

MANAGEMENT COMPENSATION'S IMPACT ON TAX AVOIDANCE IN INDONESIA WITH MODERATION OF MANAGEMENT OWNERSHIP IN THE CONSUMPTION INDUSTRY

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Abstract

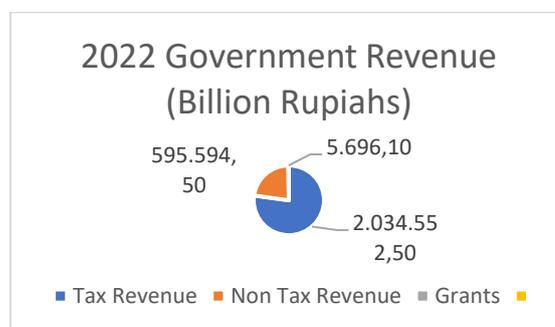
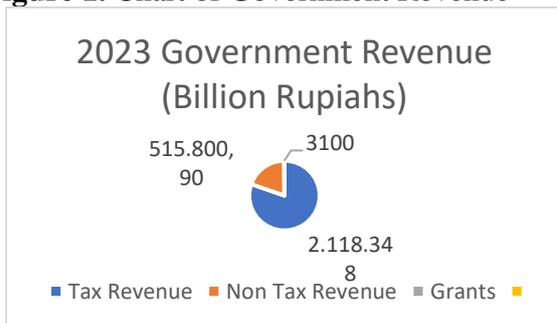
This study aims to determine the significance of management compensation on tax avoidance and the interaction between management compensation and management stock ownership on tax avoidance in the consumption industry 2020-2023. The method used is Multiple Regression Analysis (MRA) with moderation of management ownership. The results show that management compensation is significant in relation to tax avoidance. Meanwhile, the interaction between management compensation and management ownership is not significant in relation to tax avoidance. Percentage of management ownership is not large enough to change their decisions regarding tax strategies. So that companies do not have to add management shares in the compensation package to motivate management to take tax avoidance actions.

Keyword: Compensation; stock ownership; tax avoidance; moderation; management.

Introduction

It is known from the 2023 State Budget Information that tax revenue in 2023 is IDR 2.118 T from total state revenue of IDR 2.637 T. The ratio of tax revenue is 80% of total government revenue. While in 2022 tax revenue is 77% of government revenue (Badan Pusat Statistik, 2024). This means that most of the state revenue is supported by tax revenue. Therefore, the government tries to maximise tax revenue.

Figure 1. Chart of Government Revenue



Source : BPS (2024)

The government needs taxes to finance government spending. Different motives with the government, taxes for the company are a deduction of net income or economic ability of the company which will have an impact on investment decisions, expansion, and others (Amri, 2017). Taxes reduce the benefits obtained by shareholders and managers from the contractual relationship between the two because managers and shareholders are tax subjects (Bauer et al., 2018). Therefore, taxpayers want to reduce

the tax burden in order to obtain high profits. Tax avoidance measures are one technique to lessen the tax burden. Tax avoidance is done by utilising loopholes in tax regulations (Suandy, 2014).

Tax avoidance can be beneficial in the short term. One reason is that tax avoidance in firms with high organisational capital is seen as value enhancing as it increases future cash flows and after-tax profits. This motivates companies with high organisational capital to avoid taxes more to maximise manager and shareholder benefits (Hasan et al., 2021). However, tax avoidance also increases the company's risk in the long run because taxes are an undesirable action. In practice, companies that avoid taxes deviate from tax regulations so that they are prone to tax fraud. In Indonesia, taxpayer compliance is still low. There are still many companies that do tax avoidance (Madani et al., 2023). An example of a tax avoidance case is the case of PT Adaro Energy. PT Adaro Energy was accused of tax fraud by Global Witness, an NGO, in 2019. The investigation said that Adaro recognised its income and profits around the world to lower its tax obligations to the state (Dayani & Suryandari, 2020).

Factors that influence tax avoidance have been widely researched. One of them is management compensation. Research on how managerial compensation affects tax avoidance has produced inconsistent findings. According to certain research, management compensation reduces tax avoidance (Armstrong et al., 2015; Rego & Wilson, 2012; Reza & Asqolani, 2022). Meanwhile, According to other research, management pay has a detrimental impact on tax avoidance (Amri, 2017; Desai & Dharmapala, 2006). Desai & Dharmapala (2006) found a negative effect of management compensation on tax avoidance. According to the study's findings, raising pay generally lowers the degree of tax evasion. High incentives have a favorable impact on tax avoidance because they encourage managers to spend

in risky tax avoidance above and beyond what shareholders expect (Armstrong et al., 2015). This statement is supported by the results of research by Rego & Wilson (2012) which concluded that incentives are significant to corporate tax aggressiveness. Greater incentives have an effect on greater tax risk. Research by Amri (2017) suggests that management compensation has a detrimental influence on business tax avoidance. managers compensation can discourage managers from pursuing opportunistic acts. Although many studies (Rego & Wilson, 2012; Amri, 2017, (Armstrong et al., 2015) explore compensation and tax avoidance, but there are not many studies that use managerial ownership as a moderator in research on management compensation and tax avoidance in the consumer industry.

Agency conflicts are the driving force behind corporate tax avoidance. Managerial ownership, which aligns the interests of management and shareholders, reduces this agency conflict (Wongsinhirun et al., 2024).

Using managerial share ownership as a moderating variable, this study reexamines the relationship between tax avoidance and management compensation in consumption companies listed on the Indonesia Stock Exchange. This study sought to ascertain how management compensation affected tax evasion and how management ownership affected the relationship between management compensation and tax evasion. The contribution of this research is to determine whether management ownership strengthens the influence of management compensation on tax avoidance.

Literature Review

AGENCY THEORY

When one or more principals hire an agent to perform a service and then give the agent decision-making authority, agency relationships are created (Jensen & Meckling, 1976). In the relationship between the principal and agent

relationship, conflicts may occur due to differences in interests. To ensure effectiveness and efficiency of the agent's performance, there will be an agency cost. Capital owners will prioritise their desire for the continuity of the company in a going concern condition, while agents are more concerned with welfare in managing the company. To achieve its wishes, the agent may do things that harm the company such as misstatement or fraud. This is due to moral hazard in the agent. This difference in interests (Endiana & Suryandari, 2021).

Agency cost itself is divided into monitoring cost, bonding cost and residual loss. Monitoring costs are costs incurred and borne by the principal to monitor agent behaviour, namely to measure, observe and control agent behaviour. Bonding cost is the cost borne by the principal so that the agent fulfils and complies with the mechanism that ensures that the agent will act in accordance with the principal's interests. Furthermore, residual loss is a sacrifice in the form of reduced principal prosperity as a result of differences in agent decisions and principal decisions (Jensen & Meckling, 1976).

Management team act as agents, have a comprehensive understanding of effective administration of the company to maximise profits owners while maintaining cost efficiency. While the principal party which is the owner of the company (shareholders), desires to achieve profit as much as possible with the costs they have incurred and provide incentives to agents with various facilities, both in incentivise agents with various facilities, both in financial and non-financial forms (Lesmono & Siregar, 2021).

TAX AVOIDANCE

Tax Avoidance is an attempt legal reduction that is done by utilising the provisions in the field of taxation such as exemptions and allowable deductions as well as the benefits of things that have not been regulated and the weaknesses that exist in the taxation sector that have not been regulated and the weaknesses that

exist in the prevailing taxation applicable taxation (Suandy, 2014). Ethically, tax avoidance is not something wrong if the practice of tax avoidance is still within the provisions of the rules and tax laws that have been enacted. There are several ways or strategies for companies to avoid taxes (Maulana et al., 2021):

1. Adding the cost of personal interests as an operational cost or company expense with the aim of reducing company profits,
2. Recognising the company's capital expenditure as operational expenditure so that in the recording it is recognised as an expense so that it reduces revenue,
3. Recording excessive raw material costs with the aim that profits will be reduced before the tax burden is paid.

Tax avoidance is done by managers if the marginal benefit exceeds the marginal cost. This is because tax savings derived from tax avoidance are economically valuable and can increase the availability of cash flow which directly and indirectly benefits shareholders and managers. Tax avoidance is different from tax evasion because tax evasion is an effort made by taxpayers to violate applicable tax rules (Prastyo et al., 2024).

MANAGEMENT COMPENSATION

According Maulana et al., (2021) compensation is one of the payroll mechanisms to improve harmony between workers from the lower level to management and shareholders. Executive compensation is a special benefit provided by a company for a small group of key executives in a company and is designed to give executives a privilege. The executives in question are the board of directors including directors, deputy directors, commissioners or managers and their assistants. Basically, incentives for management are an agency contract between the company and management that tries to create harmonious conditions between the interests of shareholders and management with management incentives

based on one or more in measuring management efforts in carrying out the company's operational activities.

MANAGEMENT OWNERSHIP

The Company, through its management, will endeavour to improve its overall corporate governance, including tax policy, in order to maximise the Company's performance. Overall corporate governance, including tax policy, in order to maximise company performance. One possible approach is to grant share ownership to managers, which creates managerial ownership, and develops tax policies that can help maximise corporate profits. ownership, and developing tax policies that can help maximise corporate profits (Sinaga et al., 2023).

When managers own firm stock, this is known as managerial ownership. Therefore, in this instance, the manager serves as both the company's management and its owner or shareholder. Managerial ownership is one of the corporate governance mechanisms used to reduce agency conflicts (Kartikasari et al., 2022). The higher the number of shareholdings in the entity, the more management tends to work in the interests of shareholders. The existence of managerial ownership in the company will tend to improve management performance for own interests and the shareholders. Low managerial ownership causes management to be more concerned with their own interests rather than the interests of the company. The amount of share ownership that is not significant causes managers to be more concerned with his goals as a manager rather than as a shareholder. The percentage of firm shares owned in the financial statements indicates managerial ownership (Indri Agustini & Nursasi, 2020).

THE EFFECT OF MANAGEMENT COMPENSATION ON TAX AVOIDANCE

Agency issues are reflected in tax avoidance. Unfavorable tax rulings may

result from the separation of owners and agents. Therefore, in order to minimize these agency costs, a mix of control and incentive mechanisms is required (Jensen & Meckling, 1976). To align the interests of decision makers and shareholders, owners should establish executive compensation contracts that can ensure tax efficiency (Crocker & Slemrod, 2005). When the transaction's marginal benefit outweighs its marginal cost, a tax-efficient choice is one that can boost the business owner's after-tax wealth (Hanlon & Heitzman, 2010). Tax avoidance can be done by taking advantage of unclear tax rules (grey area), especially complex transactions. The degree of business tax evasion is mostly determined by executives (D.Dyrenge et al., 2010).

Executive compensation decisions can have an impact on the company. When compensation is as expected, executive behavior will be aligned with the company's strategy. However, when executive compensation is poorly managed, it can result in loss of talent, demotivation, misaligned goals, and shareholder losses (Groysberg et al., 2021). Management compensation itself is a corporate governance function in relation to tax avoidance (Desai & Dharmapala, 2006). Incentives and compensation motivate managers to make risky investment and financing decisions. Tax aggression tactics can be costly for the company and management and involve a great deal of uncertainty. To encourage managers to employ riskier tax techniques, incentives must be provided to management (Rego & Wilson, 2012). The results of Rego & Wilson (2012) research concluded that incentives are significant to corporate tax aggressiveness.

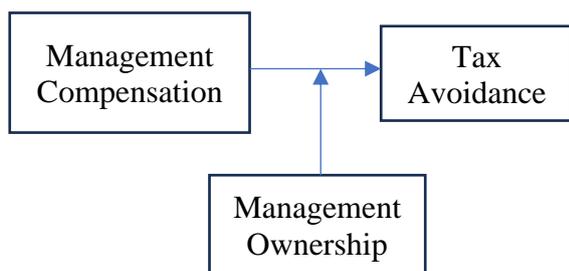
H1 : Tax avoidance is positively impacted by management pay.

THE MODERATING EFFECT OF MANAGEMENT OWNERSHIP ON THE RELATIONSHIP BETWEEN MANAGEMENT COMPENSATION AND TAX AVOIDANCE

The consequences of management ownership include entrenchment and alignment. According to the alignment effect, managerial ownership can lessen agency issues by bringing managers' and stakeholders' interests into alignment (Ming Jia, 2012). According to the entrenchment effect, managers that have more ownership will also be more entrenched, which translates into more opportunistic behavior and superior authority. Agency conflicts are the driving force behind corporate tax avoidance. Managerial ownership, which aligns the interests of management and shareholders, reduces this agency conflict (Wongsinhirun et al., 2024). Highly compensated management has a stronger level of influence on tax avoidance when he has share ownership in the company. Managerial ownership can be known based on a proportion of the manager's shares, where the management can be involved in company policy. The larger a company's manager ownership percentage, according to Prasetyo & Tarigan (2020), the managers will try to optimise their performance in order to achieve a company goal.

H2 : Management ownership strengthens the effect of compensation on tax avoidance.

Figure 2. Conceptual Framework



Source: Data Process (2024)

Research Method

DATA SAMPLE

Consumption companies listed on the IDX between 2020 and 2023 as the research sample. Companies in the consumer sector play a role in producing goods that become daily consumer needs, such as food, beverages, hygiene products, and other products. the consumer goods industry

sector is one of the sectors that has a significant contribution to the national economy. so it does not rule out the possibility that this sector has a large enough profit. the greater the profit earned by the company, the greater the tax burden that will be paid by the company, thus motivating the company to conduct tax avoidance. Purposive sampling was the method utilized for sampling in this investigation. The following are the sample criteria:

1. Companies in the consumption category that were listed between 2020 and 2023 on the Indonesia Stock Exchange
2. Publish audited annual reports
3. The company has complete research data
4. The business's pre-tax profit is positive or does not experience losses during the observation year
5. The Rupiah is the currency used by the business for financial reporting.
6. The company has a financial year ending 31 December

The data collected is 72 consumption companies with 3 years of observation period so that the total sample is 216 sample data

OPERATIONALISATION OF VARIABLES

The research model used in this study is:

$$TER = \beta_0 + \beta_1 Ln_REMUN + \beta_2 MANSHARE + \beta_3 REMUN_MANSHARE + e$$

Description :

TER = TER is tax avoidance, the dependent variable in this research. Corporate tax avoidance calculated by dividing the total income tax expense by the profit before taxes.

Ln REMUN = Ln REMUN is an independent variable of management compensation calculated by the Natural Logarithm (Ln) of the amount of board

of directors and board of commissioners compensation.

Ln_REMUN follows research from Amri (2017).

MAN_SHARE = MAN_SHARE is a managerial share ownership measured by the percentage of management share ownership owned by board of directors and board of commissioners.

REMUN_ MANSHARE = Management ownership as moderating variable.

Management compensation data, management ownership data, and data used to calculate corporate tax avoidance are obtained from the company's annual report.

Descriptive Statistics

Table 1. Descriptive Statistics

	Min.	Max.	Mean	Std. Deviation
Ln (remun)	18.84	26.30	23.7344	1.30431
MAN_SHARE	.00	75.55	6.1809	15.72642
ETR	.05	.94	.2423	.11740

Source: Data Process (2024)

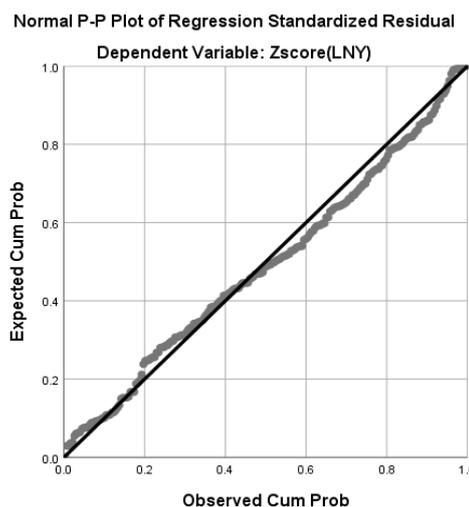
Descriptive statistics are used to obtain the average (mean), standard deviation, maximum value, and minimum value of the research data. The results of descriptive statistical processing can be seen regarding information on data characteristics. It can be seen in table 1 that management compensation has a minimum value of 18.84 and a maximum value of 26.30 with an average of 23.7344 and the standard deviation value is 1.30431. Minimum value of management compensation owned by PT. Gudang Garam sample in 2021.

Maximum value of management compensation owned by PT. Indofood Sukses Makmur sample in 2022. While the minimum value of management ownership is 0 owned by some of company, such as PT. Astra Agro Lestari, PT. PT Akasha Wira International, PT. Budi Starch & Sweetener, meaning that the company doesn't have management ownership. The maximum value of management ownership is 75.55 owned by PT Pinago Utama. The average value of management ownership is 6.1809 and the standard deviation value is 15.72642. The high standard deviation of management ownership indicates a large sample diversity. Tax avoidance has a minimum value of 0.05 owned by PT Nippon Indosari Corpindo sample of 2020. The maximum value of tax avoidance is 0.94 owned by PT Gema Grahasarana sample of 2022. The average value of tax avoidance is 0.2423 and the standard deviation value is 0.11740. Tax avoidance has a low standard deviation, closer to the average.

Classical Assumption Test

1.The Result of Normality Test

Figure 3. Normal P-Plot



Source: Data Process (2024)

Table 2. One-Sample Kolmogorov Smirnov Test

Source: Data Process (2024)

Normality test is a statistical analysis conducted to determine whether the observed data has a normal distribution. In table 2 One-Sample Kolmogorov Smirnov Test, it can be seen that the significance value (Asymp. Sig. (2-tailed)) is $0.200 > 0.05$, which means that the regression data residuals are normally distributed. This shows that the normality assumption is met. In figure 3 normal p-plot, it can be seen that the data points follow the normal line, so graphically the residual data is normally distributed.

		Unstandardized Residual
N		216
Normal Parameters ^{a,b}	Mean	.0000000
	Std. Deviation	.97437888
	Most Extreme Differences	
	Absolute	.052
	Positive	.052
	Negative	-.046
Test Statistic		.052
Asymp. Sig. (2-tailed)		.200 ^{c,d}

2.The Result of Multicollinearity Test

Table 3. Variance Inflation Factor (VIF) and Tolerance Test

Model		Collinearity Statistics	
		Tolerance	VIF
1	(Constant)		
	Ln_REMU	.931	1.074
	N		
	MANSHA	.745	1.342
	RE		
	REMUN_	.745	1.342
	MANSHA		
	RE		

Source: Data Process (2024)

The independent variables have a tolerance value of 0.931 and 0.745. The VIF values are 1.074 and 1.342. because the tolerance value > 0.10 and $VIF < 10$, so the regression model avoids multicollinearity problems or the multicollinearity assumption is met. The regression model is good because there is no correlation between the independent variables.

3.The Result of Autocorrelation Test

Table 4. Durbin-Watson Test

Model	Durbin-Watson
1	1.824

Source: Data Process (2024)

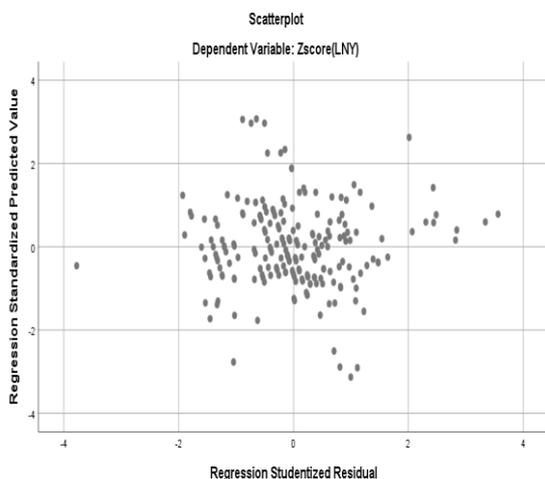
The autocorrelation test aims to test whether in a linear regression model there is a correlation between confounding errors in period t and confounding errors in the previous period. A Durbin-Watson value of 1.824 was obtained, which shows that this Durbin-Watson value is between dU and 4-dU, where the dU value = 1.805 and the 4-dU value = 2.195. So it can be concluded that there are no autocorrelation symptoms in the regression model or the autocorrelation assumption is fulfilled.

4. The result of Heteroskedastisity Test

Figure 4. Scatterplots test

and the moderating variable of management

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	10.876	3	3.625	3.765	.012 ^b
	Residual	204.124	212	.963		
	Total	215.000	215			



Source: Data Process (2024)

The heteroscedasticity test measures the variance difference between the residual value from one observation period and another. It can be seen in figure 4 that the distribution of data spreads randomly and does not form a certain pattern. It indicates that there are no signs of heteroscedasticity in the regression mode.

**MRA (Moderated Regression Analysis)
Regression Analysis Results**

Table 5. Model Summary

R	R Squar e	Adjusted R Square	Std. Error of the Estimate
.225 a	.051	.037	.98124885

Source: Data Process (2024)

It can be seen from table 5 that the R Square value is 0.051, meaning that the independent variable of management compensation, management ownership,

ownership are only able to influence the dependent variable of tax avoidance by 5.1%, the remaining portion is determined by factors not included in the study.

Simultaneous Test

Table 6. ANOVA Test (F TEST)

Source: Data Process (2024)

Judging from the table, the significance value (Sig.) is 0.012. The significance value is < 0.05, so it can be concluded that the research model is suitable and can be used. Or in other words, the variables management compensation, management ownership, and interaction management compensation and management ownership simultaneously / together affect variable tax avoidance.

Result and Discussion

Table 7: Parsial Test (T TEST)

Model		Unstandardized Coefficients		Standardized	t	Sig.
		B	Std. Error	Coefficients Beta		
1	(Constant)	-.018	.068		-.264	.792
	Ln_REMUN	-.224	.069	-.224	-3.225	.001
	MANSHARE	-.122	.078	-.122	-1.576	.117
	REMUN_ MANSHARE	-.132	.091	-.112	-1.448	.149

Description = Management compensation calculated by the Natural Logarithm (Ln) of the amount of board of directors and board of commissioners compensation, MAN_SHARE = indicating that this result measured by the percentage of management share ownership owned by board of directors and board of commissioners. REMUN_SHARE = Management ownership as moderated variable

<0.05, it can be concluded that the compensation management variable significantly affects the tax avoidance

variable. Standardized coefficients beta MAN_SHARE = -0.224 indicating that this result shows that the company's tax avoidance activities will decrease with higher management compensation, whereas tax avoidance will grow with lower management compensation. Providing optimal compensation to management can reduce agency problems in the company so that it can be used as a solution to reduce management's opportunistic behaviour in conducting tax avoidance (Budiadnyani, 2020).

Result of this study supports the research of Armstrong et al. (2012) and Budiadnyani (2020) which concluded that management compensation has a negative effect on tax avoidance. Based on the test results, it can be concluded that the management compensation can serve as a corporate governance tool to curb opportunistic manager's tax avoidance behavior (Amri, 2017).

As salaries and benefits are fixed components, a bonus system can motivate managers to simply improve performance, without putting more effort into tax avoidance. An increase in performance also means that it will increase the company's profits, and increase taxes (Puspita & Harto, 2014). In addition to engaging in tax evasion, the size of the remuneration package offered to management may incentivize them to carry out efficiency expenditures that the business must incur through other means. (Amri, 2017).

The significance value of the management compensation variable is 0.001. Because the significance value

The management ownership variable does not significantly affect the tax avoidance variable, because it has a significance value of 0.117. Hypothesis 2 predicts that management ownership will strengthen the link between tax avoidance and management compensation is rejected.

The REMUN_MANSHARE variable has a significance value of 0.149. because the significance value > 0.05 , the REMUN_MANSHARE variable does not significantly affect variable Y. Management ownership doesn't increases the impact of management pay on business tax avoidance.

The test results demonstrate that the management ownership does not strengthen Management compensation's impact on tax avoidance because in many cases, management's shareholding is only a fraction of the total shares outstanding. Such ownership is not large enough to change their decisions regarding tax strategies, especially if there are greater incentives from performance-based compensation.

Conclusion

This study sought to ascertain how management compensation affected tax avoidance and how management ownership affected the relationship between management compensation and tax avoidance in consumption industry. This study's contribution is to ascertain how management ownership and management salary interact as moderating factors in their impact on tax avoidance in consumption industry.

It can be inferred from the findings and discussion that there is a significant negative effect of management compensation on tax avoidance. The interaction of management compensation and management ownership is insignificant on tax avoidance.

The study's findings indicate that there is a significant negative effect of management compensation on tax avoidance, so

shareholders or owners (principals) need to minimize the amount of compensation paid to key management. Paying employees can stop management from taking advantage of opportunities. The correlation between tax evasion and management compensation is not strengthened by management ownership.

In this study, management compensation does not take into account the number of directors and commissioners in a company. This research discusses core management compensation while tax avoidance decisions are mostly made by the finance director. Future research can use the option of financial director compensation variables. Future research can use other measurements such as through questionnaires.

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