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An Influence: Executive Compensation, Tax Avoidance, and Multiple Large Shareholders (As Moderation)

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ABSTRACT

This research is conducted to analyze how executive compensation affects tax avoidance with the presence of multiple large shareholders (MLS) as moderation. This research uses descriptive and verificative methods with a quantitative approach and is conducted on companies engaged in the consumer non-cyclical sector on the IDX in the range of 2019 – 2021. There were as many as 164 total observational data from 68 obtained companies as research samples using purposive sampling techniques. In this research, we found that executive compensation has positive impacts on the practices of corporate tax avoidance. Additionally, it could be moderated by the existence of multiple large shareholders (MLS). MLS moderation can amplify and turn that influence into a negative one. Based on the obtained test results, executive compensation is a monitoring cost incurred to motivate company managers to conduct tax avoidance. Additionally, executive compensation also acts as a reward for additional risks that company managers must face. Companies in the consumer non-cyclical sector were used in this research because of their large numbers and massive contributions to the economy with 2019 – 2021 as a research year due to the COVID-19 outbreak which also impacted the economy.

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1. INTRODUCTION

Based on statements of Direktorat Jenderal Pajak (2015, 2016, 2017, 2018, 2019) the realization of tax revenue only reached 81.61% – 92.23% of the predetermined target. Later on, Direktorat Jenderal Pajak (2020) stated that the realization of tax revenue was only able to 89.43% or equal to IDR 1,072.11 trillion from the predetermined target. However, based on Direktorat Jenderal Pajak (2021), the realized tax revenue finally reached IDR 1,278.65 trillion or 103.99% of the target. Ironically, the DGT needs 12 years to realize this since the last time the tax revenue target could be met (Amaranggana, 2022). The non-fulfillment of tax revenue could happen because there are tax avoidance practices done by corporate taxpayers. This action is carried out because companies assume that tax is a burden that must be minimized to increase company profits (Ardiyanto and Marfiana, 2021). This topic is very important to be discussed to develop tax accounting science and explain what underlies the occurrence of tax avoidance based on the existing theories so that the truth and solution can be found.

Hanlon and Heitzman (2010) define tax avoidance as an action to reduce direct taxes with different levels of aggressiveness depending on the opinions of parties in the field of taxation, so the legality is difficult to determine. Quoting from Rachmad *et al*. (2023), we can describe the practice of tax avoidance as a contradictive behavior between the letter of the law against its spirit, which means that the practice is indeed not against the law, but it certainly does not meet the essence and purpose of the law itself. Based on the theory of planned behavior by Ajzen (1991), there are determinants related to a person's intention to behave, each determinant is also formed by beliefs. Company managers believe, that by doing tax avoidance, it could increase the profit as the tax burden is minimized (Prastiwi and Ratnasari, 2019; Riska and Sumaryati, 2021). Additionally, pressure from shareholders to improve company performance and the loopholes in tax regulations can encourage managers' intentions to carry out tax avoidance. The role of company managers is very crucial in making some decisions that are important and strategic, thus they could determine the level of tax avoidance, especially if there are some compromises on the amount of compensation they would receive (Dyreng *et al*., 2010; Saragih *et al*., 2021).

Based on agency theory by Jensen and Meckling (1976), executive compensation is a monitoring cost incurred by shareholders as principals to motivate company managers as agents who manage the company in conducting tax avoidance. Despite being profitable, tax avoidance practices also contain various risks. However, according to Kovermann and Velte (2019), managers will perform tax avoidance at the level desired by shareholders as long as there are incentives and effective monitoring. Therefore, executive compensation also plays a role in reward for the risks that managers take. On the other hand, agency conflicts also develop, not only between shareholders and company managers but also between fellow shareholders or type II agency conflicts (Panda and Leepsa, 2017). Particularly the existence of a concentrated company ownership structure as is common in Indonesia makes the conflict easier to occur due to the lack of protection of minority shareholders from expropriation actions (Boubaker and Sami, 2011) and able to reduce supervision and become a loophole for company managers to divert company resources for their interests. Therefore, the presence of parties who can prevent those conditions is needed, one of which is multiple large shareholders (MLS) that can limit the diversion of company resources for individual interest because corporate decision-making also requires approval from MLS which has significant voting rights with a percentage of more than 10% (Attig *et al*., 2009; La Porta *et al*., 1999). Therefore, the effect of executive compensation on tax avoidance could be moderated by the MLS.

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Previous research related to the effect of executive compensation on tax avoidance as done by Armstrong *et al*. (2015), Maulana *et al*. (2021), Meilia and Adnan (2017), Rego and Wilson (2012), and Syahruddin *et al*. (2020) resulting in the conclusion that executive compensation has a positive influence on tax avoidance. However, the previous research by Amri (2017), Ardiyanto and Marfiana (2021), Budiadnyani (2020), Chee *et al*. (2017), and Rohyati and Suripto (2021) lead to the opposite conclusion. The existence of these inconsistencies could happen because previous researchers did not consider the existence of other variables that could affect the relationship of the independent variable to the dependent variable. Therefore, this research adds moderation variables of multiple large shareholders (MLS). Additionally, the lack of exploration of MLS makes this research interesting to do. Later on, the subjects of this research are companies engaged in the consumer non-cyclical sector on the IDX in the range of 2019 – 2021. The rationalization of the selection of subjects is to consider the amount of tax contributions and the large number of companies so that tax avoidance is difficult to detect. The 2019 – 2021 period was chosen as the research period, considering that during that period the COVID-19 pandemic occurred, while several previous researchers concluded that tax avoidance increased during the COVID-19 pandemic.

The goal of this research is to find and analyze how executive compensations could have some impacts on tax avoidance and how it could be moderated by multiple large shareholders. Later on, the results of this research are conducted to determine an answer related to inconsistencies and lack of exploration in previous research and become a reference that could be used for future research. Additionally, it is also expected to increase the insight and knowledge of students and the public related to tax avoidance and support the development of accounting science.

2. METHODS

This research uses descriptive and verificative methods with a quantitative approach. Furthermore, this approach has been widely used by various previous research, such as research by Dyreng *et al*. (2010), Armstrong *et al*. (2012), Attig *et al*. (2008), Amri (2017), Chee *et al*. (2017), and many others. This research is conducted on companies engaged in the consumer non-cyclical sector on the IDX in the range of 2019 – 2021. The technique used in screening research samples is purposive sampling. The criteria and obtainment of observational data are as follows (See **Table 1**):

Table 1. Sampling

Sample Criteria	Year 2019	Year 2020	Year 2021
Companies in the consumer non-cyclical sector on the Indonesia Stock Exchange (IDX).	79	87	98
Companies that do not present key management compensation data in the financial statements.	(8)	(14)	(27)
Companies with financial statements that use currencies other than Rupiah.	(0)	(1)	(1)
Companies that did not make a profit in the range of 2019 – 2021.	(16)	(20)	(13)
Research Sample	**55**	**52**	**57**
Total Data Observation		**164**	

Source: Processed data by the author (2023).

Later on, data from the companies that were selected by document research techniques would be analyzed by using descriptive statistical analysis and panel data regression analysis. Before conducting the analysis, the data on each variable would be transformed into logarithmic form and measured using the following indicators:

This research uses the cash effective tax rate (CETR) as an indicator of tax avoidance variables. If the value of CETR increases, then the level of corporate tax avoidance will decrease and if the value of CETR decreases, the rate of tax avoidance will increase. The CETR ratio is formulated as follows:

$$\mathbf{CETR} = \frac{\mathbf{Total\ cash\ tax\ payment}_{(\mathbf{t})}}{\mathbf{Total\ accounting\ profit\ before\ tax}_{(\mathbf{t})}}$$

Then to measure the executive compensation variable, this research uses an indicator that is formulated as follows:

$$\mathbf{EC} = \mathbf{Total\ compensation\ received}_{(\mathbf{t})}$$

Apart from that, the multiple large shareholders (MLS) variable is measured using a dummy variable where companies with an ownership structure that has an MLS are given a score of 1 and companies with an ownership structure that does not have an MLS are given a score of 0, assuming that each share has one voting right based on Law Number 40 of 2007 Article 84 paragraph (1).

This research used secondary data obtained through documentation research. Furthermore, descriptive statistical analysis and regression analysis of panel data with unbalanced panel data types were carried out on the data obtained with regression models as follows:

$$\mathbf{TA}_{\mathbf{it}} = \boldsymbol{\alpha} + \boldsymbol{\beta}_{\mathbf{1}}.\mathbf{EC}_{\mathbf{it}} + \mathbf{e}_{\mathbf{it}}$$

Notes:

TA_{it} : Tax avoidance
α : Constant (intercept)
$β_1$: Regression coefficient of executive compensation
EC_{it} : Executive compensation
e : Error term
i : Companies
t : Year (time)

To test the ability of MLS to moderate the effect of executive compensation on tax avoidance, this research uses a panel data of moderation regression model as below:

$$\mathbf{TA}_{\mathbf{it}} = \boldsymbol{\alpha} + \boldsymbol{\beta}_{\mathbf{1}}.\mathbf{KE}_{\mathbf{it}} + \boldsymbol{\beta}_{\mathbf{2}}.\mathbf{MLS}_{\mathbf{it}} + \boldsymbol{\beta}_{\mathbf{3}}.\mathbf{KE}_{\mathbf{it}}.\mathbf{MLS}_{\mathbf{it}} + \mathbf{e}_{\mathbf{it}}$$

Notes:

TA_{it} : Tax avoidance
α : Constant (intercept)
$β_1$: Regression coefficient of executive compensation
EC_{it} : Executive compensation

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β_2	: Regression coefficient of MLS
MLS_{it}	: Multiple Large Shareholders
β_3	: Regression coefficient of the interaction of EC_{it} and MLS_{it}
$EC_{it}.MLS_{it}$	: Interaction between executive compensation and MLS
e	: Error term
i	: Companies
t	: Year (time)

3. RESULTS AND DISCUSSION

3.1. Descriptive Statistical Analysis

The following is the result of descriptive statistical analysis using transformed data consisting of mean, maximum, minimum, and standard deviation values along with their explanations (see **Table 2**):

Table 2. Descriptive statistical analysis results

Descriptive statistics	TA	EC	MLS
Mean	0.565226	23.83807	0.304878
Maximum	2.749936	27.61382	1.000000
Minimum	0.079345	20.12218	0.000000
Std. Dev.	0.347632	1.557535	0.461766

Source: Processed data with EViews software ver.12 by the author (2023).

Based on the **Table 2**, the tax avoidance variable has a value of 0.565226 as the average (mean) value, which indicates a low level of corporate tax avoidance because the average amount of tax paid by companies in cash is 56.52% of total profit before tax. Furthermore, a maximum value of 2.749936 and a minimum value of 0.079345 indicate that the highest amount of tax that the company pays in cash is almost eight times the profit before tax, whilst the lowest amount of tax paid in cash by the company is only 1% of profit before tax. Then, the standard deviation value of 0.347632 describes the distance of data distribution from the average value being close together or the range of data variation is relatively small, indicating that the data obtained tend to be homogeneous.

As summarized in **Table 2**, it is known that the average amount of executive compensation received by company managers in companies engaged in the consumer non-cyclical sector on the IDX in the period 2019 – 2021 is 23.83807 or equal to IDR 67.861.911.442,24. Then the maximum value of the observation shows that the highest amount of executive compensation received by company managers is 27.61382 or equal to IDR 982.942.000.000,00 and the minimum value shows that the lowest amount of executive compensation received by company managers is 20.12218 or equal to IDR 548.214.286,00. Then, the standard deviation value from the observation is 1.557535. This value is less than the average value and shows that the distance of data distribution from the average value is close or in other words, the range of data variations is small so that the data obtained is homogeneous, as well as tax avoidance variable data.

Table 2 also shows that the mean of the multiple large shareholders (MLS) variable is 0.304878, which shows that the average presence of MLS in the company's ownership structure in Indonesia is still relatively small. Furthermore, a maximum value of 1.000000 indicates there is at least one MLS in the company's ownership structure and a minimum value of 0.000000 suggests that the company has no MLS at all in its corporate ownership structure. The standard deviation value of 0.461766 indicates that the distance of data distribution from the mean value is far or the range of data variation is wide, indicating that the data obtained are heterogeneous.

3.2. Panel Data Regression Analysis

It is then carried out by transformation which results in the following **Table 3**:

Table 3. Partial test results (T-test)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.827223	0.516977	3.534440	0.0005
EC	-0.052282	0.021741	-2.404709	0.0173

Source: Processed data with EViews software ver.12 by the author (2023).

The executive compensation variable has a p-value that turned out to be smaller than 0.05, which is a significance level value with an obtained value of 0.0173, as can be seen from the partial test results so H_0 was rejected. Additionally, a negative coefficient value of -0.052282 indicates a negative relationship between executive compensation and CETR as an indicator of tax avoidance. If the CETR value obtained increases, the level of tax avoidance that has been done by the company will decrease and vice versa. This suggests there is indeed a crucial positive impact from executive compensation to tax avoidance practices.

The interaction test results (see **Table 4**) showed the p-value of the variable of executive compensation obtained is 0.0581 or equal to 0.05, which is a level of significance and has a value of -0.152496 as a coefficient so that executive compensation has a significant effect on tax avoidance with a positive relationship. Furthermore, from the interaction test, the p-value of the multiple large shareholders (MLS) variable is 0.0422. The value is less than 0.05, which is the significance level value. It turns out there is a significant positive influence from MLS on tax avoidance, which can be shown from the interaction test results with a value of -4.689021 as a coefficient.

Table 4. Interaction test (moderated regression analysis) results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	4.155931	1.896201	2.191714	0.0309
EC	-0.152496	0.079497	-1.918251	0.0581
MLS	-4.689021	2.276243	-2.059982	0.0422
EC_MLS	0.201788	0.094910	2.126101	0.0361

Source: Processed data with EViews software ver.12 by the author (2023).

As yet based on the interaction test results, H_0 was decided to be rejected because the interaction variable between executive compensation and MLS has a p-value of 0.0361, which is smaller than 0.05, which is a significance level value. Based on that, it could be known that the positive impact of executive compensation on the practice of tax avoidance can be moderated by the MLS by switching the course of that influence to negative.

As can be seen in **Table 5**, the adjusted R-squared value is 0.024266, which states that the magnitude of the ability of the executive compensation variable to explain the tax avoidance variable is very small or limited, only reaching 2.43% in the regression model of this research,

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then 97.57% could be explained by variables other than the variables of this research. This is possible due to the limited number of independent variables in this regression model, which amounts to only one.

Table 5. Coefficient of determination (R^2) test results

Effects Specification			
		S.D.	**Rho**
Cross-section random		0.260752	0.5745
Idiosyncratic random		0.224420	0.4255
Weighted Statistics			
Root MSE	0.238591	R-squared	0.030252
Mean dependent var	0.272046	Adjusted R-squared	0.024266
S.D. dependent var	0.252126	S.E. of regression	0.240059
Sum squared resid	9.335788	F-statistic	5.053736
Durbin-Watson stat	1.855282	Prob(F-statistic)	0.025922
Unweighted Statistics			
R-squared	0.037097	Mean dependent var	0.565226
Sum squared resid	18.96749	Durbin-Watson stat	0.913169

Source: Processed data with EViews software ver.12 by the author (2023).

In **Table 6**, the adjusted R-squared value was known to be 0.596973, which could be interpreted that the contribution of executive compensation variables, multiple large shareholders, and their interaction with executive compensation together can explain the tax avoidance variable of 59.70%, while the remaining 40.30% could be explained by variables that were not being researched in this research.

Table 6. Coefficient of determination (R^2) test results – regression moderation

Effects Specification			
Cross-section fixed (dummy variables)			
Root MSE	0.166191	R-squared	0.770052
Mean dependent var	0.565226	Adjusted R-squared	0.596973
S.D. dependent var	0.347632	S.E. of regression	0.220692
Akaike info criterion	0.114491	Sum squared resid	4.529569
Schwarz criterion	1.456506	Log-likelihood	61.61173
Hannan-Quinn criter.	0.659299	F-statistic	4.449136
Durbin-Watson stat	3.511263	Prob(F-statistic)	0.000000

Source: Processed data with EViews software ver.12 by the author (2023).

Additionally, the adjusted R-squared value after moderation has increased compared to the adjusted R-squared value before moderation. It shows that moderation of MLS variables can strengthen the positive effect of executive compensation on tax avoidance and change the direction of that influence to negative.

3.3. Discussion

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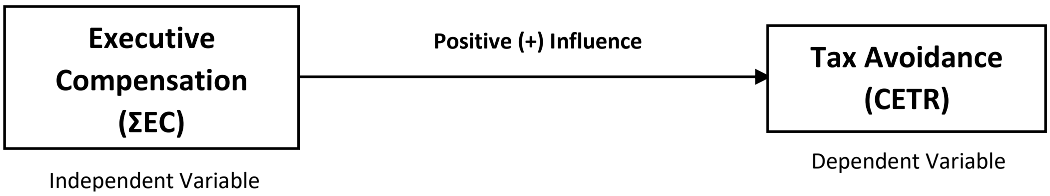
The p-value of the executive compensation variable of the partial test results (t-test) obtained was less than the level of significance and the value of the obtained coefficient is positive so that the research hypothesis could be accepted. In this research, tax avoidance practices are measured using CETR, in which if the value is higher, the tax avoidance rate will decrease and vice versa. Therefore, the results of this research state that executive compensation positively affects tax avoidance practices (see **Figure 1**).

The explanation shows that if the managers received more executive compensation, the company's tax avoidance practice would also increase. Furthermore, the results of this research align with the agency theory proposed by Jensen and Meckling (1976) that agency relations will cause agency costs consisting of monitoring costs, bonding costs, and residual losses. Based on this, shareholders must include executive compensation in monitoring costs so that company managers can act in their interests. Therefore, the level of tax avoidance carried out by company managers would later be adjusted to the desire of shareholders. Although on the one hand, tax avoidance can benefit shareholders with an increase in dividends, on the other hand, tax avoidance risks the company's reputation which can later affect stock prices. This risk will certainly be greater along with the higher level of tax avoidance requested by shareholders. Therefore, the provision of executive compensation acts as an additional reward because of the additional risk borne by the company's managers.



Source: Processed by the author (2023).

Figure 1. Overview of how tax avoidance is influenced by executive compensation

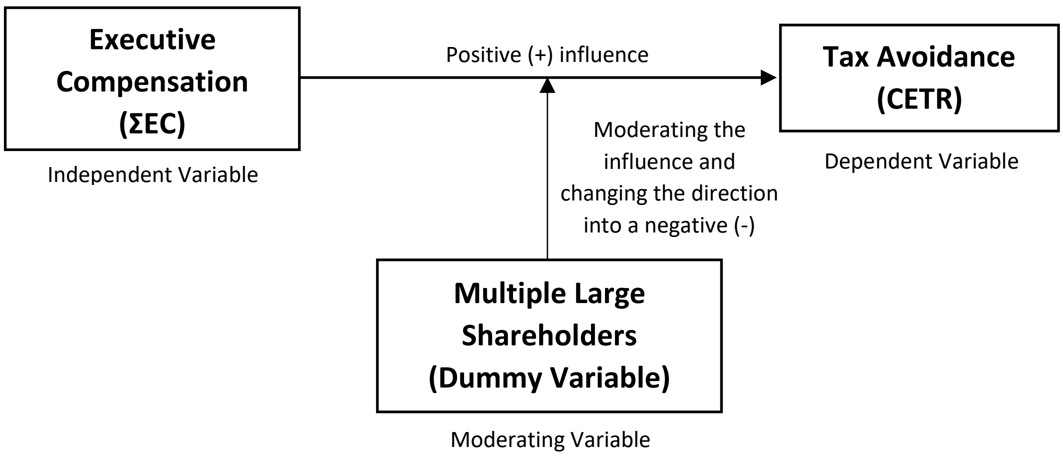
In addition, the impact of the COVID-19 pandemic, which made many companies lose money created great demands on company managers to maintain the sustainability of the company so that executive compensation was encouraged to motivate them to act more aggressively in limiting company expenses, including tax expenditures, one of which was done by the rise of tax avoidance practice. This explanation can certainly show that the increase in corporate tax avoidance practices was influenced by the increase in executive compensation when the COVID-19 outbreak occurred, thus providing additional support related to the results of this research that there is a significant positive effect of executive compensation on corporate tax avoidance practices.

This research provides results that are aligned with research compiled by Armstrong *et al.* (2015), Maulana *et al.* (2021), Meilia and Adnan (2017), Rego and Wilson (2012), and Syahruddin *et al.* (2020) with the result of the statement that executive compensation positively affects tax avoidance practices. Based on these researches, the provision of high executive compensation can increase the sense of responsibility of company managers to shareholders in meeting company goals, one of which is to maximize company profits so that managers are motivated to act more aggressively by doing tax avoidance.

However, the results of this research are contradictive to the results of research by Amri (2017), Budiadnyani (2020), Chee *et al.* (2017), Desai and Dharmapala (2006), and Rohyati and

Suripto (2021) with the result of the statement that executive compensation negatively affects tax avoidance. Based on these researches, large amounts of executive compensation can be a corporate governance mechanism in limiting the opportunistic behavior of company managers and could increase manager conservatism towards risks so that tax avoidance practices would be avoided because tax avoidance practices contain various risks that can threaten the sustainability of the company.

Furthermore, the results of the interaction test (moderated regression analysis) showed that the p-value of the MLS interaction variable with executive compensation obtained is less than the level of significance so the research hypothesis can be accepted. Therefore, this research results in the assertion that the effect of executive compensation on tax avoidance practices could be moderated by the MLS. The results of this research show that MLS moderation reinforces the positive influence of executive compensation on tax avoidance practices and changes the direction of that influence to negative (see **Figure 2**).



Source: Processed by the author (2023).

Figure 2 Overview of how tax avoidance is influenced by executive compensation with the presence of multiple large shareholders

The results of this research also support the statement of Panda and Leepsa (2017) that over time, agency conflicts occur not only between shareholders and company managers but also between majority shareholders and minority shareholders, known as type II agency conflicts, where agency conflicts are more vulnerable to occur in companies with centralized share ownership as most are applied in Indonesia so that the presence of MLS in the ownership structure of companies with significant voting rights makes them have sufficient resources to influence company decision making and conduct monitoring to prevent majority shareholders from expropriating minority shareholders and utilizing company managers in carrying out risky tax avoidance. The role of MLS supervision could also be carried out on company managers to prevent them from diversion of company resources through compensation that creates a mismatch between the compensation given to company managers and their performance in managing the company.

This research provides results that are aligned with research compiled by Andriyanto and Marfiana (2021) and Pratama and Apandi (2019) with the result of the statement that multiple

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large shareholders (MLS) can moderate the influence of independent variables on tax avoidance, such as ownership structure (family and foreign) and business strategies. Based on these researches, the presence of MLS in the company's ownership structure can reduce expropriation actions by majority shareholders against minority shareholders so that type II agency problems can be overcome and carry out a supervisory role to prevent diversion of company resources for personal interests through tax avoidance.

4. CONCLUSION

This research aims to conclude how executive compensation could have some impacts on tax avoidance practices by using consumer non-cyclical sector companies during 2019-2021 as the sample, and multiple large shareholders as the moderation. After going through a series of research processes, the author can conclude that there is a significant positive effect of executive compensation on tax avoidance practices carried out by companies, which means that the greater the value of compensation given to company managers, the higher the level of corporate tax avoidance. This indicates that the higher the executive compensation given by the company, the more aggressive company managers are in taking risks to increase company profits through tax avoidance.

Furthermore, the positive influence of executive compensation on tax avoidance practices could be moderated by the presence of MLS, which could be done by strengthening and changing the direction into some negative ones. The presence of MLS in a company's ownership structure can reduce agency conflicts between fellow shareholders and provide additional monitoring of majority shareholders and company managers to prevent them from diverting company resources.

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