

Moderating effect of audit quality: the case of political connection, executive compensation and tax aggressiveness

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Abstract

The study examines the moderating effect of audit quality on relationship between political connection, executive compensation on tax aggressive. The secondary data used for this study in the form of financial statements of 56 financial sector firms listed on Indonesian stock exchange from 2018 to 2021. Moderated Regression Analysis used for analyzed data. Result indicate, that political connection positively affected tax aggressive. These result support the view of grabbing hand theory, where a bureaucrat who occupies a position in the company will be controlled by the corporation because they get welfare. Furthermore, we find that executive compensation negatively affected tax aggressive. The result of moderation analysis show that audit quality can weaken the relationship of executive compensation on tax aggressive. These findings of this research suggest that audit quality is an effective corporate governance mechanism, thereby protecting users against the opportunism and fraud by managers. This show that corporate governance is able to mitigating information asymmetry that exist in the relation between agent and principals.

Keywords: tax aggressiveness, political connection, executive compensation, audit quality

Abstrak

Penelitian menguji pengaruh moderasi kualitas audit terhadap hubungan koneksi politik, kompensasi eksekutif terhadap agresivitas pajak. Data sekunder berupa laporan keuangan 56 perusahaan sektor keuangan yang terdaftar di Bursa Efek Indonesia pada tahun 2018 hingga 2021. Teknik analisis data menggunakan Moderated Regression Analysis. Hasil penelitian menunjukkan bahwa koneksi politik berpengaruh positif terhadap agresivitas pajak. Hasil ini mendukung pandangan teori *grab hand*, dimana seorang birokrat yang menduduki suatu jabatan di suatu perusahaan akan dikuasai oleh korporasi karena mendapatkan kesejahteraan. Lebih lanjut, ditemukan bahwa kompensasi eksekutif berpengaruh negatif terhadap tindakan agresif pajak. Hasil analisis moderasi menunjukkan bahwa kualitas audit memperlemah hubungan kompensasi eksekutif terhadap agresivitas pajak. Temuan penelitian ini menunjukkan bahwa kualitas audit merupakan mekanisme tata kelola perusahaan yang efektif, sehingga melindungi pengguna terhadap oportunistik dan penipuan oleh manajer. Hal ini menunjukkan bahwa tata kelola perusahaan mampu memitigasi asimetri informasi yang ada dalam hubungan antara agen dan principal.

Kata kunci: agresivitas pajak, koneksi politik, kompensasi eksekutif, kualitas audit

Permalink/DOI : <https://doi.org/10.21067/jem.v19i1.7762>

How to cite : Sihono, A., & Munandar, A. (2023). Moderating effect of audit quality: the case of political connection, executive compensation and tax aggressiveness. *Jurnal Ekonomi Modernisasi*, 19(1), 15–30.

Article info : Received: January 2023; Revised: August 2023; Accepted: August 2023

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ISSN 0216-373X (print)
ISSN 2502-4078 (online)



Introduction

Companies pay attention to tax payments because they have an impact on competition (Jihene & Moez, 2019). Tax is a cost for the Company, which result in decrease the net income or wealth received by shareholders. In other words, the increase in income received, the company must pay more taxes. As a result, the Company strives to make tax payments to a minimum, so that the net profit generated is maximum (Iswari et al., 2019). According Hanlon and Slemrod (2009) tax aggressiveness is an effort made by the Company to pay taxes. Tax aggressiveness is considered a major problem, remembering complicated has also economic consequences. Tax aggressiveness by taxpayers, including companies, will cause the state to suffer losses, because taxes are a source of state revenue, which will be used as a source of financing for state expenditure. The practice of tax aggressiveness deprives the government of a major source of revenue and has received increasing attention from regulators (Li et al., 2016). If many companies do tax aggressiveness, the state revenue that comes from taxes will be affected. In addition, tax aggressiveness has an adverse effect on the reputation of a company.

Tax aggressiveness is synonym of tax management, tax planning, and tax avoidance, which has the same meaning (Richardson et al., 2013). The act of violating tax regulations is an illegal act called tax evasion, one of the act of tax avoidance is carried out legally is tax aggressiveness (Hanlon & Heitzman, 2010). The loopholes in a tax regulation are used in the context of tax aggressiveness actions. Companies can use allowable deductions and exclusions, so that no rules are broken. Even though the state is at a loss due to reduced income, tax aggressiveness cannot be prohibited by the government (Hardianti, 2014).

Previous studies have conducted research on the factors that determinant tax aggressiveness (Ardillah & Prasetyo C, 2021; Gaaya et al., 2017; Hardianti, 2014; Iswari et al., 2019; Li et al., 2016; Mulia et al., 2019; Silaban & Purba, 2020), among these factors is political connections. Political connection can affect tax aggressiveness (Li et al., 2016). A company are politically connected when the president director or majority shareholder simultaneously serves as a member of the legislature or government, president or king of a country, or member or leader of a political party (Faccio et al., 2010). Companies take advantage of political connections to gain profit for their business (Francis et al., 2016). In the context of taxation, politically connected companies have better information about impending regulatory changes (Milyo et al., 2000). This information is used in the context of aggressive tax avoidance. Companies that have political connections get easier access to capital loans with easy-to-extend loan facilities (Houston et al., 2014). This condition is possible because creditors obtain bailout guarantees from the government associated with the company when of a financial crisis (Agarwal et al., 2012). As a result of these privileges, political connections cause the company to have a tendency to carry out higher aggressive tax strategy (Kim & Zhang, 2016). Political connection owned by the commissioners and directors has a positive relationship on tax aggressiveness (Agarwal et al., 2012). Other studies have shown that political connections negatively affected tax aggressiveness (Iswari et al., 2019; Jian et al., 2012; Pranoto & Widagdo, 2016). Politically connected companies will act cautiously in making decisions regarding taxation. This is done in order to increase the perception of compliance that is owned by the company as a taxpayer (Lestari & Putri, 2017).

Tax avoidance is an action that has risks and is influenced by the decisions,

orientations, and motivations of managers. Desai & Dharmapala (2006) in their study found that tax avoidance affected by incentive compensation. The higher the compensation received by the manager, the lower the tax avoidance activity carried out. Desai and Dharmapala (2006); Ohnuma (2014); and Gaaya et al. (2017) state that corporate governance is a supervisory mechanisms prevent managers also minimizing actions to take advantage of existing opportunities to take tax avoidance actions. Based on this research, it is found that there is a varying relationship between executive compensation and tax aggressive depending on the level of good governance applied in the company. Managers will not take tax aggressiveness actions if they do not get rewards, because there is a manager's personal interest which is expected to be in the form of excessive rewards (Rego & Wilson, 2012). Increasing executive compensation can reduce tax aggressiveness, this condition due to compensation can make managers take actions that are in line with the interests of shareholders (Amri, 2017; Desai & Dharmapala, 2006; Halioui et al., 2016; Ohnuma, 2014). Meanwhile, Mulia et al. (2019) and Armstrong et al., (2012) in his research stated that high compensation given to executives could not motivate managers to take aggressive tax actions. Executive compensation reduces managers' opportunistic behavior, thereby reducing tax aggressiveness (Desai & Dharmapala, 2006).

Studies related to political connection, compensation of executive and tax aggressiveness has been carried out (e.g. Agarwal et al., 2012; Desai & Dharmapala, 2006; Jian et al., 2012; Li et al., 2016; Yuwono, 2019)). However, inconsistent results of previous studies and were conducted separately, further study is needed on the relationship of political connections and executive compensation. Furthermore, previous studies used the relationship of political connections on tax aggressiveness from the perspective of agency theory, but our research used the

Grabbing hand theory, which is expected to provide a new perspective on political relations. Grabbing hand theory stated that bureaucrats has the objective for increasing welfare when occupying a functions in government. This theory holds that when bureaucrats are controlled by corporations, they will receive gain from corporation. As a result, bureaucrats who have the task of supervising the company's compliance with the regulation, are unable to maintain order.

In addition to examining the factors that influence tax aggressiveness consisting of political connections and executive compensation, efforts are needed to reduce opportunistic actions, monitoring structures that enable managers to be disciplined and reduce opportunism, especially when it concerns tax aggressive. Thus, to address additional gap, our research examines the moderating effect of the corporate governance mechanism on the association between political connection, executive compensation on tax aggressiveness. Good governance structures reduce the level of tax avoidance (Kiesewetter & Manthey, 2017). The one of the effective good governance mechanisms is audit quality, since that is able to provide stakeholder protection against opportunism and fraud (Jihene & Moez, 2019). According to the view of agency theory, conflict that occur between managers and shareholders as principal can be reduced by the role of audit quality. For the reason, our study uses audit quality as a proxy for corporate governance. Thus, it is expected that this research will be able to expand the influence between political connection, executive compensation on tax aggressiveness, as well as the role of corporate governance.

The research aims to analyze the impact of political connections, executive compensation on tax aggressiveness with audit quality as a moderating variable. This research provides information on the importance of corporate governance in

order to protect users of opportunistic actions and managers' fraud.

Political Connection and Tax Aggressiveness

Tax aggressiveness is influenced by political connections (Kim & Zhang, 2016). Companies with political connections get preferential treatment, this can be seen from the high level of tax aggressiveness carried out. The government will reward companies that have a large contribution to high tax payments (Kim & Zhang, 2016). The political connections owned by the Company provide advantages, including easy access to funding, as well as the low potential for inspection by the tax office, so that this triggers the Company to carry out tax aggressiveness which results in the transparency of financial reporting is lower. In addition, aggressiveness of tax level is higher if the companies are politically connected than those without political connections (Kim & Zhang, 2016).

Previous studies with varying result on the influence between political connection and tax aggressiveness. Different author has investigated the relationship of political connection on tax aggressiveness. Some studies have suggested a positive relationship political connection on tax aggressiveness (Butje & Tjondro, 2014; Francis et al., 2016, 2019; Houston et al., 2014; Kim & Zhang, 2016; Li et al., 2016; Malinda et al., 2022; Nugroho, 2019). In view of Grabbing hand theory, where a bureaucrat who occupies a position in the Company will be controlled by the corporation because they get welfare. Based on this explanation, the research hypotheses are:

H₁: Political connection positively affected tax aggressiveness

Executive Compensation and Tax Aggressiveness

Agency theory explains that agent are required to manage company operations based on the wishes of the principal, where through compensation given to executives it

can be used as a way for agents to fulfill the interest of shareholders (Tandiono & Santosa, 2021). When there are advantages for the executive, then they are willing to take the risk to do aggressive tax action. One of the endeavors to lessen tax avoidance by organizations is executive compensation (Ardillah & Prasetyo C, 2021). Executive compensation is regularly seen as an instrument to adjust managerial interests (specialists) with stockholders. Tax directors and tax consultants can be directly involved in making tax avoidance decisions in a company. Corporate executives can influence corporate tax avoidance decisions because they can gain large financial benefits from tax avoidance policies carried out. The best effort in implementing efficiency related to corporate tax payments is to provide high compensation to executives. Executives will feel benefited by receiving higher compensation, so that executives will improve company performance even better. One such performance is through the ability to increase aggressive tax strategies (Hanafi & Harto, 2014).

Previous studies of the relation of executive compensation on tax aggressive where there is a positive relationship (Hanlon & Slemrod, 2009; (Chee et al., 2017; Jihene & Moez, 2019; Minnick & Noga, 2010; Mulia et al., 2019; Rego & Wilson, 2012). They argue that an increase in executive compensation is in line with an increase in shareholder wealth, thus encouraging managers to do tax evasion to increase the company's wealth. Based on this explanation, the research hypotheses are:

H₂: There is positive relationship between executive compensation to tax aggressiveness

Political Connection, Tax Aggressiveness and Audit Quality

Tax aggressiveness causes an increase in agency problems within companies and a decrease in the quality of

financial reporting (Abdullah et al., 2022; Christensen et al., 2016). Previous studies revealed tax aggressive action taken by the companies that have a risk to reputation, namely increase supervision by regulators and legal action from stakeholders (Cook et al., 2017). These risk include difficulties in obtaining external funding, through charging high interest. Based on these risk, one of the benefit resulting from the company's political connection is in order to overcome reputational problems and ease of access to funding (Faccio et al., 2010; Hashmi et al., 2018). Therefore, even though aggressive tax measures expose the company to various risks, due to political connections, this condition is not a problem for the company because they will still receive preferential treatment.

Companies that have political connections have the courage to take minimal tax payments, this is because the risk of being audited by the tax office is lower (Chaney et al., 2011; Kim & Zhang, 2016). These factors further motivate the company's management to have political connections with the government and political party leaders, so that the company benefits (Li et al., 2016). Corporate governance is a mechanism in order to provide protection for shareholders. However, in the view of agency theory, there is conflicts between managers and shareholders often occur (Jensen & Meckling, 1976). In addition, there is a conflict between the majority and minority shareholders, this occurs as a result of the exploitation by the majority holder of the minority which is carried out directly or indirectly, so that the agency problem get bigger (Shleifer & Vishny, 1997). Good governance structures reduce the level of tax avoidance (Kiesewetter & Manthey, 2017). The one of the effective good governance mechanisms is audit quality, since that is able to provide stakeholder protection against opportunism and fraud (Jihene & Moez, 2019). The perspective of agency theory, conflict of interest that occur between manager and shareholders can be

reduced through the role of audit quality. Audit quality is one of the mechanisms of corporate governance that is capable of controlling and avoiding the action of managers in the context of manipulating accounting provisions and fraud (DeAngelo & W Masulis, 1980). An independent assessment of the Company's financial statements is expected to be carried out by external auditors. One of them is to ascertain whether the company is taking aggressive tax actions, thereby risking detection by the tax office (Gallemore et al., 2014; Guenther et al., 2017).

Based on the above explanation above, we estimate that the tendency towards to rent extraction as a result of tax aggressive actions that occur in politically connected companies can be reduced through qualified auditor. However, the negative effect on the level of tax aggressiveness is the impact of political connections, causing a lack of alignment with minority shareholder and less opportunism. We then formulate the research hypothesis:

H₃: Audit quality weakens the effect of political connections on tax aggressiveness

Executive Compensation, Tax Aggressiveness and Audit Quality

Tax aggressive can strengthen managers' opportunistic behavior (Desai & Dharmapala, 2006). Tax aggressiveness strategy provide benefits to managers. Mulia et al. (2019); Jihene & Moez (2019) and Chee et al. (2017) found a positive effect between executive compensation on tax aggressive. One of the effective ways for managers to be willing to take aggressive tax action in order to improve performance of the company's is by giving high compensation (Tandiono & Santosa, 2021). In order to improve the company's performance and meet the wishes of shareholders, one way to reduce tax payment an aggressive tax strategy.

However, opportunistic actions can be suppressed through the implementation of corporate governance. Effectiveness of governance roles, able to weaken the power of managers, especially in the context of tax aggressiveness. Managers can blame the use and take steps of tax aggressiveness on companies with low governance (Armstrong et al., 2015). The structure of good governance is effective in reducing tax avoidance (Kiesewetter & Manthey, 2017).

Audit quality is an effective good governance mechanism in order to provide protection against actions to take advantage of opportunities and fraud by managers (Jihene & Moez, 2019). Firms audited by the big four are less likely to adopt an aggressive tax strategy (Richardson et al., 2013). The relationship of audit quality on tax aggressiveness is negative (Kanagaretnam et al., 2016). The main reason high quality auditors don't want involvement of tax avoidance practices, since this practice risk destroying reputation and expose litigation of the company. Therefore, they are trying to detect these risky practices and mitigate them to save their reputation in the market. (Gaaya et al. (2017) declared that family ownership has positive influence on aggressive taxes, however, this condition can be reduced through the implementation of corporate governance, namely audit quality.

Therefore, we estimate that although there is a high tendency for managers to choose an aggressive tax strategy as a result of the benefits they receive in the form of high compensation they receive, this can be prevented by implementing effective corporate governance through the use of quality audits. Based on this description, the hypotheses of this research are:

H₄: Audit quality weakens the effect of executive compensation on tax aggressiveness

Method

Data and Sample

This study consists of four main variables: tax aggressiveness, political connection, executive compensation and audit quality. We use sample consist of 56 company for financial industry listed on Indonesian stock exchange from 2018 to 2021, which obtain from annual report. Tax data, executive compensation, audit quality, size of the company, return on asset and leverage were extracted and collected from the financial statement available in Indonesian stock exchange website (www.idx.co.id) or official website of the company. Government and politically party website provide more detailed information on the role that board and shareholder of the company (e.g. as member the assembly, cabinet, member of military have played in politics). Sample selected with criteria of period reporting ends in December, and the Company in condition profit before and after tax. The final samples included 224 firm-years observations.

Variable & Measurement

Tax Aggressiveness (TA)

Tax aggressiveness is defined as the capture of tax revenue through tax planning, both legally and illegally (Frank et al., 2009). Tax aggressiveness is a plan or scheme with the aim of doing evasion taxes (Richardson et al., 2013). Referring to research by Lanis & Richardson (2011); Minnick and Noga (2010); Chen et al. (2010); and Adhikari et al. (2006) measurement tax aggressiveness is carried out by the effective tax rate (ETR), where previous researchers has used that which has been calculated by the amount of tax expense divided by previous income tax.

Political Connection (PC)

The company is considered to have political connections if the president director or holder its controlling share holds a position in parliament or government, a position as king or president of a country, political party leader, or political party members (Faccio et al.,

2010). This research the measurement of political connections is measured based on board relations, as has been used by several previous researchers (Fan et al., 2007; Habib et al., 2017; Junaidi & Siregar, 2020). The company includes political connections if the directors or board of commissioners occupy or have occupied as the following positions head of state or regional head, member of the people's representative assembly, ministers or cabinet ranks, officials of political parties, other political connection such as military members, ambassadorial and other positions (Fan et al., 2007; Habib et al., 2017; Junaidi & Siregar, 2020). Based on research by Faccio et al (2010); Adhikari et al. (2006); Nugroho (2019) political connections are measured by a dummy variable, where code 1 is given if Companies are politically connected and 0 otherwise.

Executive Compensation (EC)

Executive compensation is all compensation received by managers either salary fixed and variable compensation such as bonuses, shares. Refers in research Jihene and Moez (2019), the measurement of executive compensation used is the natural logarithm of the amount of compensation received by the manager. Audit quality plays an important role in solving the resulting problems from conflicts of interest that occur between shareholders and managers. Based on research by Gaaya et al. (2017); and Jihene and Moez (2019) audit quality measurement using a dummy variable, which is given code 1 if the company is audited big 4 next 0 otherwise.

Audit Quality (AQ)

Audit quality plays an important role in solving the resulting problems from conflicts of interest that occur between shareholders and managers. Based on research by Gaaya et al. (2017); and Jihene and Moez (2019) audit quality measurement using a dummy variable, which is given code 1 if the company is audited big 4 next 0 otherwise.

Control Variables

Control variables that used for this research, consist of firm size (SIZE), leverage (LEV) and return on assets (ROA). Total assets, total sales, and total equity are a reflection of size companies (Mawarti et al., 2022; Prasetya Margono & Gantino, 2021). Profitability shows how effective and efficient the management of the Company is (Ikhsani & Adhikara, 2022). Measurement of return on assets using the percentage of net profit with the amount assets, then measuring leverage with the percentage of total liabilities to total assets, and company size using the natural logarithm of total assets (Kim & Zhang, 2016).

Model of Research and Measurement

To analyze the relationship of political connection, executive compensation on tax aggressiveness our study used multiple regression analysis. The relationship between political connection (PC), executive compensation (EC), size (SIZE), return on asset (ROA), leverage (LEV), audit quality (AQ) and tax aggressive (TA) presented are as follow:

$$TA = \beta_0 + \beta_1 PC + \beta_2 EC + \beta_3 AQ + \beta_4 SIZE + \beta_5 LEV + \beta_6 ROA + \epsilon$$

To analyze effect of audit quality as moderating variable, we use Moderated Regression Analysis. Analysis of regression used for examine of the association between political connection, executive compensation, and moderating effects of audit quality. Here the political connection and executive compensation is the independent variable, tax aggressiveness is the dependent variable, and audit quality is the moderating variable. To analyze the moderating effect of audit quality, the model presented are as follow:

$$TA = \beta_0 + \beta_1 PC + \beta_2 EC + \beta_3 PC * AQ + \beta_4 EC * AQ + \beta_5 SIZE + \beta_6 LEV + \beta_7 ROA + \epsilon$$

Result

Descriptive Statistic

Table 2 presents a descriptive statistical analysis of 224 samples showing the research variables including tax aggressiveness. Tax aggressiveness shows the mean value which means companies in the financial industry sector do not take aggressive tax actions. Political connection has a mean value of 0.37, which means that 37% the financial sector companies have political connections, the rest 63% are not politically connected. Executive compensation provided by the financial sector industry is Rp24.1 billion. Audit

quality shows a mean value of 0.51, which means that 51% of companies in the financial sector industry are audited by the Big four and the remaining 49% are audited by non-Big four. Descriptive analysis of the variables shows that the mean return on assets is 2%, with a mean leverage value of 0.64, which means that 64% of the company's assets are financed by debt.

The regression results in table 3 model 1 show that political connection negatively and significant effects the tax aggressiveness ($\beta = -0.025$, $p < 0.1$). The results suggested that political connection can be lower the effective tax rate, it mean

Table 2. Descriptive Statistics

Variable	Obs.	Min	Max	Mean	Std. Dev
TA	224	0.01135	0.38754	0.21672	0.09035
PC	224	0.00000	1.00000	0.37500	0.48521
EC	224	20.96792	26.95491	24.12662	1.56921
AQ	224	0.00000	1.00000	0.50892	0.50103
ROA	224	0.00125	0.07081	0.02220	0.01906
SIZE	224	27.18986	34.44971	30.53266	2.06078
LEV	224	0.13123	0.87551	0.64645	0.23241

Source: data analyzed.

Table 3. Regression Result

Variable	Model 1			Model 2		
	Coef.	t-value	Sig.	Coef	t-value	Sig.
Cons	0.108		0.301	0.133		0.222
PC	-0.025	-1.923	0.056***	-0.025	-1.463	0.145
EC	0.014	2.233	0.027**	0.013	2.099	0.037**
AQ	0.034	3.112	0.002*	NA	NA	NA
SIZE	-0.009	-1.772	0.078***	-0.009	-1.825	0.069***
LEV	0.082	2.843	0.005*	0.083	2.863	0.005*
ROA	-0.033	-5.793	0.000*	-0.033	-5.681	0.000*
PC*AQ	NA	NA	NA	0.000	0.010	0.992
EC*AQ	NA	NA	NA	0.001	2.597	0.010*
N	244			244		
Adjusted R ²	0.32			0.32		
F-Test	18.59			18,92		
P-value	0.000			0.000		

Source: data analyzed.

the hypothesis 1 that there is positive relationship between political connection and tax aggressiveness is thus accepted.

The results also showed that executive compensation positively and significant effects the tax aggressiveness ($\beta=0.014$, $p < 0.05$). The results suggested that executive compensation can be increase the effective tax rate, it mean the hypothesis 2 that there is positive relationship between executive compensation and tax aggressiveness is thus accepted.

Regarding the control variables, table 3 show that size, leverage and return on asset significant effects the tax aggressiveness. Furthermore, regression results of the moderating effect of audit quality on the association between political connection and tax aggressiveness not significant ($\beta=0.000$, $p > 0.1$), it means audit quality cannot as moderate the influence of political connection and tax aggressiveness, thus the hypothesis is rejected. Hereafter, the result show that audit quality as moderating of the relation executive compensation on tax aggressiveness ($\beta=0.001$, $p < 0.05$), thus the hypothesis is accepted..

Discussion

Table 3 shows that political connections positively affected tax aggressiveness. The results of the current research indicate that companies that have political connections have a tendency to take tax aggressiveness. Francis et al., (2016) argue that the advantage of the companies to gain profit when politically connected. The company politically connected they can more access for information regarding tax regulation changes for the future (Milyo et al., 2000). This information is used in the context of aggressive tax avoidance. Houston et al. (2014) stated that political connections make it easier for companies to obtain capital loans, this condition is possible because creditors have bailout guarantees from the government if one day there is a financial crisis. As a result of these

privileges, tax aggressiveness tends to carried out by politically connected companies (Kim & Zhang, 2016; Malinda et al., 2022). The results of this research support the grabbing hand theory, where a bureaucrat who occupies a position in the company will be controlled by the corporation because they get welfare. As a result, bureaucrats who have the responsibility to ensure the company compliance with regulations, lose power in order to maintain company compliance. The results of this study provide contribute to science contributions and support previous study that political connections have a positive effect on tax aggressiveness (Butje & Tjondro, 2014; Francis et al., 2016, 2019; Houston et al., 2014; Kim & Zhang, 2016; Li et al., 2016; Malinda et al., 2022; Nugroho, 2019). However, this study contradicts the research of Iswari et al. (2019); Pranoto and Widagdo (2016) and Jian et al. (2012) which argue that the a negative relationship of political connections on tax aggressiveness.

Table 3 show that the results, executive compensation has a negative impact on tax aggressiveness. This shows that the greater the executive compensation given to the executive, the lower the tax aggressiveness action. This study contradicts agency theory where there is an assumption that principals and agents have motivation to increase personal welfare. However, this study proves that high executive compensation does not encourage managers to manipulate taxable income through aggressive tax actions. The provision of appropriate compensation makes the relationship between pay and performance (pay and performance) make the agent act in the direction of the principal's interests, so that it can reduce the opportunistic actions of managers, one of which is a lower aggressive tax policy (Desai & Dharmapala, 2006). Therefore, providing high incentives can prevent managers from taking risky strategies, namely more

aggressive tax actions (Chee et al., 2017). This study is in line with Desai & Dharmapala (2006); Armstrong et al. (2012); Ohnuma (2014); Halioui et al. (2016) and Amri (2017) which state that executive compensation has a negative effect on aggressive tax actions, but contradicts Mulia et al. (2019); Jihene and Moez (2019); and Chee et al. (2017) who argue that executive compensation has a positive effect on tax aggressiveness.

The test results show that audit quality has a negative effect on tax aggressiveness. This implies that the level of tax aggressiveness is influenced by the auditor who audits the company's financial statements. Audit quality is an effective good governance mechanism in order to provide protection against actions to take advantage of opportunities and fraud by managers (Jihene & Moez, 2019). Firms audited by the big four are less likely to adopt an aggressive tax strategy (Richardson et al., 2013). Langli and Willekens (2017) argue that the credibility of financial statements will be increase when they use high audit quality, thus can reduce the agency problem by avoiding aggressive tax actions. They are not interested in tax aggressive activities, since doing of tax aggressive practices will damage their reputation and expose them to litigation (Kanagaretnam et al., 2016). Thus, they try to detect these risky practices and mitigate them to save their reputation in the market. This finding support previous study which state that audit quality has a negative impact on tax aggressiveness (Jihene & Moez, 2019; Kanagaretnam et al., 2016; Kiesewetter & Manthey, 2017; Malinda et al., 2022; Richardson et al., 2013).

Furthermore, related to control variables, showing in table 3 that firm size has a positive impact on tax aggressiveness. Thus, large companies are likely to take greater tax aggressiveness than small companies, this condition is carried out because they are able to protect the negative impact for this practice (Lin et al., 2014; Richardson et al., 2013). There is an

assumption that taxes is the expense for companies that will reduce the distribution of wealth to shareholders (Iswari et al., 2019). Consequently, all companies strive to maximize profits, one of which is by taking aggressive tax actions. This finding is in line with the study of Jihene & Moez (2019); Lin et al. (2014) and Richardson et al. (2013) which states that firm size has an effect on tax aggressiveness.

This research also found the relationship of leverage on tax aggressiveness is negative and significant. Companies that have a larger composition of debt financing than equity financing in their operational activities are less likely to take aggressive tax action. The level of the leverage of the financial sector industry shows that the public has high trust, thus placing their fund in the industry. Therefore, in order to maintain trust, the financial industry does not take actions that pose a risk to the public, namely by taking tax aggressiveness actions. This is done because they maintain their reputation in order to reach the market (Jihene & Moez, 2019). This study strengthens previous findings which state that leverage negatively affected tax aggressiveness (Dyrenge et al., 2008; Iswari et al., 2019; Jihene & Moez, 2019).

Furthermore, profitability positively affected tax aggressiveness. The higher profitability, the level of tax aggressiveness higher too or the company is more aggressive related with the taxation. Companies with higher returns on assets indicate the success of a manager in managing the company. The consequence that must be borne by the company is high tax payments, thus triggering them to act more aggressively in paying taxes (Iswari et al., 2019). The research in line with the view of agency theory where there are differences of interests between the companies as agent and the government as principal where government expects high tax payments, while companies want high profits by paying lower taxes. This study

supports research which argue that profitability has a positive impact on tax aggressiveness, companies that have high profits more aggressive in tax since have more incentives (Iswari et al., 2019; Kim & Zhang, 2016; Lanis & Richardson, 2011; Minnick & Noga, 2010; Richardson et al., 2013).

Table 3, in model 2 shows the moderating impact of audit quality on relationship of political connections and executive compensation on tax aggressiveness. The first moderation analysis shows that audit quality on the impact political connections on tax aggressiveness is not significant. This shows that the existence of auditors is not able to prevent tax aggressiveness in companies that have political connections. This condition is due to companies politically connected have tendency to choose non-big four auditors, this is done because they have a tendency to manipulate financial statements in order to hide actual performance (Armadiyanti & Iswati, 2019). The result of this research support agency theory which reveals that when a company is politically connected, it is closely related to agency conflict, which has a tendency to make minimal information disclosure (Rodríguez et al., 2007) also has a tendency the quality of financials is poor (Al-dhamari & Ku Ismail, 2015; Chung et al., 2005) compare to companies that are not politically connected (Chaney et al., 2011; Hashmi et al., 2018; Narayanaswamy, 2013) these conditions encourage them to use unqualified auditors.

The second moderating analysis is audit quality on the effect of executive compensation on tax aggressiveness. These results explain that the moderating impact of audit quality in the relationship of executive compensation and tax aggressiveness. Firms audited by the big four are less likely to adopt an aggressive tax strategy. The one most effective governance mechanisms are audit quality, since the audit quality can be protected users from opportunistic actions and fraud from agent. Audit quality able to play a role in reducing

tax evasion, due to reduced motivation of managers to engage in tax aggressive practices, if they are well regulated, because it has risky consequences, if auditors detect tax aggressive actions. In addition, the effect compensation of executive on tax aggressive is negative. Thus, audit quality has a moderating effect on managers' opportunistic behavior. The results of this study support (Gaaya et al., 2017; Kiesewetter & Manthey, 2017; Pilos, 2017).

Conclusion

The result of study provided moderating impact of audit quality on the relationship between political connections, executive compensation, and tax aggressiveness. Result indicate, audit quality is able to moderate the impact of executive compensation on tax aggressiveness. The more effective the role of corporate governance, which is indicated by the quality of the audit, it will reduce tax aggressiveness.

This study still has some limitations or limitations that improvement needed. First, this study is only conducted on the financial industry, therefore it cannot describe the industry as a whole, so it is hoped that future research can be focused on other different industries to gain broader insights about the factors that influence tax aggressiveness. In addition, the use of samples in industries other than finance are still looking for benchmarks whether the implementation of good corporate governance has been effective. Second, this research only used at political connections and executive compensation, therefore further research can expand the literature by adding other variables that can influence tax aggressiveness. Third, this study only explains the factors that influence tax aggressiveness.

The managerial implications for this research include, first, this study provide input to shareholders on the importance of implementing a good corporate governance structure, to mitigate risks that

may be carried out by managers. The second implication is to assist shareholders in ensuring that the compensation received is appropriate so that managers will show good performance and avoid risky actions for the company. The third implication, this research can encourage regulators to make provisions and regulations on strengthening corporate governance to minimize tax aggressiveness, in addition to encouraging regulators to set high ethical standards and implement audit procedures so as to improve audit quality in order to create public trust, in order to protect stakeholder interests.

Furthermore, the researcher suggestion further study by examining the consequences of tax aggressiveness on investment decisions in the capital market, as well as measuring the company's risk in the future. The last suggestion for further research is to measure tax aggressiveness using other proxies such as book tax differences and cash effective tax rate, as well as the use of other independent variables such as ratio of foreign ownership, board independence, board expertise and corporate governance index measurements.

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