UNIVERSITI TEKNOLOGI MARA

FINANCIAL AND GOVERNANCE FACTORS TOWARD TAX AVOIDANCE WITH FIRM VALUE AND AUDIT QUALITY INTERACTION

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ABSTRACT

Financial criminology in the form of tax avoidance practices has become a common issue in business entities in Indonesia. Legal profit maximization through exploiting tax loopholes is a common practice, reducing companies' tax obligations to the state. Although seemingly astute, it sparks ethical concerns and diminishes state revenues. Tax avoidance isn't exclusive to financial institutions, with various factors influencing its prevalence in the banking and non-bank financial sectors. Financial and governance factors play pivotal roles, while interventions in corporate value and high-quality audits, especially by reputable "big four" firms, empower companies to exploit tax loopholes confidently. The research aims to scrutinize these influences on tax avoidance in listed banks and non-bank financial institutions on the Indonesia Stock Exchange from 2015 to 2021.. There are only 61 banks and non-bank financial institutions that meet the criteria for the purposive sampling technique. In this context, previous research has yet to explore the influence of firm value and audit quality. Intervention against tax avoidance. In particular, the latest regulatory developments, namely Financial Services Authority Regulation (POJK) No.12/POJK. 03/2021 concerning Commercial Banks can make tax avoidance easier in Indonesia. This regulation allows foreign citizens or entities to own up to 99% of a bank's paid-up capital, thus providing a loophole for tax avoidance practices. Seeing these developments, the first research objective is to find that transfer pricing has a significant effect on tax avoidance. Multinational companies with foreign ownership, particularly those engaged in transfer pricing, often navigate related-party transactions. The second research objective reveals a noteworthy link between Corporate Social Responsibility (CSR) and tax avoidance. Increased CSR disclosures through the Global Reporting Initiative signal a higher likelihood of tax avoidance. Companies might leverage CSR to project social responsibility while strategically avoiding taxes. The third objective investigates the impact of transfer pricing and company value on tax avoidance, finding a positive correlation for transfer pricing but negative for debt shifting and no effect for derivative transactions. Meanwhile, CSR corporate governance factors have a significant positive effect on tax avoidance. Firm value has been proven to interact significantly with transfer pricing. In addition, audit quality interacts with governance factors, which are proven to influence the relationship between executive incentives, foreign ownership, CSR, and tax avoidance. This study provides valuable contribution for regulators by highlighting the important role of good risk management practices and responsible financial management in financial institutions, as well as in determining tax policies so that they can optimize tax revenues as a source of state income. In the context of existing literature, this research provides significant added value regarding the factors influencing tax avoidance in the Indonesian financial industry. Also, it contributes to academic understanding through the integration of financial and governance factors as well as empirical testing of interaction variables. For financial institutions, this study can implicitly make a positive contribution to banking and non-bank financial institutions by providing advice to investors and company shareholders regarding appropriate corporate governance mechanisms to determine appropriate tax strategies so as not to violate tax regulations and professional ethics.

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CHAPTER 1
INTRODUCTION

1.1 Chapter overview

This chapter presents an overview of this research thesis. Section 1.2 discusses the research background. Section 1.3 includes a statement of the problem focusing on reducing tax revenues and targeting tax revenues. Section 1.4 outlines the main objectives and detailed research directions of this study. Section 1.5 presents the research questions from the study objectives. 1.6 presents the significance of the study, providing an in-depth understanding of the benefits of the study for related parties. Section 1.7 provides a summary of the structure of the thesis.

1.2 Research Background

The importance of tax as a mandatory contribution that must be paid by individuals and entrepreneurs to the state is clearly stated in Law of the Republic of Indonesia Number 28 of 2007. This law emphasizes the importance of taxes as the main source of state revenue and the sustainability of public services, infrastructure development, and the nation's economic prosperity in general. Taxes are used to fund state needs while contributing to people's prosperity. State income originating from taxes is very important in supporting the development of a country to finance routine expenditures, and the surplus is used for public savings, which is the main source for financing public investment (Soemarsono, 2007). According to Sumidartini (2017), income derived from the Indonesian tax sector exhibits the most substantial proportion of total income compared to other income sources.

Tax revenue is a source of state income to fund the government's routine needs while contributing to the prosperity of the people. State income originating from taxes is very important in supporting the development of a country. Compared to other sources of income, income from the Indonesian tax sector has the highest proportion of total income (Nugraha & Lewis, 2013). The contribution of taxation to national income is very clear; tax revenues in Indonesia from 2015 to 2022, on average, account for more than 79% of total state revenues (see Table 1.1). This shows how important the