The Role of Sustainability Reporting in Shareholder Perception of Tax Avoidance

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ABSTRACT

Objective - the purpose of this study is to examine the moderating effect of sustainability reporting on the relationship between tax avoidance and firm value. This study also examines the moderating effect of sustainability reporting in both environmentally sensitive firms and non-environmentally sensitive firms.
Methodology/Technique - this research uses moderated panel regression with 596 observations and 734 observations for cash ETR and GAAP ETR of firms listed on the Indonesian Stock Exchange between 2014 and 2016. Tax avoidance is measured by both cash ETR and GAAP ETR.
Findings - this paper shows that sustainability reporting moderates the relationship between tax avoidance (GAAP ETR) and firm value. The results show that GAAP ETR has a negative association with firm value in non-environmentally sensitive firms and a positive association with firm value in environmentally sensitive firms. Consequently, the sustainability report only alters the effect of GAAP ETR on firm value in non-environmentally sensitive firms. The results imply that, unlike environmentally sensitive firms, non-environmentally sensitive firms need sustainability reporting to reduce the reputational costs of tax avoidance.
Novelty – how shareholders view tax avoidance remains unclear; research on this topic often fails to produce a uniform result. The present research fills this gap by using the existence of sustainability reporting as proof of companies' ethical motivations to moderate the association of tax avoidance and firm value, which has not been discussed in previous research.

Keywords: Sustainability Reporting; Tax Avoidance; Firm Value; Environmentally Sensitive Industries.

1. Introduction

A strong reputation is widely recognised as the most valuable asset of a firm and firms are consistently aiming to improve their reputation. Firms must consider the possible effect of every single decision on their reputation. A firm's reputation depends on the good or bad business ethics it displays (Cragg, 2002; Treviño, Hartman & Brown, 2012). One of the decisions that reflects bad business ethics is avoidance of tax (Graham et. al., 2014). Tax avoidance is the reduction of explicit taxes (Dyreng, Hanlon & Maydew, 2008; Hanlon & Heitzman, 2010). The reduction of explicit taxes can be the result of responsible tax management (good business ethics) or irresponsible tax management (bad business ethics) (Hardeck & Hertl, 2014). Since stakeholders do not know the source of tax avoidance, they regard tax avoidance as bad business ethics (Tanimura & Okamoto, 2013; Akhtar et. al., 2019).

Tax avoidance reflects bad business ethics because tax avoidance reduces tax revenue which is used for increasing societal welfare (Avi-Yonah, 2006; Mehrotra, 2014). As stakeholders are a part of the society, tax avoidance decreases stakeholders' welfare. Therefore, stakeholders usually respond negatively to tax avoidance activities (Kim, Li & Zhang, 2011; Gallemore, Maydew & Thornock, 2014).

However, research shows that stakeholders can perceive tax avoidance as a positive act (Inger, 2014; Drake, Lusch & Stekelberg, 2019). Because tax avoidance decreases a firms' tax burden, it will also increase the firms' profitability and thereby benefit stakeholders, especially shareholders (Jensen, 2001). In response to these different results, Brooks et. al. (2016) suggest that stakeholders can react positively to tax avoidance if shareholders perceive tax avoidance as a commitment by management to protect their resources without compromising stakeholder needs. Protecting resources without compromising stakeholder needs is known as corporate social responsibility (CSR). As firms can increase stakeholder welfare by conducting corporate social responsibility (CSR) activities; tax avoidance will be regarded as a money saving activity to pay for their CSR activities. In other words, the stakeholders' reaction to tax avoidance depends on how the firms assure stakeholders that they can increase their profitability while engaging in CSR.

One of the ways firms report their CSR activities is through a sustainability report. Sustainability reports show how firms protect their resources to meet present and future needs with environmental protection activities and social empowerment, thus impacting the firms' economic condition (Global Reporting Initiative, 2017). Although there are other types of CSR reporting, sustainability reporting is the most complete and comprehensive voluntary CSR report that requires the person preparing the report to understand the impact of their business operations thoroughly (Du et. al., 2017). As sustainability reporting is voluntary and sometimes difficult to produce, firms that make sustainability reports are companies that have good CSR activities. They make sustainability reports to signal that the firm cares about stakeholder needs (Lys, Naughton & Wang, 2015; Harmadji et. al., 2018). By issuing sustainability reports, tax avoidance will be regarded as result of good business ethics, and will not be considered as detrimental to stakeholders' welfare. The tax savings produced by may therefore be used for CSR activities (Davis et. al., 2016).

Indonesia has unique CSR regulation. Firms listed on the Indonesian Stock Exchange are obliged to incorporate a CSR report in their annual reports but are not required to publish a separate sustainability report (Government of the Republic of Indonesia, 2007). This regulation makes the submission of a separate sustainability report voluntary in Indonesia. Hence, according to Rudyanto and Siregar (2018), the submission of a sustainability report remains limited in Indonesia. From all stakeholders, this paper emphasises shareholders for two reasons. Firstly, shareholders are the most important stakeholders of a firm as a firms' purpose is to maximize shareholders' wealth and balance it with other stakeholders' needs (Man, 2015; Inger & Vansant, 2018). Secondly, shareholders' reaction to information is the most telling since they have a financial interest in the firm and their reaction is reflected in the financial market (Gitman & Zutter, 2013).

Previous research on tax avoidance and firm value has been inconclusive, both internationally as well as within Indonesia. Some research concludes that tax avoidance is positively associated with firm value as companies gain a benefit from tax avoidance (Simone & Stomberg, 2012; Chen et. al., 2014; Pratama, 2018). Other research concludes that tax avoidance is negatively associated with firm value as tax avoidance impacts a companies' reputation (Gallemore, Maydew & Thornock, 2014; Ni Made Ampriyanti & M, 2016; Santana & Rezende, 2016; Baudot et. al., 2019). Among these inconclusive results, other research has concluded that information transparency can decrease the negative association between tax avoidance and firm value (Wang, 2012; Alexander, 2013; Chen et. al., 2014), even in Indonesia (Ilmiani & Sutrisno, 2014). However, the method of information transparency that previous studies employ is all financial and non-financial information transparency. Tax avoidance negatively impacts a companies' reputation because tax avoidance reduces tax revenue that is used to increase social welfare (Bird & Davis-Nozemack, 2018).

As CSR increases social welfare (Kuhlman & Farrington, 2010; Markus & Shimshack, 2012), the most appropriate method of information transparency to increase a companies' reputation is CSR information (Becchetti, Ciciretti & Hasan, 2009; Clacher & Hagendorff, 2012; Kuzey & Uyar, 2017). CSR information signals that companies engage in tax avoidance to obtain tax savings which they then use to engage in CSR activities. As sustainability reporting is the most comprehensive form of CSR reporting, companies need more resources to produce sustainability reports (Rudyanto & Siregar, 2018). In addition, sustainability reporting is voluntary in Indonesia. Companies that do not pay attention to CSR will typically not make sustainability reports (Reddy & Gordon, 2010; Kuzey & Uyar, 2017). Thus, sustainability reporting can be a signal that tax saving is used to do CSR activities (Khurana & Moser, 2013) and can decrease the negative effect of tax avoidance on firm value. To our knowledge, no previous studies have analysed the role of sustainability reporting in reducing the negative effect of tax avoidance on firm value.

The purpose of this research is to obtain empirical evidence in favour of the proposition that the submission of voluntary sustainability reporting acts as an indication of an organization's sustainability which might reduce shareholders' negative reaction to tax avoidance. Before analysing the role of sustainability reporting, this research analyses whether tax avoidance is perceived negatively by shareholders in Indonesia, as a result of the negative effect of tax avoidance on firm value. This research contributes to the relevant literature by emphasising the role of sustainability reporting as a means to ascertain a firms' sustainability. The relationship between CSR to tax avoidance and firm value has been studied previously by Inger and Vansant (2018). While Inger's and Vansant's research (2018) indicates the substitution relationship between tax avoidance and CSR activities on firm value, the present research emphasises the moderating role of sustainability reporting on the association between tax avoidance and firm value. As sustainability reporting is still a voluntary practice in Indonesia, analysing the role of sustainability reporting in Indonesia will improve our understanding of the role of voluntary reporting in altering shareholders' perception of tax avoidance.

This research proceeds as follows. Section 2 discusses the literature review and hypothesis development. Section 3 discusses the research method. Section 4 discusses the results and analysis. Section 5 concludes the paper.

2. Literature Review

The Caux Round Table (a code of ethics that sets consistent and attainable worldwide guidelines for how business can behave responsibly and ethically) defines business ethics as the reconciliation of private interests with the public good (welfare) (Young, 2003). Corporate income tax is one mechanism used to reconcile firms' private interest with the public good (welfare) (Wegener & Labelle, 2017). By paying income tax, firms are contributing to welfare by reallocating part of their wealth to be managed by government for increasing social welfare. Avoiding income tax payment will reduce a firms' contribution to social welfare. Thus, tax avoidance is considered to be a violation of business ethics.

However, the relationship between business ethics and tax avoidance is not that straightforward. Tax avoidance can be a result of responsible tax management or irresponsible tax management (Hardeck & Hertl, 2014). Responsible tax management is the act of paying your fair share of taxes. Responsible tax management will decrease a firms' tax expense but will not harm social welfare. Responsible tax management is a form of good business ethics as this act increases a firms' profitability yet is not detrimental to social welfare. An example of responsible tax management is a real decision that is tax-favoured. Irresponsible tax management is the act of minimizing tax payments by all means possible to increase a firms' profitability, regardless of whether the act will reduce social welfare or not. This act is considered to be bad business ethics. An example of irresponsible tax management is shifting profits to lower tax countries.

The problem is the source of tax avoidance is unknown by stakeholders. Agency theory implies that firms need to make reports to reduce information asymmetry with stakeholders, especially shareholders (Jensen & Meckling, 1976). As firms are obliged to report their tax payment in financial statements, shareholders know the amount of the firms' tax avoidance (Government of the Republic of Indonesia, 2007). However, shareholders' knowledge of firms' tax payment is limited to the tax payment number, not the source of tax avoidance. Without additional information about the source of tax avoidance, shareholders will regard tax avoidance as bad business ethics as tax avoidance is decreasing the firms' contribution to social welfare (Prebble & Prebble, 2010; Raiborn, Massoud & Payne, 2015). Research shows that shareholders' reaction to tax avoidance depends on the firms' information transparency (Chen et. al., 2014; Goh et. al., 2016). Firms need other reports to inform shareholders about the source of tax avoidance.

Signalling theory states that a signal can only be given by firms that are better at differentiating themselves from other companies (Spence, 2011). As firms have to sacrifice their resources to make voluntary reports, voluntary reporting is only made by certain firms (Arniati *et al.*, 2019). Voluntary reports differentiate firms from one another. Therefore, signals can only be given by making voluntary report (Francis, Nanda & Olsson, 2008). Firms which do responsible tax management are firms that care for social welfare (Hardeck & Hertl, 2014). They constrain themselves to do irresponsible acts that can reduce social welfare. To give a signal to shareholders that corporate tax avoidance comes from responsible acts, firms need to make a sustainability report. Sustainability reporting is a comprehensive report that shows a firm's CSR activities. CSR activities are the proof that firms care for social welfare. CSR activities are those that firms do as a form of responsibility for the impact of its decisions and activities on society and the environment which can increase social welfare (ISO, 2010). Although CSR activities may increase social welfare, not all CSR activities are perceived positively by shareholders. Research shows that most firms in Indonesia still do not understand CSR and regard it as purely philanthropic activity (Hendarto & Purwanto, 2012) that wastes firm resources. As they are obliged to make CSR activities and report those activities, firms typically only report a small number of their philanthropic CSR activities. Therefore, shareholders will respond more favourably to firms that understand CSR and do more than philanthropic CSR activities.

Sustainability reporting urges firms to involve stakeholders in formulating the best CSR activities firms can make to meet stakeholders' needs (Ayuso, Ángel Rodríguez & Enric Ricart, 2006; Fraser et. al., 2006). According to the signalling theory, voluntary sustainability reports are produced by firms which understand CSR and have a strong system of CSR activities (Schreck & Raithel, 2018). By making sustainability reports, firms in Indonesia can signal to their shareholders that they undertake good CSR activities, not merely philanthropic activities. Thus, shareholders react positively to sustainability reports. Sustainability reports also provide signals by showing that firms use tax saving money to increase social welfare directly by engaging in CSR activities (Davis et. al., 2016). Research shows that shareholders respond negatively to tax avoidance because it is a form of a CSR violation (Antonetti & Maklan, 2016; DeZoort, Pollard & Schnee, 2018). If firms give additional information on their CSR activities, shareholders will revise their perception on firms' tax avoidance (Wang, 2012; Zeng, 2016).

2.2 Hypothesis Development

In carrying out its operations, firms need to be responsible to a variety of stakeholders who have different interests (Donaldson, Preston & Preston, 1995; Freeman & McVea, 2001). However, all of them agree that firms have to increase social welfare (Donaldson, Preston & Preston, 1995; Zheng, Luo & Maksimov, 2015). Firms contribute to social welfare by paying taxes. Governments allocate taxes paid by firms to increase social welfare. However, paying taxes to the state can only increase social welfare if government really use taxes to pay for the benefit of community (Alm & Torgler, 2011), not to increase the wealth of a certain category of people. If the company does not believe that the government can allocate taxes for the benefit of the community, the company will avoid tax and use its' money for tax avoidance to carry out its' own corporate social responsibility (Bird & Davis-Nozemack, 2018). This is what makes tax avoidance considered positive by shareholders.

Research shows different results in shareholders' perception on tax avoidance. Some researches show that tax avoidance is positively associated with firm value because the avoided tax burden increases shareholder wealth (Inger & Vansant, 2018), especially in firms with good governance (Desai & Dharmapala, 2009). However, if shareholders see tax avoidance as something that risks the firms' sustainability, tax avoidance is negatively associated with firm value (Inger, 2014). Research shows that tax avoidance is negatively associated with firm value (Hanlon & Slemrod, 2009) because it reduces report transparency (Hope, Ma & Thomas, 2013; Donohoe & Robert Knechel, 2014; Balakrishnan, Blouin & Guay, 2019), thereby increasing the risk of a collapse in the company's market price (Kim, Li & Zhang, 2011).

Differences in shareholder perceptions of tax avoidance depend on two things, namely trust in the government and the ethics of tax. A government satisfaction survey conducted by Indo Barometer shows that the level of satisfaction over the government during the period of President Jokowi served (2014-2018) rose above that of the previous period (Supriatin, 2018). The Kompas survey also shows that public satisfaction has continued to increase in the administration of President Jokowi over the past 4 years, especially in the area of social welfare (Jordan, 2018). This shows that the public believes that the government is able to provide welfare through taxes paid by companies so that tax avoidance can hamper sustainability. In relation to ethics of tax, Brooks et. al. (2016) argue that the perception of tax avoidance that was previously considered reasonable and profitable has now become an ethical issue and is no longer acceptable. Tax avoidance is seen by stakeholders as negative (DeZoort, Pollard & Schnee, 2018). Results from Indonesia also show that tax avoidance has an adverse effect on firm value (Chasbiandani & Martani, 2011; Ilmiani & Sutrisno, 2014).

Taken together, the preceding arguments imply that tax avoidance is seen by stakeholders as negative, meaning tax avoidance practices and firm value are likely to be negatively related, leading to the following hypothesis:

Ha1. Tax avoidance is negatively associated with firm value.

Sustainability reporting can decrease the negative association between tax avoidance and firm value in two ways. First, sustainability reporting signals a high level of ethics in the firm. In Indonesia, the sustainability report is a voluntary report that is separate from the annual report (Government of the Republic of Indonesia, 2007). As sustainability reporting is voluntary, firms need more resources to produce sustainability reports. If firms are not confident that their CSR activities are exceptional, they will not make sustainability reports. Sustainability reporting also shows a firms' superior CSR activities which they have to show in voluntary reports. Signalling theory implies that the cost imposed by society to firms that do not honestly report their CSR activities is a sufficient deterrent so that firms which do not have superior CSR performance will be less likely to produce voluntary CSR reports (sustainability reports) (Mahoney et. al., 2013). By engaging in a high level of CSR activities, firms show that they accept their ethical obligations beyond compliance with the law (Gribnau, 2015). Superior CSR performance is a good indicator of a firms' ethics. Tax avoidance is an ethical issue because tax avoidance reduces tax revenue that is used by governments to increase welfare (Avi-Yonah, 2006). If firms engage in tax avoidance whilst voluntarily producing sustainability reports, they are able to reduce the negative perception of their tax avoidance behaviours. This is further supported by the fact that private firms are more efficient in increasing welfare than government (Polishchuk, 2009; McGee, 2010).

Second, sustainability reports show that tax payment reduction is coming from responsible activities. Tax avoidance can stem from responsible acts and irresponsible acts. Tax avoidance from irresponsible acts is regarded by shareholders as bad business ethics (Desai & Dharmapala, 2009; Hanlon & Slemrod, 2009). Even though the economic result of those acts is similar, responsible tax avoidance is seen as clever move as responsible tax avoidance reduces tax liabilities that the firm should not be incuring (Kirchler, Maciejovsky & Schneider, 2003). Previous research shows that responsible tax avoidance is perceived positively by shareholders (Inger, 2014; Drake, Lusch & Stekelberg, 2019). By default, tax avoidance is regarded negatively by shareholders due to the associated reputational risk and tax risk that shareholders will ultimately bear (Gallemore, Maydew & Thornock, 2014; Baudot et. al., 2019). However, firms have other mechanisms to increase social welfare, such as through CSR activities. If shareholders know that tax saving money is used to carry out CSR activities, shareholders will have a positive perception of corporate tax avoidance. On one hand, sustainability reports are the most comprehensive form of CSR reporting (Rudyanto & Siregar, 2018). According to agency theory, sustainability reports reduce information asymmetry between firms and stakeholders (Quick, 2008). Firms can use sustainability reports to inform shareholders that money from tax avoidance is used for CSR activities. By providing additional information about the source of tax avoidance, shareholders may alter their perception of firms' tax avoidance. Previous research shows that information transparency reduces shareholders' negative perception of tax avoidance (Wang, 2012; Chen et. al., 2014).

The focus of this study is the link between the existence of sustainability reports and the reduction of the negative association between tax avoidance and firm value. As such, we formulate the following hypothesis:

Ha2. The negative association between tax avoidance and firm value will be moderated by sustainability reporting.

3. Research Method

This study uses non-financial firms (but not oil and gas or property firms) that were consistently listed on the Indonesian Stock Exchange from 2014 to 2017. Financial firms were excluded because they were under tighter supervision and had different tax structures. Property and oil and gas firms were also excluded because they are subject to final tax so there was no tax expenses reported. The existence of the G4 Global Reporting Initiative Index, which was introduced in 2013, gave firms the choice to make core or comprehensive reports. This choice ensured that the number of sustainability reports in 2014 increased dramatically. As the Indonesian Government adopted a regulation that obliges public firms and financial institutions to produce a sustainability report, starting on January 1, 2019 (Solikhah, 2017), this paper was limited to the year 2017. Year 2018 was eliminated because firms were preparing to make mandatory sustainability reports to publish in 2019. This research uses the year before sustainability reports are mandated because the existence of mandatory sustainability reports do not give signal to shareholders about companies' care of social responsibility. If sustainability reports are mandated, all companies should make sustainability report regardless of their level of social responsibility activities. Signalling theory does not apply in this condition. The research model is as follows:

$$Q_{i,t} = \beta 0 + \beta 1 TAX_{i,t} + \beta 2\, SR_{i,t} + \beta 3\, \mathrm{TAX}_{i,t} * SR_{i,t} + \beta 4 SIZE_{i,t} + \beta 5\, GROWTH_{i,t} + \beta 6\, PPE_{i,t} + \beta 7\, ROA_{i,t} + \beta 8\, LEV_{i,t} + \beta 9\, AGE_{i,t} + \beta 10\, LIQ_{i,t} + e_{i,t} \quad (1)$$

Firm value was measured by Tobin's q as of March 31st as financial statements were released by March 31st at the latest (Inger & Vansant, 2018). As tax avoidance and other control variables data came from financial statements, shareholders' reaction could be seen after the financial statement was released. Tax avoidance was measured by two measurements, cash ETR and GAAP ETR. ETR is a tax avoidance measure that can be interpreted easily even by ordinary people so that busy shareholders can react quickly to differences in ETR and statutory tax rates (DeZoort, Pollard & Schnee, 2018). Other measurements such as the book tax difference or abnormal book tax difference do not reflect the amount of tax that is directly borne or paid by the company (Hanlon & Heitzman, 2010). Cash ETR was measured by dividing the cash tax paid and pre-tax income (Huseynov & Klamm, 2012; McGuire, Omer & Wang, 2012; Dyreng, Hanlon & Maydew, 2018; Drake, Lusch & Stekelberg, 2019) and GAAP ETR is measured by dividing tax expenses and pre-tax income (Dyreng, Hanlon & Maydew, 2010; Huseynov & Klamm, 2012; Graham et. al., 2014; Kubick et. al., 2016). Cash ETR and GAAP ETR have different meanings. Cash ETR represents the real amount of cash tax saving and GAAP ETR represents the tax expense saving. The effect of cash ETR and firm value shows that shareholders pay attention to cash tax saving while the effect of GAAP ETR and firm value shows that shareholders pay attention to tax expense saving. To facilitate interpretation, Cash ETR and GAAP ETR times -1.

This means that the greater the ETR number, the greater the tax avoidance. Sustainability reports were assessed by the presence of sustainability reports issued by the company in that year (1 if any and 0 if none). Because the number of sustainability reports made by Indonesian companies is still limited (Rudyanto & Siregar, 2018) and tax information of Indonesian companies is limited in DataStream, this paper uses the existence of sustainability reports as a moderating variable. The use of sustainability reports will reduce the number of samples and reduce external validity of the results. Sustainability reports issued, for example in 2014, were for firm value in 2014 as seen from the stock price on March 31, 2015.

This research uses firm size, growth, plant assets, profitability, leverage, firm age, and liquidity as control variables. This study used firm size (SIZE) and profitability (ROA) because companies that are large in size and are profitable tend to be more valued by shareholders (Bebchuk, Cohen & Ferrell, 2009). Firm size is measured by a natural logarithm of total asset and profitability is measured by dividing the net income with total asset (Inger & Vansant, 2018). Plant asset (PPE) was used as a control variable as fixed assets indicate productivity (Inger & Vansant, 2018; Schreck & Raithel, 2018). Plant assets are measured by dividing the gross property, plant, and equipment owned with total assets (Inger & Vansant, 2018). Sales growth (GROWTH) was used as a control variable because growth opportunity is positively related to firm value (Inger & Vansant, 2018). Sales growth was measured by reducing this year's sales and last year's sales divided by last year's sales (Chen, Feldmann & Tang, 2015). Leverage, as measured by total debt divided by total assets, is used to control the tax shield because debt provides a tax shield (Ghasempour & bin Md Yusof., 2014). Firm age controls older companies' existing growth (Loderer & Waelchli, 2010; Dienes, Sassen & Fischer, 2016). Liquidity, measured by the amount of cash and short-term investments divided by last year's assets, is used to control the positive impact of liquidity on investors' reactions to news about social responsibility (Xu & Liu, 2018). All data was gathered from Thomson Reuters DataStream and Eikon.

This study uses non-financial, non-oil and gas and non-property companies which were consistently listed on the Indonesian Stock Exchange from 2014 to 2017; had profit in all years; and had complete data on Thomson Reuters. This paper also removed all firms which had more than 100% of CASHETR or GAAPETR. Because previous studies show that the type of industry was very influential on CSR (Patten, 1992; Sweeney & Coughlan, 2008) and firms made sustainability reports because they mimicked their peers in the same industry (Rudyanto, Gani & Rossieta, 2018), this study uses fixed industries in the random effect model. This study uses Thomson Reuters Industry Classification (TRBC). The regression is analysed by STATA 14.

4. Results and Discussion

From the sampling criteria, this study obtained 596 observations and 734 observations for cash ETR and GAAP ETR respectively. The descriptive statistics for the data are set out below.

Table 1. Descriptive Statistics

	CASHETR regression					*GAAPETR regression*				
	n	mean	SD	min	max	n	mean	SD	min	max
Q	596	2.31	5.71	-26.53	66.32	734	2.17	5.20	-1.32	66.32
CASH/GAAP ETR	596	-0.31	0.19	-1.89E-5	-0.99	734	-0.29	0.15	-0.00	-0.95
SR	596	0.09	0.28	0	1	734	0.08	0.27	0	1
GROWTH	596	0.20	1.57	-0.91	33.13	734	0.21	1.60	-0.57	36.31
SIZE (in millions)	596	1.14E+7	2.86E+7	8575	2.91E+7	734	1.05E+7	2.64E+7	8533	2.91E+4

LNSIZE	596	21.86	1.63	15.96	26.4	734	21.78	1.62	15.96	26.40
PPE	596	0.44	0.56	0.00	12.49	734	0.44	0.34	0.01	6.19
ROA	596	0.15	0.25	0.01	4.62	734	0.14	0.21	0.00	4.62
LEV	596	0.25	0.23	0	3.13	734	0.25	0.31	0	5.30
LIQ	596	0.15	0.15	0.00	1.41	734	0.14	0.14	0.00	1.19
LNAGE	596	2.53	0.83	0	4.22	734	2.55	0.83	0	4.22
AGE	596	16.37	10.15	1	68	734	16.56	9.91	1	68

Q: firm value as of March 31, ***CASHETR*** : tax avoidance from cash taxes paid, ***GAAPETR*** : tax avoidance from tax expense, ***SR*** : existence of sustainability report, ***GROWTH*** : company growth, ***SIZE / LNSIZE*** : company size, ***PPE*** : gross fixed assets, ***ROA*** : profitability; ***LEV*** : leverage, ***LIQ*** : liquidity, ***AGE / LNAGE*** : listing age

Table 2 shows the industry classification of samples used in this paper and every industries' number of companies which make sustainability report.

Table 2. Descriptive Statistics based on TRBC Industry Classification

		CASHETR regression				***GAAPETR regression***			
		n	%	n	%	n	%	n	%
Consumer goods industry (NES)		94	15.77			120	16.35		
	0			86	91.49			112	93.33
	1			8	8.51			8	6.67
Infrastructures, Utilities and Transportation (ES)		81	13.59			86	11.72		
	0			70	86.42			76	88.37
	1			11	13.58			10	11.63
Trade, Service, and Investment (NES)		222	37.25			254	34.6		
	0			214	96.4			246	96.85
	1			8	3.6			8	3.15
Basic Industry and Chemicals (ES)		55	9.23			81	11.04		
	0			52	94.55			77	95.06
	1			3	5.45			4	4.94
Mining (ES)		34	5.7			63	8.58		
	0			23	67.65			50	79.37
	1			11	32.35			13	20.63
Agriculture (ES)		34	5.7			43	5.86		
	0			27	79.41			34	79.07
	1			7	20.59			9	20.93
Miscellaneous Industry (NES)		76	12.75			87	11.85		
	0			72	94.74			83	95.4
	1			4	5.26			4	4.6
total		596	100	596	100	734	100	734	100

ES: environmentally sensitive industries (based on Rudyanto and Siregar (2018))**,** ***NES:*** non environmentally sensitive industries***, 0:*** No sustainability report, ***1***: has sustainability report

The number of companies which make a sustainability report is still limited. From 596 and 734 observations, only 52 and 56 observations reveal the submission of a sustainability report (8% on average). Of all types of industries, the industries that issued the most sustainability reports were mining and agriculture. Both of these industries are industries that are sensitive to the environment (Rudyanto & Siregar, 2018). Therefore, for additional analysis, this research will distinguish between environmentally sensitive companies and not-sensitive companies.

Before doing the hypothesis test, this paper completed a classical assumption test. It was found that there is no problem with classical assumption. Pearson Correlation Analysis (untabulated) shows that CASH ETR and GAAP ETR shows are highly correlated (0.4233 with error less than 5%). The results show that CASH ETR and GAAP ETR measure the same latent variable, which is tax avoidance. The Pearson Correlation Analysis also shows that GAAP ETR is negatively correlated with firm value and CASH ETR is not correlated with firm value. The existence of sustainability report is positively correlated with firm value. The interaction between GAAP ETR and sustainability report is positively correlated with firm value.

The regression test results in Table 3 show that tax avoidance is not associated with firm value. It shows that shareholders do not respond to companies' tax avoidance as tax avoidance is a common practice in Indonesia (Andri, 2017). Sustainability reports are appreciated by shareholders, but sustainability reports can only increase shareholders' perception on GAAPETR. CASH ETR and GAAP ETR have different meanings. Where the sustainability report from last year positively responded to tax evasion from the tax actually paid, the shareholders thought that the unpaid tax money was used for CSR (Inger & Vansant, 2018). Where the sustainability report responded positively to tax evasion from the tax expense, the shareholders considered it reasonable because the CSR expense can reduce the firms' tax burden that could increase corporate profits. The reduced GAAP ETR is assumed to come from CSR expenses so that the sustainability report reduces the negative assumption of tax avoidance (Government of the Republic of Indonesia, 2010). This assumption is strengthened by the fact that profitability is positively associated with firm value only for the GAAP ETR equation. These results indicate that shareholders do not believe that cash originating from tax avoidance is used for CSR activities. Research even shows that excess cash can reduce sustainability spending (Boso et. al., 2017).

Table 3. Regression Test Results

$$Q_{i,t} = \beta 0 + \beta 1 TAX_{i,t} + \beta 2\, SR_{i,t} + \beta 3\, \mathrm{TAX}_{i,t} * SR_{i,t} + \beta 4 SIZE_{i,t} + \beta 5\, GROWTH_{i,t} + \beta 6\, PPE_{i,t} + \beta 7\, ROA_{i,t} + \beta 8\, LEV_{i,t} + \beta 9\, AGE_{i,t} + \beta 10\, LIQ_{i,t} + e_{i,t}$$

	CASH ETR		GAAP ETR	
	No moderation	With moderation	No moderation	With moderation
Cons	0.771741	0.760571	2.716036	2.811023
CASHETR	0.097801	0.085436		
GAAPETR			-0.59719	-0.79125
SR	1.248122**	1.278584*	1.364114**	2.083861***
PPE	0.902002	0.903584	1.315899	1.323067
ROA	3.959199	3.961638	7.309091**	7.335297**
LEV	-4.35647*	-4.35959*	-1.40757**	-1.40679**
LNAGE	-0.77841**	-0.77762**	-0.39351	-0.39952
LNSIZE	0.257868	0.258088	0.052083	0.045278
GROWTH	-0.40784	-0.40858	-1.07638*	-1.07681*
SR*CASHETR		0.101154		
SR*GAAPETR				2.270195**
Wald Chi2	48.92	49.19	30.46	33.04
Prob>Chi2	0.00000	0.00000	0.0066	0.0046

Adj R Square	0.1635	0.1637	0.2362	0.2366

Q: firm value as of March 31, ***CASHETR***: tax avoidance from cash taxes paid, ***GAAPETR***: tax avoidance from tax expense, ***SR***: existence of sustainability report, ***GROWTH***: company growth, ***SIZE / LNSIZE*** : company size, ***PPE*** : gross fixed assets, ***ROA*** : profitability; ***LEV*** : leverage, ***LIQ*** : liquidity, ***AGE / LNAGE*** : listing age. *,**,***= significant in 10%,5%,1%

As the Pearson Correlation Analysis reveal different result, this research does further regression test by dividing the samples into two industry classifications, which are environmentally sensitive industries and nonenvironmentally sensitive industries. Previous research shows that shareholders' response to corporate tax avoidance and CSR depends on industry classification, especially between environmentally sensitive firms and non-environmentally sensitive industries (Hall & Rieck, 1998; Reverte, 2012, 2016; Simone & Stomberg, 2012). As the majority of the sample are environmentally sensitive firms, this study distinguishes between environmentally sensitive firms and non-environmentally sensitive firms. The results of this analysis are tabulated in Table 4. The results show that shareholders appreciate tax avoidance undertaken by sensitive firms but do not appreciate tax avoidance by non-sensitive firms. Therefore, sustainability reports can only mitigate the negative perception on tax avoidance in non-sensitive firms. The association between tax avoidance and firm value is only apparent in GAAP ETR. The results show that shareholders pay more attention to tax expenses and their effect on earnings rather than cash tax paid. Environmentally sensitive firms have good CSR activities and are close to stakeholders, so tax avoidance is assumed to come from CSR expense. They also do not need sustainability reports to improve public perception of tax avoidance. Conversely, non-sensitive firms have not been able to demonstrate their sustainability activities without making a sustainability report, so the sustainability report mitigates the negative relationship between tax avoidance and firm value. The sensitivity test is conducted by changing the firm value date to December 31 and the results are the same (untabulated).

Table 4. Regression Test Result Based on Sensitive and Non sensitive Firms

	CASH ETR		GAAP ETR	
	ENV	NONENV	ENV	NONENV
Cons	-1.04291	-0.54532	-1.83686	1.132477
CASHETR	0.08947	-0.5642		
GAAPETR			1.046397**	-2.52418*
SR	-0.16589	1.996066*	-0.46548	3.098477***
PPE	-0.34556	-0.53026	0.144849	0.075711
ROA	2.20058*	8.866206	0.479224	16.57862**
LEV	-1.72475***	-6.40804	-2.07419***	-2.9095***
LNAGE	-0.42323**	-0.72205*	-0.29199*	-0.27951
LNSIZE	0.166735*	0.225484	0.201428***	-0.02291
GROWTH	-0.56416*	-0.12268	-0.08365	0.046916
SR*CASHETR	0.160795	1.399712		
SR*GAAPETR			-0.6788	4.158478*
Wald Chi2	18.72	43.08	22.84	25.47
Prob>Chi2	0.0277	0	0.0066	0.0025
Adjusted R Square	0.3674	0.2246	0.3185	0.3846

ENV: environmentally-sensitive firms, ***NONENV:*** non environmentally-sensitive firms ***Q***: firm value as of March 31, ***CASHETR*** : tax avoidance from cash taxes paid, ***GAAPETR*** : tax avoidance from tax expense, ***SR*** : existence of sustainability report, ***GROWTH*** : company growth, ***SIZE / LNSIZE*** : company size, ***PPE*** : gross fixed assets, ***ROA*** : profitability; ***LEV*** : leverage, ***LIQ*** : liquidity, ***AGE / LNAGE*** : listing age. *,**,***= significant in 10%,5%,1%

As the decision to make a sustainability report and the decision to avoid tax should be in the same period (ex post), this study also tests using one year before the published year of the sustainability report. For example, tax avoidance in 2014 is tested with sustainability report published in 2015. It is assumed that the decision to make a sustainability report is done one year before, together with tax reduction decisions. The results are unchanged except that the sustainability report is not able to mitigate the relationship of tax avoidance to the value of the company. This is because at the time of issuing financial statements, shareholders did not know whether the company would make a sustainability report or not in that year because it had not been issued. By using the previous year's sustainability report issued in that year, shareholders feel confident that the company is responsible and ethical (ex-ante) so that the effect of tax avoidance conducted that year on the firm value can be mitigated.

Table 5. Regression Test Result for Sustainability Report One Year Before

	CASH ETR	GAAP ETR
Cons	1.0287	2.3366
CASHETR	0.1773215	
GAAPETR		-0.53522
SR	1.547653***	1.233185**
PPE	0.8711712	1.303301*
ROA	3.831969	7.226062***
LEV	-4.382949**	-1.42007***
LNAGE	-0.767315**	-0.37146*
LNSIZE	0.2438703	0.06693
GROWTH	-0.3861693	-1.06123**
SR*CASHETR	-0.5188352	
SR*GAAPETR		-0.91081
Wald Chi2	50.35	30.34
Prob>Chi2	0.00000	0.0108
Adjusted R Square	0.1731	0.245

Q: firm value as of March 31, ***CASHETR*** : tax avoidance from cash taxes paid, ***GAAPETR*** : tax avoidance from tax expense, ***SR*** : existence of sustainability report, ***GROWTH*** : company growth, ***SIZE / LNSIZE*** : company size, ***PPE*** : gross fixed assets, ***ROA*** : profitability; ***LEV*** : leverage, ***LIQ*** : liquidity, ***AGE / LNAGE*** : listing age.
*,**,***= significant in 10%,5%,1%

5. Conclusion

Motivated by POJK regulation No. 51 / POJK.03 / 2017 regarding the obligation to make sustainability reports for public firms and financial institutions starting on January 1, 2019, this study aims to demonstrate that sustainability reports are useful for companies to reduce shareholders’ negative perception of tax avoidance. The Indonesian context is very much in accordance with this research because sustainability reports in Indonesia are still voluntary, so the date for making mandatory sustainability reports is not clear. This makes shareholders see whether the sustainability reports were made in that year (ex-ante) and can only decide how to respond to corporate tax avoidance.

The results show that tax avoidance has no association with firm value. Shareholders in Indonesia do not respond to tax avoidance, both cash tax avoidance and GAAP tax avoidance (tax expense avoidance). Because tax avoidance has no association with firm value, sustainability reporting has no moderating role. This study also separates the samples into two industry classification, which are environmentally sensitive industries and non-environmentally sensitive industries. The results show that GAAP ETR has a positive association with firm value in environmentally sensitive industries and GAAP ETR has a negative association with firm value in non-environmentally sensitive industries. Thus, the role of sustainability reports is apparent in non-environmentally sensitive industries only. Environmentally sensitive industries do not need sustainability reports because tax avoidance is perceived positively by shareholders. Non-environmentally sensitive industries need sustainability reports to decrease shareholders' negative perception of tax avoidance. These results support agency theory and signalling theory. Voluntary sustainability reporting can reduce information asymmetry about CSR information and signal to shareholders that tax saving is used to finance CSR related activities.

The results of this study may have practical implications. As shareholders pay more attention to GAAP tax avoidance, companies need to reduce aggressive tax planning which reduces tax expenses. If tax expenses reduce because of CSR, companies in non-sensitive industries must produce sustainability reports to inform shareholders that the reduced tax expenses are a result of CSR activities. Sustainability reports can reduce shareholders' negative perception of tax avoidance. As sustainability reporting is soon to be mandatory, the role of mandatory sustainability reporting in mitigating shareholder's negative perception on tax avoidance is unknown. Therefore, non-sensitive firms should find a way to show their concern for sustainability issues without depending on the mere existence of a sustainability report. For example, firms can increase the quality of sustainability reporting by disclosing more information on CSR activities (Ching, Gerab & Toste, 2017; Rudyanto & Siregar, 2018) or receiving assurance for their sustainability reports (Kolk & Perego, 2010; Alon & Vidovic, 2015). Future research is needed to analyse the role of sustainability report quality on the negative association between tax avoidance and firm value.

This research is not without limitations. The decision to make a sustainability report is an endogenous variable so that future research can identify instrumental variables to overcome this endogeneity. This research has used the previous year's sustainability reports, but this is not enough to overcome the endogeneity problem. This research is also limited only to profitable firms so it cannot be generalized to companies whose profit before tax is negative. In addition, to determine shareholder perceptions, behavioural research by interview or questionnaire may enrich the results of this study.

Nonetheless, this research contributes to taxation and CSR research. This research shows the usefulness of sustainability reporting in mitigating the negative perception of tax avoidance in non-environmentally sensitive firms. The sustainability reports examined here were produced voluntarily. The impact of mandatory sustainability reporting is still unknown; this question can only be answered once the regulation has come into force.

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