Pertanika J. Soc. Sci. & Hum. 25 (S): 221 - 230 (2017)

SOCIAL SCIENCES & HUMANITIES

Journal homepage: http://www.pertanika.upm.edu.my/

The Effect of Tax Aggressiveness on Debt Policy with Independent Board as Moderating Variable

Silvy Christina

Trisakti School of Management, Jl. Kyai tapa No. 20. Grogol, Jakarta Barat 11440, Indonesia

ABSTRACT

This research aims to examine the effect of tax aggressiveness and independent boards on debt policy as well as the effect of independent boards as a moderating variable on the effect of tax aggressiveness on debt policy. The sample of this research is 632 non-financial firms listed on the Indonesian Stock Exchange between 2010 and 2015. The result of this research shows that tax aggressiveness has no effect on debt policy. It also shows that tax implications do not have an influence on the financing decisions of the company. Independent boards however have a positive effect on debt policy. This means that control of an independent board will increase if the company has high levels of debt. An independent board does not moderate the effect of tax aggressiveness on debt policy. When the companies requested approval for financing, the board did not consider the tax implications. Therefore, it can be concluded that an independent board has no impact on the decision-making process of company financing, particularly relating to tax aggressiveness. Seven controlled variables were used in this research; two of them have a positive effect on debt policy, one showed a negative effect while the rest have no effect on debt policy.

Keywords: Company financing , debt policy, independent board, Indonesian stock exchange, tax aggressiveness

INTRODUCTION

Financial decisions are one of the most important decisions made by a company. There are two sources of finances - internal and external. Some examples of external sources of finance include debt policy and equity raising. Debt financing is often preferred over equity raising because it has a lower cost and is more effective at reducing inter-agency conflict. Debt is categorised by a company as part of its financial risk as it is an ongoing liability that

ARTICLE INFO

Article history:
Received: 20 May 2017
Accepted: 01 October 2017

E-mail address:
silvy@stietrisakti.ac.id (Silvy Christina)

ISSN: 0128-7702

is not affected or reduced by the company being in a good financial situation. If the company decides not to use the debt, or the financing is done internally, the company will have no obligation to pay the debt. When making debt financing decisions, a company is limited in how much it can borrow, based on the benefits that can be obtained from the debt. The ratio of debt should not be exceeded and if it is based on this standard, then the borrowing capability will increase rapidly, and this will affect the company's capital structure (Indahningrum & Handayani, 2009).

Companies that rely on debt will increase face increasing interests which raises the likelihood that a company will face a default, whereby it cannot fulfil its debt obligations on time. However, if the company only uses its own capital (retained earnings) this will limit the opportunity to generate a larger profit. It is therefore necessary to determine the optimal amount of debt a company can incur (and the benefits obtained from doing so) in relation to the cost to be paid (Ryzkiria, 2014). Agency conflict refers to conflict between managers and owners of a company (Jensen & Meckling, 1976). Based on earlier research by Richardson et al. (2014), there are several variables that influence debt policy, namely tax aggressiveness and the existence of an independent board. Tax aggressiveness refers to minimising the tax to be paid by a company by maximising on certain loopholes contained within the tax regulations. In this case, higher levels of tax aggressiveness will increase the amount of debt that can be incurred by the company. A higher debt increases the interest that needs to be paid by the company. Tax aggressiveness may come from within the company itself, whereby the company has rules regulating the internal supervision of management. The role of an independent board is important to prevent the manipulation of financial reporting. Independent boards can supervise the performance of management because they do not have vested interests in the company. An independent board can assist in preventing tax aggressive procedures within the company. Based on this, the research questions are: (1) does tax aggressiveness affect debt policy? (2) does an independent board affect debt policy? (3) does an independent board moderate the effect of tax aggressiveness on debt policy?

LITERATURE REVIEW

Pecking Order Theory

According to Gitman and Zutter (2015), Pecking Order Theory refers to the hierarchy of financing that starts with retained earnings, debt and finally equity. This hierarchy is based on the lowest risk. Keown, Martin, Petty and Scott (2005) state that internal financing is preferable than external financing. Pecking Order Theory argues that a company's financing structure follows a hierarchy based on a sequence of risks, starting from the cheapest source of funds, internal funds, to stocks that are the last source of funding (Myers & Majluf, 1984). This is consistent with the findings of Indahningrum and Handayani (2009).

When viewed from the Pecking Order Theory, it is clear a company needs new capital to finance its investment. A financial manager adheres to two important rules when determining the source of corporate financing - use of internal corporate sources and issue securities first. External financing is sourced only if internal financing measures do not generate sufficient income. It is the responsibility of the manager to minimise problems and costs arising from debt financing.

Agency Theory

According to Godfery, Hodgson, Tarca, Hamilton and Holmes (2010), in Agency Theory, the management of a company is the agent and the investors are the principal. Agents and principals have different interests. This difference often creates agency conflicts. According to Jensen and Meckling (1976), agency relationships are defined as a contract between one or more persons, in this case it is the owner and the managers who work for the owners. As a result, managers sometimes work against the wishes of the owners. Jensen and Meckling (1976) argue that agency conflict is divided into two types. Type 1 is the conflict between shareholders and managers, that arise when managers make self-profitable policies that largely ignore the interests of shareholders. Type 2 is the conflict between the majority shareholders and the minority shareholders. The majority shareholder holds the rights to the company and as a result, they often make self-profitable policies that ignore the interests of minority shareholders.

Trade-off Theory

According to Arilyn (2016), the manipulation of a company's capital structure is not able to change the value of the firm. The Trade-off Theory states that increasing the use of debt will increase the value of the company, but only to a certain extent. After that limit is reached, the use of debt will begin to lower the value of the company because the increase in profits from the use of debt is not comparable with the increase in financial distress. Financial distress is a condition where a company experiences financial difficulties and faces the potential of bankruptcy. If a company goes into bankruptcy, they will incur certain bankruptcy costs as a result of the sale of assets below the IR market price. In other words, there is a trade-off which needs to be measured against the benefits of using debt financing (Arilyn, 2016). The trade-off theory explains the optimal corporate capital structure as the balance between tax benefits and bankruptcy costs (Surya & Rahayuningsih, 2012). As long as the benefits of using debt are greater, using additional debt is allowable. However, once the benefits of using debt are outweighed by negative consequences, the use of debt should be reduced or ceased altogether. In order to establish an equilibrium, the company must look for debt levels where the costs incurred are offset by profits generated or the tax benefits generated (Karadeniz, Yilmaz, Balcilar, & Beyazit, 2009).

Debt Policy

Most companies will require finance in order to meet its operational needs. Debt refers to the financial obligations of a company to other parties that have not been fulfilled. This debt is considered an external funding source. Company-owned debt can be divided into two parts: current debt and long-term debt. Current debt, or short-term debt, is financial obligations of the company that are discharged in the short term using assets owned by the company. Long-term debt refers to financial obligations of the company with a repayment term of more than one year.

Debt policy is created by management in order to meet the financing needs of the company. The funding policy is one of the important decisions in determining the amount of funding that a company needs. Gitman (2000) argues that short-term debt is better when compared to long-term investments. The latter type of funding certainly has an impact on the company's capital structure and the company's capital structure will have a major impact on the value of a company. To determine the structure of a company's capital requires a detailed analysis such as determining the proportions of debt and equity held by the company. The more sophisticated the capital structure of an enterprise, the better the value of the firm. A higher company value will also maximise shareholder value.

Capital structure is strongly influenced by the company's external sources of funding, obtained from the internal structures of the company. If a company has insufficient funding, its shareholders will usually prefer to engage in debt financing. This type of financing does not reduce shareholders' rights or control over the company. However, company managers do not favour debt financing because it carries a high risk. Management often aims to maximise profits and reduce the outgoings of the company (Indahningrum & Handayani, 2009). In contrast to this, the use of debt increases the risk of the company (Destriana, 2010).

Tax Aggressiveness

Tax aggressiveness is the action of decreasing the tax paid by a company. It can be both legal and illegal. Legal tax aggressiveness refers to taking advantage of loopholes in the tax regulations and illegal tax aggressiveness refers to tax avoidance measures. The main purpose of tax aggressiveness is to reduce the tax paid by the company. The form of tax aggressiveness used in this study refers to when the company's management minimises the value of taxable profits using debt reductions (non-debt tax shield). This can also be legal or illegal. Richardson, Lanis and Leung (2014) found tax aggressiveness can reduce the value of debt. Tax aggressive measures used in this study refers to the actions of management to reduce taxable profits.

Independent Board

Independent boards are also regulated in the Financial Services Authority Regulation No. 33 of 2014 in Article 20 paragraph (2) (Government of Indonesia, 2014) which states that, in the case where the board of commissioners consists of 2 (two) or more members, 1 (one) of them must be an independent commissioner. Paragraph (3) of the same article states the board should consist of at least 30% independent commissioners. Further, article 21 of the Financial Services Authority Regulation No. 33 of 2014 states that an independent commissioner must meet the following requirements:

(1) They must not be a person who is employed or has not had the authority and responsibility to plan, direct, control or supervise the activities of the issuer or public company within the last 6 (six) months, except in the case of re-appointment as an independent commissioner of the issuer or public company in the following period;

(2) They must not hold shares directly or indirectly in the issuer or public company;

(3) They must not have an affiliation or other relationship with the issuer or public company, be a member of the board of commissioners, be a member of the board of directors, or major shareholder of the issuer or public company; and

(4) They must have no direct or indirect business relationship relating to the business activities of the issuer or public company.

Under the Rules of the Financial Services Authority, the above requirements shall be met during the term of office.

HYPOTHESIS

Tax Aggressiveness and Debt Policy

Tax aggressiveness is an attempt by the company to reduce its taxes. Tax aggressiveness is divided into two forms. The first is to minimise the tax burden by exploiting loopholes within tax laws. The second is to avoid the tax burden that should be paid by the company. In this case, higher levels of tax aggressiveness can increase the debt taken by a company. Richardson et al. (2014) theorises that non-debt tax shields include depreciation as substitutes for debt (interest) deductions. Graham and Tucker (2006) observe that tax shelters can be a substitute for debt tax shields (interest deductions). They also conclude that tax-aggressive firms use less debt than non-tax-aggressive firms. A company's debt will also be reduced when a company engages in tax aggressiveness. It is also attractive to firms because of the high corporate profit. Graham and Tucker (2006) also state that tax aggressiveness has a negative effect on debt policy.

Ha_1: Tax aggressiveness has a negative effect on debt policy.

Independent Board and Debt Policy

Harford et al. (2008) states that corporate debt plays an important role in monitoring management, and thus in reducing agency costs. Accordingly, the positive influence between independent boards and debt policy reflects that the higher the proportion of independent board members, the higher the debt of a company. This is because the investors want to protect themselves by increasing the company's debt. The higher the company's debt, the higher the levels of supervision within the company. In accordance with the Pecking Order Theory, the decision to use either debt or equity financing should begin with the lowest risk and cost-efficient choice. Therefore, an independent board will be more likely to approve debt financing because it has a lower risk than equity and will not reduce the control of the shareholders in the company.

Ha_2: The proportion of independent board members has a positive effect on debt policy.

In using tax aggressiveness, a company is trying to maximise their profit. Profit generated by the company will increase the bonus received by its members. Reducing the tax paid by the company will increase the company's profits. According to Fama and Jensen (1983); Richardson et al. (2014), independent board members can provide advice on the company's capital structure without the influence of others. Based on this theory, it can be hypothesised that the proportion of independent board members strengthens the influence of tax aggressiveness on debt policy.

Ha_3: The proportion of independent board members strengthens the influence of taxation aggressiveness on debt policy.

METHODS

The population used in this research are non-financial companies listed on the Indonesian Stock Exchange between 2010 and 2015. The sample selection techniques used in this research is the purposive sampling method. The respondents in this research are 632 companies. To test the hypotheses, a multiple regression method is used.

Research Framework

Based on the research objectives, the effect of tax aggressiveness and the proportion of independent board members on debt policy as well as the proportion of independent board members as moderating variable are examined. The controlled variables in this model are the median of debt ratio, operating income, size, depreciation and amortisation, fixed assets, growth and age.

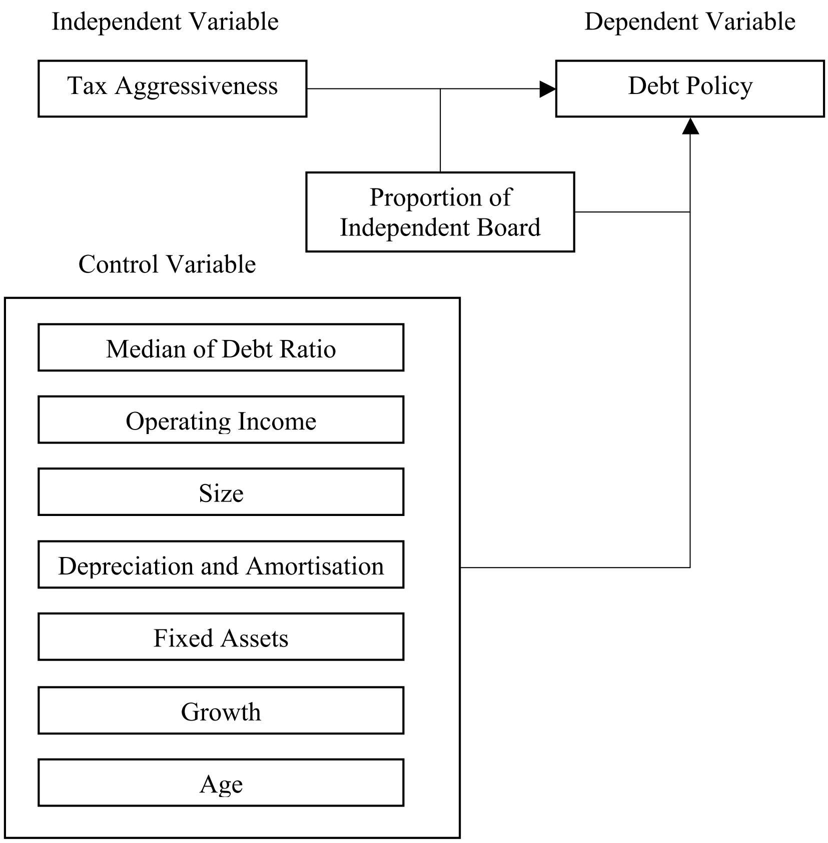

Figure 1. Research framework

Research Model

The research model is an adaptation of Richardson et al. (2014) with some modifications relating to the controlled variables. The regression models use the following equation:

$$DEBT\ it = \alpha 0 + \beta 1TAGit + \beta 2MEDit + \beta 3OIit + \beta 4Sizeait + \beta 5DEPit + \beta 6FAit + \beta 7GROWTHit + \beta 8AGEit + \varepsilon\ it$$

The second model examines the relationship between the proportion of independent directors and the company's debt policy, while a third hypothesis tests whether the proportion of independent directors strengthens the relationship between aggressiveness of tax and debt policy of the company. The research model used is as follows:

$$DEBT\ it = \alpha o + \beta 1TAGit + \beta 2INDCOMMit + \beta 3INDCOMM * TAG\ it + \beta 4MEDit + \beta 5OIit + \beta 6SIZEit + \beta 7DEPit + \beta 8FAit + \beta 9GROWTHit + \beta 10AGEit + \varepsilon\ it$$

Description of symbols in the research model:

DEBT	Debt ratio of the company
TAG	Tax aggressiveness
INDCOMM	The proportion of independent board
MED	Median of debt ratio
OI	Operating income
SIZE	Size of the company
DEP	Depreciation and amortisation
FA	Fixed assets
GROWTH	Growth of the company
AGE	Age of the company

RESULTS

The descriptive statistic and hypothesis results are shown in Table 1 and Table 2 below.

Table 1
Descriptive statistic

Variable	N	Minimum	Maximum	Mean	Standard Deviation
DEBT	632	0.0656	2.1432	0.4450	0.1992
CETR	632	0.0017	2.2682	0.3490	0.2978
INDCOMM	632	0.1666	0.8000	0.4055	0.1069
MED	632	0.1013	1.7580	0.4593	0.1503
OI	632	-0.1898	0.7105	0.1305	0.1126
LnA	632	19.5534	26.2138	22.5664	1.224
DEP	632	0.0010	1.1013	0.0563	0.0716
FA	632	0.0020	2.5517	0.6239	0.3598
GROWTH	632	0.4379	4.2436	1.2284	0.3220
AGE	632	1	156	33.71	22.297

Table 2
Hypothesis result (Model 1)

Variable	Coefficients	t-statistic	Sig
Constanta	0.108	0.750	0.453
CETR	0.044	1.749	0.181
MED	0.619	12.345	0.000***
OI	0.117	1.764	0.078*
LnA	0.000	-0.024	0.981
DEP	0.120	1.031	0.303
FA	-0.073	-3.109	0.002***
GROWTH	0.022	0.974	0.330
AGE	0.000	0.585	0.558

Table 3
Hypothesis result (Model 2)

Variable	Coefficients	t-statistic	Sig
Coefficient	t-statistic	Sig	0.453
Constant	0.001	0.005	0.996
CETR	0.192	1.875	0.161
INDCOMM	0.338	2.150	0.032**
CETR*INDCOMM	-0.335	-1.382	0.168

DISCUSSION

Table 2 shows that tax aggressiveness has no effect on debt policy. It also indicates tax implications do not have an influence on the financing decisions of the company. The variable median of debt ratio, operating income, has a positive effect on debt policy and fixed assets has a negative effect on debt policy. If the median of industry debt ratio increases, the debt will increase. Median of debt ratio is dependent on the type of industry of the company. A high income will increase the debt of the company because the taxes will be high as well. The company will then use the interest paid as a tax saving strategy. The higher the debt of a company, the higher the cost of interest expenses, which is one of the factors considered when claiming tax deductions. High debt is also one of the best ways to prevent losing control of the company. The negative effect of fixed assets on debt policy means that the company does not require other forms of financing because it has large assets. The other variables, such as size, depreciation and amortization, growth and age have no effect on debt policy.

Table 3 shows that the proportion of independent board members has a positive effect on debt policy. This means that control of an independent board will increase if the company has high levels of debt. Higher company debt will also increase the supervision within the company. The proportion of independent board members does not moderate effect of tax aggressiveness on debt policy. When companies requested approval for financing, the board did not consider the tax implications. Therefore, it can be concluded that an independent board has no impact on the decision-making process of company financing, particularly relating to tax aggressiveness.

CONCLUSION

This research has shown first, tax aggressiveness has no effect on debt policy, second, the proportion of independent board members has a positive effect on debt policy and third, the proportion of independent board members does not moderate the effect of tax aggressiveness on debt policy. Seven controlled variables were used in this research; two of them had a positive effect on debt policy, one showed a negative effect while the rest had no effect on debt policy.

REFERENCES

Arilyn, E. J. (2016). Effect of managerial ownership, institutional ownership and financial ratios on capital structure in service trade and investment sector. *Jurnal Bisnis dan Akuntansi, 18*(1), 43-52.

Destriana, N. (2010). Factors influencing debt policy on non-financial companies listed on the Indonesia Stock Exchange. *Jurnal Bisnis dan Akuntansi, 12*(1), 1-16.

Fama, E. F., & Jensen, M. C. (1983). Separation of ownership and control. *The Journal of Law and Economics, 26*(2), 301-325.

Gitman, J. L. (2000). *Principles of managerial finance* (10th ed.). San Diego State University, USA.

Gitman, L. J., & Zutter, C. J. (2015). *Principles of managerial finance*. (14th ed.). USA: Pearson Global Edition.

Godfery, J., Hodgson, A., Tarca, A., Hamilton, J., & Holmes, S. (2010). *Accounting theory* (7th ed.). New York: Wiley.

Government of Indonesia. (2014). *Financial Service Authority Regulation*. No. 33, Article 20.

Graham, J. R., & Tucker, A. L. (2006). Tax shelters and corporate debt policy. *Journal of Financial Economics, 81*(3), 563-594.

Harford, J., Mansi, S. A., & Maxwell, W. F. (2008). Corporate governance and firm cash holdings in the US. *Journal of Financial Economics, 87*(3), 535-555.

Indahningrum, R. P., & Handayani, R. (2009). The effect of manager ownership, institutional ownership, dividend, growth, free cash flow and profitability on debt policy. *Jurnal Bisnis dan Akuntansi, 11*(3), 189-207.

Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics, 3*(4), 305-360.

Karadeniz, E., Yilmaz Kandir, S., Balcilar, M., & Beyazit Onal, Y. (2009). Determinants of capital structure: Evidence from Turkish lodging companies. *International Journal of Contemporary Hospitality Management, 21*(5), 594-609.

Keown, A. J., Martin, J. D., Petty, J. W., & Scott Jr, D. F. (2005). *Financial management-principles and applications* (10th ed.). New Jersey, NY: Pearson Prentice Hall.

Myers, S. C., & Majluf, N. S. (1984). Corporate financing and investment decisions when firms have information that investors do not have. *Journal of Financial Economics, 13*(2), 187-221.

Richardson, G., Lanis, R., & Leung, S. C. M. (2014). Corporate tax aggressiveness, outside directors, and debt policy: An empirical analysis. *Journal of Corporate Finance, 25*, 107-121.

Ryzkiria, M. S. (2014). *Analysis of relationship between tax aggressiveness, proportion of independent commissioners, and corporate debt policy* (Thesis), University of Indonesia.

Surya, D. & Rahayuningsih, D. A. (2012). Factors affecting the debt policies of non-financial companies listed in Indonesia stock exchange. *Jurnal Bisnis dan Akuntansi, 14*(3), 213-225.