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TAX AVOIDANCE AND FIRM VALUE: UNVEILING THE ROLE OF EARNINGS MANAGEMENT

Amanda Izumi Azalia[1], Puji Andrika Suciati[2], Amrie Firmansyah[3]*

[1] amanda_4132230058@pknstan.ac.id, **Polytechnic of State Finance STAN**
[2] puji_4132230007@pknstan.ac.id, **Polytechnic of State Finance STAN**
[3] amriefirmansyah@upnvj.ac.id, **Universitas Pembangunan Nasional Veteran Jakarta**
*Corresponding Author

Abstract
The study of firm value remains a vital area of academic research, as it is a key indicator of a company's position in the capital market. This research examines the effect of tax avoidance on firm value, with earnings management as a moderating variable. Drawing on financial data from food and beverage sub-sector companies listed on the Indonesia Stock Exchange from 2020 to 2022, the study utilized 57 observations obtained through purposive sampling. Data analysis was conducted using multiple linear regression. The findings indicate that tax avoidance positively impacts firm value, highlighting how strategic tax planning can enhance profitability and garner favorable investor responses. However, earnings management does not significantly amplify the relationship between tax avoidance and firm value, suggesting its limited influence in this context. These results enrich the literature by offering insights into managerial decision-making in tax planning and underscoring sector-specific factors shaping investor perceptions.
Keywords: Discretionary accruals; Investor response; Tax planning

INTRODUCTION

Every company has goals that are generally categorized into long-term and short-term objectives. To achieve these goals, companies need to define business processes that align with their type of organization, whether they are private or public companies. Private companies are owned by acquainted shareholders, such as family members or close associates, with their establishment governed by corporate law (Mulya, 2024). On the other hand, public companies, or those that have gone public, have seen some definitional evolution (Mulya, 2024). According to Johan (2021), the definition of public companies has developed over time, while Margaretha & Suhartono (2016) define public companies as organizations whose shares are partially or wholly owned by the public.

Firm value is a critical factor for both types of companies. According to Salvatore & Rastog (2020), firm value reflects a company's performance and significantly influences investors' perceptions. It is also an indicator of the financial performance of public companies. A high firm value is often associated with high stock market prices (Sukirni, 2012). However, stock prices are volatile and subject to change, which requires investors to analyze annual reports to assess better a company's performance (Damayanti et al., 2014).

The fragile nature of firm value and its contributing factors often leads management to take measures to enhance financial reports. One such measure is tax avoidance. According to Huang & Zhang (2020), advancements in financial sophistication have encouraged the use of tax avoidance as a form of investment from the perspective of tax professionals. Properly implemented tax strategies benefit both the tax efficiency and the presentation of financial statements (McGuire et al., 2012). Consequently, this topic warrants further discussion due to the significant impact of financial statement adjustments on investors as the primary users of financial reports.

Several studies have explored the association between tax avoidance and firm value. Desai & Dharmapala (2009) found that tax avoidance positively impacts firm value in companies with strong governance, as it enhances post-tax value without significant risks. However, in firms with weak governance, its effect tends to be negative or insignificant, as it often creates opportunities for managerial actions that harm shareholder interests. Other studies found that tax avoidance is positively associated with firm value (Chen et al., 2016; Firmansyah et al., 2022; Hasan et al., 2021; Irawan & Turwanto, 2020; Khuong et al., 2020; Widodo & Firmansyah, 2021). Some studies concluded that tax avoidance is negatively associated with firm value (Hanlon & Slemrod, 2009; Hasibuan & Firmansyah, 2023; Lestari & Ningrum, 2018; Minh Ha et al., 2021; Santana & Rezende, 2016; Yee et al., 2018). Rezki et al. (2020) also revealed varied results, with tax avoidance negatively affecting firm value in state-owned enterprises (SOEs) but showing no significant impact in private firms. However, Nidaurrifa et al. (2024) concluded that tax avoidance is not associated with firm value. Given these divergent findings, further examination of the relationship between tax avoidance and firm value is essential to develop a more comprehensive understanding and address gaps in the existing literature.

This study seeks to investigate the impact of tax avoidance on firm value while examining the moderating role of earnings management. Tax avoidance represents a strategic approach companies use to improve the presentation of their financial statements. According to Prayoga (2018), companies engage in tax avoidance due to conflicting interests between the government and the company. Taxes reduce corporate profits, which are a key indicator of management performance. Consequently, management often seeks to minimize tax payments to maintain favorable profit levels.

The relationship between tax avoidance and earnings management has been highlighted in various studies. Desai & Dharmapala (2006) suggested that tax avoidance complements earnings management practices, as seen in cases like Enron's Project Steele, which utilized a complex tax shelter plan to manipulate earnings. Subsequent research supports this complementary effect, with studies by Amidu et al. (2019), Hong et al. (2022), Thalita et al. (2022), and Wang et al. (2019) finding that earnings management positively influences tax avoidance. Hernawati et al. (2021) also concluded a positive relationship between earnings management and firm value. Earnings management and tax avoidance are complementary strategies companies use to maintain optimal profits. These practices positively influence tax avoidance and enhance firm value, highlighting the critical role of earnings management in strengthening the relationship between tax avoidance and firm value.

This research contributes to the literature by offering insights into managerial policies influencing firm value, particularly tax planning strategies. It also provides practical implications for regulators, such as the Otoritas Jasa Keuangan (OJK), to refine policies that ensure tax avoidance and earnings management practices remain within reasonable boundaries, protecting the interests of all financial statement users.

LITERATURE REVIEW

The development of agency theory originates from the separation of ownership and control, as discussed by Berle & Means (1932). This separation creates an agency relationship where the principal (the owner) delegates decision-making authority to the agent (the manager) to act on their behalf (Jensen & Meckling, 1976). The core assumption of agency theory is that agents may act opportunistically, prioritizing their interests over those of the principals, especially in information asymmetry (Jensen & Meckling, 1976).

In practice, however, not all managerial actions are inherently opportunistic. Certain practices like tax avoidance may align with shareholders' interests by reducing tax liabilities and increasing after-tax profits. Tax avoidance refers to legal strategies to minimize a company's tax obligations by exploiting loopholes in tax regulations (Devi et al., 2022). While tax avoidance could theoretically exacerbate agency problems since managers might use the savings for personal gain or to mask inefficient operations, it can also be viewed as a strategy that directly benefits shareholders. Chen et al. (2016), Firmansyah et al. (2022), Hasan et al.

(2021), Irawan & Turwanto (2020), Khuong et al. (2020), and Widodo & Firmansyah (2021) showed that tax avoidance positively impacts firm value, aligning managerial actions with investor interests.

This alignment suggests a departure from the classic agency theory narrative, where managers are primarily viewed as opportunistic. Instead, in the context of tax avoidance, managers might act as stewards who seek to maximize shareholder wealth, reflecting principles from stewardship theory (Donaldson & Davis, 1991). This dual perspective highlights the complexity of managerial actions, which may not always fit neatly into the assumptions of agency theory. Thus, while tax avoidance could theoretically create agency costs, such as increased scrutiny or regulatory risks, its primary outcome, enhanced profits, and shareholder value align with investor expectations.

H_1: tax avoidance has a positive effect on firm value.

Agency theory was developed to address the agency problem, which occurs when there is a divergence of goals between principals and agents, and principals cannot guarantee that agents will act in alignment with their best interests (Eisenhardt, 1989). This inability to verify agent behavior is primarily caused by information asymmetry, where agents possess more information than principals. Such asymmetry may allow agents to utilize their informational advantage to implement strategies to enhance the company's efficiency.

One such strategy is efficient earnings management. According to Firmansyah et al. (2020) and Scott (2015), earnings management should not always be seen as opportunistic. Earnings management is employed to help the company achieve broader objectives, such as meeting investor expectations, maximizing share prices, or increasing firm value. Efficient earnings management is a tool to convey accurate private information to investors or avoid violating debt covenants that could harm the company (Scott, 2015).

Tax avoidance is frequently regarded as a complementary strategy for achieving organizational objectives in corporate efficiency. This practice involves legally minimizing corporate tax obligations by exploiting gaps in tax regulations (Devi et al., 2022). Existing research on the relationship between earnings management, tax avoidance, and firm value has produced mixed findings. Studies conducted by Amidu et al. (2019), Hong et al. (2022), Thalita et al. (2022), and Wang et al. (2019) demonstrated that earnings management positively influences tax avoidance. Additionally, research by Hernawati et al. (2021) highlighted a positive association between earnings management and firm value. Efficient earnings management is a strategy to enhance corporate efficiency by helping achieve strategic goals such as meeting investor expectations, maximizing share value, and increasing firm value. In this context, tax avoidance is a complementary strategy legally utilized to optimize corporate tax liabilities. The relationship between earnings management, tax avoidance, and firm value demonstrates a potential synergy that supports the effective attainment of corporate objectives.

H_2: Earnings management strengthens tax avoidance's positive effect on firm value.

METHODS

This study employs a quantitative descriptive methodology with a panel data design, integrating time-series and cross-sectional data. The data utilized are secondary data derived from companies in the consumer goods sector, specifically the food and beverage sub-sector, listed on the Indonesia Stock Exchange (IDX) during 2020–2022. The sampling began with identifying 26 companies in the food and beverage sub-sector listed on the IDX as of December 31, 2022. Companies that conducted their initial public offerings (IPO) after December 31, 2019, were excluded, although no exclusions were necessary under this criterion. Additionally, companies with incomplete financial data during the research period were removed, reducing

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the sample by 7. Ultimately, 19 companies met all eligibility criteria, resulting in 57 observations over the three-year study period.

The dependent variable in this research is firm value. It is calculated using Tobin's Q ratio because Tobin's Q is relatively free from managerial manipulation (Lindenberg & Ross, 1981) and can reflect the prospective performance of the firm (Hoyt & Liebenberg, 2011). The research conducted by Farrell & Gallagher (2015) and Pangestuti et al. (2023) illustrates the usage of Tobin's Q to calculate firm value.

$$\text{Tobin's Q} = \frac{\text{Total Market Value} + \text{Total Liabilities}}{\text{Total Asset}}$$

The independent variable in this study is tax avoidance, which is measured by taking the negation of the effective tax rate (Hanlon & Heitzman, 2010; Rahma & Firmansyah, 2022).

$$\text{TAXAV} = \frac{\text{Tax Expenses}}{\text{Pretax Income}} \text{x} - 1$$

Furthermore, this study uses earnings management as a moderating variable. Earnings management calculations are carried out by calculating performance-matched discretional accruals (DA) (Kothari et al., 2005). The proxy used to formulate the discretionary accrual model is from previous research conducted by Altarawneh et al. (2022) as follows:

$$\frac{\text{Accruals}}{\text{TAt} - 1} = \beta 0 (\frac{1}{\text{TAt} - 1}) + \beta 1 \frac{\triangle \text{ REV} - \Delta \text{REC}}{\text{TAt} - 1} + \beta 2 \frac{\text{PPE}}{\text{TAt} - 1} + \beta 3 \text{ ROA} + \varepsilon$$

Where:

Accruals	: income after-tax - cash from operation
TA t-1	: total company assets the previous year
Δ REV	: change in income from the previous period
Δ REC	: change in receivables from the previous period
PPE	: plant, property, and equipment
ROA	: return on assets is obtained from net income divided by total assets
ε	: regression residual, which is an estimate of discretionary accruals

Also, this study employs control variables such as debt-to-asset ratio (DAR), return on asset (ROA), and company size. The debt-to-asset ratio is a parameter between total debt and assets (Brigham & Houston, 2019; Husna & Satria, 2019).

$$\text{DAR} = \frac{\text{Total debt}}{\text{Total assets}}$$

Return on assets (ROA) is used as a control variable because when the ROA value is high and increases over time, it can be said that a company has good performance (Almira & Wiagustini, 2020). Return on assets (ROA) can be calculated using the following formula proxied by Husna & Satria (2019).

$$\text{ROA} = \frac{\text{Net income}}{\text{Total assets}}$$

Firm size becomes a control variable because large companies tend to avoid a drastic change in profits (Healy, 1985). That tendency can lead to a more significant opportunity for tax avoidance practices. For simplicity, these factors are formulated in one formulation as follows (Husna & Satria, 2019):

$$\text{Firm size} = \text{Ln (Total Asset)}$$

Panel data regression is used to analyze the obtained data sample with the help of Eviews software. Descriptive analysis is the first step done with the meaning to retrieve each variable's maximum, average, and minimum values. Furthermore, the Chow, Hausman, and Lagrange Multiplier test is conducted to determine the correct model and further analyze the data panel. The previous test and analysis then generated a hypothesis testing model that furtherly elaborated in the following formula:

$$\text{Tobin's } Q_{it} = \beta_1 + \beta_2 TAXAV_{it} + \beta_3 DA_{it} + \beta_4 TAXAV{*}DA_{it} + \beta_5 DAR_{it} + \beta_6 ROA_{it} + \beta_7 SIZE_{it} + \varepsilon_{it}$$

Where:

Tobin's Q	: Firm Value
TAXAV	: Tax Avoidance
DA	: Earnings Management
DAR	: *Leverage*
ROA	: *Return on Assets*
SIZE	: Firm Value

RESULTS AND DISCUSSION

The final results from selecting this research sample have been processed and presented as descriptive statistics, as seen in Table 1.

Table 1 Descriptive statistics

	Tobins Q	TAXAV	DA	DAR	ROA	SIZE
Mean	2,204	-0,247	0,071	0,382	0,085	14.997.576
Median	1,770	-0,221	0,051	0,423	0,071	14.529.829
Min	0,560	-0,863	0,001	0,098	0,001	11.495.354
Max	7,500	-0,003	0,236	0,743	0,274	19.010.724
Std Deviasi	1,506	0,130	0,066	0,175	0,061	1.721.908

Source: data processed

Based on the results of descriptive statistical tests in Table 2, it is known that there are 6 research variables, namely Tobins, ETR, DA, DAR, ROA, and Size, with a total sample size of 57. The average firm value is 2.204211, which indicates that the company experiences growth in firm value on average. The maximum value is 7.500000, while the lowest value is 0.560000. The standard deviation or inequality value is 1.506386, which shows the average deviation of the dependent variable (Tobin's Q). The independent variable is tax avoidance. The average value of all data is -0.247134. This shows that, on average, the companies in the sample avoid tax. The highest value is -0.003463, while the lowest value is -0.863180. The standard deviation or deviation value of 0.130068 shows the average tax avoidance deviation. Earnings management, measured using discretionary accrual (DA) as a moderating variable, shows an average value of 0.071393. The highest value is 0.236038, and the lowest is 0.001130, with a standard deviation of 0.062553.

Hypothesis testing includes partial and simultaneous hypothesis testing. The results of hypothesis testing using the fixed effect model are as follows:

Table 2 Results of Panel Data Regression Analysis

Variable	Coeff.	t-Stat.	Prob.
C	6,4837	3,464	0,001
TAXAV	1,8512	2,352	0,013
DA	2,5834	3,482	0,001
TAXAV*DA	1,671	0,492	0,313
DAR	0,3319	0,498	0,314
ROA	-2,1163	-1,812	0,040
SIZE	-0,2658	-2,365	0,012
Adj. R^2	0.9745		
F-Stat.	90.45		

Variable	Coeff.	t-Stat.	Prob.
Prob (F-Stat.)	0.000		

Based on the research result, tax avoidance positively affects firm value, confirming the acceptance of H_1. This finding indicates that tax avoidance is perceived as a strategic action that enhances company profitability, thereby improving investor welfare and increasing the company's value in the market. This outcome highlights the role of tax savings in amplifying retained earnings, which can be reinvested or distributed to shareholders, creating a positive perception among market participants. This result confirms several previous results (Chen et al., 2016; Firmansyah et al., 2022; Hasan et al., 2021; Irawan, 2020; Khuong et al., 2020; Widodo & Firmansyah, 2021). This result, however, contrasts with studies conducted by Hanlon & Slemrod (2009), Hasibuan & Firmansyah (2023), Lestari & Ningrum (2018), Minh Ha et al. (2021), Santana & Rezende (2016), and Yee et al. (2018), which found a negative relationship between tax avoidance and firm value. These studies suggest that the market reacts negatively to tax avoidance practices, as they may signal unethical behavior or increased risk of regulatory scrutiny, which could harm the company's reputation and long-term value.

The difference in findings can be explained by the unique characteristics of the companies examined in this study, particularly those in the consumer goods sector, specifically the food and beverage sub-sector. These companies typically operate in a highly competitive industry where profitability and market performance are critical for survival. Investors in this sector tend to prioritize financial performance and profitability, which may lead them to view tax avoidance as a legitimate and beneficial strategy to enhance earnings. Unlike industries that face intense public scrutiny for tax practices (e.g., extractive industries or large multinational corporations), food and beverage companies may not experience the same level of reputational risk, allowing tax avoidance to be perceived more positively.

Furthermore, the findings align with stewardship theory, which posits that managers act as responsible stewards of organizational resources, working toward common goals shared with investors. Investors in this study appear to trust that managers undertake tax avoidance actions to optimize the company's wealth rather than for personal gain. This mutual trust between managers and investors fosters a positive perception of tax avoidance as a tool to achieve organizational objectives, thereby reinforcing firm value. Thus, the positive effect of tax avoidance on firm value in this context is likely due to a combination of sector-specific dynamics, investor priorities, and the absence of significant reputational risks associated with tax practices. These findings underscore the importance of contextual factors in shaping the market's reaction to tax avoidance activities.

The interaction between tax avoidance and earnings management does not significantly affect firm value, leading to the rejection of H_2. Companies in this industry prioritize profitability and market performance, with investors focusing on consistent financial returns rather than scrutinizing the methods used to achieve them (Amidu et al., 2019; Hong et al., 2022). Moderate tax avoidance and earnings management levels generally do not attract significant negative attention unless they are overly aggressive or provoke regulatory scrutiny.

The nature of products in the food and beverage sub-sector, typically essential or frequently consumed items, ensures stable consumer demand, reducing the market's sensitivity to managerial strategies like tax avoidance and earnings management (Hernawati et al., 2021). This stability encourages investors to emphasize overall financial outcomes, such as total profits and dividends, rather than the technical details of these practices. Such investor behavior aligns with the principles of stewardship theory, which posits that stakeholders trust management to act responsibly and use resources to achieve organizational goals effectively (Scott, 2015).

Although the interaction between tax avoidance and earnings management does not individually affect firm value, the simultaneous influence of these variables and their individual effects significantly impacts firm value when considered part of a broader research model. This finding suggests that the combined dynamics of tax avoidance and earnings management are more relevant to driving firm value within this sector than their interaction alone (Thalita et al., 2022; Wang et al., 2019). This result highlights the importance of understanding sector-specific investor priorities and operational dynamics, where the market emphasizes financial stability and profitability over the specific mechanisms employed to achieve these outcomes.

CONCLUSIONS

This study aimed to analyze the impact of tax avoidance on firm value within Indonesia's consumer goods sector, focusing specifically on the food and beverage subsector and exploring whether earnings management amplifies this relationship. The results reveal that tax avoidance positively and significantly affects firm value, indicating that investors view tax-saving practices favorably due to their profitability-enhancing effects. However, earnings management does not considerably influence how tax avoidance impacts firm value, suggesting its limited role in shaping investor perceptions.

The research is confined to companies in the food and beverage subsector, which may limit the applicability of its findings to other industries. Furthermore, the study employed a specific analytical approach to tax avoidance, potentially overlooking other dimensions of the practice.

Future research could adopt diverse analytical methods for tax avoidance and explore additional moderating variables, such as corporate governance or financial transparency. Expanding the scope to encompass multiple sectors on the Indonesia Stock Exchange (IDX) could provide more comprehensive insights and enhance the generalizability of the findings. For regulators, such as the Otoritas Jasa Keuangan (OJK), the results underscore the need for stricter regulations to promote transparency and mitigate financial manipulation by listed companies, ultimately safeguarding investor interests and bolstering trust in the capital market.

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