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Impact of Audit Committee Expertise, Diligence, and Gender on Corporate Tax Aggressiveness in The Era of The Covid-19 Pandemic

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Abstract

This research investigates how various attributes of audit committee members—such as expertise, dedication, and gender—affect aggressive tax planning. The results reveal a significant correlation between audit committee expertise and tax aggressiveness. This underscores how professional experience enhances comprehension of corporate matters, thereby boosting members' efficiency in tax planning and risk assessment. Moreover, the continuity of the audit committee, specifically its size, plays a crucial role in determining tax aggressiveness by ensuring ample resources to facilitate supervisory roles in financial reporting and meeting tax obligations. Conversely, the committee's continuity, encompassing meeting frequency and attendance, doesn't prove effective in curbing tax aggressiveness. Notably, the findings regarding the committee's gender align with the notion that it doesn't influence limiting tax aggressiveness due to the lower representation of women compared to men on the committee.

Keywords: *expertise, diligence, gender diversity, and tax aggressiveness.*

1. Introduction

Reducing tax burdens significantly impacts a company's financial standing, often managed by the leadership (Deslandes et al., 2020). Despite adherence to legal regulations, these practices are labeled as aggressive. Tax managers prioritize their interests through aggressive strategies to ease tax burdens, potentially straining relations with shareholders (Garbarino, 2011). Sikka (2010) considers such practices standard, fostering a culture of aggressive tax reduction in the corporate realm (Lanis & Richardson, 2011). This trend persists due to outdated tax regulations, enabling exploitable loopholes that erode tax system integrity and fairness, as per the OECD (2016). Information gaps between companies and tax authorities emphasize the need for studying tax aggressiveness drivers.

Corporate involvement in tax aggressiveness relies on sturdy governance structures (Australian Taxation Office, 2006, 2010). Past studies failed to pinpoint governance factors influencing tax aggressiveness. Fama and Jensen (1983) highlight the board's role in governance and shareholder protection. Effective governance requires the board's

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capacity to deliberate, influence tax risk, and oversee it (Packard, 2010). The audit committee contributes by recommending tax risk management, as noted by Merchant (1987) and Brown et al. (2009), sharing oversight duties.

This study investigates whether audit committee traits affect tax aggressiveness. Expertise, demonstrated through experience and skills, impacts monitoring and compliance (Carter et al., 2010; Chou et al., 2010). Board persistence, linked to intelligence, influences tax protection (Ngozi & Emeka, 2022). Gender diversity might shape aggressive tax strategies (Garcia-Blandon et al., 2022).

This research bridges gaps by examining how audit committee traits influence tax aggressiveness, particularly in developing nations during the COVID-19 pandemic. It aims to understand the link between tax aggressiveness and audit committee traits—expertise, diligence, and gender—in Indonesia.

The study provides insights into audit committee traits, assisting stakeholders and authorities in comprehending aggressive tax planning and aiding boards in identifying suitable audit committee profiles.

2. Literature review and hypothesis development

2.1 Understanding Tax Aggressiveness

Distinguishing tax aggressiveness from tax evasion is fundamental. Slemrod, J. (2004) defines tax avoidance as a corporate tactic geared toward reducing tax responsibilities. On the other hand, tax evasion involves illegal actions, regardless of motives or consequences (Fisher, J.M., 2014). In contrast, tax aggressiveness disregards laws and regulations, entailing business dealings crafted for tax benefits (Garbarino, 2011). This approach allows companies to gain tax advantages without bearing corresponding costs, transferring them to others (Amidu et al., 2016). Hanlon, M., and Heitzman, S. (2010) position tax evasion along a legality spectrum, where tax aggressiveness occupies a gray area, leaning closer to illegality, a concern within academic circles (Hoi et al., 2013). The intricacies of aggressive tax planning rules often lead taxpayers to sidestep compliance (Whait et al., 2018). Typically, aggressive tax planning aims to dodge tax obligations, constituting a legal violation (CRA, 2013). This study premise suggests that tax-aggressive firms employ strategies to alleviate tax burdens over the medium to long term, strategies ranging from lawful to entirely illegal.

2.2 Tax Risk Management

There's a global drive towards tax risk management seen in diverse initiatives. Revenue authorities and businesses are embedding tax risk within broader risk frameworks (Wunder, 2009). Managing tax expenses significantly impacts a company’s operations and financial health, urging compliance within legal boundaries and steering clear of aggressive strategies (Deslandes et al., 2020). Guenther et al. (2017) highlight the success of persistent, low-risk tax avoidance, yet many companies lack rigorous monitoring of their aggressive tax practices, exposing themselves to risky actions.

Neglecting tax risks goes against the aim of maximizing shareholder wealth. Overly cautious companies face higher tax burdens, while those employing aggressive tax planning may incur greater costs to manage reputation risks (Minnick and Noga, 2010). The audit committee plays a crucial role, providing tax risk management insights to the board of commissioners. Financial aspects linked to risk typically fall under the audit committee's purview (Merchant, 1987; Brown et al., 2009). Their responsibility involves overseeing the company's tax risk management aligned with the board's directives. This study delves into how the audit committee's traits correlate with tax aggressiveness.

2.3 Relevance of audit committee characteristics to tax aggressiveness

The audit committee's impact on tax aggressiveness is assessed based on expertise, diligence, and gender, drawing from Watts and Zimmerman's agency theory (1986).

2.3.1 Expertise of the Audit Committee

The main emphasis is on expertise, evaluated by the financial or accounting background and the duration of service for each audit committee member. Several jurisdictions require finance or accounting proficiency, necessitating companies to provide educational and professional qualifications (Ontario Securities Commission, 2011). Research consistently indicates that financial expertise equips members to fulfill supervisory roles adeptly (Song & Windram, 2004; Krishnan & Visvanathan, 2008), curbing earnings manipulation (Bédard et al., 2004; Lin & Hwang, 2010), and reducing restatements (Farber, 2005; Larry & Taylor, 2012).

Audit committee tenure enhances understanding of company operations and observational skills (Bédard et al., 2004). A positive correlation exists between accrual quality and members' average tenure (Dhaliwal et al., 2010). However, Vafeas (2003) presents contrasting outcomes, suggesting longer tenures might compromise oversight. While Bédard et al. (2004) highlight negative tenure impacts, Sun et al. (2014) find no direct link. These diverse findings underscore the reinforcement of financial oversight by audit committee expertise, potentially mitigating tax aggressiveness. Hence, the proposed hypotheses are:

H1a. Financial experience negatively influences tax aggressiveness.

H1b. Longer tenure within the audit committee negatively impacts tax aggressiveness.

2.3.2 Audit Committee Diligence

The commitment of an audit committee, seen through meeting frequency, attendance rates, and its size, demonstrates the committee's capacity to meet stakeholder obligations (DeZoort et al., 2002). Regular meetings, usually quarterly, enhance managerial supervision (Farber, 2005) and strengthen committee effectiveness (Song & Windram, 2004). Xie et al. (2003) and Lin and Hwang (2010) affirm a negative correlation between the number of committee meetings and earnings manipulation. Conversely, Bédard et al. (2004) find no link between meeting frequency and earnings quality (Baxter and Cotter, 2009) or restatements (Lin et al., 2006).

Committee composition matters as additional members broaden expertise (Baxter & Cotter, 2009). However, an excessively large committee can lead to inefficiencies (Vafeas, 2005). Yang & Krishnan (2005) and Lin & Hwang (2010) suggest a negative link between committee size and earnings manipulation. Contrasting results by Xie et al. (2003) and Bedard et al. (2004) complicate the issue. Abbott et al. (2004) find no correlation between committee size and restatements. These diverse findings underscore the importance of committee diligence in stakeholder oversight (DeZoort et al., 2002). Hence, the formulated hypotheses are:

H2a. Greater committee size negatively influences tax aggressiveness.

H2b. Increased frequency of committee meetings negatively impacts tax aggressiveness.

H2c. Higher committee attendance negatively affects tax aggressiveness.

2.3.3 Gender Diversity within the Audit Committee

The inclusion of women on audit committees holds significance. Eagly et al. (2003) note female directors' process-oriented approach, enhanced participation, and effective communication (Stewart & Munro, 2007). Their presence contributes diverse perspectives to decision-making (Nielsen & Huse, 2010). Studies highlight the positive impact of female committee members on tax compliance (Hasseldine & Hite, 2003), contrasting with more aggressive tax practices by male CFOs (Francis et al., 2014). Lanis et al. (2017) support women's role in reducing tax aggressiveness, although some studies like Bobek and Hatfield (2004) find no gender-specific differences. Cumulatively, evidence suggests women enhance audit committee oversight effectiveness, leading to the hypothesis:

H3. Female representation within the audit committee negatively impacts tax aggressiveness.

3. Research methods

3.1 Sample

The study's sample encompasses active companies operating throughout 2019 and 2020 in Indonesia, all of which are listed on the Indonesia Stock Exchange (IDX). Initially comprising 793 companies listed on the IDX, the research filtered out 718 companies lacking essential information (specifically, they did not report financial statements and annual reports for the years 2019-2020). Additionally, five companies sustained negative pre-tax income throughout the entire period, signifying financial losses. Moreover, four companies were excluded for not meeting the criteria as national companies. Consequently, the study arrived at a final sample size of 66 companies for analysis.

3.2 Empirical Models

This study adopts an explanatory approach, aiming to evaluate the pertinent hypotheses concerning tax aggressiveness. Skills, continuity, and gender are employed as independent variables in this investigation. Moreover, tax aggressiveness is considered as the dependent variable. The empirical model utilized to assess the impact of audit committee traits on corporate tax aggressiveness (ETR) is outlined as follows:

ETR = b0 + b1EXP_FIN + b2EXP_TENURE + b3DIL_NMBR + b4DIL_NMEETING + b5DIL_PRESAC + b6DIV_WOMEN + b7SIZE + b8ROA + b9LEV + e…….(1)

3.2.1 Dependent variable

The dependent variable in this study is the measurement of tax aggressiveness, specifically gauged using the Effective Tax Rate (ETR) approach as outlined by Dyreng et al. (2008). This method aligns with previous research by Chen et al. (2010), Davis et al. (2016), and Dyreng et al. (2008), where tax aggressiveness is calculated by dividing the corporate cash tax paid by the company's pre-tax income for the same period. Consistent with prior studies, the ETR is constrained within a range from 0 to 1 (Chen et al., 2010; Lanis et al., 2017). The data utilized for computing the ETR is sourced from financial and annual reports accessible in the IDX database.

3.2.2 Independent variables

Regarding the independent variables, information pertaining to the audit committee characteristics—expertise, perseverance, and gender—was extracted from financial and annual reports retrieved manually from the IDX database.

3.2.2.1 Audit committee expertise

Audit committee expertise is evaluated based on the financial acumen of committee members, especially in finance or accounting, areas closely linked to tax matters. EXP_FIN serves as a proxy for expertise, calculated as the percentage of committee members possessing educational background or experience in accounting or finance. EXP_TENURE represents the average tenure of each audit committee member.

3.2.2.2 Perseverance of the audit committee

Perseverance within the audit committee is measured by aggregating multiple factors: the number of committee members (DIL_NMBR), the count of audit committee meetings held (DIL_NMEETING), and the attendance rate of members at these meetings (DIL_PRESAC) within the same observation year for each company.

3.2.2.3 Gender

The gender variable is assessed by quantifying the number of female members within the audit committee (DIV_WOMEN).

3.2.3 Control variables

Control variables, in accordance with preceding studies such as Deslandes et al. (2020) and Dyreng et al. (2008), are employed to regulate potential correlations between firm characteristics and tax aggressiveness. These encompass company size (SIZE), profitability (ROA), and leverage (LEV). Larger companies typically possess more resources for tax planning and operational management to minimize tax liabilities (Gupta and Newberry, 1997). Higher profitability (ROA) suggests increased incentives for tax obligation reduction. In leveraged companies (LEV), managers face contractual obligations necessitating financial reporting decisions to avert breaches, thereby influencing the degree of tax aggressiveness. Information about these control variables is sourced directly from financial reports available in the IDX database.

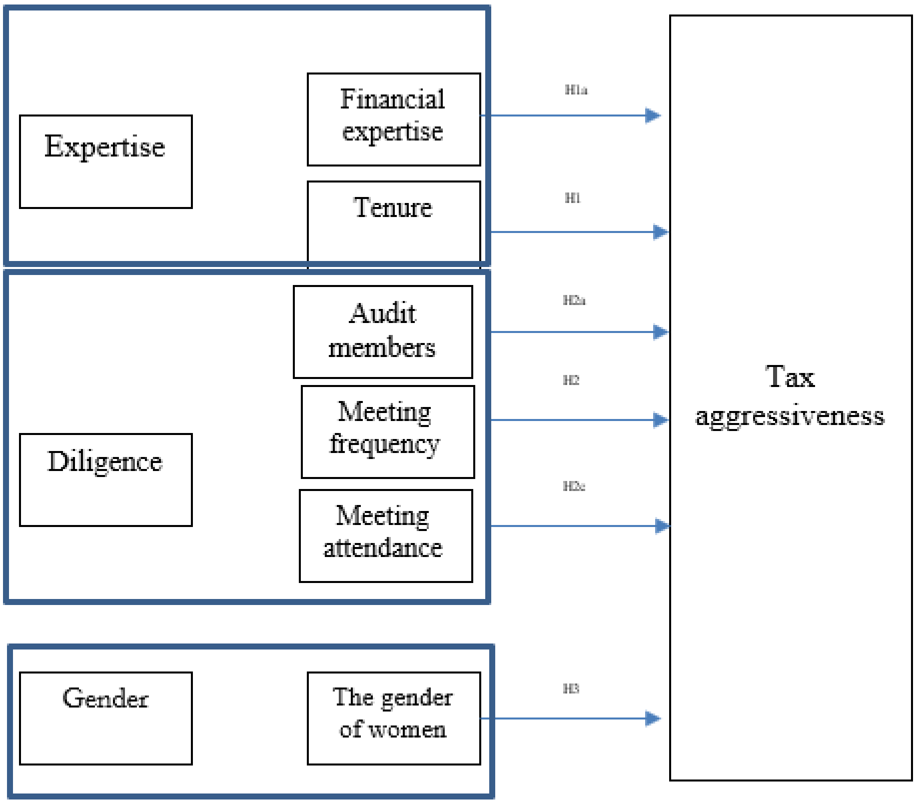

Figure 1. Conceptual framework.

4. Results and Discussion

4.1 Descriptive statistics

Table 1 presents descriptive statistics for various variables: the dependent variable (ETR), independent variables (EXP_FIN, EXP_TENURE, DIL_NMBR, DIL_NMEETING, DIL_PRESAC, DIV_WOMEN), and control variables (SIZE, ROA, LEV). The ETR's average and median values are 0.260 and 0.253, respectively. Notably, the observed corporate tax rate slightly exceeded the income tax rate for 2019-2020 in Indonesia by 1 percent, suggesting overall tax compliance by most companies. EXP_FIN highlights a substantial 72.107 percent average for committee members possessing financial or accounting expertise. The average EXP_TENURE stands at 2.3 years, enabling committee members to gain experience in addressing financial matters. DIL_NMBR approaches four members on average, with around 12 annual meetings (DIL_NMEETING), indicating committee diligence. Members' high attendance (DIL_PREAC) at around 96 percent signifies their commitment. However, women's representation (DIV_WOMEN) remains low, averaging 15.5 percent. The table illustrates reasonable variation across variables, with consistent mean and median values, indicating a normal distribution.

Table 1. Descriptive statistics

Variable	n	Mean	Std. Deviation	Minimum	Median	Maximum
ETR	66	0,260	0,117	0,000	0,253	0,760
EXP_FIN	66	72,107	28,872	0,000	66,670	100,000
EXP_TENURE	66	2,388	1,335	0,670	2,000	6,000
DIL_NMBR	66	3,409	0,784	3,000	3,000	7,000
DIL_NMEETING	66	11,697	8,698	3,000	9,000	45,000
DIL_PRESAC	66	95,827	8,212	60,000	100,000	100,000
DIV_WOMEN	66	15,509	19,692	0,000	0,000	66,670
SIZE	66	30,428	2,281	23,130	30,849	34,900
ROA	66	0,054	0,058	0,000	0,031	0,240
LEV	66	0,527	0,246	0,000	0,535	0,890
Valid N (listwise)	66					

4.2 Correlation Results

Table 2 displays the Pearson correlation findings. A notable negative correlation is evident between the dependent variable (ETR) and independent variables (EXP_FIN, EXP_TENURE, and DIL_NMBR). This correlation highlights the substantial reduction in tax aggressiveness linked to financial expertise, tenure, and committee size. Moreover, significant correlations with the dependent variable were observed for control variables—specifically, size and ROA. The table also reveals a positive correlation between ETR and DIL_NMEETING, DIL_PRESAC, and DIV_WOMAN, indicating that meeting frequency, attendance, and female representation in the audit committee heighten tax aggressiveness. Additionally, the study computed variance inflation factors (VIFs) in regression analysis, confirming VIF values surpassing 10, indicating no multicollinearity among independent variables.

Tabel 2. Pearson correlation result

		EXP_FIN	EXP_TENURE	DIL_NMBR	DIL_NMEETING	DIL_PRESAC	DIV_WOMEN	SIZE	ROA	LEV	ETR
1	EXP_FIN	1									
2	EXP_TENURE	.281(*)	1								
3	DIL_NMBR	-.101	-.181	1							
4	DIL_NMEETING	-.048	-.103	.447(**)	1						
5	DIL_PRESAC	-.198	.067	-.284(*)	-.078	1					
6	DIV_WOMEN	-.284(*)	-.026	.008	.116	.013	1				
7	SIZE	.222	-.084	.552(**)	.371(**)	-.233	.016	1			
8	ROA	-.057	.096	-.231	-.195	.175	-.231	-.249(*)	1		
9	LEV	.251(*)	-.117	.209	.223	-.268(*)	.109	.396(**)	-.544(**)	1	
10	ETR	-.409(**)	-.440(**)	-.013	.191	.076	.199	-.045	-.240	.025	1

Note: at the 0.05 level (2-tailed). **Correlation is significant at the 0.01 level (2-tailed).

4.3 Regression results

The initial hypothesis suggests that the audit committee's expertise can mitigate tax aggressiveness within companies. Regression results support this, indicating a substantial link between a proficient audit committee size and lower tax aggressiveness ($p < 0.05$), backing H1. Members' tenure on the committee (EXP_TENURE) emerges as crucial, implying that extensive experience enhances their effectiveness in tax planning and risk assessment. Lower levels of accounting or financial expertise within the committee (EXP_FIN) are associated with reduced tax aggressiveness, highlighting the need for specialized expertise in fields like finance and accounting in dealing with tax complexities.

Conversely, a hardworking audit committee doesn't appear effective in reducing tax aggressiveness (H2). However, a larger committee size (DIL_NMBR) improves its efficacy in limiting tax aggressiveness by enhancing manpower (Vafeas, 2005) and broadening expertise (Baxter & Cotter, 2009). The committee size reflects resource availability for overseeing financial reports, including tax obligations.

Unexpectedly, the number of committee meetings (DIL_NMEETING) and member attendance (DIL_PRESAC) don't significantly impact tax aggressiveness. Thus, increasing meeting frequency and attendance doesn't notably affect ETR. This suggests inadequacy in using meetings to reduce tax aggressiveness, indicating challenges in overseeing tax risk and assessing internal controls related to tax regulations.

A gender-diverse audit committee (DIV_WOMEN) doesn't seem to mitigate tax aggressiveness (H3), likely due to limited female representation (mean = 15.5 percent, median = 0; Table I), reducing their observable impact. Consistent with Bobek and Hatfield's study (2004), gender doesn't affect tax aggressiveness. Lower female representation diminishes their influence in tax-related decisions. Despite the lack of a significant effect, results lean positively toward tax aggressiveness. Researchers suspect this could stem from women's inclination toward emotions over rationality, making them susceptible to external pressures for tax planning.

ROA is the statistically significant control variable, showing a negative relationship at a 95% confidence level. SIZE has a positive but nonsignificant relationship with tax aggressiveness ($p > 0.05$). LEV and ETR display a nonsignificant negative relationship at a similar confidence level.

Tabel 3. Regression results

Variables	b	t-statistic	p value
EXP_FIN	-0,315	-2,456	0,017
EXP_TENURE	-0,359	-3,213	0,002
DIL_NMBR	-0,265	-1,869	0,067
DIL_NMEETING	0,209	1,755	0,085
DIL_PRESAC	0,011	0,094	0,925
DIV_WOMEN	0,022	0,195	0,846
SIZE	0,033	0,237	0,814
ROA	-0,285	-2,237	0,029
LEV	-0,097	-0,712	0,479

5. Conclusions and limitations

Taxes serve as a substantial expense for companies, affecting both their profitability and market valuation. To optimize shareholder wealth, management commonly adopts aggressive tax planning strategies to minimize this financial burden. While this benefits investors, there's an expectation for companies to balance stakeholder interests by fulfilling their tax obligations to the government fairly (Sikka, 2010).

The audit committee, at the forefront of financial issue resolution and risk management, plays a pivotal role in overseeing tax risk governance. This study delves into the connection between audit committee traits and tax aggressiveness. Our results highlight a negative link between a proficient audit committee and tax aggressiveness. Specifically, committees with stronger financial expertise and longer-tenured members tend to exhibit lower levels of tax aggressiveness. Larger audit committees also contribute to reducing tax aggressiveness by enhancing overall committee performance (Vafeas, 2005), aiding in more effective tax risk assessment and aggression detection.

These findings offer valuable insights for boards of commissioners in selecting potential audit committee members. A larger committee size and members with accounting or finance expertise, especially those with lengthier tenures, are advisable. Committees lacking these attributes could signal risks to shareholders, investors, and tax authorities related to aggressive tax planning. Such insights can also guide tax authorities in shaping their audit strategies.

However, this research faces limitations due to incomplete financial report information for many companies, particularly for the 2021–2022 period, impacting variable determination based on publicly available data. Furthermore, the representation of women on audit committees remains notably inadequate.

Future research could involve interviews with audit committee members to gauge their perception of tax risk and their dedication to tax-related matters. This approach aims to deepen the understanding of corporate tax structures and their influence on executive behavior concerning tax aggressiveness. Additionally, exploring alternative proxies for studied variables and new factors affecting tax aggressiveness could further enrich analysis outcomes.

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