



INTERNATIONAL JOURNAL OF ACADEMIC RESEARCH IN BUSINESS & SOCIAL SCIENCES



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ISSN: 2222-6990

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To Link this Article: <http://dx.doi.org/10.6007/IJARBSS/v11-i1/9036>

DOI:10.6007/IJARBSS/v11-i1/9036

Received: 08 December 2020, **Revised:** 11 January 2021, **Accepted:** 15 January 2021

Published Online: 30 January 2021

In-Text Citation: (Jaffar et al., 2021)

To Cite this Article: Jaffar, R., Derashid, C., & Taha, R. (2021). Company Characteristics, Non-Audit Services Fee and Aggressive Tax Planning: A Conceptual Framework. *International Journal of Academic Research in Business and Social Sciences*, 11(1), 994-1004.

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Vol. 11, No. 1, 2021, Pg. 994 - 1004

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Company Characteristics, Non-Audit Services Fee and Aggressive Tax Planning: A Conceptual Framework

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Abstract

This study aims to propose a research model on aggressive tax planning behaviour among listed companies in the Malaysian ACE market. There is no mutual decision on the relationship between company characteristics and tax planning in previous studies. Based on a thorough review of previous studies, the inconsistency was due to the utilization of other variables. Therefore, in this study, we introduced the moderating variable of non-audit services fee. Referring to the agency theory, non-audit services fee play a significant role in the relationship between company characteristics and aggressive tax planning behaviour since this fee is also one of the operating costs bear by companies. To have a deeper understanding on the role of non-audit services fee, this study will analyze further the role of this fee by introducing this fee as a moderator to see the interaction in the relationship between company characteristics and aggressive tax planning. It is hoped that the information provided in this study may help in understanding the role of non-audit services fee in reducing the companies tax burden. Besides, tax authorities may use the information in this paper as one of the criteria in choosing the sample for audit purposes.

Keywords: Aggressive Tax Planning, Malaysia, ACE Market, Size, Profitability, Leverage, Capital Intensity, Inventory Intensity, Non-Audit Services Fee.

Introduction

Research on tax planning has been widely debated in recent years and become significant to tax policymakers, regulators, including tax authorities, corporate directors, investors, and academic researchers (Martinez, 2017). Studies such as Adhikari, Derashid, and Zhang (2006); Derashid and Zhang (2003); Filip and Lazăr (2011); Gupta and Newberry (1997); Hsieh (2012); Richardson and Lanis (2007); Wang, Campbell, and Johnson (2014); Wu, Wang, Luo, and Gillis (2012) had tested many variables in determining the factors that contributed to the differences between effective tax rate (ETR) and statutory tax rate (STR) in tax planning. In these studies, company characteristics such as size, return on assets, leverage, capital intensity, and inventory intensity created variation in ETR across companies. Thus, corporate characteristics were suggested to be an important variable in determining tax aggressiveness which is one of the tax planning categories exercised by companies (Devi, Salim, & Pheng, 2018). However, there were inconclusive findings from the previous studies on the relationship between company size, profitability, leverage, capital intensity, inventory intensity, and tax planning between countries as well as in the country itself (Hadjidema, Stamatopoulos, & Eleftheriou, 2016; Kim & Im, 2017; Mascagni & Mengistu, 2018; Nomura, 2017; Parisi, 2016; Pratama, 2017; Vintilă, Gherghina, & Păunescu, 2018). For example, the relationship between size and ETR, Hadjidema et al., (2016) found a positive relationship while Kim and Im, (2017) found a negative relationship. In other studies, Minnick and Noga (2010) and Vintilă et al., (2018) found that there is no significant relationship between leverage and tax planning while others found there is a significant relationship. Thus, previous studies confirm that there are variations and inconsistencies in factors influencing tax planning activities.

Baron and Kenny (1986) indicated that the moderating variable is introduced when there are inconsistent relations between the study variables. Due to no uniformity in the relationship, this subject of research needs further investigation. Thus, in this study, the non-audit services fee is introduced as a moderating variable. One might be said this may only add to another result, but the output will provide a new view in line with the development in this field. A new study may consider new variables that might be unique due to political, territorial, regulations and cultural differences. Considering this, our study aims to propose a new research model on aggressive tax planning behaviour among listed companies in the Malaysian ACE market, which is one of the alternative markets that help small and medium companies be listed in Bursa Malaysia. The discussion will focus on the role of non-audit services fee as based on a thorough investigation of the un-uniformity of the relationship between company characteristics and tax planning might due to other variables. As we mentioned previously, the relationships between company's characteristics and tax planning are inconsistent in previous studies. Such inconsistency creates a gap that needs to be filled. Additionally, the increasing number of companies tax audit resolve from 79,642 cases in 2011 to 178,583 cases in 2017 (Inland Revenue Board of Malaysia, 2017) make this study more significant to be investigated. Therefore, it is important to introduce the moderating variable in this study to examine the factors that contribute to aggressive tax planning activities. Thus, this paper aims to answer the following question: - Does non-audit services fee moderate the relationship between corporate characteristics (size, profitability, leverage, capital intensity, inventory intensity) and aggressive tax planning among companies listed on the ACE Market?

The discussion of this paper was structured as follows; section 2 discusses the theory and past studies as well as hypothesis development, section 3 explains the research framework, section 4 describes the research methodology and the last section concludes the study.

Literature Review

Agency Theory

Agency theory can be defined as a contract between the principal who engages the agent to perform services on their behalf, which involves delegating some decision making authority to the agent (Jensen & Meckling, 1976). Based on the agency theory perspectives, managers may choose whether to engage in more or less tax aggressiveness than in maximizing shareholders' value due to the absence of monitoring and their involvement in day-to-day operations (Desai & Dharmapala, 2006; Rego & Wilson, 2012). Therefore, to solve the information asymmetry between manager and shareholder and also to reduce the agency cost, it is an important responsibility for companies to hire external auditors with a good reputation (Alshawish, Abed, & Hamadallah, 2015). In this situation, the auditor will act as an agent for the shareholders whose interests are considered different to those of the managers of the companies audited (Jensen & Meckling, 1976). Auditor which provides non-audit services such as tax service can help a company in providing effective tax planning.

Non-Audit Services Fee

Prior to 2001, the disclosure of non-audit services fee is not compulsory in Malaysia. However, with the amendment of Bursa Malaysia Listing Requirement Regarding Transparency on 1 June 2001, all listed companies must disclose the amount of non-audit services fee paid to external auditors in their annual reports but this new requirement, with respect to the non-audit fees, does not specify the manner of the disclosure (Refer to Chapter 9 under Paragraph 9.25 of Appendix 9c in Part A number 17 of the Bursa Malaysia Listing Requirement). However, in 2016, the details of the NAS fee must be disclosed if it is significant. Non-audit services were defined as any services provided by an auditor other than audit services which included management advisory services or consulting and also included tax services and accounting advice (Haron, Ismail, Ganesan, & Hamzah, 2016). In addition, Firth (1997) defined non-audit services which include tax consultancy, systems consultancy, management advice, international business advice, human resource management, and financial and investment consultancies.

Other researchers defined non-audit services as fees paid by the companies to the auditor who provided non-audit services (Santos, Cerqueira, & Brandao, 2015); and also any services provided by an auditor other than audit services which included management advisory services, consulting which also included tax services and accounting advice (Haron et al., 2016). However, Choudhary and Koester (2017) defined non-audit service fees as fees paid to audit firms for tax services. Due to the Enron scandals, the Sarbanes-Oxley Act (SOX) has been implemented to help protect investors from fraudulent financial reporting by companies. The passage of SOX imposed strict limitations on the types of non-audit services that audit firms could provide to their audit clients. Thus, the fees paid for non-audit services required to be disclosed separately by companies based on their type, especially for tax services (Hogan & Noga, 2015).

Therefore, tax services play as an important service obtained by companies. It is in line with the study by Ong et al. (2008) cited in Ganesan, Haron, Ismail, and Pitchay (2017) where they found that business such as small and medium enterprise (SME) find additional services from the external accountant regarding six matters as follows; (i) accounting services, (ii) taxation services, (iii) assurance services, (iv) corporate services, (v) corporate finance services and (vi) business consulting services. From all of the services provided, the most priority services sought after by SME is taxation services. This finding was supported by Choudhary and Koester (2017) that companies usually hired tax advisors which is an external tax professional for giving services for them in terms of income tax compliance and planning services. Study also found that the relationship between auditor and SME not just because of the audit services given by the auditor, but the auditor also acted as an advisor in order to support business activities of SME [Companies Commission of Malaysia (CCM), 2017].

Previous study also suggests that companies must recruit qualified employees to be involved in tax planning activities (Laguir, Elbaz, & Laguir, 2015; Mgammal, 2015). This is because companies which are not expert in planning their tax will get a minimum benefit from the strategy use due to the limited knowledge that they have. It was affirmed by Tee, Boadi and Opaku (2016) where they found that 56% of SME in GA West Municipal which not hired tax advisors have limited knowledge about the core tax system and its legalities. From this study, it can be concluded that small and medium companies have limited knowledge about tax matters which is very important to help them minimize their tax burden. Therefore, tax arrangement is an important activity for businesses where most of the companies hired professionals to provide this expertise (The Star, 2017).

Due to that, the non-audit services fee is seen as significant in tax planning. Utilizing actual data from Internal Revenue Services (IRS) for 1,533 firm-years during 2008 and 2009, Klassen et al. (2016) found that auditor-provided tax service has a relationship with tax aggressiveness. Consequently, tax aggressiveness companies were found to pay higher fees for external audit services (Donohoe and Knechel, 2014). The output of this study was then supported by Chyz et al. (2017). They found that companies that paid their auditor for tax services received a reduction in ETR, higher cash tax savings and lower risk than companies that did not involve their auditor for tax services. Also, studies were done by Burggrael et al. (2017); and Saremi, Mohammadi, and Nezhad (2016) found a similar result where non-audit services fee has influenced the level of tax planning in the companies. Although their studies conducted in a different country which is in German and Tehran respectively, but the negative relationship highlighted that the higher the non-audit services fee, the lower the companies' ETR. The finding of this study supports the result found by McGuire, Omer, and Wang (2012) where they found that companies receive simultaneously audit services and tax services from their auditor encourage them to conduct aggressive tax planning behaviour.

Similarly, study in Malaysia also found that auditors provided tax services have a significant relationship with tax planning activities (Hussin & Noor, 2012) indicating that SME with higher auditor provided tax services fee have lower ETR. In this study, the variable of auditor-provided tax services has been measured by using audit fees divided by total assets. Tax services are one of the types of non-audit services. As mention by previous researchers, non-audit services fee includes tax services and become the most services requested by small

and medium companies (Firth, 1997; Ganesan et al., 2017; Haron et al., 2016; Volckaert, 2016).

Previous studies indicated the inconsistent result between company characteristics and ETR. For example, the relationship between company size and ETR, some of these studies found a positive and significant relationship (Mascagni & Mengistu, 2018; Nomura, 2017; Parisi, 2016; Pratama, 2017; Vintilă et al., 2018; Yinka & Uchenna, 2018). Other studies found a negative and significant relationship (Kim & Im, 2017; Savitri, 2017; Wahab et al., 2017). Furthermore, there was an inconsistent result in the previous studies between profitability and ETR. For example, Parisi (2016); Pratama (2017); Savitri (2017) found a negative and significant relationship between profitability and ETR while others found a positive and significant relationship between profitability and ETR (Hadjidema et al., 2016; Kim & Im, 2017; Yinka & Uchenna, 2018).

The relationship between capital intensity and ETR also has a contradict result. Kim and Im (2017); Parisi (2016); and Vintilă et al. (2018) found a positive relationship while Savitri (2017) and Wahab et al. (2017) found a negative relationship. In terms of the relationship between inventory intensity and ETR, Vintilă et al. (2018) and Yinka and Uchenna (2018) found a positive and significant relationship while Hadjidema et al. (2016) and Savitri (2017) found a negative relationship. Also, there is a conflict result between leverage and ETR. The negative relationship was found by previous studies (for example Mascagni & Mengistu, 2018; Nomura, 2017; Yinka & Uchenna, 2018) while, a positive relationship between leverage and ETR was found by Savitri (2017); Wahab et al., (2017). Conversely, the relationship between leverage and ETR was found insignificant by Minnick and Noga (2010) and Vintilă et al. (2018). Therefore, due to this inconsistency, this study proposed the use of non-audit services fee as a moderating variable to investigate the relationship between company characteristics and aggressive tax planning.

Therefore, from the above discussion, we believe that the rigorous tax planning activities conducted by companies are moderate by non-audit services fee. Therefore, we proposed the following hypotheses:

- H1: The relationship between company size and aggressive tax planning among companies listed in the ACE market at Bursa Malaysia is moderated by non-audit services fee.
- H2: The relationship between profitability and aggressive tax planning among companies listed in the ACE market at Bursa Malaysia is moderated by non-audit services fee.
- H3: The relationship between capital intensity and aggressive tax planning among companies listed in the ACE market at Bursa Malaysia is moderated by non-audit services fee.
- H4: The relationship between inventory intensity and aggressive tax planning among companies listed in the ACE market at Bursa Malaysia is moderated by non-audit services fee.
- H5: The relationship between leverage and aggressive tax planning among companies listed in the ACE market at Bursa Malaysia is moderated by non-audit services fee.

Research Framework

Based on the agency theory, this study proposed that by introduce non-audit services fee in the relationship between company characteristics and aggressive tax planning might

reduce the inconsistency in previous literature. The proposed research framework is depicted in Figure 1. In this framework, this study proposed five independent variables, namely company size (SIZE), profitability (ROA), capital intensity (CAPIN), inventory intensity (INVENT) and leverage (LEV). The non-audit services fee (NASF) is a moderating variable, while the dependent variable is aggressive tax planning (ATP).

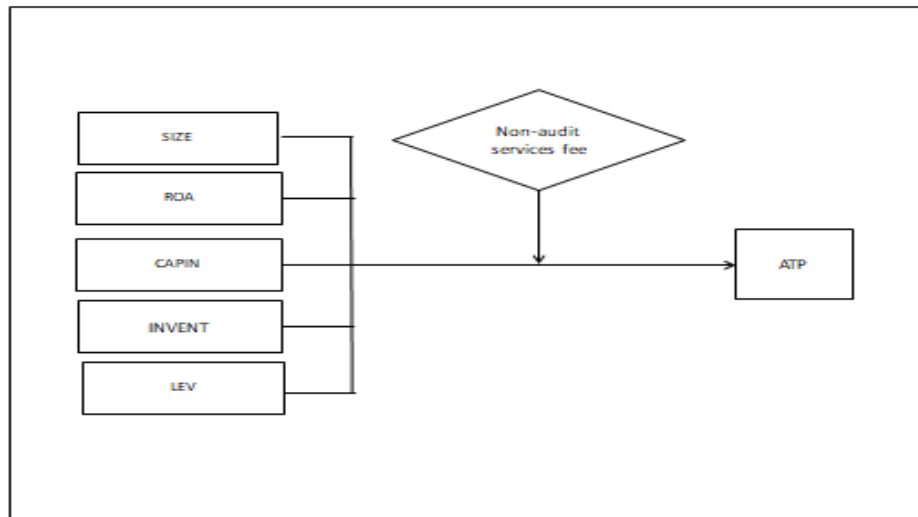


Figure 1: Proposed Research Framework

Research Methodology

The data will be collected from DataStream software and the downloaded annual reports. This study will focus on Malaysian companies listed in the ACE Market of Bursa Malaysia from 2014 to 2018 which exclude the following criteria: 1) companies listed after 2014; 2) finance/insurance/bank/trust companies; 3) companies with missing data; 4) loss-making companies a least in one of the years with negative profit. After the data have been collected, the screening process will be conducted to ensure there is no outlier in the data. Then, the data will be analyzed using STATA Software. At the end of this study, it is expected that the effect of non-audit services fee as an interaction term between the companies' characteristics and aggressive tax planning will be revealed. The equation for this proposed framework is as follows:

$$ATP_{it} = \beta_0 + \beta_1 SIZE_{it} + \beta_2 ROA_{it} + \beta_3 CAPIN_{it} + \beta_4 INVENT_{it} + \beta_5 LEV_{it} + \beta_8 NASF_{it} + \beta_9 SIZE_{it} * NASF_{it} + \beta_{10} ROA_{it} * NASF_{it} + \beta_{11} CAPIN_{it} * NASF_{it} + \beta_{12} INVENT_{it} * NASF_{it} + \beta_{13} LEV_{it} * NASF_{it} + \epsilon_{it}$$

Conclusion

The purpose of this paper was to propose a conceptual framework for examining the influence of non-audit services fee on the relationship between companies' characteristic (size, profitability, capital intensity, inventory intensity, leverage) and aggressive tax planning amongst companies listed in the Malaysian ACE Market. Therefore, to determine whether non-audit services fee influence the relationship, the proposed framework of this study has introduced a non-audit services fee as a moderating variable. Although previous studies have examined the relationship between auditor provided tax services fee and aggressive tax

planning, but there is a limited study that investigates the use of non-audit services fee as a moderating variable.

Thus, the framework presented in this paper may be useful for future financial accounting and taxation research aiming to reveal the importance of non-audit services fee in influencing aggressive tax planning behaviour. Besides, the result of this study can provide new knowledge on tackling aggressive tax planning behaviour among companies where the result can be suggested to use as one of the criteria in choosing an audit sample by the tax authority. This study is also expected to provide more evidence from an emerging market on the relationship between companies' characteristics, non-audit services fee, and aggressive tax planning.

Acknowledgement

We thank the editor and the anonymous reviewers for their helpful comments and suggestion for this paper.

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