Political Connections and Thin Capitalization on Tax Avoidance During The Covid-19 Pandemic

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ABSTRACT

Taxes are Indonesia's primary source of revenue and play a major role in promoting economic progress. The Covid-19 epidemic is thought to be capable of motivating tax avoidance. Political connections and thin capitalization tend to be associated with tax avoidance practices. The purpose of this study is to measure the effect of political connections and thin capitalization on tax evasion. The sample used is a company registered on IDX 80 in 2020 and obtained as many as 48 companies using the purposive sampling technique as sampling technique. Multiple linear regression analysis was used in this study as an analytical technique using SPSS statistical software. According to the findings of this study, variabel in political connection have a significant impact on tax avoidance, whereas thin capitalization has a negative and insignificant impact.

Keywords: Tax Avoidance; Political Connection; Thin Capitalization.

Koneksi Politik dan Thin Capitalization Pada Tax Avoidance Saat Pandemi Covid-19

ABSTRAK

Pajak merupakan sumber pendapatan utama Indonesia dan memainkan peran utama dalam mendorong kemajuan ekonomi. Epidemi Covid-19 dinilai mampu memotivasi penghindaran pajak. Hubungan politik dan kapitalisasi yang tipis cenderung dikaitkan dengan praktik penghindaran pajak. Tujuan dari penelitian ini adalah untuk mengukur pengaruh koneksi politik dan kapitalisasi tipis terhadap penghindaran pajak. Sampel yang digunakan adalah perusahaan yang terdaftar di BEI 80 pada tahun 2020 dan diperoleh sebanyak 48 perusahaan dengan menggunakan teknik purposive sampling sebagai teknik pengambilan sampel. Analisis regresi linier berganda digunakan dalam penelitian ini sebagai teknik analisis menggunakan software statistik SPSS. Berdasarkan hasil penelitian ini, variabel hubungan politik berpengaruh signifikan terhadap penghindaran pajak, sedangkan thin capitalization berpengaruh negatif dan tidak signifikan.

Kata Kunci: Tax Avoidance; Koneksi Politik; Thin Capitalization.

Artikel dapat diakses : https://ojs.unud.ac.id/index.php/Akuntansi/index

INTRODUCTION

The World Health Organization (WHO) on March 9, 2020, officially designated the coronavirus (Covid-19) as a pandemic. This means that the virus has spread throughout the world (Safira et al., 2021). The virus with the scientific name SARS-CoV-2 has changed all aspects of life that we are used to, forced to change. (Safira et al., 2021) explained that the impact was also felt in the economic sector whose growth continued to slow down. This condition causes the company to experience a decline in turnover. As a result, revenue from the tax sector also continued to decline. Taxes are included as the main source of income for the State of Indonesia which has an important role in encouraging economic growth. It is different for companies as corporate taxpayers, they see taxes as pressure to reduce profits. So many companies are trying to make tax payments as low as possible. In dealing with a pandemic situation, one way that companies can minimize the tax burden is by taking advantage of the policies provided by the government to reduce the company's burden, namely the existence of new tax regulations and tax incentives for taxpayers affected by the Covid-19 pandemic.

The Covid-19 pandemic is considered capable of increasing the practice of tax evasion. Tax avoidance itself can be interpreted as an activity to minimize the burden of paying taxes legally that does not violate tax regulations by taking advantage of weaknesses in the tax law (Puspita & Febrianti, 2018). One of the events of tax avoidance that occurred in Indonesia, namely PT. RNI is a company engaged in the field of health services that have relations with companies in Singapore. In 2016 the company was suspected of conducting tax evasion efforts by depending on the debt of affiliates. Various ways such as administration to carry out activities that intend to avoid taxes, one of which is with a capital loan provided by Singaporean owners to RNI in Indonesia, but the gift is included as a debt that will reduce the tax burden. Not only that, from the perspective of the company's financial statements, this is also illogical because there are quite large losses.

The phenomenon of tax avoidance in Indonesia can also be observed through the large tax ratio (*tax ratio*). The tax ratio is used as an indication of the government's performance in obtaining tax revenues. The greater a state's ratio, the better that state's tax collection performance. In the last five years, the tax ratio in Indonesia has tended to decline. Based on data from the Ministry of Finance, in 2016 the tax ratio was at 10,37%, in 2017 it fell to 9,89%, in 2018 it rose to 10,24%, then decreased in 2019 to 9,76%, and decreased again in 2020 to 8,33%.

Figure 1. Indonesia's Tax Ratio
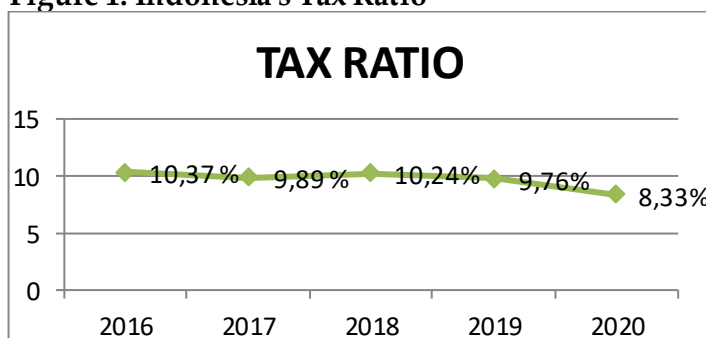
Source: www.kemenkeu.go.id

Political connections and *thin capitalization* tend to be associated with tax avoidance practices. Where the influence of political factors can affect the success of a business. This can happen because of the close relationship that exists in the business world that is used by both parties to obtain the same benefits. If a company is politically connected, it is considered to be politically connected in certain ways has an interest in politics or tries to establish interaction with politicians or the government (Tehupuring & Rossa, 2016). With political connections, companies can usually easily get credit loans, and are exempt from tax audits by the government, as well as other reliefs that make companies lead to tax evasion. One of the other mechanisms used as a tax avoidance factor is *thin capitalization.* In this mechanism, in its capital structure, a company finances larger operations using funding from debt rather than using equity capital (Andawiyah et al., 2019). So a company can increase its debt structure to take advantage of tax incentives. (Suhaidar et al., 2020) also stated that the provision of tax incentives such as lowering income tax rates allows companies to carry out *tax avoidance*. This is because even though the company has been given tax incentive relief, it will not change the expectations of a company to keep trying to minimize the tax burden it owes.

Several previous studies make tax avoidance the object of research and the factors that influence it. As in the research that has been conducted by (Andawiyah et al., 2019) using the *thin capitalization can* prove that the *thin capitalization* has an influence on tax avoidance, where the company still considers that there is an interest expense obtained from debt aimed at tax avoidance. However, these results do not support research from (Selistiaweni et al., 2020) which shows that there is no effect of *thin capitalization* on tax avoidance. Meanwhile, research related to the political connection variable has been conducted by (Tehupuring & Rossa, 2016) which states that the political connection variable harms tax avoidance. Meanwhile, according to (Maulana & Wati, 2020) The political connection variable has a significant positive impact on business value, according to the study. However, some of these studies give different results, there are inconsistent research results that have not provided actual results when associated with the Covid-19 pandemic situation and there is still a lack of literature that examines the variables of political connections and *thin capitalization* on tax avoidance. So this makes the author interested in conducting a research entitled " Political Connections and Thin Capitalization on Tax Avoidance During The Covid-19 Pandemic".

So that the formulation of the problem arises, namely: (1) Does political connection have a positive effect on tax *avoidance* during the Covid 19 pandemic? (2) Does *thin capitalization* have a positive effect on tax *avoidance* during the Covid 19 pandemic?. Research objectives are: (1) To find out whether the political connection variable has a positive effect on *tax avoidance* during the Covid 19 pandemic (2) To find out whether the *thin capitalization* has a positive effect on *tax avoidance* during the Covid 19 pandemic.

Political connections are often used by a company to practice tax avoidance. Companies that have political connections will try to minimize their tax payments because they feel they have very close ties to the government so they are less likely to be investigated, not only that these politicians also protect

companies connected to them so that the risk of tax evasion can be lower. As explained by (Santika, 2020) that firms with political ties will be granted special privileges from the government such as easy loans, low tax audit risks, and so on that trigger companies to practice tax avoidance.
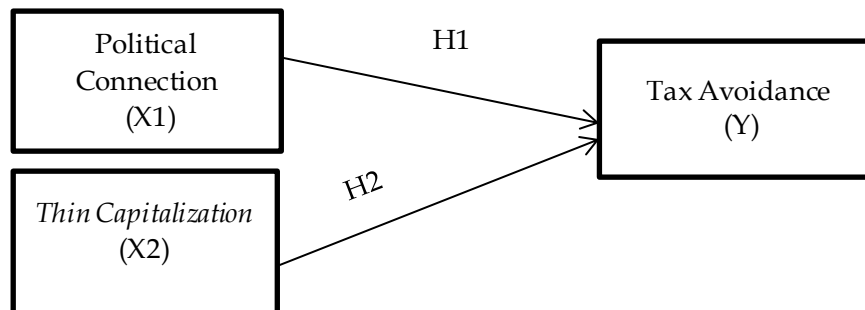
Figure 2. Conceptual Framework

Source: Research Data, 2022

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(Kim & Zhang, 2016) argue that the protection provided by the government to companies results in more aggressive planning so that the level of transparency of a financial report decreases. Other advantages obtained by politically connected companies will have easier access to obtain capital loans, lower tax audit risk, and stronger market power. So that the existence of political connections can make the company gain benefits, namely special and special treatment, such as facilities in obtaining capital loans and low audit risk.

So with this political connection, the company will get various benefits. As has been explained in research (Maidina & Wati, 2020) and (Abdani, 2020)that political connections have a positive and significant effect on tax avoidance. In contrast to the research that has been done by (Ayu et al., 2017) that political connections do not affect tax avoidance. Hypothesis of this research is as follows:
H_1: Political connection has a positive effect on tax avoidance.

Thin capitalization is one of the strategies used to minimize or eliminate the burden of paying taxes, where the preparation of the capital structure mostly comes from debt, not from the company's capital. According to (Andawiyah et al., 2019) that the debt provided carries an interest expense, and the interest expense in the tax provisions is allowed as a deduction from income. So that the practice of *thin capitalization* can result in tax incentives and can also trigger a problem for taxation because of the difference in action between capital investment and debt investment. Thin capitalization as explained by (Widodo et al., 2020)is the practice of supporting a company's subsidiaries using interest-bearing debt and existing relationships rather than with share capital.

From the existence of capital financing in the form of debt, what happens is interest costs, so the interest costs will have an impact as a deduction from the level of taxable income. Vice versa, if the company obtains financing in the form of share capital, what will be obtained is dividends where dividends are not included in the element of deducting taxable income. The difference in treatment in taxation of interest costs that are allowed as income deductions, results in gaps and opportunities for companies to avoid tax through the use of interest (Andawiyah et al., 2019).

Practice Thin *capitalization* is mostly carried out by companies in running their business. This activity is carried out so that the company can get a small tax burden. This certainly has an impact on the decline in the tax sector as the main source of income for the state. Regulations Article 18 paragraph (1) of the Income Tax Law regulates thin capitalization in relation to the debt-to-equity ratio. Under this law, the Minister of Finance has the ability to decide the level of debt-to-equity ratio that can be justified for tax purposes. (Russel, 2020) explained that, in accordance with Minister of Finance Regulation No. 169/PMK.010/2015, Indonesia implemented DER (Debt to Equity Ratio) with the greatest debt-to-capital ratio of four to one (4:1).

In a study conducted (Russel, 2020) and (Taylor & Richardson, 2012) said that *thin capitalization* has a positive effect on tax avoidance. Meanwhile, research conducted by (Salwah & Herianti, 2019) proves that *thin capitalization* has a negative and significant effect on tax avoidance. Based on this description, the hypotheses of this research are as follows.

H_2: Thin capitalization has a positive effect on tax avoidance.

RESEARCH METHOD

This type of research is quantitative research in the form of using numbers in data collection, data interpretation, and appearance of the data results. (Siyoto, S., & Sodik, 2015) explains that quantitative research methods are research based on the philosophy of positivism that is used to examine certain populations or samples. The objects used in this study are political connections (x1) thin capitalization (x2) and tax avoidance (y). As for the subject, the companies listed on the IDX 80 Stock Index 2020 during the Covid-19 pandemic. IDX 80 itself is an index that assesses the price ability of 80 stocks that have high liquidity and large market capitalization and are supported by good company fundamentals.

The population in this study are companies listed on the IDX 80 Stock Index in 2020 and the sample was obtained using the IDX 80 method *purposive sampling* with certain considerations. This study includes quantitative data types with secondary data in the form of financial statements and annual reports from companies listed on the 2020 IDX Stock Index, which were obtained from the IDX official website www.idx.co.id and each company's official website, as well as documentation techniques data collection. As explained by (Siyoto, S., & Sodik, 2015) that the documentation technique is a technique for obtaining the data needed by looking for data related to things or variables in the form of notes, transcripts, books, newspapers, magazines, inscriptions, meeting minutes, longer, agenda, and soon.

Table 1. Sampling Criteria

Description	Total
IDX 80 listed company in 2020	80
Companies that do not report using rupiah currency	14
Companies that do not publish annual reports in 2020	2
Companies that suffer losses in 2020	13
Outlier Data	3
Number of samples	48

Source: Research Data, 2022

Tax avoidance is an attemp to reduce taxes obligations by using loopholes or policies allowed in tax regulations so that a company can reduce the number of tax payments without the need to oppose the rules of taxation. In this study, tax avoidance is calculated using the formula *Cash Effective Tax Rate* (*CETR*) which is obtained from the company's cash issued for tax costs divided by profit before tax. The formula *for tax avoidance* is as follows.

$$CETR = \frac{Cash\ Tax\ Paid}{Pre\ Tax\ Income} \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots(1)$$

A close link between the board of commissioners or directors who have political affiliations or are connected to politicians or the government is known as a political connection. According to (Faccio, 2004), a firm is deemed politically connected when a company has at least one important partner, leader, or group member with relatively close ties to political individuals or parties

The measurement used in this variable uses a dummy variable. Namely, by assigning a code of 0 to companies without an indication of political connections, and a code of 1 to companies with an indication of political connections. With the classification of the directors, commissioners, board of directors, and audit committee in the company are government officials in this period or the previous period, and if the directors, commissioners, board of directors, and audit committee are politicians who have affiliation with political parties.

Thin Capitalization is a strategy used to practice tax avoidance by exploiting gaps in the presentation of a company's capital structure, through the maximum possible contribution of debt financing and minimal capital (Taylor & Richardson, 2013). The practice of *thin capitalization* is widely used by companies to fund their subsidiary companies through interest-bearing debt, from capital financing activities in the form of debt, an interest expense will appear which is a deductible expense so that it is not taxed. The Debt to Equity Ratio (DER) is used to calculate this variable, which is calculated by dividing the total debt by the total capital owned by the company. The following is a formula for DER.

$$DER = \frac{Total\ Liabilities}{Total\ Equity}\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots..(2)$$

This research approach comprises descriptive statistical analysis, classical assumption testing, and hypothesis testing as data analysis methods. When studying the effect of political connections and thin capitalization on tax avoidance, the relevant data is statistically analyzed so that it may be used to answer the problem formulation. This data is analyzed with the SPSS program. Multiple linear regression analysis was used to test the hypothesis in this study, in order to provide a clear picture of the effect of the independent variables (more

than one) on the dependent variable. The equation for multiple linear regression can thus be written as follows.

$$Y = \alpha + \beta1X1 + \beta2X2 + \varepsilon \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots(3)$$

Information:

Y = Dependent Variable / Tax Avoidance
α = Constant Value
$\beta_1 - \beta_2$ = Coefficient of each independent variable
X_1 = Independent variable 1 / Political connection
X_2 = Independent variable 2 / *Thin* capitalization
ε = Standar error

RESULTS AND DISCUSSION

The results of descriptive statistical test are presented in table 2 as follows:

Table 2. Descriptive Statistical Test Results

Variabel	N	Minimum	Maximum	Mean	Std. Deviation
Political Connections	48	0.00	1.00	0.479	0.504
Thin Capitalization	48	0.00	16.08	1.981	3.002
Tax Avoidance	48	0.00	1.90	0.325	0.361
Valid N					

Source: Research Data, 2022

Table 2 shows the descriptive statistics test results for a sample of 48 companies on the IDX 80 stock index 2020. The smallest value is 0.00 and the maximum value is 1.90, with a mean is 0.325 and the standard deviation is 0.361, indicating that the data distribution is normal, as evidenced by the magnitude of the average value being less than the standard deviation. The variable thin capitalization with a minimum value of 0.00 and a maximum value of 16.08, with a mean of 1.981 and the standard deviation of 3.002, indicating that the data distribution is normal and the variable quality is good. Likewise, the political connection variable that has a drinking value of 0.00 and a max of 1.00, an estimated value of 0.479, and a standard deviation of 0.504

Table 2. Normality Test Results

		Unstandardized Residual
N		48
Normal Parameters [a,b]	Mean	0.000
	Std. Deviastion	0.342
Most Etreme Differences	Positive	0.242
	Negative	0.242
Kolmogorov-Smirnov Z		1.679
Asymp. Sig(2-tailed)		0.070

Source: Research Data, 2022

The residual value derived from the regression is normally distributed in the regression model according to a normality test. Based on the normality test in Table 3, it can be seen that the value of *Kolmogorov-Smirnov* is 1.679 and the *asym.sig* (2-*tailed*) value is 0.070 which indicates the residual data is normally distributed because it has a significant level above 0.05 (0.07 > 0.05).

In a regression model, the multicollinearity test is used to see if there is a correlation between the independent variables. Table 4 shows the results of the

multicollinearity test on the political connection variable having a VIF value of 1.156 < 10 with a tolerance value of 0.865 > 0.10, which means that the regression model is free from multicollinearity symptoms and is feasible to be used in research. Similarly, the *thin capitalization* has a VIF value of 1.156 < 10 with a tolerance value of 0.865 > 0.10, which means that the regression model has no multicollinearity symptoms and is feasible to be used in research.

Heteroscedasticity is a regression model test that checks for variance inequality and residuals from one observation to the next (Shaliha, 2020). This study uses a *scatterplot* to detect the presence or absence of heteroscedasticity in a regression model by looking at random scatter points both above and below the number 0 on the Y-axis. The results of the heteroscedasticity test do not indicate the occurrence of heteroscedasticity.

Table 3. Multicollinearity Test Results

Model		Collinearity Statistics	
		Tolerance	VIF
1	(Constant)		
	Political Connections	0.865	1.156
	Thin Capitalization	0.865	1.156

Source: Research Data, 2022

Table 4. Autocorrelation Test Results

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin Watson
1	0.328	0.107	0.068	0.349	2.077

Source: Research Data, 2022

Table 5 shows the DW value of 2.077, then this value will be compared with the number of samples of 48 (n) the number of independent variables 2 (k = 2), and a significant value of 5%, so that the value of dU = 1.231 and for the value (4- dU) which is 2.769. It can be concluded that this research is good by using formula (du ≤ d ≤ 4 – du). because there is no autocorrelation with the translation of the results as follows: (1.231 < 2.077 < 2.769).

Table 5. Multiple Linear Regression Analysis Test Results

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(*Constant*)	0.240	0.72		3.343	0.002
Political Connections	0.252	0.109	0.352	2.323	025
Thin Capitalization	- 0.018	0.018	-0.149	-0.986	0.329

Source: Research Data, 2022

Table 6 shows the results of multiple linear regression analysis, the regression equation is obtained as follows

$$Y= 0.240 + 0.252X_1 – 0.018X_2 + \varepsilon$$

From the results of the equation, it can be seen that the constant is 0.240, which means that the political connection and *thin capitalization* are zero then *tax avoidance* will be worth 0.240. In the political connection variable (X1) the regression coefficient value is 0.252 which indicates if the value of political connection increases by 1 unit, then the value of *tax avoidance* will increase by 0.252. And for *thin capitalization*, it has a regression coefficient value of -0.018, which

means that if the value of *thin capitalization* increases by 1 unit, then the value of *tax avoidance* will decrease by 0.018.

Table 6. T-Statistical Test Result

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(*Constant*)	0.240	0.72		3.343	0.002
Political Connections	0.252	0.109	0.352	2.323	025
Thin Capitalization	-0.018	0.018	-0.149	-0.986	0.329

Source: Research Data, 2022

Table 7 shows the results of a partial regression coefficient test (T-test) for the political connection variable, which has a significance level of 0.025 and thus indicates that the political connection variable has a significant positive effect on tax avoidance, as evidenced by the significant value of less than 0.05. Thin capitalization on the other hand, has a significance value of 0.329, indicating that it has a negative and insignificant influence on tax avoidance, with a significant value greater than 0.05.

Tabel 7. Analysis Coefficient of Determination

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.328	0.107	0.068	0.349

Source: Research Data, 2022

Table 8 shows the results of the analysis of the coefficient of determination with an *R Square* (R²) of 0.107. So it can be concluded that the ability of the political connection variable and *thin capitalization* in explaining the tax avoidance variable is 10.7%. While the rest 89.3% is explained factors not included in the regression model.

In the research that has been done, the hypothesis that political connections have a positive effect on tax avoidance is accepted where researchers still find political ties to certain companies. This is evidenced by the existence of former government officials who held positions on the board of commissioners or the board of directors. As for former TNI or POLRI personnel who are also known to be commissioners in a company registered on IDX 80 in 2020. As a company registered on IDX 80 should be an example of a taxpayer who obeys other companies listed on the stock exchange and does not make tax evasion efforts. However, this political relationship is still widely used by several companies and with the Covid-19 pandemic, many companies have experienced a decrease in income, thus encouraging them to minimize the burden of paying taxes due because they are considered a deduction from the company profits. While the hypothesis that thin capitalization has a positive effect on tax avoidance is rejected. This shows that companies listed on IDX 80 have applied the maximum limit for the ratio of capital to debt following PMK 169 which is 4:1.

CONCLUSION

This study examines the variables of political connections and *thin capitalization* on *tax avoidance,* with a sample size of as many as 48 companies are listed on IDX 80 in 2020 and uses a *purposive sampling technique* with certain criteria

as sampling technique. The conclusion that can be drawn is that political connections have a significant positive effect on *tax avoidance* so that the existence of political connections is indicated by the existence of political relations, both those who have positions or former officials in government institutions make companies take *tax avoidance*. The results of this study are supported by research conducted by (Maidina & Wati, 2020) that political connections have a positive and significant effect on tax avoidance. variable *thin capitalization* has a negative and insignificant effect on *tax avoidance.* This demonstrates that the firm prefers to finance its business using debt rather than capital, with the goal of using it for the company's operational objectives rather than avoiding taxes owing..

This study has several limitations in terms of the sample and the year of research, using only companies listed on the IDX 80 stock index in 2020. Then in terms of research variables, it only uses political connections and *thin capitalization*. As a conclusion, it is suggested that other variables that affect tax avoidance be included in future studies, as well as a formula other than CETR (Cash Effective Tax Rate) that may be used to quantify tax avoidance. And for the object of research can use other sectors that have the appropriate sample criteria so that the data becomes more varied and the number of samples increases, as well as increase the period of the study to get more accurate results. The sample that can be used for further research for the political connection variable is comprised of BUMN companies, which are most likely to have close relationships with government officials so that they are used as opportunities for companies to practice tax avoidance because these companies feel they are getting protection from the government. As for the measurement indicators on the thin capitalization variable, further research is expected to use thin capitalization rules (TCR) to detect hidden capital through excessive borrowing with approaches other than DER as recommended by the OEDC, namely through interest limitation, also known as the earning stripping/earnings thresholds.

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