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Does tax risk effect on the relationship between tax avoidance and firm value? A Case study on companies on the IDX in 2016-2019

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Abstract

This study aims to investigate the direct and moderating relationship between tax avoidance and firm value proxied by CETR where tax risk as a moderator. The population of this study are public companies listed on the Indonesia Stock Exchange for the period 2016-2019 with the sampling criteria used is purposive sampling technique and obtained a sample of 376 observations. Data obtained from the company's financial statements and analysed using SmartPLS3 software. The data analysis technique in this study uses path analysis with the SEM-PLS approach. The results of this study provide evidence that tax avoidance has a positive and significant effect on firm value, and tax risk is not able to moderate the effect of tax avoidance on firm value.

Keywords: Tax Avoidance; Tax Risk; Firm Value; CETR

1. Introduction

Tax risk can create future conflicts and reduce firm value through tax cost, interest, increases, penalties, and reputational damage (Hanlon and Slemrod, 2009) due to investors' perception that the firm is not paying its "fair share" to the government (Dyreng et. al., 2016), which can affect the firm's financial statements, cash flows, and assets, either directly or indirectly. Although there is no agreement on the definition of tax risk in the literature. Drake (2019) states, by focusing on a view of tax risk similar to the traditional view in classical finance, risk refers to the spread of potential returns from an investment. For example, Markowitz (1952), implicitly argues that risk can be seen as the variance of undesirable returns. The use of variance in assessing risk is also expressed by Brealey et. al. (2011: 165), where in his book states "we use variance or standard deviation to summarise the spread of potential returns. These measures are natural indices of risk''. Other literature reveals that tax avoidance may not be sustainable (McGuire et. al., 2016; Saavedra, 2017), so it is understandable why recent studies use the standard deviation of the cash effective tax rate as a measure of tax risk (CETR) (Guenther et. al., 2017; Hutchens and Rego, 2015). Given that this tax risk measure represents the variance in cash savings from tax avoidance, researchers believe tax risk negatively affects firm value.

This research is important because tax avoidance by companies is thought to not only have a positive impact on stock prices, but also a negative impact through increased tax risk. Long-term tax risk can lead to conflicts that are very likely to end in tax losses and in some cases end in the realm of tax crimes. This will provide losses, especially for investors if they are not careful in choosing companies to invest in. To obtain a better research picture, researchers also include Return on Assets (ROA), Return on Assets Volatility (ROAVOL), Leverage, Capital Expenditure, Sales Growth, Marketing Costs (Advertising), and Depreciation as control variables in the study because they are believed to influence decisions in tax avoidance, tax risks arising, and the value of the company.

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Research on the effect of tax avoidance and tax risk on firm value using the model developed by Drake, Lusch, and Stekelberg has not been widely conducted in Indonesia. Based on the phenomena, concepts, and facts described above, research with the topic of the effect of tax avoidance and tax risk on firm value is interesting to do.

2. Literature review and hypothesis development

Stakeholder theory for strategic management suggests that managers should formulate and implement processes that satisfy groups that have an interest in the business. Stakeholder theory is able to explain how shareholders can pressure management to conduct tax avoidance in order to achieve better company financial performance. This will indirectly increase shareholder wealth through an increase in firm value.

Previous research on the relationship between tax avoidance and firm value has different results. Goh et. al. (2016) and Cook et. al. (2017) found that tax avoidance reduces the cost of equity thereby increasing firm value. Desai and Dharmapala (2009) and Wilson (2009) show a positive relationship between tax avoidance and firm value and are driven by good corporate governance. Neuman (2014) argues that the right tax planning strategy can make a significant contribution to firm value. Tax planning strategies that are often used by companies are sustainability strategies in achieving consistent tax payments over time and strategies to minimise the company's tax burden as low as possible (Neuman 2014). According to Jacob and Schütt (2013), tax planning scores have a positive effect on the relationship between pre-tax income and market-to-book ratio. Chasbiandani and Martani (2012) and Kurniawan and Syafruddin (2017) also found a positive effect of tax avoidance on firm value. Ineffective tax law enforcement in Indonesia is considered to be one of the factors that cause tax avoidance to benefit companies (Chasbiandani and Martani, 2012).

In contrast, some studies conclude a negative relationship between tax avoidance and firm value. Kim et. al. (2011) found a positive relationship between tax avoidance and falling stock prices, based on the idea that tax avoidance creates an unclear environment and can bring bad news to the company. Rego and Wilson (2012) argue that aggressive tax planning detected by tax authorities can impose large costs on companies such as consultant fees, legal fees, and other corporate resource expenditures. Tax avoidance activities can have a detrimental impact on companies and investors such as a decrease in the company's share price and other indirect costs (Hanlon and Slemrod, 2009).

Although there are different results regarding the relationship between tax avoidance and firm value, tax avoidance can be seen as a management strategy that can increase firm value. Tax avoidance can provide greater resources for the firm to invest or provide distributions to shareholders. In countries where the level of supervision and enforcement of tax laws is not yet strict, the benefits obtained from tax avoidance outweigh the risks that the company must bear.

H1: Tax avoidance has a positive effect on firm value.

Stakeholder theory is able to explain how shareholders can pressure management to carry out tax avoidance with the ultimate goal of increasing shareholder wealth through increasing company value. But on the other hand, tax avoidance through the use of tax law loopholes carried out by companies can cause tax risk. Tax risk can lead to the principal tax payable as well as interest and penalty sanctions, which in turn will reduce company performance and reduce company value. Reduced company value means reduced shareholder wealth.

Desai and Dharmapala (2009) conducted a study to examine the effect of corporate tax avoidance on firm value where the results showed that tax avoidance had a positive effect on firm value in the company. Hanlon and Slemrod (2009) examined the effect of corporate tax aggressiveness on stock price reactions. The results showed that tax sheltering activities have a negative effect on stock prices. Goh et. al. (2016) examined the effect of corporate tax avoidance on the cost of equity, where the results of his research revealed that tax avoidance has a negative effect on the cost of equity, which means increasing firm value. Chasbiandani and Martani (2012) conducted research to examine the effect of long-term tax avoidance on firm value in Indonesia with results showing that short-term tax avoidance has no significant effect on firm value, while long-term tax avoidance has a positive effect on firm value. The inconsistency of the results of previous studies provides confidence for researchers that there are other variables that may affect the relationship between tax avoidance and firm value. Drake et. al. (2019) show that tax risk affects the relationship between tax avoidance and firm value. Investors distinguish less volatile tax avoidance from more volatile tax avoidance (Drake et. al., 2019). Less volatile tax avoidance has a lower risk so that it provides more accurate information about the company's future tax risk. Meanwhile, more volatile tax avoidance means greater tax risk, making it more difficult for investors to predict the impact on the company in the future.

H2: Tax risk weakens the positive relationship between tax avoidance and firm value.

3. Material and methods

The research was conducted in companies listed on the Indonesia Stock Exchange for a period of 4 years starting in 2016-2019. The Indonesia Stock Exchange (IDX) was chosen as the research location because the Indonesia Stock Exchange (IDX) is the first exchange in Indonesia, which is considered to have complete and well-organised data. The scope of this research is tax risk, tax avoidance, and firm value in companies listed on the Indonesia Stock Exchange in 2016-2019.

The population in this study are companies listed on the Indonesia Stock Exchange in 2016-2019 consecutively. The sample uses company data obtained from the site www.idx.co.id. The company was re-selected in accordance with the previously established purposive sampling criteria. The sampling method used in this research is purposive sampling. The sample criteria used in this study are:

- Companies other than the fields of (1) finance, property, (2) real estate, and building construction, and (3) mining in 2016-2019.
- Companies listed on the Indonesia Stock Exchange in a row for the period 2016 - 2019.
- Companies on the Indonesia Stock Exchange that publish financial reports consecutively during 2016-2019.
- Companies that experienced profits during 2016-2019.

The research hypothesis will be tested using the path analysis method with an alternative approach SEM-PLS (Structural Equation Modeling-Partial Least Square) assisted by SmartPLS3 software.

4. Results and discussion

4.1. Evaluation of the Measurement Model (Outer Model)

Evaluation of the measurement model using PLS is based on measurement predictions that have non-parametric characteristics. The measurement model or outer model with reflexive indicators is evaluated by looking at the value of convergent validity, discriminant validity and composite reliability to assess the contribution of indicators. Outer model calculations are carried out with the help of SmartPLS 3.0 software. The results of the outer model calculation are presented in the following table:

Table 1 Outer Loadings

Variable	Y	X	M	C1	C2	C3	C4	C5	C6	C7
Firm value	1.0									
Tax avoidance		1.0								
Tax risk			1.0							
Roa				1.0						
Roavol					1.0					
Leverage						1.0				
Capex							1.0			
Sales growth								1.0		
Promotion expense									1.0	
Depression										1.0

Secondary Data. 2023

Table 1 shows the statistical value of outer loading. with the results of all indicators measuring each variable Firm Value. Tax Avoidance. Tax Risk. ROA (Return on Asset). ROA Volatility. Leverage. CAPEX (Capital Expenditure). Sales Growth. Promotion and Advertising Costs. and Depreciation have a loading value> 0.70 and it can be concluded that the construct meets convergent validity and the indicator can be said to be valid because there is no value below 0.70.

Table 2 Average Variance Extracted (AVE)

Variable	Average Variance Extracted (AVE)
Firm value	1.000
Tax avoidance	1.000
Tax risk	1.000
Roa	1.000
Roavol	1.000
Leverage	1.000
Capex	1.000
Sales growth	1.000
Promotion expense	1.000
Depression	1.000

Secondary Data. 2023

Validity analysis can be seen from the loading factor value of each construct. Convergent validity of the indicator reflective measurement model is assessed based on the correlation between the component score/indicator score and the construct score or latent variable calculated using PLS. Individual reflexive values can be seen based on loading factor and average variance extracted (AVE). The ideal convergent validity value is when the loading factor value is > 0.70 and the AVE value is > 0.50. Based on the PLS test. it can be seen that the loading factor and AVE values are 1.0 > 0.70 and 0.50 and indicate that the research variables are firm value. Tax Avoidance. Tax Risk. ROA (Return on Assets). ROA Volatility . Leverage. CAPEX (Depreciation). Sales Growth (Sales Growth). Advertising Costs (Advertising). and Depreciation are valid.

In addition to the construct validity test. a construct reliability test was also carried out which was measured by two criteria which can be seen from the value of composite reliability and Cronbach alpha. The construct is said to be reliable if the composite reliability and Cronbach alpha values are above 0.70.

Table 3 Composite Reliability and Cronbach's Alpha

Variable	Cronbach's Alpha	Composite Reliability
Firm value	1.000	1.000
Tax avoidance	1.000	1.000
Tax risk	1.000	1.000
Roa	1.000	1.000
Roavol	1.000	1.000
Leverage	1.000	1.000
Capex	1.000	1.000
Sales growth	1.000	1.000
Promotion expense	1.000	1.000
Depression	1.000	1.000

Secondary Data. 2023

Based on the test results related to data reliability. which can be seen from the value of composite reliability and Cronbach's alpha. The statistical test results show a composite reliability and Cronbach's alpha value of 1.0 > 0.70. so it can indicate that the variable constructs are firm value. Tax Avoidance. Tax Risk. ROA (Return on Assets). ROA Volatility.

Leverage. CAPEX (Capital Expenditure). Sales Growth. Advertising and Promotion Expenses. and Depreciation are reliable.

4.2. Evaluation of the Structural Model (Inner Model)

Inner model analysis is part of the PLS SEM analysis which functions to assess the direct. indirect. and total effects between constructs or latent variables. The direct effect is the effect of a latent variable on other latent variables that is not through other latent variables. while the indirect effect is the effect of a latent variable on other latent variables through one or more other latent variables. Structural model testing is evaluated by looking at the value of R2 (R-Square) / R Square Adjusted to see the predictive power of the structural model.

Table 4 R Square and Adjusted R Square

Independ Variable	R Square	R Square Adjusted
Firm Value	0.186	0.166

Secondary Data. 2023

Based on the output results above. an Adjusted R-Square value of 0.166 is obtained indicating that the variability of the Firm Value construct is explained by Tax Avoidance. Tax Risk. ROA (Return on Assets). ROA Volatility. Leverage. CAPEX (Capital Expenditure). Sales Growth (Sales Growth). Promotion and Advertising Costs (Advertising). and Depreciation of 16.6% for latent variables in the structural model identify that the model is weak. Meanwhile. 83.4% is explained by other variables that are not included in this research model.

4.3. Direct Effect

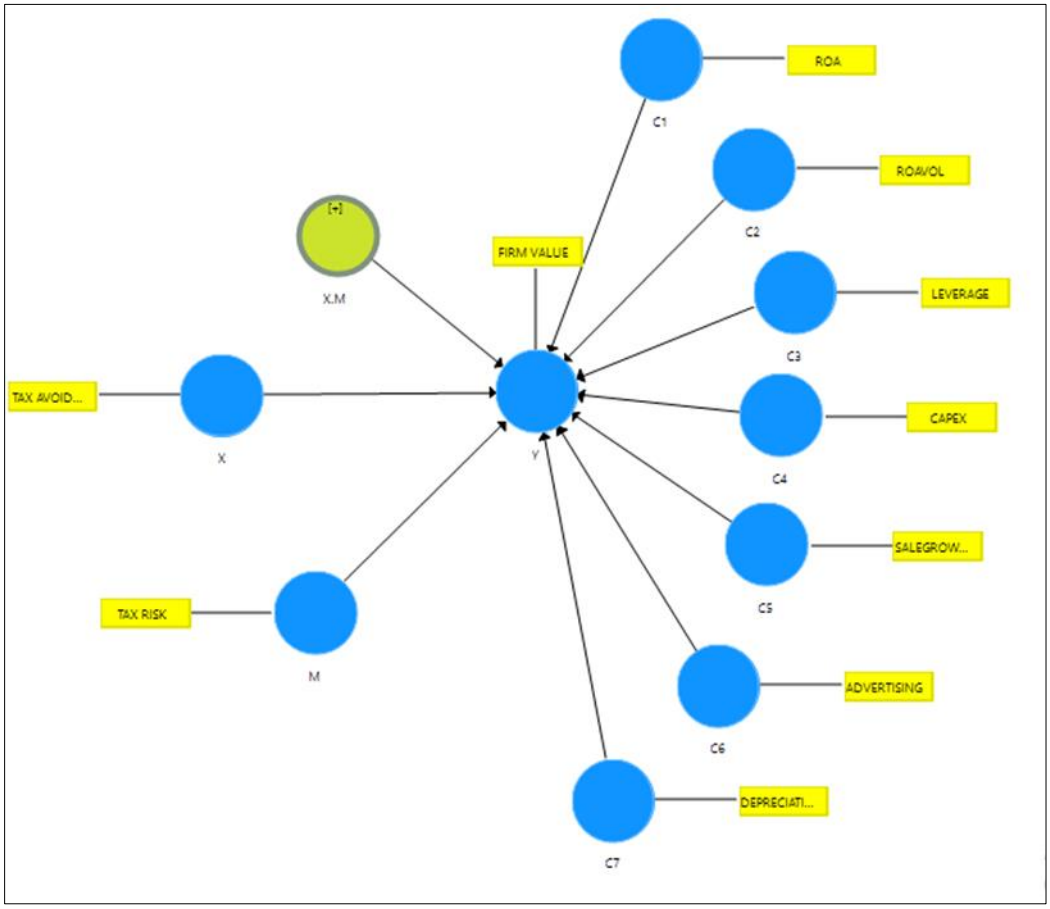

Figure 1 SEM Model

Testing the direct effect hypothesis can be seen from the output generated by the SmartPLS3 software in the path coefficients and p-value sections. Path coefficients present the results of estimating path coefficients. and the p-value

shows the results of significance. If the p-value shows a significant result (smaller 0.05) and the results of the estimated coefficient are positive. then it can be said that it has a positive effect. If the p-value shows a significant result (smaller 0.05) and the results of the estimated coefficient are negative. then it can be said that it has a negative effect. If the p-value shows an insignificant result (greater than 0.05). it can be stated that it has no effect. The following presents the output of the SEM model analysis from PLS3.

Table 5 Direct Effect

Hypothesis		**Path Coefficient**	**P Values**	**Result**
H1	Tax Avoidance (X) Company Value (Y)	0.09	0.04	Accepted
H2	Tax Avoidance (X) Tax Risk (M) Firm Value (Y)	-0.22	0.43	Rejected
-	ROA (C1) Company Value (Y)	0.33	0.00	Accepted
-	ROA Volatility (C2) Company Value (Y)	-0.01	0.67	Rejected
-	Leverage (C3) Company Value (Y)	0.07	0.06	Accepted
-	Capital Expenditures (C4) Company Value (Y)	0.14	0.00	Accepted
-	Sales Growth (C5Company Value (Y)	0.05	0.23	Rejected
-	Marketing Costs (C6) Company Value (Y)	0.07	0.15	Rejected
-	Depreciation (C7) Company Value (Y)	-0.03	0.50	Rejected

Secondary Data. 2023

In Figure 1 and Table 5. the path of tax avoidance to firm value has a p value of 0.04 which means it is significant (smaller $\alpha = 0.05$). with a path coefficient value of 0.09 indicating a positive direction to firm value. The test results can be concluded that tax avoidance has a positive and significant effect on firm value. This indicates that H1 which states tax avoidance has a positive effect on the disclosure of accepted corporate value.

The path of tax avoidance to firm value with tax risk moderation has a p-value of 0.43 which means it is not significant (smaller $\alpha = 0.05$). The test results can be concluded that tax risk does not moderate its effect on firm value. This indicates that H2 which states that tax risk can weaken the effect of tax avoidance on firm value is rejected.

5. Conclusion

Tax avoidance has a positive and significant effect on firm value. These results support Stakeholder theory and show that tax avoidance by companies can increase firm value. Tax risk is unable to weaken the positive effect of tax avoidance on firm value. This result does not support Stakeholder theory and shows that tax risk is unable to weaken the positive effect of tax avoidance by the company on firm value.

Managerial Implication

The results of this study do not fully support stakeholder theory. This happens because the findings of this study do not all support the hypothesis. Therefore. further studies related to the topic of firm value are still needed. The contribution of the results of this study proves empirically for the further development of stakeholder theory. The results of this study found that the value of companies in Indonesia is quite good even though many companies practice tax avoidance through management policies and strategies to increase firm value.

Compliance with ethical standards

Disclosure of conflict of interest

No conflict of interest to be disclosed.

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