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**The Effect of Profitability, Institutional Ownership on Tax Avoidance Moderated by Disclosure of Good Corporate Governance (Study on Consumer Goods Industry Companies Listed in the Indonesia Stock Exchange in 2016 – 2020)**

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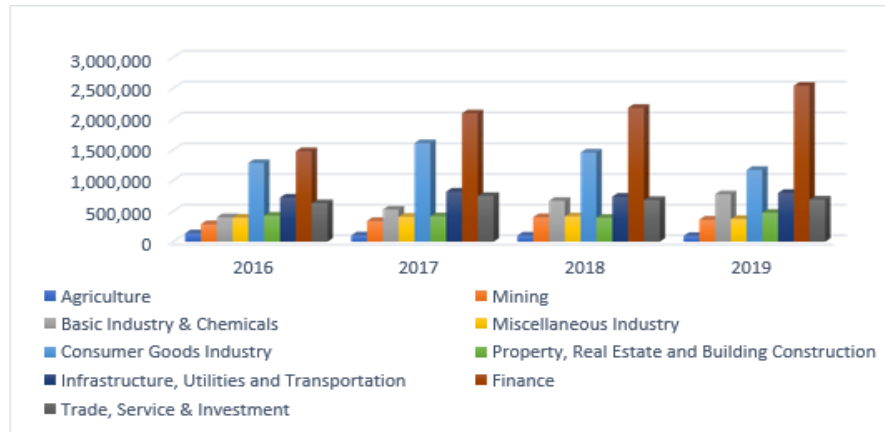
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**Abstract:** *This study aims to analyze the effect of profitability and institutional ownership on tax avoidance moderated by disclosure of good corporate governance. This study uses 24 consumer goods industrial sector companies listed on the Indonesia Stock Exchange during the 2016-2020 period as research samples. The data is collected based on the annual report and the company's financial statements. Partial Least Square (PLS) is used to analyze the information that has been obtained. The results showed that profitability had a significant adverse effect on tax avoidance. Institutional ownership has no significant impact on tax avoidance. For testing the moderating variable, it is proven that the disclosure of good corporate governance can moderate the relationship between profitability and tax avoidance. Still, the revelation of good corporate governance cannot negotiate the relationship between institutional ownership and tax avoidance.*

**Keywords:** *Profitability, Institutional Ownership, Tax Avoidance, Good Corporate Governance (GCG)*

## **INTRODUCTION**

The development of manufacturing industry activities contributes to the country's economic growth, including tax revenue. One of the manufacturing industry sectors that shows its influence is the consumer goods sector.



**Figure 1: Industrial Market Capitalization Data for 2016-2019**

**Source: Indonesia Stock Exchange**

Based on Figure 1.1, the market capitalization of the manufacturing industry in the consumer goods sector occupies the second-highest position, which means that the manufacturing industry in the consumption sector still has a significant role in the capital market. A large market capitalization level shows that companies in this sector have good potential for growth and sales increase every year. The profits obtained will be pretty significant, which causes tax payments to be more meaningful, thus enabling companies to take tax avoidance actions.

**Table 1. Target and Realization of State Tax Revenue for 2016 - 2020**

	2016	2017	2018	2019	2020
<b>Target</b>	1355,2	1283,57	1424,0	1577,6	1198,8
<b>Realisation</b>	1105,73	1151,1	1315,93	1332,12	1070
<b>Percentage</b>	81,59%	89,68%	92,41%	84,44%	89,26%

Source: Directorate General of Taxes Performance Report [www.pajak.go.id](http://www.pajak.go.id)

From the table above, it can be concluded that there is a shortage of tax revenues every year, which means that the realization of tax revenues is not by the expected target. The government is not yet maximally realizing tax revenues raises the question of whether the collection carried out has not been able to run optimally or from the taxpayer's side to avoid tax.

The following is one of the tax evasion cases by a large company in Indonesia. As quoted from the kompas.com website PT CCI is suspected of circumventing taxes, causing a tax underpayment of Rp 49.24 billion. The results of a search by the Directorate General of Taxes (DGT), Ministry of Finance, found a significant increase in costs from 2002 to 2006. The enormous cost burden caused the taxable income to

decrease so that the tax payment was also reduced. For DGT, this expense is suspicious and leads to transfer pricing practices to minimize taxes. DGT calculated a shortage of CCI income tax (PPh) of Rp 49.24 billion. This data shows that tax avoidance has impacted state revenues for the past few years.

According to Xynas (2011), tax avoidance is an attempt to reduce tax debts that are legal (Lawful), while tax evasion (Tax Evasion) is an attempt to reduce tax debts that are illegal (Unlawful). Therefore, the issue of tax avoidance is complex and unique. On the one hand, tax avoidance is allowed, but on the other hand, tax avoidance is undesirable.

One of the financial conditions that will affect the practice of tax avoidance is profitability. The profitability ratio is a ratio to measure the company's ability to seek profits from its business activities (Hery, 2016). Profitability consists of several ratios, one of which is Return on Assets (ROA). ROA is an indicator that reflects the company's financial performance. ROA has a relationship with the company's net income and the imposition of income tax for the company (Kurniasih & Sari, 2013). The more profit the company earns, the more likely it is to practice tax avoidance. Based on previous research conducted by Dhypalonika (2018) and Ganiswari (2019), the results show that profitability has a positive and significant effect on tax avoidance. According to the study results, the greater the profitability of a company, the greater the amount of tax to be paid, and the level of tax avoidance will also be more significant. In contrast to Arianandini and Ramantha's (2018) research, the results show that profitability has no significant effect on tax avoidance.

In addition to profitability, the thing that affects tax avoidance is institutional ownership. Institutional ownership is share ownership owned by several non-bank institutions such as mutual fund companies, insurance companies, and other non-bank companies. Based on previous research conducted by Husna (2018) and Dhypalonika (2018), the results show that institutional ownership has a positive and significant effect on tax avoidance. According to the study results, the greater the institutional ownership of a company, the greater the level of tax avoidance that will be carried out. In contrast to research conducted by Arianandini and Ramantha (2018), the results show that institutional ownership has no significant effect on tax avoidance. This condition is due to the lack of quality resources from institutional owners so that they cannot adequately supervise and control the decisions taken by the manager.

The implementation of Good Corporate Governance (GCG) is also explained as influencing tax avoidance. Corporate governance describes the relationship between

various participations in companies that determine the direction of company performance (Haruman, 2008). According to Hadayani (2017), the corporate governance structure will affect how the company fulfills its tax obligations. It all depends on the dynamics of corporate governance run by the company.

Several researchers have researched the practice of tax avoidance in Indonesia. However, the research that has been conducted has shown various conclusions with various independent variables. Through research that has been done on tax avoidance measures, researchers will examine the independent variables, namely Profitability and Institutional Ownership. Then the dependent variable that the researcher will use is tax avoidance. In addition, the researcher also adds Disclosure of Good Corporate Governance (GCG) as a moderating variable which will later strengthen or weaken the influence between the independent and dependent variables.

Based on the description that has been presented, the authors are interested in conducting a research entitled: "The Effect of Profitability and Institutional Ownership on Tax Avoidance with Disclosure of Good Corporate Governance (GCG) as a Moderating Variable (Study on Consumer Goods Industry Sub-Sector Companies Listed on the Indonesia Stock Exchange in 2016 – 2020)."

## **LITERATURE REVIEW**

### **Agency Theory**

Jensen and Meckling (1976) explain that agency theory is a theory that explains the relationship or contact between principals (shareholders) and agents (managers). Agency theory begins to apply when there is a contractual relationship between the owner of the capital (principal) and the agent. The principal employs the agent to perform tasks in their interest, including delegating decision-making authority from the principal to the agent.

### **Signaling Theory**

Signaling theory explains the provision of information by companies to users of financial statements to reduce information asymmetry between the two. Information asymmetry can occur because one party does not have access to the same information as the other party. To facilitate it, the company must disclose information in financial and non-financial information (Jama'an, 2008).

### **Trade-Off Theory**

Modigliani and Miller (1958) developed the trade-off theory and quoted Myers (1977). This theory states that determining the capital structure that is considered optimal includes a trade-off between the tax benefits derived from the use of debt and the costs

of planning investments that are less than optimal in the future. When the company has debt, interest payments will arise. Interest incurred on debt is a tax deduction so that it can reduce the company's tax payment obligations.

### **Stakeholder Theory**

According to A Chariri and Imam Ghozali (2007), stakeholder theory says that the company is not an entity that only operates for its interests but must benefit stakeholders, shareholders, government, and society.

### **Tax Avoidance**

Tax avoidance is an effort made by taxpayers legally that does not violate tax laws by exploiting weaknesses in tax laws to reduce the amount of tax paid. (Badriyah, 2017).

### **Institutional Ownership**

Institutional ownership is the ownership of company shares owned by financial institutions such as Banks, Pension Funds, Insurance Companies, Limited Liability Companies, and other Financial Institutions. (Siregar and Utama, 2005). According to Putri and Yuyetta (2013), Institutional ownership can effectively control management through the monitoring process.

### **Profitability**

Profitability is an indicator of financial management performance in managing the company's wealth which is indicated by the profit generated. If the profitability ratio is high, it shows efficiency carried out by the management. The increased gain resulted in the company's profitability also growing. (Hery, 2016).

### **Corporate Governance**

According to The Indonesian Institute for Corporate Governance (IICG), corporate governance is a process and structure implemented in running a company with the primary objective of increasing shareholder value in the long term while taking into account the interests of other stakeholders.

### **Effect of Profitability on Tax Avoidance**

The company carries better asset management and shows good financial planning to earn profits. The efficiency is carried out by the management, which means showing increased profits. Companies with high profitability values indicate that the higher the company's profits, and increased the profit results in a higher amount of tax to be paid. Alternatively, it can be said that there is a possibility of an attempt to take tax avoidance.

When viewed from stakeholder theory, companies do not only fulfill the company's interests and prosper their own companies. Still, they must provide benefits to stakeholders, such as investors, institutions, or the government, that affect the company's performance, including matters relating to its tax policy. In contrast, trade-off theory emphasizes that the company will owe up to a certain level of debt, where the company gets tax shields from additional debt.

Previous research conducted by Dhypalonika (2018), Ganiswari (2019), and Husna (2018) showed the results that profitability had a positive and significant effect on tax avoidance. According to the study results, the greater the profitability of a company, the greater the amount of tax to be paid, and the level of tax avoidance that will be carried out will also be more significant. In contrast, Arianandini and Ramantha's (2018) research show that profitability has no significant effect on tax avoidance. Based on the study results, it can be concluded that profitability has a significant negative impact on tax avoidance. The more profitable the company is, the more beneficial it can position itself in tax planning to obtain optimal taxes.

H1: Profitability affects tax avoidance

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

Institutional owners play an important role in monitoring, disciplining, and influencing managers. Institutional ownership plays a vital role in overseeing a more optimal management performance because it is considered capable of effectively monitoring managers' decisions and forcing managers to be more careful in making opportunistic decisions. This condition can suppress the personal profit-seeking activities of company managers to avoid behavior that is detrimental to shareholders.

Based on stakeholder theory, companies do not only fulfill the company's interests and prosper their own companies. Still, they must provide benefits to stakeholders, such as investors, institutions, or the government, that affect the company's performance, including matters relating to its tax policy. In contrast, Agency theory states a conflict of interest between shareholders and managers, where managers want to profit as much. In contrast, shareholders wish their welfare to be guaranteed.

Previous studies conducted by Husna (2018) and Dhypalonika (2018) showed that institutional ownership had a positive and significant effect on tax avoidance. According to the study results, the greater the institutional ownership of a company, the greater the level of tax avoidance that will be carried out. In contrast to research conducted by Arianandini and Ramantha (2018), the results show that institutional ownership does not have a significant effect on tax avoidance. This condition is due to

the lack of quality resources from institutional owners so that they cannot adequately supervise and control the decisions taken by the manager.

H2: Institutional ownership affects tax avoidance

### **The Effect of Profitability on Tax Avoidance with Disclosure of Good Corporate Governance as a Moderating Variable**

Previous research conducted by Arinda and Dwimulyani (2019) showed that GCG could moderate the relationship between profitability and tax avoidance. It is because the company implements corporate governance by its principles. It is expected that the agent in agency theory can carry out company activities by regulations. Applicable in the company or the government is no exception regarding tax regulations. Meanwhile, Azam & Subekti's (2020) research results stated that GCG failed to moderate the effect of profitability on tax aggressiveness.

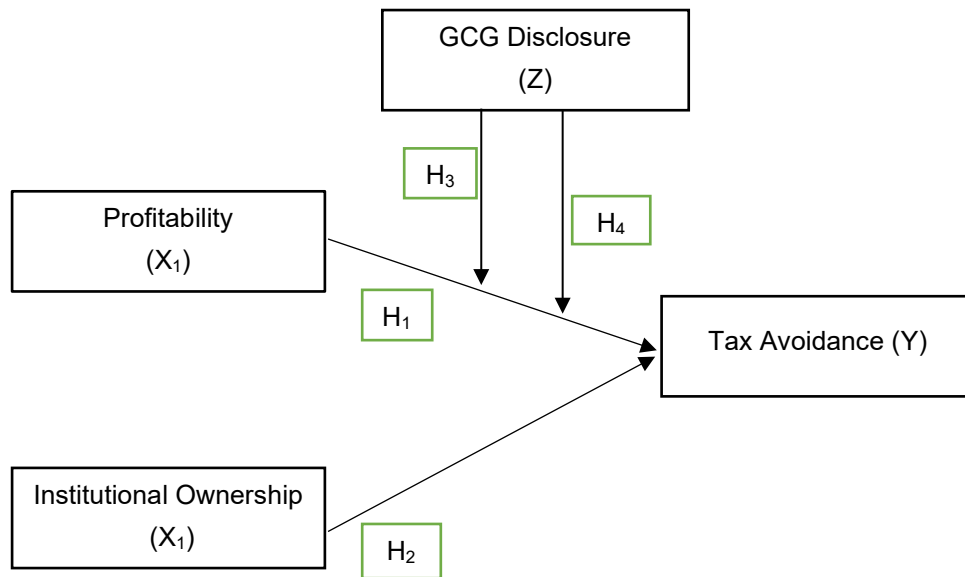
H3: Disclosure of GCG moderates the effect of profitability on Tax Avoidance

### **The Effect of Institutional Ownership on Tax Avoidance with Disclosure of Good Corporate Governance (GCG) as a Moderating Variable**

The size of the institutional ownership concentration will affect the company's tax policy. The greater the institutional ownership, it will improve tax policy and good tax planning, supervise and control the company's management, and as the owner of the company is believed by researchers to try to maintain the company's good name. On the other hand, the smaller the institutional ownership, the lower the excellent tax planning and the possibility of tax avoidance actions because of the low level of supervision of the company's management. This explanation is by agency theory, which states a conflict of interest between shareholders and managers.

The company can implement good corporate governance (GCG) to reduce agency conflict, a mechanism for implementing a good system. By implementing good corporate governance, it is hoped that the company's management can also avoid actions that violate the rules, not least in terms of taxation, despite the low level of supervision of the company's management, because the company's management will try to maintain the good name of the company and stick to the principles of good corporate governance. Previous research conducted by Khurana and Moser (2013) stated that the size of institutional ownership concentration would affect the company's tax policy.

H4: Disclosure of GCG moderates the effect of institutional ownership on Tax Avoidance



**Figure 2: Research Model**

## METHOD

The population used in this study are all manufacturing companies in the consumer goods sector listed on the Indonesia Stock Exchange for the 2016-2020 period. The population in this study was 56 companies.

The research sample was determined based on a purposive sampling technique, selecting samples based on specific criteria. The criteria for selecting the sample to be studied are as follows:

1. Manufacturing companies in the consumer goods industry sector were listed on the IDX from 2016 to 2020.
2. Manufacturing companies in the consumer goods sector are listed in succession and report complete annual and financial reports for 2016 - 2020 2020.
3. Manufacturing companies in the consumer goods industry earn profits from 2016 to 2020. (Negative equity exceptions are not allowed).
4. Manufacturing companies in the consumer goods industry sector publish information on Good Corporate Governance (GCG) disclosure from 2016 to 2020

The first dependent variable (X<sub>1</sub>) in this study is profitability. Profitability in this study was measured using ROA. This ratio is used to measure the level of strength and weakness of the company in generating its overall operating profit. Where ROA is calculated using the formula. (Hery, 2016):

$$ROA = \frac{\text{Earning After Interest and Tax (EAT)}}{\text{Total Asset}}$$



The second dependent variable (X2) in this study is Institutional ownership. Institutional ownership is expressed as a percentage measured by comparing the number of shares owned by institutional investors divided by the number of shares outstanding. (Cornett et al., 2008).

$$\frac{\text{Number of shares owned by institutional investors}}{\text{total shares outstanding}}$$

Measurement of tax avoidance using Effective Tax Rates (ETR). The independent variable (Y) in this study is tax avoidance. According to Badriyah (2017), tax avoidance is an effort made by taxpayers to reduce the tax burden by not violating the law or other applicable rules.

$$ETR = \frac{\text{Tax expense}}{\text{Revenue before tax}}$$

This study's moderating variable (Z) is Disclosure of Good Corporate Governance. Assessment of good corporate governance (GCG) disclosure is assessed using the content analysis method. The researcher will observe whether there are items of information that are disclosed in the annual report. If the items are disclosed in the annual report, they are given a score of "1", but if the items are not disclosed, they are given a score of "0". so that a disclosure score will be obtained in the form of a percentage number.

$$PCG = \frac{\text{Total score of items disclosed by the company}}{\text{maximum score that the company should announce}}$$

## RESULTS & DISCUSSION

### Descriptive statistics

The results of this descriptive statistical analysis can be seen in the following table below:

**Table 1. Descriptive Statistics**

	<b>N</b>	<b>Minimum</b>	<b>Maximum</b>	<b>Mean</b>	<b>Std. Deviation</b>
<b>ROA</b>	120	0.010	92.100	13.018	12.945
<b>INST</b>	120	21.000	94.480	74.503	15.649
<b>IPCG</b>	120	20.000	88.570	55.404	14.079
<b>ETR</b>	120	9.220	96.210	27.214	11.121

Source: Processing results of SmartPLS 3.0 (2021)

The table above shows the amount of data, as much as 120 data. It can be seen that the mean value is greater than the standard deviation value, which indicates a good distribution of data for all variables during the current period.

**Table 2. Hypothesis Testing**

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics ( O/STDEV )	P Values	Statement
ROA -> ETR	-0.207	-0.216	0.066	3.144	0.002	Accepted
INST -> ETR	0.070	0.063	0.065	1.081	0.280	Rejected
GCG -> ETR	0.148	0.147	0.061	2.421	0.016	Accepted
ROA* GCG -> ETR	-0.324	-0.317	0.163	1.982	0.048	Rejected
INST * GCG -> ETR	0.112	0.110	0.069	1.633	0.103	Rejected

Source: *SmartPLS 3.00* (Processed Data)

**The Effect of Profitability on Tax Avoidance.**

Based on the table above, the t-statistic value of Profitability on Tax Avoidance is 3.144, and the p-value is 0.002. These results show that the value of t-statistics is more significant than t-table  $3.144 > 1.96$ . So profitability significantly affects tax avoidance with an Original Sample (O) value or path coefficient of -0.207, which indicates a negative direction. The negative path coefficient value indicates that the relationship between Profitability and Tax Avoidance is the opposite. With these results, it can be concluded that profitability affects company performance, so the hypothesis is accepted.

This study found that profitability has a significant effect on tax avoidance. This study shows a negative and considerable direction which indicates that the more influential the company's profitability, the lower the level of tax avoidance. Companies that have high profitability tend to pay substantial taxes as well. Still, when a company owes a certain level of debt, the company will get tax shields from additional debt with interest payments so that the percentage of tax payments will be smaller. This result is in line with The trade theory that has been presented previously emphasizes that the company will be in debt to a certain level of debt, where the company gets tax savings (tax shields) from additional debt with interest payments.

The results of this study are from research conducted by Arianandini, and Ramantha (2018), Dhypalonika (2018), and Ganiswari (2019), which state that there is a significant effect between tax avoidance and tax avoidance.

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

Based on the table above, the t-statistic value of Institutional Ownership on Tax Avoidance is 1.108, and the p-value is 0.280. From these results, the value of t-statistics is smaller than t-table  $1.081 < 1.96$ . So that institutional ownership has no significant effect on tax avoidance with an Original Sample (O) value or a path coefficient of 0.070, which indicates a positive direction. The positive path coefficient value indicates that the relationship between Institutional Ownership and Tax Avoidance is the opposite.

With these results, it can be concluded that institutional ownership does not affect tax avoidance, so the hypothesis is rejected. This study found that institutional ownership has no significant impact on tax avoidance. This study shows a positive direction toward tax avoidance, which shows that the greater the company's institutional ownership, the higher the level of tax avoidance. Institutional ownership that acts as a party that monitors the company cannot necessarily provide reasonable control over management's opportunistic actions in tax avoidance practices. This result can be caused by the lack of quality resources from institutional owners so that institutional shareholders do not carry out their authority properly in supervising and controlling decisions made by managers so that the tendency of tax avoidance actions still occurs.

This research aligns with the study conducted by Arianandini & Ramantha (2018), which states that institutional ownership has no significant effect on tax avoidance.

### **Disclosure of Good Corporate Governance Moderates the Effect of Profitability on Tax Avoidance**

Based on the table above, the t-statistic value of GCG Disclosure moderates the effect of Profitability on Tax Avoidance on Tax Avoidance is 1.982, and the p-value is 0.048. These results show that the value of t-statistics is more significant than t-table  $1.982 > 1.96$ . This number indicates that the GCG disclosure variable has a substantial effect in moderating the impact of Profitability on Tax Avoidance with an Original Sample (O) value or path coefficient of -0.324, which indicates a negative direction. With these results, it can be concluded that GCG Disclosure moderates the effect of Profitability on Tax Avoidance, so the hypothesis is accepted.

This study found that the disclosure of Good Corporate Governance with the IPCG indicator as a moderating variable shows a negative and significant direction on the relationship between profitability and tax avoidance, indicating that disclosure of Good Corporate Governance can moderate in strengthening profitability against tax avoidance.

The results of this study are in line with research conducted by Arinda and Dwimulyani (2019), showing the effects that GCG can moderate the relationship between profitability and Tax Avoidance.

### **Disclosure of Good Corporate Governance Moderates the Effect of Institutional Ownership on Tax Avoidance**

Based on the table above, the t-statistic value of GCG Disclosure moderates the effect of Institutional Ownership on tax avoidance is 1.633, and the p-value is 0.103. From these results, the t-statistic value is smaller than the t-table  $1.633 < 1.96$ . This number shows that the GCG disclosure variable has no significant effect in moderating the impact of Profitability on Tax Avoidance with an Original Sample (O) value or path coefficient of -0.112, which indicates a positive direction. With these results, it can be concluded that GCG Disclosure does not moderate the effect of Institutional Ownership on tax avoidance, so the hypothesis is rejected.

The results of this study found that the disclosure of Good Corporate Governance as a moderating variable shows a positive direction but is not significant to the relationship of institutional ownership to tax avoidance which indicates that the disclosure of Good Corporate Governance is not able to moderate in strengthening the relationship of institutional ownership to tax avoidance. Based on the understanding of previous studies, Khurana and Moser (2013) stated that the size of the concentration of institutional ownership will affect the company's tax policy.

### **CONCLUSION**

The conclusions of this study are:

1. The study results found that profitability had a significant adverse effect on tax avoidance. This result is because the company gets tax savings (tax shields) from additional debt with interest payments, thereby reducing the total burden of tax obligations.
2. The study results found that institutional ownership has no significant effect on tax avoidance. This result is due to the lack of quality resources from institutional owners so that it does not impact tax avoidance actions.
- 3) The study results found that disclosure of good corporate governance can moderate in strengthening profitability against tax avoidance.
3. The study results found that disclosure of good corporate governance could not moderate in strengthening institutional ownership concerning tax avoidance.

## SUGGESTION

The suggestions of this study are:

1. In future research, additional independent variables can be used to influence tax avoidance to form a research model that is proven to be better at controlling solicitation avoidance.
2. Further research that will conduct similar research topics should develop a research model using broader objects and new theories to maximize the study made.
3. Further research can add a more extended research year to obtain more accurate results.
4. Further research can use other indicators to project the variables used in this study.

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