Tax Avoidance Cost of Equity

by Anies Lastiati

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

Introduction

Tax issues have been interesting discussions in both public policy and corporate finance areas. While public policy practice considers tax income as a substantial income for the nation, corporations consider taxes, including tax management, as important topics in managing performance and seeking better capital costs.

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Recently, the news about Apple Co. in Ireland which carried out its tax management to an extent that it was able to pay zero dollar tax expense, despite its USD 250 billion of net income, shook European nations. The European Union's Tax Investigation Office, furthermore, was not able to find that Apple undertook fraud practice in its tax avoiding actions.

There are considerable amount of researches on whether or not tax avoidance benefits the corporations undertaking it. Tax avoidance is considered to have impacts on the firms' capital costs (Moore, 2012; Graham & Tucker, 2006; Lim, 2010 and 2012; Dhaliwal et al., 2008). Slemrod (2004) defines tax avoidance as any creative actions made by corporations with the purpose to reduce their tax liabilities, hence generating saving. This efficiency provides the company with an alternative source of fund (Lim, 2010), which provides higher return to the shareholders. Higher return is perceived as lowered bankruptcy risks, hence lower cost of debt (Lim, 2010 and 2012; Graham & Tucker, 2006).

On the other hand, Dhaliwal et al. (2008) find that tax avoidance in some extent imposes company with higher capital cost. They argue that shareholders would perceive that the corporations undertaking tax avoidance would also easily manage the performance reported in their numbers. This leads to less transparency between management and the shareholders, hence higher information risks and agency problems. The higher the information risks the company has, the higher the cost that has to be borne by the shareholders in order for them to be able to attain more information from other resources. Eventually, the cost of equity becomes higher, from the corporate standpoint.

Jensen & Meckling (1976) seminal work on agency theory underlines that there are distinct interests between management and its owners and its lenders, or called rent diversion. Jensen & Meckling (1976) argue that management could undertake actions that would solely benefit them, and sometimes at the expense of the shareholders and lenders. Therefore, if the

shareholders or lenders consider that the management is carrying out tax management, they would be more watchful, and try to overcome the low transparency by finding alternative sources of information (Desai & Dharmapala, 2006; 2009; Desai et al., 2007).

Rent diversion occurs when the result of the tax avoidance, the transfer of resources from the state to the corporate, is not passed on to the shareholders in the form of increase in firm value (Desai & Dharmapala, 2009). There is when information asymmetry between the management and shareholders occurs, and transparency decreases, hence increases of agency cost.

Moreover, Desai & Dharmapala (2006) find that any alignment between the shareholder and the manager interests will lead to higher degree of tax sheltering, which is one form of tax managements. However, this phenomena is less prominent in firms owns by institutional shareholders, as these type of shareholders function more as monitoring agents for the management (Lim, 2011; Moore, 2012).

Many researches on company ownership argue that agency cost and assymetric information problems in publicly traded firms are primarily driven by the separation between controlling rights and cash flow rights (La Porta et al., 1999; Claessens et al., 2000; Faccio & Lang, 2002). The agency problem escalates in firms with pyramidal structure with or without cross-shareholding situation. The ultimate owners, who posses higher controlling rights, compared to their cash flow rights, would have the ultimate voice on the firms (called the entrenchment effect), sometimes in expense of the minority interest holders (Fan & Wong, 2002). This kind of firms are widely found in Asian countries including Indonesia.

More recent studies find that there are other group of shareholders that pose certain effects on the existance of large (ultimate) shareholders by providing valuable internal monitoring either by forming coallitions with large equity stakes or by competing for corporate control (Attig et al., 2008; Laeven & Levine, 2008).

Based on the above premises, this paper has the following objectives. First, it aims to assess whether the tax avoidance increases the cost of equity that is whether tax avoidance is unfavorable to the shareholders. Following Francis (2004), this study uses Capital Price Model (CAPM) as the proxy for the cost of equity.

The second objective of this paper is to investigate managerial opportunistic theory on the relationship between the tax management and the cost of equity by examining the effects of shareholders as monitoring agents on the relationship. On examining the shareholders' roles as monitoring agents, the paper investigates three elements of the ownership structure: 1) how ultimate (controlling) owners affect the relationship between the tax management and the cost of equity, 2) whether a controlling owners is an individual or group of family would affect the relationship, and 3) whether the second large shareholder (SLS) other than the ultimate owner has any monitoring role and therefore will have mitigating impact on the relationship.

There are several contributions of our study. First, it provides additional empirical result on the current body of research on impact of tax avoidance on cost of equity. Importantly, to the best of our knowledge, this is the first research that examines the role of controlling owners, second largest shareholder, and family ownership structure on the relation between the tax management and the cost of equity. Second, this research uses sample of listed firms in Indonesia. Choosing Indonesian market as the research sample provides advantage to the richness of the existence body of knowledge as Indonesian market has unique characteristics, as follow. First, currently, the Indonesia capital market is in its emerging state with limited means for minority stakeholders' protection. Second, corporations in Indonesia tend to be owned by certain concentrated owners (family), which would increase the possibility of any entrenchment acts undertaken by the controlling owners to the minorities. Third, from the practice point of view, Indonesian market is considered as a big potential world investment destination, as its governance recently opens wider possibilities for international investments.

Literature Review and Hypotheses Development

Previous studies find that cost of equity tends to rise in cases where supply of information provided by corporations to shareholders is insufficient (Botosan, 1997) or poor information quality (Francis, 2004; 2005; 2008). In the condition where asymmetric information exists and with higher information risk, shareholders need to put extra efforts to obtain complete information about the firm from external sources, hence higher cost of equity. Easley et al. (2004) also support the notion that uninformed investors would have to bear increase risks of holding equity (stock) because of the existence of private information while privately informed investors have the ability to shift its portfolio whenever the private information exists.

On the other side, some research find that Tax avoidance is a source of information asymmetry (Lim, 2011; Moore, 2012; Goh, 2013). Hanlon & Heitzman (2010) define tax avoidance as the reduction of explicit taxes per dollar of pre-tax accounting earnings. The underlying incentives for management to avoid taxes are widely researched, but the main use of the tax avoidance is the legal utilization of the tax regime for one's own advantage, to reduce the amount of tax that is payable by means that are within the law (Pasternak & Rico, 2008), thus transfer value from the state to shareholders (Desai & Dharmapala, 2009).

Tax avoidance encompasses activities that arise from both general tax reduction methods and tax shelters, that sometime involve questionable actions from the side of the firm, in order to achieve minimum tax liabilities (Lim, 2011). These tax saving actions become the firms' devices that transfer resources from the government to the firms, and thus should increase after-tax value of the firm (Desai and Dharmapala, 2009). Lambert et al. (2007), however, argues that these additional cash flows possessed by the firms might or might not be transferred and received by the shareholders as their residual claimants. It is argued that the firms might utilize the fund on their potential investment. Furthermore, Desai

et al. (2007) claim that self-interest managers may try to facilitate transactions that reduces taxes and divert corporate resources for private use, thus rent diversion exists.

Both being utilized for the source of investment and for the private use, the existence of the tax avoidance would cause uncertainty of future cash-flow for the shareholders, hence information asymmetry (Dhaliwal et al. 2008). The less transparent the firms are, the more efforts that have to be exercised by the shareholders to obtain insider information, the higher the cost of equity. On examining the cause and effect relationship, we propose the following hypothesis 1:

H1*: the tax avoidance is positively related to the cost of equity.*

The separation between control and ownership rights (excess control) of the controlling shareholders causes agency costs and asymmetric information problems in publicly traded firms (LaPorta et al., 1999). In many developing countries, majority of firms are owned by only certain small group of people (concentrated), hence the development of pyramidal ownership structure and crossholdings. This results in wide gap (excess) between control rights and cash flow rights hold by the ultimate owner (the owner that is at the top of the pyramid).

The ultimate owner's position with a high excess of control rights over its cash flow right enable the holder to expropriate minority shareholders (Fan & Wong, 2002), through actions with possible entrenchment effects. Therefore, firms with higher level of excess control would be viewed as having more asymmetric information that would lead to higher cost of equity. From this, we propose hypothesis 2 as follows:

H2: *The positive effect of the tax avoidance on the cost of equity increases with the level of the excess of the ultimate owner's control rights over its cash flow rights.*

Chen et al. (2010) find that firms owned by family tend to be less risk averse. Therefore, it is argued that those firms are less prone to undertake tax avoidance activities.

These firms like to maintain their reputations as a legacy from generations to generations. From this point of view we can conclude that family owned companies would be perceived to provide more reliable information, thus would decrease the extent of positive relation between tax avoidance and the cost of equity.

However, other studies find that in cases where ownership structure are concentrated family owned provide, it is found that more entrenchment effects occurred in favor of the controlling owners, and most of the time, at the expense of the minority interests (Fan & Wong, 2002; Diyanty, 2012). A firm is defined as concentrated when few of individuals or certain group of individuals with family relationship owns or co-owns a lot of firms. In these situations, ultimate owner which is family might also become a source of information asymmetry as holding high controlling rights will enable the family owners to expropriate. Therefore, our hypothesis 3 is as follows:

H3: *The positive effect of the tax avoidance on the cost of equity changes on the presence of family as the ultimate owner.*

Chen et al. (2010) investigate a unique agency conflict between dominant (controlling) and minority shareholders in firms. This, which refers to a type-II agency problems, occurs when there is a conflict of interest among the shareholders themselves, and not between the management and the shareholders. Attig et al. (2008) further examine the governance role of the second largest shareholder on the value of the cost of equity. One of their results shows that the existence of second largest shareholder (and multiple shareholders/MLS) has a monitoring effect on the largest owner. This existence of second largest shareholder influences firms' governance and information problems, thus their costs of capital. Therefore, the presence of a second largest shareholder (MLS) is perceived as an alternative internal governance device that enables shareholders, especially the non-controlling shareholders, to monitor managerial performance.

More researches on ownership structure tell that when there are other investors holding large percentage of shares of the firm over controlling shareholder, there is less use of discretionary accruals (Chung, 2002), which means decrease in agency problems between managers and shareholders leads to lower yield of new bond issued (Bhojraj and Sengupta, 2003). Therefore, when there is a presence of another large ownership, the scrutiny over managerial performance also becomes at great degree. As a consequence, the conflict of interests between managers and debt-holders or shareholders will be less important. Otherwise, it could reduce the cost of equity and debt through alleviating agency conflicts, decreasing the opportunities for employing tax avoidance techniques (Lim, 2011).

Based on these previous findings on the role of ownership structure, especially on the role of the second largest shareholder, we following Attig et al. (2008), propose the following hypotheses 4a to 4c:

H4a: *The existence of the second largest shareholders affect the positive association of tax avoidance and the cost of equity*.

H4b: *The control rights level held by the second largest shareholders affect the positive association of tax avoidance and the cost of equity*.

H4c: *The ratio of the second largest shareholders control rights affect the positive association of tax avoidance and the cost of equity*.

Research Method

To test the hypotheses of the association between the DTAX and COE, we use this model following Francis (2004):

$$COE_{it} = \alpha_0 + \alpha_1 DTAX_{it} + \alpha_2 Growth_{it} + \alpha_3 Leverage_{it} + \alpha_4 Size_{it} + \alpha_5 MTBV_{it} + \alpha_6 DA_{it} + \alpha_7 Beta_{it} + \varepsilon_{it} \quad (1)$$

For the rest of the hypotheses (H2, H3, H4a, H4b, and H4c), we add all moderating variables into the model, as follows:

$$COE_{it} = \beta_0 + \beta_1 DTAX_{it} + \beta_2 RATIO_{it} + \beta_3 RATIO_{it} * DTAX_{it} + \beta_4 FAM_{it} + \beta_5 FAM_{it} * DTAX_{it} + \beta_6 SLS2_{it} + \beta_7 SLS2_{it} * DTAX_{it} + \beta_8 Growth_{it} + \beta_9 Leverage_{it} + \beta_{10} Size_{it} + \beta_{11} MTBV_{it} + \beta_{12} DA_{it} + \beta_{13} Beta_{it} + \varepsilon_{it} \quad (2)$$

Cost of Equity

Following Francis (2004) and (2005), we measure the cost of equity using Capital Asset Pricing Model (CAPM). CAPM is widely accepted in many academic literatures as a measure to estimate the cost of capital (Da et al., 2012). CAPM represents the value or the price of the risks that has to be borne by investors in investing their funds in the company.

$$COE = Rft + \beta i\ (RMt - Rft)$$

where:

Rft:	Risk-free rate of return
βi:	Beta
RMt:	Market return

Discretionary Book-Tax Difference (DTAX)

Tax avoidance is measured by using DTAX and, following Frank et al. (2009), using permanent difference of book-tax difference as the basis for calculating the book-tax difference (BTD). This measurement excludes the temporary difference from the calculation as many earnings management and tax sheltering undertaken by management result in permanent book-tax different (Frank et al., 2009).

We obtain DTAX from the residuals of the following regression out of the company's book-tax permanent difference:

$$PERMDIFF_{it} = \gamma_0 + \gamma_1 INTANG_{it} + \gamma_2 UNCON_{it} + \gamma_3 MI_{it} + \gamma_4 CSTE_{it} + \gamma_5 \Delta NOL_{it} + \gamma_6 LAGPERM_{it} + \varepsilon_{it}$$

PERMDIFFit: Total book-tax differences less temporary book-tax differences: [BIit – (CTEit/STRit)] – (DTEit/STRit).

BIit: Pre-tax book income for firm i in year t.

CTEit :Current tax expense for firm i in year t.

DTEit: Deferred tax expense for firm i in year t.

STRt: Statutory tax rate in year t.

INTANGit: Goodwill and other intangibles for firm i in year t.

UNCONit: Income (loss) reported under equity method for firm i in year t.

MIit: Income (loss) attributable to minority interest for firm i in year t.

CSTEit: Current state income tax expense for firm i in year t.

ΔNOLit: Change in net operating loss carry-forwards for firm i in year t.

LAGPERMit: One-year lagged PERMDIFF for firm i in year t.

Ownership Structure:

a. EXCESS: the total control rights deducted by the cash-flow rights of the ultimate owner (the highest in the pyramidal structure of a firm). The greater the EXCESS the higher potential entrenchment actions would occur (LaPorta et al., 1999).

b. FAMILY: following Diyanty (2012), we define FAMILY as one individual name or group of family that hold the ultimate controlling rights of a firm. This is a dummy variable where 1 is for family owned firms, and 0 otherwise.

c. *Second Largest Shareholder:*

This proxy refers to ownership of large shareholder that possesses second largest stakes after the controlling (ultimate) shareholder. Following Attig et al. (2008), this proxy is represented by three variables as follows:

- PRESENCE: a dummy variable that takes the value of 1 if the firm has at least two large shareholders, and 0 if otherwise.
- CONT2: the size of the control rights of the second largest shareholder.

- C21: ratio of the control rights of the second largest shareholders to those of the controlling (ultimate) shareholders.

Control Variables:

- Growth: a ratio of sales in year t with the previous year. The higher the growth of the firms, the higher the investor's expectation on the return of the firm, the higher the cost equity would be.
- Leverage: the ratio between total long term debt and total stockholder equity scaled by total asset. The higher the firm's leverage, the higher the cost of equity would be.
- Market to Book Value (MTBV): firms with high MTBV have a higher growth and revenue prospects, therefore investors incline to spend lower cost of equity.
- Size: the natural logarithm of total assets. Larger firms tend to have lower bankruptcy risk and more certain future earnings and be more transparent compared to smaller firms, hence lower cost of equity.
- Discretionary Accruals (DA): calculated by using Modified Jones model (1995). Basically, the ABTD numbers imply two elements, which are the tax avoidance and the earnings management. We use DA variable is to isolate the earnings management element from the equation (Desai & Dharmapala, 2006).
- Beta: systematic risk (Francis et al., 2004). Higher systematic results will result in higher cost of equity.

Sample firms are selected companies listed in Indonesian Stock Exchange (IDX) for 5 years observations: 2008 to 2012. We exclude companies listed under industries: banking and finance, mining, construction and real estate, and group of companies which have their own characteristics in term of financial performance and regulatory as well as different application

of tax regulation. Inclusion of the companies in these industries into the sample is suspected to result in bias research outcome.

We further exclude companies that have no sufficient data either for the development of the dependent variables or the independent variables, both for the tax avoidance variable and the ownership structure variables, as well as the controlling variables. Table 1 describes the summary of this selection process.

We collect data from the annual reports released by the firm and some information that could not be obtained from the annual report from the Thomson Reuters Data Stream. Ownership Structure data were handpicked from the business establishment data owned by the Ministry of Law and Human Rights of Indonesia.

Table 1. **Sample Selection**

4. Results and Discussion

Table 2 provides descriptive statistics of the variables used in the analysis. The mean of DTAX is -0.0009. It means that, on average, the income reported for the accounting is slightly lower than for the tax purposes. Even though the mean of the difference is small, but the individual firms' DTAXs varies. It can be seen from the maximum DTAX which is positive while the minimum DTAX is negative with the standard deviation is 0.054969. The average of CAPM is positive with the maximum of 21.32% and minimum of 5.28%.

From the table 2, we can see that 70% of the firms in the sample are owned by family while the average excess ratio (controlling rights divided by cash-flow rights) held by ultimate owners is around 1.16. For the SLS variables, we find that almost 70% of the sample possesses second largest shareholder, in which counts for 141% cash-flow right, (minimum 0% and maximum 60.21). Proxy CONT2_1 which measures relative power of the second largest shareholder compared to the first largest shareholder, shows that the second large shareholders hold 32% power over their first largest counterparts.

Table 2. **Descriptive Statistics**

Result of first model in Table 3, shows that coefficient DTAX (discretionary permanent book-tax differences) is positive and significant by 0.303, implying that higher tax avoidance activities undertaken by the firms increase their CAPM on average by 0.3 times. This result confirms the hypothesis (H1) which says that the firm's decision to avoid tax (proxied in this research with the discretionary permanent book-tax difference) will result in the increase of the firm's cost of equity.

Table 3. **Relationship between tax avoidance and cost of equity**

All controlling variables show significant value in correlation with the cost of equity as seen in Table 3. It shows that firms with higher leverages and higher betas will naturally generate higher costs of equity, while bigger firms and those which have higher market-to-book values will bear smaller cost of equity. Two of the controlling variables, growth and discretionary accruals, show weak results, where firms with higher growth rate show slightly higher costs of equity, and those with higher number of discretionary accruals show marginally lower costs of equity.

Table 4 presents the results of regression model 2. The variable used to check on the power of the ultimate owners to the relationship is EXCESS, which is the difference between control rights and the cash-flow rights held by the ultimate owners. The table shows that the interaction between variables EXCESS and DTAX has a positive relation with the CAPM. This confirms the hypotheses 2, which says that the positive effect of tax avoidance on the cost of equity increases as the excess of the ultimate owner's control rights over its cash flow rights increases. The more the difference between the control rights held by the ultimate

owners and its cash flow rights, the higher the possibility that the ultimate owners exerting their power, the higher the possibility any entrenchment effect occurs (Diyanty, 2012).

Table 4. **The role of ownership structure on the relationship between tax avoidance and cost of equity.**

We find a slightly stronger result when the family ownership is tested. As we can see from the interaction variable between FAM and DTAX, we can conclude that family-owned firms tend to have negative effects on the positive relations between the tax avoidance and the CAPM. This result is in sync with the third hypothesis that says that the presence of family as the ultimate owner will change the positive effect of the tax avoidance and the cost of equity. This result confirms Chen et al. (2010) finding that family firms will be less tax aggressive in order for them to maintain their reputations.

From table 4, we can conclude that the SLS in the sample does not have any impact on the relationship between the tax avoidance and the cost of equity, hence rejecting the hypotheses 4a, 4b, and 4c, which say that the existence of second largest shareholder, the amount of control rights held by this shareholder, and the ratio of control rights held by this shareholder over those held by ultimate owners have impacts on the relationship between the tax avoidance and the cost of equity.

The coefficient of interaction variable between DTAX and SLS in the model which represent the presence of the SLS in the firm, and amtSLS that equals to level of control rights hold by the SLS, and RatSLS that is the ratio of control rights hold by SLS compared to the ultimate owners are not statistically significant. It can be deducted then, that SLS is not able to alter or affect the positive relationship between the tax avoidance and the cost of equity.

Sensitivity Test

In order to completely explore the reliability of our result, we conduct sensitivity tests as follows:

1. As a proxy for tax avoidance, we use another measure that is based on the total book-tax instead of the discretional permanent book-tax difference. The measure, Abnormal Book-Tax Differences (ABTD) separates the total book-tax difference into the *normal book tax difference* (difference on income used for accounting report and tax report purposes that come from the rules of the perspective purposes), and *abnormal book tax difference* that shows the difference that is more likely to be caused by earnings management and tax avoidance and interactions between the two actions. By using this measure, we try to capture how the market reacts on the existence of *abnormal* sources of differences between the accounting book and the tax report income (Tang & Firth, 2011).

   The result of this sensitivity analysis (not reported) is similar with the main test that we have conducted. The tax avoidance is positively correlated with the CAPM with the coefficient of 0.032, which means that one unit of the tax avoidance will increase the firm's cost of equity by 3.2%.

2. To measure the cost of equity, we also use the Earning-Price Ratio (Francis et al. 2004). The measure implies price multiple that is attached to the earnings reported. Higher price implies lower cost of capital, that means that market is willing to pay more for a given value of earnings. Following Francis et al. (2004), the EP ratio is adjusted for the overcoming industry bias as follows. First, medians for all EP ratios for all firms with positive earnings in year t in each industry are calculated. Industry-adjusted EP of firm *i* from year *t* then calculated by subtracting the EP*i* with the median of EP*j* from year *t* (where *j* is the industry of firm i).

Result of this sensitivity test is also similar with the main test, where the tax avoidance (both using DTAX and ABTD as the measurement alike), have a strong positive relationship with the cost of equity.

3. In measuring the extent of control that is hold by ultimate owners, Claessens et al. (1999) use the ratio between the control rights hold by these owners over their cash flow rights rather than the difference between the two rights. In this third sensitivity test, we apply the ratio to substitute the EXCESS variable in testing hypothesis 3. The test also results in similar outcome, where the higher the ratio of the control rights held by ultimate owner over its cash flow right would emphasize the positive impact of tax avoidance to the cost of equity.

Conclusion

This paper provides empirical evidence on the relationship between tax avoidance, cost of equity and ownership structure using Indonesian firms listed in IDX from year 2008 to 2012. This research addressed two questions. First, it provides answer to whether firms participating in tax avoidance activities have higher cost of equity (COE). Second, whether the ownership structure acts as good corporate governance system affecting the relationship between of tax avoidance and the COE.

Using a tax avoidance measure derived from Frank et al. (2012), we find a positive relationship between the tax avoidance and the cost of equity. This result is consistent with the hypothesis and the agency theory on the information asymmetry. The result concludes that, firms undertaking tax avoidance are perceived to have less transparent reporting, rising possibility of rent diversions that lead to the increase demands for investors to obtain more internal information, hence higher costs of equity. This result should provide important input for firms engaging in tax avoidance. Market has negative perception on this tax avoidance which resulted in higher cost of equity

Further examination on the relationship between the tax avoidance and the cost of equity involving ownership structure reveals that this positive relationship could be affected by the ownership structure of the firms. Nevertheless, there are two main results on this ownership structure part of the study:

1. The ultimate owner has a significant impact on the positive relation between tax avoidance and the firms' cost of equity. The excess control rights over cash flow right held by the ultimate owner will increase the positive relation. The higher the excess (or ratio) of control rights held by an ultimate owner over its cash flow rights, the greater impact of tax avoidance on the cost of equity.

   Furthermore, whether the ultimate owner is a family or an institution would also have an impact on the positive relationship between the tax avoidance and the cost of equity. Family owned firms in Indonesia tend to decrease the intensity of positive impact of tax avoidance on firms' cost of equity. This results provide support for capital market regulator to regulate on disclosure of ultimate shareholders.

2. On the other hand, the second largest shareholders, those who hold highest control rights next to the ultimate owners, are found to have no impact on mitigating the positive relations between the tax avoidance and the cost of equity. Based on the results of this study that, contrary to the result found in previous research by Attig et al. (2008), second largest shareholder (SLS) in Indonesian market does not possess any monitoring effect that can have a greater control on the firms' management and ultimate owners.

There are several limitations of our study. First, we did not able to determine all ultimate shareholders, especially for those companies whose shareholders are foreign firms. Second, there are other corporate governance variables which may affect the association between tax avoidance and cost of equity, such as monitoring by board of commissioners.

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