



The Role of Multiple Large Shareholders (MLS) and Family Firms (As Moderating) on Tax Avoidance in Indonesia

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ABSTRACT

Conflicts of interest between shareholders often arise, including in tax avoidance decisions. This research aims to explore the role of multiple large shareholders (MLS) on tax avoidance in the firm, and whether family-held firms influence its relation. MLS explained as the second largest shareholders who at least held 10% of shares, while tax avoidance measured by book-tax differences. This research used panel data regression analysis techniques to analyze sample data from 68 public companies in Indonesia from 2017 until 2020. The results show that MLS is negative and significantly related to corporate tax avoidance, indicating that MLS has incentives to monitor and control agency problems that lead to reduced tax avoidance practices for private benefits. In addition, family firms strengthen the negative relationship between MLS and tax avoidance. This shows that the existence of MLS is effective in reducing tax avoidance since they have quite high voting rights to monitor corporate tax avoidance. On the other hand, family-held firms further strengthen MS in reducing tax avoidance as their family names could degenerate if they collude to aggressively avoid paying taxes.

Keywords: Shareholders, Book-tax differences, Family firms

1. INTRODUCTION

Taxes have important roles in the fundamentals of a country's economy, especially in developing countries which tend to be more dependent on tax revenue than developed countries to finance general expenditure for public welfare, supported by Muthitacharoen [1]. The UN Tax Committee has also considered tax revenue in financing the Sustainable Development Goals (SDGs). Therefore, it is very important to combat tax avoidance practices.

Tax avoidance has received more attention since several large companies such as Tyco, Enron, Google, IKEA, and Starbucks were found to avoid taxes, supported by Desai et al [2], Munisami [3]. The G20 conference also continues to discuss how to prevent tax avoidance and strengthen each country's tax base. Optimizing the tax system is one of the main discussions to overcome tax avoidance. The COVID-19 pandemic has increased the urgency of tax regulations that can optimize tax revenue to finance sustainable development.

The corporate tax expense becomes a burden on shareholders since taxes reduce the company's total income. Therefore, companies try to pay tax as little as possible because it is also considered to generate additional internal funds, supported by Kovermann [4]. Tax avoidance is tax planning by looking for loopholes in tax regulations to minimize tax payments. However, tax avoidance is detrimental to the country and is considered unethical. In 2020, the Tax Justice Network reported that lots of tax loss was caused by corporate tax abuse, supported by Shaxson N [5]. Tax avoidance practices are generally seen as beneficial to all parties in the company, however, the complexity of tax planning can result in ambiguity in management control and induce losses for some parties in the company, supported by Desai, et al [2]. In addition, tax avoidance also provokes conflict of interest. For example, tax avoidance is used as a shield to expropriate minority shareholders, supported by Chan K [6] or shift the company's resources outside.

The separation of ownership and control encourages tax avoidance activities, supported by Kovermann [7]. In countries with concentrated ownership, conflict between controlling and noncontrolling shareholders (agency

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problems II) is more common, especially when the controlling shareholders are family, supported by Villalonga et al [8]. Highly concentrated ownership increases the intensity of controlling shareholders to pursue their private benefits, supported by Jara-Bertin [9] and manage tax planning, supported by Chen, S et al [10]. The Board of Directors (BOD), as part of corporate governance, has responsibility for managing the company and determining the company's policies to ensure the company carries out all shareholders' interests that do not violate the regulations. Shareholders have the opportunity to influence fundamental corporate issues, including the selection board of directors (BOD) and approval of certain transactions, supported by G20/OECD [11]. Thus, it will be difficult for controlling shareholders to gain private benefits alone.

In Asia, most public companies are generally concentrated around single large shareholders and minority shareholders, supported by Faccio et al [12], Villalonga et al [8]. However, some companies have other large shareholders besides the top largest shareholders. Around 25% of large companies in prosperous countries have a second-largest shareholder, supported by Faccio et al [12] and 33% of companies in East Asia have at least two large shareholders, supported by Claessens et al [13]. Following prior research, this research defines second-largest shareholders who hold at least 10% of the total outstanding shares as Multiple Large Shareholders (MLS), supported by Attig et al [14], Ouyang et al [15].

Previous research shows that tax avoidance practices are related to corporate governance, supported by Minnick et al [16]; Montenegro [17], ownership structure, supported by Chen, S. et al [10], and information asymmetry, supported by Chen, T. et al.[18]. Several large shareholders engage in less tax avoidance since they can alleviate financial constraints thereby reducing tax avoidance practices, supported by Ouyang et al [15]. However, its research subjects use a socialist market economy system that is only used by a small number of countries. Moreover, the government dominates economic activities, hence MLS may not have the opportunity to collude.

Prior literatures found that large shareholders are beneficial to minority shareholders since they can increase shareholder protection, monitor and restrain controlling shareholder who pursue private benefits, supported by Boubaker et al [19], Alm J. et al [20], there is debate that several large shareholders in the company are more costly and worsen agency problems [21], especially when the family holds excess control rights, supported by Chen, S. et al [10]. The role of MLS in Europe and Asia is different because "family principle" in East Asia increases the potential for MLS to collude and receive private benefits, supported by Faccio et al [12]. This is in line with the finding that found family firms have different management and characteristics affecting the ability of corporate governance differently, supported by Manogna et al [22], since controlling shareholders and their descendants would participate in management, supported by Claessens et al [13], Desai et al [2]. Therefore, the concentration of ownership in the family can facilitate the collusion of MLS to expropriate minority shareholders. but on the other hand, family-controlled firms have lower monitoring costs than nonfamily, supported by Burkart et al [23], Jensen et al [24] and they are highly concerned about the company's reputation, supported by Chen, S. et al [10]. Thus, the impact of MLS on corporate tax avoidance can be different in family and nonfamily-controlled firms.

Based on the explanation above, this research aims to fill the gap in the literature regarding tax avoidance. We investigate the role of MLS on corporate tax avoidance in Indonesia. We chose Indonesia for several reasons. First, Indonesia is implementing a mixed economic system, in which the government and private sector collaborate to carry out economic activities. Since this system is used by several countries, its findings can be implemented by a large number of countries. Second, corporate ownership in Indonesia is highly concentrated and controlled by the family, supported by Claessens et al [13]. Third, Indonesia has weak governance and shareholders' protection, supported by La Porta et al [25]. Lastly, Indonesia is a developing country where the main source of the country's income comes from tax revenue, supported by Muthitacharoen et al [1]. Furthermore, we investigate the roles of family firms in the relationship between MLS and tax avoidance.

The rest of this study is organized as follows. In section II, we discuss the literature review. Section III describes the research design and methodology. Section IV discusses the findings. In the end, we present discussion and conclusion.

2. LITERATURE REVIEW

Corporate governance is a system to manage the company to perform well. Corporate governance has several roles, for example ensuring shareholders and stakeholders have the same protection rights (including minority shareholders), devising and allocating the company's assets, as well as monitoring the company's

performance, supported by G20/OECD [11]. Companies with good governance will apply the principles to reduce agency problems.

Agency problems discussed conflicts of interest between principal and agents, supported by Eisenhardt [26], Jensen et al [24]. In countries with concentrated ownership, problems between controlling and noncontrolling shareholders (Agency Problem II) are more common, supported by Villalonga et al [8]. Controlling shareholders can use their control rights for their private benefits and harm minority shareholders. In a tax context, the controlling shareholder may use tax avoidance as an excuse to expropriate company resources, for example for tunnelling or related-party transactions, supported by Chan, K. et al [27], Nuritomo et al [28]. Moreover, sometimes they ignore nontax costs to get the benefits of tax avoidance.

Conflict of interest can be reduced by monitoring carried out by shareholders, supported by G20/OECD [11]. The second largest shareholders have enough control rights to participate in making decisions. They do not hold shares more than the largest shareholders, therefore they cannot expropriate a minority by themselves, while they can monitor the controlling large shareholder. Thus, they may reduce aggressive tax avoidance that harms other shareholders.

2.1. Hypothesis Development

Company's income and dividend to shareholders may be higher when they perform tax management. However, tax management behaviour by avoiding tax is considered to increase agency problems since there may be differences in decisions by the largest shareholders when avoiding tax for their private benefits. In countries with concentrated ownership, problems between majority and minority shareholders (Agency Problem Type II) tend to be found more frequently than problems between shareholders and managers (Agency Problem Type I), supported by Villalonga et al [8]. Majority shareholders tend to have more controlling rights and use it for their own private benefit by sacrificing minority shareholders. For example, they maximize the benefits of tax avoidance and ignore the potential nontax costs (such as a company's reputation or penalties by tax authorities).

Previous research highlights that there are concerns in problems arising from a discrepancy between principal-principal's goals (e.g., the largest shareholder may use tax avoidance as an excuse to expropriate company's resources, supported by G20/OECD [11]. To reduce the differences in interests can by using a third party to monitor the contracts, supported by Watts et al [29]. Several previous researchers found that MLS has a positive effect on firm value, supported by Attig et al [14], Boateng et al [30], Maury et al [31]. They argue that the existence of MLS enhances the monitoring role and reduces principal – principal conflicts. MLS is also viewed as having a role as corporate governance in monitoring controlling shareholders to not to carry out aggressive tax avoidance activities. Thus, we build hypothesis as below:

Hypothesis 1: MLS has a negative relationship with corporate tax avoidance

Even though shareholders with substantial shareholding help to monitor or restrain managers from taking action in their private interests, this may differ in different ownership structures, supported by Chen, S. et al [10]. The formation of the MLS coalition also exacerbates the expropriation of minority shareholders if the firm is family owned, supported by Jara-Bertin et al [9]. Family firms have unique management compared to nonfamily firms. Several family members commonly take executive positions and perform the firm's operations. The presence of the family in management further strengthens the right to making decisions. They can "pressure" the head of the tax division to lower the firm's effective tax rate since executives play an important role in determining the level of tax avoidance, supported by Dyreng et al [32].

As a theory, family firms maintain their reputation to build trust within shareholders and other stakeholders, as well as inherit the firm to their descendants. Family firms are more concerned about nontax costs from potential price discounts by minority shareholders arising from the tax avoidance practices that may be detrimental to minority shareholders, supported by Chen, S. et al [10]. Family firms prioritize nonfinancial goals over financial goals. Therefore, the possibility of MLS colluding to commit tax avoidance and expropriate minority shareholders may be lower. Thus, we build hypothesis as below:

Hypothesis 2: Family firms strengthen the negative relationship of MLS on corporate tax avoidance

3. METHODOLOGY

This research is quantitative research using samples from Indonesia from 2017 to 2020. We chose Indonesia as our sample for several reasons as follow:

1. Indonesia is a developing country where most of the government revenues come from taxes;
2. Corporate ownership in Indonesia is highly concentrated and controlled by family, supported by Claessens et al [13], Rachmawati et al [33];
3. Indonesia has weak governance and shareholders' protection [25], where it would be easier for controlling shareholders to appropriate minority shareholders.

The purposive sampling method was used to select samples by considering the following criteria: (1) the firms listed before 2017, (2) the firms do not suffer losses, (3) firms in the financial, construction and real estate industries were excluded since these sectors have different regulation and tax provisions, State-owned firms were also excluded since most of its outstanding shares are controlled by the government, (4) the firms have complete data. Thus, the total sample in this study comprises 68 companies for 4 years, resulting in 272 observation years.

There are two equation models in this research. The Model 1 tests the role of MLS on tax avoidance, while Model 2 examines the role of family firms on relationship between MLS and tax avoidance. Control variables were added to strengthen the models, namely Leverage (LEV), Return on Assets (ROA), and liquidity (LIQUID). LEV shows how the company uses debt to finance the company assets, ROA identifies the level of profitability of its total assets, which the greater ROA value the more efficient the company, LIQUID describes company's ability to payoff short-term debt obligations (a good liquidity ratio if the value > 1.0).

Tax avoidance is measured by Book-Tax Differences (BTD) by Guenther (2018). BTD is used since it is considered to be able to capture opportunistic reporting and book-tax manipulation caused by managerial interest, supported by Tang T, et al [34]. In addition, corporate tax rate in Indonesia has decreased from 25% to 22%, therefore BTD is more suitable for this research since BTD scaled to pretax income statistically equivalent to Effective Tax Rate (ETR) measurement, supported by Guenther [35]. The financial data in this research use dollar currency and collected from the Refinitif Eikon database (Thomson Reuters).

MLS is measured by the ratio of large non controlling shareholders to the largest shareholder, supported by Ouyang et al [36]. The presence of second largest shareholders is indicated if shareholders hold at least 10% of the total outstanding shares of the company, supported by Attig et al [14]. For family firms, we examine the biographies and careers of major shareholders further to indicate whether they have family relations or not. We categorize family firms if the large shareholders in a firm have meet some criteria as follows: (1) all individual shareholders whose ownership listed; (2) not a public company, state, and financial institutions; (3) owns 10% of ownership, (4) the majority shares are hold by founders or those who acquire the firm; (5) shareholders sharing same family name. We gathered the ownership structure from the Refinitif Eikon database and each companies' website. Table 1 provides details of the variables and the measurements, including control variables.

The panel data equation of Model 1 examines the influence of MLS on tax avoidance, as follow:

$$TA_{it} = \beta_0 + \beta_1 MLS_{it} + \beta_2 FAMILY_{it} + \beta_3 LEV_{it} + \beta_4 ROA_{it} + \beta_5 LIQUID_{it} + \varepsilon_{it} \quad (1)$$

Further, Model 2 investigate the moderating effect of the family firms on MLS by adding the $MLS * FAMILY$ variable to provide further examination on whether family firms influence the relationship between MLS and tax avoidance. The panel data equation as follow:

$$TA_{it} = \beta_0 + \beta_1 MLS_{it} + \beta_2 FAMILY_{it} + \beta_3 MLS * FAMILY + \beta_4 LEV_{it} + \beta_5 ROA_{it} + \beta_6 LIQUID_{it} + \varepsilon_{it} \quad (2)$$

Table 1. Definition and measurement of variables

Definition and measurement	
<i>Dependent Variables</i>	
BTD	Tax avoidance measured by Book-Tax Differences which is the difference between commercial income and estimated taxable income scaled by commercial income [35].
<i>Independent Variables</i>	
MLS	Multiple Large Shareholders measured by the ratio of the number of shares owned by second largest shareholders to shares owned by the largest shareholders [15].
FAMILY	Family firms: 1 if the firms owned by family, 0 otherwise [36].
<i>Control Variables</i>	
LEV	Leverage measured by the ratio of total liabilities to total assets [15].
ROA	Return on Assets measured by the ratio of net income to total assets [37].
LIQUID	Liquidity measured by the ratio of current assets to current liabilities [15].

4. RESULT AND DISCUSSION

4.1. Descriptive Statistics

Table 2 presents the descriptive statistics of the data in this study. The table shows that the average value of BTD was -0.008. This result indicated that tax profit for companies in Indonesia is greater than book profit. The negative value of BTD can be caused by the differences in recognition of income and expenses between accounting provisions and tax regulations, supported by Rachmawati et al [33], Tang, T et al [34]. The average value of MLS was 0.314. This result indicated on average, 23% of companies have large non-controlling shareholders. Meanwhile, the average value of family firms was 0.731 which is more than half of the sample-companies held by family. These results support that most companies in Indonesia consist of a single controlling shareholder and several minority shareholders and mostly controlled by the family, supported by Claessens et al [13].

Table 2. Descriptive Statistics

Descriptive Statistics						
	N	Mean	Median	Std. Dev	Min	Max
BTD	272	-0.008	0.005	0.132	-0.365	0.284
MLS	272	0.23	0	0.351	0	1
FAMILY	272	0.731	1	0.444	0	1
LEV	272	0.422	0.414	0.201	0.069	0.873
ROA	272	0.082	0.062	0.077	0.001	0.534
LIQUID	272	2.525	1.787	2.256	0.234	15.82

Table 2 also shows on average 42% of company assets are financed with debt (LEV). Meanwhile, the average ROA and LIQUID values show quite good values. The ROA value (8.2%) is positive and good in generating profits, even though ROA can vary in various industries. Liquidity ratio (LIQUID) > 1.0, this explains on average the company is not hampered to fulfill debt obligations and less likely to have financial constraint.

4.2. Determination of Panel Data Regression Estimation

We performed Chow test, Lagrange Multiplier test, and Hausman test to select the best panel data regression equation model. Chow test used to select either Pooled Least Square (PLS) or Fixed Effect Model (FEM). Hausman test used to select either FEM or Random Effect Model (REM). Lagrange Multiplier (LM) test used to select either PLS or REM. Table 3 shows the conclusion that the best equation for both models in this research was REM. Next, we undertake a normality test to ensure the data was normally distributed. Based on Table 3, the data in this research were normally distributed. Then, we performed classical assumptions to meet the characteristics of BLUE. Since the chosen regressions are random effect model (REM) or Generalized Least Square (GLS), we considered GLS has the ability to produce estimators that are freed from homoscedasticity and autocorrelation assumption, supported by Gujarati [38].

4.3. Hypothesis Testing

Table 4 presents the results of hypothesis testing on Model 1 and Model 2. Both models show that MLS is negatively associated with tax avoidance on a significance level of 1%. This explains if a company has MLS, the difference between book-tax difference would be smaller which indicates the tax avoidance practice is smaller. The results support prior research that several second-largest shareholders reduce tax avoidance, supported by Ouyang et al [15]. This evidence also supported MLS playing a role to monitor the largest shareholder and resolve the agency problem [14], [39], [40], that has the incentive to avoid tax for their private benefits that inflict nontax costs and harm minority shareholders. Hence, H1 is supported.

Table 3. Normality and determination of panel data regression estimation tests results

Normality and Determination of Panel Data Regression Estimation Tests			
Model 1		Model 2	
Chow Test	0.000	Chow Test	0.000
Hausman Test	0.181	Hausman Test	0.087
LM test	0.000	LM test	0.000
Conclusion: The best model is REM		Conclusion: The best model is REM	
Normality Test	0.095	Normality Test	0.196

Model 2 in Table 4 shows variable MLS*FAMILY is negatively associated with BTD on the significance level of 1%. It indicates that family firms are strengthening the relationship between MLS to reduce tax company tax avoidance practices. The result supports that family firms prioritize non-financial goals rather than financial goals, as well as maintain their reputation to not perform aggressive tax avoidance, supported by Chen, S. et al [10], hence the effectiveness of MLS to combat tax avoidance would be increasing. Thus, H2 is supported.

All the control variables in Table 4 are consistent with the prediction. Control variables are used to minimize the influence of other factors besides the independent variables. LEV is negatively associated with tax avoidance. The result shows that when the company uses more debt as funding resources, tax avoidance practices will decrease. Anticipating the risk, the debt obligation can be a medium for creditors monitoring and limiting the company's actions that can harm creditors, such as tunnelling activities and tax avoidance, supported by Chan et al [6], Frank et al [41], Watts et al [29]. ROA is positively associated with tax avoidance. ROA reflects the firm performance in generating profits from its total assets. The higher the company's profitability, the higher the income taxes, thus the company would aggressively reduce the tax burden, supported by Atwood et al [41], Frank et al [42], Ouyang et al [35]. LIQUID is negatively associated with tax avoidance. Companies with low liquidity tend to be more aggressive in avoiding taxes to maintain their cash flow and be able to pay back their short-term obligations, supported by Alm J, et al [20].

Table 4. Hypotheses test results

Hypothesis Test	Variable Independent	Prediction	BTD	
			Model 1	Model 2
	MLS	-	-0.19*** (0.000)	-0.074* (0.058)
	FAMILY	-	-0.014 (0.380)	0.015 (0.384)
	MLS*FAMILY	-		-0.147*** (0.001)
	LEV	-	-0.317*** (0.000)	-0.299*** (0.000)
	ROA	+	0.323*** (0.000)	0.34*** (0.000)
	LIQUID	-	-0.021*** (0.000)	-0.021*** (0.000)
	R ²		0.593	0.622
	F-statistic		0.000	0.000
	N		272	272

Notes: ***<0.001; **p<0.05; *p<0.1

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by Atwood et al [41], Frank et al [42], Ouyang et al [35]. LIQUID is negatively associated with tax avoidance. Companies with low liquidity tend to be more aggressive in avoiding taxes to maintain their cash flow and be able to pay back their short-term obligations, supported by Alm J, et al [20].

4.4. Robustness Test

We conduct robustness testing to check the validity of the main findings. This study uses 3-Year Adjusted ETR to measure tax avoidance, supported by Balakrishnan et al [43]. The lower ETR value indicates the higher corporate tax avoidance, supported by Balakrishnan et al [43]. Table 5 presents the robustness result. In model 1, MLS is positively associated with ETR at the significance level of 1%. It explains that MLS increased corporate effective tax rates. Furthermore, family firms’ interaction shows a positive relation to the relationship between MLS and tax avoidance. However, in Model 2 we found that MLS is not associated with ETR. The inconsistency of these results indicates that additional robustness tests with diverse measurements are needed. This inconsistency may be caused by the ETR measurement not reflecting the changes in statutory tax rates in Indonesia. However, in general, the research model is proven to be robust and supports the result of the main model.

Table 5. Robustness test result

Robustness Test		ETR	
Variable Independent	Prediction	Model 1	Model 2
MLS	-	0.151*** (0.000)	0.05 (0.121)
FAMILY	-	0.01 (0.425)	-0.014 (0.318)
MLS*FAMILY	-		0.127*** (0.000)
LEV	-	0.097*** (0.006)	0.083*** (0.014)
ROA	+	-0.152** (0.023)	-0.157*** (0.14)
LIQUID	-	0.005* (0.081)	0.005* (0.078)
R ²		0.451	0.481
F-statistic		0.000	0.000
N		272	272

Notes: ***<0.001; **p<0.05; *p<0.1

5. CONCLUSION AND FUTURE RESEARCH

The conflict of interest between the largest shareholder and other large shareholders in managing tax payment motivates this research. Prior research shows that second largest shareholders have the ability to monitor the largest shareholder using tax as a shield to expropriate minority shareholders since they have high voting rights. The results show the firms that have other large shareholders engage in less tax avoidance. They have capability to decrease aggressive tax avoidance that may be harmful to minority shareholders. In addition, family firms strengthen their relationships. Presumably, MLS has its incentive to reduce tax avoidance, especially when the company is held by a family, the effectiveness of MLS is increased.

This research has implications for the government, regulators, investors, and tax avoidance literature. The government and regulators are expected to be more stringent in developing tax regulations so there will be no grey area for controlling shareholders to take tax avoidance as a shield to expropriate the minority shareholders, as well as more incentives to monitor the managerial ownership structure, and increase the protection of minority shareholders’ rights. This research also expected to be a consideration for investors to monitor the large shareholders whether they deliberate minority shareholders before taking certain transactions.

However, we cannot avoid some limitations. First, this study only focused on Indonesia. The difference in the economic system and tax regulations can establish the difference in political intervention and incentives that may influence the role of MLS in the firm. Further research can carry out cross-country research to investigate the different country characteristics and compare the role of MLS to tax avoidance decisions. Second, we measured the family firms only by one dummy variable. Further research can consider using a better measurement of ownership structure to obtain more precise family firms’ data, for example by the percentage of shares held, the number boards, or other executives.

AUTHORS CONTRIBUTIONS

The first author responsible for the study conception, data collection, analysis, interpretation of results, and manuscript preparation. The second author is responsible for the study conception, analysis and interpretation of results. The third author responsible for the manuscript preparation, editor, and corresponding author.

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