INVESTIGATION THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND TAX VIOLATIONS IN TEHRAN STOCK EXCHANGE

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Abstract

The main purpose of the present research was the investigation the relationship between corporate governance and tax violations in Tehran Stock Exchange. Correlational research methodology used in this study and the types of research is descriptive and also it is an Expose-Facto research. The population of the study was all company that listed in Tehran Stock Exchange. According to Cochran sampling, the sample size of this research was set at 85. In order to analyze the data resulted from collected questionnaires deductive and descriptive statistical methods are used. The results K-S Test shows the test distribution is not Normal. So re-running the test and the results in Table (3) is observed that a significant amount of initial data from which the natural logarithm (Ln (V)) has been more than 0.50, therefore, with a 0.95 Confidence level, data distributions are normal. So we can use Multi Regression to test the hypothesis of the research. In order to determine Findings show that Ownership percentage executive managers, Institutional Ownership and boards of directors Independence has not significant relationship with effective tax rate at company that listed in Tehran Stock Exchange. But, boards of director's independence has not significant relationship with effective tax rate at company that listed in Tehran Stock Exchange.

Keywords: *corporate governance, tax violations, tax evasion, effective tax rate*

INTRODUCTION

In 1968, Nobel laureate economist Gary Becker first theorized the *economics of crime (*Gary Becker, 1968) on the basis of which authors M.G. Allingham and A. Sandmo produced, in 1972, an economic model of tax evasion. This model deals with the evasion of income tax, the main

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source of tax revenue in developed countries. According to the authors, the level of evasion of income tax depends on the level of punishment provided by law. The literature's theoretical models are elegant in their effort to identify the variables likely to affect non-compliance. Alternative specifications, however, yield conflicting results concerning both the signs and magnitudes of variables believed to affect tax evasion. Empirical work is required to resolve the theoretical ambiguities. Income tax evasion appears to be positively influenced by the tax rate, the unemployment rate, the level of income and dissatisfaction with government (Cebula and Feige, 1986).

Tax evasion is the illegal evasion of taxes by individuals, corporations and trusts. Tax evasion often entails taxpayers deliberately misrepresenting the true state of their affairs to the tax authorities to reduce their tax liability and includes dishonest tax reporting, such as declaring less income, profits or gains than the amounts actually earned, or overstating deductions. Tax evasion is an activity commonly associated with the informal economy. One measure of the extent of tax evasion (the "tax gap") is the amount of unreported income, which is the difference between the amounts of income that should be reported to the tax authorities and the actual amount reported (Hebous, 2011). In contrast, tax avoidance is the legal use of tax laws to reduce one's tax burden. Both tax evasion and avoidance can be viewed as forms of tax noncompliance, as they describe a range of activities that intend to subvert a state's tax system, although such classification of tax avoidance is not indisputable, given that avoidance is lawful, within self-creating systems (Wenzel, 2002).

The level of evasion depends on a number of factors, including the amount of money a person or a corporation possesses. Efforts to evade income tax decline when the amounts involved are lower. The level of evasion also depends on the efficiency of the tax administration. Corruption by tax officials make it difficult to control evasion. Tax administrations use various means to reduce evasion and increase the level of enforcement: for example, privatization of tax enforcement (Chowdhury, 1992) tax farming (Stella, 1993).

Corporate governance practices in the Iran have received increasing attention. In this study, we use a scorecard developed to assess the corporate governance of Iran listed companies. It provides a comprehensive measure of the extent to which a company has adopted international best practices in corporate governance, as disclosed in their corporate governance disclosures. Many papers have dealt with the determinants of corporate governance. Weisbach (1988) and Klein (852) look into the incentives of insiders and show that there exists a negative correlation between the ownership of managers and the proportion of outside directors on the boards of directors, or on audit committees. Shivdasani and Yermack (1999) claim that CEO exercises major influence on the selection of new directors when the ownership distribution of his firm is dispersed, while it is the controlling shareholder under concentrated ownership structures. Recently, Durnev and Kim (853) show that firms with good investment opportunity, higher sales growth rates and higher dependency on external financing would maintain a better corporate governance not to lose those good investment opportunities. However, their focus is not on the incentives of controlling shareholders, and they use governance scores, as evaluated by outside institutions, as a proxy for corporate governance.

Corporate governance based on existing theories and empirical results, and identifies variables that will be used to test the hypotheses.

1- *Ownership and Corporate Governance*

Ownership structure is a part of corporate governance in its broad sense, and it also affects other elements of corporate governance. Controlling shareholders have a strong incentive to monitor the management of firms and can be the most important part of corporate governance. Existing theories and empirical studies that analyze ownership structure generally identify block shareholders such as corporate shareholders, institutional investors and financial institutions as monitors in addition to controlling shareholders (Eunjung and Kyung, 854).

2- *Business Structure and Corporate Governance*

Another major factor that can affect the governance structure of a firm is business structure, and conglomerates have been a focus of interest since they offer a very comfortable environment for controlling shareholders to pursue their own benefits through transactions among affiliated firms. Tunneling, as it is known in the literature, has been widely reported in European conglomerates by Johnson, La Porta, Lopez de Silanes and Shleifer (852), and also in Korean conglomerates by Bae, Kang and Kim (852). A conglomerate business structure also allows controlling shareholders to maintain their control through affiliated ownerships.

3- *Firm Size and Corporate Governance*

Since governance mechanisms consume corporate resources. Larger firms would have better corporate governance, and we include asset size as a control variable. Most of the monitoring system such as the board of directors, internal control system, and financial reporting and disclosure system incur financial costs, most of which are of a fixed component and can be borne more efficiently by larger firms. The more complicated business structure of large firms may also require better corporate governance (Eunjung and Kyung, 854).

4- *Other Financial Characteristics and Corporate Governance*

Some financial characteristics would affect the governance decision and need to be controlled. Control variables include represent profitability, liquidity, financial structure and growth rates of firms. The effects of profitability on corporate governance may be two way. High profitability implies a good capability of management and so monitoring them may not be necessary. On the other hand, high profitability means the company can afford a better governance system. Outside investors may also demand better governance as they have a greater economic stake to lose (Eunjung and Kyung, 854).

5- *Board Composition*

Board composition is defined as ‘the proportion of outside directors to the total number of directors’ (Shamser and Annuar, 1993, p.44), thereby making a distinction between executive and non-executive directors. There are two views on this issue – those who argue for more non-executive directors on boards and those who favor more executive directors on boards.

6- *Role Duality*

One aspect of corporate governance which has given rise to concern is the ‘dominant personality’ phenomenon and this was found to be associated with poor disclosure (Forker, 1992). This phenomenon also includes role duality, when the chief executive officer (CEO) or managing director is also the chair of the board. There are two views regarding this issue.

Proponents of agency theory argue for separation of the two roles because this would provide the essential checks and balances over managements' performance. Furthermore, when the CEO is also the chair, the board's effectiveness in performing its governing function will be at stake because role duality concentrates power so that the CEO will be able to control board meetings, the selection of agenda items, as well as the selection of board members. Among those who argue for separation of the two roles include Argenti (1976), Donaldson and Davis (1991), Shamsher and Annuar (1993) and Blackburn (1994).

7- Cross-directorships

Another issue often discussed in the corporate governance literature is 'cross-directorships' which refers to the situation where directors (regardless of executive or non-executive) sit on more than one board. It has been suggested in the literature that this will help in making information more transparent as comparisons can be made from knowledge of other organizations (Dahya et al., 1996).

METHODOLOGY

The main purpose of the present research was Investigation the relationship between corporate governance and tax violations. Correlational research methodology used in this study and the types of research is descriptive and also it is an Expose-Facto research.

The population of the study was all company that listed in Tehran Stock Exchange in 2007-2012. According to Cochran sampling, the sample size of this research was set at 85 that selected simple.

Table 1: Sample selection based on the limitations of the research

Sampling procedures	Number of Company
Accepted companies in Tehran stock exchange till 2012	478
Fiscal year is not 19st March.	87
Financial intermediation and insurance companies	38
Companies that were operating over a four-month hiatus	132
Companies that their information is not available or have been removed from the stock exchange	123
The remaining firms in the sample	85

In order to analyze the data resulted from collected questionnaires deductive and descriptive statistical methods are used. The results K-S Test shows the test distribution is not Normal.

Table 2: K-S Test results

	ETR	DS	BI	InsI	FFSH	Size
N	85	85	85	85	85	85

Mean	3535.12	75.25	.85	73.9798	3711	1.7518
Std. Deviation	10.99	100	.173	22.16	2068	.9591
Kolmogorov-Smirnov Z	7.368	5.99	7.31	3.79	806.8	1.42
Asymp. Sig. (2-tailed)	.000	.000	.000	.000	.000	.036

The results of K-S Test shows that the test distribution is not normal. So re-running the test and the results in Table (3) is observed that a significant amount of initial data from which the natural logarithm (Ln (V)) has been more than 0.50, therefore, with a 95 percent Confidence level, data distributions are normal.

Table 3: re-running the test results

	ETR	DS	BI	InsI	FFSH	Size
N	85	85	85	85	85	85
Asymp. Sig. (2-tailed)	**.859**	**.56**	**.121**	**.55**	**.85**	**.99**

So we can use Multi Regression, T test, F test and Durbin Watson to test the hypothesis of the research. In order to determine the relationship between the variables of the study, the SPSS tool has been used.

The Regression model has being in the follow:

$$ETR_{it} = \beta_0 + \beta_1 DS_{it} + \beta_2 BI_{it} + \beta_3 INST_{it} + \beta_4 FFSH_{it} + \beta_5 IntAu_{it} + \beta_6 Size_{it} \varepsilon_{it}$$

RESULTS AND CONCLUSION

In this paper we have four main hypotheses. The statistical way of analysis of hypotheses is two ways, H_1 is acceptance of hypothesis and H_0 is rejecting of hypothesis. In other words, it means that H_1 has positive meaning and H_0 has no meaning.

In order to select one of the methods panel data or data compilation, the F-statistic is used.

Table 4: F test for multiple regression model

Effects Test		Statistic	d.f.	Prob.
Cross-section F		2.727458	(75,371)	0.0000
Cross-section Chi-square		198.491411	75	0.0000
Variable	Coefficient	Std. Error	t-Statistic	Prob.
DS	-0.068444	0.085180	-0.803522	0.4221

BI	3.759870	2.705741	1.389590	0.1653
INST	-0.086702	0.091389	-0.948720	0.3433
FFSH	-0.164957	0.056735	-2.907496	0.0038
SIZE	-1.468323	0.443058	-3.314066	0.0010
C	42.04430	10.79857	3.893506	0.0001

R-squared	0.051098	Mean dependent var	12.58133
Adjusted R-squared	0.040460	S.D. dependent var	15.40715
S.E. of regression	15.09224	Akaike info criterion	8.279424
Sum squared resid	101588.0	Schwarz criterion	8.334030
Log likelihood	-1865.150	Hannan-Quinn criter.	8.300942
F-statistic	4.803400	Durbin-Watson stat	1.188952
Prob(F-statistic)	0.000274		

According to the above results, the statistical probability F (0.000) is rejected the null hypothesis and is suitable for panel data.

After the F test the null hypothesis is rejected, the question is which one of the ways the relationship can be in the form of fixed or random effects, can be examined. The Hausman test determines.

Table 5: Hausman test multiple regression model

	Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
	Cross-section random	5.405557	5	0.3684
Variable	Fixed	Random	Var(Diff.)	Prob.
DS	-0.059311	-0.072325	0.021177	0.9287
BI	-6.689454	0.955471	14.560578	0.0451
INST	-0.151379	-0.096440	0.029710	0.7499
FFSH	58.471546	-0.174024	282144.605164	0.9121
SIZE	1.455135	-1.367334	5.168988	0.2144
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1125.499	10303.06	-0.109239	0.9131
DS	-0.059311	0.182505	-0.324986	0.7454
BI	-6.689454	5.098889	-1.311943	0.1904

INST	-0.151379	0.209417	-0.722859	0.4702
FFSH	58.47155	531.1729	0.110080	0.9124
SIZE	1.455135	2.361544	0.616179	0.5382
	Effects Specification			
	Cross-section fixed (dummy variables)			
R-squared	0.388347		Mean dependent var	12.58133
Adjusted R-squared	0.256454		S.D. dependent var	15.40715
S.E. of regression	13.28544		Akaike info criterion	8.172142
Sum squared resid	65482.63		Schwarz criterion	8.909328
Log likelihood	-1765.904		Hannan-Quinn criter.	8.462642
F-statistic	2.944414		Durbin-Watson stat	1.841844
Prob(F-statistic)	0.000000			

Thus, according to the results of the above table, the null hypothesis at 95% confidence level (using random effects) regression does not reject the random effects will be estimation procedure.

Table 6 shows that Multi Regression analysis has been done in order to determine independent variable and dependent variable.

Table 6: Multi Regression of the independent and dependent variables

Variable	Coefficient	Std. Error	t-Statistic	Prob.
DS	-0.072325	0.110143	-0.656646	0.5117
BI	0.955471	3.382025	0.282514	0.7777
INST	-0.096440	0.118935	-0.810863	0.4179
FFSH	-0.174024	0.082895	-2.099329	0.0363
SIZE	-1.367334	0.638671	-2.140905	0.0328
C	43.09649	14.55015	2.961927	0.0032
	Effects Specification			
			S.D.	Rho
		Cross-section random	7.358907	0.2348
		Idiosyncratic random	13.28544	0.7652
	Weighted Statistics			

R-squared	0.022034	Mean dependent var	7.482970
Adjusted R-squared	0.011070	S.D. dependent var	13.36289
S.E. of regression	13.28724	Sum squared resid	78741.58
F-statistic	2.009731	Durbin-Watson stat	1.531379
Prob(F-statistic)	0.076077		
	Unweighted Statistics		
R-squared	0.048508	Mean dependent var	12.58133
Sum squared resid	101865.2	Durbin-Watson stat	1.183752

First hypothesis: There is a significant relationship between executive manager's ownership percentage and effective tax rate. According to the table 6, the p-value (0.4221) is bigger than 0.05. It means that executive manager's ownership percentage has not significant relationship with effective tax rate at company that listed in Tehran Stock Exchange.

Second hypothesis: There is a significant relationship between institutional ownership and effective tax rate. According to the table 6, the p-value (0.1653) is bigger than 0.05. It means that institutional ownership has not significant relationship with effective tax rate at company that listed in Tehran Stock Exchange.

Third hypothesis: There is a significant relationship between boards of director's independence and effective tax rate. According to the table 6, the p-value (0.3433) is bigger than 0.05. It means that boards of directors independence has not significant relationship with effective tax rate at company that listed in Tehran Stock Exchange.

Forth hypothesis: There is a significant relationship between authorities of the shareholders free float and effective tax rate. According to the table 6, the p-value (0.0038) is little than 0.05. It means that authorities of the shareholders free float has significant relationship with effective tax rate at company that listed in Tehran Stock Exchange.

Findings show that Ownership percentage executive managers, Institutional Ownership and boards of directors Independence has not significant relationship with effective tax rate at company that listed in Tehran Stock Exchange. But, boards of director's independence has not significant relationship with effective tax rate at company that listed in Tehran Stock Exchange.

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