

CEO Characteristics and Tax Avoidance: Niccolo Machiavelli Thinking

Melisa Elizabeth Simon, Heru Tjaraka

Airlangga University, Mulyorejo, Surabaya, East Java 60115, Indonesia

Email: melisa.elizabeth.simon-2019@feb.unair.ac.id

Abstract

Tax is one of the state revenues which has the biggest role in the Indonesian economy. Unaccomplished of tax revenues realization in Indonesia due to tax avoidance effort. Decision making for tax avoidance is determined by decisions from top management, which is the director of the company or often also known as CEO (Chief Executive Officer). Therefore, decision making to avoid taxes is also influenced by the characteristics of the CEO of a company. The purpose of this article is to determine the relationship of the characteristics of the CEO with the understanding of the concept of power according to the philosopher Machiavelli, with the tax avoidance of a company. The results of this article are top management has an important influence on a company's decision making, and understanding the concept of power according to philosophers Machiavelli had a negative impact on the characteristics of the CEO in doing tax avoidance effort.

Keywords: Tax Avoidance, Characteristics of the CEO, Power, Machiavelli.

The strength of an actor greatly influences ratings in the film industry. Similar to a company, where the results of a company is largely determined by the characteristics of the CEO who runs the company. According to (Hambrick & Mason, 1984), a reflection of the value and cognitive basis of an actor's power in an organization influences the organization's results in both the strategy and effectiveness of an organization. Upper echelons theory is the main theory that premised interest in a top manager who became one of the factors that can affect the outcome of an organization (Carpenter et al., 2004; Finkelstein et al., 2009; Nielsen, 2010). This theory emphasizes that organizational results are strongly influenced by each individual from top management in terms of decision making that is influenced by the characteristics of the top managers. In running a

company, a CEO also has the power used to make a company's decisions. Decision making can harm and benefit the company, so that by understanding the definition of power according to Niccolo Machiavelli, an Italian diplomat and politician who is also a philosopher known as the reality of political theory can influence the characteristics of the CEO in using his power (www.wikipedia.org, accessed November 14 2019). According to the philosopher Machiavelli, traits such as deer and lion, must be possessed by a state leader. A country leader can do all kinds of ways so that his goals can be achieved. "Het doel heilighet de middele" which means to justify or justify all means or efforts, in Machiavelli's theory, the state must be prioritized so that leaders can commit a plentiful tricks for the interests of the country. In this case, a state leader is likened to a CEO who can perform

many ways, one of the action is an effort to avoid taxes in the interests of companies that are likened to a country.

Power that is interpreted to justify or justifying all means or efforts, in our opinion, the theory can affect the characteristics of a CEO so that it can influence the CEO to justify all means, in this case could lead to avoid tax illegally (Tax Evasion) for company's interest hence not reducing income of company. In addition, according to Machiavelli's theory, a leader must be skillful, smart and slick so that CEOs can make tax avoidance legally.

Tax is one of main issue that cannot be avoided by many Indonesian companies (Stefany & Agustina, 2022). The increasing number of changes made in taxation laws and regulations in Indonesia have an impact on companies to continue doing tax avoidance efforts. This is supported by the target set in the State Budget (APBN) of Rp. 1,424 trillion in 2018 (www.kemenkeu.go.id, accessed November 13, 2019) while based on the APBN on Performance and Facts of the December 2018 edition, the realization of tax revenue is only Rp. 1,136.66 trillion of the target. The Ministry of Finance notes that there is still a shortfall of Rp. 288 trillion which is still not reached. That is because one of the results of a company to determine the amount of tax to be paid by the company is affected by the characteristics of the CEO.

Therefore, this article will further explain the concept of CEO characteristics according to Upper Echelons Theory, the concept of power according to Machiavelli's theory and the concept of tax avoidance, and discuss the relationship between CEO characteristics on tax avoidance, based on the thought of Machiavelli's theory, along with its impact and continued with the final part of the conclusion showing that top management, namely the company's CEO plays an important role in decision making and the concept of Machiavelli's power has a bad influence on the CEO to do tax avoidance.

Literature Review

Characteristics of The CEO - Upper Echelons Theory

Based on the concept model of the Upper Echelons theory explains that the characteristics of the top manager, the CEO that will be discussed in this article, are divided into characteristics of non-observable and observable CEO. Characteristics of non-observable CEO are CEO characteristics that are viewed from a psychological perspective, such as the cognitive basis and values held by each CEO. Whereas observable CEO characteristics are CEO characteristics in terms of background, including age, functional path, work experience, education, socioeconomic resources, financial position, group characteristics and leadership style (Hambrick, 2007; Hambrick & Mason, 1984; Waldman et al., 2004). According to the theorists from Carnegie School also explained that the behavior factor is one of the important factors in decision making in a company (Cyert & March, 1963; March & Simon, 1958).

Power - Niccolo Machiavelli

Niccolo Machiavelli, an Italian diplomat and politician who is also a philosopher known as the reality of political theory (www.wikipedia.org, accessed November 14, 2019). In his book, named *Il Principe*, which implies the King or the Book of Study for the King, this character gives the definition of a ruler should have characteristics such as deer and lion, where a deer looking for a net hole and shocking wolf for a lion. In addition, it must have a clever nature, clever and slippery like a deer and has the nature of an iron hand and cruel like a lion. A new ruler to secure his power can do everything he can even harm his citizens. The definition of power according to Machiavelli is considered to contain negative elements by several other political figures, so a leader must set the step of cruelty to seize the country and gain power to lead the country. "Het doel heiligt de middeled" which means to justify or justifying all means or efforts, in Machiavelli's theory, the state must be

prioritized so that leaders can do plentiful of actions for the interests of the country. Therefore, the definition of power is how a leader runs and leads a country, realizing his power as Machiavelli said that power is only intended for the country.

Tax Avoidance

Fuest and Riedel (2009) explain that there is a decrease in state revenue especially state revenue on taxes, due to tax avoidance (Fuest & Riedel, 2009). Tax avoidance is divided into legally tax avoidance and illegally tax avoidance (Wulandari & Nilasari, 2023), namely Tax Evasion. Legally tax avoidance consists of activities that exploit the cracks of the system of taxation, while the Tax Evasion depict illegal activities involving the concealment element (Slemrod & Yitzhaki, 2002). There will always be a gap for choices that can be exploited by companies to reduce the tax burden of the company (Shome & Tanzi, 1993). Using this gap is not necessarily a violation of the law, so attempts to use the gap are classified as tax avoidance

Methodology

The research employs a descriptive method with a qualitative approach. The choice of the descriptive method stems from the research's primary goal: to offer a comprehensive depiction based on objective facts regarding the correlation between a company's CEO characteristics and the company's tax avoidance practices. The qualitative approach underpins the methodology as it enables researchers to delve into and grasp intricate, multifaceted phenomena.

By leveraging the descriptive method and qualitative approach, and drawing upon pertinent data sources, the research strives to cultivate an in-depth comprehension of the potential interplay between CEO characteristics and tax avoidance practices within the framework of Machiavellian thinking. This approach aspires to yield novel insights, enhancing our comprehension of factors that may influence

corporate taxation policies. Moreover, it aims to bridge classical philosophical concepts with the contemporary business landscape.

Results of Study

Based on Figure 1, it can be seen that the condition of a company that is influenced by internal and external factors in the company environment can directly influence the selection of strategies that the company will choose. In addition, the characteristics of upper echelons also directly influence the selection of corporate strategy and directly affect the company's performance. Therefore, the characteristics of top management, in this article that is CEO, directly influence the decision making of a company regarding what strategy will be taken which directly and indirectly influences company performance, namely company profits, company growth and the company's ability to survive in the face of competition in the industry. Hambrick and Mason (1984) state that in predicting the results of an organization is determined by managerial characteristics. The outcome of an organization discussed in this article is the decision to determine the amount of tax to be paid and reported in a company.

Based on Figure 1, in terms of strategy selection, a company leader, namely the CEO, can use his power to regulate and choose what strategies will be used to avoid the amount of tax to be paid, whether the company will openly report all of its income or the company will do efforts to avoid taxes, one of which is by reducing the amount of income generated. The definition of power according to the philosopher Machiavelli, a ruler can do everything possible for the benefit of the state. A ruler should have characteristics such as deer and lion. A deer looking for a net hole and shocking a wolf for a lion. In this case, a leader must be ingenious, intelligent and slick like a mouse deer and have an iron hand and cruel nature like a lion. In this case, the CEO is a leader or ruler, and the company is like the state. A CEO must have an

ingenious, clever and slick nature in running a company. Therefore, with the thought of philosopher Machiavelli, a CEO can do a lot of ways to conduct legally tax avoidance effort, which utilizes the crack of the tax system so that the amount of tax to be paid is smaller than the actual tax paid.

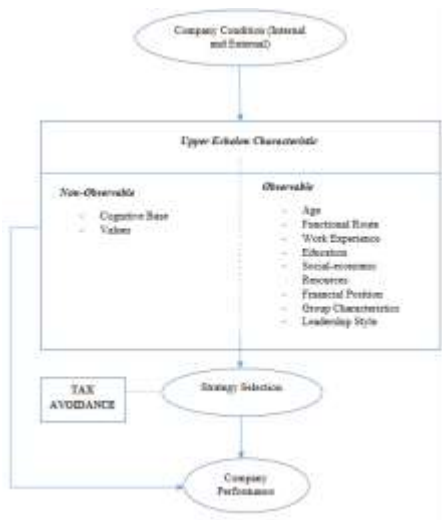


Figure 1. Upper echelons theory model (Carpenter et al., 2004; Hambrick, 2007; Hambrick & Mason, 1984; Waldman et al., 2004)

Tax avoidance efforts can also be done illegally (Tax Evasion), in accordance with the thinking of the philosopher Machiavelli that a State leader may do all kinds of ways so that his goals can be achieved. "Het doel heiligh de middele" which means to justify or justifying all means or efforts. In this case, a CEO can do everything possible, one of them is by making an effort to avoid taxes with concealment elements and doing things that are contrary to law in the interests of the company. For example, a CEO doing tax avoidance illegally can make double reporting books, which can make the reporting books for internal and external companies, or what is called double reporting. The calculation

of tax payments is based on books made externally, where the value of income can be smaller than the bookkeeping internally where the books are made based on the actual condition of the company. This clearly affects the amount of income tax that will be paid by the company, where if the amount of income is narrow then the amount of tax to be paid will be even smaller. Therefore, a CEO can use and realize his power to determine the amount of tax that will be paid by the company, which with the aim of maximizing profit or corporate profits. In Machiavelli's theory, power is only for the sake of the country so that the power held by the ruler or leader of a company is only for the benefit of the company. With an understanding of the definition of power in Machiavelli's theory, it is clearly said that a CEO can do everything he can in the interests of the company, one of them by doing tax avoidance efforts, so that the income obtained is greater, because the tax paid is getting smaller.

Conclusions

Understanding the definition of power in Machiavelli's theory, has a negative influence on the characteristics of the CEO in making decisions in terms of taking tax avoidance. The definition of power according to Machiavelli is also considered to contain negative elements by several other political figures, so a leader must arrange cruelty steps to seize the country and gain power to lead the country. Therefore, efforts to avoid taxes legally and illegally can also be done in the interests of the company, where Tax Avoidance utilizes the tax system gaps so that the tax paid is getting smaller and Tax Evasion utilizes gaps and involves an element of concealment to reduce the company's tax burden.

Acknowledgements

We would like to thank Universitas Airlangga for their tremendous support in the completion of this research. Hopefully this collaboration can continue for the advancement of science.

WORKS CITED

- Carpenter, M. A., Geletkancz, M. A., & Sanders, W. G. (2004). Upper echelons research revisited: Antecedents, elements, and consequences of top management team composition. *Journal of Management*, 30(6), 749-778. <https://doi.org/10.1016/j.jm.2004.06.001>
- Cyert, R. M., & March, J. G. (1963). A behavioral theory of the firm. Englewood Cliffs, NJ, 2(4), 169-187.
- Finkelstein, S., Hambrick, D. C., & Cannella, A. A. (2009). Strategic leadership: Theory and research on executives, top management teams, and boards. *Strategic Management*.
- Fuest, C., & Riedel, N. (2009). Tax evasion, tax avoidance and tax expenditures in developing countries: A review of the literature. *Oxford University Centre for Business Taxation*, 44(0). <https://doi.org/https://doi.org/10.1017/CBO9781107415324.004>
- Hambrick, D. C. (2007). Upper Echelons Theory : An Update Published by : Academy of Management Editor ' S Forum Upper Echelons Theory : An Update. *Academy of Management Review*, 32(2), 334-343.
- Hambrick, D. C., & Mason, P. A. (1984). Upper Echelons: The Organization as a Reflection of Its Top Managers. *Academy of Management Review*, 9(2), 193-206. <https://doi.org/10.5465/amr.1984.4277628>
- March, J. G., & Simon, H. (1958). *Organizations*. New York.
- Nielsen, S. (2010). Top management team diversity: A review of theories and methodologies. In *International Journal of Management Reviews* (Vol. 12, Issue 3, pp. 301-316). <https://doi.org/10.1111/j.1468-2370.2009.00263.x>
- Shome, M. P., & Tanzi, M. V. (1993). A Primer on Tax Evasion. *International Monetary Fund*.
- Slemrod, J., & Yitzhaki, S. (2002). Tax avoidance, evasion, and administration. In *Handbook of public economics* (Vol. 3, pp. 1423-1470). Elsevier.
- Stefany, J., & Agustina, L. (2022). Do Corporate Social Responsibility and Political Connections Matter to Financial Performance and Financial Stability in the Banking Sector? Evidence from Indonesia. *International Journal of Sustainable Development and Planning*, 17(8), 2445-2452. <https://doi.org/10.18280/ijstdp.170812>
- Waldman, D. A., Siegel, D. S., & Javidan, M. (2004). CEO transformational leadership and corporate social responsibility.
- Wulandari, P. A., & Nilasari, A. P. (2023). Literature Review of Factors Affecting Tax Avoidance in Banking Companies Listed on The IDX. *Journal of Humanities, Social Sciences and Business (JHSSB)*, 2(2), 487-499.