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THE INFLUENCE OF POLITICAL CONNECTIONS, RELATED-PARTY TRANSACTIONS, AND CORPORATE GOVERNANCE ON TAX AVOIDANCE IN MANUFACTURING COMPANIES LISTED ON THE INDONESIA STOCK EXCHANGE

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Abstract: This study aims to examine the influence of political connections, related-party transactions, and corporate governance on tax avoidance. The sample for this research consists of manufacturing companies listed on the Indonesia Stock Exchange during the period of 2014-2019. The sample was selected using purposive sampling technique, resulting in 25 companies. The analytical technique employed in this research is panel data regression analysis using Eviews version 10 software. The research findings indicate that political connections, related-party transactions, the proportion of independent commissioners on the board, audit quality, and the audit committee have a significant influence on tax avoidance in Indonesian manufacturing companies.

Keywords: Political Connections, Related Party Transactions, Proportion of Independent Board of Commissioners, Audit Quality, Audit Committee, and Tax Avoidance

INTRODUCTION

In 2014, European countries faced controversy regarding Ireland's tax facilities, leading many large multinational companies such as Amazon, Apple, Facebook, PayPal, and Twitter to establish their headquarters in Ireland to benefit from lower tax rates compared to other European countries. The Swiss HSBC case further fueled the debate on tax avoidance in the continent. Towards the end of 2014, it was also revealed that tax evasion cases involved many multinational companies in Luxembourg. Recently, there have been numerous tax avoidance practices carried out by major global companies, as shown in Table 1 (Chew, 2016). Tax avoidance has also been conducted by companies such as Asian Agri and Bakrie Group (Asadanie & Venusita, 2020). Both companies are suspected of engaging in tax evasion related to their political connections. Asian Agri is a subsidiary of Royal Golden Eagle International (RGEI), owned by Sukanto Tanoto. Bakrie Group is owned by Aburizal Bakrie. Both company owners have close relationships with several former Presidents. Political connections are also evident in President Jokowi's administration, where commissioners of State-Owned Enterprises (BUMN) are appointed from political parties or volunteers. This indicates that political relationships are common within the BUMN organizational structure.

Previous research has stated that political connections enhance company performance and yield tax benefits (Wu et al., 2012). Similar results indicate that political connections are positively related to firm value, through knowledge and influence in the development of laws affecting company performance (Guerra Pérez et al., 2015). Conversely, (Du & Girma, 2010) found that private companies not connected to politics have higher productivity compared to politically connected companies. This aligns with tax avoidance practices. To generate high profits, companies must engage in various business activities, including opening new factories or establishing subsidiaries. Transactions between the parent company and its subsidiaries are called related-party transactions (RPT), which must be disclosed with transfer pricing regulations and reported in the parent company's financial statements. Intercompany transactions can be seen as transactions that play a significant role in meeting the company's economic needs (Farahmita, 2011). So far, there has been limited research on the role of related-party transactions in tax avoidance. Research on the influence of related-party transactions on tax aggressiveness indicates that related-party transactions have a significant and positive effect on tax aggressiveness (Azizah & Kusmuriyanto, 2016). Another study examined the influence of related-party transactions and thin capitalization on tax avoidance strategies and found that related-party transactions (RPT-receivables and RPT-debt did not significantly affect tax avoidance strategies) (Darma, 2019).

In addition to political connections and related-party transactions, corporate governance is also a factor that can affect tax avoidance. The concept of corporate governance is a requirement that must be addressed when a company is listed on the Indonesia Stock Exchange. Therefore, it is important for management to run the company as best as possible, placing itself in the midst of society, the nation, and the state, and setting an example for other companies. Companies engaged in tax avoidance demonstrate that corporate governance has not been fully implemented by public companies in Indonesia (Maharani & Suardana, 2014). In this study, proxies for corporate governance used are the proportion of independent commissioners, audit quality, and the audit committee.

Empirical research on the influence of corporate governance on tax avoidance is dominated in developed countries (James & Igbeng, 2015); (Fernandes et al., 2013); (Armstrong et al., 2015) and (Sabli & Md Noor, 2012). In contrast, in developing countries, particularly Indonesia, research is still very limited. In this study, the author focuses on manufacturing companies listed on the Indonesia Stock Exchange because manufacturing companies are large-scale companies compared to others. Therefore, the research results obtained are expected to depict the situation of companies in Indonesia, especially in the manufacturing sector, which is more numerous than other sectors.

Table 1
Tax evasion scandal

Company	Fraud Charges
Google	In 2014, Google transferred $12 billion in revenue to a holding company in Bermuda, which is an Ireland-listed subsidiary called Google Ireland Holdings. Google has adopted a strategy called "Dutch Sandwich Double Ireland" to help its parent company, Alphabet, enjoy a tax rate of just 6% of profits outside the United States.
Apple	Apple was accused of being one of the first to use well-designed methods to avoid paying more taxes.
Starbucks	Starbucks has reportedly reduced its tax burden by 30 million euros since 2008 and paid it to the Netherlands Profit is only 2.6 million euros from a pretax profit of 407 million euros, with a tax rate of less than 1%.
IKEA	IKEA has been accused of paying no more than 1 billion euros in taxes in the past six years. According to the Greens/European Freedom Union, in 2014, IKEA did not pay 35 million euros in taxes in Germany, 24 million euros in France, and 11.6 million euros in the UK.
Amazon	Amazon reportedly paid only $5.86 million of its $6 trillion in total sales. Amazon could also allegedly get away with low tax payments in the UK.
Gap	Since 2011 Gap has reportedly paid almost no taxes in Europe, despite sales of about $1.4 trillion.

Literature Review

Tax is one of the largest sources of national revenue in a country. However, not all taxpayers are willing to fulfill their tax obligations, which violates national tax laws and regulations (Aumeerun et al., 2016). Non-payment and non-reporting can be done legally, through tax evasion, and also illegally, through tax fraud. Tax avoidance is defined as tax savings generated by reducing common taxes, where sometimes the legality of minimizing tax liabilities is still questionable (Lim, 2011). Tax avoidance takes actions to minimize tax liabilities within the legal framework, while tax evasion takes illegal actions to avoid paying taxes. Tax planning is the first step in tax management, used to estimate the tax owed and take tax avoidance actions by collecting and examining tax laws, with the intention of choosing the types of tax-saving measures that can be implemented (Astutik & Mildawati, 2016). A company uses various strategies to reduce its tax liability, including engaging in consulting services (Huseynov & Klamm, 2012). Tax management should be carried out as effectively as possible to avoid tax evasion. Companies can also take aggressive actions by utilizing the smallest possible loopholes in tax laws to reduce their tax burden (Putra & Merkusiwati, 2016).

The most obvious benefit of tax avoidance is cash savings from tax avoidance. Cash savings lead to increased company cash flow, where the company can use its stored cash for investment, thereby increasing the company's value and shareholder wealth by increasing dividends. Likewise, managers can benefit from it by being compensated for effective tax management (Annuar et al., 2014). However, there are adverse effects accompanying tax avoidance activities. Countries facing an increasing amount of tax avoidance tend to exhibit less productive mixed investments, where economic growth is low, and public companies can suffer negative consequences (Dalu et al., 2012). Moreover, tax avoidance, which is an aggressive tax strategy aimed at minimizing tax burdens, can lead to increased corporate risks such as fines and a poor corporate reputation in the eyes of the public (Rizal, 2016).

There are several factors suspected to be the causes of tax avoidance, namely political connections, related-party transactions, and corporate governance. A company is believed to have political connections if at least one major shareholder (someone who controls at least 10% of the total voting rights) or one of the company leaders (CEO, president, vice president, head, or secretary) is a member of parliament, minister, or closely related to top politicians or political parties. Political connections can also be assessed by the direct ownership of the government in the company (Hardianti & Puji, 2014). Political connections owned by a company can influence the company in both directions. In the first direction, in line with the theory of political power where it is found that politically connected companies will use their proximity to gain available benefits in the market. Political connections are beneficial in the market and avoid the possibility of being punished for takeover and poor management activities. Therefore, politically connected companies are more likely to engage in takeover activities and have poor management levels (Muttakin et al., 2015).

Related-party transactions (RPT) are transactions conducted by an entity with parties that have special relationships, namely transactions conducted with parties such as associated companies, key employees, companies within one controller, individual companies, closely related family companies, or companies with significant voting rights (Farahmita, 2011). RPT plays a crucial role in meeting the company's economic needs (Farahmita, 2011). When conducting related-party transactions (RPT), several important things must be considered, one of which is that because the parties involved are affiliated parties, the transactions are likely to be very different from regular business transactions with external parties. Transactions with controlling shareholders (management) can create incentives for opportunism, i.e., filtering personal benefits from company benefits by using their authority to influence transaction conditions to match their personal goals, and, conversely, it will be a cost to other shareholders or minority shareholders.

Corporate governance is the key to increasing a company's value, essentially showing how a company is managed, guided, and controlled; and is related to supervision, accountability, guidance, and management control (Uwuigbe, 2014). It can be concluded that corporate governance is an important factor in controlling a company so that activities within the company can run effectively in accordance with policies and regulations. The National Committee on Good Corporate Governance (KNKG) has issued the first national guideline for good corporate governance (national GCG guidelines) in 1999, which was later revised in 2001 and 2006 (OJK Roadmap for Indonesian Corporate Governance, 2014). There are five GCG principles: transparency, accountability, responsibility, independence, fairness, and equality.

RESEARCH METHODOLOGY

This study aims to examine the effects of political connections, related-party transactions, and corporate governance on tax avoidance by manufacturing companies listed on the Indonesia Stock Exchange. The data structure used in this study is panel data, comprising 25 companies in Indonesia, and time series data for the period 2014 - 2019. The data used in this research are secondary data obtained from the annual reports of the companies on the website www.idx.co.id and their respective company websites.

This study employs the method of panel data regression analysis to test the variables under investigation. The analysis aims to determine the influence of the variables of political connections, related-party transactions, and corporate governance on tax avoidance in manufacturing companies listed on the Indonesia Stock Exchange. The study uses Eviews version 10 software to process the data to be analyzed. The regression equation used in this research is as follows:

$$CETR = \alpha + \beta_1 \mathrm{KP} + \beta_2 \beta 2\mathrm{TPB} + \beta_3 \mathrm{KualAudit} + \beta_4 \mathrm{KomAudit} + \mathcal{E} \quad (1)$$

where:

CETR = Tax avoidance
α = constant
β = Regression coefficient of each independent variable
KP = Political connection
TPB = Related party transactions
PKI = Proportion of independent commissioners
QualAudit = Audit Quality
ComAudit = Audit committee
Ɛ = *Error*

After each variable is measured, testing will be performed for each hypothesis specified in the study. To determine whether a hypothesis is accepted or rejected, it is necessary to test it statistically. The selection of regression methods in the panel data to be used in this study uses the chow test. The chow test is a test used to select the best model between *Common Effect* and *Fixed Effect*. The chow test can be performed using the following hypothesis:

Ho : *Common Effect*
Ha : *Fixed Effect*

If the Chi Square Statistical value > the Chi Square table then Ho is rejected and Ha is accepted, so *the Fixed Effect Model* is better than *the Common Effect* and vice versa. In order for the regression model in this study to be consistent and unbiased, several classical assumption tests were carried out, namely normality test, multicollinearity test, heteroscedasticity test, autocorrelation test.

RESULTS AND DISCUSSION

Descriptive Statistics

The results of descriptive statistical tests of the variables used in this study are as follows:

Table 2: Frequency Distribution

Variable	Frequency	Percentage
Political Connections		
No political connections	54	36.0
Have political connections	96	64.0
Total	150	100.0
Audit Quality		
Not the top four.	54	36.0
Top four	96	64.0
Total	150	100.0
Komite Audit		
2 persons	4	2.7
3 persons	123	82.0
4 persons	16	10.7
5 persons	7	4.7
Total	150	100.0

Based on Table 2, it can be seen that in general about 96 observations have political connections and 54 have no political connections. Based on the number of companies audited by public accounting firms (KAP), the top four obtained 54 observations (9 companies) that were not audited by the top four KAP. In general, the sample of this study was audited by the top four public accountants, namely 96 observations (16 companies). Based on the results of the research obtained, in general, the company has an audit committee of 3 personnel, namely 123 observations or 82%.

Tabel 3: Descriptive Statistics

Variabel	CETR (Y)	KP (X1)	TPB (X2)	KI (X3)	Kual (X4)	Kom (X5)
Min	0.021	0.00	0.000	0.200	0.00	2.00
Max	0.824	1.00	0.453	0.600	1.00	5.00
StDev	0.146	0.482	0.085	0.080	0.482	0.540
Median	0.271	1.000	0.034	0.333	1.000	3.000
Mean	0.316	0.640	0.068	0.378	0.640	3.173

Based on Table 3, the mean value of tax avoidance (CETR) is 0.316 with a median value of 0.271. This value shows that companies generally do tax avoidance because the smaller the CETR value, the higher the company does tax evasion (Astuti &; Aryani, 2016). The average tax avoidance in this study was 0.316 with a minimum value of 0.021 and a maximum value of 0.824. Political connections (KP) have a mean value of 0.640. This illustrates that as many as 64% of the companies sampled have political connections. The average value of related-party transactions is 0.068. This value illustrates the smaller the value of the SDGs that the higher the company does tax avoidance. Related party transactions (TPB) are transactions carried out by companies with parties who have special relationships, namely transactions carried out with parties such as associated companies, key employees, companies in one controller, individual companies, companies of their immediate families or companies that have significant voting rights. The average score of the independent commissioner (KI) was 0.378. This value indicates that the smaller the KI value, indicating that the company is higher in tax avoidance. An independent commissioner is defined as a person who is not affiliated in all matters with the controlling shareholder, does not have an affiliation with the board of directors or board of commissioners and does not serve as a director in a company related to the owning company according to regulations issued by the IDX.

Regression Results

The regression results obtained from the *Random Effect Model are* 25 regression models (which means that the objects studied are considered to have different characteristics). The difference with *the Fixed Effect Model is that* the Random Effect Model uses residual values in the calculation of constant values. This residual value is considered to have a relationship between time and objects. The following are the results of hypothesis testing based on random effects:

Tabel 4: Panel Data Regression Results with Random Effects

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.203342	0.112524	1.807099	0.0728
KP	0.085769	0.039197	-2.142216	0.0339
TPB	0.536491	0.156967	-2.774283	0.0063
KI?	-0.127421	0.168321	1.358250	0.0445
KUAL	-0.118745	0.041524	-2.859651	0.0049
KOM	-0.047451	0.028680	2.038411	0.0333
Effects Specification				
			S.D.	Rho
Cross-section random			0.083842	0.4148
Idiosyncratic random			0.099577	0.5852
Weighted StaZtistics				

R-squared	0.153459	Mean dependent var	0.137872
Adjusted R-squared	0.124065	S.D. dependent var	0.106397
S.E. of regression	0.099578	Sum squared resid	1.427879
F-statistic	5.220799	Durbin-Watson stat	1.745091
Prob(F-statistic)	0.000196		
Unweighted Statistics			
R-squared	0.279215	Mean dependent var	0.316011
Sum squared resid	2.287450	Durbin-Watson stat	1.089326

Based on Table 4, it is evident that there is a significant influence of political connections (KP) on tax avoidance with a significance value of 0.034 (significance smaller than 0.05). Therefore, political connections have a significant effect on tax avoidance. The regression coefficient value for political connections is 0.085, indicating a positive influence. This means that the higher the political connections, the higher the tax avoidance. There is agency theory related to the development of hypotheses regarding political connections, related-party transactions, and corporate governance (Hardianti & Puji, 2014), In the context of political connections, some literature suggests that political connections provide added value, such as preferences for access to credit, protection of regulations for access to laws, and a lack of market pressure for public transparency (Kim & Zhang, 2016). Furthermore, political connections influence corporate tax aspects and have a positive effect on tax avoidance (Kim & Zhang, 2016). This study aligns with previous research indicating that companies with political connections tend to pay lower taxes than those without political connections, making them less likely to engage in tax avoidance (Sudibyo & Jianfu, 2015).

Related-party transactions (TPB) have a significant impact on tax avoidance with a significance value of 0.006 (significance smaller than 0.05). The regression coefficient value for related-party transactions is 0.536, indicating a positive influence. This means that the higher the related-party transactions, the higher the tax avoidance. Related-party transactions are transactions conducted by a company with parties that have special relationships, such as associated companies, key employees, companies under common control, individual companies, close family companies, or companies with significant voting rights (Farahmita, 2011). Therefore, TPB plays a crucial role in meeting the economic needs of the company (Gordon & Elaine, 2016). There are two different theories about TPB: the "efficient transaction hypothesis" and the "conflict of interest hypothesis." Related-party transactions can be categorized as detrimental or beneficial (Gordon & Elaine, 2016). The results of this research are consistent with some previous studies on related-party transactions and tax avoidance. The influence of related-party transactions has a significant and positive effect on tax avoidance ((Azizah & Kusmuriyanto, 2016). Other studies have also reported that related-party transactions have a significant and positive effect on tax avoidance (Febrianto & Widiastuty, 2010).

The proportion of independent commissioners has a significant effect on tax avoidance with a significance value of 0.0445 (significance smaller than 0.05). The regression coefficient value for independent commissioners is -0.127, indicating a negative influence. This means that the lower the proportion of independent commissioners, the higher the tax avoidance. From an agency theory perspective, board members from outside the company (independent commissioners) play a role in overseeing the activities of other executives. This study aligns with previous research (Setiana & W, 2014); (Maharani & Suardana, 2014) which states that the proportion of independent commissioners has a negative and significant effect on tax avoidance. Likewise, there is a significant impact of the proportion of board commissioners on tax avoidance, indicating the effectiveness of independent board commissioners in trying to prevent tax avoidance measures (Dewi & Jati, 2014).

Audit quality has a significant effect on tax avoidance with a significance value of 0.005 (significance smaller than 0.05). The regression coefficient value for the audit quality variable is -0.119, indicating a negative influence. This means that the higher the audit quality, the lower the tax avoidance. This value can also be interpreted as a 0.119 decrease in tax avoidance per unit increase in audit quality. In corporate governance implementation, audit quality with transparency is one of the essential elements. Transparency to shareholders can be achieved by reporting tax-related matters in the capital market and shareholder meetings. Increased transparency regarding tax matters to shareholders is increasingly demanded by the public authorities. This study shows that companies choosing to use the services of auditors from the top four Public Accounting Firms (PAFs) can ensure the financial information reported to investors. However, the presence of these auditors opens up opportunities for tax avoidance because auditors are aware of tax avoidance loopholes. Companies audited by the top four PAFs are more competent and professional than auditors from non-top four PAFs. Therefore, there is more knowledge about how to detect and manipulate financial statements that companies can use. These results align with (Eksandy, 2017), which suggests that audit quality affects tax avoidance. This research provides evidence that audit quality influences tax avoidance. Thus, if a company is audited by one of the top four PAFs, it will be more challenging to implement aggressive tax policies.

The audit committee has a significant effect on tax avoidance with a significance value of 0.033 (significance less than 0.05). The regression coefficient value for the audit committee variable is -0.047, indicating a negative influence. This means that the higher the audit committee, the lower the tax avoidance. The primary role of the audit committee is to develop a global-class corporate governance framework, primarily for listed companies. The audit committee believes that companies need guidance to improve their corporate governance standards, which should be equivalent to international standards (Ramly, 2012). The audit committee plays a significant role in overseeing the financial reporting process under its main duty to ensure the integrity and credibility of financial reports (Gajevszky, 2014). The audit committee functions to provide views on issues related to company financial policies, accounting, and internal control (Pranata, 2014). The number of audit committees in a company that does not comply with BEI regulations will increase management actions to minimize tax benefits for tax avoidance. Empirically, previous researchers have found that the audit committee has a significant impact on tax avoidance (Maharani & Suardana, 2014); (Dewi & Jati, 2014); (Annisa & Kurniasih, 2012).

The results of this research demonstrate that the audit committee does not have a positive effect on tax avoidance. These findings are consistent with previous research (Swingly & Sukartha, 2015) stating that the audit committee's role is to monitor and assist the board of commissioners in producing quality information, enabling control to minimize conflicts of interest within the company, including tax savings in the form of tax avoidance.

CONCLUSION

Based on the results of the discussions that have been conducted, it can be concluded that political connections, related party transactions, the proportion of independent board of commissioners, audit quality and audit committees have a significant influence on tax avoidance.

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