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Controlling Shareholders' Tendency Toward Tax Avoidance in Family Firms and Independent Commissioners

Rachmat Dwi Supantri[a], Alfa Rahmiati[b*], [a,b]Department of Accountancy, Faculty of Economics and Business, Universitas Airlangga, Email: [b*]alfa@feb.unair.ac.id

This study aims to obtain empirical evidence of the relationship between controlling shareholders and tax avoidance with family firms and independent commissioners as moderation variables. This study uses listed manufacturing firms in Indonesia Stock Exchange (IDX) for the period 2015 to 2018 amounting to 182 firm-year observations. The analytical techniques used are simple linear regression with SPSS version 23 programs. The research documents that controlling shareholders have a relationship with tax avoidance. In addition, family firms and independent commissioners moderate the relationship between controlling shareholders and tax avoidance. This research provides information for management on taxation avoidance measures that can increase profits and are allowed by law.

Keywords: *Independent commissioners, Controlling shareholders, Tax avoidance, Family firms.*

Introduction

As one of the most substantial state revenues, tax must be optimised for government revenue in order to assist the growth and implementation of the development of the country (Dewi & Jati, 2014). This expectation can be realised by the cooperation between the government and the taxpayer. The government, in this case, acts as a policymaker, while taxpayers act as executors of such obligations (Astuti & Aryani, 2016). Therefore, taxpayers must fulfil their obligations following the prevailing laws and regulations in Indonesia.

In doing its role in collecting taxes, the government does not always receive a warm welcome from the firm. A firms as a taxpayer tends to have an opposing view to the government. The firm considers taxes as expenses that lower their earnings (Gaaya et al., 2017) while the government strives to increase the revenue from sectors that can potentially support the country's development. The difference in perspective between governments and firms gives the firm the possibility to undertake numerous methods to lower their tax burden. Therefore, the firm conducts tax avoidance to increase their earnings. Tax avoidance is an action taken within the boundaries of law and does not violate the tax laws of Indonesia. This action can be done by utilising the gaps in the rules that exist in Indonesia.

Tax avoidance behaviour is closely related to controlling shareholders. Claessens et al. (2000) explained that the existence of controlling shareholders raises the agency's conflict as they can control the firm they own. The controlling shareholder will undertake an action that can benefit itself by waiving the interests of non-controlling shareholders (Diyanty, 2012). One way the controlling shareholder performs such action is to influence the management to conduct tax avoidance. It can be one of the reflections of the firm's agency issues (La Porta et al., 1999; Hanlon & Heitzman, 2010). McGuire et al. (2014) also found the result that the controlling shareholder has a positive relationship with tax avoidance. On the contrary, Hadi and Mangonting (2014) found evidence that the controlling shareholder has a negative relationship in tax avoidance.

Indonesia provides an ideal setting for researching controlling shareholders, which is a common issue in Indonesia, especially within family firms. Prior studies such as Arifin (2003) study the ownership of the shares in developing countries such as Indonesia and found more than 50% of firms are controlled by family ownership. Hidayanti and Laksito (2013) and Chen et al. (2010) state that the family firm plays a substantial role in economic stability both locally and regionally. Besides, Harymawan et al. (2019) also explained that the firm that is actively controlled by family members leads to having better firm performance and higher firm value. With the dominance of the family's controlling shareholders, it is not uncommon that agency conflict exists between the family controlling shareholder and the non-controlling shareholder related to tax avoidance.

The agency problem can be minimised with good corporate governance. Corporate governance relates to the principles portraying the relationship between each participant or related parties in the firm that can determine the performance direction of the firm (Winata, 2015; Irawati et al., 2019; Panjaitan et al., 2018). Larasati et al. (2019) explained that the internal control system and good corporate governance are essential in improving the accountability of the firm. This relationship is in line with the study undertaken by Carolina et al. (2014). In their research, the authors mentioned that good corporate governance would reduce the gap between shareholders and decision-makers within the firm. According to Friese et al. (2008), a tax planning strategy of a firm is reflected in its corporate governance mechanism. This reflection means that under good corporate governance, a tax planning strategy practises minimal tax avoidance. Desai and

Dharmapala (2006) mentioned that if there is no value transfer from the firm to the shareholders, tax avoidance does not need to be done.

One of the mechanisms of governance used as a moderation variable in the study is the board of commissioners' (BOC) independence. The independence of the BOC is expected to monitor the firm's management performance in conducting firm business activities. This role is in line with research from Jo and Harjoto (2011) that uses corporate governance proxies as a top management behaviour monitor.

Specifically, this study aims to examine the relationship between controlling shareholders and tax avoidance within the family firm as moderation variables and BOC independence. This research uses manufacturing firms listed on the Indonesia Stock Exchange (IDX) during the period 2015 to 2018. The results of this study show that controlling shareholders have a relationship to tax avoidance. Controlling shareholders are more likely to engage in tax avoidance because they choose not to pay a substantial tax fee. Furthermore, corporate governance mechanisms demonstrated through family companies and the BOC independence moderate the relationship of controlling shareholders to tax avoidance. This research contributes by adding literature in the field of taxation, especially related to tax planning through tax avoidance. This research also provides information for management on taxation avoidance measures that can increase earnings and are allowed by law.

The rest of this article is organised as follows: section 2 contains the explanation of research hypothesis development; section 3 is the explanation of the research variable, sample, and model; section 4 discusses empirical analysis and the hypothesis test result, and section 5 contains concluding remarks, include a suggestion for future studies.

Literature Review

Theoretical Framework

Taxes are expenses that lower earnings for the firm. The tax payment system currently adopted by Indonesia is the self-assessment system. The taxpayer is given the authority and responsibility to calculate, pay, and report its tax obligations. This responsibility requires the awareness of taxpayers as a reflection of their compliance (Dewi and Jati, 2014). Within the system, the taxpayer has the opportunity to conduct tax avoidance to reduce the tax paid to the government. Tax avoidance is an action made by utilising the gaps in the applicable tax law. According to Dyreng et al. (2008), the definition of tax avoidance is an explicit tax reduction in general and reflects all transactions that have a direct effect on the firm's tax obligations. Tax avoidance practices are conducted by management following the expectations of shareholders (Desai & Dharmapala, 2006). This practice is part of agency theory.

Agency theory shows the relationship between corporate management and shareholders (Jensen & Meckling 1976). Agency theory explains that there is an agreement between the two parties in the use of resources owned by the shareholders and steered by the management. Management has tasks as an agent who can utilise the resources owned by the shareholders. While the shareholders act as principals who do not intervene in running the firm, the authority given to management will create a conflict between managers who have more information related to the firm than the shareholders (Elmanizar et al., 2019). Jensen and Meckling (1976) suggest that individuals in this theory are agents and principals having their respective interests which often differ between the two parties.

Relationship Between Controlling Shareholders and Tax Avoidance

Agency theory explains the separation of roles between shareholders and management of a firm (Jensen & Meckling, 1976). The shareholder serves as the principal of the firm; then management becomes an agent controlling the firm's operations. In agency theory, a problem can arise due to the separation between ownership and control (Rosa et al., 2017). Iskandar et al. (2012) explain that foreign and managerial holdings provide supervision over the use of firm assets, especially in firms with high free cash flows. Conflicts between agent and principal may harm either party. Management as an agent will want incentives for what they have done for the firm, while shareholders want a competitive return on their capital (Putra et al., 2018).

Prior studies have examined the relationship between controlling shareholder ownership and tax evasion. Hanlon and Heitzman (2010) mentioned that the actions taken to raise the firm's earnings, such as tax avoidance, possess adverse effect potential to the shareholders. Therefore, the shareholders prefer not to undertake tax avoidance as it is regarded as a risky strategy. In different situations, controlling shareholders can affect management in order to perform actions that benefit themselves. One of them is taking transfer pricing action, which is one form of tax avoidance often done by firms in Indonesia. Thus, controlling shareholders can enjoy the indirect benefits of the firms they own. McGuire et al. (2014) found empirical evidence that controlling shareholders have a positive relationship to tax avoidance. This result comes as the desire of controlling shareholders who were craving competitive returns on their investment. Based on the explanation that has been submitted, the first hypothesis of this study is:

> **H1:** Controlling shareholders have a relationship to tax avoidance

Family Firms' Moderating Effect on the Relationship between Controlling Shareholders to Tax Avoidance

The ownership structure of a family firm is closely related to agency issues. In agency theory, it is mentioned that management, as an agent, is charged with the task to run a firm owned by shareholders (Jensen & Meckling, 1976). Shareholders are divided into controlling shareholders and non-controlling shareholders. If in a family firm, the controlling shareholder is a descendant of the firm's founder (Claessens et al., 2000). The characteristics of a family firm are that it is owned by a family group whose total dominant ownership is more than 50%, perceived as a firm, and managed by people coming from families who have majority shares or controlling shareholders (Westhead & Cowling, 1997).

Several previous studies have been conducted to examine the relationship between the family firm and tax avoidance. Family firms are more likely to tend not to undertake tax avoidance measures to avoid the sanctions received in the future (Desai & Dharmapala, 2006). Chen et al. (2010) also stated that family firms have less aggressive tax strategy compared to non-family firms. In contrast, Gaaya et al. (2017) found that family firms tended to commit more tax avoidance compared to non-family firms. This result is due to the influence of the controlling shareholder who wants to gain maximum profit. Thus, it can be concluded that the second hypothesis on this study is:

> **H2:** Family firms moderate the relationship between the controlling shareholder and tax avoidance.

Board of Commissioner Independence Moderating Effect on Relationship between Controlling Shareholders and Tax Avoidance

The independent Board of Commissioners (BOC) is a party that can supervise management performance to achieve the firm's specified objectives. Management in agency theory is established as an agent that runs a firm owned by shareholders as well as a principal (Jensen & Meckling, 1976). Agency conflicts that occur between the agent and the principal can be addressed with good corporate governance. Harymawan et al. (2019) explained that the supervisory body is expected to monitor management activities in order to effectively steer the company so that it can improve the operation and performance of the firm. Besides, Suhadak et al. (2018) explained that the quality of the firm could be demonstrated through GCG, which in turn gives signals by delivering financial statements along with the corporate governance information achieved by the firm within a specified period. One of the mechanisms of corporate governance is characterised by the independence of the BOC (Minnick & Noga, 2010). The presence of BOC is expected to align the interest between management and shareholders, which in this study context is controlling shareholders. This means that the BOC may represent the interests of minority shareholders instead of majority shareholders.

Several previous studies have been conducted to examine the relationship between council independence and tax evasion. Timothy (2010) found empirical evidence that the percentage of independent commissioners had a negative relationship with tax avoidance. This is because independent commissioners have a role as a representation of minority shareholders in a firm, and independent commissioners do not have any relationship with the controlling shareholder. Hadi and Mangonting (2014) also found that independent commissioners could minimise the issue of agency. An independent party from the BOC could resolve the conflict. This assumption is because this independent party has no binding interest in the company. Thus, the third hypothesis in this study was:

> **H3:** Independent BOC moderates the relationship between controlling shareholders and tax avoidance.

Research Methodology

Sample and Data Source

The samples used in this study were listed manufacturing firms on the Indonesia Stock Exchange for the period 2015 to 2018. The data sources in this research are obtained from the firm's annual report and the financial statements from the IDX website and the firm's official website. We used manufacturing firms as our research sample as they are one of the most substantial contributors to state income in taxation, and a high degree of operations complexity enable the opportunity to commit tax avoidance (Hartadinata & Tjaraka, 2013). The sample selection technique used is purposive sampling, taking into account several selection criteria. Table 1 describes the sample selection criteria in this study.

Table 1: Sample selection Criteria

Sample selection criteria	**Sample year**			
	2015	**2016**	**2017**	**2018**
Manufacturing listed firm in IDX	135	141	153	167
Firms that have controlling shareholders less than 50%	(58)	(57)	(74)	(89)
Firms that experience loss in current year	(42)	(34)	(33)	(27)
Sample amount	35	50	46	51
Final sample	**182**			

Variable Operationalization

Dependent Variable

The dependent variable in this research is tax avoidance. Tax avoidance (TA) variable is using proxy negative Current Effective Tax Rate (CETR) as it can accommodate the total current tax paid by the firm (Hanlon & Heitzman, 2010). CETR formula as follows:

$$Current\ ETR = \frac{Current\ tax\ expense}{Pretax\ income}$$

Independent Variable

The independent variable of this study is controlling shareholders (CS). In Indonesia's Financial Authority Services Law No.9/POJK.04/2018, article 1, paragraph 4 states that the controlling shareholder at least has shares equal to or more than 50%. In addition to these criteria, it is also mentioned that the controlling shareholder can either directly or indirectly promote or discontinue the board of directors or commissioners and make changes to the firm's articles of association. The controlling shareholder is calculated with the largest percentage of shareholding in a firm.

Moderation Variable

The moderation variables in this research are the family firm (FF) and the independent commissioners (IC). To determine whether a firm is a family firm or not, we examine the surname of the board of directors and commissioner with the firm’s founder. If we document the same surname, the firm is considered as a family firm. This variable is measured using a dummy variable, i.e., given a value of 1 for the family firm and a value of 0 for the non-family firm. Furthermore, the independent commissioner variable measured with the proportion of independent commissioners was compared to the entire board of commissioners.

Methodology

This study uses ordinary least square regression analysis with supporting program SPSS version 23. The first equation is used to examine the relationship between controlling shareholders and tax avoidance. The second equation is to examine the moderating effect of family firms and independent commissioners on the relationship between controlling shareholders and tax avoidance.

$$\boldsymbol{TA = \alpha + \beta 1CS + e} \qquad (1)$$

$$TA = \alpha + \beta 1CS + \beta 2FF + \beta 3IC + \beta 4CS \times FF + \beta 5CS \times IC + e \quad (2)$$

Result and Discussion

Sample Distribution

Table 2 shows the research sample distribution. It is divided into family firms and non-family firms. From a total of 182 firm-year observations, it is known that 74 observations are family firms, while for the rest, 108 observations are non-family firms. Therefore, the family firm included in the research sample is 40.7%.

Table 2: Sample distribution based on family firms and non-family firms

Description	Frequency	%
Family firms	74	40.7
Non-family firms	108	59.3
Total	182	100.0

Statistic Descriptive

Table 3: Descriptive statistics

	N	Minimum	Maximum	Mean	Std. deviation
CS	182	0.5007	0.9914	0.7133	0.1430
CETR	182	0.1312	0.4010	0.2573	0.0458
FF	182	0	1	0.41	0.493
IC	182	0.0000	0.8333	0.4185	0.1242

Table 3 demonstrates a descriptive statistical analysis of the variables used in this study. The average value of the controlling shareholder is 0.7133, with a standard deviation of 0.1430. Furthermore, the tax avoidance variable measured by negative CETR has an average value of -0.2573 and a standard deviation of -0.0458. The family firm variable has an average value of 0.41 and a standard deviation of 0493. Thus, the average family firm that became a research sample in this study was 41%. The independent commissioner variable has an average value of 0.4185 and a standard deviation of 0.1242.

Classic Assumption Test

Normality Test

Test normality in this study uses the Kolmogorov-Smirnov Test. This test is a non-parametric statistical approach test. If the probability (asymp. Sig) > 0.05, then it can be said that the research data is normally distributed. On the equation 1, it examines the relationship between controlling shareholder to tax avoidance. This test result showed the value of Kolmogorov-Smirnov 0.063 with a significance level of 0.071. This value means that equation 1 has a normal data distribution. Then, on equation 2 of the moderation regression model, this equation shows family firms' and independent commissioners' moderating effect on the relationship between controlling shareholders to tax avoidance. The test result showed the value of Kolmogorov-Smirnov 0.062 with a significance level of 0.081. This value means that the equation 2 has normal data distribution.

Heteroscedasticity Test

The study used the heteroscedasticity test with the Glejser test method. To fulfil the assumption of this test, the significance value of each model should be more than 0.05. Based on table 4, the significance values for models 1 and 2 exceed 0.05. This result means that there are no heteroscedasticity symptoms in both models.

Table 4: Glejser test result

Variable	**Model 1**	**Model 2**
	Sig	**Sig**
CS	0,270	0.550
FF	-	0.076
IC	-	0.159
CS*FF	-	0.085
CS*IC	-	0.152

Main Analysis

Controlling Shareholders and Tax Avoidance

Table 5 shows the ordinary least square regression test result that examines controlling shareholders to tax avoidance. Table 5 shows the controlling shareholder's coefficient value of 0.088 (t = 3.810) and is significant at a 1% level. This value means that the controlling shareholder has a relationship to tax avoidance. The larger the percentage of the controlling shareholder, then the CETR value will be higher. The firm is considered more obedient if the value of CETR is high. Thus, the first hypothesis (H1) is accepted. Furthermore, regression models have R-square value or determinant coefficient of 0.075. This means that the independent variable that is the controlling shareholder can explain tax avoidance by 7.5%, while the remaining 92.5% is explained by other variables not contained in this study.

Table 5: Regression analysis result of first model

Variable	**Unstandardised Coefficients**		**t**	**Sig.**
	B	**Std. Error**		
(Constant)	0.195	0.017	11.643	0.000
CS	0.088	0.023	3.810	0.000***
R	0.273			
R2	0.075			
Std Error of estimate	0.0442749			
F test	14.517			
Significance	0.000			

Note: * for significance level 10%, ** for significance level 5%, *** for significance level 1%.

The results of this study show that the controlling shareholder has a negative relationship to tax avoidance. The higher the percentage of the controlling shareholder's ownership, the more obedient the firm's tax obligations were, by avoiding tax avoidance practices. Empirical evidence documents that the presence of controlling shareholders made management less likely to apply tax avoidance practices. This relationship can be seen from PT. Campina Ice Cream Industry Tbk. (CAMP) with the controlling shareholder of 98.72% has CETR value 0.4010, while the other sample PT. Indocement Tunggal Perkasa Tbk. (INTP) has 51% as controlling shareholder and has the CETR value 0.1312. From these two samples, it can be concluded that a higher proportion of controlling shareholder is less likely to conduct tax avoidance.

This result is consistent with Zhou (2011), who found empirical evidence that controlling shareholders have a positive relationship to tax avoidance. Furthermore, this result is in line with McGuire et al. (2014), who state that controlling shareholders are less likely to conduct tax avoidance as they prefer not to incur a substantial cost as result of these actions. Hanlon and Heitzman (2010) also state that tax avoidance practices have the potential to incur a substantial cost for the firm, such as tax consultant fees, reputation fines fee, and fines from the tax authority. This result makes the controlling shareholders prefer to avoid tax planning practices.

Family Firms and Independent Commissioner Moderation Effect on Relationship between Controlling Shareholder and Tax Avoidance

Table 6: Regression result of Model 2

Variable	Unstandardised coefficients		t	Sig.
	B	Std. error		
(Constant)	0.095	0.059	1.592	0.113
CS	0.211	0.082	2.560	0.011**
FF	-0.066	0.036	-1.085	0.073*
IC	0.288	0.139	2.076	0.039**
CS*FF	0.104	0.051	2.032	0.044**
CS*IC	-0.368	0.191	-1.922	0.056*
R	0.354			
R^2	0.125			
Std Error of estimate	0.0435280			
F test	5.050			
Significance	0.000			

Note: * for significance level 10%, ** for significance level 5%, *** for significance level 1%.

Table 6 shows the regression analysis result to examine the relationship between controlling shareholders and tax avoidance with family firms and the independent commissioner as a moderation variable. Table 6 shows the controlling shareholder's coefficient value of 0.211 (t = 2.560) and its significance at a level of 5%. This result means that the controlling shareholder of non-family firms and a low proportion of independent commissioners has a positive relationship to tax evasion. If the controlling shareholder has increased, the tax evasion measured by CETR is increased as well. The larger the value of CETR, the more obedient the firm, which means not committing tax avoidance. Furthermore, the coefficient value of the family firm is 0.066 (t =-1.085) and is significant at 10%. This result indicates that the relationship between the family firm and tax evasion is the opposite. The family firm has a lower CETR value used to measure tax evasion compared to the non-family firm. The value of the independent commissioner coefficient is 0.288 (t = 2.076) and is significant at 5%. This value means the relationship between the independent commissioner to tax avoidance. The higher the independent commissioner proportion value, the higher the value of CETR used to measure tax avoidance.

The moderated results can be seen at the value of the CS * FF and CS * IC. The coefficient value of controlling shareholder interaction with the family firm has a value of 0.104 (t = 2.032) and is significant at a 5% level. This value means that the family firm moderates the relationship between controlling shareholders to tax avoidance. Thus, the second hypothesis (H2) is accepted. Furthermore, the value of the coefficient of controlling shareholder interaction with the independent commissioner has a value of -0.368 (t =-1.922) and is significant at a level of 10%. This value indicates that the independent commissioner also moderates the relationship between the controlling shareholder and tax avoidance. Thus, the third hypothesis (H3) is accepted.

The R-square of the second regression equation is 0.125. This means that independent and moderation variables explain the tax avoidance changes for 12.5%, while for the remaining 87.5% is explained by other variables that are excluded in this study. The results showed that the family firm moderates the relationship between controlling shareholders and tax avoidance. The results of this study were similar to the research conducted by Chen et al. (2010), which suggests that family firms have less interaction with tax avoidance actions. This result is due to the preference of the controlling shareholder, who comes from the family, to keep the firm's respected name in comparison to the profits gained from tax avoidance actions. Desai and Dharmapala (2006) also explained that family firms are willing to forget the benefits of savings and tax evasion than receive a fine and a poor reputation.

Further, the results of the study also showed that the independent commissioner moderates the relationship between controlling shareholders to tax evasion. In this case, a higher proportion of independent commissioners means that the firm will conduct tax avoidance. The higher the proportion of independent commissioners, the higher the pressure given by the independent commissioner to the management to perform tax avoidance action in the interest of investors. This relationship occurs because the independent commissioner represents the vote of non-controlling shareholders. The existence of BOC that originated from outside the firm has a role in the monitoring of the firm's course and actions of executives in the firm. The performance and wealth of shareholders will increase in line with the proportion of the independent commissioners (Minnick & Noga, 2010).

The research was in line with research conducted by Pohan (2008) and Timothy (2010), explaining that the presence of BOC has a relationship with tax avoidance. Based on agency theory, the independent commissioners are expected to assist with the problem of agency. The independent commissioners are those who have no relationship or affiliation with the shareholders or management of the firm, so do not heighten the risk of conducting tax avoidance as they are not directly connected with the firm. As such, the higher the percentage of independent commissioners, the weaker the relationship with tax avoidance.

Conclusion

This study aims to obtain empirical evidence of the relationship between controlling shareholders and tax avoidance with family firms and independent commissioners as a moderation variable. This study uses listed manufacturing firms in Indonesia Stock Exchange

(IDX) for the period 2015 to 2018. The research result shows that controlling shareholders have a positive relationship to tax avoidance. This result means that as the proportion of controlling shareholders increases, the firm will tend to obey the taxation regulations and is less likely to participate in tax avoidance practices. This study also documents that family firms moderate the relationship between controlling shareholders to tax avoidance. This result shows that controlling shareholders' presence in the family firm will tend not to coincide with tax avoidance actions. Furthermore, the independent commissioner also moderates the relationship between controlling shareholders to tax avoidance. This result shows that as the independent commissioner proportion increases, the firm will tend to conduct tax avoidance.

This research has some limitations, which one of them is the R2 value in the research model is relatively low. This value proves that there are still many other variables that can explain tax avoidance, such as audit quality. Researchers have not gotten complete information relating to this variable. The next limitation is the measurement for the shareholder variable controlling less detail, not using the separation between controlling rights and cash flow rights by the controlling shareholder. Therefore, further research may consider adding other variables and using other measuring methods for variables of the controlling shareholder. This research contributes literature to the field of taxation, especially related to tax planning through tax avoidance. This research also provides information for management on taxation avoidance measures that can increase profits and are allowed by law. Finally, this research can be an input for the Directorate General of Taxation to make efforts in improving compliance in the reporting system of financial statements with prevailing standards because there are firms that do not report related data.

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