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Tax Avoidance, Cost of Equity, and Ownership Structure: Case of Indonesia

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ABSTRACT

The paper examines the relationship between the practices of tax avoidance and the cost of equity. Importantly, the paper further investigates managerial opportunistic theory on the relationship between tax avoidance and cost of equity by examining the effects of ownership structure, as an element that is expected to hold a monitoring role on the relationship.

The research uses financial and ownership data from companies listed in Indonesian Stock Exchange from the year 2008-2012. The result shows that the tax avoidance practice represented by Discretionary Permanent Book-Tax Differences (DTAX) has a positive relation with the cost of equity. This confirms that investors perceive that tax avoidance undertaken by the company generates greater information risks, hence higher cost of equity. Furthermore, this study finds that the ownership may have a mitigating impact on the relationship. The family ownership and the extent of control rights held by their ultimate owners significantly mitigate the positive relation between the tax avoidance and cost of equity, while the second largest shareholders do not.

The research provides a starting point for further research in the monitoring role of the shareholders on its tax compliances. The result of this study provides better and clearer pictures for the companies about the consequence of undertaking any tax avoidance. This study is the first that probe the role of the firm's ultimate shareholder and its second largest shareholder on the relationship between the tax avoidance and the cost of equity.

Keywords: *tax avoidance, ownership structure, cost of equity*