Corporate governance and tax disclosure phenomenon in the Malaysian listed companies

Mahfoudh Hussein Mgammal, Barjoyai Bardai and Ku Nor Izah Ku Ismail

Abstract

Purpose – *This paper aims to examine the impact of corporate governance internal mechanisms on tax disclosure in non-financial firms in Malaysia. Managerial ownership and incentive compensation are used as proxies to reflect corporate governance conduct.*

Design/methodology/approach – *This study uses panel data set to analyse 286 non-financial listed companies on Bursa Malaysia for the years 2010-2012. Tax disclosure was gathered from the financial statements, particularly in the consolidated of tax expenses. Tax disclosure was measured using modified effective tax rate reconciling items. Multivariate statistical analyses were run on the sample data.*

Findings – *This study finds that managerial ownership and incentive compensation do not significantly influence tax disclosure. On the other hand, it is found that there are significant positive associations between each of firm size and industry dummy, and tax disclosure. This means that company-specific characteristics are important factors affecting corporate tax disclosure.*

Research limitations/implications – *This study extends the work of previous studies by suggesting that the signalling theory and the agency theory are the main theories concerned with tax disclosure and corporate governance. The authors add an additional appreciation of the contribution of corporate governance from the interested parties' tax disclosure evaluation in the Malaysian environment.*

Practical implications – *The evidence found by this study has important policy and practical knowledge implications for the authorities, researchers, decisionmakers and firm managers. The findings provide them with some relevant insights on the importance of corporate governance practices from the companies' perspectives and contribute to the discussion of who verifies and deduces from tax disclosure directed by companies.*

Originality/value – *To the best of the authors' knowledge, this study is the first attempt to examine the influence of the corporate governance internal mechanisms on tax disclosure in a developing nation like Malaysia. Although this paper focuses on a single country, it contributes significantly to the debate about tax disclosure in relation to "comply or explain", as suggested in the Code of Corporate Governance. This study shows that companies are trying to avoid as far as possible disclosing tax-related information.*

Keywords *Corporate governance, Incentive compensation, Managerial ownership, Tax disclosure*

Paper type *Research paper*

Mahfoudh Hussein Mgammal is Assistant Professor at the Accounting Department – College of Humanities and Administrative Sciences, Al Jouf University, Skaka, Saudi Arabia and Amran University, Amran, Yemen. Barjoyai Bardai is Emeritus Professor at MUST and Universiti Tun Abdul Razak, Kuala Lumpur, Malaysia. Ku Nor Izah Ku Ismail is Professor at TISSA – College of Business, University of Utara Malaysia, Sintok, Malaysia.

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1. Introduction

Most national codes focus on the "comply-or-explain" principle, which was first adopted in the Cadbury Code as a practical means to establish a single code of corporate governance (CG) to avoid an inflexible "one-size-fits-all" approach. Cadbury (1992) required listed companies to state in their reports and accounts whether they comply with the Code and to highlight and give reasons for any non-compliance. They received strong support from The High Level Group of Company Law Experts (2002), who compared and evaluated different code regimes throughout Europe, which have been advocated by the Commission (Communication of the Commission, 2003) for use by member states.

Theoretically, the comply-or-explain mechanism provides both flexibility in the application of the code and a means by which to assess compliance. It is of course the expectation of the industry that listed companies will comply with the Code's provisions most of the time. However, it is recognised that departure from the provisions of the code may be justified in particular circumstances. Every company must review each provision carefully and give an explanation if it departs from the Code's provisions (Financial Reporting Council, 2006, p. 5).

Despite its promotion by various national and supranational organisations, very little is known about the way that the mechanism functions in practice. There have been numerous surveys on compliance rates (Von Werder, 2002; Von Werder *et al.*, 2005, 2006) and the correlations between compliance rates and firm performance (Bobylev *et al.*, 2006; Drobetz *et al.*, 2004; Gompers *et al.*, 2003). However, the "comply-or-explain" principle has been criticised in numerous studies, commenting that there is a chain of problems about its execution and its efficiency (Marston and Shrives, 1991; Nerantzidis, 2015; Sergakis, 2013; Shrives and Brennan, 2015). This has been acknowledged by the European Commission (2014).

There were hardly any systematic studies conducted on the way in which companies make use of the option to "explain". An exception to this is the study by MacNeil and Li (2006), who examined the contents of compliance statements dismissing them in a sweeping generalisation as unsuitable to provide reasoned explanations. However, a closer look at compliance statements shows that some companies do indeed provide some very good justifications. Arcot and Bruno (2006) showed that there are indeed some quite substantial qualitative differences between "explanations".

Moreover, Nerantzidis (2015) provides evidence regarding the efficiency of the "comply-or-explain" approach in Greece. The findings show that the level of compliance is low, inferring that the non-appearance of the corporations' acceptable explanations make them deviating both from the soul of the code and the "comply-or-explain" concept. This means that even if the "comply" section of the concept is not respected by the majority, this in itself is not problematic as long as the "explain" section is entirely respected in Greece, as well as in other nations. Furthermore, Ho Virginia (2017) shows that the comply-or-explain approach is effective in improving CG practices and increase corporate transparency, particularly in the markets that are similar to the USA.

This paper attempts to bring in another paradigm in the CG disclosure, namely, the specific disclosure requirement, under other regulations that run in parallel with the corporation governance disclosure requirement. The idea is if other regulatory institutions impose their specific rule of disclosure, which is parallel with the CG disclosure requirement, then the CG disclosure is not seen to be the central focus of the disclosure requirement. Our research will also look at the level of tax disclosure (TD) and the circumstances and rationale for such practices. We want to explore whether a parallel principle of "disclose or explain" can be applied in the TD rules and regulation.

Recently, the focus of regulators, auditors and Internal Revenue Service (IRS) has been primarily on taxation policies and CG practices, mainly because of the Enron and WorldCom collapse. Slemrod (2005, p. 91) speculates that there is a "rethinking of the governance of public corporation, and a new set of laws". This "rethinking" also includes the reconsideration of taxation regulations. Consequently, the US disclosure requirements have been increased in the zones of IRS requirements and public accounting. The modifying regulatory environment brings with it calls for increased responsibility, resulting in a projected increase in attention to areas such as risk management and certain taxes (Lenter *et al.*, 2003). Furthermore, Slemrod's (2005) findings revealed high levels of awareness among tax executives of changing legislation and of the emergence of a CG-type environment and indicates how this awareness could lead to a breakthrough in the tax planning (TP) process and shows a good levels of TD.

Only a handful number of studies on the influence of CG on disclosure in Malaysian non-financial firms is currently available. There are some studies which discover the association between CG and disclosure separately. A very limited number of studies examined the association between CG and internal mechanisms, namely, managerial ownership and incentive compensation with disclosure. To the authors' knowledge, there is no previous study which has examined the association between both (CG internal mechanisms and company-specific characteristics) with TD.

This study wants to relate CG and taxation literature in several ways. First, it is one of the few that investigate the relationship between CG internal mechanisms and taxation (Abdul Wahab and Holland, 2012). An incentive to carry out this study is that, to the best of the researchers' knowledge, there are no published studies that examine the influence of CG internal mechanisms on TD within Malaysian corporations. We report a positive and significant relationship between firm size and industry dummy with TD, which means that company-specific characteristics are important factors affecting corporate TD. Hence, by using non-financial firms, we provide new evidence of the relationship between CG conduct and TD.

2. Literature review and hypotheses development

2.1 Tax disclosure

Public disclosure of income tax information is one of a tax system policy tool. Disclosed information about a company's tax received more attention in 2003 (Hasegawa *et al.*, 2013). Sweden, Norway and Finland presently have a policy requiring the public disclosure of taxable incomes.

In Japan, TD was required from 1950 until 2004. Australia is presently considering implementing a system of TD. In the USA, the issue of firm tax-disclosure was brought up in 1987 by a staff study for New York State's Legislative Tax Study Commission (Pomp, 1993). Since then, three states (Arkansas, West Virginia and Massachusetts) have embraced regulations requiring some state-level disclosure by corporations. Whilst Wisconsin has had a disclosure regulation since 1923, it has just as of late been utilised for tax policy purposes (Mazerov, 2007).

Currently, activists around the world approach governments to demand disclosure of information for public users from businesses about what, what amount and where on the globe firms, predominantly multinational businesses, pay taxes (Christians, 2013). Their point is to instigate public thoughtfulness to the systemic under-taxation of multinational businesses to demonstrate that this is related to the failure of development in developing countries and to convince lawmakers that the public is interested in changing this model.

In their task for financial transparency through tax-disclosure, activists are admitting themselves to an elite policy-making yardstick that has customarily been dominated by the political elites and looking for change. Tax transparency through applying TD rules challenges the tax policy standards developed within this yard, and the interest for activists in non-governmental organisations challenges the institutional foundations of contemporary worldwide tax policy-making (Christians, 2013; Mgammal and Ku Ismail, 2015a). In the same context, Mazerov (2007) argued that state companies' income TD was broadly discussed in the early 1990s, when legislature in Massachusetts was amended to implement a disclosure regulation. To contribute to the Massachusetts discussion, Professor Pomp of the University of Connecticut School of Law wrote a major report in 1993 on companies' TD (Pomp, 1993). TDs have been defined as a term utilised to depict two separate situations:

> The first is the legal requirement to provide current taxation information to the other party. The second is related to transactions that may be viewed as tax sheltering that must be disclosed to the government when filing income taxes (Francois, 2015, Para. 1.2).

Paragraph 81 of IAS 12-Income-Taxes (World GAAP Info, 2009) and Paragraph 81 (c) of MFRS 112 Income Taxes (MASB, 2012) require an independent disclosure of reconciliation of the tax expense items to interpret the association between effective tax expense and statutory tax expense. The disclosures required by Paragraph 81(c) of income taxes allow users of financial statements to understand whether the association between tax income or expenses and accounting loss or profit is out of the normal, as well as outlining important factors that might influence this association in the future (Mgammal and Ku Ismail, 2015a). The association between tax income or expenses and accounting loss or profit can be affected by factors such as normal income exempt from taxation, expenses that are not discountable in deciding the loss or gain for tax and the impact of tax losses and possible tax rates incurred abroad. Furthermore:

> [...] an explanation of the relationship between spending (income) tax and accounting are required, in one of the following forms, or both at once: a reconciliation between the numerical expense (income) tax and the result of multiplying the result by the accounting rate or rates of tax applicable, specifying the manner of computing the applicable rates used; and a reconciliation between the numerical average cash and the tax rate applicable, specifying the manner of computing the applicable rate used (World GAAP Info, 2009, p. 36).

On the other end of the scale, managers of firms who are utilising TP do not desire to disclose data about these activities (Gleason and Mills, 2002). In line with FIN48, disclosures would be further costly and expensive for businesses in TP. Frischmann *et al.* (2008) reported negative market reactions to the release of FIN 48, indicating that these responses were based on the assumption that TP would be costly for the businesses involved. This is because TP requires the integration of the organisation with more staffing and increased budgets (Phillips, 2003). Mills and Maydew (1998) postulated as an example that the cost of disclosure by businesses with the largest TP ought to be higher. Businesses that disclose tax data to the public undertake higher extents of TP and, as a consequence, owe increased amounts to the IRS, thus increasing the cost of disclosure (Gross, 2011) with the purpose of avoiding from being liable to large IRS fees.

Some investors avoid investing in businesses with high extents of TP. Taxes and fees imposed by the IRS upon businesses using unlawful tax avoidance measures can likewise increase the cost of disclosing tax data (Mgammal and Ku Ismail, 2015b; Mills and Maydew, 1998). Consequently, it could be pricy for businesses with higher extents of TP that have too much to hide and could get further control over their tax reserves (Sidhu and Whittred, 2003). Hence, Gross (2011) expected that higher corporate TP offers decreased disclosure quality and lower tax reserves.

As mentioned above, TD is a new field, and there is a dearth of empirical studies that have delved into this area. In such a scenario, the signalling theory is the most relevant and appropriate theory that can explain the context of TD. Moreover, this theory highlights a clear argument on TD, compared with other theories. The signalling theory states companies issue "signals" about what they believe and who they are (Spence, 1973, p. 355). Information disclosed by firms, including information about tax, falls somewhere between full disclosure and no disclosure, depending on their motivations (Premuroso, 2008). It is understood that these motivations will vary and will have different effects on the level of disclosure in different corporations and countries. Reasons for variations in the level disclosure may include, for example, regulations and tax law (Bhattacharya and Ritter, 1983).

Further possibility of utilising the signalling theory is that managers may desire to provide through the dissemination of financial statements some information asymmetry regarding firms' performance. For instance, disclosures may serve as "signals" if they reflect information about unobservable attributes of a company's decision (Morris, 1989). Under such situation, managers of higher quality firms with private information can distinguish

themselves from lower quality companies via disclosures. In this context, managers can use TD to send signals to related parties that need information about tax to help them make sound decisions.

Additionally, in the case of circumstances of asymmetric information, Akerlof (1970) recommended that firms with higher performance utilise financial information (including tax information) to send signals to the market, users and tax authority. In such scenarios, it is clear to see how companies can send signals to the users of information or financial statements. In the same context, tax information can be sent as signals to the Inland Revenue Board of Malaysia or users through TD.

Moreover, some individuals desire to express information and others desire not to have information conveyed, but "in either case, the fact that actions convey information leads people to alter their behavior, and this is why information imperfections have such profound effects (Stiglitz, 2002, p. 473)." The signalling theory offers a unique, practical and empirically testable viewpoint on problems of social selection under conditions of defective information. The fact that scholars in areas as diverse as economics and marketing continue to use the signalling theory to clarify selection phenomena in their own disciplines is reassuring (Connelly *et al.*, 2011).

2.2 Corporate governance

The separation of management roles, ownership and the existence of asymmetric information introduce the possibility of principal-agent conflicts, such as manager's self-interest, which may guide to the abuse of all what a company has, for instance, on the pursuit of risk on account of the capital suppliers (Haniffa and Hudaib, 2006; Jensen and Meckling, 1976; John and Senbet, 1998; Shleifer and Vishny, 1986). To reduce agency conflicts and costs, several mechanisms of internal and external CG have been proposed. The governance mechanisms include, among other things, changes in the structure of the board, debt financing, shareholdings by outsiders and insiders and the market for company control (Haniffa and Hudaib, 2006). CG is necessary to explain the attitude of management and how a corporation is monitored to alleviate the conflict between owners and management. Furthermore, issues of CG have been vastly discussed and studied because of information asymmetry effects on shareholder wealth (Boubakri *et al.*, 2005).

Theories of CG issues are driven by the agency theory, which focussed on the phenomenon of separation of control and ownership in the context of information asymmetry. Moreover, because of information asymmetry, shareholders depend on the CG mechanisms to ensure that actions taken by management are in line with the target to maximising their wealth (Weir *et al.*, 2002). Hence, from the economic perspective, CG interacts in managerial opportunism in which a disagreement of interest interprets the managers' chance to pursue their own self-interest in TP (Desai and Dharmapala, 2008).

The OECD defined CG as:

> Corporate governance involves a set of relationships between a company's management, its board, its shareholders, and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good CG should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring (OECD, 2004, p. 11).

This is in consistent with the definition of CG as "a response to the agency problems that arise from the separation of ownership and control in a corporation" (Boubakri *et al.*, 2005, p. 370).

Shleifer and Vishny (1997) defines CG as a means of ensuring that suppliers of finance receive a return on their investment. Williamson (1988) defined CG as a way to manage the interests of shareholders and management. Zingales (2008) argued that CG is the tool for

managers and shareholders to talk about valuation and distribution of shares. In this context, the definition set out in the High Level Finance Committee Report (1999) is:

> [...] corporate governance is the process and structure used to direct and manage the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long term shareholder value, whilst taking into account the interests of other stakeholders (Securities Commission Malaysia, 2012, p. 5).

From this definition, CG mostly concentrates on procedures utilised to manage a corporation with the aim to act for the best interests of shareholders whilst also attaining corporate objectives. CG can be described as providing guidance on how the board of directors and managers of a firm should act in the interests of shareholders, investors and creditors (Zainal Abidin and Ahmad, 2007).

2.3 Theories of corporate governance

The main CG theories are the agency theory, stewardship theory, stakeholder theory and resource dependency theory. These theories address the reasons and impact of CG mechanisms, such as audit committee, the configuration of independent directors, board members and the function of top management and their social associations rather than its regulatory frameworks (Haslinda and Valentine, 2009). These main theories are important in explaining various issues of CG, including CG mechanisms and firm performance. This is because of the functions that the theory can systematically predict, which interpret and underpin the cause and impact association of the variables or the observed phenomenon (Mallin, 2013).

2.3.1 Agency theory. The agency theory concerns about the association between the agent (decisionmaker) and principal (shareholder) (Padilla, 2002). The agency theory is supported by the agency association, where there is a separation between control and ownership. It recognises that problems can occur when management, acting on behalf of the owners, do not behave in ways that maximise the owners' welfare when involved in an agency association. The agency association is defined as:

> [...] a contract under which one or more persons (the principal [s]) engage another person (the agent) to perform some service on their behalf which involves delegating some decision-making authority to the agent (Jensen and Meckling, 1976, p. 308).

According to Jensen and Meckling (1976), the agency theory supplies a framework connecting disclosure behaviour to CG. CG mechanisms are introduced to manage the agency problem and make sure that managers work in the interests of shareholders. In theory, the effect of governance mechanisms on company disclosures may be substitutive or complementary to the internal monitoring of the company (Ho and Wong, 2001). Further, Mallin (2013) described the agency theory as a theory which:

> [...] identifies the agency relationship where one party, the principal, delegates work to another party, the agent. In the context of a corporation, the owners are the principal and the directors are the agent (Mallin, 2013, p. 16).

As there is a difference between control and ownership, the agency problem will happen when the management, who acts on behalf of the owners, may not in fact conduct in such a way as to maximise the owners' welfare.

CG characteristics are considered necessary to decrease divergence of agents' interests from the principals' interests (agency problem). For example, CG is a mechanism utilised for effective utilisation of company resources. It is a hybrid of external and internal mechanisms with a view to achieve effective utilisation of company resources (Ho and Wong, 2001). CG characteristics are manifold and generally comprise external mechanisms and internal mechanisms (Biswas and Bhuiyan, 2008).

2.3.2 Stakeholder theory. The stakeholder theory is "a theory of organizational management and business ethics that addresses morals and values in managing an organization*"* (Phillips, 2003, p. 15). Similarly, Mallin (2013) explains stakeholder theory as a theory that:

> [. . .] takes account of a wider group of constituents rather than focusing on shareholders. Where there is an emphasis on stakeholders, then the governance structure of the company may provide for some direct representation of the stakeholder groups (Mallin, 2013, p. 16).

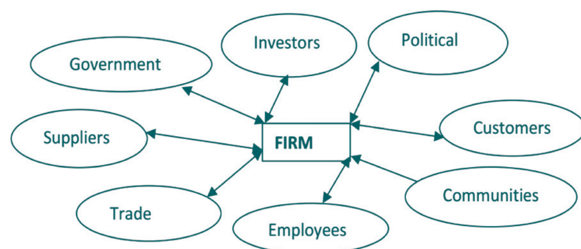
Likewise, Jensen (2010) refers to stakeholders as a group comprising all groups or individuals who can substantially affect the welfare of the firm. This includes not only the financial investors and creditors but also communities, customers, employees and governmental officials who "say that managers should make decisions that take account of the interests of all the stakeholders in a firm" (Jensen, 2010, p. 236).

It can be seen that the theory of stakeholders, at a global level, is a theory that comprehensively considers all stakeholders, individuals and communities affected by decisions taken by the management of the corporations. Figure 1 presents stakeholder parties in order to illustrate how they are affected by or within the firm.

Generally, shareholders are not the only affected parties to be considered in the decision-making procedure by managers. This is because of inputs from stakeholders in terms of skills, capital and other factors are also important. The stakeholder theory pays attention to the significance of the welfare of stakeholders. This leads to alternative theoretical models of stakeholders (Abdul Wahab, 2010). As far as CG is concerned, it is significant to note the variation of views in relation to stakeholders and shareholders. From the point of view of shareholders, CG is considered a confidential matter, whilst stakeholders consider companies as a social entity (Letza *et al.*, 2004). This is because the stakeholder theory may be inconsistent with CG because the theory is not consistent with the concept of CG that is accountability of management to shareholders and accountability of company employees and other company agents to the shareholders (Sternberg, 1997).

2.3.3 Stewardship theory. The stewardship theory is a theory that assumes that "managers, left on their own, will indeed act as responsible stewards of the assets they control" (Barney and Hesterly, 2012, p. 263). Moreover, the stewardship theory defines directors as "the stewards of the company's assets and will be predisposed to act in the best interest of the shareholders" (Mallin, 2013, p. 16). This simply means the stewards (managers) strive in realising the organisational goals such as profit growth and revenue growth, which in turn

Figure 1 The stakeholder model



Source: Figure 3. Contrasting Models of the Corporation: The Stakeholder Model "The stakeholder theory of the corporation: Concepts, evidence and implications," by Donaldson and Preston, 1995, Academy of Management Review, p. 69

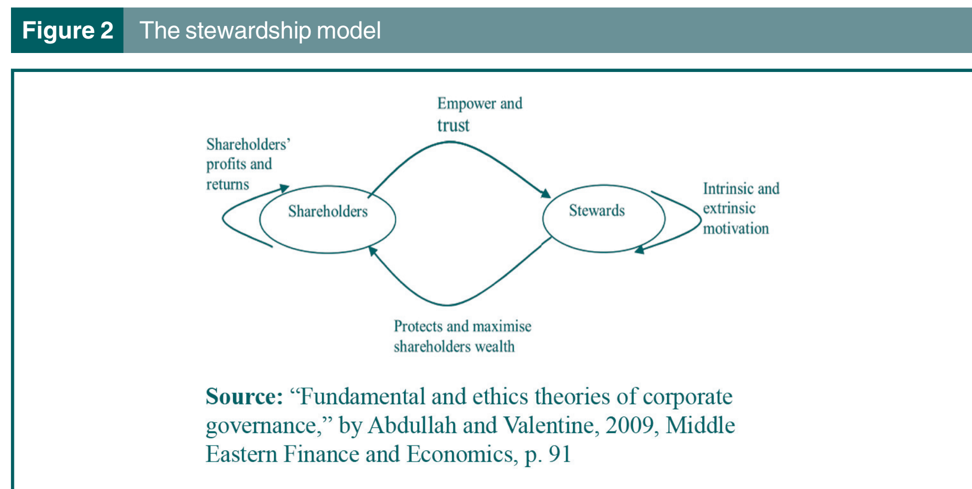
reflect the shareholders wealth. Consequently, CG mechanisms are viewed as insignificant in disciplining the managers from the point of view of the shareholders. Moreover, the stewardship theory depends on the supposition that managers are "stewards whose motives are aligned with the objectives of their principals" (Davis *et al.*, 1997, p. 21). The theory also investigates the role of managers in maximising the wealth of principals by CG mechanisms. Certainly, this can reduce the costs targeted at controlling behaviours. This is in contrast with the agency theory, which considers the managers' behaviours and acts as being undertaken to maximise their own wealth only (Davis *et al.*, 1997; Donaldson and Davis, 1991).

Furthermore, the stewardship theory proposes integrating the function of the chief executive officer (CEO) and the chairman to decrease agency costs and to have bigger function as stewards in the organisation (Haslinda and Valentine, 2009). Indeed, Fama (1980) contended that directors and executives are also managing their careers to be seen like efficient stewards of their business. The stewardship model can have resemblance in countries such as Japan and Malaysia, where the worker presumes the function of stewards and takes ownership of their work and jobs at it diligently (Haslinda and Valentine, 2009). The model in Figure 2 explains that stewards are empowered by shareholders to maximise and safeguard the shareholders' wealth through the reinforcement of the company's return and profitability. The shareholders supply some intrinsic and extrinsic motivation in the form of managerial perks to avoid stewards acting purely out of self-interest. Figure 2 illustrates the stewardship model.

2.4 Corporate governance in Malaysia

CG initiatives in Malaysia are similar to those in other Asian countries and were introduced in Malaysia in late 1997. It became important to both public and private sectors because of crises in regulations, where by these regulations do not have the ability to accommodate and treat with such crises, including CG standards. In Malaysia, the Malaysia Code of Corporate Governance (MCCG) was established officially in March 2000 and was derived largely from the recommendations of the Cadbury (1992) Report and the Hampel (1998) Report in the UK (Bursa Malaysia, 2015; Du Plessis *et al.*, 2014; MCCG, 2000). Nevertheless, the Malaysian business environment is different from that in the UK in many ways, and the application of several of these recommendations may be controversial. For example, there is a high concentration of ownership in Malaysia. This means that there is no active market for company control, and there are few opportunities for hostile takeovers, which can

Figure 2 The stewardship model



Source: "Fundamental and ethics theories of corporate governance," by Abdullah and Valentine, 2009, Middle Eastern Finance and Economics, p. 91

discipline managers who do not work to maximise shareholders' value (Haniffa and Hudaib, 2006; OECD, 1999).

Moreover, even before and during the 2001 financial crisis, there was some good sides of Malaysian CG in that time. For example, Iu and Batten (2012) claimed that Malaysian CG has attracted successfully a better treat (compared to the UK and other Asian countries) of public interest because of its significance of the economic health of both the companies and society in general. The concept of CG covers a number of economic phenomena and is not a "one-size-fits-all" solution. Malaysian firms have now attained an acceptable level of compliance and CG practices, which is evident in a joint study by the emerging market investment bank Credit Lyonnais Securities Asia and Asian CG in 2003 (OECD, 2014; Roche, 2005).

2.5 Requirements of corporate governance in Malaysia

Since the early 2000s, studies have highlighted the significance of CG in the monitoring of operational activities undertaken when managing a business (Aguilera and Cuervo-Cazurra, 2004; Haniffa and Hudaib, 2006; Lokman *et al.*, 2009; Securities Commission Malaysia, 2012). Similarly, the Malaysian Code of Corporate Governance (MCCG, 2012) adopts recommendations and structure from the blueprint issued by the Malaysian Securities Commission in 2012 and sections of the previous 2007 Code. Table I presents the recommendations and principles of the MCCG (2012), harmonising the blueprint recommendations and related sections of the 2007 Code to assist the understanding of the MCCG (2012).

The MCCG Code requires public firms to abide to the principles based on the varying circumstances of individual firms. Hence, public corporations need to adhere to the Malaysian Code on Corporate Governance associated with CG disclosure on directors, audit committees and auditors. The MCCG underwent amendments in 2007 and 2012, as shown in Table I. The new revision of MCCG made significant changes in the process of evaluating and nominating board members (Securities Commission Malaysia, 2007, 2012). Based on the code, the board should carry out yearly evaluation for the efficiency of the board of directors, board committees and the contribution of every individual director. The modified code also supplied criteria that must be considered by the nominating committee when suggesting candidates for directorships. The suggested criteria includes knowledge, skills, expertise and professionalism, experience and integrity (Kamardin and Haron, 2011).

Appendix also shows that the MCCG (2012) concentrates more on strengthening board composition and structure, recognising the function of directors as active and responsible

Table I Summary of the operationalisation of the company-specific characteristics variables

Control variables	*Measurement*	*Author*
Firm size (FSIZ)	Total assets	Holland (1998), (Phillips *et al.*, 2003) and Armstrong *et al.* (2012) and Derashid and Zhang (2003)
Earnings management (EM)	Total accruals, derived by subtracting net cash flow from operation from profit before tax	Abdul Wahab (2010), Abdul Wahab and Holland (2012)
Capital intensity (CAPNT)	Ratio of equipment and gross machinery to total assets. Property and plant are eliminated from the measurement	Armstrong *et al.* (2012)
Leverage (LEVE)	Proportion of long term debt to total assets	Mills and Maydew (1998)
Dividend (DIVID)	Proportion of dividend per share on earnings per share	Berkman *et al.* (2002) and Xu *et al.* (2012)
Industry dummies (INDS)	1 for each particular industry classification, and 0 otherwise	Belsley *et al.* (2004) and Chen *et al.* (2005)
Growth (GRTH)	Percentage change in annual net sales revenues	Belsley *et al.* (2004)

fiduciaries (Securities Commission Malaysia, 2012). Directors have a responsibility to be efficient stewards and guardians of the firm, not only in overseeing the behaviour of business and strategic direction such in the Malaysian Code on Corporate Governance 2007 but also in ensuring that the firm is in compliance with regulations and ethical values and maintains an efficient governance structure to guarantee the suitable management of internal controls and risks. To remain compliant with the current code, management and boards should be aware of their duty to manage their resources and efforts towards the best interest of the firm and its shareholders, whilst ensuring that the interests of other stakeholders are not compromised.

2.6 Corporate governance mechanisms

CG mechanisms are capable of mitigating agency costs of free cash flow that emerge from the principal-agent problem (Jensen, 1986; Jensen and Meckling, 1976). In this context, the agency model determines a number of CG mechanisms that lead to better governance relative of other lower efficient mechanisms. Moreover, with regard to reduced agency cost, the CG mechanisms align the interests of agents and principals (McKnight and Weir, 2009).

Demirag *et al.* (2000) clarified that the external mechanisms of CG consist of stock market evaluation of company performance and a statutory audit, whilst the internal mechanisms consist of non-managerial big shareholdings and the composition of the board, as well as managerial ownership (inclusive shareholding institutional). Furthermore, CG mechanisms are presented as comprising a board of directors, big shareholders, proxy fights, financial structure and hostile takeovers (Hart, 1995). In addition to the above-mentioned mechanisms, Sharma (2011) additionally specified CG mechanisms as board composition (board independence and outside directorship), committee structure (audit, compensation, nominating, compensation and productivity committees) and board size. The adequacy of these mechanisms in moderating agency problems is discussed in the next subsections.

2.6.1 Internal mechanisms. The internal mechanisms' viewpoint sees the equity ownership and boards of directors as the essential internal mechanisms. In this context, Hamilton (2012) argued that owners have choices for reigning in self-interested management. They can provide incentives to improve the consistency of management behaviour and can afford the costs necessary for overseeing the management and reducing divergent behaviour (Jensen and Meckling, 1976). Internal CG mechanisms consist of incentive compensation and managerial ownership.

2.6.1.1 Incentive compensation. Incentive compensation is a set of compensation based on the performance of an organisation. Ei Yet and Song (2012) claimed that so far, studies on Malaysia's executive compensation are more focussed on pay-for-performance. For example, Abdullah (2006) studied 86 distressed companies in 2001 and found an insignificant association between performance and pay. Tee and Hooy (2009) established a positive association of performance proportions and ratios for 21 government associated firms from 2001 to 2006. Furthermore, Dogan and Smyth (2002) found that remuneration is related to future growth and company size but not for performance.

According to the Malaysian Code of Corporate Governance 2012, annual reports must reveal remuneration of every director. This requirement promotes and recognises significant principles of accountability and fairness (Securities Commission Malaysia, 2012). According to the Listing Requirement of Bursa Malaysia (BM), App. 9C (12), annual reports must contain a statement of how the firms have applied the principles set out in Part 1 of the MCCG to their exacting circumstances. They are required to disclose directors' remuneration, which involves the level and make-up of remuneration and the process. Firms

are also required to disclose the cumulative figure of remuneration of executives with categorisation, including executives' salaries, bonuses, commissions, fees, compensation for loss of office, benefits in kind based on an estimated money value differentiation between non-independent and independent directors and the number of directors whose remuneration falls in each sequent band of RM50,000. Nevertheless, disclosure of directors' remuneration is not compulsory (Talha *et al.*, 2009).

In Malaysia, the "Articles of Association in Schedule Four of the Companies Act 1965" stated that directors' remuneration is subject to shareholders' ratification. However, there is no exact definition of directors' remuneration provided by the Companies Act 1965 to define what constitute remuneration. The majority of corporations only tabled directors' fees at the shareholders' annual general meeting for their ratification as required by "Bursa Malaysia Listing requirement Under Para 7.26" (Securities Commission Malaysia, 2007; Talha *et al.*, 2009). However, the above-mentioned matter should be taken into account by the companies to be consistent with BM listing requirement.

The function of a remuneration committee in Malaysia is to recommend suitable remuneration levels of executive directors to the board in all its forms, drawing on external advice where needed (Bursa Malaysia, 2015). Executive directors should not play a part in deciding their personal remuneration. In the directors' report, the membership of the remuneration committee must be disclosed in the annual reports. The remuneration committee also is encouraged to consist of entirely or mostly non-executive directors. The whole board is also accountable for determining remuneration packages of non-executive directors, inclusive the chairman of board of directors, and the individuals concerned shall refrain from discussing their own reward (Talha *et al.*, 2009).

2.6.1.2 Managerial ownership. In a study utilising Malaysian data, Abdullah (2006) proposed that ownership by non-executive directors effectively raises the incentive to monitor management in ensuring that their wealth in a company remains intact. The author found that non-executive directors' interests are negatively associated with financial distress. However, in a study of earnings management within Malaysian listed firms, Johari *et al.* (2008) found that managerial ownership is positively associated with earnings management practices. This proposes that when managerial ownership is significant, it might incite managers to manage earnings, as managers have the opportunity to make decisions that advantage themselves at the cost of other stakeholders.

Abdullah's (2006) study provided argument to sustain the theory that ownership by non-executive directors meaningfully raises their incentives to monitor management to warrant that their wealth is taken care of. Nikkinen and Sahlstrom (2004) conducted an analysis on audit pricing and its association with agency theory by utilising data from seven countries including Malaysia. In line with the theory, they found a significant and negative relationship between managerial ownership and audit fees, with a 5 per cent confidence level for Malaysian data.

Additionally, Mustapha and Ahmad (2011) focussed on managerial ownership as the primary mechanism in aligning the interests of shareholders and managers in Malaysian companies. The outcomes of the study are in line with the earlier results of studies in Western countries that found that managerial ownership is an important factor that affects a firms' monitoring costs (Ang *et al.*, 2002; Jensen and Meckling, 1976; Niemi, 2005; Nikkinen and Sahlstrom, 2004; O'Sullivan, 2000). The findings also suggested that managerial ownership in Malaysian firms has a significant and negative association with total monitoring costs, as forecasted by agency theory. In depth, the analysis of the indirect shareholdings and direct managerial shareholdings also detect the same pattern of outcomes. Mustapha and Ahmad (2011) suggested that future research should be extended to include an increased number of years of data, meaning that additional examination on the influence of

managerial ownership on the demand for monitoring mechanisms in the short-and long-terms can be analysed.

Moreover, Jensen and Meckling (1976) found that within the agency theory, CEO ownership serves to align management's behaviour with interests of shareholder. Some studies have recognised a trade-off between low levels of ownership that serve to align CEO interests and greater levels of ownership that foster CEO entrenchment, suggesting that the association between the level of CEO ownership and the alignment of interests is non-linear (Sundaramurthy, 1996). These findings are consistent with the management disclosure literature, which demonstrates that lower levels of CEO ownership are related with a greater likelihood of issuing management forecasts (Karamanou and Vafeas, 2005) and increased voluntary disclosure quality (Eng and Mak, 2003).

Several different types of ownership structures have been studied by prior studies, for example, family ownership, ownership concentration, government ownership, institutional ownership, foreign ownership and managerial ownership. According to Jensen and Meckling (1976), the principal-agent problem between managers and shareholders arises when managers have little equity in a company, which guides managers to decrease incentives to maximise job performance. Managers' behaviour should be under shareholders' observation to decrease the agency problem.

Tam and Tan (2007) studied ownership, governance and corporate performance in Malaysia by investigating ownership concentration among major ownership types in Malaysia and exploring how the influence of ownership concentration varies throughout Malaysian firms. The results demonstrated that Malaysian CG requires scrutiny of major shareholders to preserve minority shareholders' interests. Moreover, Malaysia's rapid economic growth does not weaken the concentrated ownership structure in Malaysian companies. In this context, the majority shareholders still possess an average of 30.3 per cent of outstanding shares through all listed companies in Malaysia in 1998, with the top most five shareholders owning 58.8 per cent. Two-thirds of companies in East Asia and about 40 per cent of companies in Malaysia are held by individual large shareholders. This indicates that the ownership concentration is still high in Malaysia (Claessens *et al.*, 2000). Furthermore, family and individual shareholders are often the major shareholders in Malaysia. Therefore, the existence of better CG mechanisms is probably a significant consideration for these companies (Zhuang *et al.*, 2001). These large shareholders maintain good associations with their companies, even after the firms are overtly listed. Redding (1996) found that they often connect their families' prosperity to the company's performance.

2.7 Corporate governance and tax disclosure

The direct association between TD and CG has rarely been researched. In the past, studies were only concerned with the interaction of CG and taxation (Sabli and Noor, 2012). The disclosure of companies' tax information could raise tax compliance and discourage explicit aggressive TP (Kornhauser, 2005). Moreover, disclosure of company tax return information could help regulators develop the function of financial markets, discourage aggressive TP and, more generally, promote tax compliance (Lenter *et al.*, 2003).

TD rules which are applicable during the tax year require any taxpayer that contributes, straight or indirectly, in a "listed transaction" and any firm taxpayer that participates in "other reportable transactions" to file a disclosure statement as part of the taxpayer's return. The disclosure statement (the list of deals that the individual taxpayer disclosed) must contain, amongst other items, an explanation of the principal items of the deals, the tax advantage of the transaction and the identity of the persons who promoted, solicited or suggested the

taxpayer's contribution in the deal or who had a financial stake in the taxpayer's decision to participate (Lipton, 2003).

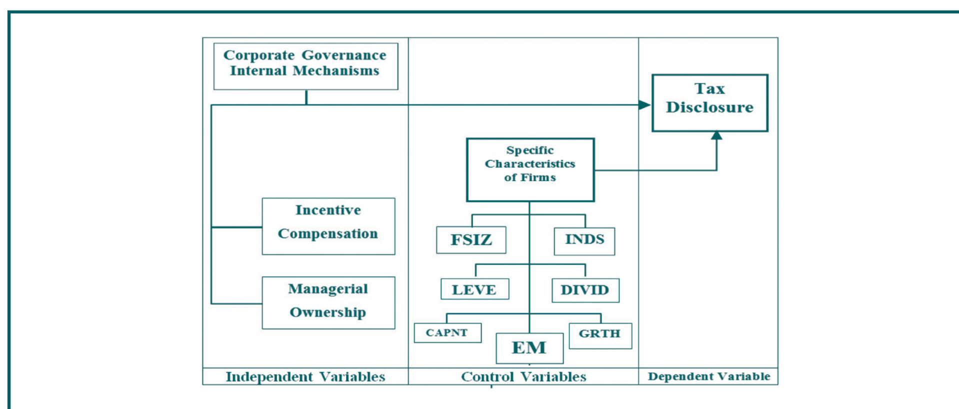
The gap between CG and taxation studies contributes to insights of further research. Taxation has an important relationship with different CG mechanisms, which act to improve companies' governance conduct (Desai and Dharmapala, 2008). In the association between incentive compensation as one of the internal CG mechanism and TD, the recent literature linked TD with top executive incentive compensation (Desai and Dharmapala, 2006; Rego and Wilson, 2012) and CG culture. Based on the aforementioned literature, together with literature that explained the information asymmetry problem, Desai and Dharmapala (2008) concluded that internal mechanisms drive a company's TD. Regarding the association between board monitoring and TD, Fama and Jensen (1983) and Munter and Kren (1995) found that boards provide a relatively low-cost mechanism to monitor and review an administration's decision-making.

2.8 Hypotheses and study model

CG can mitigate the agency costs of free cash flow that emerge from the principal-agent problem (Jensen, 1986; Jensen and Meckling, 1976). Furthermore, CG reduces agency cost because CG mechanisms align the interests of principals and agents (McKnight and Weir, 2009). In this context, Slemrod's (2005) findings revealed that there are high levels of awareness among tax executives of firms in jurisdictions with changing legislation and the emergence of a CG. Slemrod (2005) also indicates how this awareness could show acceptable levels of TD.

The disclosure of firms' tax information could increase tax compliance or encourage corporations to become less willing to take positions within the framework of CG rules (Kornhauser, 2005). In addition, disclosure of information on company tax return could help regulators develop the function of financial markets, encourage compliance with CG rules and, more generally, encourage tax compliance. Lenter *et al.* (2003) claimed that the relationship between TP and TD can be better interpreted if linked with CG mechanisms. Based on the aforementioned literature, as well as the literature that explained the information asymmetry problem in previous study, Desai and Dharmapala (2008) concluded that internal mechanisms drive a firm's TD. Therefore, it is hypothesised that the level of corporate TD is associated with the companies' CG conduct, namely, incentive compensation and managerial ownership. Figure 1 depicts the model of the study in which we also include some firm-specific characteristics as control variables (Figure 3).

Figure 3 Model of the study



3. Methods

3.1 Data collection and sample selection

This study utilises panel data set from a large sample of publicly traded listed firms in BM. The sample of this study is all non-financial firms listed on the BM from 2010 to 2012. The sample, consisting of 296 companies or 888 observations, excluded financial companies, companies making a loss and companies with incomplete data. In terms of outliers, this study used a studentized residual to identify outliers of the data (Hair *et al.*, 2013). In this context, outliers are observations that have "a substantial difference between the actual value for the dependent variable and the predicted value" (Hair *et al.*, 2013, p. 155). Outliers can be detected using a variety of tools, such as univariate, bivariate and multivariate techniques, based on the number of variables and the Cook Distance test[1] (Hair *et al.*, 2013; Hamilton, 2012). Based on Chen *et al.*'s (2005) study, the outliers were specified using studentized residual >l 2 l, as this displays a high observation residual that may point out an abnormal value of the variable offering its value on the regressors.

In this regard, 18 observations (2.03 per cent of the entire sample of 888 observations) have extreme effective tax rate values and 12 observations (1.35 per cent of the full sample of 888 observations) were specified as influential observations and outliers based on the studentized residual >l 2 l). To avoid deformation in the results, the 30 outliers pertaining to ten companies were excluded (Hair *et al.*, 2013). Consequently, a final sample of 858 observations involving 286 firms were analysed.

3.2 Measurements

TD can be measured using the extent of firm TD. In this regard, TD is measured by assigning a score for TD information based on the number of items disclosed in the companies' annual reports. This paper measured the extent of company TD by assigning a score for TD information based on the number of items disclosed in the annual reports of the corporations. The study assigned the score based on items identified by Abdul Wahab (2010). Although Abdul Wahab's (2010) items had been built based on UK companies, the authors disaggregated the items based on the accounting standard, IAS 12, that the Malaysian firms apply. Paragraph 81 (c) of MFRS 112 Income Taxes, from MASB (2012), requires an independent disclosure of reconciliation tax expense items to interpret the association between effective tax expense and statutory tax expense.

The disclosures required by Paragraph 81(c) MFRS 112 Income Tax allows financial statement users to understand whether the relationship between tax expenses or income and accounting profit or loss is abnormal and provides further understanding of the significant factors that may influence this association in the future. The association between accounting profit or loss and tax expenses or income is influenced by factors such as ordinary income exempt from taxation, as the expenses are not subtracted in deciding the loss or gain for tax, the impact of tax losses or possible tax rates incurred overseas (MASB, 2012).

To assign the score of TD items, this study utilises an unweighted approach. This approach is more suitable when no significance is given to any particular user-groups (Akhtaruddin *et al.*, 2009). The items of information are numerically scored on a dichotomous basis. Based on the unweighted disclosure approach, a company is scored "1" for an item disclosed in the annual report and "0" if it is not disclosed. The sum of TD items in the above scores are calculated for each sampled company as a proportion of the sum disclosure score to the highest potential disclosure by the company. The TD items for each company is then expressed as a proportion (Tsalavoutas, 2011).

The unweighted TD items determine the level of disclosure as the percentage of the total items disclosed to the utmost potential score applicable for a particular firm. This is a popular way to identify the level of disclosure based on the annual reports (2011). Tsalavoutas (2011), for example, termed this method as “Cooke’s dichotomous approach”.

Recent CG measures are based on current Malaysian CG studies by Buniamin *et al.* (2011), Htay *et al.* (2012), Baek *et al.* (2009), Cheng *et al.* (2011) and Securities Commission of Malaysia (Murphy and Conyon, 2000). CG mechanisms adopted in this study primarily represent incentive compensation and managerial ownership. There are many discussions on the way in which managerial ownerships could be an efficient mechanism in decreasing agency contradict because of the opportunity to align managers and owners’ wealth purposes. In this context, managerial ownership is measured as a ratio of ordinary shares held by the CEO and executive directors to the total shares issued and fully paid.

Another internal mechanism of CG taken in account into this research is incentive compensation. Incentive compensation stands for the value of long-term incentive awards granted through the year, such as alternative shares or grants earmarked below long-term incentive plans. Long-term incentive plans award evaluations are calculated as the corporation share price multiplied by the maximum potential number of shares that can be received because of the award (2008). In addition, Murphy and Conyon (2000) defined total compensation as the sum of base salary, long-term incentive plans, yearly bonus and share options valued at grant date. Based on that, as well as based on the study by Florackis (2008), this study measures the compensation structure by total salary paid to executive directors scaled by total assets.

This study utilises several company-specific characteristics as control variables to ensure that the findings on the coefficient estimation of the CG and TD is not driven by these variables. Table I shows the measurement of all the control variables.

3.3 Regression model

The model tests the effects of CG internal mechanisms ($BCOMS_{it}$ and $MOWNR_{it}$) on TD and includes company-specific characteristics variables. Essentially, the estimation model is as follows:

$$TD_{it} = \beta_0 + \beta_1 BCOMS_{it} + \beta_2 MOWNR_{it} + \beta_3 EM_{it} + \beta_4 CAPNT_{it} + \beta_5 LEVE_{it} + \beta_6 DIVID_{it} + \beta_7 FSIZ_{it} + \beta_8 INDS_{it} + \beta_9 GRTH_{it} + \varepsilon_{it}$$

where:

TD_{it} = tax disclosure of ETR reconciling items;

$BCOMS_{it}$ = board compensation of firm *i* at time *t*;

$MOWNR_{it}$ = managerial ownership of firm *i* at time *t*;

EM_{it} = earnings management of firm *i* at time *t*;

$CAPNT_{it}$ = capital intensity of firm *i* at time *t*;

$LEVE_{it}$ = leverage of firm *i* at time *t*;

$DIVID_{it}$ = dividend payout ratio of company *i* at time *t*;

$FSIZ_{it}$ = firm size *i* at time *t*;

$INDS_{it}$ = industry dummy of company *i* at time *t*;

$GRTH_{it}$ = growth of company *i* at time *t*; and

ε_{it} = error term.

4. Results and discussion

Table II reports the descriptive statistics of the variables. TD scores for the sample companies vary from 3.23 to 70.97 per cent with a mean of 22.31 per cent. This indicates that TD tends to be low on the average within the sample companies.

The mean of both managerial ownership (MOWNR) and board compensation (BCOMS) shows an average of 11.89 and 5.46 per cent, respectively. This indicates that control effect of CG factors tends to be low on the average. The results of BCOMS indicated appropriate remuneration levels of executive directors to the board in all its forms; this means that the function of a remuneration committee in Malaysia is applied well (Bursa Malaysia, 2015). Moreover, the executive directors did not play a role in determining their own remuneration; this is consistent with Talha *et al.'s* (2009) recommendations. In this context, MOWNR was not affected by the rapid economic growth in Malaysia. Additionally, individual and family shareholders are often the main shareholders in Malaysia. Consequently, the need of better CG mechanisms is probably a significant consideration for Malaysian companies (Zhuang *et al.*, 2001).

Multivariate analyses were performed after controlling for influential observation and outliers (Eicker, 1963; Huber, 1967; White, 1980). The independent variables were tested for multicollinearity (Belsley *et al.*, 2004); multicollinearity does not exist between independent variables of this study. Moreover, heteroscedasticity tests shows that the residuals' differences are not fixed in that residuals are scattered randomly through the range of the estimated dependent (Lenter *et al.*, 2003).

Results on the association between TD and CG produced are presented in Table III. Overall, the model of the direct association between TD and CG is significant ($p < 0.000$) with a Wald chi^2 value of 128.90 and R^2 of 17.68 per cent. The model reports that the direct association between the level of companies' TD and the companies' CG as stated in the hypothesis is insignificant with both of its proxies: MOWNR and BCOMS. Consequently, the hypothesis which predicts the presence of a direct impact of CG on TD is not supported. The results do not support Slemrod's (Abdul Wahab and Holland, 2012) study that

Table II Descriptive statistics: CG effects on TD

N = *858*		*Mean*	*Min*	*Max*	*SD*
TD		0.2231	0.0323	0.7097	0.0815
MOWNR		0.1189	0.0000	0.6967	0.1723
BCOMS		0.0546	0.0000	0.4576	0.0713
FSIZ		5.6477	3.7564	7.8161	0.6372
EM		0.0086	−0.0990	0.1052	0.0255
CAPNT		0.3934	0.0000	1.3395	0.2958
GRTH		0.1193	−0.9983	1.5814	0.3216
LEVE		0.0776	0.0000	0.5832	0.1017
DIVID		1.2095	0.0000	7.0000	1.0443
INDS*	Firms	(%)			
INDPROD	75	26.22			
CONSUM	44	15.38			
CONSTR	14	4.90			
TRADSERV	76	26.57			
TECHNO	20	6.99			
REITS**	10	3.49			
PROPERT	21	7.34			
PLANT	20	6.99			
IPC	3	1.05			
HOTELS	3	1.05			
TOTAL	*286*	100			

Notes: *Industry dummy variable; **REITS industry sector has been eliminated from all regressions by STATA software

Table III Regression results: TD and CG

DV = TD[a]	IV = CG internal mechanisms Coefficient	z-statistic
MOWNR	0.0156	(0.60)
BCOMS	−0.0325	(−0.71)
FSIZ	*0.0447*	*(4.81)****
EM	0.0796	(1.35)
LEVE	−0.0236	(−0.81)
CAPNT	0.0000538	(0.00)
DIVID	−0.00197	(−1.13)
GRTH	−0.000656	(−0.12)
INDPROD	*0.128*	*(7.71)****
CONSUM	*0.116*	*(5.80) ****
CONSTR	*0.0946*	*(4.27)****
TRADSERV	*0.107*	*(7.28) ****
TECHNO	*0.119*	*(5.64)****
PROPERT	*0.0879*	*(5.80)****
PLANT	*0.100*	*(4.66)****
IPC	0.0110	(0.44)
HOTELS	*0.0934*	*(4.80)****
Cons	*−0.132*	*(−2.44)***
R^2	–	0.1768
N	–	858
Wald chi2	20[#]	*128.90****
Breusch-Pagan	18[#]	*118.33****

Notes: [a]Tax disclosure; dependent variable: tax disclosure (TD); numbers in brackets symbolise cross-section clustered Eicker–Huber–White adjusted *z*-statistics; *5%, **2.5%, ***1%; coefficient is outside parentheses, while *z*-values are within parentheses. The *z*-values are based on the robust standard errors clustered at the firm level for heteroscedasticity and autocorrelation; #degree of freedom

documented high levels of awareness among tax executives of changing legislation and of the emergence of a CG type environment, indicating how this awareness could show acceptable levels of TD.

The findings showed that $BCOMS_{it}$[2]and $MOWNR_{it}$[3]are not a significant factor in the association between TD and CG. The findings of this study are in line with the UK study that failed to underpin the evidence on the significance of CG to moderate the association between TP and other factors that affect the quality of companies' financial statement (2014). This may be due to the interested parties' point of view that there is generally a good CG practice in Malaysia, and thus, practice of CG is not a distinguishing factor from the interested parties' perception.

Consequently, it can be inferred that the findings do not support the hypotheses in testing the impact of CG on TD. This does not enhance the argument that taxation has a significant association with various CG mechanisms, which work to develop the firms' governance behaviour (Chen *et al.*, 2010).

In terms of firm-specific characteristic variables, the results show positive and significant associations only between TD and two variables: firm size (FSIZ) and industry dummy (INDS). The positive and momentous association between FSIZ and TD is consistent with a study by Evers *et al.* (2014). The results are generally consistent with the empirical disclosure literature.

5. Additional tests and sensitivity analysis

Several further sensitivity and robustness tests were run for all the models to evaluate the robustness of the results and to further supply supplementary results. The analysis is related to results of the ordinary least squares (OLS) regression and year dummies.

5.1 Pooled ordinary least squares regression results

The outcomes of this paper are presented based on random effect estimation. This estimation is suitable as this study aims to generalise the results from the sample to its population (Kennedy, 2003). Table IV presents the results of testing the hypotheses on OLS regression estimation regression model of the relationships between TD and CG by using the OLS regression method and utilising the STATA software package to evaluate this relationship.

We conducted a robustness check by using OLS regressions to confirm that all time-invariant differences between the companies were controlled for. The outcomes are similar to the main results. Table IV depicts the estimated model coefficients, the associated significant test outcomes and the R^2 of the model.

5.2 Year dummies and annual regressions

To examine if the findings stabilise through time, the model was tested over three annual regressions – 2010, 2011 and 2012. This procedure is suitable compared to other options, such as averaging the variables, as this examination is aimed to provide additional understanding of interested parties' TD evaluation, as an alternative to mitigating statistical doubts of time series impact. The findings are depicted in Table V.

Results of the annual associations between TD and CG variables (MOWNR and BCOMS) are similar to the primary findings, indicating that the insignificant relationship between TD and both MOWNR and BCOMS are applicable throughout the period.

Finally, the annual results in all models indicate consistent positive and significant associations between TD and three control variables: FSIZ, LEVE and industry dummy (INDS). There are eight sectors of the control variable industry dummies measurement that are positively significant.

Table IV Results of OLS regression of TD with CG

	IV = CG internal mechanisms	
DV = TD	*Coefficient*	*z-statistic*
MOWNR	0.0252	(1.34)
BCOMS	0.0402	(0.86)
FSIZ	0.0503	*(7.04)****
EM	−0.00257	(−0.03)
LEVE	−0.0739	*(−2.39)***
CAPNT	0.00193	(0.2)
DIVID	−0.00303	(−1.09)
GRTH	0.00644	(0.88)
INDPROD	0.119	*(11.37)****
CONSUM	0.106	*(8.77)****
CONSTR	0.0856	*(6.23)****
TRADSERV	0.0993	*(11.09)****
TECHNO	0.108	*(8.19)****
PROPERT	0.0789	*(7.88)****
PLANT	0.0933	*(7.03)****
IPC	0.000554	(0.03)
HOTELS	0.0834	*(6.64)****
Cons	−0.158	*(−4.0)* ***
N		858
R^2		0.189
F-statistic	22#	*15.32****

Notes: Numbers in brackets symbolise cross-section clustered Eicker–Huber–White adjusted *z*-statistics; *5%, **2.5%, ***1%; coefficient is outside parentheses, while Z-values are within parentheses; #degree of freedom

Table V Annual regressions: TD and CG				
DV= TD	*2010*	*2011*	*2012*	*All*
MOWNR	0.0159 (0.46)	0.0527 (1.44)	0.015 (0.51)	0.0252 (1.34)
BCOMS	0.0905 (1.17)	0.0728 (0.8)	−0.0118 (−0.15)	0.0402 (0.86)
FSIZ	0.0506 (3.95)***	0.0598 (3.86)***	0.0446 (4.48)***	0.0503 (7.04)***
EM	0.0281 (0.21)	0.122 (0.61)	−0.164 (−0.96)	−0.00257 (−0.03)
LEVE	−0.0443 (−0.70)	−0.113 (−2.01)**	−0.069 (−1.43)	−0.0739 (−2.39)*
CAPNT	−0.00346 (−0.19)	−0.00656 (−0.35)	0.0124 (0.84)	0.00193 (0.2)
DIVID	−0.00564 (−1.25)	0.000242 (0.05)	−0.00339 (−0.68)	−0.00303 (−1.09)
GRTH	−0.0056 (−0.38)	0.0013 (0.11)	0.0245 (2.12)**	0.00644 (0.88)
INDPROD	0.123 (6.71)***	0.118 (6.56)***	0.116 (6.85)***	0.119 (11.37)***
CONSUM	0.107 (5.12)***	0.102 (4.64)***	0.109 (5.76)***	0.106 (8.77)***
CONSTR	0.0930 (3.91)***	0.0753 (2.84)***	0.0854 (3.63)***	0.0856 (6.23)***
TRADSERV	0.105 (6.65)***	0.0934 (6.21)***	0.0990 (6.95)***	0.0993 (11.09)***
TECHNO	0.116 (5.16)***	0.105 (4.15)***	0.102 (4.83)***	0.108 (8.19)***
PROPERT	0.0700 (4.2)***	0.0870 (4.99)***	0.0764 (4.71)***	0.0789 (7.88)***
PLANT	0.108 (4.75)***	0.0798 (3.49)***	0.0989 (4.06)***	0.0933 (7.03)***
IPC	−0.0339 (−0.78)	0.0221 (1.06)	0.00614 (0.23)	0.000554 (0.03)
HOTELS	0.0604 (3.12)***	0.0873 (4.21)***	0.101 (5.59)***	0.0834 (6.64)***
Cons	−0.162 (−2.31)**	−0.213 (−2.55)**	−0.132 (−2.35)**	−0.158 (−4.00)***
N	286	286	286	858
R^2	0.245	0.186	0.203	0.189
adj. R^2	0.188	0.124	0.143	0.167
F-statistic	6.42***	6.59***	6.81***	15.32***
	20#	20#	20#	22#

Notes: Numbers in brackets symbolise cross-section clustered Eicker–Huber–White adjusted *z*-statistics; *5%, **2.5%, ***1%; #degree of freedom

6. Conclusion and implications

This study aims to investigate the relationship between CG internal mechanisms conduct and TD using Malaysian non-financial listed firms. The study uses panel data analysis and provides evidence that CG conducts have no impact on TD level.

In particular, we find that board compensation and managerial ownership are not significant in explaining the level of TD. In addition, it is found that bigger firms tend to disclose more information about tax compared to their smaller counterparts. Industry sector also appears to influence the amount of TD.

These results reflect the unique setting of non-financial related firms in Malaysia. Accordingly, we provide further evidence, using non-financial firms in BM, about the effect of CG internal mechanisms conduct on TD level. These findings are important for industry, decisionmakers and management of Malaysia listed companies. Further research could examine CG conduct as a moderator between TD and other taxation factors such as TP.

The evidence found by this study has important policy and practical knowledge implications for at least three parties – the authorities, researchers and firm managers. The authorities include legislators and regulatory agencies associated with taxation, financial reporting and CG.

The results contribute to the policy and practical implications for CG. The results indicate an insignificant impact of CG on interested parties' TP assessment. If this indicates that the present CG practices or corporate TDs are not sufficient to supply governance information to interested parties when evaluating moral hazard of managers in TP, the financial reporting authorities need reporting regulations and rules that require managers to be more transparent.

If there is previously enough disclosure of CG and tax information to allow users to measure TP, users may need to become more vigorous in restricting managers' moral hazard

through TP activities. Disclosure of tax information is like disclosure of CG practices, as the findings of previous studies signify that users consider tax expense information in equity-pricing. The authorities must also be concerned with whether the present disclosure requirements, especially on tax expenses, are satisfactory in supplying enough taxation information, especially TP information, to users.

This study is regarded as the first attempt to examine the impact of CG internal mechanisms on TD in a developing nation such as Malaysia. In spite of the fact that this paper focuses on a single country, it contributes significant insights to the debate about TD. We agree that independent directors play a monitoring role, and their influence over financial reporting and compliance can reduce information asymmetry and agency problems. Also, the TD requirement is related to internal controls and financial reporting process, which is also overseen by the independent directors (e.g. their presence on the audit committees). However, we excluded them from the study as they play only a monitoring role. Future studies may take them into consideration.

Providing incentives for good disclosure can be another important strategy to be introduced to promote better TD in Malaysia. Back in 1949, Professor Karl Soup recommended a Blue Return System be implemented in Japan. The system encourages companies to keep a good tax accounting records and disclose exhaustively the tax information in the annual report. For this, the company were given a Blue Return status (instead of the White and the Pink return), which provides them with the privileges as a company to operate not only when dealing with the government departments but also when dealing with the financial institutions and suppliers in their business. The system has been adopted in Taiwan and Nepal successfully. This system could promote better disclosure of tax information by using a new principle of "disclose and enjoy" the privileges. (Khadka, 1992; PWC, 2015).

Finally, as we only investigated Malaysian companies, the question of whether our results are relevant to other countries with good internal CG mechanism and clear understanding of TD exists. Future research, thus, may test the associations hypothesised in this study in different nations by using a big sample.

Tax signal is not merely linked with financial benefit. The Japanese success case had shown that companies had adopted the voluntary disclosure ultimately as a culture rather than to gain from the direct incentives provided. Considerable opportunities exist for future research. This includes the various characteristics of tax signals such as the reliability and observability that might take on different meanings when used by different signallers. The areas of research surrounding the tax signaller and receiver may interact to yield especially effective, or ineffective, signalling. Possible future research could also explore tax signalling at multiple levels of analysis (Bamberger, 2008) such as on how the aggregate tax signalling between managers and subordinates in an organisation could have implications for firm quality between the organisation and its stakeholders (Wayne *et al.*, 1997).

Notes

1. There are many ways to identify an outlier or unusual observation such as: Studentized residual to reveal influential observations in which the dependent variable is exceptional for certain values of the independent variables, Leverage discover whether the independent variable' observation has swerved from its mean and which might affect the regression coefficients estimation. According to the latter, observations with leverage of more than 2k/n (where n is number of observations and k is the number of independent variables) determine outliers.
2. Board Compensations.
3. Managerial Ownership.

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Corresponding author

Mahfoudh Hussein Mgammal can be contacted at: mrrsr77@yahoo.com

Appendix

Table AI CG Regulations comparison between the MCCG 2012 and the 2007 code

Prin.No.	*MCCG 2012 Principle*	*Re.No.*	*MCCG 2012 Recommendation*	*Blueprint Recommendation no.*	*2007 Code*
CG in Malaysia				24 mandate companies to focus on substance rather than form in meeting CG requirements	Introduction : Parts 3 and 4
1	Establish clear roles and responsibilities	1.1	"The board should establish clear functions reserved for the board and those delegated to management"	–	Part 2 : AA XVI "Relationship of the board to management"
		1.2	"The board should establish clear roles and responsibilities in discharging its fiduciary and leadership functions"	–	Part 1 : A I "The board" Part 2 : AA I "Principal responsibilities of the board"
		1.3	"The board should formalize ethical standards through a code of conduct and ensure its compliance"	10 "Mandate boards to formulate ethical standards and system of compliance through the company's code of conduct"	–
		1.4	"The board should ensure that the company's strategies promote sustainability"	11 "Mandate boards to formulate strategies that address sustainability and stakeholder interests through internal policies"	–
		1.5	"The board should have procedures to allow its members access to information and advice"	–	Part I : A III "Supply of information"
		1.6	"The board should ensure it is supported by a suitably qualified and competent company secretary"	30 "Enhance the role of company secretaries through clarifying their role and look into qualification requirements needed to raise the skills and professional standards for company secretaries of listed companies"	Part 2 : AA XIX "Access to information" Part 2 : AA XX "Access to Advice" Part 2 : AA XXI and XXII
		1.7	"The board should formalize, periodically review and make public its board charter"	12 "Mandate formalization of the board charter and disclosure of the charter in the annual report"	–
2	Strengthen composition	2.1	"The board should establish a Nominating Committee which should comprise exclusively of non-executive directors, a majority of whom must be independent"	16 "Mandate boards to establish a Nominating Committee with enhanced roles chaired by an independent director"	Part I : A IV and Part 2 : AA VIII "Appointments to the board"
		2.2	"The Nominating Committee should develop, maintain and review the criteria to be used in the recruitment process and annual assessment of directors"	–	Part 2 : AA IX Part 2 : AA X Part 2 : AA XIII "Directors' training"
		2.3	"The board should establish formal and transparent remuneration policies and procedures to attract and retain directors"	–	Part 1 : B I "The level and make-up of Remuneration" Part 1 : B II "Procedure" Part 1 : B III "Disclosure" Part 2 : AA XXIV "Remuneration Committees"
3	Reinforce Independence	3.1	"The board should undertake an assessment of its independent directors annually"	14 "Mandate boards to undertake an assessment on independence annually, upon re-admission and when any new interests or relationships surface-based on a set of criteria established by the boards"	–
		3.2	"The tenure of an independent director should not exceed a cumulative term of nine years. Upon		–

(*continued*)

Table AI

Prin.No.	MCCG 2012 Principle	Re.No.	MCCG 2012 Recommendation	Blueprint Recommendation no.	2007 Code
			completion of the nine years, the independent director may continue to serve on the board subject to the director's re-designation as a non-independent director	13 "Mandate a cumulative term limit of up to nine years for an individual to serve as an independent director"	
		3.3	"The board must justify and seek shareholders' approval in the event it retains as an independent director, a person who has served in that capacity for more than nine years"		
		3.4	"The positions of chairman and CEO should be held by different individuals, and the chairman must be a non-executive member of the board"	15 "Mandate separating the position of chairman and CEO and for the chairman to be a non-executive member of the board"	Part 2 : AA II "Chairman and Chief Executive Officer"
		3.5	"The board must comprise a majority of independent directors where the chairman of the board is not an independent director"		
4	Foster commitment	4.1	"The board should set out expectations on time commitment for its members and protocols for accepting new directorships"	21 "Mandate boards to set out their expectations on time commitment including protocols for accepting other external appointments in their board charter"	–
		4.2	"The board should ensure its members have access to appropriate continuing education programmers"	–	–
5	Uphold integrity in financial reporting	5.1	"The Audit Committee should ensure financial statements comply with applicable financial reporting standards"	–	Part II : BB II
		5.2	"The Audit Committee should have policies and procedures to assess the suitability and independence of external auditors"	–	
6	Recognize and manage risks	6.1	The board should establish a sound framework to manage risks	–	Part I : D II "Internal control"
		6.2	"The board should establish an internal audit function which reports directly to the Audit Committee"	–	Part 2 : BB VII & VIII
7	Ensure timely and high-quality disclosure	7.1	"The board should ensure the company has appropriate corporate disclosure policies and procedures"	23 "Move beyond minimum reporting by making explicit the requirement for shareholders to be provided with quality and timely information"	–
		7.2	"The board should encourage the company to leverage on information technology for effective dissemination of information"	25" Promote better use of technology by companies to communicate with their shareholders"	–
8	Strengthen relationship between company and shareholders	8.1	"The board should take reasonable steps to encourage shareholder participation at general meetings"	5 "Mandate companies to make public their commitment to respecting shareholder rights and take active steps to inform shareholders of how these rights can be exercised 27 Encourage companies to provide better quality and timely information through notices and documents and to serve notices for meetings earlier than the minimum notice period"	Part 3 : I "Shareholder voting"
		8.2	"The board should encourage poll voting"	3 "Impose obligation for the chairman of the general meeting to inform shareholders of their right to demand a poll vote"	–
		8.3	"The board should promote effective communication and proactive engagements with shareholders"	–	Part I : C I "Dialogue between companies and investors"

(*continued*)

Table AI

Prin.No.	*MCCG 2012 Principle*	*Re.No.*	*MCCG 2012 Recommendation*	*Blueprint Recommendation no.*	*2007 Code*
					Part 2 : CC I “The relationship between the board and shareholder” Part 3 : II “Dialogue between companies and investors”

Sources: Table I: Comparison between the MCCG 2012 and the 2007 Malaysian Code on Corporate Governance, by Securities Commission Malaysia (2012), www.sc.com.my/eng/html/cg/cg2012.pdf, p. 24