



Faculty of Economics and Business

**THE ROLE OF OWNERSHIP EXPROPRIATION ON RELATIONSHIP
BETWEEN CLIMATE CHANGE EFFORT AND TAX AVOIDANCE:
EVIDENCE FROM MALAYSIA**

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the requirements for the degree of Bachelor of Finance with
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Statement of Originality

The work described in this Final Year Project, entitled
**“The role of Ownership Expropriation on relationship between Climate
Change Effort and Tax Avoidance: Evidence from Malaysia”**

is to the best of the author’s knowledge that of the author except
where due reference is made.

Date Submitted

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Abstract

The role of Ownership Expropriation on relationship between Climate Change Effort and Tax Avoidance: Evidence from Malaysia

By

You Hui Wei

This study is to examine the relationship between tax avoidance, climate change efforts, firm size, growth, profitability, leverage and ownership expropriation in Malaysia during the sample periods from year 2008 to 2013. Based on the sample of 248 publicly listed in Bursa Malaysia for 6 year and the chosen company from the 6 industries which are consumer, construction, plantation, property, technology and trading. This result shows that the higher climate change effort disclosure of a company, the lower the tax avoidance or tax planning. The results find that the climate change effort is significantly negative relationship with the tax avoidance. The results of other independent variables are inconsistent relationship with the hypothesized. Additional the empirical result suggest that there is moderating effect of ownership expropriation on the relationship between of climate change efforts and tax avoidance. Meaning that the ownership expropriation involve positive or negative impact on the relationship between tax avoidance and climate change effort, regardless the ownership expropriation is high or low.

Abstrak

Peranan Pemilikan rampasan hubungan antara Perubahan Iklim Usaha dan Cukai Pengelakan: Bukti dari Malaysia

Oleh

You Hui Wei

Kajian ini adalah untuk mengkaji hubungan antara pengelakan cukai, usaha perubahan iklim, saiz firma, pertumbuhan, keuntungan, hutang dan rampasan hak milik di Malaysia semasa tempoh sampel dari tahun 2008 hingga 2013. Berdasarkan sampel 248 orang awam yang disenaraikan di Bursa Malaysia 6 tahun dan syarikat yang dipilih daripada 6 industri iaitu pengguna, pembinaan, perladangan, hartanah, teknologi dan perdagangan. Ini menunjukkan hasil bahawa perubahan iklim usaha pendedahan yang lebih tinggi syarikat, lebih rendah mengelakkan cukai atau perancangan cukai. Keputusan mendapati bahawa usaha perubahan iklim adalah lebih hubungan negatif dengan mengelakkan cukai. Keputusan pembolehubah bebas yang lain adalah hubungan yang tidak selaras dengan hipotesis ini. Tambahan hasil empirikal mencadangkan bahawa terdapat sederhana kesan rampasan hak milik ke atas hubungan antara usaha perubahan iklim dan mengelakkan cukai. Bermakna rampasan pemilikan melibatkan kesan positif atau negatif terhadap hubungan antara pengelakan cukai dan usaha perubahan iklim, tanpa rampasan pemilikan yang tinggi atau rendah.

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CHAPTER ONE

INTRODUCTION

1.0 Introduction

Tax avoidance or tax planning is important for taxpayer to minimize, eliminate or defer payment of income tax (Choong, 2013). Chen, Chen, Cheng and Shevlin (2010) argued that tax is important cost of the firm, and tax avoidance is significant to shareholders wealth. Thus, tax avoidance activities that decrease transmits from stockholders to the administration ought to increase shareholder wealth. On the other hand, an empirical literature, which investigates tax avoidance in an agency framework, suggests that opportunistic managers use the tax avoidance to proceed management, rather than shareholder, benefits (Desai & Dharmapala 2009).

This research explores various factors that may influence tax avoidance. According to the Lanis and Richardson (2012), previous research has been conducted to analysis the relationship between tax avoidance, climate change effort, size, leverage, growth, profitability and ownership expropriation. However, past study has rarely aimed the relationship between climate change and tax avoidance (Freedman, 2003; Desai & Dharmapala, 2006; Williams, 2007). Therefore, this study plans to investigate the role of Ownership Expropriation on relationship between Tax Avoidance and Climate change efforts. The latter, this study examines ten related research questions and ten related research objective. It is related one main independent variable climate change effort and four control variables which are firm size, leverage, growth, and profitability. In addition, the role of ownership expropriation is the moderating variable.

The introduction section addresses common point of observation and problem statement. It delivers about the background of the study including the explanation of tax avoidance and the climate change efforts which explain the problems. Moreover, it explains on the role of ownership expropriation between tax avoidance and climate change effort as a contribution of this study. In this chapter, the research question and objectives are also acknowledged. Lastly, the introduction chapter ends with scope of study, organization of the study and summary.

1.1 Background of study

Income tax has been the main receipts for Malaysia effectively started from 1 January 1948 under the Income Tax Ordinance 1947 (Singh, 2003). It contributes 16.11% (2012) in Malaysia GDP. The tax receipts of Malaysian government are RM 162.13 billion, RM185.419 billion and RM207.913 billion for the year 2010, 2011, and 2012 respectively. Malaysian Prime Minister, Najib, has addressed tax will be the main source to finance the public goods in Malaysia in regards of achieving 2020 vision.

Direct taxes, such corporate tax, contribute as a most important part of the government revenue. Corporate tax is main parts of direct tax collected by the Inland Revenue Board of Malaysia (IRBM). In Malaysia, total tax collections for 2012 of RM124.88 billion contributed 60.07% of the total Federal Government income of RM207.913 billion, and corporate tax with RM59.31 billion collected, making up 47.48% % of the total collections, while it was RM55.08 billion, making up 50.25% of the total tax revenues in 2011.

Using the data extracted from the annual report of the Inland Revenue Board of Malaysia, the graph of corporate taxes in overall direct tax collection and tax avoidance investigation cases resolved by file type are detailed for eight years from 2005 to 2012 (refer to Figure 1.1 and Figure 1.2).

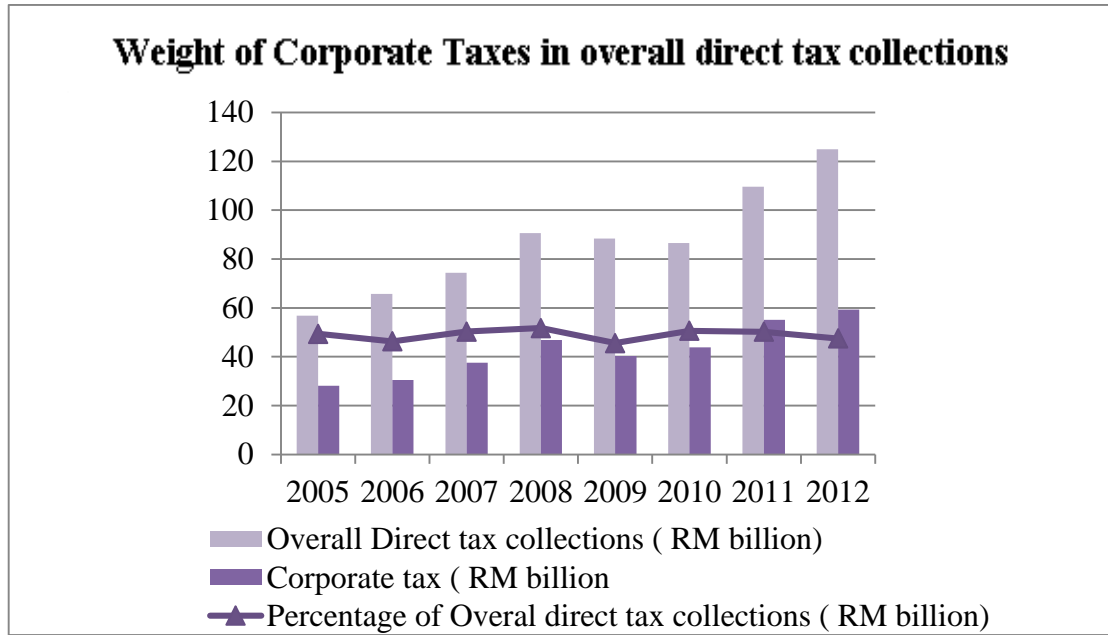


Figure 1.1 Weight of Corporate taxes in overall direct tax collections
 Source: Annual reports of the Inland Revenue Board of Malaysia

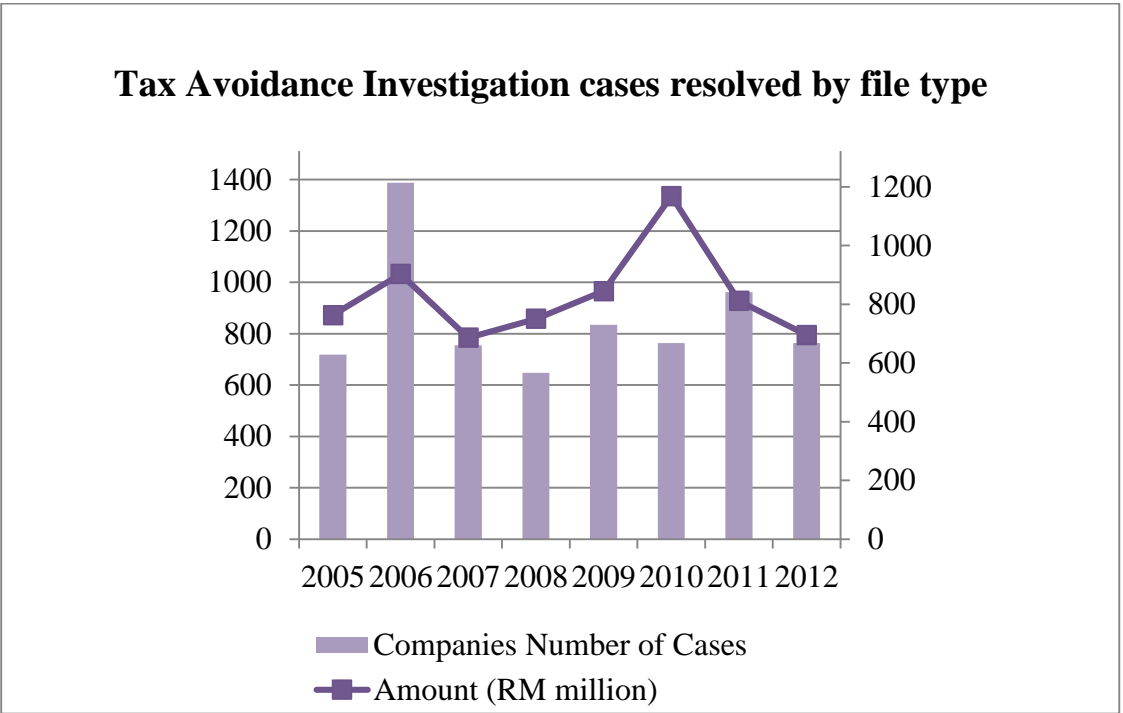


Figure 1.2 Tax avoidance investigation cases resolved by file type
 Source: Annual reports of the Inland Revenue Board of Malaysia

Tax avoidance is becoming a most important concern of the world community (Gravile, 2009) and Malaysian Government. The IRBM's the Civil Investigation Division carries out investigations to tackle intentional as well as incorrect tax reports which are tent to avoid giving tax. In 2011, 961 tax avoidance cases under investigation were successfully resolved, while 763 cases in 2010. Conversely, the amount of the avoided taxes recorded decrease of 44.00% from RM1168.55 million in 2010 to RM811.50 million in 2011. In 2012, tax avoidance cases decreased to 764. The amount of the avoided taxes recorded in 2012 dropped reached RM 695.70 million. Although the amount from 2010 to 2012 is keeping dropped but it also still remains the significant value to influence the government. Although there have been issued many of anti-avoidance rules, companies are still utilizing this perform in their tax reporting.

Furthermore, Malaysia tax systems include the Self Administered System (SAS). On 1 January 2005, the Inland Revenue Board Malaysia (IRBM) has applied the self-assessment tax system (the SAS) on individual taxpayers to encourage voluntary tax fulfillment. Based on the SAS, individual who has income accruing in or derived from Malaysia are obligatory to compute tax payable correctly, disclose taxable income truthfully, file tax return form and pay tax on a timely manner. In short, under SAS, the responsibility to charge the tax liability is on the taxpayers.

Tax planning or tax avoidance is knowledge of tax laws and agreement with tax requirements. The objective of tax avoidance or tax planning is to eliminate, reduce, minimize or defer income tax within the field of law. Furthermore, it also minimize or defer the amount of taxes that have to be paid, maximize non-refundable income and consider of and employ different strategies in order to minimize or defer the amount of taxes paid during a period (Choong, 2013). When company doing tax avoidance or tax planning activities, as a result in reducing or deferred tax liability, reduce climate change effort, thus more money to enjoy for donating, investing, spending, and saving.

As the Financial Reporting Foundation (FRF) and Malaysian Accounting Standard Board (MASB) proclaimed Malaysia has set 1 January 2012 as the goal for full convergence with IFRS. IFRS regulate tax avoidance through deferred tax by adoption of Tax reporting which is International Accounting Standard (IAS) 12. IAS 12 has inferences on published financial statement. IAS 12 involves full acknowledgment of deferred tax away from current tax. In fact, thus, all company cannot be evaluating their tax position based on their financial accounting treatments only. This is because,

current tax is directly related to effective tax rates (ETRs), whilst deferred tax could delay or speed up the future tax liabilities.

In other side, the climate change has been rapidly changing globally. The impact of the global issue is environmental degradation such as increase temperature, melting icecaps in the polar areas, rainfall and storms became floods, pollutions by industry and others else. On the government perspective, the United Nations Intergovernmental Panel on Climate Change (IPCC) 2014, the global warming caused directly by the Greenhouse gases emission from industry. It means that when there is increasing greenhouse gases emission, the temperature will raise sea level in global. This climate change has been concerned by firms over the world and Malaysia is no exceptions, where at least 90% of Malaysian firm's top management concerned with this issue (Devi & Wong, 2010).

Greenhouse gases emissions is the main factor of the climate change and global warming. The main reason by increases in Greenhouse gases emissions is Carbon Dioxide (CO₂) emissions. CO₂ emissions of Malaysia main contributors are industry's pollutant. Using the data extracted from World Bank, the graph of CO₂ emissions of Malaysia is detail for 40 years from 1970-2010. The graph shows that rapid change of CO₂ emission of Malaysia (refer to Figure 1.3).

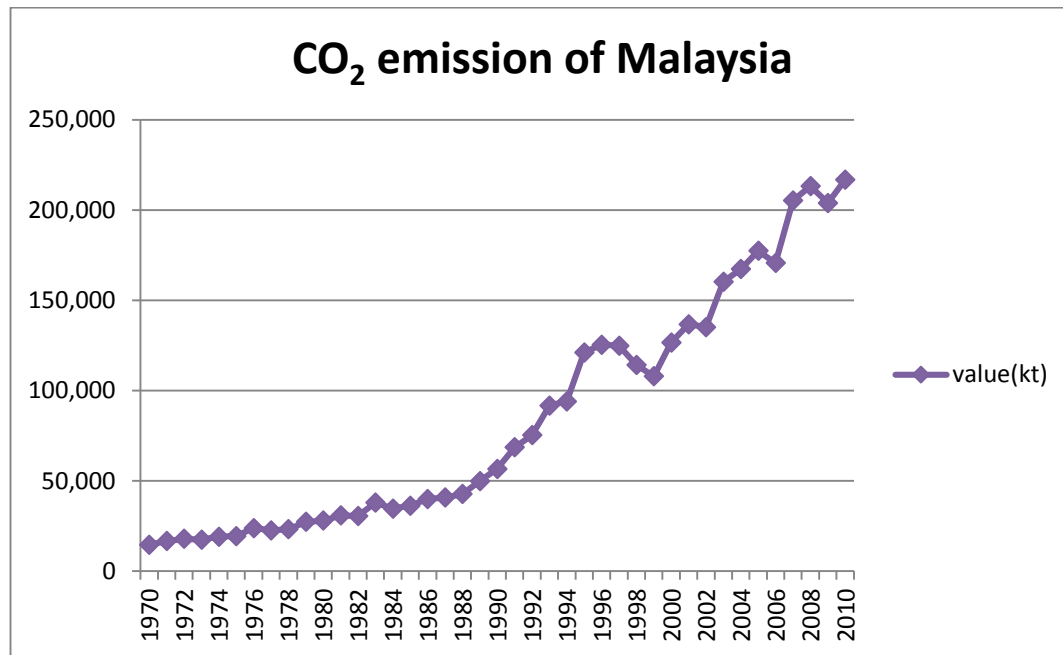


Figure 1.3. CO₂ emissions of Malaysia

Source: WorldBank

The value for CO₂ emissions in Malaysia was 216,804 in 2010. The graph above illustrates, over the past 40 years this indicator achieved a minimum value of 14,602 in 1970 and a maximum value of 216,804 in 2010. The CO₂ emission of Malaysia implies that is a serious problem. Therefore, company need undertakes for climate change effort activities, this have positive impact to the society and improve their quality of life.

Besides that, company can participate in climate change effort through many ways. Such as to take action to climate change effort, reducing greenhouse gas (GHG) emissions or CO₂ emissions through energy efficiency, renewable power, and cleaner vehicles. Yet, there is a room for companies to do tax planning or tax avoidance through this climate change mitigation.

Company is a firm's membership in society. Thus, a tax to curb climate change should be levied directly on the company responsible. All company responsible for the climate change and based on the quantity of greenhouse gases emitted. In principle, climate change taxes based directly on measured emissions can be very accurately targeted. When climate change has reduced, the polluter's tax liability reduces and their tax avoidance rise. Similarly, action by the polluter to increase their tax liability and decrease tax avoidance results in a rise in climate change. Moreover, they pay additional tax proportional to the increase in climate change.

Furthermore, the achievement and survival of a corporation may be determined by the climate change effort. The Commission of the European Communities (2001) stated that the climate change effort is based on the concept of company's decisions to contribute a beauty or cleaner environmental and a superior society. However, there is no any rule, regulation, order, and notification to command the climate change effort of a corporation. Therefore, a corporation has alternative to plan and formulate a particular approach of climate change effort.

According to Lanis and Richardson (2012), there are dissimilar points of observation as to why a business may hold in climate change effort activities in the primary situation. For instance, Watts and Zimmerman (1970; 1990) shown that climate change effort is an illegal challenge by executives to tax shareholders not including their permission, and show the ways to executives being inexplicable to shareholders in the agency framework complex in business. Thus, particularly given the power of agency theory in business research (Lanis and Richardson, 2012), this may help to clarify why

only some business studies have considered the impact of a firm's climate change effort activities on firm tax.

In a short, this study aims to investigate the relationship between tax avoidance and climate change effort. It also aims to investigate the role of ownership expropriate. Note that the examination of a firm assumed in this research is broader than that implies by agency theory and considers stakeholders other than shareholders as also being significant to a corporation's continuing operations (Ibrahim, 2003; Christensen & Murphy, 2004; Williams, 2007).

1.2 Problem statement

Recent years many corporate have focused and concentrated on the relationship between tax avoidance and climate change effort. Certain studies such Hanlon and Heitzman (2010), and Sikka (2010) have suggested that businesses, researchers, academicians and commentators have to conduct for more examination into the relation between tax avoidance and climate change effort; an intriguing question that this study aims to tackle.

One issue of tax in Malaysia is tax avoidance. This is because taxes can adequate benefit between the government and society for the expense of company tax to be considered as an expense to the public (William, 2007). If corporate employs climate change effort, manager links it with tax avoidance, where manager might use climate change effort as the tool for tax deduction. This implies a negative effect on society because firms receive tax deduction and reduce the financial of public goods (Freedman, 2003; Slemrod, 2004; Landolf, 2006; William, 2007).

Nowadays, everyone quick argues that is Bill Gates big charity donation designed to avoid income tax? Is it one way to avoid tax through charity? Donations made to charities or non-trading institutions from income earned. Donations are not wholly incurred in the production of income is not tax deductible (Choong, 2013). On the other hand, the amount that can be deducted such gifts of money made by corporations is restricted to 10 percent of their aggregate income in the current year. The restricted of 7 per cent of the aggregate income for non-companies which are individual, trust, club, co-op society and so on. Section 44(6) offers that a subtraction made from a individual's income for any presents of money to the administration, a State administration, institution or local authority or any organization consent by the Director General (Choong, 2013).

The problem is previous studies stated that climate change effort for tax avoidance news show that negative relationship between climate change effort and tax avoidance. However carbon dioxide and tax positively correlated. By comparing tax revenue and carbon dioxide emission, it show that CO₂ and tax revenue are significant (refer to Graph 1.4) and this study can clearly know their relationship.

Figure 1.4 using the data extracted from World Bank, the graph of CO₂ emissions of Malaysia is detail for 15 years from 1996-2010. It also use the data extracted from the annual report of the Inland Revenue Board of Malaysia, the graph of tax revenue is detail for 15 years from 1996 to 2010.

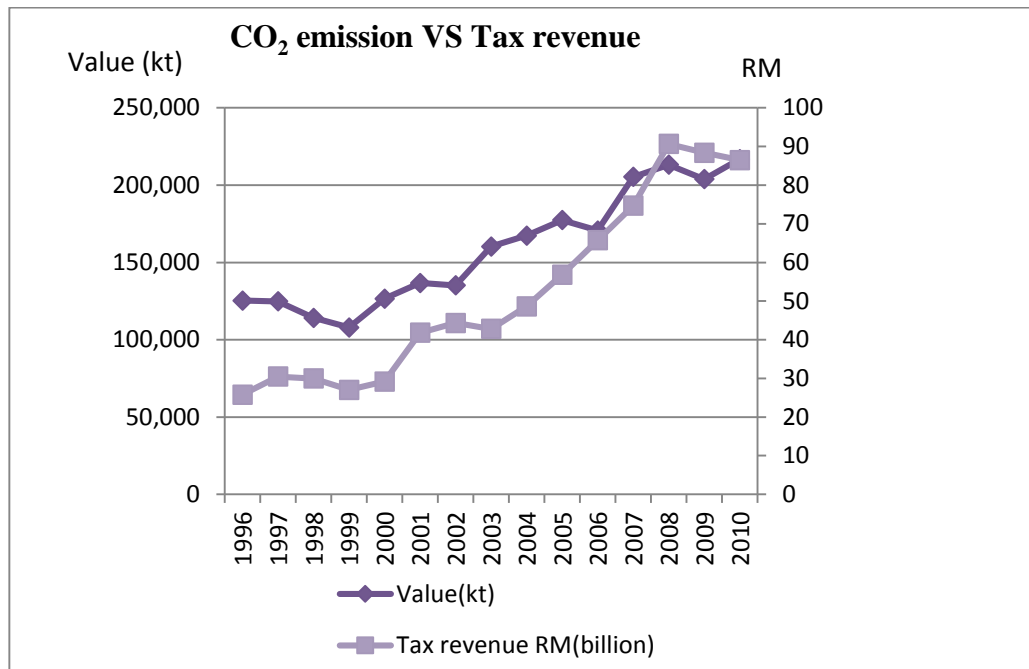


Figure 1.4 CO₂ emissions of Malaysia Vs Tax revenue of Malaysia in 1996-2010
 Source: WorldBank and Annual reports of the Inland Revenue Board of Malaysia

The graph above shows that CO₂ emissions and tax revenue are same direction relationship. In 1998, tax revenue decrease 1.63% from RM 30.476 billion to RM29.978 billion, while CO₂ emission also decrease 8.52% from 124,821 to 114,187. Conversely, in 2008, tax revenue increase 21.35% from RM 74.703 billion to RM90.651 billion, similarly CO₂ emission also increase 3.85% from 205,308 to 213,221. This implies the receipts of tax increase as firm is more profitable year by year. Yet, the CO₂ emission also increases indicating firm optimizes performance but not considering environment.

Moreover, according to Lanis and Richardson (2012), shows that larger firms as expected to be less tax avoidance or planning. On the contrary, smaller firms expected to be more tax avoidance or planning. Since larger firms have superior economic,

business, and political powers relative to smaller firms and are allowed to decrease their tax consequently (Siegfried, 1972). So, firm size also has the impact on tax avoidance.

This problem statement discovers various issues that may influence tax avoidance. Following the Lanis and Richardson (2012), their own research has been accomplished to analysis the relationship between firm characteristics and tax aggressiveness. Nevertheless, not often examined the relationship between climate change and tax avoidance (Freedman, 2003; Desai and Dharmapala, 2006; Williams, 2007; Avi-Yonah, 2008). In analysis of this research gap and lack of information concerning firm characteristics this study aimed to examine the relationship between firm characteristics, ownership expropriation, climate change effort, and tax avoidance among the public listed companies in Malaysia.

1.3 Research Question

Research question is conveying the research objectives in terms of questions that can be addressed by research. It helps us in hypothesis development. It also helps us to design a study that produces useful results. Hence, this research includes 10 research questions as follows:

1. Is there a negative significant relationship between the tax avoidance and climate change efforts?
2. Is there a positive significant relationship between tax avoidance and firm's size?
3. What is relationship between the tax avoidance and leverage?
4. What is relationship between the tax avoidance and growth?
5. Is there a positive significant relationship between the tax avoidance and profitability?

6. Is there a moderating effect of ownership expropriation on the relationship between climate change efforts and tax avoidance?

1.4 Research Objective

Research objective is to assessing the research question whether positive or negative that can be addressed by research. Since, this study has 10 research questions. Therefore, this paper includes 10 research objectives as below:

1. To examine whether tax avoidance give a significant negative impact on climate change efforts.
2. To investigate the relationship between the tax avoidance and firm's size.
3. To examine whether tax avoidance give a significant positive impact on leverage.
4. To assess the relationship between the tax avoidance and growth.
5. To investigate the relationship between the tax avoidance and the profitability.
6. To assess the role of ownership expropriation on the relationship between climate change efforts and tax avoidance.

1.5 Scope of study

This research covers all listed companies in Malaysia, and it examines the role of ownership expropriation on the relationship of climate change and tax avoidance. This research, using the data based on annual report listed in Main Board of Bursa Malaysia (previously known as Kuala Lumpur Stock Exchange, KLSE) for the years 2008 to 2013. Therefore, this research ensures that six year data are accuracy. Besides that, the