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An analysis of tax avoidance of family companies in Indonesia

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ABSTRACT

Taxes have an important role in building a country's economy. Therefore, as good citizens, we must pay taxes according to the regulations set by the government. This study aims to examine the effect of thin capitalization, executive characteristics, and transfer pricing on tax avoidance in family companies in Indonesia. This research uses quantitative methods. The data analysis technique used is descriptive statistical analysis. The population in this study consists of family companies listed on the Indonesia Stock Exchange in 2018-2020. This study used a purposive sampling technique with 317 family companies. Based on the analysis results, thin capitalization significantly affects tax avoidance; executive characteristics do not affect tax avoidance; transfer pricing does not affect tax avoidance. Therefore, further research needs to further analyze other variables outside the model in this study.



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Introduction

Taxes have an important role in building the economy of a country. Therefore, as good citizens, we are required to pay taxes in accordance with the regulations set by the government. Where the company is one of the taxpayers who provide income tax to the state (Wijayani, 2016). Apart from that, according to vana, tax is one of the biggest revenues for the state, so the government pays more attention to the taxation sector (Saputra et al., 2019). However, most people still think paying taxes is a burden. Not only the community, the company also thinks so. Therefore, the company does everything possible to avoid paying taxes by practicing tax avoidance. According to (Irawati et al., 2020), it is suspected that there are many tax evasions in Indonesia, for example by recording losses for operational activities so that they are not automatically taxed. One of the obstacles in optimizing tax revenue is tax avoidance (Mahidin & Danastri, 2017).

Thin capitalization strategy, means changing the structure of debt to be greater than capital. As research conducted by (Taylor & Richardson, 2013), (Falbo & Firmansyah, 2018) and (Prastiwi & Ratnasari, 2019), thin capitalization has an effect on tax avoidance. This shows that the company is trying to increase the amount of debt to benefit from reduced interest on the basis of corporate taxation. On the other hand, (Salwah & Herianti, 2019) proves that thin capitalization has a negative and significant effect on tax avoidance through the common effect method, fixed effect, and random effect. Likewise, (Ismi & Linda, 2016) stated that although many companies do thin capitalization, but it has no effect on tax avoidance.

The character of the executive also affects the practice of tax avoidance. Their ability not only adds value to the company, but also tends to support companies to avoid tax. The character of the executive as a decision maker can be risk-averse (Lewellen, 2006) or risk-taking (Low, 2008). According to (Mahmud, 2020), the

executive character had a negative effect on tax avoidance. This research is in line with (Butje & Tjondro, 2014), that the executive character had a significant negative effect on tax avoidance. With the nature of risk averse, executives will tend to avoid risk and do not dare to take big decisions and do tax avoidance. Different with (Mahmud, 2020), (Hanafi & Harto, 2014), the executive character has a positive effect on tax avoidance because executives who dare to take risks (risk takers) will have more influence than executive characters who do not (risk averse). This is in line with research conducted by (Budiman, 2012), that the executive character has a positive effect on tax avoidance.

Another strategy for tax avoidance is transfer pricing. Transfer pricing is a company policy in determining the transfer price of a transaction in the form of goods, services, intangible assets, or financial transactions carried out to manipulate the burden of a company transaction that has a special relationship to minimize the company's tax burden. The latest rules regarding transfer pricing are included in the Minister of Finance Regulation (PMK) Number 213/PMK.03/2016, that corporate taxpayers who conduct transactions with related parties also have an obligation to submit an overview of transfer pricing documentation (TP Doc). Transfer pricing documents consist of master documents, local documents, and country-by-country reports. The regulation also stipulates that an overview of the TP Doc must be submitted together with the Annual Income Tax Return. If the company makes transactions of more than 20 billion rupiah for tangible goods transactions or more than 5 billion for payment of services, interest, intangible goods, or other transactions, the company must include transfer pricing documents.

According to (Nugraha & Kristanto, 2019) said that transfer pricing is often misused by companies to practice tax avoidance. Research conducted by (Anwar, 2019) found that transfer pricing had a positive effect on tax avoidance. The greater the transfer pricing rate, the higher the level of tax avoidance of a company. This is in line with research conducted by (Napitupulu et al., 2020), that transfer pricing has a positive effect on tax avoidance. However, there is research which states that transfer pricing has a negative effect on tax avoidance, namely the research conducted by (Nadhifah & Arif, 2020). These results are supported by research conducted by (Rafiq, A., Dwianika, A., & Nusarifa, 2021), that transfer pricing has a significant negative effect on tax avoidance because the government's new policy regarding transfer pricing can reduce the company's motivation to practice tax avoidance through transfer pricing. Based on the research gap and phenomenon above, this study aims to examine whether thin capitalization, executives' characteristics, and transfer pricing that have an effect on tax avoidance in family companies in Indonesia. The novelty of this study is to add transfer pricing variables and use a sample of family companies that have not concerned by previous researchers.

Agency Theory

According to research by Jensen and Meckling in (Wongso, 2013), agency theory explains the relationship between the decision maker (shareholder) and the party executing the decision (agent). If both parties have the same goal to maximize the value of the company, it is believed that the agent will act in a way that is in the interests of the principal. However, agency theory does not always produce good results where the principal and agent prioritize their respective interests so that it can cause conflict. In practice, tax avoidance in agency theory is influenced by a conflict of interest between the party giving the authority and the party receiving the authority. Companies that carry out tax avoidance also go through the policies taken by the company's leadership.

The Effect of Thin Capitalization on Tax Avoidance

Based on agency theory, thin capitalization is a way for management to fulfill the wishes of shareholders in order to get large profits and make management have good performance because it has succeeded in maximizing profits by reducing the tax burden that must be paid by the company. Companies that do thin capitalization can deduct interest payments at a higher rate on reported taxable income. This causes the tax burden to be smaller and more efficient. Thus, the company has a tendency to do tax avoidance.

Research conducted by (Taylor & Richardson, 2013), (Falbo & Firmansyah, 2018) and (Jumailah, 2020) proves that thin capitalization has a positive effect on tax avoidance. This research is in line with research conducted by (Prastiwi & Ratnasari, 2019), that thin capitalization has a positive effect on tax avoidance. Therefore, the first hypothesis can be formulated as follows:

H1: Thin Capitalization has a positive effect on Tax Avoidance

Effect of Executives Characteristics on Tax Avoidance

Agency theory explains the phenomenon that occurs when the leader gives orders to his subordinates to perform a task. The phenomenon in this case is that companies that carry out tax avoidance are certainly through the policies taken by the company's leaders. Therefore, company executives are encouraged to do tax avoidance.

The size of the company's risk will indicate the tendency of the executive character. The higher the risk of a company, the executives tend to be risk takers. Conversely, the lower the risk of a company, the executives tend to be risk averse. Additionally, executive characters who have the nature of risk takers, will tend to do tax avoidance. According to (Prastiwi & Ratnasari, 2019), executive character has a positive effect on tax avoidance. This statement is in line with research conducted by (Maharani & Suardana, 2014), that the executive character as measured by company risk has a positive effect on tax avoidance. Hence, the second hypothesis can be formulated as follows:

H2: Executive Characteristics has a positive effect on Tax Avoidance

Effect of Transfer Pricing on Tax Avoidance

Agency conflicts occur because there are parties who have different interests. Agency conflict can harm the principal because the principal is not directly involved in the management of the company. Management as an agent is given the authority to manage the company's assets so that it has an incentive to transfer pricing with the aim of reducing taxes that must be paid.

Transfer pricing transactions carried out by certain parties can be a gap for managers within the company to avoid tax. This is because the higher the tax rate of a country, the more likely the company is to do tax avoidance, because taxes are seen as a burden for companies that will reduce profits. This statement is in line with research conducted by (Anwar, 2019), that transfer pricing has a positive effect on tax avoidance. This is in line with the research of (Nadhifah & Arif, 2020), that transfer pricing has a positive effect on tax avoidance. However, the latest regulations regarding transfer pricing where taxpayers must include transfer pricing documents allows the company to cancel its intention to carry out transfer pricing. Hence, the third hypothesis can be formulated as follows:

H3: Transfer Pricing has a negative effect on Tax Avoidance

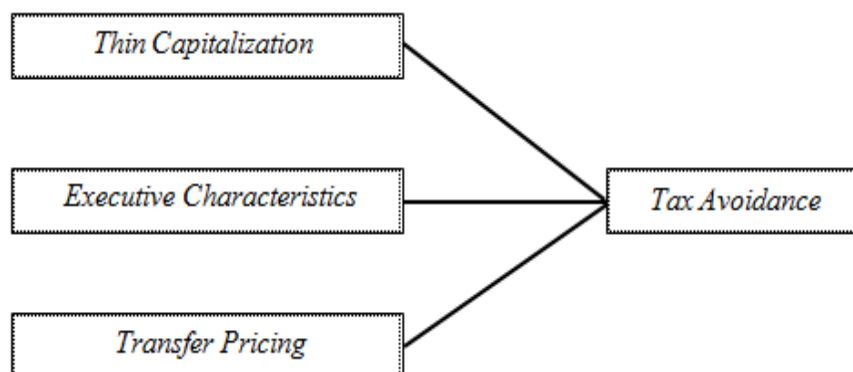


Figure 1. Research Framework

Method

This research uses quantitative research methods. According to (Sugiyono, 2019), research using quantitative methods is a research method based on the philosophy of positivism; quantitative methods are used in research with a specified population or sample, data are collected using research instruments, quantitative or statistical data analysis is carried out, aiming at testing predetermined conjectures. The population in this study consisted of family companies listed on the Indonesia Stock Exchange in 2018-2020. The sample selection in this study used a purposive sampling technique, namely the technique of determining the sample to determine certain criteria. The criteria used in this sample are as follows: first, family companies listed on the Indonesia Stock Exchange in 2018-2020, issuing complete and audited financial statements because companies listed on the IDX are required to publish audited financial statements as a form of accountability for having trade receivables related or related parties in the financial statements for 2018-2020. Where with a sample of 317 family companies. Thin capitalization is the practice of financing more company branches or subsidiaries with debt than using equity capital (Prastiwi & Ratnasari, 2019). This variable is measured by MAD Ratio = Average debt: SHDA. Where SHDA is = (Average Total Assets – non-IBL) x 80%. Executives Characteristics is measured by Standard deviation of EBITDA: total assets. Transfer pricing is measured by related receivables divided by the company's total debt. Tax avoidance is measured by CETR = amount of cash tax paid/earnings before tax. The data analysis technique used is descriptive statistical analysis. The relationship between the dependent and independent variables can be described by the following equation:

$$\text{CETR} = a + \text{TC} + \text{EC} + \text{TP} + e$$

Which means:

CETR = Tax Avoidance

TC = Thin Capitalization

EC = Executives Characteristics

TP = Transfer Pricing

Results and Discussions

The sample used in this research is a family company listed on the Indonesia Stock Exchange in 2018-2020 which was obtained from www.idx.com. Based on the company sample criteria, the 317 family companies were obtained with a 3-year research period from 2018 to 2020.

Table 1. Research Sample

No	Sample	2009	2010	2011	Total
1	Total Family Company	398	443	460	1.301
2	Finance Company	(69)	(70)	(73)	(212)
3	Incomplete Data	(234)	(266)	(272)	(772)
Total Samples		95	107	115	317

Table 2. Statistical Description

	N	Minimum	Maximum	mean	Std. Deviation
Thin Capitalization	317	.001	1.079	.60507	.266031
Executives Characteristic	317	.012	.337	.06487	.076854
Transfer Pricing	317	.001	.947	.10557	.235879
Tax Avoidance	317	-3.481	.848	-.32690	.715111
Valid N (listwise)	317				

Classic Assumption Test Results

Normality test aims to test the normality of the data in the regression model on the dependent variable and the independent variable. The test using the Kolmogorov-Smirnov level of significance is 0.128 which is greater than 0.05 so that the data is normally distributed. Based on the results of data processing, The VIF value of each variable < 10, namely thin capitalization of 1.006, executives characteristics of 1.020, and transfer pricing of 1.104 and the tolerance value of each variable is > 0.1. Thus, there is no multicollinearity.

Based on the results of data processing, the Durbin Watson value of 1.657 which will then be compared with the value at a significance level of 5%. Furthermore, it also found the upper limit value (du) of 1.6503, the lower limit value (dl) = 1.1805 and 4-du is 2.3497, k = 3 and n = 28. Thus, after being calculated and compared with the Durbin-Watson table, the Durbin-Watson value is greater than the du value and smaller than the 4-du value, namely $1.6503 < 1.657 < 2.3497$. It can be concluded that there is no positive or negative autocorrelation. The results of the heteroscedasticity test show that the significance level of the Executives Characteristic and Transfer Pricing variables has a significant value greater than 0.05, which means that the regression model does not contain heteroscedasticity. Meanwhile, the thin capitalization variable is 0.015 (smaller than 0.05) so that the data have heteroscedasticity and the outliers must be carried out on the data.

Table 3. Classic Assumption Test Results

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-1.271	.362		-3.508	.002
	Thin Capitalization	1.435	.503	.504	2.854	.009
	Executives Characteristic	.357	2.174	.029	.164	.871
	Transfer Pricing	.052	.553	.017	.094	.926
Dependent Variable: Tax Avoidance						

The thin capitalization variable shows the t value of 2.854 with a significant value of $0.009 < 0.05$, it means the thin capitalization has a positive and significant effect on tax avoidance. The research hypothesis which states "Thin capitalization has a positive effect on Tax Avoidance", is accepted. The executives' characteristics variable shows a t-value of 0.164 with a significant value of $0.871 > 0.05$, a significance value greater than 0.05

indicates that executives' characteristics do not have a significant effect. The context of family companies in Indonesia has not been able to prove that there is an effect on tax avoidance. Thus, hypothesis (H2) which reads "Executives Characteristics has a positive effect on Tax Avoidance", is rejected. The transfer pricing variable shows t-value of 0.094 with a significance value of $0.926 > 0.05$, a significance value greater than 0.05 indicates that transfer pricing does not have a significant effect. In the context of family companies in Indonesia, the transfer pricing mechanism has not been able to prove its influence on tax avoidance. Therefore, the hypothesis (H3) which reads "Transfer Pricing has a negative effect on Tax Avoidance", is rejected.

The Effect of Thin Capitalization on Tax Avoidance

The results in this study indicate that thin capitalization has a positive and significant effect on tax avoidance in family companies listed on the Indonesia Stock Exchange in 2018-2020. This research is supported by research conducted by (Taylor & Richardson, 2013) and (Falbo & Firmansyah, 2018) that the higher the practice of thin capitalization carried out, the higher the interest expense that must be paid which of course will erode the company's profits and will reduce the income tax payable.

Based on agency theory, thin capitalization is a way of management in fulfilling the wishes of shareholders in order to get large profits and make management have good performance because it succeeded in maximizing profits by reducing the tax burden that must be paid by the company. This research is supported by previous research conducted by (Taylor & Richardson, 2013) and (Falbo & Firmansyah, 2018), that thin capitalization has a positive effect on tax avoidance. This research is in line with (Prastiwi & Ratnasari, 2019), that thin capitalization has a positive effect on tax avoidance.

Effect of Executives Characteristics on Tax Avoidance

Based on the results in the study, it shows that executives characteristics have no effect on tax avoidance, thus rejecting the previous hypothesis which states that executives' characteristics have a positive effect on tax avoidance. In descriptive statistics, the standard deviation value is greater than the mean value, this indicates that there is a gap between the minimum and maximum values, thus causing executives characteristics to have no effect on tax avoidance.

The relationship of this research with agency theory as the theoretical basis used is that the leader gives orders to his subordinates to carry out the best policy for his company. This policy is certainly not far from a risk. The size of the company's risk will indicate the tendency of the executive character in the company. The higher the risk of a company, the executives tend to be risk takers. Conversely, the lower the risk of a company, the executives tend to be risk averse. The executive character does not affect tax avoidance because company executives in family companies have a risk averse nature which will tend to avoid tax avoidance practices to avoid a big risk. If they practice tax avoidance, the company will be viewed badly by the market. Therefore, company executives will prefer to make and report finances according to facts to minimize tax avoidance. The results of this study are in line with research conducted by (Wibowo, 2019), that the executive character has no effect on tax avoidance.

Effect of Transfer Pricing on Tax Avoidance

The results in this study indicate that transfer pricing has no effect on tax avoidance. The Ministry of Finance acts decisively regarding the completeness and accuracy of information regarding related party disclosures in the company's annual financial statements. This is due to several factors, such as the latest regulation regarding transfer pricing as stated in the Minister of Finance Regulation (PMK) Number 213/PMK.03/2016 which states that corporate taxpayers who conduct transactions with related parties also have an obligation to submit an overview of transfer pricing documentation (TP Doc).

The relationship between this research and agency theory as the theoretical basis used is the existence of a new regulation regarding transfer pricing in which the principal and agent jointly avoid tax avoidance practices. With strict and firm control from the ministry of finance, it is difficult for companies to do tax avoidance. The results of this study are in line with previous research conducted by (Napitupulu et al., 2020), that transfer pricing has no effect on tax avoidance. This research is in line with previous research conducted by (Falbo & Firmansyah, 2018), that transfer pricing has no effect on tax avoidance.

Conclusions

Based on the results of the analysis that has been carried out, the results of this study draw some points as follows. First, thin capitalization has a significant positive effect on tax avoidance. Second, executives' characteristics has no effect on tax avoidance. Fourth, transfer pricing has no effect on tax avoidance. Besides, this study has some limitations. First, family companies in Indonesia tend to have different characteristics of

family executives so that the results of management characteristics do not affect tax avoidance. Future research needs to analyze more about the characteristics of family executives that can reflect the family company. Second, the results of the low R² value indicate that the variables in this study have not been able to fully explain their effect on tax avoidance. Therefore, future research needs to analyze further other variables outside the model in this study.

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