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RELATIONSHIP BETWEEN OWNERSHIP STRUCTURE AND TAX AVOIDANCE: A MODERATING ROLE OF AUDIT REPORT LAG

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Abstract: This paper aims to find empirical evidence on how ownership affects tax avoidance and how audit quality moderates this relationship. This study chose family ownership to represent ownership structure since Indonesia has a unique setting of concentrated family ownership. The sample consisted of companies listed on the Indonesian Stock Exchange from 2018 to 2021. The data obtained were panel and secondary data from annual reports and financial statements. In this study, tax avoidance has two measures: ETR (effective tax rates) and SETR (statutory-effective tax rate gap). The finding suggests that a higher level of family ownership is associated with higher levels of tax avoidance. Additionally, the relationship between family ownership and tax avoidance is moderated by audit report lag (ARL). This study has policy implications for the government of Indonesia to consider crucial factors that can impact tax avoidance, such as ownership structures and audit report lag. By understanding these factors, policymakers can implement more targeted strategies to improve tax compliance and revenue collection. The social implication is that this study provides a better understanding of the importance of tax compliance and how ownership structures play a role in influencing it.

Keywords: ownership structure, audit lag, Indonesia, tax avoidance

1. Introduction

Tax planning is a strategic approach to maximising reported profits, as tax expenses are operational costs that reduce firm profitability (Lee & Kao, 2018). Companies acting as profit-maximising agents aim to reduce liabilities, including tax liabilities, to enhance after-tax profits, incentivising them to create tax-cutting methods (Shi et al., 2020). The most common strategy is tax avoidance, involving aggressive tax planning that hinders governments' access to primary resources, drawing attention from policymakers and academics worldwide. The ownership structure, particularly in developing countries with weaker corporate governance and concentrated ownership, significantly impacts tax avoidance behaviour (Waris & Haji, 2023). Audit report lag, the delay between a

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company's fiscal year-end and the issuance of its audit report, can influence the effectiveness of these tax avoidance strategies. Audit report lags may indicate governance efficiency and reporting complexity, potentially moderating the relationship between ownership structure and tax avoidance.

Ownership structure plays a critical role in tax avoidance. Family shareholders tend to be more family-oriented in decision-making (Suárez, 2017). Family ownership, seen as an efficient structure with low agency costs, may reduce opportunities for managerial opportunism, leading to less aggressive tax strategies. Family firms often prioritise long-term value over short-term profits, making them less likely to avoid tax (Gaaya et al., 2017). However, some argue that family firms may engage in more aggressive tax avoidance to benefit family members acting as majority owners, creating conflicts of interest (Steijvers & Niskanen, 2014). This conflict arises as family firms maximise tax-saving benefits, often at the expense of minority shareholders, leading to more aggressive tax avoidance behaviours (Brune et al., 2019; Kovermann & Wendt, 2019).

The entrenchment theory suggests that family shareholders may engage in tax avoidance for reasons tied to control, risk aversion, and personal interest. Thus, this study hypothesises a positive relationship between family ownership and tax avoidance. Furthermore, audit report lag can moderate the relationship between ownership structure and tax avoidance through the lens of alignment theory. An audit enhances transparency and aligns the interests of the management and shareholders, so an extended audit lag can potentially reduce aggressive tax avoidance. This study also hypothesises that audit report lag can be a remedy to reduce the tax avoidance practices executed by family-controlled firms.

Firms in Indonesia have a unique ownership structure, which is concentrated on family ownership (International Finance Corporation, 2018). Most investors in an environment with weaker shareholder protection can influence decision-making to their advantage, often engaging in tax avoidance to maximise wealth (Kovermann & Wendt, 2019). Furthermore, Indonesia has seen a decline in tax revenue due to tax avoidance, impacting essential public services like healthcare and education (Tax Justice Network, 2020). Despite this, studies on the relationship between family ownership and tax avoidance are still underexplored (Syukur et al., 2022). Therefore, this article aims to find empirical evidence regarding how family ownership, moderated by audit report lag, impacts tax avoidance in Indonesia.

2. Methodology

Companies listed on the Indonesian Stock Exchange by 2018-2021 were the population in this study. We used specific criteria by purposive sampling techniques to investigate these companies and determine samples. The study excluded financial sector companies due to their different financial structures and regulations (Wen et al., 2020) and eliminates flow-through companies like REITs since they have close to zero effective tax rate (ETR) (Chen et al., 2019). Companies with negative pre-tax income and negative tax expense are also excluded due to difficulties in interpreting the effective tax rate (Chen et al., 2019; Gaaya, 2017). Based on these specific criteria, the final sample is 632 companies, resulting in 2,528 observation years in total. Additionally, this study measures tax avoidance by ETR and SETR (the gap between statutory tax rate and effective tax rate). The ETR has an inverse relationship with tax avoidance, meaning a higher ETR indicates lower tax avoidance.

This study includes a set of control variables to account for corporate governance mechanisms and financial performance indicators. The governance-related variables are board meetings (BMEET), which reflect board activity; board independence (BIND), which indicates external oversight; and board size (BSIZE), which represents board structure. Financial controls include capital intensity (CAPINT), reflecting asset investment; long-term leverage (LTLEVERAGE), measuring reliance on long-term debt; return on assets (ROA), an indicator of profitability; and firm size (SIZE) denoting the company's scale.

Data for this study was collected from two primary sources: annual reports and financial statements. Financial statement data derives specific accounting ratios and financial metrics that serve as dependent and control variables. Corporate governance variables, the audit report date, and ownership structure information are manually extracted from the annual reports. This study utilised panel data combining longitudinal and cross-sectional elements and employed a panel data regression model with fixed effects to account for unobserved heterogeneity across entities.

3. Results and Discussion

Table 1 presents the regression results for the relationship between family ownership and tax avoidance, including ARL's moderating effect. The analysis was split into Model 1 and Model 2, where Model 1 used the effective tax rate (ETR) as the dependent variable, and Model 2 used the statutory-effective tax rate (SETR). Both models include the independent variable FAMILY and the moderator ARL and their interaction term FAMILY*ARL to assess the moderation effect.

Panel A of Model 1 shows that FAMILY has a negative relationship with ETR, indicating that higher family ownership leads to higher tax avoidance. From this result, we have sufficient evidence to accept the hypothesis that family ownership has a positive relationship with tax avoidance. Family-owned companies are often owned and operated by family members. As a result, they have fewer agency issues, and the entrenchment impact is more pronounced. The entrenchment effect is the propensity for family members to prioritise their personal interests over the company's best interests. As a result, family-owned companies are more likely to engage in actions that emphasise personal wealth creation, increasing the possibility of tax avoidance. This finding is supported by Brune et al. (2019), Kovermann and Wendt (2019), Puji et al. (2019), and Qawqzeh (2023). However, studies conducted by Bauweraerts et al. (2020), Kuo (2022), and Rakayana et al. (2021) discovered that family-owned companies can reduce tax avoidance practices.

Table 1: The regression results

Variable	Model 1	Model 2
Dependent variable	ETR	SETR
Intercept	0.2004***	0.1149***
	11.0022	8.1480
Panel A: Independent Variable		
FAMILY	-0.0007***	0.0002*
	-7.1811	1.9319
Panel B: Moderator and its moderation effect		
ARL	0.0002***	0.0000*
	4.7120	-1.0583
FAMILY*ARL	0.0000***	0.0000***
	5.0309	-3.3023
Panel C: Control Variables (Corporate Governance)		
BMEET	0.0001	0.0003
	0.3504	0.8631
BIND	-0.0119	-0.0257***
	-1.6307	-2.6612
BSize	0.0003	-0.0004
	1.5304	-1.5408
Panel D: Control Variables (Financial Indicators)		
CAPINT	0.0296*	-0.0120
	1.8754	-1.3574
LTLEVERAGE	-0.0430***	0.0558***
	-3.2995	4.3351
ROA	0.1309***	-0.1129***
	5.0450	-5.6373
SIZE	-0.0053	-0.0076***
	-1.8410	-3.2255
Adjusted R-squared	0.9203	0.9245
F-statistic	57.7302***	47.9518***
Model effect	Fixed	Fixed

In Panel B of Model 1, the study shows that the FAMILY*ARL interaction has a positive relationship with ETR, indicating that the interaction has a negative relationship with tax avoidance. Thus, this study has sufficient evidence for Hypothesis 2. This finding suggests that the relationship

between family ownership and tax avoidance is weakened by considering audit report lag in the model. Audit report lag can reduce the influence of family and institutional ownership on tax avoidance since it allows for more thorough auditing processes, potentially revealing any tax avoidance activities. The result in Panels A and B of Model 1 is consistent with the Model 2. FAMILY has a positive relationship with SETR, indicating that a higher family ownership leads to higher tax avoidance. In Model 2, the FAMILY*ARL interaction has a negative relationship with SETR, indicating that the interaction has a negative relationship with tax avoidance.

In both models, the control variables show mixed effects on the dependent variables ETR (Model 1) and SETR (Model 2). Board independence (BIND) is significant and negative only in Model 2, indicating that greater board independence is associated with lower tax avoidance. Firm size (SIZE) is negatively significant only in Model 2, indicating larger firms may have less tax avoidance. However, the relationship is consistent for LTLVEREAGE and ROA with tax avoidance, which suggests that firms with more long-term debts and smaller return assets are associated with being more aggressive in avoiding tax. Thus, these findings have mixed results compared to Alkurdi and Mardini (2020) and Barros and Sarmiento (2020).

4. Conclusions

This study investigates the relationship between ownership structures, namely family ownership, and tax avoidance in Indonesian listed companies, focusing on the moderating role of audit report lag. The findings reveal that higher family ownership levels are associated with increased tax avoidance. Also, audit reports lag significantly moderate the impact of ownership structures on tax avoidance.

This study aligns with the entrenchment effect/theory, mentioning that shareholders with more influential power tend to entrench their intention to increase their wealth by engaging in tax avoidance. These behaviours are exacerbated by Indonesia's concentrated ownership structures, which provide powerful shareholders with significant control. In this study, ARL is an important moderator of the relationship between ownership and tax avoidance, suggesting that thorough audits can mitigate tax avoidance activities. In this case, an extended ARL can help align shareholders on the intention of reducing tax avoidance practices.

The study's implications are significant for policymakers and corporate governance in Indonesia. Understanding how ownership structures influence tax avoidance can help design targeted strategies to improve tax compliance. Extending audit report lag may enhance audit quality, which can be crucial in mitigating aggressive tax planning practices. Future research should explore a broader range of tax avoidance proxies and consider industry-specific characteristics to comprehensively understand the factors influencing tax avoidance. Additionally, examining the role of other corporate governance mechanisms could further elucidate the complex dynamics between ownership structures and tax practices.

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