ratings. In this condition managers will take various strategies to keep the business running by maintain firm's liquidity through tax avoidance. Tax avoidance is become an option taken by managers even though it can potentially cause risk to the company. Chen, et al. (2010) and Richardson, et al. (2015) found that the intensity of tax avoidance activities is increasing when companies experience financial distress. The purpose of tax avoidance is to saving tax payment, so that company can allocate its cash to the creditors which can maintain its credit rating and it will eventually generate capital to funding its operations (Brondo-lo, 2009).

H1: Financial distress positively affects on tax avoidance.

Mulyadi & Anwar (2015) examined the effect of corporate governance and financial reporting aggressiveness on tax management with assuming that company managers will implement aggressiveness in financial reporting to minimize corporate tax liabilities. Managers who have more information than outsiders are performing tax avoidance by utilizing loop-holes in the tax regulation, so that it categorized as legal action. Consistent with Mulyadi & Anwar (2015), Suharti & Ariefiara (2019) also found that to counterbalance their activity in financial reporting aggressiveness, managers also increase the intensity of tax avoidance activities. Thereby, managers could ascertain that aggressiveness financial reporting will not increase tax payment.

Empirical evidence from United States showed that large book-tax difference which is the difference between earnings reported in the financial statements and taxable income indicates that companies aggressive in financial reporting and avoiding tax at once (Manzon, Jr. & Plesko, 2005). Consistent with this, Lisowsky (2010) also supports by examining the existence of tax sheltering through information in company financial reports. Meanwhile, Frank et al. (2009) have explained comprehensively that there is relationship between tax avoidance and financial reporting aggressiveness. In Indonesia context, Suharti & Ariefiara (2019) found financial reporting aggressiveness has a positive effect on tax avoidance.

H2 = Financial Reporting Aggressiveness positively affect tax avoidance.

Lanis & Richardson (2011) found the effect of the board of directors on tax avoidance. The study found that independent boards of commissioners decrease tax aggressive action. (Taylor & Richardson, 2013) also documented the existence of corporate governance able to decrease aggressiveness in taxation. Tax avoidance is gray in nature so it is necessary to implement corporate governance to reduce the risk of being sanctioned by the company, that is monitoring from BOC's independence.

Financial distress condition can trigger manager to take strategic action to keep the company survive, minimizing tax payment will save its liquidity (Chou, Li, & Yin, 2010). In Addition, Chou et.al. (2010) found that when company facing financial distress condition, monitoring from BOC will ensure manager to take the right action in order to prevent it from bankrupt, and will ensure that managers' tax avoidance activity does not induce more risk to company. Independency of BOC will strengthen the quality of corporate governance mechanism, this will also make the intensity of tax avoidance activity lower especially when company facing financial distress condition. The board of commissioners as independent parties will ensure that the company is able to fulfill its financial obligations. Thus, in a financial difficult condition, the board of commissioners will give more attention to the company's going concern aspect by monitor the managers to lower their intensity in avoiding, so it could not harm the company

Independent member of board of commissioners tends to minimize the level of corporate tax avoidance practices because tax avoidance practices induce large marginal costs (Armstrong, Blouin, Jagolinzer, & Larcker, 2015). Several previous studies have

investigated board of commissioners as moderating variable and give evidence of the board of commissioners' existence as part of the company's governance mechanism (Wisnuwardhana & Di-yanty, 2015; Savitri, 2019).

H3 = The independence of the Board of Commissioners moderates the effect of financial distress toward tax avoidance

The existence of independence member can lower the possibility of opportunistic behavior of managers, that is action or decision according to managers' interest, such as aggressiveness in financial reporting. The board of commissioners monitors and control the firms' management process. Companies that have optimal level of independence BOC's member are expected to be able to decrease agency problems, such as aggressiveness in financial reporting and tax avoidance (Taylor & Richardson, 2013).

H4 = Independence of the Board of Commissioners moderates the effect of Financial Reporting Aggressiveness toward Tax Avoidance

Research and Methodology

This study focuses on consumer goods and mining industry sector companies listed on Indonesian Stock Exchange (IDX) during 2016 to 2018. This study aims to determine the relevancy of independent BOC in corporate monitoring; besides that, this study aims to investigate effect of financial distress and financial reporting aggressiveness on tax avoidance with the independence of the board of commissioners as a moderation variable. We used purposive sampling technique and total final sample is 147 firm years.

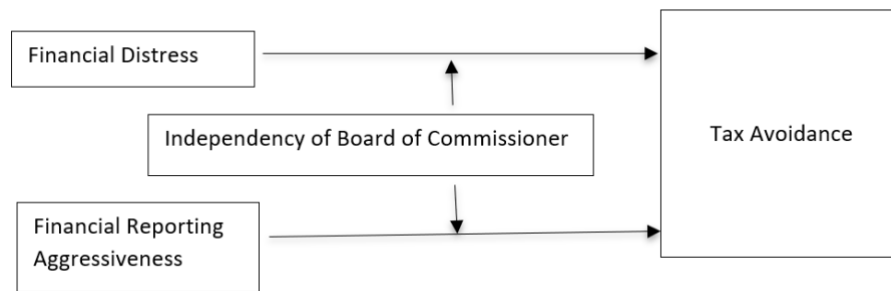


Figure 1: Conceptual Framework

Empirical Model

Based on literature reviews and problem identification above, the empirical model to test four hypothesis is as follows:

$$BTD_{it} = \alpha_{it} + \beta_1 FD_{it} + \beta_2 FRA_{it} + \beta_3 FD_{it} * BOC_{it} + \beta_4 FRA_{it} * BOC_{it} + e_{it}$$

Data analysis technique using multiple linear regression and expected results from this study were β_1 and β_2 are expected to be positive, β_3 is expected to be negative and β_4 is expected to be not equal to 0 ($\beta_1 \neq 0$), all is expected to be significant.

Richardson et al. (2015) defines tax avoidance as manager's action to reduce taxable profit through tax planning. Based on Guenther (2018), tax avoidance is measured using Book-Tax Differences (BTD). The gaps or differences between reported Income per Book and Tax or Book-Tax Differences BTD which looks at the difference from income according to accounting (book income) and taxable income according to taxation provisions (Guenther, 2018) Income according to accounting (book income) is defined as accounting profit before tax or Earnings Before Tax (EBT). Because data on taxable income, it is difficult to obtain income according to tax in this study using current tax expense divided by 25% (tax rate in Indonesia).

Following Ariefiara et al., (2020); Nuritomo (2019); Widyari & Rasmini (2019), BTD formula is as follow:

$$BTD = \frac{Net\ income}{Total\ Assets} - \frac{\frac{Current\ tax\ expense}{tax\ rate}}{Total\ Assets}$$

BTD value indicates to the extend tax avoidance of company, the higher value of BTD means that the higher tax avoidance of company. Ariefiara et al. (2020) stated that BTD brings more objective and relevant measure of manager's activity in tax avoidance rather than Effective Tax Rate (ETR).

Financial Distress is a financial difficulties condition faced by the company as a result of economics distress and poor management action (Whitaker, 1999). Firstly, company who facing financial distress, experience declining in financial performance compares to previous period of time, and this condition may be triggered by bad economic condition or economic distress. Secondly, company will have experience of declining in operating income as a result of poor management action. This research used Springate Model to measure firms' financial distress level, as follows:

$$FD = 3,07 \frac{EBIT}{Total\ Assets} + 1,03 \frac{Net\ Working\ Capital}{Total\ Assets} + 0,4 \frac{Sales}{Total\ Assets} + 0,66 \frac{EBT}{Total\ Current\ Liabilities}$$

Based on Prihantini & Sari (2013), cut-off point of Springate Model is $FD > 0,862$ which means company who has score above 0,862 is categorized as lower potential occurs bankruptcy. Meanwhile, a company who has Springate Model score $< 0,862$ will be categorized as higher potential occurs bankruptcy company.

Financial Reporting Aggressivity (FRA) is one of earnings management activity to increase income reported on the financial statement with accommodate accounting policies (Frank et al., 2009). Modified Jones Model used to measure the Financial Reporting Aggressivity, based on (Suharti & Ariefiara, 2019), financial reporting aggressiveness is captured by the discretionary accrual, which is the error term from Equation (4).

$$\frac{TACC_{it}}{A_{it-1}} = \beta_1 \left(\frac{1}{A_{it-1}} \right) + \beta_2 \left(\frac{\Delta Rev_{it}}{A_{it-1}} - \frac{\Delta AR_{it}}{A_{it-1}} \right) + \beta_3 \left(\frac{PPE_{it}}{A_{it-1}} \right) + e_{it}$$

Independent Board of Commissioner (BoC) is used as moderating variable, which proxied by board’s effectiveness scoring based on Hermawan (2009). The effectiveness scoring comprises of 5 indicators, such as: (1) numbers of independent members in BoC; (2) status independency of BoC Chairman; (3) definition of independency stated on the annual report; (4) BoC ownership on affiliation entities; and (5) existence of remuneration committee. Every item of these indicators would be maximum 3 and minimum 1, company will have score 3 (good) if the information is clearly stated in the annual report and tend to beyond the basic requirement of effective board monitoring activity; score 2 (fair) if the information is not too clear; and score 1 (poor) if the information regarding effectiveness indicator can’t be found in the annual report.

Result and Discussion

Data used in this research is consumer goods industry and mining during 2016 to 2018. The aim of this study was to determine the Effect of Financial Distress and Aggres-siveness of Financial Reporting on Tax Avoidance with the Independence of the Board of Commissioners as a Moderation variable, where in this study the purposive technique was used. The final data is 147 firm years of observation. Data met the requirement for normality test and classic assumption test

From Table 2 the description of observation shown that in general, mean value of book-tax difference was -0.0117 indicated that book income reported by the company is lower than taxable income for about 1.17 % relative to total assets. This means that in general, companies tend to defer income recognition but according to tax-based companies should report income higher than accounting-based. This could be an indication that manag-er did some effort to make income decreasing reporting in order to lower income base for tax computation. Meanwhile for financial distress condition, observation shown that in general companies have 1.4709 mean score for Financial Distress (FD), it means that overall compa-nies are experiencing lower probability to bankruptcy. Table 2 also shown that mean score of financial reporting aggressiveness was -0.0387, which means that in general, companies in-curred lower earnings or income decreasing earnings management. This is according to Kaszink (1999) stated that firms with lower earnings are likely to exhibit negative discre-tionary accruals. In general, companies had effective monitoring from independent board of commissioners since the value of BoC variable is 0.7845 which this value is near to 1, and data shown that the minimum score for Board’s monitoring effectiveness is above 0.5 or above moderate level:

Table 2: Descriptive Statistics

Variables	Observation	Max	Min	Mean	Std. Deviation
BTD	147	0.04	-0.08	-0.0117	0.0236
FD	147	4.54	0.02	1.4709	0.9628
FRA	147	1.55	-1.52	-0.0387	0.5327
BoC	147	1.00	0.60	0.7845	0.0799

Where:

BTD = Book-Tax Differences, indicator for Tax avoidance activities

FD = Financial Distress

FRA = Financial Reporting Aggressiveness

BoC = The effectiveness of Board of Commissioners monitoring

The result of hypotheses testing is showed in Table 3. Hypothesis 1 was supported by the data, it means that financial distress positive significantly affects tax avoidance. Hypothesis 2 was supported by the data which means that financial reporting aggressiveness positive significantly affects tax avoidance. From Table 3, the result shown that the effectiveness of BoC’s monitoring did not have moderating effect on financial distress and financial reporting aggressiveness on tax avoidance.

Table 3: Summary of Hypotheses Testing Result

$$BTD_{it} = \alpha_{it} + \beta_1 FD_{it} + \beta_2 FRA_{it} + \beta_3 FD_{it} * BoC_{it} + \beta_4 FRA_{it} * BoC_{it} + e_{it} \quad (1)$$

Variables	Predicted Sign	Coef	t	p-value
Constanta		-0.012	-6.331	0,000***
FD	H1: +	0.005	2.331	0,021**
FRA	H2: +	0.012	3.059	0,003***
FD*BoC	H3: -	0.000	-0.016	0,987
FRA*BoC	H4: +/-	0.002	-0.040	0,968
Fstat	4.317			
Prob f-stat	0.001			
RSquare	0.133			
N	147			

Where:
BTD = Book-Tax Differences, indicator for Tax avoidance activities
FD = Financial Distress
FRA = Financial Reporting Aggressiveness
BoC = The effectiveness of Board of Commissioners monitoring
 ***, **, * significant at 1%, 5% and 10%

The Effect of Financial Distress on Tax Avoidance Activities

The result of this research supported the hypotheses that financial distress and financial reporting aggressiveness were positive significantly affect tax avoidance activity. The first hypothesis of this study was that financial distress had a positive effect on tax avoidance, this supports the results of Richardson et al. (2015). This happens because, the greater the financial distress experienced by the company, the more the company will do tax avoidance, the additional marginal benefits derived from tax avoidance are greater than the costs incurred due to tax avoidance. In addition, when companies face higher financial distress, access to sources of funds from outside the company is increasingly limited, so they will face reduced sources of funding from external parties, increased costs of capital, low credit ratings, and more risks taken by managers can change management views about tax avoidance. Under these conditions, the company will act to avoiding tax (Brondolo, 2009) in order to save tax costs.

Companies that are stuck in Financial Distress, trying to keep their companies survive, inevitably take more risks, and are more aggressive in tax avoidance as the need for cash is increasingly critical, and must make tax savings, especially if the company's tax burden is the main thing in cash outflows. They will rule out the possibility of a negative reputation gained from aggressively tax evasion.

According to (Edwards et al., 2012) Companies experiencing financial difficulties tend to avoid tax in order to increase marginal benefits and cover marginal costs. The marginal benefits include reducing tax obligations, increasing cash flow, maintaining a good credit rating, and making assumptions about the company's sustainability. Meanwhile, the marginal costs referred to here such as burdens and litigation, penalties, and reputational losses that will be received.

The Effect of Financial Reporting Aggressiveness on Tax Avoidance Activities

This study proves that there is often a trade-off between aggressiveness of financial reporting and tax avoidance. Managers always face the shareholders interest that the company is able to report relatively larger profits in the financial statements, and at the same time the company also has a lower tax burden to pay. This is supported by the fact that companies in the United States show that there is a Book Tax Difference or the difference between profit in financial statements and taxable income that is getting bigger (Manzon, Jr. & Plesko, 2005).

This positive relationship is in line with previous predictions that there is a tendency for managers to be able to report higher profits and at the same time have a lower tax burden than they should. This is in line with research by (Frank et al, 2009) in the United States, then re-examined by (Ledewara, et. al, 2020) on manufacturing companies in Indonesia, which shown a positive relationship between aggressiveness of financial reporting and tax avoidance by companies.

The Moderation Effect of the Board of Commissioners Monitoring on the relationship between Financial Distress and Financial Reporting Aggressiveness on Tax Avoidance

In this study, the role of corporate governance is not only assessed in terms of its independence, but is measured from the effectiveness of the independent board of commissioners, which is not only assessed from independence but also from board's competencies, activities and others in a whole.

The presence of board of commissioners monitoring did not have effect on the relationship between bankruptcy risk and aggressiveness of financial reporting toward corporate tax avoidance, so hypotheses 3 and 4 were not supported. The results of this study are in line with several studies conducted in Indonesia. According to Ridha & Martani, (2014) in his research said that in Indonesia the implementation of corporate governance was not optimal, this resulted in no matter how big the GCG score was, it did not guarantee that corporate governance was going well.

Astuti & Yuniarto, (2019) said that the independence of the board of commissioners did not have significant relationship with financial problems in the company, in line with (Pradipta & Supriyadi, 2015), that independent commissioners have no effect on tax avoidance. The Independent Commissioners in the company have not been able to carry out their supervisory functions optimally in accordance with the laws and regulations and the lack of control over employees, making it easy to take tax avoidance actions.

Conclusions

From the results we can imply that (i) managers should pay attention more to the financial health condition of the company, since it will cause inclination of tax avoidance activities, which is it can eventually affect corporate's reputation toward shareholders, creditors or other external stakeholders; (ii) regulator, especially the Financial Services Authority should reconsider or reformulation the concept of independence of Board Commissioners, in terms of the real function or contribution in order to monitor managers activities on tax avoidance particularly when managers aggressively in financial reporting and company facing financial distress condition as well.

This research concludes the following points:

- i. *Financial distress has positive and significant effect on tax avoidance.*
- ii. *Financial reporting aggressiveness has positive and significant effect on tax avoidance.*
- iii. *The result failed to documented that the independence of the board of commissioners have moderation effect on the relationship between financial distress and tax avoidance*
- iv. *The result failed to documented that the independence of the board of commissioners have moderation effect on the relationship between financial distress and tax avoidance, nor to the relationship between Financial Reporting Aggressiveness and tax avoidance*

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