Innovation, Earning Management, and CEO Profiles Against Tax Avoidance

R. Rosiyana Dewi[1], Rakendro Wijayanto[2], Syamsu Rizal[3], Salwa Hayati[4]

{rosiyana@trisakti.ac.id[1], rakendro@trisakti.ac.id[2], syamsurizal@trisakti.ac.id[3], salwahayati2024@gmail.com[4]}

Universitas Trisakti, Jakarta, Indonesia[1, 2, 3, 4]

Abstract. This study aims to analyze the influence of innovation, earnings management, and the profile of the CEO, consisting of age, tenure, and ability, on tax avoidance. This study conducted observations over three years, from 2019 through 2021, utilizing secondary data extracted from the companies' annual reports. This study focused on firms in the primary consumer sector listed on the Indonesia Stock Exchange (IDX). A purposive sampling approach was employed to select a sample comprising 108 data points across 36 companies. For hypothesis testing, the study applied panel data regression analysis using the eViews 9 software. This study was able to confirm four out of the five proposed hypotheses. Specifically, it found that innovation, earnings management, and the length of service of the CEO positively influence tax avoidance activities. Conversely, the age and competence of the CEO were observed to have a detrimental impact on tax avoidance. This study is a combination of previous research and adds a control variable for company size.

Keywords: Innovation, Earning Management, CEO Profile, Tax Avoidance

1 Introduction

Taxes as state income are borne by the public to fund state development. In Indonesia, tax revenue is among the primary sources of national income. The Indonesian government is making various efforts to maximize tax revenues. The Indonesian government is targeting revenues from the tax sector of IDR. 1,229.6 trillion from the total 2021 APBN target of IDR. 1,743.6 Trillion [1]. Various government regulations have been established to achieve this target, including in 2022 the government has established a policy to adjust the Value Added Tax (VAT) rate from ten percent (10%) to eleven percent (11%). There is a concern that raising the tax target by increasing rates will lead to greater efforts by taxpayers, particularly businesses, to reduce their tax liabilities by seeking ways to lower their tax obligations. [2].

Differences in interests arise as companies often seek to reduce their tax liabilities using tax avoidance strategies. Taxpayers, especially corporations, typically engage in efforts to identify

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and utilize gaps within the Indonesian tax regulations to minimize their tax payments [3]. Apart from that, the opportunity to carry out tax efficiency is also supported by taxpayer regulations in Indonesia by carrying out tax obligation procedures independently, or with the term self-assessment. In this case, taxpayers are given leeway to calculate taxes, pay taxes, and report them to the government independently. Numerous instances of tax evasion have been discovered, including cases within Indonesia in 2018 involving companies in the primary consumer sector listed on the Indonesia Stock Exchange (IDX). Through PT Bentoel Internasional Investama Tbk, tax avoidance behavior was carried out by companies owned by British American Tobacco (BAT) by diverting income out of Indonesia. Innovation can be used by companies to minimize tax liabilities by incurring research and development expenses [4]. Companies will benefit from innovation development programs in tax avoidance. This seems to be consistent with the government program which will provide tax incentives for innovative products. Based on the research results of [5], innovation by corporations, as demonstrated through patents has a significant positive relationship with tax planning. In contrast to [6] research, innovation has a negative influence on tax avoidance. [7] earnings management is a manager's decision in determining accounting policies that can influence the reporting of profit values in financial reports.

Earnings management is carried out by managers deliberately to maximize their welfare. Tax saving measures are carried out by reducing the tax burden so that reported profits will appear high. Earnings management positively influences tax evasion, according to research by [8] and [9], but another study indicates that tax evasion is unaffected by earnings management [10]. And according to research by [11] and also, tax avoidance is negatively impacted by earnings management. Tax avoidance can't be separated from the motivation of a company's top leadership. A person's behavior is also influenced by their age, in the view of [12], the age of the CEO or Chief Executive Officer (CEO) has an encouraging impact on the Effective Tax Rate (ETR) and a negative effect on tax avoidance. Apart from that, a CEO who has a long term of office tends to better comprehend the company's circumstances for them to be more adaptive to applicable tax provisions, but in contrast according to [13], a CEO tenure of office has an insignificant positive effect on tax avoidance. The background of CEO capabilities can be a factor that can determine the direction of strategy, policy, and decision-making by the CEO in achieving organizational goals. A version of [14] Upper Echelon Theory, CEO and CEO background qualities are assumed to impact various organizational outcomes. Top managers' capacity to accomplish corporate investment efficiency will have an encouraging effect on the quality of profitability and business performance, [15]**.** When it comes to tax avoidance, managers must consider the costs and benefits. Managers with higher capacities may have distinct views of the marginal costs of tax aggressiveness than managers with lower abilities, emphasizing that CEO abilities have a detrimental effect on tax avoidance [16]. Director age and CEO tenure has no significant effect on tax avoidance [17]. Based on this background, this research project tries to assess the influence of innovation, earnings management, and the CEO's profile on tax avoidance.

Literature review

Agency Theory, Upper Echelon Theory, *Resource Based View Theory*, *Attribution Theory*

The agency theory developed by [18] states that the agency relationship between the principal and the agent is the commitment of the company owner who acts as the principal to employ other people and delegate authority to the agent to carry out the duties and obligations of the company owner. The conflict that occurs between the two parties is because they both have opposing needs and goals. As defined by [19], agency associations involve the dynamic between the government as the principal and corporate taxpayers as agents compelled to follow existing laws on taxes. The government mandates that businesses comply with their tax duties as prescribed by tax legislation. Nonetheless, companies inherently prioritize their primary objective, which is to maximize profits. According to [20], the taxation method with the self-assessment system implemented in Indonesia can encourage companies as agents to maximize their profits by minimizing the tax burden paid. Companies have the potential to avoid taxes so that the tax burden that the company should pay decreases.

The Upper Echelon theory presented by states that CEO background can influence company strategy and performance. CEO plays a role in the sustainability of the company. The characteristics of top managers' age as a measure in assessing the level of maturity of management in making decisions and age are usually associated with aggressive actions taken by CEOs. Work experience characteristics are generally used to see how long the individual has served in a CEO position. The longer someone is in a CEO position, the more familiar that person will be in making strategic decisions which will have an impact on company performance. The resources owned by the company are useful in the continuity of the company's business [21]. The Resource Based View theory posits that companies can achieve a competitive edge and ensure their long-term viability (going concern) by optimizing their resources, thereby enhancing their capacity to secure a competitive advantage., [22]**.** Companies create various innovations to be able to create competitive advantages for companies. Companies that can maximize their resources and can create innovations will certainly have added value compared to other companies.

Attribution theory is a theory that discusses a person's behavior. In this theoretical perspective, the causes or reasons why someone carries out a behavior are seen which are influenced by internal and external factors. This theory was first developed by [23]**.** According to a person carrying out an action or behavior is influenced by internal and external factors. Then, according to [24], attribution theory explains how someone evaluates other people by linking them to certain behavior. It can be concluded that this theory assumes that a person's behavior or actions can be influenced by internal factors from within the person himself and external factors that can come from the surrounding environment.

Hypothesis Development

Innovation Against Tax Avoidance

The company innovates to achieve the highest revenue targets with various and creative ideas through competitive advantages and product differentiation. Companies carry out research and development (R&D) activities as a process of innovation, this activity can incur quite high expenses so that company profits will fall. A decrease in profits has an impact on a decrease in the value of taxes that must be paid. Apart from innovation being charged to R&D expenses, innovation can also be recognized as a patent which can also lower the amount of taxes owed. Various studies that have been conducted prove that companies that have a high level of innovation can result in high levels of tax avoidance [25] and [26] and [27].

Earning Management Against Tax Avoidance

In agency theory, there is a conflict of interest between the agent and the principal, the company manager tries to gain profits but does not want high tax payments. Earning Management carried out by companies from an attitude assessment perspective can be said to be unethical so earnings management actions are suspected to also result in tax avoidance. One of the goals of earnings management is to increase the after-tax rate of return to maximize shareholder value and attract investment. research conducted by [28] on companies in Vietnam shows that the higher the earnings management, the higher the company's level of income tax avoidance, that is, the more profit adjustment behavior the company carries out through discretionary actuals, the lower the effective tax rate will be.

H2 = Earnings management has a positive effect on tax avoidance

Age of CEO Against Tax Avoidance

In Upper Echelon theory, the age of a CEO is a benchmark for someone to take action and take risks so the CEO's age can also be related to tax aggressiveness. Age can show a person's level of knowledge and experience, apart from that, age also has a relationship with the success of a top manager in leading a company [29]. Age affects performance someone in the company. The age of the board of directors will demonstrate maturity, according to [30], which will encourage both young and experienced board members to share ideas before making several key decisions that will impact the company's advancement. Age will create a strong synergy between young and old members of the board of directors to take several actions to save corporate reputation including the board of directors' tendency to support tax avoidance. Thus, when the age of the board of directors becomes younger, it will increase tax avoidance in the company. According to [31], there is either a negative influence on tax evasion or a positive influence on the Effective Tax Rate (ETR) based on the age of the Chief Executive Officer (CEO).

H3 = The age of CEO has a negative effect on tax avoidance

CEO Tenure Against Tax Avoidance

Based on the Upper Echelon theory, a company's CEO who has a long tenure will have good experience and be competent in manifesting important company decisions. CEO with high tenure can potentially engage in aggressive tax management. The tenure of a top manager represents how long the top manager has been in the CEO position of a company. The longer a top manager holds this position, the more he will understand the state of the company's operational procedures. [32] proves that the tenure of top managers has a positive effect on tax avoidance.

H4= Tenure of CEO has a positive effect on tax avoidance

CEO Ability Against Tax Avoidance

Managers are required to have high abilities because managers are obliged to carry out operational activities to obtain profits and increase the value of the company for returns to the owners. The CEO's ability is not only in making a profit but also in having a strategy for efficiency. Top managers as agents with their abilities can try to maximize their interests and ignore other interests such as saving taxes. Research conducted by [33] provides evidence that the ability of top managers can increase tax avoidance behavior. Tax avoidance practices are considered more beneficial compared to the risks that will occur in the future

H5= The ability of CEO has a positive effect on tax avoidance

2. Method

Research Design

This is quantitative research involving the use of secondary data from Indonesian company annual reports. This sort of research is causal, indicating it tests a hypothesis to prove the influence of independent factors (innovation, earnings management, and CEO profile) on the dependent variable tax evasion using multiple linear regression statistical tests with panel data. In this study, the researchers gathered and utilized secondary data derived from the financial and annual reports of companies in the primary consumer sector listed on the Indonesia Stock Exchange, covering the years 2019 to 2021.

Table.1
Variables Measurement

Variables Dependent Variable	Measurement	Scale	Researcher
Tax Avoidance	$ETR = \frac{tax\ expense}{Earning\ Before\ taxes}\ x - 1$	Ratio	Anggita (2022)
Independent Variable			
Innovation	Inovation = $\frac{R\&D\ expense}{net\ sales}$	Ratio	Dewi *et al* (2022)
Earning management	1. *Total Accrual* (TAC) $TAC = NI_{it} – CFO_{it}$ 2. total accrual with regresi OLS : $TAC_{it} / A_{it-1} = \beta_1 (1 / A_{it-1}) + \beta_2 (REV_{it} – REV_{it-1} / A_{it-1}) + \beta_3 (PPE_{it} / A_{it-1})$ 3. *nondiscretionary accrual* (NDA) $NDA_{it} = \beta_1 (1 / A_{it-1}) + \beta_2 ([REV_{it} – REV_{it-1}] – [REC_{it} – REC_{it-1}] / A_{it-1}) + \beta_3 (PPE_{it} / A_{it-1})$ 4. *Discretionary Accrual* (DA) $DA_{it} = TAC_{it} / A_{it-1} - NDA_{it}$	Ratio	Rakhsit&Paul (2020)
CEO Age	CEO Age= Ln age of CEO	Ratio	Gestanti (2019)

CEO Tenure	Dummy variable by dividing into 2 (two) groups. In the first group, a CEO's tenure of less than 6 years will be given a value of 0. Meanwhile, in the second group, a CEO's tenure of more than 6 years will be given a value of 1.	Nominal	Oliver (2019)
CEO Ability	Max : $\frac{Sales}{COGS + SGA + PPE + OpsLease + RD\ + Go}$ Firm Efficiency : a+*b1*Ln(total assets) + *b2market* share + *b3*free cash flow + *b4*Ln(age) + *b5*business segment concentration + *b6*foreign currency indicator + e	Ratio	Simamora (2021)
Control Variable			
Company Size	Company Size= Ln (Total Aset)	Ratio	Furqon (2022)

Sampling technique

All businesses in the primary consumer sector that are listed on the Indonesia Stock Exchange between 2019 and 2021 are the population utilized for this study. The method used in sampling is purposive sampling by determining a certain size in selecting the sample. The decisions made for sample selection are as follows: 1) The company is listed in the primary consumer sector on the Indonesian Stock Exchange for the 2019–2021 term; 2) There is no negative profit before tax 3) The organization has all the data necessary for the study.

Data collection and Data Analysis Technique

This research project collected data utilizing the documentation technique. This technique is carried out by taking quantitative secondary data. The current research includes secondary data derived from certified financial reports and/or annual reports of the main customer sector companies listed on the Indonesia Stock Exchange from 2019 to 2021entities listed on the Indonesian Stock Exchange (IDX) in the main consumer category in 2021 amounting to 105 entities. Through the websites of each company and the official Indonesian Stock Exchange website, www.idx.co.id, researchers were able to download the reports.

Descriptive statistical tests are the fundamental step in the process, where data is provided using the standard deviation, median, mean, mode, variance, and least and most values. Data testing was carried out by carrying out 3 tests, namely the Chow Hausman Test and the Lagrange Multiplier (LM) test. This test was run to identify which regression model method—the Common Effect Model (CEM) approach or the Random Effect Model (REM) approach—should be used. The Random Effect Model (REM) is the regression model strategy utilized if the Breusch-Pagan cross section value is less than 0.05.

Statistic equation

$$TA = \alpha + \beta_1 I + \beta_2 EM + \beta_3 AC + \beta_{4CT} + \beta_5 CA + \beta_6 CS + e$$

TA = *Tax Avoidance*

α = constanta

$\beta_1,...,\beta_6$ = Regretion coefisien

I = Inovation

EM = Earning Management

CA = CEO Age

CT = CEO Tenure

CA = CEO Ability

CS = Company Size

e = *Error*

3. Results and Discussion

Descriptive Statistic

Sample selection used purposive sampling so this study used 105 observation samples with descriptive statistics results in the table below:

Table 2

Descriptive Statistic

	Mean	**Max**	**Min**	**SD**
Tax avoidance	-0.294238	-0.017500	-1.609600	0.198913
Innovation	0.003491	0.065000	0.000000	0.011439
Earning Management	-0.042802	0.173828	-0.321189	0.081035
CEO AGE	3.978463	4.277000	3.555000	0.152184
CEO Tenure	0.509259	1.000000	0.000000	0.502245
CEO Ability	0.160459	0.634900	-0.506700	0.196665
Company Size	29.61685	32.82039	27.37466	1.411586

Source= data processed 2023

The Tax Avoidance variable has an average value of -0.294. This indicates that, on average, companies in the primary consumer sector listed on the Indonesia Stock Exchange (IDX) are subject to a tax rate of 29%. Meanwhile, regulations on taxes declare that the current effective tax rate on entities is 22%. Companies at the primary consumer level get listed on the Indonesia Stock Exchange (IDX) and, on average, can be considered compliant with tax regulations. The Earning management variable has an average (mean) value of -0.04802, this illustrates that most companies practice earnings management by reducing company profits. A negative value means the tendency of a company to practice earnings management by reducing profits. The standard deviation value of 0.081035 exceeds the average value, indicating that the data occurs heterogeneously or not in groups. The Innovation variable's average value is 0.003. This implies the average sample company devotes 0.3% of total revenue to innovation. The average value of this variable is 3,978 logarithms in natural form (54 years when converted). This indicates that companies listed on the Indonesian Stock Exchange (IDX) in the primary consumer sector will face an average CEO age of 54 years between 2019 to 2021. CEO Tenure is a dummy variable which is measured using scores 1 and 0. A score of 1 is given if the company has a CEO with a tenure of more than equal to 6 years. Meanwhile, a score of 0 is given if the company has a CEO with a tenure of less than 6 years. The average (mean) value of this variable is 0.552. This means that the average company has a CEO with a tenure of more than the same as 6 years. CEO ability has an average value (mean) of 0.1605. A positive value means that the company has a fairly high level of skill and efficiency from managers in utilizing the company's resources to generate profits

Research Models

The analysis method used is panel data regression. There are three possible model estimation approaches, namely CEM (common effect model), FEM (fixed effect model), and REM (random effect model).

Table 3
Chow and Hausman Test

Effect Test	***Statistic***	**Probability**	
Cross-section F	3.587941	0.0000	*Fixed Effect Model* (FEM)
Cross-section Chi-square	115.089121	0.0000	
Effect Test	***Chi-Sq. Statistic***	**Probability**	
Cross-section Random	21.421966	0.0015	*Fixed Effect Model* (FEM)

Source= data processed 2023

Based on the cross-sectional test results according to Table 3, the cross-sectional test results for both F and chi-square produce a probability value or p-value of 0.0000. Because the p-value <0.05, it can be concluded that there is a significant fixed effect from the cross-sectional data component. Thus, the approach chosen in model estimation is the Fixed Effect Model (FEM). Then the cross-sectional test results in the table show that the probability value or p-value is 0.0062. Because the p-value is <0.05, it can be concluded that fixed effects are a more appropriate specification than random effects. Thus, the approach chosen in model estimation is the Fixed Effect Model (FEM).

Regression equation

$$TA = 6.923938 + 22.62858\ I + 0.221813\ EM - 1.237286\ CA + 0.093297\ CT - 0.477190 CA - 0.078878 CS$$

Table 4
R Square

Goodness of Fit	
R^2	0.703179
Adj R^2	0.518790

Source= data processed 2023

Based on the data processing results in Table 4, the coefficient of dependency indicates that the model can explain a substantial difference in the value of the dependent variable. The regression model in this study has a coefficient of determination (R^2) of 0.703179 and an Adj R^2 value of 0.518790. The R^2 value is relatively closer to 1, indicating that the regression model obtained has a fairly good ability in explaining the value of the dependent variable (Tax Avoidance). It also indicates that all independent and control factors account for 51.8% of the variation in Tax Avoidance.

Table 5
T and F Test Result

Variable	Coefficient	t-statistic	Probability (1 tail)	Hypothesis Prediction	Decision
C	14.46168				
Innovation	22.62858	3.619409	0.0006	+	**H1 Accepted**
Earning Management	0.221813	2.861258	0.0056	+	**H2 Accepted**
CEO Ages	-1.237286	-12.28195	0.0000	-	**H3 Accepted**
CEO Tenure	0.093297	2.592631	0.0117	+	**H4 Accepted**
CEO Ability	-0.477190	-2.481413	0.0156	+	**H5 Rejected**
Company Size	-0.078878	-3.588538	0.0006		
F-Statistic			3.813566		
Prob. F-Statistic			0.000001		

Source= data processed 2023

Results and Discussion

The influence of innovation on tax avoidance

The analysis of data presented in Table 5 reveals that for the innovation variable (I), the regression coefficient is 22.62858, with a p-value of 0.0006. This indicates a positive effect of the innovation variable on tax avoidance, leading to the acceptance of hypothesis H1. This finding coincides with the analyses of, which show that innovation is a value-adding activity that strengthens a company's competitive edge. Tax breaks and other government incentives encourage businesses to break barriers. spending linked to innovation, such as research and development (R&D) costs, can be deducted from a company's taxable income, which permits aggressive tax planning through R&D spending. This increase in R&D expenses will lead to lower gains before tax and tax obligations are paid.

The influence of earnings management on tax avoidance

Based on the data considering results in Table 5, the regression coefficient value regarding earnings management on tax avoidance is 0.221813. The probability p-value is 0.0056. This demonstrates that the earnings management variable has an advantageous effect on tax avoidance. so H2 is accepted. Managers carry out earnings management actions to increase efficiency or opportunity. The existence of gaps in accounting policies allows managers to do this. The difference in interests between the agent and the principal encourages earnings management actions. Earnings management techniques have an advantageous impact on tax avoidance. This research offers the same evidence as research, namely that the more profit adjustment behavior a corporation engages in through discretionary actuals, the lower the effective tax rate.

The influence of CEO age on tax avoidance

The analysis of the data in table 5 shows that the significance of CEO age on tax avoidance is represented by a coefficient of -1.237286, with a probability value of 0.0000. Given that the probability value for the CEO age variable is less than the significance threshold of 0.05, it can be concluded that the age of the CEO negatively influences tax avoidance, leading to the acceptance of hypothesis H3. This study demonstrates that as the age of a top manager increases, the tendency to engage in tax avoidance decreases. This shows that age influences a person's maturity in acting. In Upper Echelon theory, the age of a CEO is a benchmark for someone to take action and take risks so that age can also be related to tax aggressiveness. Age can show a person's level of knowledge and experience, apart from that, age also has a relationship with the success of a top manager in leading a company [34]. Age affects a person's performance in a company. Age of the board of directors will show maturity, thereby encouraging young and old board members to exchange ideas before making several strategic decisions for the company's progress. Age will create a strong synergy between young and old members of the board of directors to take several actions to save corporate reputation including the board of directors' tendency to support tax avoidance. Thus, when the age of the board of directors becomes younger, tax avoidance will increase in companies. [35], the age of the CEO has a beneficial impact on the Effective Tax Rate (ETR) however has an adverse effect on tax avoidance.

The influence of CEO tenure on tax avoidance

Table 5 indicates that CEO tenure has a positive correlation with tax avoidance, as evidenced by a regression coefficient of 0.093297 and a probability value (p-value) of 0.0117, which is less than the threshold of 0.05. This allows us to infer that CEO tenure positively influences tax avoidance, leading to the acceptance of hypothesis H4. This finding aligns with the studies conducted, which also reported a positive relationship between CEO tenure and tax avoidance. Due to the upper-echelon concept, CEOs with longer tenures tend to excel at strategic decision-making and are more likely to engage in aggressive tax planning. The more extended a CEO's tenure, the better their understanding of the company's intricacies, enabling them to leverage this knowledge to reduce the company's tax liabilities. Thus, a longer-serving CEO tends to become more skilled and confident in executing aggressive tax planning strategies [36].

The influence of CEO' abilities on tax avoidance

The examination of the data demonstrated in Table 5 illustrates that the CEO's ability to evade taxes is indicated by a regression coefficient of -0.477190 and a probability value (p-value) of 0.0156, which is less than 0.05. This implies that the CEO's capabilities exert a beneficial impact on tax avoidance, leading to the rejection of hypothesis H5. This outcome contradicts the findings of the study conducted. This research cannot provide evidence that a CEO's ability to carry out efficiency can increase tax avoidance behavior. The ability of top managers to make product efficiencies does not encourage tax savings.

4. Conclusion, Limitation, and Implication

Conclusion

From the data analysis and hypothesis evaluation, this study confirms four hypotheses while rejecting one, summarized as follows: 1. Innovation positively influences tax avoidance. 2. Earnings management also leads to increased tax avoidance. 3. The CEO's age negatively impacts tax avoidance efforts. 4. A longer tenure of the CEO is associated with greater tax avoidance. 5. The CEO's ability is found to have a detrimental effect on tax avoidance.

Research Limitations

The limitations of this researcher are 1. In measuring tax avoidance, data is needed on companies that have positive profits, while in the year of observation, many companies had negative earnings before tax, so the number of samples that should have been processed data was greatly reduced. 2. When calculating the innovation variable, companies do not display research and development (R&D) cost information. is assigned the number zero, and most companies do not provide that information.

Implications

Theoretical implications

This study incorporates three theoretical frameworks: Upper Echelon Theory, Resource-Based View Theory, and Agency Theory. Upper Echelon Theory suggests that a CEO's impact on company strategy and performance is influenced by their background, including age, work experience, and abilities, which may include strategies such as tax avoidance. The findings confirm that the backgrounds of CEOs, particularly their age and tenure, motivate senior managers to adopt policies aimed at tax evasion. Agency Theory establishes an alliance between the government as the principal and the companies as agents, in which the government expects companies to uphold tax regulations. Nonetheless, this study reveals a disconnect between the government's expectations and company actions, with earnings management leading to increased tax avoidance. The Resource-Based View Theory posits that innovation positively impacts tax avoidance, suggesting that leveraging company resources, including through R&D expenditures, doesn't solely yield positive outcomes but can also facilitate tax avoidance strategies that ultimately may decrease pre-tax profits.

Practice implications

This research has implications for policymakers, in this case, the government, where age, tenure, innovation, and earnings management are proven to influence tax avoidance. The government can increase its supervision of the tax sector so that there are no gaps for companies to carry out tax avoidance.

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