

Shareholder's Political Motive and Corporate Tax Avoidance

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ABSTRACT

This paper describes the relationship between shareholder's political motive and corporate tax avoidance using the Fraud-Risk Theory framework. Many corporate shareholders around the world actively participated in their country's political arena, either as politicians or as donors to political parties. In order to maintain their political activities, they need easy, cheap and large sources of funds. One of the possible sources of funds is the undisbursed income tax payment to the government. However, this predicament has aroused the suspicion of taxation authorities on the extent of shareholder's corporate tax compliance. Since corporate tax avoidance and shareholder's political motives are attached to two different entities (corporations and individuals), it is not possible to measure the direct relationship between the variables. However, in this case the relationship will be partially measured. The first part measures the relationship between corporate ownership and corporate tax avoidance, and the second part measures the relationship between shareholder's political motive and his ownership in the corporation. Results from multivariate data analysis show that there are significant relationships between variables in both partial relationships. Therefore, this study concludes that shareholder's political motive is negatively related to corporate tax compliance level, and shareholder's political motive is considered as factor that has significant negative influence on corporate tax avoidance's decision.

Keywords: Corporate tax avoidance; corporate tax compliance; shareholder's political motive; book-tax differences; long-run cash effective tax rates; fraud-risk theory

INTRODUCTION

In the political area of research, Nassmacher (2003) reported that individuals who decide to participate in electoral campaign must consider three important trends: (1) Candidates must largely finance their own campaigns; (2) Political parties, generally, do not play a significant role in raising money for candidates; and (3) Businesses are reluctant to finance individual candidates. As such, the personal financial burden of this individual in this game of extreme risk is high. Interestingly, many wealthy corporate shareholders have their own reasons for participating in political arena as politicians or donors to political parties (will be referred to as political motivated shareholders for the rest of the paper) in every country around the world. As political motivated shareholders, their participation in the political arena requires a large amount of financial support in order to maintain the momentum of their (and their party's) political activities. This situation raises a question about the source of the funds; as to whether it is derived from their own wealth, sponsorship, loan or money "borrowed" from the government in the form of taxes not disbursed.

According to Maslow (1943), an act typically has more than one motivation. Furthermore, Maslow also indicated that even when the psychological, safety, love and esteem needs have been satisfied, the need of self-actualization sometimes motivates an action to occur. In the research on the psychology of fraud, Cressey (1953) found that fraud generally shares three common traits: 1) embezzlers have the opportunity to perpetrate fraud, 2) the individual

perceived a non-shareable financial need (pressure) and 3) the individual involved in a fraud rationalized that the fraudulent act as being consistent with their personal code of ethics. Skousen and Wright (2006) used Crassey's Fraud-Risk Theory to identify a set of contemporaneous firm-related factors that are empirically related to financial statement fraud. This theory provides the framework for identifying a firm's fraud-risk factor and they contended that pressure, opportunity and rationalization are always present in varying degrees when financial statement fraud occurs. In discussing financial statements' fraud and corporate tax avoidance activities, the common traits mentioned by Crassey (1953) will be found in each type of activity. Financial statements' fraud and corporate tax avoidance activities are similar and comparable because there are: supply of motivated offenders, availability of suitable targets and absence of capable guardians (Krambia-Kapardis 2001) in financial statements' fraud and corporate tax avoidance. Thus, it becomes relevant when this study tries to investigate the relationship between shareholder's political motive and corporate tax avoidance in the Fraud-Risk Theory framework.

Graham and Tucker (2006) and Desai and Dharmapala (2006) proposed that tax planning is a value-enhancing activity and found that shareholders hold to that belief. Scholes et al. (2009) pointed out that in addition to opportunity costs, there are other costs involved when using resources for tax management; i.e. transaction costs, implicit taxes and uncertainty. The bottom line is that,

corporations are willing to engage in tax planning if it is deemed as a value-enhancing activity and there is net benefit. The benefit of tax planning is clear; the avoiders will receive their economic benefit in terms of the amount of corporate income tax undisbursed to the government. Thus, the decision to pay corporate income tax depends on the willingness of each individual shareholder to pay taxes and what motivates such decision. In the research area of taxation, it seems that the fraud-risk theory has never been used in explaining on why a taxpayer commits tax avoidance. Emulating the success of by Skousen & Wright (2006) in using this theory at explaining why managers engage in fraudulent financial statements and how the auditors detect fraud in a corporation, this study utilized Cressey's theory to identify and empirically examine a broad range of related factors that motivate corporate tax avoidance.

In testing the relationship between shareholder's political motives and corporate tax avoidance, this study employed Book Tax Differences in the long run (Long-run BTDs) analysis and Cash Effective Tax Rates in the long run (Long-run CETRs) as corporate tax avoidance measures. The BTDs are derived from the differences between income reported to the capital market and income reported to the tax authorities. Manzon and Plesko (2002) and Desai (2003) used BTDs as an indirect approach to construct a measure of corporate tax avoidance. On the other hand, Dyreng, Hanlon and Maydew (2008) introduced another measure called Long-run CETRs based on the ability to pay a low amount of cash taxes per dollar of pre-tax earnings over long period.

Based on the results from multivariate data analysis within Indonesian setting, this study found that there are significant relationships between variables in both partial relationships. Therefore, this study concluded that shareholder's political motive is negatively related to corporate tax compliance level, and shareholder's political motive has significant negative influence on the corporate tax avoidance decision. Another finding from this study was that Fraud Risk Theory, usually used to explain fraud in psychology and accounting area of research, is applicable at explaining the relationship between tax avoidance and its related factors. This study contributes to the literature by identifying shareholder's political motive as one of the factors that significantly affect corporate tax compliance decision in addition to the corporate ownership and corporate status discussed in the previous studies. The other contribution is that Fraud Risk Theory is useful at identifying factors that significantly influence corporate tax avoidance in tax research.

The remaining of the paper will be structured as follows: Section 2 describes the literature review regarding corporate tax avoidance, how to identify it and what motivates tax avoidance; section 3 describes the literature review regarding Fraud-Risk Theory; Section 4 describes data collection and framework of the study; Section 5 elaborates on the findings and discussions; and Section 6 presents the conclusion.

CORPORATE TAX AVOIDANCE DEFINITION OF CORPORATE TAX AVOIDANCE

As far as the researchers are concerned, many definitions have been adduced to explain Tax Evasion and Tax Avoidance. GIZ (2010) defines tax evasion as the illegal practice of not paying taxes, not reporting income, reporting expenses that are not legally allowed, or not paying taxes owed. Simply put, tax evasion is a general term for the efforts of individuals, firms, trusts and other entities in evading the payment of taxes through illegal means; while tax avoidance is described as the legitimate effort of minimizing taxes by using methods approved by the authorities. Other researchers pointed out that tax avoidance is a highly subjective and covers a wide range of actions. As such, it is no longer sufficient to distinguish between avoidance (a legal action) and evasion (an illegal action). Amiram et al. (2012) defined corporate tax avoidance as any corporate activity, legal or illegal, designed to reduce corporate tax burden relative to the statutory rate. Dyreng et al. (2008; 2010) defined tax avoidance broadly as encompassing anything that reduces the firm's taxes relative to its pre-tax accounting income. Dyreng et al. (2008) noted that the connotation of wrongdoing associates with the terms tax sheltering, tax evasion, and tax aggressiveness; and also considered the broad construct of tax avoidance. In the context of this research, the broad definition of tax avoidance is used as the basis of analysis and discussion.

The list for the practices of corporate tax avoidance is long, starting from the exploitation of tax laws' loopholes to the exploitation of tax rates differentials between countries in order to reduce corporate tax burden. As stated in studies such as Braithwaite (2005); Desai, Foley & Hines (2006); Rego 2003; Slemrod (2001), corporate tax avoidance is entrenched within the corporate culture of many western economies. The act is about taking advantage of the gaps or loopholes in tax legislation to significantly reduce corporate taxes (Braithwaite 2005; Killaly 2009). Moreover, international tax avoidance arrangements might be structured and included in a firm's overall commercial arrangement (Hamilton et al: 2001). Tax authorities around the world have recognized that international tax avoidance has been contributing to the progressive erosion of tax revenue as evidenced by the decline in corporate ETRs and the increase in the number of firms reporting a zero tax liability (ATO 2010). Taylor and Richardson (2012) mentioned that some of the main reasons attributed for reporting zero tax liabilities by firms are thin capitalization, abuse of transfer pricing rules and use of tax havens.

IDENTIFYING CORPORATE TAX AVOIDANCE

Corporate financial statements are the results of corporate book and record keeping based on the Generally Accepted Accounting Principle (GAAP). Financial statements are the media for the management in communicating the corporate financial performance to its shareholders. On the other hand, corporate financial statements are also used as the

basis to communicate the amount of taxable income and the amount of tax liability owed by the corporation for a specific tax period. The issue arises when the shareholders and the management (as the taxpayer) are reluctant to contribute part of the corporate income to the government; this is because income tax payments can decrease the portion meant to be distributed to its shareholders. The taxpayer can employ numerous methods in order to reduce the amount of tax liabilities such as reducing the total amount of reported income, increasing allowable deductions and practicing tax shelters within different tax jurisdictions (due to different tax rates). An important issue highlighted by emerging research is how to measure tax avoidance. Chen et al. (2010) employed four measures of tax avoidance: the GAAP ETR, the Cash ETR, total BTDS, and abnormal total BTDS. Taylor and Richardson (2012) used multiple measures of tax avoidance based on BTDS and long-run ETR to collect evidence on tax avoidance activities. Wilson (2009) mentioned that total BTDS, an indication of tax shelter participants, is one form of tax avoidance. Meanwhile, Frank et al. (2009) relied on permanent difference as proxies of tax shelter (tax aggressiveness). On the other hand, Rego and Wilson (2009) utilized three existing measures of tax avoidance, including discretionary BTDS, tax shelter prediction scores, and cash ETR at examining equity risk incentives as a determinant to corporate tax aggressiveness.

It is important to note that each of those measures involving tax avoidance captures only non-conforming tax avoidance. Hanlon & Heitzman (2010) concluded that not all tax avoidance measures are appropriate for all research questions and that these measures depend on the availability of data. Corporations report taxable income on their tax returns, as well as report their income tax expenses and income tax assets and liabilities in their GAAP financial statements. Thus, estimates of taxable income and tax payments, which are important factors when measuring tax avoidance, could be obtained from either source. Most tax avoidance measures are obtained from financial statement data because tax returns are not publicly available and access is granted to only a few.

BTDS refer to the gap between the pre-tax income reported in a corporate financial statement and the taxable income reported to the tax authorities. The BTDS have been proposed as a measure of both earnings management and corporate tax avoidance (Graham, Raedy & Shackelford 2012). Corporations that are relatively successful at tax avoidance are likely, although not necessarily able, to sustain large differences between accounting income and taxable income (Alexander, Ettredge, Stone & Sun 2008; Dyreng et al. 2008; Frank et al. 2009; Rego & Wilson, 2009). Wilson (2009) found that BTDS are larger for corporations accused of engaging in tax shelters than for a matched sample of non-accused corporations. The evidence from these studies suggests that BTDS capture some elements of tax avoidance. Wilson (2009) indicated that BTDS are positively and significantly associated with incidences of

tax sheltering activity. These results are consistent with BTDS of being a useful proxy for tax aggressiveness (Desai 2003 and Mills 1996, 1998); but it is difficult to detect tax sheltering activity simply by examining corporate financial statements. Despite the complexity associated in examining BTDS, some researchers suggested that large positive BTDS are a signal of tax aggressiveness. Desai (2003) argued that the divergence between book and tax income during the 1990's was not attributable to traditional drivers of BTDS such as depreciation, but was actually caused by increased levels of tax sheltering. Heltzer (2006) found that BTDS provide insight into a firm's relative level of tax reporting aggressiveness, but not a firm's relative level of financial reporting aggressiveness.

The formula used to calculate the BTDS of each sample is:

$$\text{BTDS } it = \text{Pre-Tax Income in Financial Statements } it - \text{Taxable income in Tax Return } it$$

Even though large BTDS signal the possibility of tax avoidance, it must be remembered that BTDS do not only contain "illegal" differences but also contain "legal" differences allowed by tax provision and the subjects are considered as non-confirmed tax avoiders. Thus, in order to provide a comparison to the results of the BTDS analysis, the Long-run CETRS as proposed by Dyreng et al (2008) will be employed in this study. Long-run CETRS is calculated as the sum of cash tax paid over a period divided by the sum of pre-tax accounting income over the same period. Taylor and Richardson (2012) used long-run (four years) measures due to the potential for significant variation in annual ETR that might obscure indications of tax avoidance (Dyreng et al. 2008).

In their study, Dyreng et al. (2008) measured Long-run CETRS as the average of accounting tax expenses divided by pre-tax income over five- and ten-year periods to measure the average tax liability of the firm. The main advantage of the measure is the long-run nature of the computation, which avoids year-to-year volatility in annual effective tax rates. The utilization of long period allows the use of cash taxes paid in the numerator because the long-run measure avoids much of the mismatch in cash taxes and earnings. This type of analysis indicates the ability of corporations to pay low amount of taxes in the long run as reflected in the cash income tax paid divided by the amount of accounting pre-tax income. This shows that if tax liability is reduced, corporations will receive increased cash flow and an increase in after-tax net income. In addition, the amount of income tax paid as mentioned in the financial statement will be calculated for comparison. High Long-run CETRS (above average), that is closer to the statutory income tax rates, means that the corporation does not engage in any tax avoidance schemes. Conversely, low Long-run CETRS (below average) indicate that the corporation engages in tax avoidance. The formula for calculating Long-run CETRS proposed by Dyreng et al. (2008) is:

$$\text{LRCETR}_{it} = \frac{\sum_{t=1}^N \text{Cash Tax Paid}}{\sum_{t=1}^N (\text{Pretax Income}_{it} - \text{Special Items}_{it})}$$

SHAREHOLDER'S MOTIVE BEHIND CORPORATE TAX AVOIDANCE

Corporations are willing to engage in tax planning if it is deemed to be a value-enhancing activity. In previous researches, corporation will only engage in tax planning if there is net benefit, in other words, if the tax savings from planning outweigh the associated costs of executing the planning. Desai and Dharmapala (2006) found that tax avoidance is valued by shareholders. Meanwhile, Alm and Mc Clelland (2012) demonstrated a strong connection between the decisions that individuals make for themselves and the decisions individuals make through their corporations. Thus, the willingness to pay taxes at corporate level differs depending on each of the shareholders' needs.

Existing researches on corporate tax avoidance that linked to corporate shareholders' motives are carried with focus on the economic benefit reason (motive) of tax avoidance. Ownership patterns can have an important effect on tax avoidance (Desai and Dharmapala 2008). Firms with concentrated ownership, such as the family firms examined in Chen et al. (2010), may avoid more taxes because controlling owners benefit more from the savings. McGuire, Wang, and Wilson (2011) found that firms with dual class stock ownership engage in less tax avoidance practices than other firms, consistent with managers who are insulated from takeovers avoid the costly effort associated with increased tax avoidance. Lastly, Badertscher, Katz and Rego (2011) provided the evidence that private equity firms significantly increase tax planning effectiveness of the firms in which they invest. This tax planning expertise persists even after private equity firm ownership is substantially reduced or terminated. Thus, different ownership structures have a significant impact on corporate tax practices.

On the other hand, Van Biezen (2003) mentioned that the main traditional sources of internal party financing are membership fees, income from property, revenue from party activities such as the sale of newspapers or other party publications, fund raising activities, party festivals and other social events, and occasional public collections. These traditional modes of financing are no longer sufficient for parties which face the ever increasing expenses of political participation and competition. Donations continue to constitute a crucial source of income for parties. As the result, those who decide to participate in electoral politics in the surveyed countries must consider that candidates must largely finance their own campaigns (NDI 2005). The taxation practices in a corporation are very much dependent upon the person who has the main control and power in the corporation, which is reflected by the portion of ownership in the corporation. Furthermore, with an understanding that a corporation will behave like the

individual who has control over the corporation and if the majority shareholder (as political motivated shareholder) expects financial need as well as having the knowledge to exploit the opportunity of tax avoidance through their corporations, then corporate tax avoidance will be the most possible option to the source of his financial need. Unfortunately, there is no specific research being done to address this particular issue of corporate tax avoidance.

FRAUD-RISK THEORY

Corporate fraud is a topic that has received significant and growing attention from regulators, auditors, and the public. External auditors have increasingly being asked to play an important role in helping organizations to prevent and detect fraud. Detecting fraud is not an easy task and requires thorough knowledge about the nature of fraud, why and how it is perpetrated, and how it is concealed. Cressey (1953) explained on why trust violators commit fraud and why it is widely used by regulators, professionals, and academicians. Three factors must be present for a person to violate trust, which are: non-shareable financial problems as a reflection of the pressure, opportunity to commit trust violations, and rationalization by the trust violator or also known as the fraud triangle, as shown in the Figure 1.

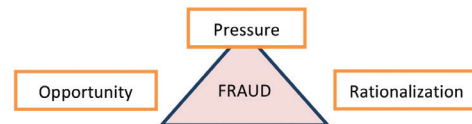


FIGURE 1. Fraud Triangle
Source: Lister (2007)

Pressure or motive to commit fraud, in the first corner of the fraud triangle, is the main factor of fraud. Lister (2007) described pressure or motive to commit fraud as "the source of heat for the fire" but he believed that the presence of the pressure in someone's life does not mean he or she will commit fraud. Pressure or motive, which is non-sharable component in fraud, can be derived from many factors, such as financial or non-financial problems (Albrecht et al. 2008; 2010; Murdock 2008) emanating from an internal or external organization associated with personal or corporate pressure (Vona, 2008), political or social pressure (Murdock 2008) and also ego or power over people as well as over situation (Duffield & Grabosky 2001). Lister (2007) also mentioned that there are three types of motivations or pressure: personal pressure to pay for a lifestyle, employment pressure from continuous compensation structures, or management's financial interest; and external pressure such as threats to the businesses financial stability, financier's covenants, and market expectations. Furthermore, Albrecht et al. (2008; 2010) gave some examples of perceived financial pressure that can motivate fraud, such as personal financial losses,

falling sales, inability to compete with other companies, greed, living beyond one's means, personal debt, poor credit, the need to meet short term credit crises, inability to meet financial forecasts, and unexpected financial needs. Meanwhile, examples of non-financial pressure are the need to report results that are better than actual performance, frustration with work, or even as challenge to beat the system.

In the second corner of fraud triangle, Lister (2007) expressed opportunity as "the fuel that keeps the fire going" and he believed that even if a person has a motive, the person could not perpetrate a fraud without being given an opportunity. Vona (2008) believed that a person's position in the organization contributes to the opportunity to commit fraud. He also believed that there is a direct correlation between opportunity to commit fraud and the ability to conceal the fraud. However, Rae and Subramaniam (2008) suggested that opportunity refers to weakness in the system where the employee has the power or ability to exploit, whereby making fraud possible. Lister (2007) gave some examples of opportunities that can lead to fraud such as high turnover of management in key roles, lack of segregation of duties, and complex transactions or organizational structures. As for perceived opportunities to commit fraud, the examples include a weak board of directors, a lack of or circumvention of control that prevents or detects fraudulent behavior, failure to discipline perpetrators of fraud, lack of access to information, and lack of audit trail (Albrecht et al. 2008; 2010).

As for the third component of the fraud triangle, which is rationalization, Lister (2007) defined it as "the oxygen that keeps the fire burning". Rae and Subramaniam (2008) argued that rationalization is the justification of fraudulent behavior emanating from an employee's lack of personal integrity, or other moral reasoning. Albrecht et al. (2008; 2010) mentioned some examples of rationalization that executives use to commit fraud, such as; "we need to keep the stock price high", "all companies use aggressive accounting practices", or "it is for the good of the company". Meanwhile, Duffield and Grabosky (2001) stated that rationalization is a process of reducing the offender's inhibitions. Regardless of the type of fraud, most offenders seem to seek vindication or rationalization to their activities.

DATA COLLECTION AND FRAMEWORK

THE DATA

This study was conducted as a pilot project for a wider study intended to explain the relationship between shareholder's political motive and corporate tax avoidance in an Indonesian setting. In order to test the relationship among variables, this study needs a specific type of corporate micro data such as accounting data and tax data related to corporations owned by shareholders involved in political arena. Before the collection of the financial

and tax data, the selection of appropriate corporation as study sample is very important. For the purpose of defining shareholder's political motives, this study will justify the status of the ultimate individual shareholder of the corporation as the measure of shareholder's involvement in political arena. When the status of corporate shareholder is a politician or related to a political party, this study deemed this shareholder as having political motive. Data from the National General Election Commission and political parties' official websites are also important in assessing the individual shareholder's status. Unfortunately, the direct shareholders of a public company are also companies. Thus, through the multi-layered corporate ownership examination, we tracked down the owner as to identify the ultimate corporate shareholder.

This study did not employ proportional samples methodology in selecting qualified samples. Rather, this study selected its samples based on the sequence when a corporation is identified as a sample. First, the shareholders were categorized into political motivated and non-political motivated shareholders; this study put two political parties' members into one group and three non-political parties' members into other group. After tracking down the multi-layered ownership (starting with 12 listed companies), this study tracked down another 20 private companies that are directly and indirectly owned by the five shareholders. After the samples were selected, accounting and tax data that are important at explaining the relationships were collected. The data include information such as: 1) portion of share owned by specified subjects, 2) elements of the corporate financial statements, and (3) elements of corporate tax returns. Portion of shares will be used as indicators of the shareholders' power in controlling the corporation. Corporate financial statements and corporate tax return data are very important in assessing corporate tax compliance level. Corporate financial data are extracted from corporate financial statements, while tax return data are obtained from the Indonesian Tax Authority. However, due to data confidentiality, data regarding the taxpayer's identity will not be disclosed. Furthermore, quantitative financial statements and tax return data will be transferred into proportional fractions. The period of data quantification is 10 years, i.e. from 2002 until 2001. This is due to the need to identify the practice of corporate tax avoidance and minimize the issue of temporary variations in BTDS in the long run.

IDENTIFYING CTA RELATED FACTORS BASED ON THE FRAUD TRIANGLE

In the research of fraud in financial statements, a growing body of empirical evidence indicates that there is a relationship between various corporate governance-related issues and incidence of financial statement fraud. For example, fraud has been linked to concentration of power (Dunn 2004), CEOs serving on boards of directors (Dechow et al. 1996), audit committee independence (Abbott et al. 2000), board of director composition (Beasley 1996),

and the existence of audit committees (Beasley 1996). Fraud is also linked to financial-related factors, such as sales growth and leverage (Beneish 1997), inventory and return on assets (Summers and Sweeney 1998), and the desire to obtain low-cost financing (Dechow, et al. 1996). While extant research identifies a number of factors related to fraud in various settings, Skousen and Wright (2006) could not find any study that identifies a set of risk factors linked to financial statement fraud. Additionally, they also examined an array of potential fraud risk factors in order to identify a comprehensive set of coexistent factors that are consistently linked to the incidence of financial statement fraud. Using the examples cited in SAS No. 99 and employing Cressey's (1953) fraud risk theory, they developed fraud proxy variables representing various measures of pressure, opportunity and rationalization and tested these variables using a sample of fraud-firms and a matched sample of no-fraud firms. This analysis yields a number of significant factors related to pressure and opportunity. These results indicate that (1) the proportion of independent audit committee members is inversely related to the incidence of fraud; (2) when the proportion of ownership held by managers holding more than 5 percent of the outstanding shares increases, the probability of fraud increases; (3) when the proportion of insider ownership (management and directors) decreases, the probability of fraud increases; (4) the frequency of fraud is higher among firms that do not have an audit committee; and (5) when one individual holds both the CEO and Chairman of the Board positions, the incidence of fraud is significantly higher than when the two positions are held by different individuals.

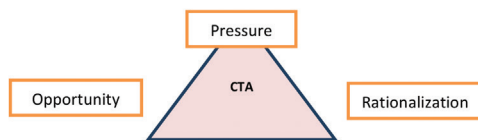


FIGURE 2. CTA Triangle
Source: Lister (2007) - elaborated

This study used the basic premise that tax avoidance is a function of pressure received by the corporation or its management, opportunity presented to the corporation and rationalization of corporate tax avoidance. As such, the basic understanding of corporate tax avoidance as represented on the tax avoidance triangle as shown on Figure-2 can be expressed according to the function below:

$$CTA = f(\text{Pressure, Opportunity, Rationalization})$$

At corporate level, pressure for corporate tax avoidance is as a result of perceived pressure of the corporation, by an entity or a person who rules the corporation, such as the management and the shareholders. In this study, pressure will be determined based on financial strain that is non-

shareable. The pressure on the management to undertake aggressive tax reporting can be triggered by financial strain faced by the corporation's shareholders as to satisfy their political activities. Cornett et al. (2007) mentioned that institutional investors are becoming increasingly willing to use their ownership rights to pressure managers to act in the best interest of the shareholders. Recent accounting research investigated the link between ownership structures and corporate tax avoidance. It is found that ownership patterns can have an important effect on tax avoidance (Desai and Dharmapala 2008). Meanwhile, firms with concentrated ownership, such as the family firms, as examined in Chen et al. (2010), may avoid more taxes because controlling owners benefit from the savings. Additionally, McGuire, Wang and Wilson (2011) found that firms with dual class stock ownership engage in lesser tax avoidance practice than other firms, consistent with managers that are insulated from takeovers; avoiding the costly effort associated with increased tax avoidance. Lastly, Badertscher, Katz and Rego (2011) provided the evidence that private equity firms significantly increase the tax planning effectiveness of the firms in which they invest.

According to Cressey's fraud triangle model, the presence of a non-shareable financial problem (pressure) itself, will not lead to the act of fraud. Meanwhile, Lou & Wang (2009) mentioned that opportunities are results of firm's circumstance; whereby it provides the chance to commit fraud. Status of a corporation, besides loopholes in the tax laws and regulations, provide the chance for corporate tax avoidance. Aside from Chen and Chu (2002), all of the preceding literature assumed that the firm owner, or residual claimant, makes tax reporting decision with no agency consideration. This assumption makes sense when one is analyzing small, closely-held businesses. However, in a large, publicly-held corporation, decisions about taxes (and accounting) are not made by the shareholders directly, rather, by their agents, i.e. the chief financial officer or the vice president for taxation. In order to align the incentives of the decision makers and the shareholders, the corporation has the incentive to tie the agent's compensation to observable outcomes that affect after-tax corporation profitability.

Rationalization of tax avoidance is not the main factor of corporate tax avoidance but this factor provides an additional motivation. Rarely being audited and being imposed of severe tax penalties are examples of the justification to tax avoidance. Cressey (1953) believed that most fraudsters see themselves as ordinary, honest people who are caught in a bad situation; thus, enabling them to justify that their act of fraud is acceptable or justifiable. Furthermore, he pointed out that rationalization is a part of motivation of the fraud. In their research, Skousen and Wright (2006) mentioned that rationalization is a necessary component to the fraud triangle, and an individual's rationale is difficult to observe. Extant researches indicated that frequent audit failure and litigation increases immediately after a change in auditor.

VARIABLES DEFINITION, MEASURES AND THE MODEL

This paper focused on three types of independent variables. Meanwhile, the dependent variable is Corporate Tax Avoidance (CTA); representing corporate tax compliance level. CTA will be defined into two score classifications: '0' for relatively comply-condition and '1' for suspected non-comply condition. In justifying taxpayer compliance levels, this study relies on the common tax avoidance measures, i.e. Long-run BTDs and Long-run Cash ETR. For Indonesia, effective 2002, its average corporate income tax rate for a 10-year period is around 28% for non-public corporations and 27% for public corporations. This study assumed a 20% income tax rate on accounting pre-tax income as the moderate effective tax rate to justify corporate tax compliance level. Consequently, the allowed BTDs are in line with the 20% moderate income tax rate (which is around 30% on accounting based earnings). A corporation is justified as a relatively complying corporation if it holds a relatively small BTDs (less than 30% differences) during the period of ten years and holds a relatively high amount of income tax paid compared to the pre-tax income (more than 20% on its accounting earning). On the contrary, when a corporation holds Long-run CETRs that are less than 20% on its accounting earnings and the book-tax differential ratio is more than 30%, this corporation is justified as a suspected non-complying corporation.

In order to analyze the effect of shareholder's political motive in the decision of corporate tax avoidance, this study included shareholder's political motive (SHPOLMOT) variable as an independent variable into the model. SHPOLMOT reflects the shareholders' political activities as politician or donor that possibly provide the pressure to the corporation in deciding to undertake tax avoidance activity for economic benefit goal. For analysis purpose, SHPOLMOT variable will be determined by two score classifications. Score '1' denotes shareholders that are actively engaged in the political activities, and score '0' for otherwise.

As the factor that possibly provides the pressure for corporate tax avoidance decision, SHPOLMOT by its own cannot directly influence this decision. This motive of shareholders needs a vehicle as to be effective in pressuring the corporation, i.e. through ownership structure. As Desai & Dharmapala (2008) concluded that ownership pattern can have an important effect on tax avoidance, this study adopted corporate ownership (CO_OWNERSHIP) as another independent variable in the model. CO_OWNERSHIP reflects on control and power of the shareholders and will be classified into two score classifications: '1' for corporations where majority of their shares (> 50%) are owned by a specific shareholder, and '0' for corporations with minority shares (less than 50%), owned by a specific shareholder; except for public corporations where public shareholders can only hold corporate shares of not more than 5% (in the form of corporate common stocks).

Status of a corporation is believed to be a factor that provides the opportunity for corporate tax avoidance activity. With more control and power residing in the corporation, it is easier for the majority shareholders to drive the

corporation to the direction they desire. McGuire, Wang and Wilson (2010) found that firms with dual-class stock ownership engaged in lesser tax avoidance activity as compared to other firms; rendering public corporations to be more open to third-party access and less tax avoidance rather than non-public corporations. In this study, the independent variable for opportunity factor of corporate tax avoidance is corporate status (CO_STATUS), which is determined by two score classifications, '1' for a public company and '0' for a non-public company.

Even though it is a necessary component to the fraud triangle, this pilot project study did not include variable for rationalization into the model. This is because corporate shareholder's perception on corporate tax avoidance in this context is difficult to observe. Thus, the model of corporate tax avoidance is expressed on the equation as follow:

$$CTA = \alpha_0 + \alpha_1 CO_OWNERSHIP + \alpha_2 CO_STATUS + \alpha_3 SHPOLMOT + e$$

With the understanding that ownership patterns can have an important effect on tax avoidance (Desai & Dharmapala 2009); firms with concentrated ownership might avoid more taxes because controlling owners benefit more from the savings (Chen et al. 2010); and the relationship between shareholder political motive (SHPOLMOT) and corporate tax avoidance (CTA) constitutes an indirect relationship, we built another model in order to explain the relationship, the equation is as follows:

$$CO_OWNERSHIP = \rho_0 + \rho_1 SHPOLMOT + e$$

STAGE OF ANALYSIS

Stage 1 – Descriptive Statistics This study examined the relationship between corporate tax avoidance with shareholder's political motive that creates pressure on corporate tax avoidance. The descriptive statistics for the variables of 32 samples are as shown on Table 1 below. For the CTA variable, the mean CTA level of the samples is at 0.625 (in the range level of 0 for non suspected CTA to 1 for suspected CTA). It means that the level of CTA of the samples varied and do not concentrate at single justification. From the mean value of corporate status, it can be seen that 37.5% of the sampled corporations are private corporations; and from the mean value of corporate ownership it shows that 81.25% of the samples are directly and indirectly owned by majority shareholders. Meanwhile 65.6% of the sampled corporations are owned by political motivated shareholders, regardless of the level of their ownerships. Based on the condition of the samples, we concluded that the samples are representative in explaining the relationship in this pilot project study.

Stage 2 - Relationship Test In order to test the relationship among the variables, the multivariate statistical analysis was employed. After filtering the samples into groups of companies based on the ownership, multiple regressions

were used to test the relationship between the dependent variable (CTA) and independent variables (CTA related factors).

FINDINGS

This study started with the analysis on the relationship between CTA and its related factors at corporate level. Results from regression analysis of the equation with CTA as dependent variable with CO_STATUS and CO_OWNERSHIP as the dependent variables indicate that corporate status (CO_STATUS) and corporate ownership (CO_OWNERSHIP) do not significantly impact corporate tax avoidance (CTA) at 0.05 level. However, when this study included the variable, shareholder political motive (SHPOLMOT), into the model, the coefficient of corporate ownership and also its significance level changed. As shown in the Table 2, the regression results indicate that corporate ownership (CO_OWNERSHIP) gives a significant negative effect (coefficient -0.710) on corporate tax avoidance (CTA) at 0.021 level.

Looking at the regression analysis on equation with CO_OWNERSHIP as dependent variable and SHPOLMOT as the independent variable as shown on Table 3, the results indicates that shareholder's political motive (SHPOLMOT) significantly and positively influences corporation's ownership structure (CO_OWNERSHIP) at 0.000 level and the coefficient for independent variable (SHPOLMOT) is at 0.545.

Based on the regression results above, this study concluded that there is a significant negative indirect correlation between shareholder's political motive

(SHPOLMOT) and corporate tax avoidance (CTA) through corporate ownership. Results from this study also supported the findings of Desai and Dharmapala (2008) where ownership patterns can have an important effect on tax avoidance; and also the finding of Chen et al. (2010) where concentrated ownership, such as the family firms, may avoid more taxes due to savings' benefits.

On the other hand, this study concluded that the relationship between corporate status (CO_STATUS) and corporate tax avoidance (CTA) is not significant at 0.05 level even though the significance level moved down from 0.578 to 0.168 after the inclusion of SHPOLMOT variable. As the result, this study is still unable to confirm the research findings from the study of McGuire, Wang, and Wilson (2011) where firms with dual class stock ownership engage in lesser tax avoidance practices than other firms; and also from Badertscher, Katz and Rego (2011) who posited that private equity firms significantly increase the effectiveness of tax planning of firms they invest.

CONCLUSION

This study tries to examine the relationship between shareholder's political motive (SHPOLMOT) and corporate tax compliance level (CTA) through the Fraud-Risk Theory framework. Result from the analysis shows that there is a negative indirect relationship between these two variables. Thus, it can be inferred from the results that there is a positive significant relationship between shareholder's political motive (SHPOLMOT) and corporate ownership (CO_OWNERSHIP); and corporate ownership

TABLE 1. Descriptive Statistic

	N	Minimum	Maximum	Mean	Std. Deviation	Variance
CTA	32	.00	1.00	.6250	.49187	.242
CO_STATUS	32	.00	1.00	.3750	.49187	.242
CO_OWNERSHIP	32	.00	1.00	.8125	.39656	.157
SHPOLMOT	32	.00	1.00	.6563	.48256	.233

TABLE 2. Regression Result (dependent variable CTA)

Independent Variable	COEFFICIENT	T	Sig.
(Constant)	.780	3.205	.003**
CO_STATUS	.329	1.415	.168
CO_OWNERSHIP	-.710	-2.456	.021*
SHPOLMOT	.454	1.495	.146
<u>Model fit:</u>			
R	.459		
R Square	.211		
Adjusted R Square	.126		
Std. Error	.45979		
F Statistic	2.492		

*. Significant at the 0.05 level (2-tailed).

**. Significant at the 0.01 level (2-tailed).

TABLE 3. Regression Result (dependent variable CO_OWNERSHIP)

Independent Variable	COEFFICIENT	T	Sig.
(Constant)	.455	5.000	.000**
SHPOLMOT	.545	4.861	.000**
Model fit:			
R	.664		
R Square	.441		
Adjusted R Square	.422		
Std. Error	.30151		
F Statistic	23.625		

** . Significant at the 0.01 level (2-tailed).

(CO_OWNERSHIP) has significant negative relationship with corporate compliance level (CTA). Also, it can be said that shareholder's political motive is a factor that significantly influences a corporation's tax avoidance decision. Findings on the relationship between corporate tax avoidance and corporate ownership are in line with the findings of Desai and Dharmapala (2009) and Chen et al. (2010). The findings on the relationship between shareholder's motive and corporate tax avoidance is a new understanding in tax compliance research and will add a new corpus of knowledge. Furthermore, the findings also gave an understanding that the Fraud-Risk Theory is applicable at explaining taxpayer behavior in this tax compliance research.

This study is conducted as a pilot project study that captures only 32 corporations as samples. Additionally, this research only covered three independent variables, and ignored other unexplained variables. As a result, the findings can yet be generalized and further research is still open as to explore the issues in the relationship between corporate tax avoidance and its related factors based on Fraud Risk Theory framework.

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