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CORPORATE GOVERNANCE AND TAX AVOIDANCE IN THE LISTED COMPANIES OF BANGLADESH: A CONCEPTUAL OVERVIEW

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Abstract: *Tax revenue provides as a basis for making government budget and long-term development plan of an economy. In addition, corporate tax revenue has an association with the social wellbeing initiatives to be undertaken by the government. However, agency theory argues that corporate managers could take on tax avoidance (TA) initiatives for their opportunistic rent extractions from the benefits that come up through tax avoidance. Moreover, tax avoidance is a sustainability problem since it does not discharge morale and communal demands of the society. The agency costs and irresponsible social behaviour that come up from corporate tax avoidance (CTA) have an adverse association to firm value. Tax avoidance is not a type of breach of the law; it takes the benefit from a legal vacuum i.e. the formal mistreatment of the law. Corporate managers could undertake tax avoidance initiatives through taking benefit from the loopholes of existing tax laws. Therefore, corporate governance mechanisms (CGMs) could play an important function to shape TA behaviour of the firm. This paper attempts to integrate relevant empirical researches and literature to expand the intended potentials of CGMs to limit the TA behaviour of the listed firms in Bangladesh. Moreover, the paper will endow with theoretical base for empirical study to extend agency theory justification on CGMs and CTA relationship. Furthermore, as existing literature presents inconsistent and fewer evidence that effort to look at the effect of CGMs on CTA, this paper proposes and shows promising propositions for potential empirical investigation.*

Keywords: *Corporate Governance, Corporate Tax Avoidance, Agency Theory*

Introduction

Tax avoidance corresponds to a company's planned attempts for decreasing tax liabilities using either lawful or unlawful ways or policies (Lee et al., 2015). The learning about CTA is rising since novel features are attached increasingly due to multidisciplinary character of the topic (Salhi et al., 2019). Evasion of tax is a type of breach of the law, but TA is the taking advantage from a legal vacuum i.e. formal mistreatment of the law where exemptions and incentives are lawful (Jamei, 2017). Tax avoidance comprises tax planning actions which are lawful or which could drop into grey region, as well as actions which are against the law (Chen et al., 2010). There remains opportunism for the corporate management in being tax aggressive (Wang et al., 2014). Managers might employ aggressiveness in taxes like a mask only for their personal advantage (Luo & Wei, 2012; Luo & Du, 2014).

Business firms should have profit motive but they also have some accountabilities to the people and surroundings where does it function. The deficit in corporate tax revenue generates a major and probably irrecoverable harm to the general public (Williams, 2007). Hence, corporate tax antagonism could be believed irresponsible in a social context (Schön, 2008). In societal point of view, disbursement of corporate taxes makes sure the funding of public supplies (Freise et al., 2008). Therefore, a firm's tax aggressive strategies might have an adverse consequence on the community (Landolf, 2006). More socially accountable corporations are less to be expected to attach in corporate tax aggressiveness (Lanis & Richardson, 2012).

Agency theory argues that costs of tax avoidance, for instance, shareholders' uncertainty once releasing its news, legal humiliations, getting fines and other associated expenses are more significant than payback of tax avoidance actions (Akbari et al., 2019). Moreover, reputational threats take place when tax avoidance activities are identified and released to the common people (Christensen et al., 2014). Furthermore, tax avoidance is a risky movement imposing significant costs on companies and managers (Rego & Wilson, 2012). In addition, CTA could make a communal protest (Christensen et al., 2014).

Tax avoidance disregards the moral expectation of the stakeholders from the business. Corporations and societies are mutually dependent, and thus, companies should provide a broad societal purpose than merely serving the shareholders' interests (Capasso et al., 2015; Miles, 2017). Tax avoidance has an effect on the environmental, societal and economic facets of the society (Bird & Davis-Nozemack, 2018). Moreover, tax revenue has a vast significance to the government, as well as the community (Kiesewetter & Manthey, 2017).

However, superior corporate governance depends mainly on trade-off amid a variety of clashing interest groups such as government, common people, shareholders, creditors, and workforce of the business (Rouf & Akhtaruddin, 2020). Corporate governance setting interacts to sketch out tax reporting as well as TA behaviour of firms (Desai & Dharmapala, 2006). From the agency theory view, corporate governance is linked to CTA (Huseynov et al., 2017; Salhi et al., 2019).

Corporate tax avoidance has become the most difficult problem of our generation since TA corresponds to a severe loss of income to the government (Hundal, 2011). Developing countries are confronted by societal, political as well as secretarial complications in instituting a well-established public funding system, and thus, emergent economies are in jeopardy of tax evasion along with TA initiatives from individual tax payers and companies (Kadir, 2018). Many emergent countries have failed to collect tax revenue necessary for funding civic services (Fuest & Riedel, 2009). This failure to raise the necessary tax revenue has always been blamed on tax avoidance and tax evasion (Kadir, 2018).

Problem Statement

Developing countries has a greater reliance on tax revenues for the reason that it has fewer well-built establishments and basis for financial support (Jenkins & Newell, 2013). In an emerging economy like Bangladesh, the major source of governmental income is tax revenues, and government carry out most of the public welfare activities from the tax revenue. Therefore, if business firms avoid tax, it would affect the social welfare initiatives to be undertaken by the government. However, firms have accountability to obey the rules to moral and communal desires from the general public, and tax revenue is a vital component of working of the government, hence, tax avoidance is considered as a sustainability problem (Bird & Davis-Nozemack, 2018).

In Bangladesh, the tax revenue receipts as percent of gross domestic product (GDP) was 10.28% for the FYR 2016-17 (Bangladesh Economic Review, 2018), whereas the average percentage of tax revenue to GDP over the world was 15.126% in the year 2017 (The World Bank, 2020). The development initiatives are held back in Bangladesh as a consequence of low revenue collection, which is the effect of high propensity of tax evasion as well as tax avoidance by individual taxpayers and companies of the state (Shakila, 2019). However, tax revenue is the major source of finance to meet up public spending by the Bangladesh government. Accordingly, its key source of income in national budget is the tax revenues (approximately 90%) collected from the individuals and institutions (Bangladesh National Budget, FY 2019-2020).

Over the last few years the national budget of Bangladesh has been showing deficit balance, moreover, the government has failed to collect the budgeted tax revenues both from the individual as well as organizational sources (Ministry of Finance, Bangladesh, 2020). However, Bangladesh government is trying to overcome this unevenness between budgeted and collected tax revenue. Bangladesh government has set to improve revenue mobilization mark to 14.10 percent of GDP in the closing year of 7th five-year plan, 2020, which appears out of reach with the current improvement and past experiences throughout the year 2000 to 2016 (Hossain, 2017).

Tax revenues play an imperative role to the national and economic progress of a country. Presently, multiple corporate tax rates are in existence for diverse corporate sectors in Bangladesh. Devereux et al. (2008) found that countries struggle over the statutory as well as effective average tax rate. Effective tax rates are persuaded by firms' financial and operational features and role of the corporate governance characteristics (Miah, 2016).

Tax avoidance actions support opportunistic managerial behaviour (Wang et al., 2014). Hence, there is a significant association between TA and governance system (Huseynov et al., 2017). Better CG decreases information asymmetry and CTA, despite the foundation of a country's legal system (Salhi et al., 2019). Capital market to facilitate good governance with smooth flow of information is fragile in Bangladesh, and companies have tiny motivation for listing on the stock exchange (Rouf & Akhtaruddin, 2020). In the light of agency theory, in Bangladesh, where there is a lack of good governance, corporate managers can utilize tax avoidance strategy to extract their personal gains and not for the interest of shareholders.

Literature Review

In recent years, empirical investigation on corporate tax avoidance has been increased very rapidly, and tax avoidance related academic studies have come with soaring public attention in the topic (Kovermann & Velte, 2019). This paper is an effort to extend the TA literature by inspecting the rapport of CGMs with TA in the context of an emerging economy like Bangladesh. This section reviews some selected extant studies regarding CG and TA.

Tax avoidance is intimately related to corporate governance due to agency cost implications (Chen et al., 2016). Further, other indirect consequences of TA comprise unclear economic information (Balakrishnan et al., 2019), rising chances of earnings manipulation (Frank et al., 2009), as well as increasing cost of investment (Lambert et al., 2007). In addition, tax avoidance could be multifaceted and obscure, and could probably agree to managerial opportunistic actions (Minnick & Noga, 2010). In agency theory approach, the advantages of tax avoidance are considered together with the non-financial costs incurred by such activities including time, labours and resources put away for tax avoidance strategies, for instance, restatement of financial reports, along with the possibility of legal action by the law enforcement authorities (Chen et al., 2015). Aggressive tax planning gives the pretexts for managers to manipulate earnings, hold up corporate private news, and craft financial reports complex to external investors, all of which amplify information asymmetry and corporate opacity (Feng et al., 2019). However, board of directors act as an important mechanism in the alleviation of the agency conflicts caused by the partition of the managing and controlling facets of the decision-making procedure (Fama & Jensen, 1983a, 1983b).

Director attendance improves investors' safeguard via decreasing tunnelling by controlling shareholders (Liu et al., 2016). Similarly, director attendance lessens opportunistic earnings manipulation (Sarkar et al., 2008). Moreover, past studies also found that lower board meeting attendance is connected to larger managerial opportunism (Min & Verhoeven, 2013; Liu et al., 2016). Barros and Sarmento (2020) found that an upper level of board meeting presence lead to lesser TA. Furthermore, higher presence of directors at board as well as meetings advances the supervising and guiding role of corporate board (Nowland & Simon, 2018; Nowland, 2019). However, directors' attendance in board meeting is considerably lower in emerging markets (Nowland, 2019). Very limited number of studies has linked board meeting attendance with tax avoidance (Barros & Sarmento, 2020). Giving emphasis on board meeting attendance and its association with corporate tax avoidance in the perspective of an emergent country like Bangladesh is one of the inspirations of the present study.

The presence of an audit committee within a company is expected to be capable to provide insight on issues regarding financial policies, accounting as well as internal control of a company (Purba, 2019). Moreover, an audit committee could also decrease earnings management (Lin & Hwang, 2010), reduce the chance of restatement (Lary & Taylor, 2012), as well as dislike to allow deception or antagonistic accounting (Abbott et al., 2000). Financial and tax-risk allied issues are normally examined by the audit committee prior to bring to the board's concentration (Ernst & Young LLP, 2014). However, some extant studies have found negative association (e.g. Aliani & Zarai, 2012; Sandy & Lukviarman, 2015; Tandean &

Winnie, 2016) of audit committee independence on TA; whereas some other investigations have found an insignificant effect (e.g. Kurniasih et al., 2017; Kadir, 2018; Purba, 2019; Ratnawati et al., 2019) of audit committee independence on TA. Therefore, the effect of audit committee independence on TA is not conclusive yet.

The presence of gender-diverse board in decision-making procedure permits a company to formulate moral strategy, bearing in mind the benefits of diverse stakeholders, along with lessens the tax aggressiveness of a firm (Vacca et al., 2020). In addition, gender-diverse board is more vigilant about possible reputation threats linked to aggressive tax planning, and as a consequence, board gender diversity has negative association to TA (Chen et al., 2017). Existence of female members on the corporate boards decreases the initiatives of TA (Kastlunger et al., 2010; Richardson et al., 2016a). Though most of the recent tax researches (e.g. Hoseini & Gerayli, 2018; Riguen & Kachouri, 2019) have found negative liaison of TA with board gender diversity, Aliani and Zarai (2012) have found that there is no significant association of gender-diverse board with the decision-making procedure in taking up a tax strategy, moreover, having more female on corporate boards might not necessary be effectual in restraining tax avoidance actions. Thus, existing literature on the association of board gender diversity with TA could be extended to get a consistent result.

Board independence defends the interest of minority shareholders, as well as decrease agency conflicts (Jensen & Meckling, 1976; Shleifer & Vishny, 1997). Furthermore, the board experience and board independence is negatively associated with agency conflict (Badu & Appiah, 2017; Wu et al., 2019). Therefore, board independence could pressure the corporate tax avoidance actions as it is one of the important mechanisms to alleviate the agency conflicts. The larger percentage of external members on the board is negatively linked to tax avoidance (Salhi et al., 2019). There is a positive relationship of board independence with low levels of TA, whereas a negative relation of board independence to more excessive levels of TA (Armstrong et al., 2015). However, board independence lessens TA (Minnick & Noga, 2010). Contrarily, Richardson et al. (2016b) found board independence raise tax avoidance. Hence, the consequence of board independence on TA is not conclusive yet.

Amplification in managerial ownership aids to tie the wellbeing of insiders with investors, as well as making superior decision together with upper firm value (Ruan et al., 2011). Managerial ownership acts like a corporate governance mechanism, and decreases the agency conflicts. Therefore, managerial ownership could influence the tax avoidance behaviour of the firms. Furthermore, equity-based compensation persuades corporate managers to increase TA (Xian et al., 2015). Jamei (2017) found that the relationship of managerial ownership to TA is not significant. However, some of the extant studies (e.g. Mills & Newberry, 2001; Frank et al., 2009) have found positive link of managerial ownership to TA, whereas, some other researches (e.g. Xian et al., 2015; Cabello et al., 2019) have found negative link of TA to managerial ownership. Hence, the association of managerial ownership with tax avoidance is inconclusive yet.

Research Gap

To inhibit the CTA practices in Bangladesh, determinant factors of CTA should be investigated. Good governance lessens the inspiration of managers for tax avoidance actions (Desai & Dharmapala, 2009). Moreover, agency theory argues that superior corporate governance

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confines managerial opportunism, and thus, managers could be dispirited to tax avoidance, and stay away from tax avoidance. On the basis of agency theory, extant evidences, and existing code of corporate governance in Bangladesh, the present paper effort to look at the relationship of CGMs with CTA since it is hoped would be helpful for Bangladesh government in its force to seal the tax gap, boost compliance, and collect more revenue.

There is a dearth of empirical researches on TA, specially, from the South Asian region. In particular, very limited number of tax researches is found in the perspective of Bangladeshi listed firms. Moreover, extant researches on tax avoidance to the context of other countries have shown inconclusive result on the relationship between CG and TA. The present paper attempts to evaluate the association of CGMs with TA from the agency theory standpoint to the context of an emerging economy like Bangladesh. Furthermore, the paper will contribute to accomplish a conclusive idea on the association between CGMs and CTA. It is also among the first initiative to make a conceptual background for future empirical investigation focussing on the usefulness of CGMs to restrain CTA, subsequent to the latest reformation of Corporate Governance Code by the Bangladesh Securities and Exchange Commission (BSEC) in the year 2018.

Research Question And Objective

In this paper, we have looked at the determinants of TA with a focus on CGMs. The objective of the paper is to inspect the relationship between CGMs (i.e. board meeting attendance, audit committee independence, board independence, board gender diversity, and managerial ownership) and TA.

To attain the above research objective, the research question of the paper is ‘Is there any association between CGMs and TA?’

Significance Of The Study

The present paper is an initiative to provide knowledge to understand how the agency theory could be applied to build up a theoretical framework for explaining the link between CGMs and TA in the context of an emerging economy like Bangladesh. The projected empirical investigation on tax avoidance following this paper could be used not only to endow with a gap analysis between current status and ideal outcome but can also be employed to help out in producing an outline for future progresses. Moreover, the projected empirical investigation would provide information in relation to the efficacy of CGMs in the perspective of listed companies in Bangladesh which will facilitate investors to forecast potential firm performance and help shareholders to hold down the opportunistic behaviour of the corporate managers.

Corporate managers could utilize the outcomes of this paper to better organize and direct their work efforts on tax management. Besides, the propositions of the paper might prove helpful to tax adviser and professional bodies that are involved with the task of making tax planning for the corporate bodies. In summary, it is hoped that the paper would help policy makers and practitioners to understand and trim down tax avoidance initiatives of the listed firms in Bangladesh. Furthermore, the paper would motivate the interest and attention intended for future investigational study on CTA in the perspective of Bangladesh.

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Underlying Theory

From the perspective of agency theory, every person is self-centred, and the interest of principal and agent on a business may not agree (Neifar & Utz, 2019). However, tax avoidance generates managerial opportunism (Wang et al., 2014). Furthermore, tax avoidance is a transaction as well, and subsequently, gives rise to agency costs (Cabello, et al., 2019). Agency theory argues that good corporate governance limits managerial opportunism, and thus, in the perspective of agency theory, CG is linked with CTA (Salhi et al., 2019). Moreover, the agency theory approach, besides taking into consideration the benefits of tax avoidance, thinks about the costs occurred by such initiatives (Chen et al., 2015). In summary, firm-level tax avoidance is connected with agency conflicts (Chyz & White, 2014).

Directors' absence in board meeting creates weak monitoring of the management as well as poor performance of the firm (Nowland & Simon, 2018). In addition, an audit committee ought to be independent from management to accomplish its monitoring responsibility and defend shareholders' interests (Deslandes et al., 2020). From agency theory perspective, a more diverse a board is, it will show the way to superior monitoring of management for the reason that board diversity leads to enlarge board independence (Carter et al., 2007). Furthermore, women board members usually poise multiple issues in their decisions, as well as think about a broader range of stakeholders' benefits (Konrad & Kramer, 2006). Therefore, in line with the agency theory, companies with gender-diverse boards are expected to have a higher information lucidity level (Riguen & Kachouri, 2019). Moreover, managerial ownership could reduce agency conflicts and tax avoidance initiatives. Thus, corporate governance mechanisms could reduce agency conflicts through better monitoring and controlling on the managerial actions and restraining the managerial opportunism, and hence, CG mechanisms have an impact on corporate tax avoidance.

Conceptual Model

Traditionally, conceptual papers do not use empirical data to reach conclusion, however, engage the incorporation and amalgamation of extant evidences from formerly developed concepts as well as theories (Hirschheim, 2008). Accordingly, this conceptual paper is prepared on the basis of agency theory and findings from the past conceptual as well as empirical studies. Moreover, after taking into consideration the existing code of CG in Bangladesh, to find out the answer of the research question and to reach the objective of the paper, our conjecture is that board meeting attendance, audit committee independence, board independence, board gender diversity and managerial ownership are the most influential mechanisms which could restrain the corporate tax avoidance in Bangladesh.

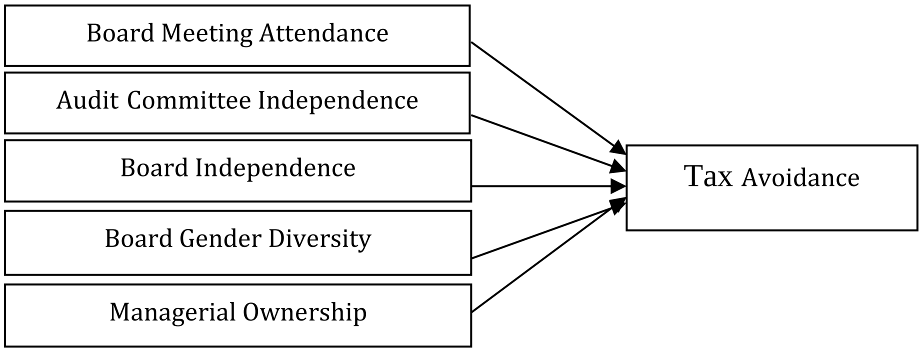

Figure 1: Conceptual Model

Proposition Development

We have developed five propositions from the above conceptual model, which are discussed below.

Board Meeting Attendance and Tax Avoidance

Lower presence of directors in board meeting is associated with inefficient monitoring along with poor company performance (Min & Verhoeven, 2013). Furthermore, an upper level of board meeting presence reduces TA (Barros & Sarmento, 2020). Besides, prior studies have recognized that lesser director attendance is linked to higher managerial opportunism with the shape of greater earnings management, along with higher tunnelling of company assets (Sarkar et al., 2008; Liu et al., 2016). Moreover, agency theory argues that board meeting attendance improve the capability of board directors concerning well-built watching on the managerial actions and dropping the managerial opportunism. Therefore, board meeting attendance could reduce the agency conflicts, as well as CTA initiatives. From the above discussion and with the support of agency theory our assumption is that board meeting attendance decreases corporate tax avoidance.

Proposition (a): Board meeting attendance has negative association with tax avoidance.

Audit Committee Independence and Tax Avoidance

An audit committee could be helpful in serving the board to provide sufficient concentration for managing tax-risk for the reason that financial as well as risk-allied affairs are frequently studied in the audit committee before passing to the board's concentration (Ernst & Young LLP, 2014). Moreover, independent directors lessen the antagonistic tax planning (Lanis & Richardson, 2011; Aliani & Zarai, 2012). In addition, audit committee independence boosts economic information screening that is needed for managing tax-risk, as non-independent members of the audit committee might desire to reduce taxes to raise net earnings as well as stock prices (Deslandes et al., 2020). Besides these, agency theory argues that audit committee independence reinforces the corporate governance, and thus, reduces the agency conflicts, which in turn decreases managerial opportunism and CTA. On the basis of above discussion, in the light of agency theory our assumption is that audit committee independence is negatively linked to TA.

Proposition (b): Audit committee independence has negative association with tax avoidance.

Board Independence and Tax Avoidance

Agency theorists advocates for more independent directors in the board to discharge their responsibilities effectively (Dey, 2008). In case of weaker investor protection, monitoring by external directors is more essential, leading to more significant results for superior board independence (Klapper & Love, 2004; Jaggi et al., 2009). However, board independence has negative association with TA (Minnick & Noga, 2010). Moreover, agency theory argues that an independent board is capable to efficiently bring into line managerial action with shareholders' interest through exact monitoring and proficient contracting (Li & Roberts, 2018). Furthermore, according to agency theory, managers are self-centred, and independent directors attempt like an effectual monitoring instrument to take care of shareholders' interests, bring under control the self-interest actions of the management, and restrain the agency problem (Shan, 2013). Thus, on the basis of agency theory, board independence hold backs managers

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from extracting opportunistic gains through tax avoidance. Our proposition is that board independence is inversely associated with tax avoidance.

Proposition (c): Board independence has negative association with tax avoidance.

Board Gender Diversity and Tax Avoidance

The need to incorporate more women in corporate boards has been accentuated as they have initiated to fetch a new viewpoint to board deliberations (Smith et al., 2006; Duc & Thuy, 2013). Moreover, gender-diverse board reduces the agency conflicts through decreasing information asymmetry, rising information transparency level (Riguen & Kachouri, 2019) and confirming the lucidity of financial reports (Srinidhi et al., 2011). The board comprising of female members is more to be expected to encourage honesty, elevated ethical values and independent way of thinking which enhance the lucidity level of the board, as well as trustworthiness within the board (Lanis et al., 2015). Attendance of female member on corporate boards is capable to restrain managerial opportunistic behaviours, as well as to stop managers' fake munificence and intention to stay away from tax to increase shareholders' wealth (Adams & Ferreira, 2009). In addition, woman directors perform their best to poise the responsible deeds of companies to society as well as investors (Lanis et al., 2015). However, gender-diverse board is further conscious regarding probable reputation threats linked to TA (Chen et al., 2017). On the basis of agency theory and above discussion, our proposition is that gender-diverse board is negatively linked to tax avoidance.

Proposition (d): Board gender diversity has negative association with tax avoidance.

Managerial Ownership and Tax Avoidance

Managerial ownership is viewed as an attribute of corporate governance mechanisms (Bolton, 2014). Managerial ownership is the percentage of shares hold by the members of the corporate board (Jamei, 2017). Owners are expected to be more risk averse, hence, reluctant to invest in risky plans such as TA (Cabello et al., 2019). However, ownership structure is capable to explain tax avoidance (McGuire et al., 2014). In addition, earnings management-linked book-tax differences decline when the equity-based pay of executives raises (Xian et al., 2015). Moreover, upper insider ownership reduces agency costs, as well as enhances firm value (Shan, 2019). Furthermore, equity-based pay is supposed to effectively alleviate the conflicts that come up between shareholders and executives, with giving a fraction of firm's wealth to executives (Hall & Murphy, 2002). On the basis of agency theory and above discussion, our proposition is that when managers will participate in corporate ownership then they would have no more interest and intention on opportunistic rent extraction from the benefits that come up through tax avoidance, and thus, managerial ownership is negatively associated with tax avoidance.

Proposition (e): Managerial ownership has negative association with tax avoidance.

Conclusion

Agency theory argues that effective corporate governance mechanisms persuade corporate management to take better decisions by alleviating agency conflicts. However, board meeting attendance, audit committee independence and board independence could increase the financial transparency of a firm through better monitoring on managerial activities. Our proposition is

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that board meeting attendance, audit committee independence and board independence is negatively linked to tax avoidance. Besides, board gender diversity lessens the agency conflicts since they encourage superior financial transparency and internal monitoring system of the firm. We have built up our proposition as gender-diverse board is negatively linked to TA. Moreover, managerial ownership decreases the agency conflicts by falling information asymmetry as well as managerial opportunism. On the basis of agency theory, our proposition is that managerial ownership is negatively allied to TA.

In summary, our conceptual proposition is that superior corporate governance is negatively associated with tax avoidance, and thus, in empirical phase, the investigation could adopt a correlation study to examine the link between CGMs and CTA. CGMs are decisive in providing instructions and information to investors, policy makers, regulators, business practitioners and other stakeholders. Therefore, the propositions of the paper could act as a guideline to BSEC in designing appropriate governance mechanisms to reduce corporate tax avoidance in Bangladesh. Furthermore, it is expected that the theoretical framework and propositions of the paper will be extended to an empirical phase in the context of an emerging economy like Bangladesh.

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