
Domestic and Foreign Institutional Ownership and Sustainable Tax Strategies

Domestic and
Foreign Institutional
Ownership

59

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ABSTRACT

This study aims to explore how institutional domestic and foreign ownership influence sustainable tax strategies (STS) in firms. This research implements *Weighted Least Square* (WLS) regression as an analytical tool with a final sample of 767 observation for period of 2015 - 2020. There are 158 manufacturing firms listed in Indonesia Stock Exchange (IDX) used as objects in study. Findings in the study show that domestic and foreign ownership structure have impact on STS. This indicated that increases in domestic and foreign ownership within the firms, would lead to a further decrease in the volatility of long-term tax payments. Based on the results of the empirical tests, domestic and foreign ownership were found to influence the enhancement of STS. However, our findings indicated that domestic ownership exhibited a stronger relationship with STS than foreign ownership. This study provided recent evidence that both domestic and foreign ownership within a firm affected the implementation of STS. These findings were expected to imply that firms with higher levels of foreign ownership should be aware of and exercise caution regarding differences in preferences between foreign and domestic owners. Foreign-owned companies are obligated to follow not only domestic tax laws but also foreign tax laws.

Keywords: Domestic Ownership, Emerging Market, Foreign Ownership, Institutional Ownership, Sustainable Tax Strategies.

Introduction

The ownership structure of a firm affects the way a company handles its tax matters. As stated by Hong et al. (2022), the business group structure can make it easier for companies to avoid taxes by allowing the ultimate owners to allocate resources and income among their affiliated companies. The difference in ownership between domestic and foreign investors leads to different managerial actions, which are influenced by host-country factors, including the regulatory environment, country-specific taxation systems, and the nature of the home countries of the investors (Syukur et al., 2022). Previous studies, such as those on family ownership (Gaaya et al., 2017), institutional ownership (Khan et al., 2017), and foreign institutional ownership (Hasan et al., 2022), have mainly investigated corporate tax avoidance. Nevertheless, there has been little emphasis on the connection between domestic and foreign institutional ownership and sustainable tax strategies (STS). Ma and Park (2021) discovered that corporate sustainability management can improve STS. The current research differed from Ma and Park (2021) in that this study further investigated the contribution of institutional ownership to the development of STS.

Previous studies on domestic ownership and tax plans have shown varying results. Nguyen et al. (2021) established that domestic-owned firms took advantage of loopholes in tax laws to minimize their tax burden in Vietnam. On the other hand, Hansson et al. (2017) noted that domestic firms were less likely to engage in tax avoidance behaviors such as transfer pricing because they were unable to transfer profits and expenses across countries to take advantage of lower tax rates. Income and profits are transferred with the aim of achieving the greatest benefits economically; thus, a reduction in deductible expenses increases the net income and returns for parent companies and non-controlling shareholders (Medioli et al., 2021).



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Foreign ownership structure has also been found to have a positive impact on tax avoidance (Suranta et al., 2019). This indicates that foreign ownership structure plays an important role in monitoring firms, and at the same time, it also increases the scope for tax avoidance by utilizing income in different geographical locations with high and low tax rates (Alkurdi & Mardini, 2020). However, Hasan et al. (2022) found that when foreign investors entered the firm, tax aggressiveness decreased due to differences in institutional quality between their home country and the firm's country. To our best knowledge, no study has investigated whether the ownership structure of corporations affects sustainable tax strategies. Therefore, this study built on the study of Ma and Park (2021) by examining whether institutional ownership structure, as represented by domestic and foreign ownership, affects sustainable tax strategies.

Aggressive tax planning has now emerged as a significant issue for governments, as it affects their revenues, which are used for investments in sustainable development (Van de Vijver et al., 2020). Tax evasion not only hurts the government, but it also hurts the space that regulatory compliance, organisational integration, and social cohesion need to flourish (Bird & Nozemack, 2018). In the years 2015 and 2016, there were a number of multinational corporations operating in the United States, with whom there were tax disputes with the European Commission. This led to a significant amount of tax being imposed on these corporations. The corporations involved in this tax dispute included a number of large corporations using a number of planned tax strategies, including royalty payments, transfer pricing between affiliated companies, intercompany loans, and income from mobile intangible assets. One of the most prominent cases of this type of tax dispute was Apple, which had to pay €13 billion in unpaid taxes (Yang & Metallo, 2018).

When international tax laws oblige multinational companies to make available important information about global income allocation, economic activities, and taxes paid, companies are likely to display sustainable tax practices (Cho, 2020). However, tax aggressiveness is considered to create value for the short term only. Ma and Park (2021) found that companies that follow STS outperform other companies in the short term and long term. Many previous studies have investigated the link between ownership structure and tax avoidance.

The originality of this research is based on its focus on the relationship between foreign and domestic ownership and STS in corporations. The difference between tax avoidance and STS is captured by the volatility of annual taxes. Through the implementation of STS, corporations are able to minimize volatility and ensure the creation of value for stakeholders on a constant basis. In other words, corporations aim to maximize value for all stakeholders, including governments in the jurisdictions where they operate, through the tax structures they choose (Dang & Nguyen, 2022). Corporations are driven by the need to avoid costs associated with tax avoidance structures, including tax fines, sanctions, and loss of reputation due to tax embezzlement. Rather, corporations are likely to focus on creating value for all stakeholders, including local governments, through sustainable taxes, thus contributing to the public purse in the countries where they operate. Therefore, this research question was developed that institutional ownership affect STS.

In order to test this hypothesis, a sample of firms listed on the Indonesia Stock Exchange was used. The results showed a significant negative relationship between domestic and foreign ownership and STS, with a stronger relationship observed for domestic ownership. This shows that both domestic and foreign institutional investors would like firms to support local governments by making constant tax payments, as opposed to engaging in aggressive tax planning, which might be beneficial to the firms in the short term but would harm their reputation in the long term. The study also shows that tax enforcement was effective in Indonesia from 2015 to 2020, which led to an improvement in sustainable tax practices.

The findings of this study will be useful for management and investors, both domestic and foreign, as it shows that manufacturing companies in Indonesia have consistently added value to the community through sustainable long-term tax payments. The significance of this study lies in the fact that it is one of the first studies to investigate the relationship between domestic and foreign institutional holders and STS. The findings of this study will add to the little literature on sustainable taxation.

The remaining part of this paper is organized as follows: Chapter 2 discusses the theoretical framework and hypothesis development, while Chapter 3 explains the sample selection and research methodology. Chapter 4 discusses the empirical results, and Chapter 5 concludes the study, including its limitations.

Theories and Hypothesis Development

Sustainable Theory

In recent years, sustainability has emerged as a very important consideration in the management of corporations, taking a holistic approach that views companies from an economic, environmental, and social perspective. As the application of approaches has become increasingly important, the role of shareholders has become important in improving the application of sustainability theory. Therefore, the role of sustainability theory in corporate environments has developed over the last sixty years (Chang et al., 2017). According to Memili et al. (2017), sustainability practices are the organisation of national efforts and approaches that help firms succeed.

The issue of tax dodging and the use of tax havens is leading to sustainability challenges since it impacts the government's ability to spend in areas of sustainable development goals. Although tax avoidance and profit-shifting activities provide incentives to businesses, they have social impacts that affect societal sustainability (Cho, 2020). Therefore, it is essential to understand the impact of national and international transfer pricing legislation in promoting sustainable tax behavior globally (Cho, 2020). Batrancea et al. (2018) indicate that sustainable tax behavior includes legal, moral, ethical, and sustainability issues that benefit society. Thus, future society is an essential aspect of company sustainable tax behavior.

Moreover, STS also affects stakeholders such as employees, investors, management, society, and governments. Hanlon and Slemrod (2009) observed that when corporations engage in tax avoidance practices, their stocks fall, as investors do not want to risk investing in such businesses. As per Marwat et al. (2021), tax avoidance practices can result in a loss of trust on the part of investors, as tax payment allows governments to provide public services such as healthcare, education, transportation, national defense, and other public utilities. The second factor is the external pressure from media attention, which forces management to not engage in unethical practices. Surveys conducted by EY (2014) and PwC (2014) reported that increased media monitoring has led to increased concerns about corporate reputation.

As Rezaee (2016) argues, for a business to be sustainable, it has to concentrate on the achievement of the five EGSEE dimensions: economic, governance, social, ethical, and environmental. This is achieved through the initiation of activities that improve value beyond self-interest and compliance with laws and regulations. Business sustainability is the improvement of the positive and negative impacts of a firm on society and the environment to create value for stakeholders.

Hypotheses Development

Domestic Institutional Ownership and Sustainable Tax Strategies

The relationship between tax avoidance and sustainable tax strategy lies in how companies manage their tax obligations efficiently while remaining responsible and

forward-looking. A sustainable tax strategy addresses these concerns by integrating tax efficiency with long-term considerations such as compliance, ethics, transparency, and corporate sustainability. Therefore, tax avoidance implemented within a sustainable tax strategy framework can function as a balanced tax management approach, enabling firms to achieve financial optimization without undermining regulatory trust, stakeholder confidence, or long-term business sustainability (Velte, 2023).

An increase in institutional ownership is linked to a greater level of corporate tax avoidance, as shown in Jiang et al. (2020) and Khan et al. (2017). This is supported by Jiang et al. (2020) in China, as most institutional investors tend to be short-term oriented, hence focusing on short-term gains. However, contrasting evidence is presented in Boussaidi and Sidhom (2020) and Dakhli (2021). In addition, Khelil and Khlif (2022) found a negative relationship between tax avoidance and family businesses in the United States, Finland, and Belgium. On the other hand, the relationship between family businesses and tax avoidance is seen as positive and significant in both developed countries such as Germany and Italy, as well as emerging countries such as Malaysia, Tunisia, India, and Brazil.

In Indonesia, the empirical findings reveal that the majority of domestic institutional ownership is held by families, amounting to 57.3 per cent (Carney & Hart, 2015). It has also been observed by Nuritomo et al. (2020) that family firms in Indonesia prefer to avoid taxes by using dividend-based mechanisms instead of related-party transactions. Gaaya et al. (2017) have also established that family ownership can motivate family firms to avoid taxes in order to maximize tax savings. Similar findings have been observed by Chang et al. (2021), who contend that family shareholders attempt to extract “rents” by engaging in tax avoidance with the objective of extracting private benefits and diverting them.

However, Kuo (2022) reveals that companies with dominant family control do not engage in tax avoidance practices. This is because companies view tax avoidance as too risky and harmful to firm value. Similar results are also observed by Herawati et al. (2021), which indicate that family firms in Indonesia avoid aggressive tax practices. This is because family firms recognize that the benefits of aggressive tax practices do not exceed the costs incurred. Abdelfattah and Aboud (2020) further clarify that family firm owners are more interested in long-term goals. In support of this argument, Ma and Park (2020) argue that minimizing taxes does not represent an efficient tax practice. This is because an efficient tax practice should increase firm value instead of decreasing it. Hence, companies are advised to implement STS that do not change tax performance significantly in the long term. Thus, the first hypothesis is stated as follows:

H₁: Domestic institutional ownership is negatively associated with sustainable tax strategies.

Foreign Institutional Ownership and Sustainable Tax Strategies

The presence of foreign investors in a firm has a significant effect on tax decision-making for the firm. Salihu et al. (2015) state that the presence of foreign ownership in a firm encourages tax avoidance practices. Similar results were obtained by Shi et al. (2020) regarding the role of foreign investors in tax avoidance practices for a firm. The tax avoidance practices of a firm are even encouraged by the presence of foreign directors, as they have more opportunities to participate in specific tax planning practices. Therefore, it seems that the firm is focusing on the tax benefits of these practices.

However, other studies have different findings. Kim and Im (2017) provide evidence that corporate monitoring by foreign investors helps to prevent the firm from resorting to tax avoidance practices. This is because the firm is under stricter

audit, and foreign investors are not willing to compromise the corporate reputation by engaging in such practices. Hasan et al. (2022) also provide similar findings that foreign investors discourage the firm from resorting to such practices. However, it is best for the firm in the long run if it resorts to STS, as the firm will benefit from a less volatile performance. This is similar to the findings by Ma and Park (2020). Therefore, the second hypothesis is as follows:

H₂: Foreign institutional ownership is negatively associated with sustainable tax strategies.

Methodology

Source of Data and Sample

This study adopts a quantitative research design. To test the proposed hypotheses, panel data regression models are employed and analysed using the statistical software Gretl. The research sample consists of manufacturing firms listed on the Indonesia Stock Exchange (IDX) over the period 2015–2020, as presented in Table 1. The secondary data used in this study are obtained from publicly available corporate disclosures, including annual reports, the Osiris database, and other reliable sources.

Initially, the sample comprises all manufacturing firms listed on the exchange during the 2015–2020 period, yielding 1,098 firm-year observations. Of these, 331 observations are excluded due to the unavailability of complete data over six consecutive years required to calculate STS. Consequently, the final sample consists of 767 observations drawn from 158 firms.

Measures

The dependent variable for this research is sustainable tax strategies (STS), which is calculated by the variance of the Cash Effective Tax Rate (CETR) over five consecutive years, as described in the methodology developed by Ma and Park (2020). The ownership of institutions, both domestic and foreign, is the independent variable and is calculated by the percentage of domestic and foreign ownership in the firm, respectively, with ownership interests above 25%. There are also numerous control factors that may influence the dependent variable. A detailed description of the variables used in this research is provided in Table 2.

Research Model

This study aims to examine whether domestic and foreign institutional ownership influence firms' STS. A detailed empirical analysis is conducted to investigate the relationship between domestic and foreign institutional ownership and STS. The regression model is specified as follows:

$$STS = \alpha + \beta_1 \text{domesticultimate}_{it} + \beta_2 \text{foreignultimate}_{it} + \beta_3 \text{Size}_{it} + \beta_4 \text{ROA}_{it} + \beta_5 \text{Lev}_{it} + \beta_6 \text{OCF}_{it} + \beta_7 \text{PPE}_{it} + \beta_8 \text{Intangible}_{it} + \beta_9 \text{LQ}_{it} + \beta_{10} \text{Industry} + \beta_{11} \text{Year} + \epsilon_{it}$$

Table 1. Sample Selection

Category	Obs
Manufacturing firms	1098
Firms without data available for six consecutive years	(331)
The overall total observations	767

Table 2. Variable definitions and data source

Variable(s)	Definitions	Data source
Domestic Ultimate	Represents the total domestic ownership in a firm with an ownership stake exceeding 25.00 per cent.	Annual report & Osiris
Foreign Ultimate	Represents the total foreign ownership in a firm with an ownership stake exceeding 25.00 per cent.	Annual report & Osiris
Sustainable tax strategies (STS)	Represents a measure of the long-term volatility of corporate tax avoidance, measured by the standard deviation of the Cash Effective Tax Rate (CETR) over a five-year period.	Osiris
Size	Represents firm size, measured by the natural logarithm of total assets.	Osiris
ROA net income (ROA)	Represents the extent to which a firm's assets generate profits, measured as the ratio of net income to total assets.	Osiris
Leverage (Lev)	Measures financial leverage, calculated as total debt divided by total assets.	Osiris
Operating Cash Flow (OCF)	Evaluates operating cash flow, which is calculated by dividing net operating cash flow by total assets.	Osiris Osiris
Liquidity (LQ)		
Property, Plant, and Equipment Net (PPE net)	Liquidity is evaluated by calculating cash and short-term investments divided by total assets.	Osiris
Intangible	Measures intangible asset intensity, calculated as intangible assets divided by total assets.	Osiris

Analysis and Discussion

Descriptive Statistics

Table 3. Descriptive Statistics

	Mean	Median	Min	Max	STD
Domestic Ultimate	32.622	29.350	0.000	100.000	33.051
Foreign Ultimate	20.854	0.000	0.000	100.000	31.665
SIZE	28.483	28.272	25.079	33.495	1.574
ROAnetincome	0.032	0.029	-0.631	0.921	0.096
LEV	0.264	0.254	0.000	3.769	0.273
OCF	0.063	0.055	-0.311	0.799	0.099
PPEnet	0.403	0.385	0.001	0.966	0.198
Intangible	0.009	0.000	0.000	0.539	0.034
LQ	0.100	0.058	0.000	0.762	0.116
ST	3.402	1.283	0.030	141.710	10.719

Table 3 presents the descriptive statistics for each variable, providing further information on the minimum, maximum, mean, and standard deviation of the dependent, independent, and control variables employed in this study. As shown in Table 3, the sustainable tax strategies (STS) variable has a mean value of 3.4. Lower ST values indicate more STS, reflecting less volatility in tax payments. The average level of domestic ownership is 32.62 per cent, while foreign ownership averages 20.85 per cent.

Return on Assets (ROA) ranges from a minimum of -0.631 to a maximum of 0.921, with negative ROA values indicating that firms incur losses. Leverage (LEV) reaches a maximum value of 3.769, suggesting a relatively high level of debt financing. Operating Cash Flow (OCF) records a minimum value of -0.311, indicating that corporate cash outflows exceed cash inflows. Net property, plant, and equipment (PPE) range from 0.001 to 0.966. Intangible assets record a maximum value of 0.539, while liquidity reaches a maximum value of 0.762.

Panel Data Regression

In the analysis of the panel data, it is essential to choose the best estimation model. As the data has both time-series and cross-sectional dimensions, the analysis begins with the common effects model, which is also known as the Pooled/Organize Least Squares (OLS) approach. Once the pooled OLS model has been established, the best regression model is established using three statistical tests. First, the F-test is used to establish whether the common effects or the fixed effects models are more appropriate. Second, the Hausman test is used to establish the best option between the fixed effects and the random effects models. Finally, the Breusch-Pagan Lagrange Multiplier test is used to establish whether the common effects or the random effects models are more appropriate. The results are presented in Table 4.

In addition to this, classical assumption tests are used to ensure the robustness of the results obtained through regression analysis. This includes heteroskedasticity and multicollinearity. The presence of heteroskedasticity refers to unequal error variances between data points, which violates assumptions of regression analysis. A p-value less than 0.05 indicates heteroskedasticity. In this research, the heteroskedasticity test has a p-value of 0.000, indicating heteroskedasticity. The regression analysis is therefore computed using the Weighted Least Squares (WLS) method.

Moreover, the test for multicollinearity is employed to establish if the independent variables are highly correlated. This is not desirable in regression analysis. The presence of multicollinearity can be established by the Variance Inflation Factor (VIF) and tolerance. If $VIF > 10$ and $tolerance < 0.10$, then multicollinearity is present. The findings indicate that there is no presence of multicollinearity in the model. The findings are presented in Table 5.

Table 4. Panel diagnostic

Dependent Variable	Sustainable Tax Strategies (STS) p-value
Fixed effect estimator	9.96E-07
Result	Fixed Effect
Random effect estimator	
Breush-Pagan test statistic	2.60E-05
Result	Random Effect
Hausman test statistic	0.0196724
Result	Fixed Effect

Hypothesis and Research Result

Based on the results reported in Table 5, the p-values for domestic ultimate ownership and foreign ultimate ownership are both below 0.05. These findings indicate that domestic and foreign ownership are negatively associated with firms' STS. This result may be explained by the absence of differential tax regulations in Indonesia between domestic and foreign ownership. Because the tax framework applies uniformly across ownership types, firms do not face distinct tax incentives or disincentives based on whether they are domestically or foreign owned. As a result, variations in ownership structure are unlikely to generate meaningful differences in tax-related outcomes, which may account for the observed empirical result. Consequently, an increase in domestic or foreign shareholders is associated with a reduction in the volatility of corporate tax payments. This suggests that shareholders, both domestic and foreign, prefer firms to maintain stable tax payments over time by adopting STS. Accordingly, firms are expected not to focus solely on short-term gains through tax avoidance practices, which may generate various costs and risks as discussed earlier, but rather to adopt a long-term perspective. By implementing STS, firms are able to maintain relatively stable tax payments across years.

Table 5. WLS and Collinearity

	Coefficient	p-value	VIF
Const	897.896	0.0000***	
DomesticUltimate	-0.0179475	0.0000***	1.431
ForeignUltimate	-0.00839616	0.0025***	1.474
Size	-0.212028	0.0000***	1.263
ROAnetincome	-2.57422	0.0750**	1.531
LEV	-0.496828	0.2007**	1.241
OCF	156.496	0.2743**	1.433
PPEnet	108.947	0.0006***	1.361
Intangible	-5.33567	0.0010***	1.157
LQ2	-4.18606	0.0000***	1.471
Industry	-0.121340	0.4833*	1.091
dt_2	0.266101	1.2826	1.744
dt_3	0.417695	0.2549**	1.776
dt_4	0.584205	0.0030***	1.86
dt_5	0.511466	0.0081***	1.86
dt_6	157.016	0.0000***	1.914
Heteroskedasticity	0		
Adjusted R-squared	0.6837		
P-value (F)	0.0000		

Furthermore, Table 5 also indicates that domestic ownership exerts a stronger influence on firms' STS than foreign ownership. This is evidenced by the larger coefficient magnitude and/or lower p-value associated with domestic ownership compared to foreign ownership.

Discussion

As found in previous research, like Sun (2021), private domestic companies are more likely to adopt tax avoidance than state-owned enterprises and foreign companies because domestic companies face higher effective tax rates, and hence tax avoidance seems less attractive to them. However, the result is opposite to the findings of the current study. The results of the present study suggest that both domestic and foreign institutional investors contribute to the promotion of the adoption of sustainable tax strategies (STS). This is because institutional investors generally give more priority to long-term firm value, as well as regulatory and reputational considerations. This leads firms to avoid opportunistic and aggressive tax practices. Instead, firms adopt more stable and sustainable tax planning strategies, which result in a more stable and less volatile tax payment profile over time. This indicates that institutional investors contribute not only to better tax governance but also to more stable tax payment behavior of firms.

This variation can be justified by the Indonesian setting, in which the tax rates for domestic and foreign institutions are the same. In addition, the ownership of domestic institutions in Indonesia is largely family-controlled. Therefore, the results show that domestic institutions have a greater impact on STS than foreign institutions. This is justifiable, as family-controlled institutions are largely driven to maintain the reputation of the firm in the eyes of all stakeholders. In this manner, firms are likely to attain sustainability and meet the going concern principle.

In addition, foreign institutional investors experience additional costs when operating in foreign markets, which include limited knowledge of the host country's institutional environment, regulatory environment, and culture, as well as the risk of being at a disadvantage compared to local firms as a result of government policies in favor of local firms (Huang & Tang, 2018). In view of the aforementioned disadvantages, foreign investors are reluctant to experience additional costs associated with aggressive corporate taxation. Moreover, Hasan et al. (2022) assert that although there is a short-term benefit to tax avoidance, foreign investors are concerned that such gains are not sustainable, thereby hurting the reputation of the firm. Long-term foreign investors, in particular, place more emphasis on the value of the firm in the long term.

Conclusions and Recommendations

Based on the results of this study, it can be concluded that both domestic and foreign institutional investors have a positive impact on firms' sustainable tax strategies (STS). This is in accordance with the results of previous studies conducted by Ma and Park (2021), which stated that firms are increasingly focused on long-term performance and, therefore, STS is a viable solution. With the implementation of STS, firms are able to maintain a stable level of tax payment. This is because the level of tax payment is less likely to fluctuate. However, it is found that the relationship between domestic institutional ownership and STS is stronger than the relationship between foreign institutional ownership and STS. This is because most of the domestic institutional investors in Indonesia are family-owned. Therefore, decisions are made cautiously in order to avoid any risk that may negatively impact the reputation of the firm, which in turn may threaten the sustainability of the firm in the future.

Through this study, it is anticipated that firms will be more focused on ensuring the stability of their tax payments. Stable corporate tax payments are preferable to highly volatile tax payments. In addition, it is anticipated that this study will improve corporate consciousness about STS, as it can allow firms to satisfy their stakeholders and shareholders in the long term with a strong corporate reputation. Fundamentally, it is anticipated that stakeholders can be satisfied when they perceive a firm to have a good reputation.

These results offer implications for companies that have higher foreign ownership to be more cautious in the process of decision-making, as there are differences in geographical, legal, and institutional knowledge between foreign and domestic investors. In addition, foreign-owned companies that operate in foreign countries are obligated to follow not only domestic tax laws but also foreign tax laws. By acknowledging and understanding these laws and their differences, companies can make more informed and cautious decisions. This study has some limitations, as it only considers companies that operate in the manufacturing industry. Therefore, future studies can expand the sample to companies in other industries to improve the generalizability and validity of the results. These extensions will enable the results to be a more trustworthy reference for companies in different industries and provide more certainty for stakeholders and policymakers in formulating and implementing policies.

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