The Significance of Financial Distress on Tax Avoidance Compared to Gender Diversity and Social Responsibility: A Study from Indonesia

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ABSTRACT

The research aimed to examine the effect of Corporate Social Responsibility (CSR), Corporate Governance (CG), and financial distress on tax avoidance in manufacturing companies listed in Indonesia Stock Exchange during the period ranging from 2016 to 2020. By employing multiple regression analysis, it was found that CSR did not have an effect on tax avoidance. Contrastingly, CG proxied through the gender diversity of directors negatively affected tax avoidance. In contrast, board size and audit quality did not have an effect on tax avoidance. The study also supports previous findings that financial distress has a positive effect on tax avoidance. This study used rare variables combined which were CSR, CG and financial distress as independent variables to determine tax avoidance.

Keywords: Corporate Social Responsibility, Corporate Governance, Financial Distress, Tax Avoidance

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INTRODUCTION

Tax avoidance has been a continuing discourse as it carries ethical aspects (Contractor, 2016; Hanlon & Heitzman, 2010), despite its reasoned need by the companies to conserve capitals especially in times of financial distress. Indeed, the study regarding financial distress has been proven to contribute much to tax avoidance (Richardson, Taylor, & Lanis, 2015). At multinational level, tax avoidance can be achieved by strategies such as transfer pricing by taking advantage of different tax tariffs across countries.

Syanthi, Sudarma, & Saraswati (2012) stated that tax avoidance is a policy strategy carried out by companies in looking at opportunities in tax regulations to minimize the tax burden. In other words, tax avoidance is a utilized loopholes policy or incomplete regulations in tax provisions. It is not a violation to the applicable law.

Interestingly, a company that claims to practice Corporate Social Responsibility (CSR) views tax avoidance in two ways. First, a company that has a high level of CSR will tend to reduce tax avoidance practices, because of its awareness of tax payment as a social responsibility. Second, a company that has a high level of CSR may perform a high tax avoidance, since the company allocates its funds for corporate social responsibility programs that can reduce its taxable income. There has been research gap on this issue. Previous research conducted by Lanis & Richardson (2016) found that CSR had a positive influence on tax avoidance. On the contrary, the research by Sandra & Anwar (2018) showed that CSR had a significantly negative effect on tax avoidance.

According to Uchendu (2016), good corporate governance (CG) is a set of managerial controls aimed at improving the company's performance. Good CG, when applied properly will avoid agency conflict. In addition, it also supervises the management performance of the company in tax avoidance practices. Good CG can produce high revenue for the government because the total or tax payment is increased. In contrast, tax avoidance can occur because of the dynamics of corporate governance in the company.

Further research gap is also shown by previous research regarding CG and tax avoidance. Ambarsari et al. (2018) showed that there was a negative influence between the diversity of gender on the board of directors and tax optimum. However, the board size of commissioners did not affect tax aggressiveness. This finding is in contrast to the result of research conducted by Rinanda & Ardiany (2020) that implied a significant influence between the board size of commissioners with tax aggressiveness of the company. In addition, the finding by Su et al. (2019) showed that women would have an effect on the reduction of tax avoidance because women had a higher level of tax compliance than men. On the contrary, findings by Dewi & Jati (2014) stated that audit quality influenced tax avoidance. They support that audit quality can reduce the tax avoidance practice. However, Purba (2018) found that audit quality did not affect tax avoidance. The inconsistent findings drove us to use gender diversity of directors, board size, and audit quality as components of CG.

Financial distress is a company condition in financial difficulties where in this condition the entity has high debts but the company can still run its operations (Richardson et al., 2015). If a company has a high debt and it is continuously unable to pay it, the company will be liquidated or falls into bankruptcy. Companies that have financial difficulties will tend to minimize their tax burden. Therefore, financial distress is considered to affect tax avoidance (Feizi, Panahi, Keshavarz, et al 2016, Dang & Tran 2021, Richardson et al., 2015). Yet, Nugroho & Firmansyah (2017) showed that financial distress did not affect tax aggressiveness in Indonesia.

In Indonesia, the tax is regulated based on law No 28 of 2007 as a mandatory contribution that is coercived under the law with no direct compensation and it is used for the need of the state for the greatest prosperity of the people. It is the highest income source in a country including Indonesia. There has always been a tug of war between the government and companies; the government tries to maximize tax collection, meanwhile, the company will minimize the tax payment. Hence, there has been issues of non-compliance on tax, though study shows non-compliance has been claimed by taxpayers because of its complexity (Saad, 2014). The tendency of companies to minimize tax payments is found to be caused by insignificant compensation received from the government, whether the companies are paying in large or small amounts (Huda, 2016). Tax planning is therefore used as a strategy to manage taxes in order to minimize tax payments.

Tax avoidance in Indonesia is not quiet of scandals. In 2019, for instance, a coal company, PT Adaro Energy Tbk, by employing a transfer pricing scheme through its subsidiary in Singapore, Coaltrade services International Pte Ltd, was suspected to conduct tax avoidance. It did so to provide higher income for the company's shareholders. There were non-arm's length prices between PT Adaro Energy Tbk and Coaltrade services International Pte Ltd, which showed an imbalance in transfer prices when compared to global coal market prices. There was also a case in 2016 with PT RNI, an affiliated health service company in Singapore, that was identified as having tax avoidance by recognizing affiliation's debt as capital, reporting sizable losses in the company's financial statements, and reporting the company's turnover remained below 4, 8 billion rupiah per year with the aim of utilizing Indonesian Government Regulation 46/2013 concerning Income Tax specifically for MSMEs, in order to obtain a final PPh rate facility of 1%. Anggraeni and Kurnianto (2020) found that in Indonesia, tax compliance was relatively low.

The objective of this study was to analyze the effect of CSR CG proxied through diversity of gender of directors, board size, and audit quality), and financial distress on tax avoidance. The novelty of this study lies on the variables studied, and the objects of research, which were manufacturing companies listed in Indonesia Stock Exchange in 2016 – 2020, as the largest sector in Indonesia.

LITERATURE REVIEW

Agency Theory, Legitimation Theory, and Tax avoidance

The discourse of Agency Theory (AT) is never outdated since it highlights a contract agreement between principal and agent (Scoot, 2006), and in terms of tax avoidance, agents will satisfy principles to higher income by paying less tax (Putra, Syah, & Sriwedari, 2018). This Theory describes that the agent (management) conducts their responsibility and authority over stockholders. However, this condition may cause agency conflict, when the decision taken by management is opposite to the interests of the stockholders (Brian & Martani, 2017).

Tax planning can be considered as an application of AT practice whereby managers (agents) are required by the owner (principal) to legally evade taxes. This action will lead to lower tax paid and a promised bonuses to be given to managers if more income can be attained (Putra et al., 2018)

The Legitimation Theory (LT) is the idea that for an organization to continue operating successfully, it must act in a manner that society deems socially acceptable (O'Donovan, 2002). Recently, Schnider and Scherer (2021) studied public deliberations on the legitimacy of organizations and practices in the context of corporate tax avoidance at global level. They found that in the rising digital era, news on tax avoidance will harm norms accepted by society faster. In terms of the LT a company always tries to create a balance between the value that is related to their activity to the norms and behavior existing in the social system. As a result, the company must get the suitability of the organization's activities and the social value that is relevant to keep the existence of the company.

Kurniasih et al. (2013) stated that tax avoidance is an efficient activity for the company legally due to loopholes in tax laws. However, Prebble (2012) stated that tax avoidance is actions that take advantage of reducing taxes owed that take advantage of existing legal weaknesses. In other words, the practice of tax avoidance is an action that is set in such a way according to the tax planning carried out. Based on the Organization for Economic Cooperation and Development (OECD), the three main characteristics of tax avoidance are, namely, the existence of artificial elements, schemes that take advantage of loopholes from the provisions, and secrecy. However, this practice is also risky to taxpayers. The risk of tax avoidance if detected by the fiscal officer can cause tax penalties, publicity, and the reputation of the taxpayer (Kovermann & Velte, 2019).

Hypotheses Development

Corporate Social Responsibility

CSR is defined as the contribution of the company to the environment where the company operates. It is the form of responsibility of the company to stakeholders or other related parties to be ethical. In Indonesia, CSR must be applied by a company according to law No. 40 of 2007 article 74 about "Social and Environmental Responsibility". In addition, the social cost spent by the company must consist of three types of costs to fulfill the CSR: the cost used for the training program of employees (employee relation), the cost for the Social Responsibility programs (community service), and the cost for the environment program (environment awareness). Previous research suggests that CSR has a positive influence on tax avoidance (Lanis & Richardson, 2016; Richardson et al., 2015), yet a study in Indonesia proves otherwise (Sandra & Anwar, 2018).

H1: Corporate Social Responsibility has a positive effect on tax avoidance.

Gender Diversity of Directors

The Organization for Economic Co-Operation and Development (OECD) defines CG as a system that regulates the rules and procedures for making decisions to achieve the goals among management, stockholder, and stakeholders. Goergen and Renneboog (2006) stated that CG is the combination of mechanisms that ensured the management conducted the responsibility in the company for shareholders, one of which, is having gender diversity in the directors. The board of directors has a central role in CG. Hamdani (2016) stated that the board of directors has duties and responsibilities collegially in managing the company, each member will be given it based on the authority. Low (2006) explained that in carrying out their duties as the head of the company, the directors have two characters (risk-taker and risk-averse). The director who is a risk-taker is braver in charge the decision making. In contrast, the board of directors that has risk-averse will tend to avoid the risk. Furthermore, the diversity of gender will influence decision-making. According to Francis et al (2014) women are generally more risk-averse than men. The presence of female directors in the company is expected to be able to provide better and careful consideration in making the decision and the direction of company policies, especially about taxation. Báez et al., (2018) findings imply that genders diversity affect corporate governance. Specifically in Indonesia, a study by Novita (2016) finds that male executives are willing to take more risks in tax avoidance risk, when compared with women executives.

H2: Gender diversity of directors has a negative effect on tax avoidance

Board Size

Based on the law of limited company (PT) article 108, the functions of the board of commissioners in a company are controlling and giving advice. Furthermore, each member of the board of commissioners must base themselves on the interest of the company with the objectives of the company. In carrying out their duties, they should be based on good manners, full of prudence and responsibility to avoid mistakes or losses of the company.

In addition, the regulation of the Indonesian financial services authority (OJK) number 33 of 2014 requires the board of commissioners consists of at least 2 members which one of them will be the president commissioner. The members of the board of commissioners act in unity and each member cannot act based on their own interests. They also act as mediators and liaisons between shareholders and agents to reduce conflicts between them. In this case, they will provide direction and guidance to manage and decide the company's strategy. Anggraeni and Kurnianto (2020) found that board size had a positive and statistically significant relationship to the level of corporate tax avoidance. Yet, Jamei, R. (2017) found contrasting evidence that board size had no effect on tax avoidance. We believed that if number of board members increases, tax avoidance will likely decrease because of moral pressure within the board is exerted.

H3: Board size has a negative effect on tax avoidance

Audit Quality

One of the principles of corporate governance is transparency. The preparation of financial statements must be done fairly and free from fraud. Transparency in the financial report is very much needed by stakeholders. It means that the financial report has to be audited by a public accountant. Rezaee (2005) states that fraud in financial statements will be detected more easily if audited by Big Four than Non-Big Four public accountant firms. The Big Four has special attention to maintain their reputation so that they have better technical expertise and a more systematic audit strategy to detect tax avoidance(Rai, 2008). It is found that high quality auditors represented by Big Four will have more concern on tax avoidance activities, because their involvements in such a practice might hurt their reputations and expose them to litigation (Jihene & Moez, 2019).

H4: Audit Quality has a negative effect on tax avoidance

Financial Distress

Financial distress is a condition of the company when it gets into financial difficulties. According to Platt in Fahmi (2013), financial distress is a stage of decline in financial condition before bankruptcy or liquidation. The causes of this term come from internal or external that can not be handled by the company. For example, the inability of the company to manage its assets and bad corporate governance. Wijoyo (2016) stated that financial difficulty arises when the company is unable to fulfill payment schedules and the company's cash flow indicates that it will soon be unable to pay its obligation. The research shows that financial distress affects tax avoidance (Feizi, Panahi, Keshavarz, et al 2016, Dang & Tran 2021, Richardson et al., 2015), and in Indonesia contrastingly it did not affect tax avoidance (Nugroho & Firmansyah 2017).

H5: Financial Distress has a positive effect on tax avoidance

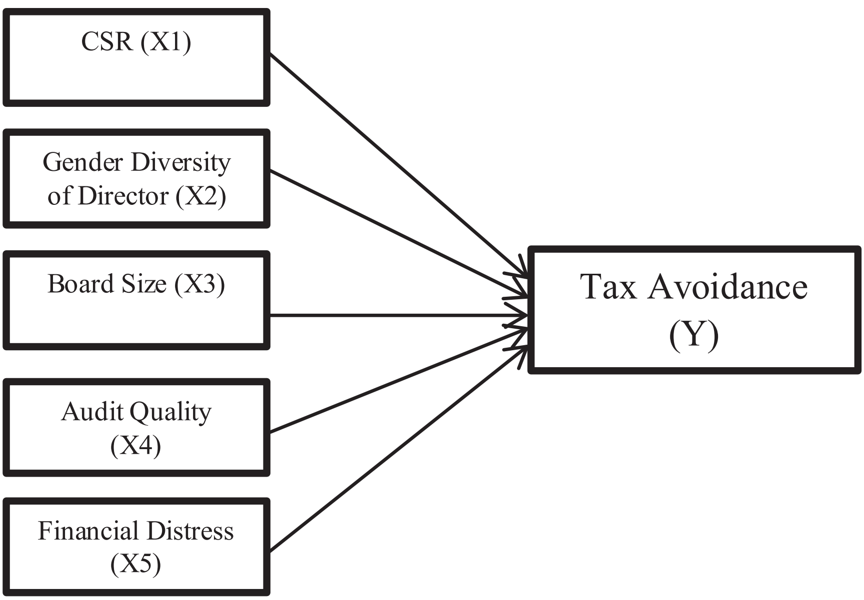

Figure 1: Conceptual Framework

RESEARCH METHOD

The population was manufacturing companies listed in Indonesia Stock Exchange from 2016 to 2020. Manufacturing companies were taken as objects of the study because they were the largest contributor to the Indonesian national economy through "an increase in the value-added by domestic raw materials, absorption of local labours, and foreign exchange earnings from exports" (Anggraeni & Kurnianto, 2020, p. 1128).

This study employed secondary data obtained from financial statements published in the Indonesian stock market (www.idx.co.id). Purposive sampling used the following criteria:

1. Manufacturing companies listed in the Indonesia Stock Exchange sequentially from 2016-2020.
2. Manufacturing companies that disclosed the Annual Report sequentially from 2016-2020.
3. Manufacturing companies that published financial statements in rupiah.
4. Manufacturing companies that did not experience loss from 2016-2020.
5. Manufacturing companies that disclosed CSR costs in the annual report

Variables measurements in this study is displayed in Table 1.

Table 1: Variables Measurement

Variable	Measurement
Tax Avoidance	$\text{Current ETR} = \frac{\text{Current Income Tax Expense}}{\text{Income Before Tax}}$ Hanlon & Heitzman (2010)
Corporate Social Responsibility	$\text{Opportunity Cost} = \frac{\text{CSR Cost}}{\text{Operational Cost}}$ Lestari & Solikhah (2019)
Gender Diversity of Directors	Dummy variable, score "1" if there is a woman director and score "0" if there is no woman's director
Board Size	The Number of Board of Commissioners
Audit Quality	Dummy variable, score "1" if the external auditor is Big Four Company and score "0" if " if the external auditor is Non-Big Four Company
Financial Distress	$\text{ICR} = \frac{\text{Interest Expense}}{\text{Operational Profit}}$

RESULT AND DISCUSSION

A total of 80 samples from 16 manufacturing companies, ranging for five years (2016-2020) were analyzed. We ensured that all data can be regressed by complying to the normality classic assumptions. This research used the One-Sample Kolmogorov- Smirnov statistic test as a technic for testing normality. The significancevalue of the unstandardized residual was 0.066. The value was higher than 0.05, therefore it was concluded that the data was distributed normally as a perquisite for further hypotheses testing.

The result of multicollinearity testing showed that the tolerance value of independent variables was higher than 0.10. It indicated that there was no correlation among the independent variables as the value was higher than 95%. In addition, the result for Variance Inflation Factor (VIF) showed that all the independent variables had a VIF value lower than 10. Based on the result, it was concluded that multicollinearity did not occur in the regression model for the independent variables. The result of the Glejser Test was the probability value of the independent variables was higher than 0.05. The regression model of this study did not contain heteroscedasticity. The result of the autocorrelation test was 0.261, which confirmed that the regression model contained no-autocorrelation because the significance value was higher than 0.05.

The form of the regression equation in this study is as follows:

$$TA = 3.512 – 0.288\ CSR – 0.792\ GDD + 0.144\ BZ + 0.248\ AQ + 0.246\ FD + e$$

The regression equation had a constant value of 3.512 which denoted that tax avoidance was at the number when CSR, Gender Diversity of Director, Board Size, Audit Quality, and Financial Distress did not change or were constant. In addition, as in Table 2 the independent variables factor affecting the dependent variable had a big coefficient, indicating that the equation had a strength in explaining the tax avoidance phenomena.

Table 2: The Result of Multiple Regression Testing

Coefficients[a]

Model		Unstandardized B	Coefficients Std..Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	3,512	.995		3.531	.001
	CSR	-.288	.356	-.091	-.809	.421
	GDD	-.792	.321	-.264	-2.468	.061
	BZ	.144	.101	.176	1.419	.160
	AQ	.248	.388	.085	.639	.525
	FD	.246	.090	.331	2.729	.008

Dependent Variable: TA

Table 3 shows that the value of R square (R^2) was 0.26. Based on the result, it was concluded that the tax avoidance variable can be explained by CSR, Gender Diversity of directors, Board Size, Audit Quality, and Financial Distress in the amount of 0.21 or 21%. Meanwhile, 79% can be explained by other factors that were not included in the model, such as capital intensity, transfer pricing, and others.

Table 3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.510[a]	.260	.210	1.25849296

a. Predictors: (Constant), FD, GDD, BZ, CSR, AQ

b. Dependent Variable: TA

DISCUSSION

The result of statistical T-testing for CSR on tax avoidance showed that the level of significance was 0.421 which was higher than 0.05. The first hypothesis was rejected, meaning CSR did not affect tax avoidance.

The implementation of CSR in the taxation field is supported by Law of Government No.93 the Year 2010 Article 3 “the total cost of contribution and/or social infrastructure development that can be credited from gross income is limited by not higher than 5% from fiscal net income in previous tax year”. However, the data from Table 2 inform that the average CSR cost spent by the company was 1.7% per total expenses in the income statement. In this case, the number was still low from the total maximum that had been set by the government. According to Suprapto (2013), this condition occurred because there were several lacks in the implementation of CSR in Indonesia such as limited budget, unscheduled implementation, and the lack of communication and socialization. Besides that, the information on CSR that has been disclosed in the annual report is not consistent with the actual condition then it could not be used as a guarantee that the company takes low tax aggressively (Winarsih,2014).

The finding of this study is not supported by the LT that explained that the company conducting CSR activity for acceptance and obtaining legitimation in operating the business from the community. Furthermore, the entity should pay the tax based on the applicable provisions because it is suitable for the norm in the community. However, the actual condition is the company that conducts CSR activitiesdoes not guarantee that tax avoidance practices do not exist (Apriliyana & Suryarini, 2018). It can be explained by the company's cost that is spent on CSR which does not have an effect on tax avoidance.

Table 3 showed gender diversity of directors had a significance level of 0.0016 in the negative direction. As the result, the hypothesis purposed by the researcher was accepted that the Gender Diversity of directors has a negative effect on tax avoidance. It means that the higher level of diversity gender in the board of directors, the lower the opportunity for tax avoidance.

The proportion of composition between women and men in the executive company will affect decision-making because their nature and personality are different. In addition, the risk-averse character owned by women tends to avoid risk because they should consider everything to make the decision. The role of women as directors in executive positions will result in right decision making and control to reduce tax avoidance practices. Bhagiawan (2020) explained that the presence of women on the board of directors will increase ethical standards. Besides that, the agency problem as the consequence of tax avoidance can be solved by the women's role. However, the directors only give effect on management activity, which is related to tax percentage, not tax cash flow.

The testing for the board size and tax avoidance variables showed that the significance level was 0.160. It confirmed that the hypothesis cannot be accepted. The finding of this study is that board size does not have an effect on tax avoidance because the result was higher than 0.05.

This finding is consistent with the research conducted by Pramudito & Sari (2015) because the increase in the number of commissioner's does not affect the regulation of the company in tax avoidance practices. The duties of commissioners are to control and give suggestions to the company, while it is still low for company policy, especially taxation. This case occurred because commissioners were considered not involved in taxation strategies (Bhagiawan, 2020). Furthermore, board size does not describe the knowledge, skill, and performance of commissioners in affecting tax avoidance (Khoula and Ali, 2012; Khoula and Moez, 2019).

However, this finding is relevant to the AT which is that the existence of the board of commissioners is one way to deal with agency conflict. This is because the commissioner is an important element in the implementation of good corporate governance. Based on the Indonesian regulation of the financial services authority (OJK) No 33/POJK.04/2014 Chapter III article 20 regulates the number of members of the commissioner's board consisting of the president commissioner, independent commissioner, and general member commissioner. This is aimed at maximizing the function of commissioners for the implementation of good CG.

Table 2 shows that the audit quality variable did not have an effect on tax avoidance because the level of significance was 0.525 > 0.05. It meant that this finding didnot match with the hypothesis purposed by the researcher, so the hypothesis was rejected. This finding of this study explained that the purpose of financial statements audited independently is to avoid fraud based on the applicable regulations. So, the result of the audit did not show the existence of tax avoidance in a company because this action takes advantage of loopholes in regulations.

Audit quality was proxied by Big-four and Non-Big-four accountant firms as auditors indicate that they only give the audit opinion on the financial report presented (Septiadi et al., 2017). This opinion is based on several things, for example the financial statement must be suitable with applicable accounting standards. In this case, an auditor should give more attention because there is a difference between accounting standards and taxation regulations. However, the company must conduct a fiscal correction to spread out the tax regulation. After that, the auditor also considers this correction in giving a fair opinion of the financial statement. On the other side, Winata (2014) stated that the audit practice is based on audit quality control standard guidelines that have been set by Dewan Standard Professional Akuntan Publik Institute Akuntan Publik Indonesia (DSPAP IAPI) and the rules of public accountant ethics by IAPI. As a result, it causes the implementation of audit quality less influential in reducing tax avoidance practices.

Based on the explanation above, audit quality is one of the methods to prevent agency problems stated in the AT. Financial reports have been audited independently giving a guarantee that the information disclosed is based on standards which have been set by the authorities and it does not stand according to personal interests or a particular group.

Table 3 showed that the result of the significance level was 0.008 and the value of the T-count was 2.729. So, the sixth hypothesis was accepted "Financial Distress has a positive effect on tax avoidance". The explanation of this finding is that the bigger the financial distress, the bigger the tax avoidance. One of the financial distress indicators of the company less ability to pay the liabilities. Besides that, the company's cash flow can describe the financial condition of an entity. Edwards et al. (2013) (2013) explained that the increase of cost capital and the credit rate are the indicators of the managers' tendency to conduct tax aggressiveness in a company.

The finding of this study is consistent with the AT in which there is a mismatch between the objective of management and stakeholder. Investors as stakeholders regard tax avoidance as a high-risk action. Furthermore, if the companies have financial problems coupled with the risks due to tax avoidance actions, it can increase the probability of the company facing bankruptcy (Nugroho & Firmansyah, 2017). On the other side, management will take action aggressively in reducing their obligation in tax of the company. It was conducted because the company desires to pay the lesser tax than the actual amount. In addition, the tax rate that applies to Indonesia is 25% of taxable income and it was changed to 22% in 2020. As a result, companies conduct tax avoidance to prevent bankruptcy due to financial distress.

CONCLUSION

This study aimed to analyze the effect of CSR, Gender Diversity of Directors, Board Size, Audit Quality, and Financial Distress on Tax Avoidance. It used data obtained from 16 listed companies in the Indonesian Stock Exchange from 2016 to 2020. The result of regression testing proved that CSR, Board Size, and Audit Quality did not have an effect on tax avoidance. However, Gender diversity of directors had a negative effect on tax avoidance. It means that the increase in the gender diversity of directors can reduce the management's behavior to practice tax avoidance. In addition, the result also showed that financial distress had a positive effect on tax avoidance. It means that the higher the financial distress in the company, the higher the tax avoidance it will take. Moreover, CSR, gender diversity of directors, the board size, audit quality, and financial distress simultaneously affected tax avoidance although there are other independent variables not taken into account in this study that also affect tax avoidance.

The paper has several practical contributions. First, the company as taxpayers should pay attention to the tax payment based on tax provisions and be more careful in the forming and making-decision of management strategies related to taxation. Second, the government should socialize the importance of rights and obligations of the companies in tax contribution to the country. In addition, the government should update tax regulations to reduce loopholes in these regulations and be more assertive in giving sanctions to companies that do tax planning that is not under tax regulations. Third, further research is expected to extend to the other sectors because the scope of this research was only manufacturing companies and other independent variables that affect tax avoidance must also be investigated.

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