Corporate Governance, Tax Planning and Firm Value

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Abstract: This study examined the influence of corporate governance and tax avoidance on firm value and moderating effect of corporate governance on the relationship between tax planning and firm value. The data cover 37 manufacturing companies listed in Indonesia Stock Exchange (BEI) for the period of 2014 to 2016. Empirical analyses are conducted using multiple regression and path analysis to identify the presence of moderating variable. The result shows that corporate governance has a positive effect on firm value, which means the greater the corporate governance in companies, higher the firm value. Tax planning has a negative effect on firm value, which means the higher tax expense the lower the firm value. For moderating effects, the result shows that corporate governance does not moderate the relationship between tax planning and firm value.

1 INTRODUCTION

The purpose of establishing a company is to make a profit. The greater the profit generated by the company, the higher the value of the company seen in the company's stock price. Therefore management tries to increase company profits. In addition to increasing the value of the company, large profits also show management's performance in managing its assets to generate profits. If the resulting profit gets smaller, then the management performance is considered bad and vice versa: if the resulting profit is higher the management performance is considered good. Many methods are attempted by a management to increase company profits with one of them making efficiency in tax payments. According to Nike et al., (2014), there are several ways to reduce the tax burden that must be paid, namely tax planning, tax avoidance, and tax evasion. Tax planning and tax avoidance is a fairly safe way to do it because it does not violate taxation rules. This is different from tax evasion which actually violates the prevailing tax rules. According to Suandy (2011), tax planning is an effort made to save and minimize tax payments legally without violating applicable rules. In addition to tax planning, to increase the value of the company, companies can implement good corporate governance. Better corporate governance provides protection to shareholders against manipulating financial statements so as not to harm investors.

Based on several research results such as Nike et al., (2014), Wahab and Holland (2012), Winanto and Utoyo (2013) state that tax planning does not affect the value of the company, because tax planning activities are considered as practicing earnings management so as to not increase the value of the company. However, according to Fajrin et al., (2018), Oyeyemi and Babatunde (2016), Zemzem and Ftouhi (2016), and Zemzem and Ftouhi (2013), tax planning has a negative effect on firm value which means that the smaller the tax payment the higher the value of the company. According to the results of research by Zemzem and Ftouhi (2016) the existence of corporate governance will increase the value of the company. Because the results of research on tax planning and corporate governance on the value of the company produce results that are inconsistent, and investors are now starting to invest a lot of money in companies. Therefore the value of the company must be increased to attract investors, one way to do that is with tax planning and corporate governance. So, this is the motivation of this research, and this research also looks at whether corporate governance moderates the influence of tax planning with firm value.

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1.1 Agency Theory

In agency theory, the parties involved are the management of a company, acting as agents, and the investors, acting as principals. The agent and the principals have different interests, and the principal relies on the agent to protect those interests (Godfrey et al., 2010). Jensen and Meckling (1976) stated that the separation between the owners and managers of a company may cause agency problems or conflicts. Because the agent and the principal have different interests, the principal have to spend on the costs of agency, including: (1) the monitoring expenses incurred by the principal to supervise the behavior of agents, (2) the bonding expenses incurred by the agent to ensure that the agent will not act in a way that harms the principals interests, and (3) the residual loss in the form of decreased levels of well-being, for both parties.

1.2 Tax Planning and Firm Value

According to Pohan (2013) tax planning is the process of organizing personal and corporate taxpayer businesses by utilizing loopholes that can be taken by companies in the corridor of the provisions of taxation regulations. Thus, the company can pay taxes in the minimum amount. According to Zemzem and Ftouhi (2016), Oyeyemi and Babatunde (2016), Zemzem and Ftouhi (2013), Fajrin et al., (2018) stated that tax planning negatively affect firm value. This shows that the smaller the payment of corporate taxes the higher the value of the firm. If a company is able to reduce tax payments it will make the profits generated by the company greater so investors will be interested in buying company shares. Based on the explanation above, the hypothesis built is:

H_1: Tax planning negatively affects firm value

1.3 Institutional Ownership and Firm Value

Institutional ownership is the ownership of company shares by institutions (pension funds, investment companies, banks and others). According to Parrino et al., (2003), Ferreira and Matos (2008), Alfaraih et al., (2012), Fazlzadeh et al., (2011) and Uwuigbe dan Olusanmi (2012), institutional ownership positively affects firm value. The greater the institutional ownership, the higher the value of the company will be. According to Chung et al., (2002), institutional ownership has an important role in monitoring management so as not to take opportunistic actions for personal interests so the value of the company will increase. Based on the explanation above, the hypothesis built is:

$H_{2:}$ Institutional ownership positively affects firm value

1.4 Board of Director and Firm Value

In this study the board of directors is a supervisor in the company or also called the board of commissioners, where the board of commissioners is an organ in corporate governance that oversees management in managing the company. According to Andres and Vallelado (2008), the board of directors has a positive effect on firm value. This shows that the more the number of board of directors in the company the higher the value of the company because it will improve supervision, governance, and increase returns (Andres and Vallelado 2008). Based on the explanation above, the hypothesis built is:

$H_{3:}$ Board of director positively affects firm value

1.5 Independent Board and Firm Value

The independent board is a member of the Board of Commissioners who has no relationship with the company. According to Trisnantari (2010) and Amyulianthy (2012), the independent board has a positive effect on firm value. This shows that the greater the number of independent boards, the higher the value of the company, because the independent board is able to carry out the monitoring function to oversee the policies and activities carried out by the directors. The existence of an independent board in the company can provide an effective contribution in the process of preparing more high quality financial statements (Muryati and Suardika 2014). Based on the explanation above, the hypothesis built is:

$H_{4:}$ Independent board positively affects firm value

1.6 Corporate Governance Moderates the Relationship between Tax Planning and Firm Value

In this study, we also wanted to test whether corporate governance moderates the influence of tax planning with firm value. Based on the results of Zemzem and Ftouhi (2013), Nike et al., (2014), Wahab and Holland (2012) and Winanto and Utoyo (2013), corporate governance is able to strengthen the negative influence of tax planning on firm value. This is because companies that have good governance coupled with minimum tax payers will increase the value of the company. Based on the explanation above, the hypothesis built is:

H_5: Corporate governance strengthens negative effect of tax planning on firm value

2 METHODOLOGY

The paper employs a panel set data of manufacturing firm listed in Indonesia Stock Exchange during the period 2014-2016. The data taken uses purposive sampling and consists of 37 manufacturing companies. Below is a sample selection table.

Table 1: Sample procedure selection.

Description	Number of companies	Number of data
Manufacturing companies that are consistently listed on the Indonesia Stock Exchange during the 2014-2016 period	137	411
Manufacturing companies that do not issue annual reports and financial statements for the period 2014-2016	17	51
Manufacturing companies that do not present financial statements that ended on December 31 during the 2014-2016 period	16	48
Manufacturing companies that do not present financial statements in Rupiah currency for the period 2014-2016	25	75
Manufacturing companies that do not have a positive profit during the 2014-2016 period	33	99
Manufacturing companies that do not have institutional ownership	5	15
ETR greater than 1	4	12
Total	37	111

3 MODEL SPECIFICATION

This study is an empirical analysis of the effect of corporate governance, tax planning on firm value and moderating effect of corporate governance on tax planning and firm value. The regression model is:

$$ROA_{it} = \beta_0 + \beta_1 ETR_{it} + \beta_2 IO_{it} + \beta_3 BOD_{it} + \beta_4 IND_{it} + \beta_5 SIZE_{it} + \beta_6 CR_{it} + \varepsilon \quad (1)$$

To assess the potential impact of tax planning on firm value the above regression is modified by changing the ETR to CashETR.

$$ROA_{it} = \beta_0 + \beta_1 CashETR_{it} + \beta_2 IO_{it} + \beta_3 BOD_{it} + \beta_4 IND_{it} + \beta_5 SIZE_{it} + \beta_6 CR_{it} + \varepsilon \quad (2)$$

A third regression tests whether the relationship between tax planning and firm value is moderated by corporate governance.

$$ROA_{it} = \beta_0 + \beta_1 ETR_{it} + \beta_2 ETR{*}IO_{it} + \beta_3 ETR{*}BOD_{it} + \beta_4 ETR{*}IND_{it} + \beta_5 IO_{it} + \beta_6 BOD_{it} + \beta_7 IND_{it} + \beta_8 SIZE_{it} + \beta_9 CR_{it} + \varepsilon \quad (3)$$

Where:
ROA = Return on Assets = net income / total assets
ETR = Effective Tax Rate = income tax / income before tax
CashETR = Cash Effective Tax Rate = cash tax paid / income before tax
IO = Institutional Ownership = % of share owned by institutional
BOD = Board of Director
IND = Independent Board = % of independent board
SIZE = Natural Logarithm of total assets
CR = Current Ratio = current assets / current liabilities

4 RESULT AND DISCUSSION

Below is presented descriptive statistics for each variable.

Table 2: Descriptive Statistics.

Variable	Minimum	Maximum	Mean	Std. Deviation
ROA	0.0000665	0.401838	0.099841	0.081357
ETR	0.001470	0.727738	0.252391	0.091429
CETR	0.042839	0.881081	0.294666	0.128127
IO	0.297900	0.981800	0.686309	0.173832
BOD	2.000000	12.00000	4.547009	2.036290
IND	0.125000	1.000000	0.400426	0.121633
SIZE	25.61948	33.19881	28.68814	1.782535
CR	0.605632	8.088936	2.548071	1.599937

Below is presented result of each model to test the effect of corporate governance, tax planning and firm value.

Table 3: Regression Model.

Dependent variable: ROA	Model (1)	Model (2)	Model (3)
ETR	-0.1129 (-1.6292)		0.2445 (-3.269)
CETR		-01029 (-2.052)*	
IO	0.1215 (3.305)*	0.1136 (3.1069)	0.1188 (0.8157)
BOD	-0.0074 (-1.6989)	-0.0059 (-1.3651)	-0.0028 (-0.2552)
IND	0.1585 (2.975)	0.1489 (2.8170)*	0.3257 (1.7932)

Table 3: Regression Model. (cont.)

Dependent variable: ROA	Model (1)	Model (2)	Model (3)
ETR*IO			0.0266 (0.0506)
ETR*BOD			-0.0214 (-0.4538)
ETR*IND			-0.6378 (-0.9618)
SIZE	0.0161 (0.0018)*	0.01446 (2.8249)*	0.0170 (3.2799)*
CR	0.0255 (6.3128)*	0.0238 (5.8033)*	0.0252 (6.1786)*
Constanta	-0.5136	-0.4561	-0.6316
Adj. R^2	0.3255	0.3347	0.3156
F value	10.3332*	10.7292	6.9940

* indicate significance at 5%

Based on the test results it can be concluded that tax planning, if measured by the cash effective tax rate has a negative influence on the value of the company, and if using an effective tax rate, planning has no influence. Corporate governance (institutional ownership and independent board) has a positive effect on the value of the company. From the third model 3, it can be concluded that corporate governance does not moderate the influence of tax planning on firm value.

5 CONCLUSION

The purpose of this research is to get empirical evidence the effect of corporate governance, tax planning on firm value and to get empirical evidence of moderating effect of corporate governance on tax planning and firm value. The result shows that tax planning has a negative effect on firm value, this result is consistent with Zemzem and Ftouhi (2016), Oyeyemi and Babatunde (2016), Zemzem and Ftouhi (2013), Fajrin et al., (2018). The smaller the payment of corporate taxes the higher the value of the firm will be. If a company is able to reduce tax payments it will make the profits generated by the company greater, so investors will be interested in buying company shares.

Corporate governance has a positive effect on firm value, this result is consistent with Parrino et al., (2003), Ferreira and Matos (2008), Alfaraih et al., (2012), Fazlzadeh et al., (2011) and Uwuigbe dan Olusanmi (2012) Andres and Vallelado (2008) Trisnantari (2010) and Amyulianthy (2012). The more effective corporate governance in the company the higher the value of the company will be. This isbecause it will improve supervision, governance, and increase returns. However, corporate governance corporate does not moderate the influence of tax planning on firm value. This study provides an overview to companies that minimal tax payments coupled with good governance will increase the value of the company, which will attract investors to invest their money in the company, and help investors in determining the criteria for investing if they want to get a higher rate of return.

6 LIMITATION

This study has several limitations, namely the use of sample manufacturing companies that do not represent the company population in Indonesia, tax planning calculations that have not used temporary differences and permanent differences or tax books difference, and the use of ROA in measuring the value of a company that may be replaced by Tobin q or price to book ratio.

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