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Thin Capitalization Determinants in Manufacturing Companies In Indonesia

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Keywords:
Thin capitalization, multi-nationality, tax haven utilization, substantial foreign ownership, foreign directors.

ABSTRACT
This study aims to analyze the determinants of thin capitalization practices on manufacturing companies in Indonesia. This study focuses on the manufacturing sector, which ranks the second largest recipient of foreign debt. The population of this study consisted of all manufacturing companies listed on the Indonesia Stock Exchange from 2016 to 2019. This study used the purposive sampling technique to determine samples. From that technique, 308 samples were obtained. The hypothesis analysis technique in this study employed the Ordinary Least Square (OLS) method. The results revealed that tax havens utilization and substantial foreign ownership positively affected the thin capitalization practice. Meanwhile, the presence of foreign directors in the company had a negative effect on the thin capitalization practice. This study could not prove the effect of multi-nationality on the thin capitalization practice.

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INTRODUCTION

The company's decision regarding funding is vital as it affects its financial position and value (Alvita & Khairunnisa, 2019). To support its operational activities, the company can take advantage of funding sources from internal or external sources (Sugiarto, 2009). In finding external funding sources, companies can choose funding, either debt or equity. Regarding debt financing, interest is charged on the debt, while in equity funding, dividends are paid in return for the investment of the company's shareholders (Waluyo & Doktoralina, 2018).

In relation to taxation, there are differences in the treatment of interest expense and dividends. When calculating income tax, interest expense is deducted, but not for dividends. It can be used by companies to reduce taxes that must be paid. Discrimination on the cost of financing with debt and share capital then encourages the practice of financing with more debt than share capital (Makagiansar, 2010).

In the capital structure, the decision to use interest-bearing debt instead of equity funding is a form of thin capitalization practice (Taylor & Richardson, 2013). Waluyo & Doktoralina (2018) asserted that the thin capitalization practice is a strategy to shift profits to other countries. It is also performed in Indonesia to reduce the corporate tax burden (Waluyo & Doktoralina, 2018).

However, despite having a number of advantages, the decision to finance with debt may still provide losses for the company (Makagiansar, 2010). Companies with large amounts of debt also have a high probability of bankruptcy (Sugiarto, 2009). Another negative impact is that the practice of excessive thin capitalization can result in the erosion of state revenues from taxes (Darussalam & Kristiaji, 2015).

Moreover, the thin capitalization practice is a form of international tax avoidance (Taylor & Richardson, 2012). In Gravelle (2015), it was uncovered that most profit shifting schemes carried out by multinational companies in the US are debt allocations. In Indonesia, the Directorate General of Taxes (DGT) also stated that more than two thousand foreign companies in Indonesia have substantial profits but are not obliged to pay income tax. The method is to accumulate debt to be calculated as a tax-deductible expense (Supriadi, 2015).

The phenomenon of the thin capitalization practice in Indonesia has been exposed in the Tax Justice Network (TJN) report. The report alleged that British American Tobacco (BAT) carried out tax avoidance with an intercompany loan scheme through its subsidiary, PT. Bentoel Internasional Investama Tbk. (RMBA). The loan funds to the RMBA came from BAT's subsidiary in the UK, Pathway 4 (Jersey) Limited. On the other hand, Indonesia and the Netherlands have a double taxation agreement so that loans from companies in the Netherlands will be more profitable. In this case, Indonesia was estimated to lose revenue of 11 million dollars per year (Amri et al., 2019).

In addition, Taylor & Richardson's (2012) research found evidence that thin capitalization positively affected tax avoidance. This result prompted Taylor & Richardson (2013) to research the thin capitalization determinants on 300 public companies in Australia. In Indonesia, a study related to the determinants of thin capitalization practices was carried out by Christiana & Martani (2015). The same research was conducted by Nuraini & Marsono (2014) and Nugroho & Suryarini (2018) on multinational companies in Indonesia.

Previous research also uncovered evidence that the thin capitalization practice tends to be carried out by multinational companies. Multinational companies with subsidiaries and/or branches in tax haven countries tend to have a thin capitalization structure (Nuraini & Marsono, 2014). Besides, companies with multinational characteristics cannot be separated from the interests of foreign parties. According to Salihu et al. (2015), the structure of foreign ownership and the composition of foreign directors and commissioners can characterize foreign interests in a company. The research results by Salihu et al. (2015) also have proven that foreign interests in companies had a positive effect on tax avoidance.

Disclosed by the Directorate General of Taxes and the Tax Justice Network, the phenomenon of the thin capitalization practice in Indonesia is closely related to international activities and foreign interests. This practice was carried out by more than two thousand foreign companies in Indonesia. It was estimated to cost the state up to 11 million dollars every year until the Minister of Finance stipulates

PMK Number 169/PMK.010/2015 concerning Determination of the Comparison between Debt and Company Capital. Thus, this phenomenon becomes the focus and limitation of the problem in this study. The company's international activity here is characterized by multinational characteristics (Nainggolan & Sari, 2020). Meanwhile, foreign interests in a company can be portrayed by foreign ownership and the composition of foreign directors (Salihu et al., 2015).

Furthermore, thin capitalization refers to funding decisions prioritizing debt over equity (Taylor & Richardson, 2013). Concerning this, in the Foreign Debt Statistics (SULNI), Bank Indonesia informs that the manufacturing sector ranked as the second-largest recipient of foreign debt in 2016-2018 after the financial sector. The financial sector is excluded in PMK Number 169/PMK.010/2015, so that this research's object was manufacturing companies. In this study, its contribution is to add substantial foreign ownership and foreign director variables, which have not been found in previous studies. In addition, although the thin capitalization practice has tax-deductible benefits, on the other hand, it has the potential to harm companies and erode state tax revenues, prompting this research to be conducted. This research is essential to find out the thin capitalization determinants related to international activities and foreign interests in the company.

Therefore, this study aims to obtain evidence of the determinants of thin capitalization practices by manufacturing companies in Indonesia. In contrast to previous research, this research's object is manufacturing companies listed on the IDX. Once again, this study's contribution is to add substantial foreign ownership and foreign director variables, which have not been found in previous studies. To determine the research development on the thin capitalization determinants, bibliometric analysis was carried out utilizing Harzing's Publish or Perish software and VOSviewer, using Scopus and Google Scholar metadata. The bibliometric analysis results showed that research related to the thin capitalization practice determinants had not been done much. In addition, the thin capitalization practice, which has the benefit of tax deductibles, has the potential to harm companies and erode state tax revenues on other hand, prompting the authors to conduct this research.

Literature Review and Hypothesis Development

Agency Theory

Jensen & Meckling (1976)the theory of property rights and the theory of finance to develop a theory of the ownership structure of the firm. We define the concept of agency costs, show its relationship to the 'separation and control' issue, investigate the nature of the agency costs generated by the existence of debt and outside equity, demonstrate who bears these costs and why, and investigate the Pareto optimality of their existence. We also provide a new definition of the firm, and show how our analysis of the factors influencing the creation and issuance of debt and equity claims is a special case of the supply side of the completeness of markets problem. The directors of such [joint-stock] companies, however, being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company. Adam Smith, The Wealth of Nations, 1776, Cannan Edition (Modern Library, New York, 1937 described agency theory as a contractual relationship between principal and agent. In accounting studies, agency theory tends to focus on the relationship between companies and managers, but taxpayers can also be seen as agents (Malik, 2020). It is reinforced by Reinganum & Wilde's (1985) research, explaining that the relationship between principal and agent can occur between the tax authorities and taxpayers.

In agency theory, Eisenhardt (1989) elucidated that principals delegate authority to agents. Here, the role of the tax authorities is to collect taxes, while taxpayers are given the authority to determine the amount of tax to the government themselves. In addition, agency theory arises because there is a conflict of interest between the principal and the agent (Jensen & Meckling, 1976)the theory of property rights and the theory of finance to develop a theory of the ownership structure of the firm. We define the concept of agency costs, show its relationship to the 'separation and control' issue, investigate the nature of the agency costs generated

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by the existence of debt and outside equity, demonstrate who bears these costs and why, and investigate the Pareto optimality of their existence. We also provide a new definition of the firm, and show how our analysis of the factors influencing the creation and issuance of debt and equity claims is a special case of the supply side of the completeness of markets problem. The directors of such [joint-stock] companies, however, being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company. Adam Smith, The Wealth of Nations, 1776, Cannan Edition (Modern Library, New York, 1937. In this case, the company seeks to obtain large profits by minimizing taxes through the thin capitalization practice. Meanwhile, the tax authorities attempt to get maximum tax revenue.

Thin Capitalization

Thin capitalization is a decision to form a capital structure with debt much larger than share capital (Kurniawan, 2015). As Taylor & Richardson (2013) stated, thin capitalization leads to funding decisions that prioritize debt over equity. This practice is due to differences in the tax treatment of interest expense and dividends. In the thin capitalization context, debt refers to loans from parties affiliated with the borrower (Nuraini & Marsono, 2014).

Indonesia regulates the thin capitalization practice in the Regulation of the Minister of Finance of the Republic of Indonesia Number 169/PMK. 010/2015 concerning Determination of Comparison between Debt and Company's Capital for Calculation of Income Tax. The regulation standardizes the debt and capital ratio of corporate taxpayers, with a maximum of four to one.

Previous Studies

Taylor & Richardson's (2013) research is the first study to discuss the thin capitalization determinants. The study was conducted on public companies in Australia. The results showed that multi-nationality, tax haven utilization, withholding tax, and tax uncertainty positively affected thin capitalization.

In Indonesia, Nuraini & Marsono (2014) researched multinational companies. Their research's results uncovered that multi-nationality and the utilization of tax havens had a positive effect on thin capitalization, while the variable withholding taxes had a negative effect. However, the study could not prove the effect of institutional ownership on thin capitalization.

In a study conducted on public companies in Indonesia, Christiana & Martani (2015) provided evidence that multi-nationality, tax havens, and effective tax rates positively affected thin capitalization. Meanwhile, tax liability uncertainty and foreign exposure had a negative effect on thin capitalization.

Nugroho & Suryarini's (2018) study was carried out on multinational companies in Indonesia. The study results found that multi-nationality, tax haven utilization, withholding tax, and company size positively affected thin capitalization. On the other hand, audit committee size had a negative effect on thin capitalization.

In addition, Waluyo & Doktoralina (2018) researched factors influencing tax avoidance through thin capitalization. Their results showed that multi-nationality and tax haven utilization positively affected thin capitalization, whereas institutional ownership had a negative effect on thin capitalization. Multi-nationality and tax haven utilization also had a positive effect on tax avoidance, mediated by thin capitalization.

Research Hypothesis

Multinational

A company's operaA company's operations in more than one country can be exploited for tax evasion through profit shifting and manipulation of affiliate transactions (Nainggolan & Sari, 2020). The research results by Taylor & Richardson (2013) showed the positive effect of multi-nationality on thin capitalization. It is supported by Waluyo & Doktoralina's (2018) research, which proved that multi-nationality had a positive effect on tax avoidance mediated by thin capitalization. According to Waluyo & Doktoralina (2018), with affiliated companies and subsidiaries spread across various countries, it is an opportunity for multinational companies to practice thin capitalization. In accordance with the phenomenon revealed by the DGT and TJN, the thin capitalization practice was carried out by foreign companies in Indonesia. Based on this, the international activities of multinational companies are suspected to influence the thin capitalization practice.

H_1: Multinational has a positive effect on the thin capitalization practice.

Utilization of Tax Havens

One of the phenomena of the thin capitalization practice in Indonesia is utilizing Indonesia's treaty partner countries, which have lower tax rates. According to Gravelle (2009), one source of problems and debates regarding tax avoidance and tax evasion is the existence of countries with low tax rates and tax haven countries. Tax haven countries provide facilities in the form of low or no taxes on some income, lack of transparency, banking secrecy and information sharing, and ease of obtaining legal entity status (Gravelle, 2015). Tax haven countries also provide a number of more profitable facilities than treaty partner countries. It is possible that companies in Indonesia take advantage of tax havens for thin capitalization. Several previous studies examining the determinants of thin capitalization practices have uncovered evidence that the use of tax havens had a positive effect on thin capitalization practices (Christiana & Martani, 2015; Nugroho & Suryarini, 2018; Nuraini & Marsono, 2014; Taylor & Richardson, 2013).

H_2: The use of tax havens has a positive effect on the thin capitalization practice.

Substantial Foreign Ownership

Evidence of the phenomenon of thin capitalization practice in Indonesia is carried out by a company funded with more debt by its parent company abroad. Based on this phenomenon, this study attempts to prove the effect of substantial foreign ownership in a company on the thin capitalization practice. Previous studies have illustrated that foreign ownership in a company can negatively affect the company (Nainggolan & Sari, 2020). In addition, Kinney & Lawrence's (2000) research found that companies with substantial foreign ownership tend to be tax evaders. The study results concluded that this phenomenon occurs since company owners tend to use profit-shifting strategies obtained from their geographical flexibility. The research results by Salihu *et al.* (2015) also provided evidence that foreign interests, consisting of foreign ownership, substantial foreign ownership, and foreign directors, had a positive effect on tax avoidance.

H_3: Substantial foreign ownership has a positive effect on the practice of thin capitalization.

Foreign Directors

The structure of foreign ownership and the composition of foreign directors and commissioners can characterize foreign interests in a company (Salihu *et al.*, 2015). According to Sugiarto (2009), shareholders have voting rights that allow them to elect directors. The Board of Directors is the representative of the company owner, who is responsible for protecting the interests of the company owner (Nainggolan & Sari, 2020). In this regard, directors who represent foreign shareholders can have a considerable influence on the company's operations, including in terms of tax avoidance behavior (Nainggolan & Sari, 2020). In addition, foreign interest in companies characterized by foreign ownership, substantial foreign ownership, and foreign directors positively affect tax avoidance (Salihu *et al.*, 2015). Here, foreign directors are closely related to foreign interests and foreign ownership in a company. Foreign directors will also protect the interests of owners, including decisions related to funding. Based on this, foreign interests in companies represented by the presence of foreign directors are suspected of influencing the thin capitalization practice.

H_4: Foreign directors have a positive effect on the practice of thin capitalization.

RESEARCH METHODS

Research Population and Sample

This study had a population of all manufacturing companies listed on the Indonesia Stock Exchange (IDX) in 2016-2019. Manufacturing companies were selected based on information from Bank Indonesia in the Indonesian Foreign Debt Statistics (SULNI) report, informing that during 2016 to 2018, the manufacturing sector was the second-largest recipient of foreign debt after the financial sector. The financial sector is excluded in PMK Number 169/PMK.010/2015, so that this

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research's object was manufacturing companies. The sample selection period for 2016-2019 was due to the Regulation of the Minister of Finance of the Republic of Indonesia Number 169/PMK. 010/2015 concerning Determination of the Comparison between Debt and Company Equity, effective since 2016. The sample in this study was chosen utilizing a purposive sampling technique.

Research Model

In this study, regression analysis was conducted to see the effect of the independent variables on the dependent variable. The regression model was estimated using the Ordinary Least Square (OLS) method, which was applied to panel data. The following is the regression model in this study:

$$\text{Thincap}_{it} = \alpha_0 + \beta_1\text{Multi}_{it} + \beta_2\text{Taxhav}_{it} + \beta_3\text{Forgsub}_{it} + \beta_4\text{Forgboard}_{it} + \beta_5 \textit{Size}_{it} + \beta_6\text{RoA}_{it} + \varepsilon_{it}$$

Description :

Thincap	: Thin capitalization
α_0	: Constant
Multi	: Multinational
Taxhav	: Utilization of tax havens
Forgsub	: Substantial foreign ownership
Forgboard	: Foreign directors
Size	: Company size
RoA	: Return on Assets
B_1- β_6	: Regression coefficient
i	: Company
t	: Financial statement year
ε	: Error

Definition of Variable Operationalization
Dependent Variable

The measurement of thin capitalization in this study used the Maximum Amount Debt Ratio (MAD Ratio), referring to the research of Taylor & Richardson (2013). Meanwhile, the steps for calculating the MAD ratio are as follows:

- To calculate the Safe Harbor Debt Amount (SHDA), the ratio of debt and equity was adjusted to the maximum Debt to Equity Ratio (DER) of 4:1, in accordance with the provisions in PMK Number 169/ PMK.010/2015.
- Then, the average debt was calculated by the following formula:
- Next, the MAD ratio was determined.

The MAD ratio value close to or past 1 indicates the company's thin capitalization practice is getting higher as the company's average debt exceeds the allowable debt limit.

Independent Variables
Multinational

In this study, multinational proxy (Multi) alluded to the research of Taylor & Richardson (2013). Its measurement was with a dummy variable; a value of 1 was given to a company with at least one subsidiary or branch of a company abroad, and a value of 0 was given for the opposite. Concerning this, Taylor & Richardson (2013) found that companies with thin capitalization structures tend to have at least one overseas affiliated company. Thus, the multinational variable is predicted to have a positive influence on the thin capitalization practice.

Utilization of Tax Havens

The tax haven utilization proxy (Taxhav) referred to the research of Taylor & Richardson (2013). Its measurement was with a dummy variable; a value of 1 was for companies with at least one subsidiary or business branch located in a tax haven country according to Gravelle (2015), and vice versa, a value of 0 was given. The research results by Taylor & Richardson (2013) have proven that companies that utilize tax havens are more likely to have a thin capitalization structure. Thus, the variable of the utilization of tax havens is predicted to influence the thin capitalization practice positively.

Substantial Foreign Ownership

Substantial foreign ownership (Forgsub) was measured by a dummy variable; a value of 1 was assigned to companies with foreign ownership of more than 20%, and a value of 0 was assigned otherwise. Proxy of substantial foreign ownership referred to the studies of Salihu *et al.* (2015) and Nainggolan & Sari (2020), which are based on the definition of PSAK 15. Ownership is significant if there is share ownership with a percentage of more than 20%. Foreign ownership can significantly influence the direction of company policy in funding decisions. Thus, the substantial foreign ownership variable is predicted to influence the thin capitalization practice positively.

Foreign Directors

Foreign directors (Forgboard) are the proportion of foreign directors in a company. The measurement was done by dividing the number of foreign directors by the total number of directors. The proxy for foreign directors alluded to the research of Nainggolan & Sari (2020). The presence of foreign directors in the company can represent the interests of ownership. Hence, the variable of foreign directors is predicted to influence the practice of thin capitalization positively.

Control Variable

The control variables of this study consisted of firm size (size) and Return on Assets (RoA), referring to Taylor & Richardson's (2013) research. This study focuses on the determinants of thin capitalization practices related to international activities and foreign interests in companies. Thus, size and RoA variables were employed to control company size and profitability to get better research results.

In this study, firm size (size) was calculated by the natural logarithm of total assets. Once again, firm size was used as a control variable referring to Taylor & Richardson's (2013) research to control the effect of firm size on the research samples. In this regard, large companies tend to have small tax debts due to their tax planning practices and the incentives and resources they have (Taylor & Richardson, 2013). Meanwhile, Return on Assets (RoA) in this study was determined by dividing profit before tax by total assets. Referring to the study by Taylor & Richardson (2013), RoA was utilized as a control variable in the study to control the company's profitability.

RESULTS AND DISCUSSION

Research Sample Selection

This study included all manufacturing companies listed on the Indonesia Stock Exchange (IDX) in 2016-2019. During those four years, the number of listed companies was 205 companies. A total of 73 companies of which were not listed for four consecutive years. A total of 132 companies listed on the IDX for four years were then reduced based on predetermined criteria. Thus, the total sample of this study was 77 companies, with an observation period of four years, so that the total sample was 308 samples.

Table 1. Research Sample Selection

Sample Selection Criteria	Number
Manufacturing companies listed on the Stock Exchange in 2016-2019	132
Subtracted by:	
Incomplete annual report for 2016-2019	7
Companies with negative equity	2
Companies with negative profit before tax	43
Companies with a fiscal year not ending on December 31	1
Companies with incomplete financial statement information	2
Number of sample companies	77
Observation period	4
Total research sample	308

Source: Data processed.

Descriptive Statistics

The descriptive statistics results showed that companies did not have interest-bearing debt in their capital structure. The value of the MAD ratio (Thincap proxy), which was more than one, was due to a significant increase in interest-bearing debt compared to the previous year but was not followed by a significant increase in equity. Meanwhile, the MAD ratio value close to or past 1 indicated the company's thin capitalization practice was getting higher as the company's average debt exceeded the allowable debt limit. Based on the Thincap mean value of 0.342, it signified that the company samples in this study had not shown any intention to practice thin capitalization. The table below also displays that some companies did not have foreign directors. However, there were companies where the entire board of directors was filled by foreign nationals. In general, the mean proportion of foreign directors in the research sample was 15.6%.

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Table 2. Descriptive Statistics

	N	Min.	Max.	Mean	Std. Deviation
Thincap	308	0.000	1.445	0.342	0.274
Multi	308	0	1	0.39	0.488
Taxhav	308	0	1	0.26	0.439
Forgsub	308	0	1	0.46	0.499
Forgboard	308	0.000	1.000	0.156	0.239
Size	308	11.825	19.679	15.047	1.617
RoA	308	0.000	0.709	0.102	0.106

Source: IBM SPSS Statistics 25 output (processed data)

The frequency distribution table for the dummy variable shows that the mode of the Multi variable data was 0. Thus, it can be concluded that most companies in the research sample were non-multinational companies. Meanwhile, 39% of the sample companies in the study had subsidiaries and/or branch companies abroad. Furthermore, the mode of the data variable Taxvah was 0. It can be seen that most companies in the research sample did not have subsidiaries and branch companies in tax haven countries. The table below also presents that the mode of the Forgsub variable data was 0, so that most sample companies in the study did not have substantial foreign ownership.

Table 3. Frequency Distribution of Dummy Variables

		Frequency	Percentage
Multi	0	188	61.0
	1	120	39.0
	Total	308	
Taxhav	0	228	74.0
	1	80	26.0
	Total	308	
Forgsub	0	166	53.9
	1	142	46.1
	Total	308	

Source: IBM SPSS Statistics 25 output (processed data)

Hypothesis Test

Coefficient of Determination (R^2)

The test results revealed the Adjusted R2 value of 0.292. This result indicates that 29.2% of the dependent variable, namely Thincap, could be explained by all independent variables, namely Multi, Taxhav, Forgsub, and Forgboard, and the two control variables, namely size and RoA. Meanwhile, 70.8% of the Thincap variables were explained by factors other than the independent and control variables in this study.

Individual Parameter Significance Test (T-Test)

Multinational on the Thin Capitalization

The results of testing the first hypothesis could not prove the influence of multinationals on the thin capitalization practice. The results of this study are different from other studies Christiana & Martani (2015); Nugroho & Suryarini (2018); Nuraini & Marsono (2014); Taylor & Richardson (2013). The argument that can explain it is that there are a number of differences between this study and previous studies. Nuraini & Marsono (2014) and Nugroho & Suryarini (2018) researched multinational companies in Indonesia, while this study's objects were manufacturing companies. The operationalization of the dependent variable of this study, namely the MAD ratio, is also different from the research of Christiana & Martani (2015), which used the Debt to Equity Ratio (DER). In addition, differences in research objects might cause this study to have different results with Taylor & Richardson (2013), who conducted a similar study in Australia.

Furthermore, the reason that multinational variables did not affect the thin capitalization practice is the possibility that the company's goal of operating abroad is to expand the market and obtain resources at a lower cost (Nainggolan & Sari, 2020). It can be seen from the sample of companies in this research, showing that the company's operations abroad were mostly factories and marketing offices. According to Widodo et al. (2020), the purpose of multinational companies setting up operations in various countries is to increase the company's revenue, strengthen trade alliances, and reinforce the company's global base.

Utilization of Tax Haven on Thin Capitalization

This study succeeded in proving that the utilization of tax havens had a positive effect on the thin capitalization practice. Based on this result, it can be denoted that companies with subsidiaries or business branches located in tax haven countries are more likely to practice thin capitalization. The results of this study align with the studies of Christiana & Martani (2015); Nugroho & Suryarini (2018); Nuraini & Marsono (2014); Taylor & Richardson (2013). Slemrod & Wilson (2009) stated that an entity in a tax haven country could be used by multinational companies to pay the interest-bearing debt by subsidiaries in high tax jurisdictions.

The results of this study also support the results of Taylor & Richardson (2013), which found that companies that have operations in tax haven countries are more likely to have thin capitalization structures. According to Christiana & Martani (2015), when an Indonesian company gets a loan from an affiliated company in a tax haven country, the company benefits from the use of debt interest, which is treated as a tax-deductible expense.

Substantial Foreign Ownership on Thin Capitalization

This study also succeeded in proving that foreign ownership had a substantial positive effect on the thin capitalization practice. These results provide evidence that companies with substantial foreign ownership are more likely to practice thin capitalization. Foreign ownership can substantially influence a firm's decision to use interest-bearing debt over equity financing in its capital structure. Research from Kinney & Lawrence (2000) also uncovered that companies with substantial foreign ownership tended to become tax evaders. The research results of Kinney & Lawrence (2000) further explained that the phenomenon of companies with substantial foreign ownership tends to use profit-shifting strategies obtained from their geographical flexibility.

The results of this study also agree with the research results of Salihu *et al.* (2015), which found that foreign interests characterized by substantial foreign ownership had a positive effect on corporate tax avoidance. On the other hand, Sugiarto (2009) affirmed that financing with debt would not affect the power (voice share) of the owner. Besides, investors, who feel that power in the company is crucial, will prefer debt financing. The costs of paying debts to creditors here are treated as tax-deductible expenses. Those some advantages of financing with debt were then utilized by companies with substantial foreign ownership in the research samples.

Foreign Directors on Thin Capitalization

The results of testing the fourth hypothesis indicated that foreign directors had a negative effect on the thin capitalization practice, so that the third hypothesis was rejected. The argument that could explain this is that the presence of directors of foreign nationality creates diversity in the composition of the company's directors. It provides a diversity of knowledge, opinions, and competencies of directors, which underlies the decision-making process within the company, including its relation to taxation (Dewi, 2017). According to Suh *et al.* (2018), foreign directors in the composition of the board of directors had a positive effect on the function of supervising tax avoidance behavior by executives, increasing the independence of directors, and enhancing company transparency. Almutairi's (2020) research also explained that foreign directors in companies have greater influence and a strong supervisory function to eliminate managers' opportunistic behavior.

The presence of foreign directors in this study's sample companies influenced the company's decision-making not to practice thin capitalization. Substantial foreign ownership and foreign directors of thin capitalization practices, which have opposite coefficient directions, indicate agency problems described in agency theory (Nainggolan & Sari, 2020). Agency problems occur because of differences in interests between company owners as principals and directors as agents.

Control Variables on Thin Capitalization

The variable size positively affected the thin capitalization practice in line with Taylor & Richardson's (2013) research results. These results indicate that the larger the company size, the

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higher the tendency to practice thin capitalization. Meanwhile, the RoA variable had a negative effect on the thin capitalization practice consistent with the research of Christiana & Martani (2015). Based on this, it can be seen that the higher the company's profitability, the smaller the tendency to practice thin capitalization. It happens since companies with large interest-bearing debt will be followed by a large interest expense, which will reduce the company's profitability.

Table 4. Hypothesis Testing

	Adjusted R Square	F-statistic	Prob(F-statistic)	Unstandardized Coefficients B	Std. Error	Sig.
(Constant)				-0.528	0.295	0.75
Multi				-0.036	0.044	0.412
Taxhav				0.096	0.047	0.042
Forgsub	.292	22.099	.000	0.075	0.032	0.021
Forgboard				-0.186	0.053	0.001
Size				0.329	0.080	0.000
RoA				-0.820	0.109	0.000

Source: IBM SPSS Statistics 25 output (processed data)

CONCLUSION

This study provides evidence that foreign ownership has a substantial positive effect on the thin capitalization practice. Companies with substantial foreign ownership tend to practice thin capitalization. Meanwhile, foreign directors have a negative effect on the thin capitalization practice. In this case, the presence of foreign directors creates diversity in the composition of the company's board of directors, thereby increasing the supervisory function of thin capitalization practices.

Moreover, this study's results support previous research that the utilization of tax havens has a positive effect on the thin capitalization practice. Companies with operations in tax haven countries are more likely to practice thin capitalization. Meanwhile, this study could not prove the influence of multinationals on the thin capitalization practice. In this research, IDX-listed manufacturing companies operating overseas aimed to expand, obtain lower-cost resources, and strengthen the company's global base.

Limitation and Suggestion

This research has a number of limitations. In detecting foreign ownership, the researchers only based on the number of shares listed in the companies. This study has not been able to detect indirect foreign ownership that can control the direction of company policy. The number of samples of this study was also relatively limited due to several conditions that should be met for this study. Sample companies that met the requirements in this study were limited to only 77 companies.

It is hoped that this study's limitations can be improved by increasing the number of samples and other independent variables to provide better results. Thus, further research is expected to increase the number of research samples so that the research results can be used as a comparison for this study.

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