The Effect of Firm Size and Institutional Ownership on Tax Avoidance

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ABSTRACT

This study aims to determine the effect of firm size and institutional ownership on tax avoidance. The object of this study is a manufacturing company in the consumer goods sector listed on the Indonesian Stock Exchange for the 2017-2021 period. The data collection technique used in this research is a documentation study. This research method in this study uses a quantitative approach with Eviews analysis tools. This study amounted to 32 population with a sample of 160 data. The sampling method used is purposive sampling. The analysis method of this study uses multiple linear regression. The results of this study showed that firm size has a negative effect on tax avoidance. In contrast, institutional ownership does not affect tax avoidance.

Introduction

Globalization has created a great demand for various public services, prompting governments to raise taxes to fund these development-oriented programs (Adela et al. 2023). National development is an activity in a country that aims to improve people's welfare, such as constructing public facilities. In this case, taxes are mandatory. Taxes are the largest source of income for the state. Taxes are used to run government programs to increase economic growth by developing infrastructure, public assets, and other public facilities. This is evidence that tax revenue contributes greatly to state revenue. Given the very important role of taxes for the state, the government seeks to maximize revenue from the tax sector (Ulfa et al. 2021).

For the government, taxes are significant for income for a country, so to achieve an increase in state revenue, the government encourages the public to participate in paying taxes obediently to ensure the prosperity of the community and encourage national growth and development to achieve prosperity for all people (Laeladevi et al. 2021).
The following are state revenue according to the Ministry of Finance (Ministry of Finance) in the 2017-2021 period:

Table 1. State Revenue for 2017-2021
(In Billion Rupiahs)

<table>
<thead>
<tr>
<th>Year</th>
<th>Taxes Realization</th>
<th>Taxes Percentage</th>
<th>Non Taxes Realization</th>
<th>Non Taxes Percentage</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>1,343.50</td>
<td>81.2%</td>
<td>311.20</td>
<td>18.8%</td>
<td>1,654.70</td>
</tr>
<tr>
<td>2018</td>
<td>1,518.80</td>
<td>78.8%</td>
<td>409.30</td>
<td>21.2%</td>
<td>1,928.10</td>
</tr>
<tr>
<td>2019</td>
<td>1,546.10</td>
<td>79.1%</td>
<td>409.00</td>
<td>20.9%</td>
<td>1,955.10</td>
</tr>
<tr>
<td>2020</td>
<td>1,285.10</td>
<td>78.9%</td>
<td>343.80</td>
<td>21.1%</td>
<td>1,628.90</td>
</tr>
<tr>
<td>2021</td>
<td>1,375.80</td>
<td>79.4%</td>
<td>357.20</td>
<td>20.6%</td>
<td>1,733.00</td>
</tr>
</tbody>
</table>

Source: [www.kemenkeu.go.id](http://www.kemenkeu.go.id)

Based on Table 1, it can be concluded that in 2017-2021 the percentage of tax revenue is more significant than non-tax revenue, as in 2017, the rate of tax revenue was 81.2% while non-tax revenue was 18.8%. In 2019-2020 tax revenue decreased by 80%. The decrease in tax revenue was caused by corporate taxpayers minimizing their tax burden by avoiding taxes (Anggraeni and Oktaviani 2021).

Every nation strives to maximize state revenues through the tax system. However, sometimes efforts to optimize tax revenue have problems. This happens because of the efforts made by companies to avoid paying taxes because taxes are a burden for companies that can reduce company profits. Since the beginning of tax laws, there has also been a problem with tax avoidance, widespread in all societies where taxes are collected. Due to the high corporate income tax rate, this threat is even more common among corporate taxpayers (Yusri et al. 2022).

High corporate competition often makes companies strive to develop strategies to increase revenue through the company's sales growth. Increasing sales is accompanied by increasing revenue, which increases the company's obligation to pay taxes (Ekaristi et al. 2020). Most companies use some strategies to reduce the costs that must be paid because it is a burden that must be paid that we can call tax avoidance. Tax avoidance is an effort made by companies to minimize the tax burden. Tax avoidance is considered legal because it still follows tax laws and regulations, but the government has objections because it can harm the state (Indriani and Juniarti 2020).

Companies that carry out tax avoidance are usually carried out through policies by the company's leadership without an element of intentionality. One must delve deeper into the difference between taxable income and finance to assess tax enforcement in a company. If the taxable income is low, it will have an impact on increasing the
company’s financial income. Tax avoidance is carried out to achieve the company’s
goal of obtaining high income (Kalbuana et al. 2023).

The large number of companies that practice tax avoidance will create a sense of
injustice for taxpayers who have carried out their obligations correctly and honestly.
The phenomenon of tax avoidance that occurs in Indonesia of which is the practice of
tax avoidance carried out with the transfer pricing system of multinational companies
that divert their profits to countries that are considered tax havens so that corporate
taxpayers end up paying less tax than they should be paying, causing Indonesia to lose
money. Up to IDR 68.7 trillion, as stated through the Tax Justice Network entitled The
State of Tax Justice 2020 during COVID-19, IDR 67.6 trillion is the fruit of corporate
taxpayer tax evasion in Indonesia (Kompas.com 2020).

The consumer goods industry is one of the leading choices for investors to invest
funds because it has high sales. Still, on the other hand, the taxes paid are higher, so
there is a possibility that companies registered in the consumer goods sector will take
tax avoidance. Currently, are 98 companies registered in the consumer goods sector
with 4 sub-sectors, namely the food and beverage, food and staples retailing, cigarettes,
and nondurable household products sub-sectors (www.idx.co.id n.d.).

It is stated in Law Number 36 of 2008 Article 17 Paragraph (2) Letter (a) that it is
stipulated that the Corporate Tax Payer Income Tax rate of 25% applies from 2010-
2019. As for 2020-2021, based on Government Regulation in place of Law Number 1 of
2020 Article 5 Paragraph (1) Letter (a), the Corporate Taxpayer Income Tax rate is 22%.

There are several factors that can influence the practice of tax avoidance, including
board size, board nationality, institutional ownership, ownership concentration, board
independence, female gender diversity, and corporate social responsibility (Khan et al.
2022). One of the influencing factors is firm size and institutional ownership. This
variable has been taken a lot in several studies by previous researchers, but it still
shows variations in research results or inconsistencies. Companies that are classified
as large in general will be more transparent in carrying out their operational activities
because external parties, such as the government; investors; and creditors, will pay the
company more attention to minimize tax avoidance (Sarpingah 2021).

Firm size is a scale that can classify a company's size and shows its stability and
ability to carry out its economic activities (Fauziah and Kurnia 2021). In addition, the
greater the company’s size, the managers choose accounting methods that suspend
reported earnings from the current period to the future to minimize reported profits.
Large companies have increasingly complex corporate operational activities, so there
are gaps to be used in tax avoidance decisions. While small companies that have
limited company operations and few will find it difficult to take tax avoidance
measures because of the small gaps that companies can exploit in carrying out tax
avoidance (Sarpingah 2021).
The next factor affecting tax avoidance is institutional ownership. Institutional investors have become an increasingly important type of investor in the securities market (Jiang et al. 2020). Institutional ownership is share ownership owned by the government and other institutions outside the public shareholder institutions. Institutional ownership plays a vital role in monitoring the performance of management because institutional ownership can improve better control. After all, it is considered capable of overseeing management decisions (Yuliawati and Sutrisno 2021). The larger the shares owned by an institution or institution, the higher the level of supervision of the company will be, so that it can reduce the occurrence of tax avoidance activities by company management (Andini et al. 2021).

Although there have been many studies on tax avoidance, there are many differences from the results of previous studies due to differences like both dependent and independent variables, besides that there are differences in the subjects and objects studied, the research methods chosen, and the use of research methods is of course different.

The researcher chose manufacturing companies in the consumer goods sector as the research object because the consumer goods industry has the highest contribution to the economic sector. Even during the COVID-19 pandemic, which has caused an economic slowdown so that several initiatives have collapsed, the consumer goods industry has survived. The productivity of the consumer goods industry has proven to be running well, and the consumer goods industry has even helped Indonesia's economic growth (Okefinance 2021).

**Literature Review**

**Agency Theory**

This study uses agency theory, which examines the differences in interests between agents and principals seeking to maximize or optimize their interests (Ulfa et al. 2021). Luayyi (2010) in (Irianto et al. 2017) stated that agency theory discusses a form of agreement between capital holders and managers to manage a company. The managers do not always act in the best wishes of shareholders because the choice is the worst or the existence of a moral hazard. Besides that, it also can occur the existence of information asymmetry and earning management.

Conflict in agency theory is usually caused by decision-makers who do not participate in taking risks due to decision-making mistakes. According to decision-makers, the risk should be borne by the shareholders. This causes an asynchronous between the decision maker (manager) and the shareholders. Conflicts between shareholders and company management can be minimized in a way managers must
run the company following the interests of shareholders, and in making decisions, managers must be adjusted to the interests of shareholders (Sarpingah 2021).

Principal shareholders (principals) employ company management (agents) to perform duties for the principal's benefit, whereas an agency is a party to run the principal's interests. Agency issues arise when the principal is hard to ensure that agents play a role in maximizing the principal's well-being. The conflict of interest grew because the principal could not monitor management activities constantly (Wardhani and Adiwijaya 2019).

Company management must manage the company to the fullest so that the company will get significant profit. Then the company management (agent) reports to the shareholders (principal) on the company's terms to know if the company's performance is running according to what is expected (Sari et al. 2020).

**Tax Avoidance**

According to (Pohan 2018), tax avoidance is a legitimate and reasonable tax avoidance effort for taxpayers without going against the established tax laws (not contrary to be law) where weaknesses are exploited by the techniques and methods used (a grey area) found in tax laws and regulations to ensure the effectiveness of the tax amount that must be paid.

The benefit of tax avoidance is to increase tax savings which have the potential to reduce tax payments, thereby increasing cash flow. Tax avoidance is a problem that is quite complex and unique because, on the one hand, tax avoidance is permitted because it is legal. Still, on the other hand, tax avoidance is undesirable because it can affect state revenue from the tax sector. It is legal because tax avoidance creates creative compliance where taxpayers comply with applicable tax laws but find gaps in taxation regulations themselves (Yevilia and Mukhlasin 2020). management will do tax avoidance when the cash flow is under pressure and the need to improve cash conditions because tax avoidance can save the company's cash (Ulfa et al. 2021).

Since the beginning of tax laws, there has also been a problem with tax avoidance, widespread in all societies where taxes are collected. Due to the high corporate income tax rate, this threat is even more common among corporate taxpayers. The never-ending fight against corporate tax avoidance may be because taxes now account for a larger portion of a company's pretax income and further reduce distributable profits. And they were employing pricey accountants to uncover increasingly intricate tax-reducing ways (Yusri et al. 2022).
This tax avoidance is done because many corporate or personal taxpayers feel burdened to pay taxes. Therefore, corporate and individual taxpayers seek to alleviate the obligation to pay taxes by minimizing the amount of tax to be paid (Khomsiyah et al. 2021). The ratio used to measure how much tax avoidance is done by a company using Cash Effective Tax Rate (CETR). The Cash Effective Tax Rate (CETR) can be calculated by:

$$CETR = \frac{\text{Payment of Taxes}}{\text{Earning Before Tax}}$$

**Firm Size**

Firm size is a scale that can classify the company into big and small (Irianto et al. 2017). The size of the company reflects how many resources the company has, so the size of the company is considered capable of influencing the way the company fulfils its tax obligations and can be a factor in the occurrence of tax avoidance (Ulfa et al. 2021). A large, established company will have easy access to the capital market. The public gives large companies more attention, so they will be more careful in financial reporting so that the impact of these companies is reporting conditions more accurately (Sarpingah 2021). Large companies are easier to gain trust, so capital is easier to obtain than small companies. Assets owned by the company can support trust in the company in obtaining debt is quite large (Ekaristi et al. 2020). The larger the company's size, the more information available to investors to make investment decisions. The company's size can be seen in total assets, sales, and market capitalization. However, the measure most often used in measuring the size of a company is through its assets because assets are considered relatively more stable when compared to sales and market capitalization (Yevilia and Mukhlasin 2020). Firm size can be calculated using the following:

$$\text{Size} = \ln(\text{Total Asset})$$

Based on agency theory, the agent, in this case, the company, will maximize its performance through its resources by reducing the tax burden to maximize company profits. In previous research conducted by (Ekaristi et al. 2020), (Indriani and Juniarti 2020), and (Ulfa et al. 2021), it is stated that firm size does not affect tax avoidance. But (Kalbuana et al. 2023) and (Ratnawati et al. 2018) stated that firm size negatively affects tax avoidance. This statement differs from (Irianto et al. 2017), which state that the larger the company's size, the more complex the transactions are. This makes it possible that the tax authorities do not find tax avoidance in transactions in complex financial reports. This can encourage companies to take advantage of existing loopholes or weaknesses in statutory provisions to take tax avoidance actions from each transaction.
H1: Firm Size has an effect on Tax Avoidance

Institutional Ownership

Institutional investors are important in influencing managerial decisions (Li et al. 2021). Institutional ownership is the proportion of share ownership by institutional founders of the company, not institutional shareholders (Razali and Ferawati 2019). These shares can be owned by government sector institutions, financial institutions, legal institutions, private institutions, insurance companies, investment companies, limited liability companies (PT), banks, foundations, and other institutional owners (Xaviera et al. 2020). Shares in a company that is majority owned by an institution or other body are said to be subject to institutional ownership. Institutional controlling stockholders frequently give up the interests of other shareholders.

On the other hand, high executive profits impact how much tax the business must pay, which lowers business performance. The corporation must pay more taxes the more institutional ownership it has. This is due to the decreased likelihood of corporate tax avoidance. Through their deeds of voice and power, institution owners can compel managers to concentrate on financial performance and avoid possibilities for selfish behaviour. Institutional ownership oversees the numerous administrative policies managers adopt in implementing decisions in the organization (Yusri et al. 2022). Institutional Ownership can be calculated using the following:

\[
\text{Institutional Ownership} = \frac{\text{Number of shares owned by institutional investors}}{\text{Total outstanding shares}}
\]

Based on agency theory, institutional ownership is a corporate governance mechanism that can reduce an agency’s conflict problems (Ratnawati et al. 2018). In previous research conducted by (Yusri et al. 2022) stated that institutional ownership does not affect tax avoidance. But (Ratnawati et al. 2018) stated that institutional ownership negatively affects tax avoidance. This statement differs from (Khan et al. 2017) state that institutional ownership has a significant positive on tax avoidance.

H2: Institutional Ownership has an effect on Tax Avoidance

Method

The data used in this study is using secondary data. Where the secondary data is available, data analysis is carried out according to the research objectives. Secondary data is taken from the Indonesia Stock Exchange (IDX). The data taken is in the form of financial report data and annual reports of manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the 2017-2021 period.
The population and sample in this study used manufacturing companies in the consumer goods sector, totaling 98 companies listed on the Indonesia Stock Exchange (IDX) for the 2017-2021 period. The sample selection method used was purposive sampling. Purposive sampling, namely determining the sample by considering the criteria for the object under study so that it is suitable for obtaining a representative sample. The requirements of the companies studied are as follows:

<table>
<thead>
<tr>
<th>No</th>
<th>Criteria</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Consumer Goods Sector Manufacturing Company listed on the Indonesia Stock Exchange (IDX) for 2017-2021.</td>
<td>98</td>
</tr>
<tr>
<td>2</td>
<td>Manufacturing Companies in the Consumer Goods Sector experienced losses during 2017-2021.</td>
<td>(28)</td>
</tr>
<tr>
<td>3</td>
<td>Manufacturing companies in the consumer goods sector are listed on the Indonesia Stock Exchange (IDX) for the 2017-2021 period, which has just gone IPO after the 2017 period.</td>
<td>(36)</td>
</tr>
<tr>
<td>4</td>
<td>Consumer Goods Sector Manufacturing Company listed on the Indonesia Stock Exchange (IDX) for the 2017-2021 period presents inconsistent, incomplete financial reports regarding institutional ownership.</td>
<td>(2)</td>
</tr>
<tr>
<td></td>
<td><strong>Total Research Sample</strong></td>
<td>32</td>
</tr>
<tr>
<td></td>
<td><strong>Number of Observations (Year)</strong></td>
<td>5</td>
</tr>
<tr>
<td></td>
<td><strong>Total During the Study Period</strong></td>
<td>160</td>
</tr>
</tbody>
</table>

*Source: processed data, 2022*

The dependent variable used in this study is Tax Avoidance (with measurement of Cash Effective Tax Rate (CETR)). In contrast, the independent variables are Firm Size (with a measure of Ln (Total Asset) and Institutional Ownership (with a measurement of the number of shares owned by institutional investors divided by total outstanding shares).

The data collection technique used in this research is a documentation study. A documentation study is a study conducted on documentation regarding an object or event in the past which can be in the form of written sources, films, pictures, and various other types. If the required documents are not found on the IDX website, the
author will access the necessary data directly on the website of the company concerned. This study uses multiple regression analysis to examine the effect of firm size and institutional ownership on tax avoidance.

**Result and Discussion**

**Table 3. Multiple Linear Regression Analysis**

<table>
<thead>
<tr>
<th>Variable</th>
<th>Hypothesis</th>
<th>Coefficients</th>
<th>Sig</th>
<th>Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Firm Size</td>
<td>+</td>
<td>.130</td>
<td>.007</td>
<td>Hypothesis not Supported</td>
</tr>
<tr>
<td>Institutional Ownership</td>
<td>+</td>
<td>.079</td>
<td>.069</td>
<td>Hypothesis not Supported</td>
</tr>
</tbody>
</table>

*Source: Output Eviews*

**The Effect of Firm Size on Tax Avoidance**

Based on the test results in table 3, it is known that firm size has a negative effect on tax avoidance. The larger a company, the more attention the company will receive from investors, the public and the government. So large companies will reduce tax avoidance practices which have an impact on reducing the company's image. And the larger a company, the greater the total assets it has. A company may reduce its taxable income through asset management by utilizing the depreciation and amortization expenses incurred due to expenditures to acquire assets. This means the total assets will cause large depreciation and amortization expenses so that the taxable income will be low. That way, the possibility of companies avoiding taxes also tends to decrease because large companies are considered more capable of making a good tax plan. This statement is supported by the results of research by (Zia et al. 2018), who found a negative effect of firm size on tax avoidance. But different from (Indriani and Juniarti 2020), the firm size does not affect tax avoidance and (Irianto et al. 2017) said that the firm size positively affects tax avoidance. They argue that the larger the company's size, the more stable and able to generate profits and pay its obligations.

**The Effect of Institutional Ownership on Tax Avoidance**

The size of institutional ownership cannot influence or oversee the management's policies in carrying out tax avoidance activities. Institutional Ownership delegates oversight and management of the company to the board of commissioners, which is their job, so whether or not there is institutional ownership, tax avoidance activities still occur. The orientation of institutional ownership is how to maximize the welfare (profit) obtained at the end of the period. The company will carry out tax avoidance, or it will not become the authority of the company's management. If this activity can
benefit the welfare of institutional ownership, they will continue to support every policy carried out by the company. Institutional owners have incentives to ensure that management makes decisions that can maximize the welfare of institutional shareholders so that they only focus on earnings management. This statement is supported by the results of research by (Andini et al. 2021), who found has no effect of institutional ownership on tax avoidance. But different from (Khan et al. 2017) said that institutional ownership positively affects tax avoidance, and (Ratnawati et al. 2018) said that institutional ownership negatively affects tax avoidance.

Conclusion

The result of this study shows that firm size has a negative effect on tax avoidance because, according to the previous researcher, the possibility of companies avoiding taxes also tends to decrease because large companies are considered more capable of making good tax plans. In contrast, institutional ownership has no effect on tax avoidance because, according to the previous researcher who stated that institutional ownership delegates oversight and management of the company to the board of commissioners, and that is their job, so whether or not there is institutional ownership, tax avoidance activities still occur.

The findings of this study have several implications. This finding can not only help education in tertiary institutions to add insight into the effect of company size and institutional ownership on tax evasion but also for investors it is to provide insight regarding the causes of tax evasion in companies so that investors can consider all matters that will make future decisions by the company. And for the government, it is hoped that with the research researched by the author, the results can make a positive contribution so that it is used as a basis for consideration in making policies relating to tax avoidance practices and is expected to become a source of information that can be used as evaluation material in realizing good tax governance in government.

For future researchers, it is suggested to increase the research period and object of research from various sectors to know more about the development of tax avoidance from year to year. Also is suggested to add other independent variables that are different from this research.

References


