The Effect of Public Share Ownership on Tax Evasion: Study on Companies Listed in Indonesia Stock Exchange Between 2008-2011

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Abstract

Increasing the concentration of ownership and control of public companies in Indonesia is more likely to increase the likelihood of earnings management practices through tax avoidance. The high percentage of concentrated ownership has encouraged the government and capital market regulators to more broadly promote regulations related to tax incentives and public ownership in order to encourage more transparent practices. This study aims to analyze the policy of public ownership of tax avoidance conducted by Indonesian public companies, specifically after the regulation of Government Regulation No. 81 of 2007 concerning Reduction of Income Tax Rates for Domestic Corporate Taxpayers in the Form of Public Companies, and Minister of Financial Regulation No. 238 / PMK.03 / 2008 concerning Procedures for Implementing and Supervision of Granting Tariff Reductions for Domestic Corporate Taxpayers in the Form of Public Companies. More specifically, this study aims to analyze the impact of public share ownership on tax avoidance by Indonesian public companies. The samples of 320 observations that conducted (firm-years) during 2008-2011. The software that will be used in data analysis is STATA 12. The results showed that the increase in public ownership have a significant effect in improve the practice of corporate tax avoidance, which it is also evidenced by the significant differences in the corporate tax avoidance practices before than after the enactment of these regulations. The findings show that the greater the proportion of public share ownership would result the decreasing number of ETR or ETRC which can be indicated that the greater the practice of corporate tax avoidance. Furthermore, the ROA variable has a negative and significant effect on corporate tax avoidance practices, meaning that the greater the profitability ratio of a company can cause the reported and paid tax burden to decrease.

Keywords: public stock ownership, tax evasion, majority shareholders, regulatory taxation and tax incentives

1. Introduction

The separation of ownership and control in complex organizations can result in greater agency problems along with the separation of management decision-making and the scope of risk to the public. With greater public ownership it is more likely to influence management strategies to earn profits, including one of them in carrying out corporate tax avoidance practices (Fama and Jensen, 1983). Several empirical studies show that companies listed in the Indonesian capital market have ownership structures that tend to be concentrated in one or several shareholders (Claessens et al., 2000; Siregar & Utama, 2008); Sari & Martani, 2010; Wiranata & Nugrahanti, 2013). At least 70% of issuers in Indonesia are companies under family control. The concentration of family ownership was later found to be related to earnings management behavior in the company. Siregar and Utama (2007) found that companies with high family ownership and not in a particular business group network performs efficient earnings management and does not appear to be detrimental to minority shareholders.

The practice of tax avoidance as a proxy of earnings management has received extensive attention from various previous studies. Al-Naimat (2013) discussed theoretically through an analytical legal approach the application of income tax and sales tax and its relationship to tax revenue and avoidance in Jordan. In its mapping related to research in the field of taxation, Hanlon and Heitzman (2010) state that the factors that cause individual taxpayer compliance and corporate taxpayer tax avoidance are not much different. Compliance with individual taxpayers is caused more by factors such as tax rates, detected probabilities, audits and getting sanctions and intrinsic motivation

in carrying out obligations as citizens, which according to them some of these factors can influence the practice of corporate tax avoidance. This is one of which proven by Atwood et al. (2012) who found that countries that have high law enforcement can reduce the practice of corporate tax avoidance in the country. However, as stressed by Hanlon and Heitzman (2010) that the emergence of problems over corporate tax avoidance is more dominant due to the separation between ownership and control (Slemrod, 2004), and the emergence of agency problems in the form of differences in interests between agents and principals and the occurrence of information asymmetry (Jensen & Meckling, 1976). Therefore, Hanlon and Heitzman (2010) emphasize the need for further research to analyze the implications of the separation of ownership and control (ownership structure) or the impact of agency problems on tax avoidance practices as a developmental step on the results of previous research.

This research is more specifically aimed at empirically evaluating the effectiveness of the implementation of Government Regulation (PP) No. 81 of 2007 concerning Decreasing Income Tax Rates for Domestic Entity Taxpayers in the Form of Public Companies, and Minister of Finance Regulation No. 238/PMK.03/2008 concerning Procedures for Implementation and Supervision of Granting of Decreases in Rates for Domestic Entity Taxpayers in the Form of Public Companies, which implies a decrease (incentive) of 5% Income Tax rates to Issuers that meet certain conditions, including having a proportion of share ownership public, at least 40% of all paid-up shares of the company, owned by at least 300 (three hundred) Parties, each of which has shares of less than 5% (five percent) of the total paid shares and the maximum share ownership composition short of 6 (six) months within a period of 1 (one) tax year. The objective of this policy is in addition to reducing ownership concentration, as well as a form of protection for investors. In 2011 a study was conducted by the Bapepam-LK, Ministry of Finance study team to assess the extent to which the two rules were effective in increasing the number of issuers and public share ownership, the results of which found that the regulation was not effective enough in encouraging issuers and public ownership in the Indonesian capital market, which is one of the causes due to the dependence of the decisions of the controlling shareholders. Because no party has tested the findings empirically, research is needed to prove the effectiveness of the application of these two regulations empirically. However, considering the regulation referred to as related to tax incentives, this study will evaluate the effectiveness of the regulation in relation to the practice of corporate tax avoidance. Based on agency theory and characteristics of capital markets in Indonesia, if this policy is based on the target of issuance, this policy might lead to trade -off between the purpose of reducing ownership concentration and efforts to reduce corporate tax avoidance practices.

Therefore, to provide an empirical explanation of this phenomenon, the research problem in this study is to analyze the effect of public share ownership on corporate tax avoidance practices in Indonesia. The analysis was conducted by examining the influence of public ownership on tax avoidance of companies that go public in Indonesia based on the theory of Fama and Jensen (1983) separation of ownership and control and empirical evidence found by Badertscher et al. (2013) who found that the greater the separation of ownership and control can lead to increased practice of corporate tax avoidance.

2. Literature Review and Hypothesis Development

Until now, so many studies have analyzed the influence of ownership structures on tax avoidance practices or aggressive tax actions in a particular country or across countries with mixed results, including Egger et al. (2010) in Europe, Chen et al. (2010), Badertscher et al. (2013) in the United States, Chan et al. (2013) in China, Steijvers and Niskanen (2014) in Finland, Annuar et al. (2014) in Malaysia, as well as Sari and Martani (2010) in Indonesia. Mahfud (2015) also discussed tha regulatory aspects and administration of tax institutions in Indonesia. Badertscher et al. (2013) found that companies that were concentrated in ownership and control were less aggressive in carrying out tax avoidance practices compared to companies with separate ownership and control. The results of this study are in line with Chen et al. (2010) and Steijvers & Niskanen (2014) who found that family companies have less aggressive tax actions compared to non-family companies. However, in contrast to the results of the study Annuar et al. (2014) and Sari & Martani (2010), both of them found that there was a positive influence between family ownership and tax aggressiveness and tax avoidance. The inconsistency of the results of the study was also found for the influence of government ownership on tax avoidance practices, Chen et al. (2013) found a negative influence, while Annuar et al. (2014) found a positive effect. While related to the influence of foreign ownership, both Egger et al. (2010) and Annuar et al. (2014), both of them found that there was a positive influence of foreign ownership of tax avoidance.

The problem of corporate ownership, especially related to ownership concentration is an urgent problem, because as Graham et al. (2009) in the Bapepam-LK (2011) study report that the concentration of corporate ownership in the capital market can cause a low proportion of company shares released to the market, which in turn can have an

impact on the market's lack of liquidity. On the other hand, Fama and Jensen (1983) argue that the separation of ownership and control in complex organizations can lead to greater agency problems along with the separation of management decision making and risk coverage to the public, in large companies (for example publicly listed companies) residual claims for ordinary shares do not have certain limitations, because shareholders are not obliged to have other roles in the organization. Therefore, the risk is not limited among shareholders, which can then lead to greater management opportunism. This can also be reflected in the practice of corporate tax avoidance, which Badertscher et al. (2013) found that companies that are concentrated in ownership and control are less aggressive in carrying out tax avoidance practices compared to companies with separate ownership and control.

Related to the existence of regulations that use a tax incentive scheme through increasing public share ownership, if based on the opinion of Badertscher et al. (2013), the regulation can be used by companies to practice tax avoidance rather than expecting tax incentives. Therefore, in this study it is assumed that the greater public share ownership in a public company will affect the greater tax avoidance practices carried out by companies in the Indonesian capital market. Based on that, this study hypothesizes that (Ha) the greater the public share ownership in a public company, the greater the practice of tax avoidance by the company.

3. Method

3.1 Sampling

This study uses a sample of companies listed in the ICMD (Indonesian Capital Market Directory) directory during the period 2008-2011, excluding companies included in the industries of agriculture, mining, infrastructure, and finance. Companies in the industry are excluded in the sample because they are subject to special tax regulations so that they cannot be compared with companies in other industries subject to general tax regulations. The year of observation in 2008-2011 was chosen with the assumption that PP No. 81 of 2007 and PMK No. 238/PMK.03/2008 were effective in 2009, so that samples were obtained before and after, and observations were made in the initial period of the regulation.

Sample selection is done using the purposive judgment sampling method, with the criteria as: (1) having complete data to measure all variables studied, (2) not including delisting in the observation period, (3). having a positive profit value, so as not to result in a distorted effective tax rate (Richardson and Lanis 2011), (4) companies with an effective tax rate of less than one, to avoid problems in the estimation model (Gupta and Newberry 1997).The total initial samples observed in this study were 301 companies with a period of observation for 4 years or as many as 1204 observations (company-years). However, based on predetermined data criteria, 221 samples or 884 observations were excluded from the sample, so the final sample used in this study was only 320 observations (company-years).

3.2 Model and Variable Measurement

To answer research problems and simultaneously test hypotheses the empirical model is as follows:

$$TA_{it} = \beta_0 + \beta_1 PO_{it} + \beta_2 ROA_{it} + \beta_3 PPE_{it} + \beta_4 SIZE_{it} + B_5 MB_{it} + \varepsilon_{it1} \quad (1)$$

Where, TA (Tax Avoidance), is a practice of corporate tax avoidance, measured by effective tax rate (ETR), namely total tax burden divided by pre-tax profit, and cash effective tax rate (CETR), which is paid tax divided by profit before tax as also used by Gupta & Newberry, (1997), Chen, et al (2010), Sari & Martani (2010) and Huseynov & Klamm (2012). PO (Public Ownership), is public share ownership which is defined as share ownership by the general public or outsiders whose percentage does not exceed 5% of the total paid up shares in a company going public (PP No. 81 of 2007 and PMK Number 238/PMK. 03/2008). Public share ownership is measured by the percentage accumulated number of public shares compared to the total paid up shares.

For control variables, ROA (Return on assets), measured by dividing net income by total assets; PPE (Property, Plant, and Equipment), measured by dividing the value of PPE by the total value of assets; SIZE is the market value of a company's equity, measured by the natural value of the logarithm of the market value of equity; MB (Market-to-book ratio), measured by dividing the market value of equity with book value of equity. The inclusion of ROA control variables, Leverage, PPE, market value of equity and Market-to-book ratio on the model because these variables were found to have a significant effect on both ETR and CETR in the Gupta & Newberry (1997) research model (Chen et al, 2010, Sari & Martani, 2010 & Huseynov & Klamm, 2012).

The empirical model is used to test the research hypothesis using regression testing. Meanwhile, to answer other research problems, an additional analysis will be conducted to analyze the extent of differences in public share ownership and tax avoidance practices in publicly listed companies in Indonesia both in terms of majority share

ownership (controlling shareholders) and before and after PP issuance. No. 81 of 2007 and PMK No. 238/PMK.03/2008 by testing the independent sample t-test to see the different categories of controlling shareholding and paired sample t-test to see the impact of these regulations on public share ownership and corporate tax avoidance practices . In this study, the controlling shareholder category is measured by a dummy variable, namely "1" if the majority shareholder is a domestic party and "0" if the majority shareholder is a foreign party. The software that will be used in data analysis is STATA 12.

4. Results

4.1 Descriptive Statistics

In this descriptive statistic, it will give an overview of the sample used in the study by providing a description of the mean value, minimum value, maximum value, standard deviation and variance of each variable studied. Based on the research sample which amounted to 320 observations, we obtained a description of the variables as can be seen in Table 1.

Table 1. Descriptive statistics

Variable	Obs	Mean	Min	Max	Std. Dev	Variance
ETR	320	0.286	0.00	0.86	0.102	0.010
CETR	320	0.278	-0.36	0.98	0.157	0.024
PO	320	0.250	0.01	0.79	0.162	0.026
ROA	320	0.101	0.00	0.78	0.095	0.009
PPE	320	0.299	0.01	0.76	0.161	0.026
SIZE	320	20.633	16.92	26.43	2.097	4.401
MTB	320	30.290	28.00	1880	161.208	25988.19

Based on table 1, it can be concluded that the average proportion of public ownership in the Capital Market since 2008-2011 is 25%. This shows that share ownership in the Indonesian Capital Market during the observation period is still dominated by Controlling/Majority Shareholders or whose share ownership is above 5%, which is equal to 75%. These results at least support the research of Claessens et al. (2000) who found that issuers in the Indonesian capital market had a ownership structure that tended to be concentrated in one or a few shareholders, which in the observation period until 2008, at least 70% of Issuers in Indonesia were companies that were under family control. If this is related to the regulation on Decreasing Income Tax Rates for Domestic Entity Taxpayers in the Form of Public Companies, especially in the Capital Market, based on these results it can be concluded that after the 3 years of the regulation, the average public shareholding of companies in the capital market Indonesia has not reached the target, which is 40%. While related to the measurement of corporate tax avoidance practices used in this study, both ETR and cash ETR have a mean that is not much different, which is only different from 0.012%, so it can be said that these two measurements are feasible to use.

Table 2. Correlation analysis

Variable	ETR	CETR	PO	ROA	PPE	SIZE	MTB
ETR	1.000						
CETR	0.606 (0.000***)	1.000					
PO	-0.093 (0.096*)	-0.103 (0.065*)	1.000				
ROA	-0.340 (0.000***)	-0.209 (0.000***)	-0.057 (0.302)	1.000			

PPE	-0.072	-0.051	-0.001	0.021	1.000		
	(0.194)	(0.359)	(0.980)	(0.707)			
SIZE	-0.286	-0.188	0.061	0.504	0.175	1.000	
	(0.000***)	(0.001***)	(0.274)	(0.000***)	(0.001***)		
MTB	-0.051	-0.025	-0.066	0.423	0.098	0.348	1.000
	(0.356)	(0.645)	(0.235)	(0.000***)	(0.078*)	(0.000***)	

Note: ETR, *Effective Tax Rate;* CETR, *Cash Effective Tax Rate*; PO, *Public Ownership*; ROA, *Return On Assets*; PPE, *Property, Plant, & Equipment*; SIZE, *Natural Logarithmic Value of Market Value of Equity*; MB, *Market-to-Book Ratio.*

* **, **, * = *P-value* significant 1%, 5%, 10%.

Table 2 shows the correlation between the variables to be tested in the research model. Based on the test results it can be concluded that the public share ownership variable has a significant correlation with the corporate tax avoidance practice variable (ETR and Cash ETR) at the level of 10% significance level. Likewise with the other two control variables, namely SIZE and ROA also have a significant and consistent relationship with ETR and Cash ETR at the level of 1% significance level. While the other dick variables in the form of PPE and MTB, both do not have a significant relationship to either ETR or ETR Cash.

4.2 Hypothesis Testing

In conducting data analysis and hypothesis testing, STATA-12 software is used. The results of testing the research regression model can be seen in Table 3.

Table 3. Research model testing results

Variable	ETR			ETR Cash		
	Coef.	t	P > | t |	Coef.	t	P > | t |
Cons.	0.5029	8.52	0.000***	0.5111	5.38	0.000***
OP	-0.0588	-1.79	0.075*	-0.0985	-1.86	0.064*
ROA	-0.3510	-5.12	0.000***	-0.3301	-2.99	0.003***
PPE	-0.0332	-0.99	0.324	-0.0366	-0.68	0.499
SIZE	-0.0076	-2.52	0.012**	-0.0080	-1.64	0.102
MTB	0.0001	2.39	0.017**	0.0001	1.52	0.130
Number of observations		320			320	
F-Statistic		12.03			4.86	
Prob > F		0.000***			0.0003***	
R-squared		0.160			0.0719	
Adjusted R-squared		0.147			0.0571	
Root MSE		0.09503			0.15307	

Note: ***, **, * = *p-value* significant 1%, 5%, 10%.

The practice of corporate tax avoidance, measured by effective tax rate (ETR), is the total tax burden divided by pre-tax profit, and the cash effective tax rate (CETR), which is paid tax divided by pre-tax profit. PO (Public Ownership), is a public share ownership that is defined as share ownership by the general public or an unaffiliated outsider (having a special relationship) with a percentage that does not exceed 5% of the total paid up shares in a company going public (based on PP No. 81 of 2007 and PMK Number 238/PMK.03/2008). Public share ownership is measured by the percentage accumulated number of public shares compared to the total paid up shares. ROA (Return on assets), measured by dividing net income by total assets; PPE (Property, Plant, and Equipment), measured

by dividing the value of PPE by the total value of assets; SIZE is the market value of a company's equity, measured by the natural value of the logarithm of the market value of equity; MB (Market-to-book ratio), measured by dividing the market value of equity with book value of equity.

Table 3 provides information related to the results of testing the research model and at the same time shows the results of hypothesis testing of this study which states that the greater public share ownership in a public company has an impact on the increasing practice of tax avoidance by the company. In general, it can be stated that with a F-statistic that is significant at level 1%, it can be concluded that the two research models proposed in this study, both using ETR and Cash ETR are reliable for use in predicting/forecasting the practice of corporate tax avoidance. However, there is a difference in the Adjusted R-squared value between the two models, namely 0.147 on the ETR model and 0.0571 on the ETR Cash model. This can be interpreted that the variation of the independent variable of the study, in the form of the proportion of public share ownership, ROA, company size and market to book ratio greater explains the practice of corporate tax avoidance if the measurement uses ETR versus ETR Cash, according to the results of previous studies (Huseynov & Klamm, 2012; Chen et al. 2010; Sari and Martani, 2010).

Related to hypothesis testing, the two research models also showed the same results, namely with the negative coefficient (-0.0588 in the ETR model and -0.0985 in the ETR Cash model) it could be interpreted that the greater the proportion of public share ownership would result the number of ETR or ETRC is decreasing, in other words the company will report the tax burden or pay lower taxes, which can be indicated that the greater the practice of corporate tax avoidance. The effect was found to be significant at level 10% or p-value <0.10, which is 0.075 in the ETR model and 0.064 in the ETR Cash model, which also corresponds to the results shown in the correlation between the two variables shown in Table 2. This is enough to prove that the research hypothesis can be accepted, and in accordance with the theories of Fama and Jensen (1983), and support the results of research by Badertscher et al. (2013).

In addition, in Table 3 it also shows that the ROA variable has a negative and significant effect on corporate tax avoidance practices, both the ETR model and the ETR Cash model, which can be interpreted that the greater the profitability ratio of a company can cause the reported and paid tax burden to decrease. This is in accordance with the results of Huseynov & Klamm (2012), but slightly different from the findings of Gupta & Newberry (1997), Chen et al. (2010) and Sari and Martani (2010). The size of the company variable (Size) was found to only have a negative and significant effect on the ETR model, this means that an increase in company size (market value of equity) only affects the smaller tax reported by the company. This is consistent with the results of the study of Sari and Martani (2010), but different from the findings of Chen et al. (2010). Meanwhile, the market to book ratio (MTB) variable was also found to only have a positive and significant effect on the ETR model, in contrast to the results of the research by Chen et al. (2010) and Sari and Martani (2010).

In general, the results of this study indicate that public share ownership factors need to be considered in assessing corporate tax avoidance practices, because with the release of company shares to the public then automatically there has been a separation of ownership by controlling and distributing risks from controlling shareholders (majority) to the public, which can lead to increasing agency problems (Jensen & Meckling, 1976; Fama & Jensen, 1983). The agency problem is more caused by the magnitude of opportunistic management, which is illustrated by management's efforts to increase its utility through earnings management, income smoothing or financial report aggressiveness, which is one of them carried out through tax planning strategies or corporate tax avoidance practices (Frank et al. 2009; Tang & Firth, 2011; Wibowo et al., 2019). On the basis of this, the results of this study specifically provide additional evidence that the separation of ownership and control which is marked by the increasing release of shares to the public can have an impact on the increasing practice of tax avoidance by companies, and vice versa.

5. Conclusion

The results showed that the increase in public share ownership had a significant effect in improving the practice of corporate tax avoidance with the negative coefficient in the ETR model and in the ETR Cash model. This means that the greater the proportion of public share ownership would result the number of ETR or ETRC is decreasing. The company will report the tax burden or pay lower taxes, which can be indicated that the greater the practice of corporate tax avoidance. Furthermore, ROA variable has a negative and significant effect on corporate tax avoidance practices, both the ETR model and the ETR Cash model, which can be interpreted that the greater the profitability ratio of a company can cause the reported and paid tax burden to decrease. The size of the company variable (Size) was found to only have a negative and significant effect on the ETR model, this means that an increase in company

size (market value of equity) only affects the smaller tax reported by the company. Lastly, the market to book ratio (MTB) variable was also found to only have a positive and significant effect on the ETR model.

Some of the limitations found in this study are that in the period of observation this study was very limited, ie only until 2011, so the possibility of different results was obtained if the observation period was extended. This research model has not included some control variables that are commonly used in previous studies, so it is expected that different results can be obtained by adding other control variables such as leverage, and others. To overcome the limitations of the study and as a follow-up to the conclusions of this study, it is suggested, related to public share ownership, for further research to follow up this study by identifying what factors influence public share ownership in companies going public and their impact on company value or market reaction both at Indonesia and internationally. Regarding the measurement of tax avoidance, further research can use measurements of tax avoidance other than those used in this study, which can refer to the measurement of tax avoidance described by Hanlon and Heitzman (2010) and/or used in previous research on tax avoidance.

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Apendix

1. Descriptive Statistics Results

```
. summarize etr etrc op roa ppe size mtb
```

Variable	Obs	Mean	Std. Dev.	Min	Max
etr	320	.28675	.1029109	0	.86
etrc	320	.2785	.1576421	-.36	.98
op	320	.2508437	.1628264	.01	.79
roa	320	.1011562	.0951599	0	.78
ppe	320	.2999687	.1615588	.01	.76
size	320	20.63331	2.097975	16.92	26.43
mtb	320	30.29069	161.2085	.04	1880

```
. pwcorr etr etrc op roa ppe size mtb
```

	etr	etrc	op	roa	ppe	size	mtb
etr	1.0000						
etrc	0.6065	1.0000					
op	-0.0932	-0.1030	1.0000				
roa	-0.3405	-0.2090	-0.0578	1.0000			
ppe	-0.0727	-0.0514	-0.0014	0.0211	1.0000		
size	-0.2868	-0.1883	0.0612	0.5046	0.1758	1.0000	
mtb	-0.0517	-0.0258	-0.0665	0.4230	0.0986	0.3488	1.0000

2. Regression Test Results

```
. regress etr op roa ppe size mtb, beta
```

Source	SS	df	MS		
Model	.543020102	5	.10860402	Number of obs	320
Residual	2.83539995	314	.009029936	F(5, 314)	12.03
				Prob > F	0.0000
Total	3.37842006	319	.010590658	R-squared	0.1607
				Adj R-squared	0.1474
				Root MSE	.09503

etr	Coef.	Std. Err.	t	P>|t|	Beta
op	-.058888	.0329881	-1.79	0.075	-.093173
roa	-.3510143	.0685423	-5.12	0.000	-.3245766
ppe	-.0332379	.0336421	-0.99	0.324	-.0521798
size	-.0076868	.0030511	-2.52	0.012	-.1567059
mtb	.0000889	.0000371	2.39	0.017	.1392243
_cons	.5029117	.0590098	8.52	0.000	.

```
. regress etrc op roa ppe size mtb, beta
```

Source	SS	df	MS		
Model	.569864223	5	.113972845	Number of obs	320
Residual	7.35761576	314	.023431897	F(5, 314)	4.86
				Prob > F	0.0003
Total	7.92747998	319	.024851034	R-squared	0.0719
				Adj R-squared	0.0571
				Root MSE	.15307

etrc	Coef.	Std. Err.	t	P>|t|	Beta
op	-.0985911	.0531396	-1.86	0.064	-.1018334
roa	-.3301601	.1104129	-2.99	0.003	-.1992995
ppe	-.0366964	.0541931	-0.68	0.499	-.0376082
size	-.0080597	.004915	-1.64	0.102	-.1072627
mtb	.0000908	.0000598	1.52	0.130	.0928697
_cons	.5111846	.0950573	5.38	0.000	.