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Political connections, corporate governance, and tax aggressiveness in Malaysia

Effiezal Aswadi Abdul Wahab
School of Accounting, Curtin University of Technology, Perth, Australia
Akmalia M. Ariff
School of Maritime Business and Management, Universiti Malaysia Terengganu, Kuala Terengganu, Malaysia
Marziana Madah Marzuki
Faculty of Accountancy and Accounting Research Institute, Universiti Teknologi Mara, Shah Alam, Malaysia, and
Zuraidah Mohd Sanusi
Accounting Research Institute and Faculty of Accountancy, Universiti Teknologi Mara, Shah Alam, Malaysia

Abstract

Purpose – The purpose of this paper is to examine the relationship between political connections and corporate tax aggressiveness in Malaysia. In addition, this paper investigates the relationship between corporate governance variables and corporate tax aggressiveness. Next, the study investigates the mitigating role of corporate governance in the relationship between political connections and corporate tax aggressiveness.

Design/methodology/approach – The sample of this study is based on 2,538 firm-year observations during the 2000-2009 periods. This study employs a panel least square regression with both period and industry fixed effects. The study retrieved the corporate governance variables from the downloaded annual reports, whilst the remaining data were collected from Compustat Global.

Findings – This study finds that politically connected firms are more tax aggressive than non-connected firms. Furthermore, the study finds that large board size decreases the likelihood of tax aggressiveness and a non-linear relationship exists between institutional ownership and tax aggressiveness suggesting increase in monitoring as the ownership increases. However, the study finds no evidence to suggest that corporate governance mitigates the influence of political connections in promoting tax aggressiveness behavior. The findings suggest that the impact of political connections could outweigh the benefits of changes in corporate governance in Malaysia.

Research limitations/implications – The data are not recent, but it reflects a rather longitudinal research period.

Originality/value – This paper extends the literature of tax research in Malaysia which is in its' infancy stage. Furthermore, it investigates the role of political connections in tax-planning research.

Keywords Malaysia, Political connections, Corporate governance, Tax aggressiveness

Paper type Research paper

1. Research aims

In this study, we explore the relationship between political connections, corporate governance, and tax aggressiveness among firms in Malaysia. Tax aggressiveness refers to various tax-planning strategies that are used to minimize tax liability. Tax planning is legal; however, to some extent, such activities can be used to avoid tax, which results in revenue

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losses to the nation[1],[2]. Empirical evidence on tax issues in the Malaysian capital market is limited. Earlier evidence has been exploratory in nature and has focused on understanding tax in Malaysia, such as the extent of hidden income tax and tax evasion (Kasipillai *et al.*, 2000). In terms of corporate tax, Derashid and Zhang (2003) find that certain industries (manufacturing firms and hotels) pay significantly lower effective tax rates (henceforth, ETR) in Malaysia.

Corporate tax aggressiveness can create agency problems because shareholder and manager interests may not be aligned with regards to tax risks. Shareholders often accept that managers or directors will act on their behalf to focus on maximizing profit, which includes a reduction in tax liabilities. However, based on an agency perspective, the separation of ownership and control can lead to corporate tax decisions that reflect private interests of the directors rather than the shareholders. In addition, Desai *et al.* (2006) argue that self-interest directors would structure a firm in a complex manner to facilitate transactions that divert corporate resources for private use.

In this study, we consider the influence of political connections and corporate governance on corporate tax behavior. Political connections denote firm connectedness as identified from the data of Johnson and Mitton (2003), the Khazanah Berhad website, and Faccio (2006). In the institutional settings of an emerging economy such as Malaysia, political connection is a dilemma that plagues its capital market. Owing to the relationship-based economy in Asia (Rajan and Zingales, 1998), political connections have become a common phenomenon in certain countries, including Malaysia. Faccio *et al.* (2006) find that at approximately 20 percent, Malaysia is among the countries with the highest number of politically connected firms relative to the size of its capital market (see Johnson and Mitton, 2003 for a list of politically connected firms). With regards to political connections, the agency costs for these firms are higher because of rent-seeking activities (Faccio, 2006). Furthermore, these firms are inherently high-risk (Gul, 2006), prone to corporate bailouts (Faccio, 2006), and subject to government assistance (Johnson and Mitton, 2003), which highlights their incapability to expand.

Yet, political connections exist because of the Malaysian New Economic Policy (henceforth, NEP). The goal of the NEP is to ensure better development of the capital market through the balance of wealth among ethnic groups in Malaysia. Thus, in the Malaysian context, political connections have public and policy dimensions, which could result in two conflicting effects of the connections; the provision of assistance to the firms or in the development of nepotism (Adhikari *et al.*, 2006).

Thus, our first research objective is to investigate the relationship between political connections and tax aggressiveness as a measure of tax planning in Malaysia. In line with Kim and Zhang (2015), which argue that connected firms have the advantage of a lower-detection risk, access to information regarding tax changes, complacency in being less transparent, and in its nature of risk-based activities, we predict a positive relationship between political connections and tax aggressiveness in Malaysia. Related evidence from Adhikari *et al.* (2006) indicates that Malaysian firms with political connections pay taxes at significantly lower effective rates than non-connected firms. The scarcity of the empirical evidence on the role of political connections and tax aggressiveness in Malaysia presents opportunity to extend Malaysian literature.

Another issue that is relevant in the context of an emerging economy, such as Malaysia, is the role of corporate governance in its capital market. In the context of corporate tax behavior, governance mechanisms work toward shaping and monitoring managerial behavior. The board of directors, which is responsible for allocating resources, improving performance, and increasing shareholder wealth, has a central role in choosing a tax-management strategy. Thus, firms with different governance structures may pursue different types of tax management. In addition, from the perspective of agency theory, information asymmetry between managers and shareholders may facilitate managers to act according to their own interest, including exploiting tax activities as a tool for managerial opportunism (Desai and Dharmapala, 2006).

Therefore, our second research objective is to analyze the relationship between corporate governance and tax aggressiveness. Related evidence indicates that government ownership, management power, and total accruals are important determinants of the ETR of firms (Mahenthiran and Kasipillai, 2012), and that ownership and board structures affect the extent to which the management of earnings is associated with a deferred tax component (Kasipillai and Mahenthiran, 2013). Salihu *et al.* (2015) report a positive relationship between foreign investor interests and measures of corporate tax avoidance in Malaysia. We argue that good and favorable governance prevents firms from practicing corporate tax aggressiveness policies.

Third, we examine whether corporate governance mitigates the effect of political connections on tax aggressiveness. Two opposing views exist on the possible outcome of this relationship. From one perspective, corporate governance should lessen the tendency of political connections to enhance tax aggressiveness. From another perspective, if the personal dimension of political connections supersedes the policy dimension as argued by Adhikari *et al.* (2006), we would see that corporate governance is unable to mitigate the role of political connections in tax aggressiveness. An alternative view is the role of either substitutability or complementarity of corporate governance, as the former will only replace the higher agency costs that are created by political connections, whereas the latter should mitigate the negative impact of political connections on corporate tax aggressiveness (Ward *et al.*, 2009).

This study uses unbalanced panel data that consists of 2,538 firm-year observations that are derived from firms listed on the Main Board of Bursa Malaysia from 2000 to 2009. Politically connected firms are identified from Johnson and Mitton (2003), the Khazanah Berhad website[3], and Faccio (2006). Corporate governance is proxied by an internal mechanism, which includes chief executive officer (CEO) duality, board independence, and size, and an external mechanism that comprises institutional investor ownership and an external auditor. Tax aggressiveness is measured by using the ETR method. We find a positive and significant relationship between political connections and corporate tax aggressiveness. Furthermore, we find that only board size matters in reducing corporate tax aggressiveness. Our extended analysis suggests that monitoring by institutional investors increases as their ownership increases, which results in a reduction in tax-aggressive behavior. However, our examination finds no support for corporate governance mechanisms mitigating the positive relationship between politically connected firms and corporate tax aggressiveness.

We provide several contributions to extant literature. First, we provide evidence that political connections are an important determinant for corporate tax aggressiveness in Malaysia, and thus support the findings of Kim and Zhang (2015). Next, this study provides an understanding of the role of corporate governance in tax matters. Because taxes are part of operating costs of a corporation and its shareholders (Desai and Dharmapala, 2006), governance plays a direct role in tax management because the board of directors is responsible for better resource allocation, performance, and shareholder wealth (Minnick and Noga, 2010). Our third research finding suggests that the costs of political connections could outweigh benefits from corporate governance.

The remainder of this paper is structured as follows. Section 2 discusses the institutional background. Section 3 explains the rationale behind the research hypotheses. Section 4 explains the sample selection. Section 5 elaborates on the research methodology. Section 6 presents the results and Section 7 concludes.

2. Institutional background

2.1 Political connections in Malaysia

Discussions on the institutional environment of East Asian countries, including Malaysia, highlight several idiosyncratic characteristics that heighten the role of political connections in these countries. East Asian economies are characterized by a relationship-based system (Rajan and Zingales, 1998) that engenders a self-governing network of close connections among banks, politicians, government, and other stakeholders. East Asian economies are regarded as those that give less consideration to the importance of institutional shareholders and public debt, higher political influence, and a lower anticipated cost of shareholder litigation (Ball *et al.*, 2003). In the Malaysian context, the importance of political connections is escalated because the Malaysian capital market is plagued with highly leveraged firms (Bliss and Gul, 2012a, b; Fraser *et al.*, 2006), has a weak enforcement of investor protection, and has a concentrated ownership (Claessens *et al.*, 2000) and family firms (Wan-Hussin, 2009).

Political connections among Malaysian firms may be termed cronyism. However, from the perspective of Malaysia's NEP of 1971, political connections influence the development of a capital market positively. The NEP aims to balance wealth among various ethnic Malaysian groups, especially between the majority Malays (henceforth, Bumiputras) and the Chinese, who in the past have controlled the economy (Gomez and Jomo, 1999). Gomez and Jomo (1999) describe the approach in the NEP as positive discrimination, because the policy was established to assist the Bumiputras in increasing their share of the capital market[4]. Despite remarkable progress, the NEP has remained subject to issues such as cronyism (Gomez and Jomo, 1999; Gul, 2006; Johnson and Mitton, 2003; Salim, 2006), weak professional development (Salim, 2006), and poor management control in terms of executing government contracts (Hamid, 2008).

2.2 Corporate governance in Malaysia

Corporate governance forms an important part of the Malaysian capital market framework, and has become especially important after the Asian Financial Crisis in 1997. The Securities Commission of Malaysia adopts a broader perspective of corporate governance regulatory framework, which is governed by law, code, and regulatory requirements that are instituted by the Securities Commission of Malaysia, Bursa Malaysia, and other statutory bodies. The establishment of the Malaysian Code on Corporate Governance (MCCG) in 2000, as part of the Bursa Malaysia listing requirements, is an important milestone for corporate governance in Malaysia.

It has been stated clearly in the best practices of corporate governance that there should be a clearly accepted division of responsibilities between the Chairman and the CEO to avoid power dominance. Firms are still allowed to combine roles under the condition that there should be a strong independent element in the board, and a justification for the combination should be explained clearly. In terms of board size, it has been stated clearly that every board should examine its size, to determine the impact of the board number on its effectiveness. Part 3 of the corporate governance code mentions the principles and best practices for other corporate participants such as institutional investors. The code emphasizes the direct contact of institutional investors with firms by having constructive communications with management and board members and balancing monitoring task on all aspects that attract attention.

In 2007, the MCCG went through a revision that focused on the qualifications of appointed directors by specifying candidates who had skills, knowledge, expertise, experience, professionalism, and integrity[5]. The revision in 2007 stresses the need to document all assessments and evaluations carried out by the nominating committee in the discharge of its functions and the need to provide greater disclosure of the issues discussed in board meetings. To increase the independence of the board, the MCCG 2007 specifies that all members of the audit committee should be non-executive directors and the number of meetings between the audit committee and the external auditor without the executive board members being present should be increased from once to twice a year. The purpose of the amendment is to encourage a greater exchange of free and honest views and opinions between both parties.

The MCCG was revised in 2012, with the objective of enhancing the compliance of publicly listed firms with laws and ethical values and maintaining an effective governance structure. Areas that have been strengthened in the revision include the roles, responsibilities, and composition of the board; independence, commitment, and remuneration of directors; risk-management framework and internal controls system; and the integrity of financial reporting and a relationship between the company and the shareholders (MCCG, 2012).

The MCCG must provide principles that facilitate an improvement of the boards, such as those that will develop a higher sense of responsibility and effectiveness in protecting the interests of investors. Firms are expected to adopt the principles as part of their governance structures and processes. However, the no "one-size-fits-all" approach to corporate governance provides firms with a flexibility to adopt principles within the MCCG. Despite continuous efforts to enhance corporate governance practices, as exemplified by revisions of the MCCG, emerging economies such as Malaysia are still being criticized for their ineffectiveness in aspects of accountability and transparency. Most often, external investors do not favor issues that involve institutional features of emerging economies, such as the involvement of government in business.

In this study, we examine the effectiveness of the earlier MCCG (the revised MCCG in 2007) that emphasized the responsibility of the board of directors in promoting good corporate governance in Malaysia. As in most corporate governance systems, the board of directors controls managers. This control is indicated via multiple channels, such as structures, executive incentives, and other monitoring and bonding schemes (Hoitash *et al.*, 2009). The revised MCCG in 2007 offers a powerful platform to examine a corporate governance system in relation to the monitoring of financial reporting practices in Malaysia.

2.3 Taxation in Malaysia

Taxes are one of the major contributors to the Malaysian government's revenue. In 2010, direct taxes that were collected by the Inland Revenue Board Malaysia (henceforth, IRBM) contributed 53.35 percent to the total income of the Malaysian Government, with 50.64 percent of direct taxes being derived from corporate tax. The IRBM, which was established in accordance with the Inland Revenue Board of Malaysia Act 1995, is responsible for the overall administration of direct taxes under several Acts, such as the Income Tax Act[6], the Petroleum (Income Tax) Act 1967[7], and the Real Property Gains Tax Act 1976[8].

Income tax in Malaysia is imposed only on Malaysian sources of income (Section 3, ITA, 1967). Income that is derived from sources outside of Malaysia and that are remitted by a resident company is not subject to tax, except for banking and insurance business and sea- and air-transport undertakings. For purposes of corporate tax, a company is considered to be resident in Malaysia if the control and management of its affairs are exercised in Malaysia, which is determined based on where the meetings of the board of directors are held.

Malaysian law has been enacted to highlight the importance of tax collection in Malaysia. Section 140 of the ITA gives power to the Director General of the IRBM not to ignore transactions that may have a direct or indirect effect on the tax liability of a person, such as by altering the incidence of tax payable, evading or avoiding any tax liability or relieving any person from tax liability. The enactment of this regulation highlights that the Malaysian Government pays serious attention to tax evasion or avoidance. The scope of Section 140 of the ITA covers not more than merely altering the incidence of tax liability. According to Pricewaterhouse Coopers, prior to 2010, few litigation cases existed on tax avoidance, which indicates that Malaysian tax authorities pay serious attention and are cautious in their approach to invoking Section 140 of ITA. Nevertheless, the number of cases of tax avoidance from 2010 onwards indicates that this section is very much under the radar of the tax authorities.

In 2001, the IRBM introduced the Self-Assessment System (SAS) to enhance the rate of voluntary compliance and to minimize tax non-compliance. Compared with the former Official Assessment System, through which the IRBM issues annual tax returns to taxpayers, the SAS introduces significant changes in the Malaysian tax assessment system. Under the SAS, taxpayers have to compute and determine their tax liability according to the tax laws and public rulings, pay the tax amount, and file tax returns within a stipulated period[9]. Thus, taxpayers are required to keep business records and maintain sufficient documentations for six years and to disclose taxable income honestly, compute correctly the tax that is payable, file a tax-return form and pay tax in a timely manner. A monetary penalty will be imposed upon non-submission of the tax-return form and late payment of taxes[10]. For repeated offences, imprisonment will be imposed by the Court (Fatt and Khin, 2011). Under the SAS, the responsibility to assess a tax liability rests with the taxpayers. As a result, taxpayers must have sufficient tax knowledge to assess their tax liability correctly and to file tax-return forms on time (Fatt and Khin, 2011).

The enforcements that are attached to the ITA and the SAS can be expected to decrease tax avoidance incidences in this country. Nevertheless, as the taxpayers hold the responsibility to assess their own tax under the SAS, the application of the SAS may increase the motivation for a company to plan tax activities. Furthermore, current corporate tax rate of 25 percent in Malaysia that is applicable to resident and non-resident firms from 2009 onwards may require rigorous tax-planning activities for firms to minimize their expenses and cash outflows related to tax. In this study, Table AI presents the ETRs in Malaysia from assessment years 1988-2009.

3. Research hypotheses

3.1 Political connections and tax aggressiveness

In relation to corporate tax practices, Kim and Zhang (2015) offer five reasons why politically connected firms are more tax aggressive than non-connected firms. First, politically connected firms have a lower-detection risk because they are protected by their connections to politicians. Second, the ability of the politically connected firms to access information regarding future changes in tax regulations and enforcements enables them to explore better time-series differences in tax laws or tax enforcement using complex tax strategies. Third, politically connected firms have less market pressure to be transparent. Fourth, political connections could reduce the political costs of being tax aggressive. Fifth, political connections could be associated with a higher degree of tax aggressiveness because of their risk-taking effect. Consistent with these reasons, Kim and Zhang (2015), who use data from US firms from 1999 to 2009, find that politically connected firms are more tax aggressive than their non-connected counterparts. Alternatively, the political cost hypothesis argues that firms may be reluctant to manage their taxes if the management could result in an image that shows them up as unpatriotic or bad corporate citizens (Minnick and Noga, 2010). For example, anecdotal evidence in the USA finds that firms (e.g. Stanley Works) choose not to move their headquarters offshore, even though such an act could result in substantial tax savings (*The Wall Street Journal*, 2002).

In the Malaysian context, the reasons underlined by Kim and Zhang (2015) can also be applied to describe the dilemma that involves political connections and corporate tax practices; items with a profit-and-cash effect and tax minimization through aggressive tax activities would be areas where political connection is deemed useful. Adhikari *et al.* (2006) argue that an overlap occurs between public and personal dimensions of national policies on political connections. They argue that although policies based on political connections benefit the public in terms of the participation of the Bumiputras in the capital market of Malaysia, they conflict with personal dimension of the policies. Adhikari *et al.* (2006) cite national policies that involve tax and argue that government privileges and concessions, such as special tax deductions and tax-free government bailouts, which are provided to firms that are affected by the policies, result in lower ETRs[11]. Based on an analysis of ten-year Malaysian data, Adhikari *et al.* (2006) find that politically connected firms pay tax at a significantly lower ETR than other firms.

Despite the theoretical and empirical evidence on the negative effect of political connections on corporate tax practices, including those in Malaysia, we argue that there is a need to consider developments that have taken place in the Malaysian corporate setting to understand further the interplay between political connections and tax aggressiveness. Negative perceptions that involve political risks in Malaysia are highlighted mostly during the 1997 financial crisis period, because there were cases that identify political connections as one of the factors that trigger corporate failures and a financial crisis (see Johnson and Mitton, 2003). Following the financial crisis, Malaysian authorities have made substantial improvements that have changed the Malaysian business landscape, including those that involve political risk and/or corporate tax practices directly or indirectly.

Improvements that involve the capital market and national tax policies could minimize the risk of political connections on tax aggressiveness. Alternatively, the negative influence of political connection on tax aggressiveness could prevail because political connection is an embedded institutional feature that has long been practiced among Malaysian firms and requires more time for significant changes to occur. We posit that the latter view is applicable in the setting of our studies.

Prior studies have explored the characteristics of politically connected firms worldwide (Faccio, 2010) and their effect on the capital market in relation to corporate transparency (Bushman *et al.*, 2004), firm performance (Fisman, 2001; Johnson and Mitton, 2003), conservatism (Madah Marzuki and Abdul Wahab, 2016), and earnings quality (Chaney *et al.*, 2011). Gul (2006) examines the impact of political connections on audit fees in Malaysia, and finds that auditors view connected firms as riskier, which results in higher audit fees. In short, Malaysian evidence indicates the existence of political risk that characterizes corporate Malaysian practices, and is consistent with the view that political risks are evident in countries in emerging markets (Chua *et al.*, 2007) compared with developed countries. As suggested by Faccio *et al.* (2006), politically connected firms benefit from their connections, especially in countries with a higher level of corruption.

More specifically, we argue that firms with political connections will tend to exhibit (greater) tax aggressiveness because the institutional feature of political connection still impacts corporate practices negatively, as evidenced by findings from studies on political connections in Malaysia after the financial crisis period (Gul *et al.*, 2016). Based on these arguments, we predict that:

H1. A positive relationship exists between political connections and tax aggressiveness.

3.2 Corporate governance and tax aggressiveness

Whereas tax aggressiveness may be desired by shareholders to improve corporate value (Desai and Dharmapala, 2006), evidence indicates that tax aggressiveness may not necessarily increase corporate value (Khurana and Moser, 2013). Accordingly, empirical evidence that links tax aggressiveness and corporate value is mixed (Abdul Wahab and Holland, 2012; Desai and Dharmapala, 2009). Uncertainties surrounding tax aggressiveness and corporate value lead to the question regarding the role of corporate governance in influencing tax aggressiveness. Ariff and Hashim (2014) cite two perspectives that involve the role of corporate governance in tax-management activities. The first perspective is that tax is a “boardroom issue” because it requires a well-developed strategy to balance lowering tax to improve the bottom-line performance of firms and second, that corporate governance satisfies the firms’ responsibility as good corporate citizens.

Minnick and Noga (2010) assert that a corporate governance structure affects how a company manages its taxes. Consistent with the perspective that tax strategy is part of the responsibilities of the boards, we explore the impact of internal corporate governance mechanisms on tax aggressiveness. The second perspective considers that information asymmetry between managers and shareholders on tax information, such as information regarding the extent of legally permissible reductions in taxable income, enables tax activities to be used for managerial opportunism activities (Desai and Dharmapala, 2006). Findings that firms with different governance structures exhibit different tax avoidance behaviors (Desai and Dharmapala, 2006; Chen *et al.*, 2010) indicate that agency costs surround tax aggressiveness. Consistent with the perspectives that external monitoring is needed to reduce the agency costs that arise from tax decisions, we explore the impact of external corporate governance mechanisms on tax aggressiveness. Internal and external corporate governance mechanisms serve as proxies for a comprehensive measure of corporate governance, compared with prior studies that tend to analyze individual measures of corporate governance.

The internal governance mechanisms, which include the CEO duality, board independence, and board size, emphasize the role of the board of directors, who are responsible for resource allocation, corporate performance, and shareholder wealth (Minnick and Noga, 2010). Given that taxes are part of the operating costs of a corporation (Desai and Dharmapala, 2009); the directors play a direct role in tax management. The first mechanism of CEO duality refers to a situation where a single person holds the position of CEO of the firm and chairperson of the board of directors. Agency theory suggests that a separation of the two roles could provide essential checks and balances over management performance (Haniffa and Cooke, 2002). When a person has two powerful positions on the board, a possibility exists that he or she could withhold unfavorable information to outsiders and act with self-serving behavior. Therefore, CEO duality signals a weak governance of the firm. The second mechanism, board independence, refers to the conditions for a director to be independent from management and significant shareholders. Independent directors have the most important function in monitoring managers, given that their willingness to monitor increases with an increase in independence (Fama and Jensen, 1983) and as such, their independence is seen as a check-and-balance mechanism to enhance board effectiveness. Therefore, an increased level of board independence signals an increase in good governance practice of a firm.

The third mechanism, which is the board of directors’ size, is usually used as a proxy of director expertise, from which a larger board is deemed to benefit better. A larger board is associated with effective monitoring of senior management because it increases the ability to distribute the oversight load over a higher number of observers (Ebaid, 2011). In contrast, monitoring by the board of directors could weaken as the number of observers grows. Haniffa and Hudaib (2006) argue that a small board may be seen to be more effective in improving performance and in limiting the avoidance of director incentives because the performance of each member is easier to monitor and decisions can be made more rapidly. An increase in the number of members on the board of directors could lead to long and thorough arguments over policies, which could minimize the effectiveness of decisions (Yermack, 1996). In line with various perspectives on the effect of board size, mixed empirical evidence exists regarding the board size and corporate performance (Conyon and Peck, 1998; Eisenberg *et al.*, 1998; Abdul Wahab *et al.*, 2015) and accordingly, inconclusive findings exist on the board size as a proxy for governance.

External corporate governance mechanisms that refer to institutional investors and external auditors emphasize the monitoring role in relation to minimizing the agency cost that arises from a principal-agent relationship. Institutional investors are expected to play a fiduciary duty by monitoring the investments of their contributors (Hawley and Williams, 1997) as they have the size (Jennings, 2005), expertise (Shleifer and Vishny, 1986), and the required funds to mount credible governance role in firms. In the Malaysian context, the involvement of large shareholders in monitoring or controlling activities can limit agency problems; as evidence shows that institutional investor shareholdings increase the stock performance of the firm (Abdul Wahab *et al.*, 2007, 2008). However, there is another view of a non-linearity effect of institutional ownership. This view is supported by the notion that government-controlled institutional investors dominate institutional investors in Malaysia. Hence, an increase in shareholdings could virtually convert the firm into one with political connections, which could support tax aggressiveness. Thus, the nature of monitoring from institutional investors differs as ownership increases.

An external auditor relates to the independent audit of financial statements that have long been associated with the role of assurance, from which the credibility of information presented by management is guaranteed to a certain extent. A common scenario in Malaysia is that auditing firms provide tax-planning advice in addition to their auditing services (Abdul Wahab *et al.*, 2014) because of the detailed knowledge of the business operation, corporate structure, and financial situation of clients that auditors possess. Therefore, auditors could provide better advice related to tax matters. Large audit firms are associated with a higher-quality audit and are more likely to ensure better transparency and eliminate mistakes in financial statements (Abdul Wahab *et al.*, 2011). Lisowsky *et al.* (2013) indicate that when clients are economically important to external auditors, auditors provide a strong independence effect and prevent a firm from under-reserving its tax shelter activity. Therefore, firms that are audited by huge audit firms (Big 6 firms) should provide better corporate governance, including areas involving tax.

Overall, these discussions suggest that favorable governance mechanisms could work toward resolving potential agency problems that are associated with tax aggressiveness. For internal governance mechanisms, the effectiveness of the governance role by the board of directors ensures that corporate tax decisions achieve profit and social objectives. For an external governance mechanism, the monitoring role of institutional investors and an external auditor may constrain opportunistic behaviors and provide protection from managerial rent extraction that arises from tax aggressiveness. Nevertheless, Desai and Dharmapala (2006) argue that the relationship between tax avoidance and corporate governance could be endogenous in nature[12]. Corporate governance could shape tax planning; however, the nature of tax practices could influence governance mechanisms, in such aspects as the formation of pyramidal ownership to supplement tax-planning activities.

Several studies have documented evidence on the association between corporate governance and tax aggressiveness. Because they rely on various measures of corporate governance, and often examine individual mechanisms separately, findings are inconclusive. For example, Lanis and Richardson (2011) show that a higher proportion of outside members on the board of director reduces the level of tax aggressiveness, and Khurana and Moser (2013) show that institutional investors are likely to discourage tax avoidance. We attempt to provide a comprehensive view on the effect of corporate governance on tax aggressiveness by incorporating internal and external corporate governance mechanisms in our study, compared with prior evidence that focuses on either one of these mechanisms. In line with the view that effective governance mechanism can reduce tax aggressiveness through the ability to govern and monitor corporate tax decisions, we posit that firms with more favorable governance mechanisms will tend to have lower tax aggressiveness. The following hypothesis is proposed:

H2. A negative relationship exists between favorable corporate governance mechanism and tax aggressiveness.

3.3 Political connections, corporate governance, and tax aggressiveness

To understand the role of political connections and corporate governance in influencing tax-aggressive behaviors among Malaysian firms, we extend prior studies by examining whether corporate governance mitigates the relationship between political connections and tax aggressiveness. Prior studies, as discussed in Sections 3.1 and 3.2, tend to analyze these factors separately, and do not incorporate the joint effect of political connections and corporate governance on tax aggressiveness. More specifically, we explore whether the link between political connection and tax aggressiveness differs across firms with different corporate governance structures. The mitigating role of corporate governance can be viewed from two perspectives; substitutability and complementarity of corporate governance, as detailed in Ward *et al.* (2009).

From the substitutability role perspective, corporate governance and political connections are substitutable. Ward *et al.* (2009), in explaining substitutability, indicate, "an increase in the second mechanism directly replaces a portion of the first mechanism while the overall functionality of the system remains the same." In the context of our study, the increase in corporate governance to a more favorable level only replaces the higher agency cost that arises from political connections, and results in the indifference effect on tax aggressiveness. Hence, from the substitutability perspective, there is no difference between the link between political connections and tax aggressiveness between firms that have a more favorable corporate governance compared with firms with less favorable corporate governance.

Corporate governance complements the role of political connection. The complementary role, as explained by Ward *et al.* (2009), is "where the presence or addition of one mechanism strengthens the other and leads to more effective governance in addressing agency problems." The increase in corporate governance to a more favorable situation reduces the agency costs that arise from political connections and subsequently reduces tax aggressiveness. Hence, from a complementary role perspective, favorable corporate governance mechanisms mitigate the negative effect of political connections on tax aggressiveness.

Several papers investigate the effect of corporate governance on the link between political connections and financial reporting quality (e.g. Chaney *et al.*, 2011), including those that use Malaysian data. Abdul Wahab *et al.* (2009) examine whether institutional investors mitigate the relationship between political connections and audit fees in Malaysia. They find that the presence of institutional investors increases the monitoring role. Consequently, this situation demands a higher audit, which results in higher audit fees. Abdul Wahab *et al.* (2011) extend this work by examining a group of governance variables, but find no evidence that the governance quality between connected and non-connected firms differs in terms of demanding audit fees. Overall, findings of the prior studies are inconclusive, in line with the two possible roles of corporate governance, i.e., substitutability and complementarity. However, it should be noted that the prior studies tend to analyze different individual measures of corporate governance, and as such, a conclusive result is not warranted.

In the context of tax aggressiveness in this study, the possible outcome of examining the mitigating effect of corporate governance is twofold. Our perspective in this study is more of a complementary role of corporate governance. More specifically, we expect corporate governance to play a monitoring role to prevent or mitigate the political involvement in these firms. Thus, better corporate governance mitigates the effect of political connections on tax aggressiveness. Our perspective is motivated by the reform of corporate governance that has taken place after the financial crisis period. We posit that the reforms have a negative effect on tax aggressiveness. However, it is arguable that in a relationship-based economy such as Malaysia, the personal dimension of political connections may continue to provide advantage to politically connected firms. This effect would make governance mechanisms useless in mitigating corporate tax aggressiveness.

We posit that despite the positive relationship between political connections and tax aggressiveness, the relationship is weaker in firms with more favorable governance mechanisms. Based on this argument, we predict the following hypothesis:

H3. The positive relationship between political connections and tax aggressiveness is weaker for firms with more favorable corporate governance mechanisms.

4. Sample selection

This study uses a panel data approach in which data obtained from the annual report of firms that are listed publicly in the Bursa Malaysia's Main Board from 2000 to 2009 are used. Hence, the sample consists of ten years of data observation to control for the effect of economy and tax changes. All sectors are chosen to identify the sector that engages the most in tax aggressiveness activities. Data analysis shows that the final sample consists of 2,538 firm-year observations from 2000 to 2009. Industry details are presented in Table I.

5. Research method

We use the following regressions to validate our research objectives. For the first and second research objectives, regression (1) is used to examine the relationship between political connection and corporate governance and corporate tax aggressiveness. For the third research objective, regression (2) is used to examine whether corporate governance mitigates the relationship between political connections and tax aggressiveness (the variables of interests are bold in both regressions):

$$\begin{aligned} TAX\_AGRR_{it} = {} & \beta_0 INTERCEPT_{it} + \beta_1 POLCON_{it} + \beta_2 CGOV_{it} + \beta_3 ASSETS_{it} \\ & + \beta_4 DEBT_{it} + \beta_5 XLIST_{it} + \beta_6 MTBV_{it} + \beta_7 BUMI_{it} + \beta_8 YR2000_{it} \\ & + \beta_9 YR2007_{it} + \beta_{10} YR2008_{it} + \beta_{11} YR2009_{it} + \beta_{12-21} INDUSTRIES_{it}. \end{aligned} \tag{1}$$

Table I. Industry classifications

Industries	Obs	%	Number of tax aggressive firms	Tax aggr. % A	B
AGRI	122	4.807	90	4.986	73.770
CONSTRUCT	266	10.481	140	7.756	52.632
MANU	730	28.763	567	31.413	77.671
CONSUMER	736	28.999	559	30.970	75.951
TRANSPORT	212	8.353	148	8.199	69.811
WHOLESALE	214	8.432	126	6.981	58.879
HOTEL	97	3.822	65	3.601	67.010
HEALTH	61	2.403	35	1.939	57.377
GOVT	49	1.931	36	1.994	73.469
OTHERS	32	1.261	25	1.385	78.125
MINING	19	0.749	14	0.776	73.684
	2,538	100.000	1,805	100.000	71.119

Notes: Column A: percentage of sample firms that are tax aggressive. Column B: percentage of firms in an industry that are tax aggressive

$$
\begin{aligned}
TAX\_AGRR_{it} = {} & \beta_0 INTERCEPT_{it} + \beta_1 POLCON_{it} + \beta_2 CGOV_{it} + \beta_3 POLCON_{it} \\
& \times CGOV_{it} + \beta_4 ASSETS_{it} + \beta_5 DEBT_{it} + \beta_6 XLIST_{it} + \beta_7 MTBV_{it} \\
& + \beta_8 BUMI_{it} + \beta_9 YR2000_{it} + \beta_{10} YR2007_{it} + \beta_{11} YR2008_{it} \\
& + \beta_{12} YR2009_{it} + \beta_{13-22} INDUSTRIES_{it}. \qquad (2)
\end{aligned}
$$

5.1 Dependent variable

To examine the tax aggressiveness of a firm, previous studies have used ETRs (Chen *et al.*, 2010), cash ETRs (Minnick and Noga, 2010), book-tax differences (Frank *et al.*, 2009), and residual book-tax differences (Desai and Dharmapala, 2006). In this study, ETRs are used to measure tax aggressiveness (TAX_AGGR_{it}).

An ETR is derived from the ratio of the income tax expense (either current or total tax expense) to the pre-tax income of a firm. The ETR is chosen to measure tax aggressiveness because it has been used commonly in this line of study. Xing and Shujun (2007) indicate that an ETR is used broadly by researchers because the rates reflect the actual tax burden of a firm. Furthermore, as the taxable income of a firm does not necessarily correspond to the reported accounting income of the firm, an ETR is the best measurement to identify any tax-planning activities[13]. A lower ETR (below statutory tax rates) for a firm indicates a large gap between the financial accounting and taxable incomes.

Tax aggressiveness is measured from the ETR minus the statutory tax rates. Binary coding is used to construct the variable of tax aggressiveness (TAX_AGGR_{it}). Observations with a negative value for tax aggressiveness are considered as tax aggressive, and are coded as "1." Observations with a positive value for tax aggressiveness are considered not tax aggressive, and are coded as "0".

5.2 Independent test variables

The main independent variable is political connections ($POLCON_{it}$). We operationalized this variable by assigning it a value of 1 if the firms are politically connected based on the same premise of Johnson and Mitton (2003), and 0 otherwise[14]. In addition, we identify government link firms under the Khazanah Berhad as politically connected firms[15]. Our next main independent variable is a corporate governance variable ($CGOV_{it}$). This variable could be sub-categorized into internal and external governance mechanisms.

For internal governance mechanisms, board independence ($BIND_{it}$) is measured based on the proportion of independent, non-executive directors to the total number of directors on the board. Moreover, the board size ($LBSIZE_{it}$) is measured from a natural-logarithmic transformation of the total number of directors on the board. The data for CEO duality ($DUALITY_{it}$) are derived by interrogating the data that are related to the board of directors from the annual report. $DUALITY_{it}$ takes a value of "1" when the roles of CEO and the chairman are separate and a value of "0" when CEO duality exists. For the external governance mechanisms, institutional investor ($INSTOWN_{it}$) represents the percentage of shareholdings by the top five institutional investors in a firm. External auditor ($BIGN_{it}$) is represented by a value of "1" when the firm is audited by any of the big "N" auditors; otherwise, it takes a value of "0." Big "N" auditor refers to companies Arthur Andersen, Coopers & Lybrand, Deloitte Touche, Ernst & Young, KPMG Peat Marwick, and Price Waterhouse.

5.3 Independent control variables

In this study, several variables are identified as control variables. Total assets are used to measure the firm size ($LASSETS_{it}$), which we operationalize by a natural-logarithmic transformation of the total assets. The firm size is chosen as a control variable because of the likelihood that the firm size affects tax aggressiveness. The firm size is an important determinant of better governance (Ettredge *et al.*, 2011) because larger firms perform better because of their ability to diversify risk (Abdul Wahab *et al.*, 2007). In addition, the firm size plays a role in tax management because smaller firms have higher tax rates (Dyreng *et al.*, 2008). Leverage ($DEBT_{it}$) is measured as the total debt divided by the total equity. Leverage is included as a control variable because more leveraged firms may not need to engage in tax-planning activities because of the tax shield benefit of debt financing (Chen *et al.*, 2010).

Cross-listing ($XLIST_{it}$) is an important path for integration into the world economy and financial globalization. Cross-listing could open up international financing channels, and strengthen corporate governance to enhance the corporate image (Jian, *et al.*, 2011). Because of this advantage, observations that involve firms that are cross-listed in other countries are coded as "1," and otherwise they are coded as "0." We include a market-to-book ratio ($MTBV_{it}$) to control for growth. We predict a positive relationship between $MTBV_{it}$ and corporate tax aggressiveness.

Years 2000 ($YR2000_{it}$), 2007($YR2007_{it}$), 2008 ($YR2008_{it}$), and 2009 ($YR2009_{it}$) are used as control variables because of changes in tax policies and statutory tax rates during these years. The Malaysian Government in 2001 implemented the SAS for a company. Because of the introduction of the SAS, the assumption is that tax activities in 2000 will differ from subsequent years (2001-2009), including activities that are related to tax aggressiveness. Years 2007, 2008, and 2009 are included as control variables because the government reduces the tax rates from 28 percent (assessment year 2006) to 27 percent (assessment year 2007) to 26 percent (assessment year 2008), and to 25 percent (assessment year 2009). The reduction in tax rates is expected to affect the likelihood of tax aggressiveness. We include an industry classification ($INDUSTRIES_{it}$) to control for the variation in corporate tax aggressiveness across industries.

To reflect Malaysian institutional settings, where the development of the capital market is based on ethnicity, we include a control for culture. We use the proportion of Bumiputras directors on board ($BUMI_{it}$) as our proxy for culture. Tsakumis *et al.* (2007) investigate the relationship between national cultural dimensions and tax evasion. The finding reveals that the dimensions of a higher power distance and uncertainty avoidance are associated with higher tax evasion levels, whereas a higher level of individualism and masculinity is associated with a lower tax evasion across countries. The Hofstede (1991) model suggests that the dominant Malays (Bumiputras) and Chinese are low on masculinity, but high on power distance. Hence, we predict an association between the proportion of Bumiputras directors on the board and tax aggressiveness[16].

5.4 Data description

Table II presents the descriptive statistics for this study. Approximately 71.1 percent of the sample firms are considered to be practicing aggressive tax planning (TAX_AGGR_{it}), as presented in Panel A. Only 13.9 percent of the sample firms are politically connected ($POLCON_{it}$). Panel C of Table II presents the corporate governance variable figures. The mean (median) for the percentage of independent non-executive directors ($BIND_{it}$) is 33.725 (33.333). The mean (median) value for the natural-logarithmic transformation of board size ($LBSIZE_{it}$) is 1.821 (1.791). Approximately 64.5 percent of sample firms separate the CEO and chairperson functions ($DUALITY_{it}$). The mean (median) institutional investor ownership ($INSTOWN_{it}$) is 9.860 (4.640), with a maximum of 78.917 percent. Finally, 64.3 percent of sample firms are audited by a Big N auditor ($BIGN_{it}$).

Panel D of Table II tabulates the descriptive statistics of our control variables. The mean (median) for the natural-logarithmic transformation for total assets ($LASSETS_{it}$) is

	Mean	Median	Maximum	Minimum	SD
Panel A: dependent variable					
TAX_AGGR_{it}	0.711	1.000	1.000	0.000	0.453
Panel B: institutional variables					
$POLCON_{it}$	0.139	0.000	1.000	0.000	0.346
Panel C: corporate governance					
$BIND_{it}$	33.725	33.333	83.333	0.000	19.181
$LBSIZE_{it}$	1.821	1.791	2.708	0.693	0.259
$DUALITY_{it}$	0.645	1.000	1.000	0.000	0.478
$INSTOWN_{it}$	9.860	4.640	78.917	0.000	13.954
$BIGN_{it}$	0.643	1.000	1.000	0.00	0.479
Panel D: control variables					
$LASSETS_{it}$	19.851	19.655	24.991	17.010	1.314
$DEBT_{it}$	1.787	0.864	65.00	0.000	3.833
$XLIST_{it}$	0.029	0.000	1.000	0.000	0.169
$MTBV_{it}$	2.011	1.160	20.000	0.000	2.505
Panel E: country variable					
$BUMI_{it}$	27.241	20.000	100.000	0.000	28.169

Notes: TAX_AGGR_{it} is an indicator variable that takes the value of 1 if the ETR is less than the statutory tax rates. $POLCON_{it}$ takes the value of 1 if the firm is politically connected. $BIND_{it}$ is the percentage of independent directors on board. $LBSIZE_{it}$ is the natural log transformation of board size. $DUALITY_{it}$ takes the value of 1 if the firm splits the CEO and chairperson. $INSTOWN_{it}$ is top five institutional investor shareholdings. $BIGN_{it}$ is an indicator variable that takes the value of 1 if the firm is audited by a Big *N* firm. $LASSETS_{it}$ is natural log transformation of total assets. $DEBT_{it}$ is total liability to total equity. $XLIST_{it}$ takes the value of 1 if the firm is cross-listed at an external stock exchange. $MTBV_{it}$ is market to book value. $BUMI_{it}$ is the percentage of Bumiputras directors on the board

Table II.
Descriptive statistics

19.851 (19.655) and that for $DEBT_{it}$ is 1.787 (0.864). Only 2.9 percent of sample firms are cross-listed ($XLIST_{it}$) in external stock exchanges. The mean (median) for $MTBV_{it}$ is 2.011 (1.160). The average percentage of Bumiputras directors ($BUMI_{it}$) is 27.241 percent.

6. Results

6.1 Univariate

Table III presents the correlations, and the Pearson and Spearman results. We find negative but insignificant correlations between $POLCON_{it}$ and TAX_AGGR_{it}. We find negative and significant correlations with TAX_AGGR_{it} for $BUMI_{it}$, $LBSIZE_{it}$, and $INSTOWN_{it}$ and positive and significant correlation for $DEBT_{it}$. The negative and significant correlations for $LBSIZE_{it}$ and $INSTOWN_{it}$ against TAX_AGGR_{it} provide initial support that institutional investors perform monitoring and thus prevent the likelihood of corporate tax aggressiveness.

We extend the univariate analysis by examining the differences in mean and median between firms that are considered as tax aggressive ($TAX\_AGGR_{it} = 1$) and non-tax aggressive ($TAX\_AGGR_{it} = 0$). The results are presented in Table IV. The purpose of this test is to examine any differences in the variable between corporate tax-aggressive and non-aggressive firms. The χ^2 result for $POLCON_{it}$ is insignificant. We find significant differences for the mean (*t*-test) and median (Mann-Whitney) for the board size ($LBSIZE_{it}$), which suggests that tax-aggressive firms have a significantly lower number of directors on the board. Furthermore, we find significant mean (*t*-test) differences for institutional investor ownership ($INSTOWN_{it}$) in which tax-aggressive firms have significantly lower institutional ownership than non-aggressive firms. Next, we find that tax-aggressive firms

Table III.
Correlations

Probability	TAX_AGGR_{it}	$POLCON_{it}$	$BUMI_{it}$	$BIND_{it}$	$LBSIZE_{it}$	$DUALITY_{it}$	$INSTOWN_{it}$	$BIGN_{it}$	$ASSETS_{it}$	$DEBT_{it}$	$XLIST_{it}$	$MTBV_{it}$
TAX_AGGR_{it}		−0.003	−0.095***	0.015	−0.086***	−0.020	−0.033	0.004	−0.066***	0.031	−0.002	−0.048**
$POLCON_{it}$	−0.003		0.136***	0.015	0.148***	0.068***	0.214***	0.070***	0.366***	0.102***	0.144***	0.150***
$BUMI_{it}$	−0.098***	0.157***		0.016	0.175***	0.085***	0.224***	−0.029	0.102***	−0.059***	0.005	0.089***
$BIND_{it}$	0.019	0.015	0.054***		−0.065***	−0.008	−0.008	0.002	0.015	0.048**	0.029	−0.008
$LBSIZE_{it}$	−0.087***	0.172***	0.148***	−0.035*		0.093***	0.222***	0.060***	0.129***	−0.078***	0.066***	0.191***
$DUALITY_{it}$	−0.020	0.068***	0.060***	0.006	0.107***		0.084***	0.016	0.080***	−0.019	−0.007	0.096***
$INSTOWN_{it}$	−0.052***	0.248***	0.240***	0.048**	0.182***	0.070***		0.118***	0.326***	−0.107***	0.100***	0.368***
$BIGN_{it}$	0.004	0.070***	−0.008	0.003	0.075***	0.016	0.118***		0.168***	−0.016	0.076***	0.118***
$LASSETS_{it}$	−0.051**	0.427***	0.094***	0.020	0.168***	0.065***	0.324***	0.156**		0.278***	0.175***	0.372***
$DEBT_{it}$	0.058***	0.082***	−0.014	0.046**	−0.040**	−0.025	−0.057***	0.003	0.268***		0.035*	−0.226***
$XLIST_{it}$	−0.002	0.144***	0.008	0.042**	0.089***	−0.007	0.147***	0.076***	0.268***	0.035**		0.141***
$MTBV_{it}$	0.016	0.194***	0.030	0.022	0.130***	0.070***	0.263***	0.092***	0.394***	−0.129***	0.141***	

Notes: Pearson and spearman correlations: spearman correlations are italicized. TAX_AGGR_{it} is an indicator variable that takes the value of 1 if the ETR is less than the statutory tax rates. $POLCON_{it}$ takes the value of 1 if the firm is politically connected. $BIND_{it}$ is the percentage of independent directors on board. $LBSIZE_{it}$ is natural log transformation of board size. $DUALITY_{it}$ takes the value of 1 if the firm splits the CEO and chairperson. $INSTOWN_{it}$ is the top five institutional investor shareholdings. $BIGN_{it}$ is an indicator variable that takes the value of 1 if the firm is audited by a Big *N* firm. $LASSETS_{it}$ is natural log transformation of total assets. $DEBT_{it}$ is total liability to total equity. $XLIST_{it}$ takes the value of 1 if the firm is cross-listed at an external stock exchange. $MTBV_{it}$ is market to book value. $BUMI_{it}$ is the percentage of Bumiputras directors on the board. *,**,***Significant at the 10, 5, and 1 percent levels, respectively

Table IV. Differences of mean and median between tax aggressive and non-tax aggressive firms

	Tax aggr. = 1 ($n = 1{,}805$) Mean	Median	Tax aggr. = 0 ($n = 734$) Mean	Median	t-test	Mann-Whitney
Panel A: institutional variable						
$POLCON_{it}$	0.139	0.000	0.141	0.00	0.785	0.785
Panel B: corporate governance variables						
$BIND_{it}$	33.95	33.333	33.147	33.333	0.308	0.426
$LBSIZE_{it}$	1.807	1.7918	1.857	1.791	*0.000*	*0.000*
$DUALITY_{it}$	0.639	1.0000	0.660	1.000	(0.260)	
$INSTOWN_{it}$	9.395	4.4414	11.004	5.177	*0.011*	0.126
$BIGN_{it}$	0.64	1.0000	0.640	1.000	(0.852)	
Panel C: control variables						
$ASSETS_{it}$	19.808	19.581	19.955	19.741	*0.01*	*0.001*
$DEBT_{it}$	1.929	0.860	1.436	0.870	*0.005*	0.299
$XLIST_{it}$	0.029	0.000	0.030	0.000	(0.971)	
$MTBV_{it}$	2.037	1.090	1.948	1.280	0.354	0.022
Panel D: country variable						
$BUMI_{it}$	25.486	20.000	31.557	22.222	*0.000*	*0.000*

Notes: TAX_AGGR_{it} is an indicator variable that takes the value of 1 if the ETR is less than the statutory tax rates. $POLCON_{it}$ takes the value of 1 if the firm is politically connected. $BIND_{it}$ is the percentage of independent directors on board. $LBSIZE_{it}$ is the natural log transformation of board size. $DUALITY_{it}$ takes the value of 1 if the firm splits the CEO and Chairperson. $INSTOWN_{it}$ is the top five institutional investor shareholdings. $BIGN_{it}$ is an indicator variable that takes the value of 1 if the firm is audited by a Big *N* firm. $LASSETS_{it}$ is the natural log transformation of total assets. $DEBT_{it}$ is total liability to total equity. $XLIST_{it}$ takes the value of 1 if the firm is cross-listed at an external stock exchange. $MTBV_{it}$ is market to book value. $BUMI_{it}$ is the percentage of Bumiputras directors on the board. Significant p-values are in *italic* face. χ^2 results are in parenthesis

have a lower percentage of Bumiputras directors ($BUMI_{it}$) than non-aggressive firms. This finding is significant for the mean (t-test) and median (Mann-Whitney).

We perform univariate analysis to examine differences between the mean and median of the variables between politically and non-politically connected firms. At the univariate level, we do not find any significant differences in corporate tax aggressiveness between connected and non-connected firms. However, we find significant differences in all the remaining variables, with the exception of the board of independence ($BIND_{it}$) between politically and non-politically connected firms. These findings are interesting because we do not find any significant difference in the corporate tax aggressiveness between connected and non-connected firms, but we find a difference in all the remaining variables. This result suggests that the relationship between $POLCON_{it}$ and TAX_AGGR_{it} depends on various governance and firm characteristics. The following section on multivariate analysis explores this possibility (Table V).

6.2 *Multivariate*[17]

Table VI tabulates the main regression results. Column 1 presents the main regression, and Column 2 includes the non-linearity test of institutional investors ownership ($INSTOWN\text{\^{}}2_{it}$). We find a positive and significant relationship between $POLCON_{it}$ and TAX_AGGR_{it} (0.142, $z = 1.586$, $p < 0.10$). This finding supports that political connections promote tax aggressiveness. Our finding is similar to that of Adhikari *et al.* (2006), who find that politically connected firms pay lower ETRs. In addition, our finding supports the arguments raised by Adhikari *et al.* (2006) that political connections result in overlapping policies between the public and personal dimension of political connections; thus, corporate

	Polcon = 1 Mean	$n = 355$ Median	Polcon = 0 Mean	$n = 2{,}184$ Median	T-test	Mann-Whitney
Panel A: dependent variable						
TAX_AGGR_{it}	0.707	1.000	0.711	1.000	(0.785)	
Panel B: corporate governance variables						
$BIND_{it}$	34.456	33.333	33.606	33.333	0.531	0.530
$LBSIZE_{it}$	1.932	1.945	1.8039	1.791	*0.000*	*0.000*
$DUALITY_{it}$	0.726	1.000	0.6328	1.000	*(0.000)*	
$INSTOWN_{it}$	18.438	11.511	8.4664	3.744	*0.000*	*0.000*
$BIGN_{it}$	0.726	1.000	0.6300	1.000	*(0.000)*	
Panel C: control variables						
$LASSETS_{it}$	21.243	21.119	19.624	19.487	*0.000*	*0.000*
$DEBT_{it}$	2.570	1.140	1.660	0.820	*0.000*	*0.000*
$XLIST_{it}$	0.090	0.00	0.019	0.000	*(0.000)*	
$MTBV_{it}$	3.215	1.8600	1.815	1.090	*0.000*	*0.000*
Panel D: country variable						
$BUMI_{it}$	38.238	30.000	25.453	20.000	*0.000*	*0.000*

Notes: TAX_AGGR_{it} is an indicator variable that takes the value of 1 if the ETR is less than the statutory tax rates. $POLCON_{it}$ takes the value of 1 if the firm is politically connected. $BIND_{it}$ is the percentage of independent directors on board. $LBSIZE_{it}$ is the natural log transformation of board size. $DUALITY_{it}$ takes the value of 1 if the firm splits the CEO and chairperson. $INSTOWN_{it}$ is the top five institutional investor shareholdings. $BIGN_{it}$ is an indicator variable that takes the value of 1 if the firm is audited by a Big N firm. $LASSETS_{it}$ is the natural log transformation of total assets. $DEBT_{it}$ is total liability to total equity. $XLIST_{it}$ takes the value of 1 if the firm is cross-listed at an external stock exchange. $MTBV_{it}$ is market to book value. $BUMI_{it}$ is the percentage of Bumiputras directors on the board. Significant p-values are in italic face. χ^2 results are in parenthesis

Table V.
Differences of mean and median between politically connected and non-connected firms

tax aggressiveness is promoted. Our finding on this relationship is consistent with that of Kim and Zhang (2015).

We find a negative and significant relationship between $LBSIZE_{it}$ and TAX_AGGR_{it} (-0.323, $z = -2.875$, $p < 0.01$). This negative relationship suggests that a larger board size acts as a monitoring mechanism and prevents tax aggressiveness. We could not find evidence that other corporate governance variables affect (either positively or negatively) corporate tax aggressiveness.

We find significant coefficients for $LASSETS_{it}$ (-0.060, $z = -2.218$; $p < 0.05$), $DEBT_{it}$ (0.041, $z = 3.452$, $p < 0.01$), and $MTBV_{it}$ (0.023, $z = 2.117$, $p < 0.05$), which indicates that bigger firms are less tax aggressive. Hence, firms with higher levels of debts and higher growth will practice a form of tax aggressiveness. Our sole country variable, $BUMI_{it}$ is negative and significant (-0.003, $z = -2.950$, $p < 0.01$), which suggests that Bumiputras directors are conservative; thus, they do not practice corporate tax aggressiveness. We find that $YR2007_{it}$ is positive and related significantly to TAX_AGGR_{it}, and this supports that a higher tax rate leads to tax aggressiveness methods by the directors.

Column 2 of Table VI presents the regression results test for the non-linearity of institutional investor ownership ($INSTOWN\hat{}2_{it}$). We find a positive and significant relationship between $INSTOWN_{it}$ and TAX_AGGR_{it} (0.010, $z = 2.024$, $p < 0.01$); in contrast, a negative and significant coefficient results for $INSTOWN\hat{}2_{it}$ (0.000, $z = -2.792$, $p < 0.01$). This inverse-U relationship between institutional investors and corporate tax aggressiveness suggests that the monitoring level of institutional investors increases with an increase in its ownership. Our findings support the argument raised by literature that institutional investors play a governance role. In addition, this finding supports those of Abdul Wahab *et al.* (2007)

Variable	Expected direction	Coefficient 1	2
$INTERCEPT_{it}$	?	2.300	2.356
		3.774***	3.852***
$POLCON_{it}$	+	0.142	0.157
		1.586*	1.744*
$BIND_{it}$	−	0.000	0.000
		0.261	0.344
$LBSIZE_{it}$	?	−0.323	−0.349
		−2.875***	−3.093***
$DUALITY_{it}$	−	0.005	0.007
		0.095	0.123
$INSTOWN_{it}$	−	−0.002	0.010
		−1.126	2.024**
$INSTOWN\^{}2_{it}$	?		0.000
			−2.792***
$BIGN_{it}$	−	0.055	0.056
		0.949	0.966
$LASSETS_{it}$	+	−0.060	−0.063
		−2.218**	−2.324**
$DEBT_{it}$	+	0.041	0.042
		3.452***	3.512***
$XLIST_{it}$	+	0.000	0.044
		−0.003	0.247
$MTBV_{it}$	+	0.028	0.023
		2.117**	1.724*
$BUMI_{it}$	−	−0.003	−0.003
		−2.950***	−2.948***
$YR2000_{it}$	?	−0.080	−0.084
		−0.716	−0.747
$YR2007_{it}$	?	0.211	0.227
		2.556**	2.742***
$YR2008_{it}$	?	−0.039	−0.032
		−0.309	−0.248
$YR2009_{it}$	?	−0.123	−0.115
		−0.924	−0.865
$INDUSTRIES_{it}$	?	Yes	Yes
McFadden R^2		0.050	0.052
LR statistic		151.975***	159.814***

Notes: TAX_AGGR_{it} is an indicator variable that takes the value of 1 if the ETR is less than statutory tax rates. $POLCON_{it}$ takes the value of 1 if the firm is politically connected. $BIND_{it}$ is the percentage of independent directors on board. $LBSIZE_{it}$ is the natural log transformation of board size. $DUALITY_{it}$ takes the value of 1 if the firm splits the CEO and Chairperson. $INSTOWN_{it}$ is the top five institutional investor shareholdings. $BIGN_{it}$ is an indicator variable that takes the value of 1 if the firm is audited by a Big *N* firm. $LASSETS_{it}$ is the natural log transformation of total assets. $DEBT_{it}$ is total liability to total equity. $XLIST_{it}$ takes the value of 1 if the firm is cross-listed at an external stock exchange. $MTBV_{it}$ is market to book value. $BUMI_{it}$ is the percentage of Bumiputras directors on the board. *,**,***Significant at the 10, 5, and 1 percent levels, respectively

Table VI.
Main regression

and Abdul Wahab *et al.* (2008) on the role of institutional investors. The results for the remaining variables are statistically similar to those of Column 1 of Table VI.

Table VII presents the regressions results for the *H3*, in which we run the interaction terms between $POLCON_{it}$ and $CGOV_{it}$. We could not find any evidence to suggest that corporate governance variables ($CGOV_{it}$) mitigate the positive relationship between $POLCON_{it}$ and TAX_AGGR_{it}. These findings suggest that the presence of political connections may overcome the presence of good governance in a firm. In addition, this finding supports the

Table VII.
Regressions

Variable	Expected direction	Coefficient 1	2	3	4	5	6	7
$INTERCEPT_{it}$	?	2.356	2.353	2.241	2.385	2.359	2.337	2.357
		3.852***	3.845***	3.612***	3.897***	3.820***	3.791***	3.852***
$POLCON_{it}$	+	0.157	−0.186	0.731	−0.025	0.154	0.165	0.148
		1.744*	−1.094	1.395	−0.164	1.371	1.713*	0.950
$BIND_{it}$	−	0.000	−0.001	0.000	0.001	0.000	0.000	0.000
		0.344	−0.497	0.339	0.369	0.345	0.343	0.341
$LBSIZE_{it}$	?	−0.349	−0.351	−0.294	−0.352	−0.350	−0.349	−0.350
		−3.093***	−3.108***	−2.375***	−3.117***	−3.091***	−3.083***	−3.094***
$DUALITY_{it}$	−	0.007	0.010	0.006	−0.024	0.007	0.006	0.007
		0.123	0.171	0.097	−0.389	0.125	0.107	0.124
$INSTOWN_{it}$	−	0.010	0.011	0.010	0.010	0.010	0.010	0.010
		2.024**	2.109**	2.043**	1.993*	2.015***	1.881*	2.025**
$INSTOWN\hat{}2_{it}$	?	0.000	0.000	0.000	0.000	0.000	0.000	0.000
		−2.792***	−2.957***	−2.812***	−2.744***	−2.545**	−2.184**	−2.790***
$BIGN_{it}$	−	0.056	0.050	0.056	0.058	0.056	0.056	0.055
		0.966	0.851	0.960	0.987	0.967	0.962	0.892
$POLCON_{it}{\times}BIND_{it}$	?		0.010					
			2.350**					
$POLCON_{it}{\times}LBSIZE_{it}$	?			−0.299				
				−1.114				
$POLCON_{it}{\times}DUALITY_{it}$	?				0.252			
					1.453			
$POLCON_{it}{\times}INSTOWN_{it}$	?					0.000		
						0.044		
$POLCON_{it}{\times}INSTOWN\hat{}2_{it}$	?						0.000	
							−0.240	
$POLCON_{it}{\times}BIGN_{it}$	?							0.012
								0.066
$LASSETS_{it}$	+	−0.063	−0.061	−0.063	−0.064	−0.063	−0.063	−0.063
		−2.324**	−2.233**	−2.296**	−2.339**	−2.317**	−2.290**	−2.324**
$DEBT_{it}$	+	0.042	0.042	0.043	0.043	0.042	0.042	0.042
		3.512***	3.471***	3.539***	3.552***	3.496***	3.477***	3.512***
$XLIST_{it}$	+	0.044	0.040	0.054	0.056	0.043	0.046	0.044
		0.247	0.226	0.306	0.316	0.244	0.259	0.250
$MTBV_{it}$	+	0.023	0.024	0.023	0.024	0.023	0.023	0.023
		1.724*	1.823*	1.713*	1.773*	1.718*	1.732*	1.725*
$BUMI_{it}$	−	−0.003	−0.003	−0.003	−0.003	−0.003	−0.003	−0.003
		−2.948***	−2.868***	−2.861***	−2.867***	−2.937***	−2.958***	−2.945***
$YR2000_{it}$	?	−0.084	−0.081	−0.083	−0.080	−0.084	−0.084	−0.084
		−0.747	−0.720	−0.737	−0.709	−0.746	−0.747	−0.747
$YR2007_{it}$	?	0.227	0.229	0.228	0.229	0.227	0.227	0.227
		2.742***	2.759***	2.752***	2.766***	2.742***	2.740***	2.742***
$YR2008_{it}$	?	−0.032	−0.029	−0.037	−0.030	−0.032	−0.030	−0.032
		−0.248	−0.229	−0.289	−0.238	−0.250	−0.236	−0.247
$YR2009_{it}$	?	−0.115	−0.117	−0.121	−0.117	−0.116	−0.114	−0.115
		−0.865	−0.877	−0.910	−0.876	−0.866	−0.857	−0.864
$INDUSTRIES_{it}$	?	Yes	Yes	Yes	Yes	Yes	Yes	Yes
McFadden R^2		0.052	0.054	0.053	0.053	0.052	0.052	0.052
LR statistic		159.814***	165.387***	161.058***	161.913***	159.816***	159.872***	159.818***

Notes: TAX_AGGR_{it} is an indicator variable that takes the value of 1 if the ETR is less than the statutory tax rates. $POLCON_{it}$ takes the value of 1 if the firm is politically connected. $BIND_{it}$ is the percentage of independent directors on board. $LBSIZE_{it}$ is the natural log transformation of board size. $DUALITY_{it}$ takes the value of 1 if the firm splits the CEO and Chairperson. $INSTOWN_{it}$ is the top five institutional investor shareholdings. $BIGN_{it}$ is an indicator variable that takes the value of 1 if the firm is audited by a Big *N* firm. $LASSETS_{it}$ is the natural log transformation of total assets. $DEBT_{it}$ is total liability to total equity. $XLIST_{it}$ takes the value of 1 if the firm is cross-listed at an external stock exchange. $MTBV_{it}$ is market to book value. $BUMI_{it}$ is the percentage of Bumiputras directors on the board. *,**,***Significant at the 10, 5, and 1 percent levels, respectively

substitutability argument between corporate governance and political connections by Ward *et al.* (2009). The findings suggest that the increase in corporate governance at a more favorable level replaces only the higher agency costs that arise from political connections, and result in an indifferent effect on tax aggressiveness. In addition, the findings signal that rent-seeking activities by politically connected firms neutralize the monitoring benefits from corporate governance mechanisms in reducing corporate tax aggressiveness.

We view this finding as an important reflection of the role of political connections in a relationship-based economy such as Malaysia. The results suggest that political connections shape the capital market in Malaysia and influence tax-planning practices of connected firms.

6.3 Further analysis

We extended the test by examining the impact of the MCCG revision in 2007 (MCCG 2007) on corporate tax aggressiveness in Table VIII. Similar to our main regression in Table VI,

Table VIII. Pre- and post-MCCG 2007

Variable	Expected direction	Coefficient Pre-MCCG	Post-MCCG
$INTERCEPT_{it}$	?	2.227	9.743
		3.221***	0.000
$POLCON_{it}$	+	0.099	0.385
		0.984	1.761*
$BIND_{it}$	–	0.000	0.002
		−0.081	0.853
$LBSIZE_{it}$	?	−0.291	−0.573
		−2.319**	−2.003**
$DUALITY_{it}$	–	−0.020	0.139
		−0.294	1.199
$INSTOWN_{it}$	–	0.010	0.015
		1.814*	1.334
$INSTOWN\text{^}2_{it}$	?	0.000	0.000
		−2.471**	−1.558
$BIGN_{it}$	–	0.073	0.056
		1.091	0.437
$LASSETS_{it}$	+	−0.072	−0.065
		−2.277**	−1.111
$DEBT_{it}$	+	0.059	0.028
		3.381***	1.641*
$XLIST_{it}$	+	0.041	0.003
		0.200	0.008
$MTBV_{it}$	+	0.025	0.015
		1.648*	0.511
$BUMI_{it}$	–	−0.003	−0.002
		−2.722**	−0.950
$YR2000_{it}$	?	−0.082	
		−0.720	
$YR2008_{it}$	?		−0.201
			−1.286
$YR2009_{it}$	?		−0.319
			−2.033**
$INDUSTRIES_{it}$	?	Yes	Yes
McFadden R^2		0.057	0.055
LR statistic		132.238***	38.763***

Notes: *TAX_AGGR_{it}* is an indicator variable that takes the value of 1 if the ETR is less than the statutory tax rates. *$POLCON_{it}$* takes the value of 1 if the firm is politically connected. *$BIND_{it}$* is the percentage of independent directors on board. *$LBSIZE_{it}$* is the natural log transformation of board size. *$DUALITY_{it}$* takes the value of 1 if the firm splits the CEO and Chairperson. *$INSTOWN_{it}$* is the top five institutional investor shareholdings. *$BIGN_{it}$* is an indicator variable that takes the value of 1 if the firm is audited by a Big *N* firm. *$LASSETS_{it}$* is the natural log transformation of total assets. *$DEBT_{it}$* is total liability to total equity. *$XLIST_{it}$* takes the value of 1 if the firm is cross-listed at an external stock exchange. *$MTBV_{it}$* is market to book value. *$BUMI_{it}$* is the percentage of Bumiputras directors on the board. *,**,***Significant at the 10, 5, and 1 percent levels, respectively we find that board size ($LBSIZE_{it}$) is associated significantly and negatively with corporate tax aggressiveness (TAX_AGGR_{it}). However, we find that the non-linear relationship between $INSTOWN_{it}$ and TAX_AGGR_{it} exists only in the pre-MCCG period (1999-2006), but not post-MCCG.

Next, we re-run the interaction tests between $POLCON_{it}$ and $CGOV_{it}$ for pre- and post-MCCG. Our untabulated results suggest that the results of the interactions remain similar to Table VII. The results suggest that the corporate governance variables are unable to overcome the nature of the relationship-based economy in Malaysia.

7. Conclusion

In this study, we examine the relationship between political connections and tax aggressiveness and corporate governance and tax aggressiveness. Moreover, in this study, we investigate the effect of corporate governance on the link between political connections and tax aggressiveness. To validate the three research objectives, data were collected from the annual reports of firms listed on the main board of Bursa Malaysia from 2000 to 2009. An unbalanced panel data analysis was based on 2,538 firm-year observations. Political connections denote firm connectedness according to Johnson and Mitton (2003), the Khazanah Berhad website, and Faccio (2006). Corporate governance is represented by internal and external mechanisms, namely duality, board independence, board size, institutional investors, and external auditor. Tax aggressiveness is measured using ETRs and is assumed to exist when the ETR is less than the statutory tax rates.

We find a positive and significant relationship between political connections and corporate tax aggressiveness. This finding supports that of Adhikari *et al.* (2006), who argue that the overlapping policy between public and personal dimensions of political connections suggests the favor provided to connected firms in the form of corporate tax relief and possible tax-free bailouts. The limited finding on the role of internal governance with the exception of the number of directors on the board could indicate the weaknesses of corporate governance mechanisms in preventing aggressive tax behavior by firms. There is also no evidence to suggest that corporate governance mitigates the influence of political connections in promoting tax aggressiveness behavior. We view these findings as a starting point for further research on the role of corporate governance and corporate tax aggressiveness in Malaysia. For future research, the use of other measures of tax aggressiveness such as corporate book-tax differences, or specific tax avoidance that is most likely associated with agency costs, would be a valuable research agenda.

The findings of this study provide useful feedback to the government, particularly to the IRBM, which could be used as a basis for the revamp and improvement of the current tax approach. The current approach of the tax authority is to detect tax avoidance from the audit activities by selecting cases that are based on a risk analysis of the financial statement figures. In future, political connections and corporate governance mechanisms should be incorporated as indicators to detect tax avoidance. The information gathered from this study could assist market participants in understanding fully the role of political connections and corporate governance in monitoring tax aggressiveness in firms.

Notes

1. Consistent with existing empirical research (Chen *et al.*, 2010; Frank *et al.*, 2009), we define tax aggressiveness as the downward management of taxable income through tax-planning activities. Thus, this terminology encompasses legal tax-planning activities, activities that may fall into a gray area, and illegal activities.
2. Lietz (2013) states that the terminologies "tax avoidance and tax aggressiveness" have been used interchangeably. He offers a framework that suggests that tax aggressiveness is part of tax

avoidance, and does not distinguish among clearly legal, legally doubtful, or gray-scaled and in fact, fraudulent tax practices.

3. The website is www.khazanah.com.my/Home
4. White (2004) provides an excellent study of crony capitalism in Malaysia prior to the NEP of 1971. The reason for the development of crony capitalism, especially between Chinese businessmen and Bumiputras politicians, was to gain concessions, licenses, monopoly rights, and government subsidies, and to secure protection from foreign competition.
5. Because the period examined covers this revision, we extend the test by examining pre- and post-2007.
6. The act is a binding law for tax assessments on individuals, sole proprietors, partnerships, companies, co-operatives, trusts, and Malaysian associations.
7. The tax imposed on petroleum companies.
8. This act is binding law for tax that is chargeable on gains of the disposal of real property, such as land, buildings, and houses.
9. Under the SAS, salaried individuals must submit their income tax-return forms and pay the balance of the tax liability by April 30 every year. For those who have a business income, the submission and payment deadlines are June 30. If individual taxpayers fail to submit a tax return, the IRBM will conduct their own assessment, which is based on their own estimate, and later issue a notice of assessment.
10. Under section 112 (1) of the ITA 1967, the penalty for failure to furnish a tax return by the stipulated deadline is a fine that ranges from RM200 to RM2,000, imprisonment not exceeding six months, or a fine and imprisonment. Individual taxpayers who fail to make income tax payments for a year of assessment within 30 days from the date of issue of the notice of assessment or deemed assessment are charged a 10 percent increase on the tax or outstanding tax balance. If the tax or tax balance is still unpaid after 60 days from the date, a 10 percent increase is imposed.
11. Adhikari *et al.* (2006) state that these concessions are often quite discretionary, and that disclosure regarding these activities is limited.
12. When studying the association between corporate governance and tax aggressiveness, we treat governance structures as exogenous. Our approach is the same as that of Core *et al.* (1999) where they observe that "Following most prior empirical research in this area, we treat the board and ownership structures as exogenous, when economic theory would argue that these variables are endogenous." This well-established approach of treating governance structures as exogenous is reasonable, in the sense that some institutional features of contracting cause governance characteristics to be "sticky." For example, directors serve for fixed terms, so naturally, it takes time to change board members to adjust to a changed operating environment. Consistent with many prior studies, we argue that it is difficult for firms to have optimal governance structures at all times (e.g. see Larcker *et al.*, 2007).
13. Accounting income is derived in accordance with the approved financial accounting standard, whereas taxable income is computed based on the provisions of the income tax law. Differences may emerge in both calculations, in which several items are treated as income for tax purposes but are not included in a profit-loss account. This practice is known as "timing and permanent differences" (Xing and Shujun, 2007).
14. Johnson and Mitton (2003) rely on the analysis of Gomez and Jomo (1999) by identifying officers or major shareholders with close relationships with key government officials, primarily Tun Mahathir, Tun Daim, and Dato' Seri Anwar Ibrahim.
15. Founded in 1993, Khazanah Berhad is owned by the Malaysian Government to manage selected commercial assets of the government and undertakes strategic investments on behalf of the nation.
16. See Table AIII for the Hofstede (1991) framework.
17. We have re-run the regression by using continuous dependent variable and we find the results are statistically similar.

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Appendix 1

Year of assessment	Tax rates
1988 and prior	40%
1989-1992	35%
1993	34%
1994	32%
1995-1997	30%
1998-2002	28%
2003	Company with paid up capital of RM2.5 million and below at the beginning of the basis period On the first RM100,000 chargeable income - 20% On the subsequent chargeable income - 28% Company with paid up capital above RM2.5 million at the beginning of the basis period - 28%
2004-2006	Company with paid up capital of RM2.5 million and below at the beginning of the basis period On the first RM500,000 chargeable income - 20% On the subsequent chargeable income - 28% Company with paid up capital above RM2.5 million at the beginning of the basis period - 28%
2007	Company with paid up capital of RM2.5 million and below at the beginning of the basis period On the first RM500,000 chargeable income - 20% On the subsequent chargeable income - 27% Company with paid up capital above RM2.5 million at the beginning of the basis period - 27%
2008	Company with paid up capital of RM2.5 million and below at the beginning of the basis period On the first RM500,000 chargeable income - 20% On the subsequent chargeable income - 26% Company with paid up capital above RM2.5 million at the beginning of the basis period - 26%
2009	Company with paid up capital of RM2.5 million and below at the beginning of the basis period On the first RM500,000 chargeable income - 20% On the subsequent chargeable income - 25% Company with paid up capital above RM2.5 million at the beginning of the basis period - 25%

Table AI. Summary of corporate statutory tax rates in Malaysia

Appendix 2

Table AII.
Operational definitions

No.	Variables	Sign	Definition	Source
Panel A: dependent variables				
1	TAX_AGGR_{it}		An indicator variable that takes the value of 1 if the ETR is less than the statutory tax rates	Compustat Global
Panel B: independent variables				
2	$POLCON_{it}$	+	An indicator variable, 1 for politically connected firms, 0 otherwise	Johnson and Mitton (2003), Khazanah Website and Faccio (2006)
3	$BIND_{it}$	–	Percentage of independent non-executive directors on board	Annual reports
4	$LBSIZE_{it}$	?	Natural logarithm of board of director size	Annual reports
5	$DUALITY_{it}$	–	An indicator variable if the firm separates the CEO and chairperson	
6	$INSTOWN_{it}$	–	Top 5 institutional investors' shareholdings	Annual reports
7	$BIGN_{it}$	–	An indicator variable, 1 for Big N audit firms, 0 otherwise	Annual reports
Panel C: control variables				
9	$LASSETS_{it}$	+	Natural logarithm of total assets	Compustat Global
10	$DEBT_{it}$	+	Total liability to total equity	Compustat Global
11	$XLIST_{it}$	+	An indicator variable if the firms are cross-listed at an external stock exchange	
12	$MTBV_{it}$	+	Market to book value	Compustat Global
Panel D: country variable				
13	$BUMI_{it}$	?	Percentage of Bumiputras directors on board	Annual reports

Appendix 3

Table AIII.
Hofstede (1991) framework

	Ethnic group	
Hofstede societal value	Malay	Chinese
Power distance	High	High
Masculinity	Low	Low
Uncertainty avoidance	High	Low
Individualism	Low	High

About the authors

Effiezal Aswadi Abdul Wahab is currently a Lecturer at the School of Accounting, Curtin Business School, Curtin University, Australia. He has published in *Journal of Contemporary Accounting and Economics*, *Accounting Research Journal*, *Managerial Auditing Journal*, *Asian Review of Accounting and Economic Modeling*. Effiezal Aswadi Abdul Wahab is the corresponding author and can be contacted at: effiezal.abdulwahab@curtin.edu.au

Akmalia M. Ariff is currently a Senior Lecturer at the School of Maritime Business and Management, Universiti Malaysia Terengganu, Malaysia. She has published in *Journal of International Accounting Research*.

Marziana Madah Marzuki is currently a Senior Lecturer at the Faculty of Accountancy, Universiti Teknologi Mara, Kelantan, Malaysia. She has published in *Accounting Research Journal* and *Journal of Contemporary Accounting and Economics*.

Zuraidah Mohd Sanusi is currently an Associate Professor at the Accounting Research Institute, Universiti Teknologi Mara, Selangor, Malaysia. She has published in *Managerial Auditing Journal* and *Asian Academy of Management Journal of Accounting and Finance*.