European Online Journal of Natural and Social Sciences 2013; www.european-science.com
Vol.2, No.3 Special Issue on Accounting and Management.
ISSN 1805-3602

Analysis of the Impact of Executive Directors on the Tax Level of the Companies Listed in Tehran Stock Exchange

Arezoo Zamzam*[1], Aboozar Nafarieh[2]
[1]Public Administration (Marketing and Export Major), Payame-Noor University, Karaj Branch, Iran
[2]Business Management, University of Applied Science and Technology (Branch 47), Tehran, Iran
*Email: arezoozamza218@yahoo.com

Abstract

In this research the relationship between executive directors and the difference between declared tax and absolute tax is studied. This evaluation is done by the relationship between executive management including three criteria of the percentage of non-official people among board of directors, dual role of the chairman and his lack of influence, with the amount of declared tax and absolute tax. Therefore, the information of 30 companies listed in Tehran Stock Exchange during 2006 and 2011 were used. By creating a linear Semi-logarithmic function and its estimation was determined in form of panel data. Variables of the proportion of non-official directors to the official ones (BM), differentiating chairman of board from CEO (SEP) and influence of CEO (INF) is significant statistically. Thus, the main purpose of this research is to explain the relationship between the indicators of executive management with the percentage of the difference between declared tax and absolute tax in companies listed in Tehran Stock Exchange.

Key words: executive directors, declared tax, absolute tax

Introduction

Board of directors is one of the governance factors in todays' companies that is usually known as the executive element of corporate governance principles in companies and responsible for supervision and policy making in companies. Members of board of directors are usually selected by shareholders, however, in some modern governing systems, a collection of employees' perspective, state organizations, investors and providers are influential in choosing them. Board of directors is usually a group of people who have the right to supervise, control, make large investments and dominate in a specific company. This collection of people (in form of an effective work team) should guarantee companies' health in various areas like appropriate financial performance of company, legality of activities, congruence of companies' processes and actions with their strategic objectives (Safari, 2009).

Comparison of available definitions of executive director and the company's executive team during last decades and years (like board of directors' team) indicates various changes in the duties of these people. As a result of these changes, the strategic role of these teams is reduced to a large extent and more executive responsibilities are given to them. These actors are in form of an executive team including senior financial director, senior marketing director, senior dominant director, senior learning director, senior information director, senior operation director, senior human resource director, technology director, etc. are working under the supervision of senior executive director or in other words companies CEO. The important point is that the better the relationship between this team and the team of board of directors, the more the overall performance of the company (assuming the stability of other conditions) will be promoted.

By separating ownership from management, directors as representative of shareholders administer the company. By forming the relationship of company, the contradiction between interests of directors and shareholders and other beneficiaries including the government occurs and there is the a potential possibility that directors take actions which are to their benefits and are not necessarily in the interest of shareholders and other beneficiaries including government which is called delegacy. In this regard, government as one of the company's beneficiaries relies on tax return filled and handed by tax payers to determine the tax. On the other hand, companies, especially those listed in Tehran Stock Exchange should render taxable profit and consequently calculate the amount of tax according to tax laws and regulations and mention it in tax return and hand it to the tax agent, reflect the tax in the determination paper and in case of payer request and according to article 237 of direct tax law, announce the legal basis and documentations of tax calculations to the payer. In this situation, if there are corporate governance factors whose theoretical foundation claims observing all beneficiaries' rights (known as companies with powerful corporate governance) in companies, it is expected that the taxable profit and declared tax that should be recognized according to laws and regulations and stated in tax return and be hugely confirmed with taxable profit and appointed tax and absolute tax by tax agents which is determined according to laws and regulations. Of course numerous factors including inconsistency of some articles of direct tax regulations with accepted accounting standards and especially acceptable costs also caused the contradiction between accounting profit based on accounting standards and taxable profits based on rules and regulations clear to everyone which is common in most countries even the developed countries (Babajani &Abdi, 2010). As a result, corporate governance is a mechanism through its practice the legacy problems are solved and companies' information quality is improved, shareholders' right and all beneficiaries including governments and the public society is taken into account (Fernandez, 2007). International federation of accountants (IFAC) defined corporate governance as follows: corporate governance (governance of commercial unit) is a number of responsibilities and methods applied by board of directors and director have to determine the strategic direction that guarantees achieving aims, controlling risks and responsible consumption.

Cadbury in 1992 defines corporate governance as: a system by which companies are led and controlled.

Parkinson in 1994 writes: corporate governance is the supervision and control process to guarantee directors' performance according to shareholders' interests.

International Monetary Found (IMF), and the organization for economic cooperation and development (OECD), in 2001, defines corporate governance as: the structure of relationships and responsibilities among the main group including shareholders, board of directors and the executive director to promote better competitive performance necessary to achieve primary cooperation goals.

Hype et al. in 1998, after a research conducted in Oxford, in explaining corporate governance writes: corporate governance describes internal organization and company's power structure, the method of carrying out duties by board of directors, company's ownership structure and shareholders' and other beneficiaries' interaction, especially company's labor force and their creditors.

Casey and Wright in 1994 writes: corporate governance is structures, processes, cultures and systems that provide successful operation.

Megginson in 1994 defines corporate governance as a series of rules, regulations, organs and methods that determines how and to whose benefits companies are administered.

Nell Minow and Robert Mangez, two experts who conducted researches about corporate governance in 1995 defined corporate governance as: the tool by which any society determines company's moving direction and in other words corporate governance is the relationship between different groups in determining company's direction and performance. Main groups include: shareholders, executive director and board of directors, other groups including customers, sellers, creditors and society.

Wolf Soan the previous director of international bank in 2000 said: corporate governance attempts to promote justice, clarity and accountability in companies.

Terrry Gare is another theoretician who in 1984 writes: corporate governance in not only about administration of company's performance, but also is related to all company's beneficiaries.

Statement of the problem

In stock companies, especially public ones, shareholders do not play systematic role in administering company, rather board of directors who are chosen in the public association administer the company. Therefore, there are representatives who work under company's owners. This relationship between owners and representatives is called representative relationship. The mechanism of corporate governance by share ownership significantly impacts the method of controlling companies. Thus, in fact there are representatives who act under company's owner. The mechanism of corporate governance significantly influences the method of controlling companies. Consequently, they assign company's administration to directors. Separating ownership from management leads to an organizational problem known as representativeness. One of the main hypotheses of representativeness is that the employee and the employer have opposite benefits (Rasaian and Asghari, 2007).

Ramzy and Blaier believe that increaseing the concentration on major shareholders' ownership provides enough motivation for supervising directors. Demestz and Lahen support this viewpoint empirically with the findings that bigger shareholders have the motivation to bear sustainable costs of data collection and interfering in management supervision. In contrast, sporadic ownerships have less motivation in supervising management.

Although in limited corporate governance approach, government is considered as a shareholder and companies pay government's share from benefit, but in a more expanded approach of corporate governance the question arose that whether information distributed by companies is clear enough to enable appropriate calculation of government rights in the tax from them? And whether indicators of corporate governance can cause difference between declared tax and absolute tax? It is a reasonably expected that; the more clear the information provided from companies, more companies are successful in performing their accountability with regard to beneficiaries and providing clear information in turn cause exact and proper calculation of taxable profit of company. For this reason, in a broad approach to corporate governance, government as a beneficiary has clear information derived from corporate governance system.

In such a situation, the approach is called desirable corporate governance system that observes government rights as one of beneficiary groups and its share from company's share clearly and exactly. It is necessary for principal shareholders to have sufficient supervision over company's performance and be active and activity-oriented and company's board of directors set priority on attention to all beneficiaries' rights. In the meanwhile, tax as the most observable right of government is significantly important and if the above cases are not observed leads to the difference between declared profit of companies and the appointed taxable profit from tax authorities. Consequently the purpose is the relationship between some factors of corporate governance like proportion of non-official directors to official directors in the board of directors, differentiating CEOs from chairman of the board and lack of CEO's influence on the difference between declared tax and absolute tax.

Literature review

Wang et al (2009), in their research, studied the influence of corporate governance characteristics on company's performance and then studied the influence of corporate governance' overall features on company's performance. Their research findings show that companies with better corporate governance have better performance and higher value. Also, there is significant positive relationship investors' concentration, government ownership and market performance and value.

Minnick and Noga (2010) in a study searched the influence of corporate governance characteristics on tax management. They showed that reward plans act as a motivation for directors to invest in long-term plans and tax reducer. Also, findings showed that tax management is beneficial for shareholders and tax management is positively related to

increasing income return of shareholders.

Sartori (2008) showed that there is mutual interactions between corporate governance and tax; in fact, on the one hand, corporate governance rules has structural impact on fulfilling tax commitments of companies and on the other hand, tax plans (from government's point of view) and connecting them to tax strategies (from companies' point of view) can significantly influence development of a dynamic corporate governance.

Chen et al (2010) found out that; family ownership can influence company's tax policy. They concluded that companies with family ownership adopt less bold policies about tax. These findings showed that family owners are inclined to prevent tax management in order to avoid reduction of company's share value derived from minority of shareholders' concern about risks of tax activities.

Nurwati et al. (2010) studied the relationship between corporate governance and the accuracy of profit prediction. Results showed that accounting committees that have non-official members as well as the size of accounting committee is negatively related to the absolute error of prediction. In other words, the size of accounting committee is positively related to the accuracy of profit prediction. Their results indicate that the more members with non-executive post in the accounting committee and size of accounting committee, the more the accuracy of profit prediction by management will be. Also, the results of their research indicate the positive relationship of company's size with the accuracy of profit prediction. The findings also show that profit prediction in larger companies has more credit.

Garsia Sanchez (2010) studied the influence of board of directors on the technical efficiency of 92 companies listed in Spain Stock Exchange during 2004-2006. Results of his study show that, there is positive relationship between technical efficiency and inconsistency of board of directors, unlimited number of famous, high quality members and increasing number of expert committees.

Fatma et al. (2011) concluded that, based on the Jensen free cash flow theory, the debt policy can limit the cash flow risk as the main governance mechanism. Also, results showed that management ownership reduces the level of representative costs of free cash flow. Also, ownership concentration increases the risk of free cash flow.

Lanis and Richardson (2011) concluded that; the number of irresponsible members of board of directors has a significant negative relationship with the bold tax scheme. In other words, the more the number of non-official members of board of directors, the less the company will turn to tax management.

Hypotheses

H1: There is a significant relationship between the proportion of non-official directors to official directors and the difference between declared tax and absolute tax.

H2: There is a significant relationship between differentiating CEO and chairman of the board and the difference between declared tax and absolute tax.

H3: There is a significant relationship between CEO's lack of influence and the difference between declared tax and absolute tax.

Research method

This research is applied with regard to purpose and descriptive-analytical with regard to methodology and is correlational.

Data collection method

In this research, the field and library methods were used to collect the research data. In order to gather literature review for the research, professional books and articles available in libraries and internet were used and in order to collect data for analysis, company's financial lists and information banks and financial lists distributed by Tehran Stock Exchange were used and in order to gather data about declared tax and absolute tax of companies, their tax records information in tax affairs organization of major payers of Tehran were used.

Results

Coefficients of effective variables are determined as follows. Therefore, the function is as follows:

$$Log(TAX)_{it} = \beta_0 + \beta_1 BM_{it} + \beta_2 SEP_{it} + \beta_3 INF_{it} + U_{it}$$

Table 1: Results of Fixed Effects test

Test Summary	Chi-Sq. Statistic	Prob
cross-section fixed effects	37.00	0.00

Table 2: Result of Hausman test

Test Summary	Chi-Sq. Statistic	Prob
Cross-section random	41.76	0.00

As a result, we see that fixed effects method is accepted. Now, the aforementioned function is estimated by the fixed effect method. In fact for each company, there is unique Y- intercept. Results of estimation are as follows:

Table 3: Results of second model

	fixed effects		
Variable	Coefficient	T statistics	Prob.
BM	-3.36	-4.93	0.00
SEP	-1.76	-2.42	0.01
INF	-0.71	-4.13	0.00
$\bar{R}^2 = 0.86$	$R^2 = 0.88$		
F-statistic=34.82		Prob(F)=0.000	
$D.W = 1.88$			

As it can be estimated from the output, variables of the proportion of non-official directors to official directors, separating CEO from Chairman of the board (SEP) and lack of CEO's influence is statistically significant.

Among effective factors, the proportion of non-official directors to the official ones, i.e. independence of board of directors has the highest influence on observing the company's governance principles. This variable's coefficient (3.36) is conversely related to dependent variable which is compatible with accounting theories. The second effective variable is separation of CEO from chairman of the board (SEP) that with a 1.76 coefficient negatively influences the difference between declared tax and absolute tax. Finally, the last effective factor is the lack of CEO's influence. In fact, non-official chairman of board can cause clarity and corporate governance and with 0.71 coefficient value negatively influences the level of difference between declared tax and absolute tax.

The amounts of $R^2 = 0.88$ and $\overline{R}^2 = 0.86$ indicates high expository of independent variables. It means that 86 percent of changes in difference between declared tax and absolute tax of selected companies by independent variables are justifiable. Moreover, the statistical amount of D-W=1.88 is not significantly different from 2 and on the other hand, with regard to Panel data method and short time of study (6 years), the lack of self-correlation and model health can be claimed. On the other hand, F statistics is larger than table value and regarding Prob=0.00 the significance of the overall regression can be claimed.

Conclusions

Among effective factors, proportion of non-official directors to official ones or in other words independence of board of directors has the highest influence on observing corporate governance. The coefficient of this variable with the value of 3.36 is conversely related to dependent variable which is consistent with accounting theory. The second effective variable is separation of CEO from chairman of the board (SEP) with 1.76 coefficient negatively influences the difference between declared tax and absolute tax. Finally, the last effective factor is lack of CEO's influence (INF). In fact, non-official chairman of the board can cause clarity and corporate governance disclosure and with 0.71 coefficient value negatively influences the amount of difference between declared tax and absolute tax. Accordingly, it is suggested that, in order to observe most corporate governance principles, measures should be adopted to increase the proportion of non-official directors to official ones in companies.

References

Babajani, J., & Abdi, M. (2010). The relationship between corporate governance and taxable profit of companies, *Journal of financial accounting researches,* 2:3, 65-86.

Chen, S., Chen, X. Cheng, Q. & Shevlin, T. (2010). Are family firms more tax aggressive than nonfamily firms?, *Journal Of Financial Economics,* 95, 41-61.

Fernandese N. (2007). EC: Board compensation and firm performance: The role of “independent” board members. *Journal of multinational financial management*.

Garcia-Sanchez, I.M. (2010). The effectiveness of corporate governance. Board structure and business technical efficiency in Spain. *Central European Journal Of Operations Research*, 18, 311-339.

Lanis, R., & Richardson G.(2011). The effect of board of director composition on corporate tax aggressiveness, *Journal Of Accounting and Public Policy*, 30, 50-70.

Minnick, K., & Noga, T. (2010). Do corporate governance characteristics influence tax management, *Journal Of Corporate Finance*, 16, 703-718.

Nurwati, A. et al. (2010). Corporate governance and earnings forecasts accuracy, *Asian Review of Accounting*. 18 (1), 50-67.

Rasaeian, A. & Asghari, J. (2007). The relationship between accounting criteria of performance evaluation and economic added value of EVA in Tehran Stock Exchange, *Sahand Economic Quarterly*, 13:60.

Safari, A. (2009). The reason for the difference between payers' declared profit and appointed profit by tax agents, MA thesis, Central Tehran Branch, Faculty of Economics.

Sartori, N. (2008). Effects of strategic tax behaviors on corporate governance. September 1, University of Michigan.