CHAPTER I

INTRODUCTION

A. Research Background

The Covid-19 pandemic made Indonesia's tax revenue shrunk by -19.7% in 2020. Indonesia's tax ratio diminished from 10.73% in 2019 to 8.94% in 2020. In addition, the limited resilience of the government budget and the target of normalizing the budget deficit to maximum of 3% of Gross Domestic Product (GDP) in 2023 positively requires leap forward in enhancing tax revenue in amidst the Covid-19 pandemic. According to Kristiaji (2021), one of the strategies that can be taken is to reduce the tax gap. Tax gap is clearly detrimental to the state in terms of tax revenues and in accordance with the Qur'an Surah Hud (11) verse 85 meaning:

وَيَٰقَوۡمِ أَوۡفُواْ ٱلۡمِكۡيَالَ وَٱلۡمِيزَانَ بِٱلۡقِسۡطِۖ وَلَا تَبۡخَسُواْ
ٱلنَّاسَ أَشۡيَآءَهُمۡ وَلَا تَعۡثَوۡاْ فِي ٱلۡأَرۡضِ مُفۡسِدِينَ ٨٥

"And O my people, give full measure and weigh in justice and do not deprive the people of their due and do not commit abuse on the earth, spreading corruption."

In this context, tax gap is the results of the contribution of aggressive tax planning. Cobham, A. et al. (2020) in their latest report entitled 'The State of Tax Justice 2020: Tax Justice in the time of Covid-19", uncovered that Indonesia loses tax revenues of around USD$4.8 billion or Rp 69 trillion yearly from cross-jurisdictional tax avoidance activities. In addition, as indicated by

Cobham, A. et al. (2020), In Asia, Indonesia is ranked fourth after China, India and Japan in the top five biggest losers in corporate tax losses.

In accounting, tax is one of the components of reducing company profits. The greater the profit earned by a company, the greater the tax burden that must be paid by the company on these profits. Based on this, the company will tend to take various ways to minimize the tax payable that must be deposited, often with the practice of tax aggressiveness. In fulfilling the obligation to pay taxes, the company will only consider taxes as a burden that will reduce the company's profits, without bringing in direct benefits. Thus, companies are encouraged to minimize the tax burden so that company profits can be optimized. Because of this interest, company is trying to find loopholes in order to reduce the amount of tax burden that has to be paid to state either legally (tax avoidance) or illegally (tax evasion), or both.

Tax aggressiveness is said to be a legal action because tax aggressiveness is carried out with a transaction scheme to minimize the tax burden by exploiting the weakness of tax regulations in a country. However, the more loopholes that are used or the greater the savings made, the more aggressive the company is towards taxes and that is practically unacceptable. This is because tax aggressiveness has a direct impact on the erosion of the tax base, which results in reduced tax revenues required by the state. From the point of view of tax policy, engaging the practice of tax aggressiveness can lead to injustice and reduced efficiency of a tax system.

According to Chen et al. (2010), companies view taxes an expense, so as a profit-oriented institution, companies tend to implement aggressive tax policies as a way to reduce the expense. Aggressive behaviour towards taxes seen as the implementation of various strategies in effort to minimize taxes (Wahab et al., 2017). The existence of tax aggressiveness causes a tax gap which is the difference between targets that are not achieve so that it weakens tax power as the main source of state revenue in Indonesia. With reduced state revenues, it is feared that it will disrupt national development. Therefore, tax aggressiveness is a legal activity, but to a certain extent this activity has the potential to harm the state. More than ever, taxation has become a problem for the board of directors, chief financial officer, tax authorities and other parties involved.

There are two ways to reduce the amount of tax paid by taxpayers. First, by taking unlawful actions to relieve or even escape from tax obligations. This kind of behaviour is known as tax evasion. In contrast to tax evasion, tax avoidance uses practices that are not prohibited by law, such as exploiting loopholes in tax regulations so that the Director General of Taxes cannot legally prosecute because the perpetrators of tax avoidance use loopholes that have not been regulated in tax regulations. In other words, the action is a legal action as long as it does not violate the applicable regulations. Both have differences in terms of legality.

According to Chen et al. (2010), when deciding to take tax aggressive action, the decision maker or a manager will make a calculation of the benefits and losses of his/her decision. The first benefit is the tax efficiency benefit paid by the company to the government so that the cash benefits for the owner or shareholder become wider. The second benefit is a direct or indirect benefit for managers to obtain compensation from the owners and shareholders of the tax aggressive actions taken. The third benefit is the benefit of the opportunity for managers to perform rent extraction. However, on the other hand, the downside of tax aggressiveness action is the possibility of obtaining sanctions or penalties from the tax office and exposing higher possibility of as a result of practice of rent extraction, an act that is carried out by managers with objectives to personal interest which is not suitable with principal's interests (Desai and Dharmapala, 2006).

As a matter of fact, tax aggressiveness practice and the corporate governance role and its relationship have become academic's interest regarding tax noncompliance issue. There are so many factors that contribute to the tax aggressiveness and discussion about the fairness and transparency of the underpayment of taxes paid by corporations and the effect of those in company's financial health. Therefore, further studies and exploration are needed. According to Lanis and Richardson (2011) and Chen et al. (2010), tax aggressiveness become centre of attention. Research on corporate governance and aggressive tax planning are important for two reasons. First, the strategy for choosing tax planning is one of the roles of managers. As the party responsible for the company's performance as well as the welfare of shareholders, the manager will choose the most effective strategy so that the tax burden incurred can be reduced to a minimum. Second, with the suppression of the tax burden, the company will benefit more in the short term and look good on the financial performance but will be potentially disadvantage in the long term. Therefore, this is where the importance of the role of the board of directors is in determining the direction of policies taken by the company, including in determining the tax strategy chosen by the company.

According to Bebeji et al. (2015), board members had a role in the collapse of several financial institutions and there are many debates about the chain of triggers by looking at the risks of tax problems. Companies that exposed to violate the law will be subject to tax sanctions by paying a fine. The amount of tax paid will be more than it should be. Therefore, the board is expected to participate more in corporate tax policies and strategies in the formulation of the risk management strategy framework (Landolf, 2006). If the role of the board has been effective in monitoring tax policy planning and its implementation within the company, shareholders will feel more secure.

One of the important components in encouraging the company's performance is the existence of gender diversity in the board of directors as an effort to good corporate governance. Although at first board’s gender diversity was categorized as an anti-discrimination issue, equality and same opportunity for women in the workplace but over time, policy debates regarding the composition of the board of directors and gender diversity of the board have received substantive coverage in recent years. Croson and Gneezy (2008) state that the diversity of the board of directors can directly or indirectly affect corporate tax aggressiveness. This is in line with the description of Cregut and Darioly (2019) where women on the board of directors can become transformational leaders compared to men. The presence of women on the board of directors can also compensate and even outperform male leaders in various aspects (Eagly and Schmidt, 2001).

The presence of women on the board of directors can improve company performance compared to companies with smaller female directors (Catalyst, 2004). This study is reinforced by Winata et al. (2021) that female directors have a positive influence on company performance. Compared to the board of commissioners, which is not directly related to the company's decision-making, the presence of the female board of directors takes a direct role in strategic policies in the company. This is confirmed in the study of Smith et al., (2006), the impact given by women in companies is proportional to the abilities possessed by women, not just a matter of gender differences. The existence of gender diversification will make a positive contribution to the monitoring ability of the board of directors in the company (Adams and Ferreira, 2009).

Moreover, the goal of achieving same opportunity for women presence in workplace including political field and managerial decision-making in governments and companies has been agreed by the United Nations as one of the Sustainable Development Goals (SDGs) of the agenda that has been approved for 2030. Based on the Sustainable Development Goals Report (2021), the goal number 5 which is gender equality, it is stated that women’s equal participation in decision-making is crucial for Covid-19 response and recovery, but gender parity remains far off. Goal number 5 has purpose to ensure women’s full and effective participation and equal opportunities for leadership at all levels of decision-making in political, economic and public life. However, these expectations have not been well-realized, women's full and effective participation and equal opportunities for leadership at all levels of decision-making in political, economic, and public life are still very small. In 2021, only 28.2% women participated in managerial positions.

Moreover, in Indonesia, the International Finance Corporation (IFC) has made various efforts to increase the participation of women on the board of directors since 2013. IFC believes that women are an important part of achieving equality in economic growth, and that gender diversity is an important factor in the success of corporate directors. The International Finance Corporation (2019) states that companies with more women on their boards perform better financially, according to a new study launched by IFC, part of the World Bank Group, Working Group on Women's Empowerment (WEP WG) and the Indonesia Stock Exchange (IDX). According to a study entitled Gender Diversity of Corporate Boards in ASEAN conducted by IFC, companies with more than 30% female board members reported an average Return on Assets (ROA) of 3.8%, higher than companies without female board members, with ROA of 2.4%. Similarly, the Return on Equity Ratio (ROE), companies with more than 30% female board members report an average ROE of 6.2% while companies with only male boards report an ROE of 4.2%. This study surveyed more than 1,000 companies located in China and six countries that are members of the Association of Southeast Asian Nations (ASEAN) including Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam.

International Finance Corporation (2019) in its latest research found that in terms of women's representation in the council, Indonesia is on par with the ASEAN average of 14.9%. However, Indonesia lags behind in terms of the number of women in senior management positions at 18.4%, far below the ASEAN average of 25.2%. The results of the Grant Thornton survey showed an increase in women holding the position of chief executive officer (CEO) in 2021 by 25% compared to 2020 which was only 20% (Supriyatna, 2021). The highest senior position achieved by most women in Indonesia is in the position of chief finance officer (CFO) as many as 56%, an increase from the previous year of 48% (Hamdani, 2021). One of the mining companies in Indonesia that places women as CEOs is PT Vale Indonesia, Tbk and the company is also facilitating in placing human resources from gender diversity with proportionally in female workers (Bone, 2021). The mining company, PT Sinar Mas Mining, also appointed a female director for the role of Health Safety Environment (HSE) Corporate which also the one who won the award for Best Woman in Mining at the 29th Annual Professional meeting of the Indonesian Mining Experts

Association 2020 (In Indonesia, Temu Profesi Tahunan Perhimpunan Ahli Pertambangan Indonesia/ TPT PERHAPI) (Kirnandita, 2021).

This research is part of a global series of studies on the positive effects of increasing gender diversity in business leadership. The presence of female directors in the executive ranks will provide an alternative to tax planning policies. Studies conducted by Khaoula and Ali (2012), Winasis and Yuyeta (2017), Hudha and Utomo (2021) mention that executive gender diversity has a significant positive effect on tax avoidance. This condition is because the executive board of directors has full power in determining the tax planning that will be taken by the company (Minnick and Noga, 2010). Female directors tend to be conservative in determining the risk of the chosen policy, by choosing the smallest risk. Especially in choosing the level of earning management (Francis et al., 2014). This includes choosing low risks in funding decisions and investing in company policies, compared to male directors who are more willing to take risks in company policies, including in determining tax policies (Winasis and Yuyeta, 2017). The female board of directors has the nature of prudence and thoroughness to assist the company in determining policies that have low risk and are safe for the company. Therefore, the presence of female directors will be a counterweight to male directors who tend to take high-risk policies (Wiley and Monllor, 2018). It is not surprising that female directors are more rational and transparent in financial reports than male directors (Hoseini, et al., 2018).

Compliance with the system is the key to the company's success in eradicating opportunistic behaviour by managers. Therefore, the policies taken by company managers are monitored by outside parties, such as shareholders. A shareholder is a person or entity that owns shares in a company. Shareholders have the right to obtain profits that are proportional to the number of shares owned, so they must always pay attention to the survival of the company (Hadi and Mangoting, 2014). According to Halioui et al. (2016), shareholders tend to avoid the strategy of implementing tax aggressiveness actions after considering the costs, benefits and risks that will be borne by the company because tax aggressiveness is considered detrimental to their interests.

Previous research conducted by Desai and Dharmapala (2006), Chen et al. (2010), Lanis and Richardson (2011) state that corporate governance and board characteristics has significant effect on tax aggressiveness. According to Jensen and Meckling (1976), ownership structure which included in corporate governance can create agency conflict and agency costs including debt and equity, distribution of equity, the rights in the voting and identity of equity ownership as the results from ownership and control separation.

Ownership structure can be categorized as shares owned by directors/managers, institutional share ownership, foreign owned shares, concentrated share ownership, government ownership and family ownership as well as public ownership. In terms of policy, corporate tax laws and regulations will affect the ownership structure, so the ownership structure can also affect corporate tax planning, thereby affecting the tax strategy decision-making process involving management and directors. Corporate shareholders want to minimize corporate taxes to maximize wealth therefore management feel pressured from shareholders to reduce costs from gaps in the current tax system.

Pohan (2008) said that the greater the proportion of share ownership by managerial, the better the company's performance because it helps merging the interests of shareholders as principal and management as agent. Managerial ownership exists as way to control management to improve performance and are responsible for increasing shareholder wealth or it can be concluded that management act has the same objectives as shareholders. Therefore, the high number of managerial ownerships is indicated as a way to reduce agency conflict (Jensen et al., 1992).

Ownership concentration can be included as one of strategies that is used by company to overcome agency problems between agents and principals. Although it can be seen as good mechanism, ownership concentration led to another problem which is conflict of interest between majority and minority controlling shareholders (Desai and Dharmapala, 2008). Therefore, studies that examine ownership concentration and tax aggressiveness often experience different results depending on the shareholders' attitude on tax aggressiveness. The attitude itself is depending on the cost-benefit balance principle between short term and long-term shareholders involved in tax aggressiveness.

According to Khurana and Mosser (2013), there is a need for supervision from external parties to monitor every decision taken by the manager. The outside party in question is the owner of institutional shares. The higher number of institutional share ownership, the better of the supervision of managers and will reduce the opportunity for tax aggressiveness to occur. Institutional ownership has particularly valued from other shareholders including their reputation, cultural and experience (Boussaidi and Hamed-Sidhom, 2020).

Previous study conducted by Boussaidi and Hamed-Sidhom (2020) had the aim of investigating the possible relationship in Tunisia's public corporate governance monitoring system and the level of their tax aggressiveness practices. In particular, their research examines the effect of ownership structure and the board of directors on tax aggressiveness behaviour in the post-revolutionary context. Through a sample of 39 non-financial companies listed on the Tunisia Stock Exchange (TSE) during the period 2011-2017, they found that the presence of women on corporate boards, CEO duality, managerial ownership and institutional ownership have a negative effect on corporate tax aggressiveness. Meanwhile, independent directors and ownership concentration have a positive effect on corporate tax aggressiveness.

The relationship between corporate governance mechanisms and tax aggressiveness in Indonesian mining sector companies is not as much as in manufacturing companies. Therefore, more research needs to be conducted in determining which corporate governance mechanisms can significantly decrease the possibility of tax aggressiveness and agency conflicts between principals and management in mining sector companies in Indonesia. Besides, this can become contribution to extent of literature in these matters.

Indonesia, which is the fifth-largest coal producer in the world, makes the potential for mining tax revenues to be able to contribute greatly. In 2017, Indonesia produced around 485 million tons of coal or 7.2% of total world production. In addition, Indonesia is the second largest exporter in the world after Australia. Approximately 80% of the national coal production is intended for export. According to data from the Central Statistics Agency, during 2014-2018 the coal and lignite mining industry contributed an average of 2.3% of Gross Domestic Product (GDP) per year or equivalent to IDR 235 trillion. In addition, coal is the number two contributor to the extractive sector after the oil, gas and geothermal groups (Yuliawati, 2019).

Moreover, according to Yuliawati (2019), behind the fantastic economic value generated by the coal mining industry, it turns out that the tax contribution is very minimal. The data from the Ministry of Finance shows that the tax ratio contributed by the mineral and coal mining sector in 2016 was only 3.9% while the national tax ratio in 2016 was 10.4%. Even until 2020, taxes from the mining sector had fallen to minus 43%, due to the impact of the pandemic (Lidwina, 2021). However, in reality, when prices increase, it is not accompanied by compliance in paying taxes (Kemenkeu, 2016).

The mining sector during the pandemic was indeed shaken to minus 23.8% in the first quarter of 2020 (Mulyana, 2020). However, it started to improve due to the increase in commodity prices, and this became a positive contribution in contributing to taxes of 9.29% in the first quarter of 2021 (Steven, 2020). At the beginning of the pandemic even the mining sector tax deposits fell 27.55%, due to pressure on commodity prices. The world is falling (Setiaji, 2020). However, this decline did not last long, as seen in 2021 the mining sector began to experience good conditions because it was driven by a surge in international mining commodity prices, and this condition certainly provided abundant profits for mining companies but was not accompanied by an increase in their tax obligations (Sembiring, 2021).

Based on Government Regulation No. 37 of 2018, mining companies have several tax obligations including income tax, in Indonesia known as Pajak Penghasilan (PPh) 21 for employees, income tax 23 for services supporting business activities, income tax article 4 paragraph 2 on construction services and for land rent, income tax 15 for transportation by water, VAT if coal is processed into briquettes, as well as property tax in Indonesia known as Pajak Bumi dan Bangunan (PBB) for land tenure. Due to the pandemic, the government also provides tax incentives through Minister of Finance Regulation No. 9/PMK.03 of 2021 regarding tax incentives, one of which clauses also provides incentives to mining companies with the provisions stipulated therein, to reduce the burden on companies facing the pandemic.

Along with improving conditions for world commodity prices, the Directorate General of Taxes (DGT) strictly supervises the coal, gold, tin, copper, nickel, silver mining sectors which during the pandemic experienced good price growth so that they have the potential to contribute to tax revenue, but the tax deposit given is still minimal (Kristianus, 2021). The low tax ratio cannot be separated from the problem of tax avoidance by mining industry players who experience an increase in commodity prices and production volumes. Tax avoidance is a practice that exploits legal loopholes and weaknesses in the existing tax system. Although it does not violate the law, it is not morally justifiable.

The illicit financial flows in Indonesia's coal mining industry indicate tax avoidance. Apart from that, it is a sign that taxation matters in the coal sector are not going well. This phenomenon raises big questions considering that there are many regulations that strictly regulate everything from operating licenses to profit sharing from coal sales. This study will be conducted in mining sector companies. The mining sector companies are chosen because high cases of tax avoidance in legal and illegal way in Indonesia originate from the strategic mining sector compared to other sectors. In addition, the Corruption Eradication Commission, known as *Komisi Pemberantasan Korupsi* in Indonesia, sees the mining sector as a sector prone to corruption practices (Novriansa, 2019). It is alleged that mining companies gave money to officials at the Directorate General of Taxes with the intention of reducing corporate tax payments (Pushep, 2020); Winata (2021).

This research studies mining sector companies in Indonesia and the Dollar America (USD) currency is proposed in purposive sampling. The USD currency is used in this study because most of the companies in mining sector use the currency in its annual report. Moreover, according to Riduwan (2000), in a situation where the exchange rate of the Rupiah against a foreign currency continues to fluctuate, it has caused its own problems in the presentation of financial statements. Financial statements, which are intended to provide financial information about the performance, financial position and cash flows of the company, lose their meaning and purpose because the financial statements no longer reflect the actual performance, financial position and cash flows of the company. For example, a company that has debt in foreign currency of USD 10 million, and the exchange rate of Rupiah against USD on balance sheet date weakens by Rp 500, then the company must adjust its debt account and recognize a loss on foreign exchange of Rp 5 billion which means profit (loss) of the company in the current period is reduced (increased) by that amount. Therefore, to avoid adjusting its debt account and foreign exchange only companies with USD currency will be used.

It is highly significant to conduct this study to determine the effect of board of director's gender diversity and ownership structure (managerial ownership, ownership concentration and institutional ownership) on the level of tax aggressiveness carried out by mining companies in Indonesia. This study has implications of important policy regarding gender diversity in the board and tax aggressiveness, which has become issue that attracted many publics, political and government attention recently. In Indonesia, research related to corporate gender diversity has not been conducted frequently so that there is less empirical evidence. In addition, this study is conducted to support a recent initiative by the Internal Revenue Service (IRS) linking good corporate governance practices to reduce tax aggressiveness.

From the background above, the title to be included in this thesis can be concluded as **"THE EFFECT OF BOARD OF DIRECTOR'S GENDER DIVERSITY AND OWNERSHIP STRUCTURE ON CORPORATE TAX AGGRESSIVENESS"**. This research is a replication of the research of Boussaidi and Hamed-Sidhom (2020). The research of Boussaidi and Hamed-Sidhom is located in Tunisia used nonfinancial firm while the location of this study is in Indonesia used mining companies' sector. Besides, the CEO duality as independent variable is eliminated because it is not possible to have CEO duality within the company in Indonesia as it would be contrary to the prevailing regulation in Indonesia which is Law No. 40 of 2007 on Limited Liability Company. The board's independence as independent variable is also eliminated because Indonesia Stock Exchange (IDX) has received approval from the Financial Services Authority, in Indonesia known as Otoritas Jasa Keuangan (OJK), for the revisions made to Regulation No. I-A where the independent directors is iliminated (Fajrian, 2018).

B. Research Problems

Based on the background above, the research problems are formulated as follows:

1. Does board of director's gender diversity have negative effect on tax aggressiveness?
2. Does managerial ownership have negative effect on tax aggressiveness?
3. Does ownership concentration have negative effect on tax aggressiveness?
4. Does institutional ownership have negative effect on tax aggressiveness?

C. Research Objectives

Based on the research problems that have been formulated, the research objectives are as follows:

1. To test and obtain empirical evidence that board of director's gender diversity has negative effect on tax aggressiveness.
2. To test and obtain empirical evidence that managerial ownership has negative effect on tax aggressiveness.
3. To test and obtain empirical evidence that ownership concentration has negative effect on tax aggressiveness.
4. To test and obtain empirical evidence that institutional ownership has negative effect on tax aggressiveness.

D. Research Benefits

The expected results from the conducted research are as follows:

1. Theoretically

   The results of this study are expected to be used as references for academics and future research on the corporate governance, gender equality and tax aggressiveness and can contribute to the literature related to those topics.

2. Practically

   a. For Companies

      - The results of this study are expected to provide understanding to companies about the importance of taxes for the state.
      - The results of this study are expected to provide information and be useful for companies in overcoming and minimizing agency conflicts related to taxation aspects that occur between management (agents) and shareholders (principals).
      - The results of this study are expected to become consideration to the company about the women presence and participation in the board of directors.

   b. For Government

      - This research is expected to be consideration for the government to pay attention to tax aggressiveness activities in the company and the factors that influence it.

- The government, especially the Directorate General of Taxes, can make fair taxation policies and establish a more effective supervisory mechanism for corporate taxpayers so that tax aggressiveness actions can be overcome.

c. For Investor

The results of this study are expected to be a consideration in investing in a company with good value and management to reduce the likelihood of the downfall of shares price due to tax aggressiveness actions.