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Transfer Pricing Aggressiveness, Thin Capitalization, Political Connection, Tax Avoidance: Does Corporate Governance Have A Role in Indonesia?

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ABSTRACT

This study investigates the association of transfer pricing aggressiveness, thin capitalization, and political connection with tax avoidance and the corporate governance's role in moderating these associations. The secondary data of this study are data and information obtained from financial reports and annual reports sourced from www.idx.co.id and www.idnfinancials.com. The analysis is conducted on 61 non-financial multinational companies listed on Indonesia Stock Exchange over the 2016-2019 period, chosen by the purposive sampling method resulting in 244 firm-year. Hypothesis testing employs regression analysis with a data panel. The result suggests that transfer pricing aggressiveness and political connection are negatively associated with tax avoidance. In contrast, thin capitalization is positively associated with tax avoidance. However, corporate governance can weaken each of these associations. This study indicates that the Indonesian Tax Authority should consider multinational companies with large interest debt structures on the list of priorities in tax inspection policy. Also, this study shows Indonesian firms are less likely to use political connection and transfer pricing to avoid tax.

INTRODUCTION

Tax avoidance remained one of the global strategic issues. Big multinational companies, such as Apple and Google, commit the most notorious tax avoidance cases. Apple shifts its domestic profits to tax haven countries that charge low- or tax-free-income taxes by utilizing Jersey and Ireland's small islands (DDTCNews, 2017). Under the profit shifting scheme, Apple has $128 billion in non-taxable revenue, either in the United States or other countries (Drucker & Bowers, 2017). Reuters reported that Google used a subsidiary in the Netherlands to shift profits from royalties of 22.8 billion to affiliated companies located in Bermuda, not subject to income tax (Reuters, 2019). Through profit shifting and tax base reduction, tax avoidance practices cause countries worldwide to lose up to $100-240 billion in tax potential annually or about 4 to 10% of global tax revenue (OECD, n.d.).

As one of the developing countries, Indonesia proves that tax avoidance is still a strategic issue. Indonesia Tax Authority revealed that from 2006 to 2016, there were 2,000 multinational companies running operations in Indonesia reporting losses not to pay Corporate Income Tax (Sari, 2016). In 2018, one of Indonesia's Tax Offices stated that 28% of multinational companies reported losses and not paying taxes, consisting of 3,918 companies reporting losses for 1-2 years and 1,150 companies for 3-5 years. Still, the company continued to operate and even expanded its business (Fathoni, 2018). Losses on multinational companies in Indonesia can be associated with profit-shifting strategies to reduce global taxes. The total income in the group minus profits shifted to other countries is the amount of income that should be taxable (Kristiaji, 2015). Global Witness reported tax evasion cases that reduce global taxes by PT Adaro Energy by adjusting transfer prices through transferring profits from coal mines in Indonesia to tax haven countries, Singapore, Mauritius, and Labuan. Adaro reduced the amount of tax paid in Indonesia to US$125 million (Global Witness, 2019). The increasing number of tax avoidance cases by multinational companies in Indonesia contributes to Indonesia's low tax ratio. Factors influencing tax ratio are tax rates, tax collection effectiveness, tax incentives, and the possibility of tax crimes, such as tax evasion and avoidance (Sakti, 2019).

Tax avoidance conducted by multinational companies is a concern for the Government and other stakeholders such as investors. Most MNCs are big companies that consider taxes a political expense more significant than small companies (Zimmerman, 1983). The companies with larger incomes are more aggressive in tax avoidance, in line with multinational companies that conduct extensive overseas operations showing lower effective tax rates (Rego, 2003). Political costs play an essential role in encouraging corporate tax aggressiveness (Wang et al., 2019). Companies tend to opt for profit-lowering accounting methods and aggressive tax avoidance strategies to protect themselves from tax authority scrutiny (Cloyd et al., 1996). Thus, tax avoidance especially conducted by multinational companies is important to be investigated.

Research on tax avoidance has previously been extensive. Several studies have investigated the influence of various independent variables on tax avoidance. Some of them are corporate characteristics such as corporate size, business strategy, multinationalism (Rego, 2003; Lisowsky, 2010; Hope et al., 2013; Higgins et al., 2015), internal governance such as the board of directors, internal audit committee, internal control (Lanis & Richardson, 2011; Taylor & Richardson, 2013; Armstrong et al., 2015; Gallemore & Labro, 2015; Bauer, 2016), transfer pricing aggressiveness (Taylor & Richardson, 2012; Amidu et al., 2019), thin capitalization (Taylor & Richardson, 2012), and political connections (Adhikari et al., 2006; Kim & Zhang, 2013). Furthermore, in Indonesia, several studies have tested variables that affect tax avoidance, such as the size of the company (Rusydi, 2013; Baltagi, 2015; Kurniasih & Sari, 2013; Fitria & Handayani, 2019), institutional ownership (Annisa & Kurniasih, 2012; Mulyani et al., 2018; M. Sari & Devi, 2018), leverage (Kurniasih & Sari, 2013; Permata et al., 2018; Hidayat, 2018), independent commissioner (Annisa & Kurniasih, 2012; Fitria & Handayani, 2019), transfer pricing aggressiveness (Falbo & Firmansyah, 2018), thin capitalization (Ismi & Linda, 2016; Andawiyah et al., 2019; Salwah et al., 2016), political connections (Butje & Tjondro, 2014; Sudibyo & Jianfu, 2016; Lestari & Putri, 2017; Ferdiawan & Firmansyah, 2017).

Study on tax avoidance by multinational companies is still rare. Research of tax avoidance on multinational companies has previously been

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conducted using transfer pricing aggressiveness and earning management on multinational companies in Ghana (Amidu et al., 2019), foreign investors' interest in multinational companies in Malaysia (Salihu et al., 2015), analysis of determinants of thin capitalization on multinational companies in Indonesia (Nuraini, 2014), and utilization of state tax reserves, multinationalism, institutional ownership of tax avoidance with thin capitalization in Indonesia (Waluyo & Doktoralina, 2018). According to Lenz (2020), multinational companies favor aggressive tax avoidance strategies to the extent permitted by law to maximize shareholder wealth, although contrary to the purposes of tax laws that have been agreed upon in a country. Thus, a study of tax avoidance using multinational company data is attractive.

There are differences in test results from previous studies. In contrast, testing by Irawan et al. (2020) suggested a negative influence of transfer pricing aggressiveness on tax avoidance. On the other hand, Falbo and Firmansyah (2018) proved that transfer pricing aggressiveness does not affect tax avoidance. Thus, examining transfer pricing aggressiveness effect on tax avoidance needs to be reinvestigated. Thin capitalization significantly impacts the tax imposed because some countries contain rules that allow interest expense as a deductible cost of taxable income (OECD, 2012). Multinational companies can take advantage of reduced interest expense by conducting debt transactions between subsidiaries and arranging the composition of larger debt structures on branches in countries with high tax rates to pay low taxes. Several studies have investigated the relationship of tax avoidance with thin capitalization, such as transfer pricing, multinationalism, tax haven utilization, and income shifting (Taylor & Richardson, 2012), return on assets and corporate governance (Ismi & Linda, 2018), transfer pricing aggressiveness (Falbo & Firmansyah, 2018), the influence on tax avoidance (Salwah & Herianti, 2019). Inconsistencies in the results of previous research show that this effect needs to be reinvestigated. Testing by Taylor and Richardson (2012) and Falbo and Firmansyah (2018) positively influenced tax avoidance. Meanwhile, Ismi and Linda (2018) suggested that the investigation results that thin capitalization does not affect tax avoidance. On the other hand, Salwah and Herianti (2019) obtained test results of thin capitalization's negative influence on tax avoidance. The differences in previous studies' test results resulted in thin capitalization testing on tax avoidance needing to be reinvestigated.

Some tests related to political connections and tax avoidance include, such as political connections in developing countries (Adhikari et al., 2006), relationship with tax aggressiveness (Kim & Zhang, 2013), executive character (Butje & Tjondro, 2014), political connections on SOEs (Sudibyo & Jianfu, 2016), corporate governance and leverage (Lestari & Putri, 2017), and foreign activities and natural profit management (Ferdiawan & Firmansyah, 2017). There are still inconsistencies in the results of previous research. Adhikari et al. (2006), Kim and Zhang (2013), Sudibyo and Jianfu (2016), as well as Ferdiawan and Firmansyah (2017) proved that political connections are positively associated with tax avoidance. Butje and Tjondro (2014) demonstrated that political connections are negatively associated with tax avoidance, while Lestari and Putri (2017) proved that political connections are not associated with tax avoidance. The differences in test results in previous studies resulted in the testing of political connections to tax avoidance need to be reinvestigated.

This study examines the influence of transfer pricing aggressiveness, thin capitalization, and political connections to tax avoidance by using data from multinational companies in Indonesia. Testing of transfer pricing aggressiveness, thin capitalization, and political connections to tax avoidance has never been conducted in a single research model in previous studies. Testing of transfer pricing aggressiveness and thin capitalization of tax avoidance has been led by Taylor and Richardson (2012) and Falbo and Firmansyah (2018) in one study, but not in the context of multinational corporations. In particular, research on tax avoidance in multinational companies at the international level and Indonesia using these three variables is rarely investigated.

Besides, this study used corporate governance as a moderation variable in testing transfer pricing aggressiveness, thin capitalization, and political connections to tax avoidance that is still rare in previous research, especially in the context of multinational corporations. Based on stakeholder theory, decision-making on the company's operational activities impacts all stakeholders' interests, not limited to shareholders. In the context

of multinational corporations, corporate governance is not only a means of oversight between executives and stakeholders, but also to give a clear direction to businesses spread globally and to reinforce the distribution of power, rights, and responsibilities between decision-making parties that affect global relations (Luo, 2005). Several tests of the influence of corporate governance on tax avoidance have been conducted before. Suardana and Maharani (2014) and Armstrong et al. (2015) found that corporate governance characteristics negatively affect tax avoidance in Indonesia and the United States. However, corporate governance characteristics that tend to affect tax avoidance negatively in Indonesia's companies are only a proportion of the audit committee, and other characteristics tend not to affect tax avoidance (Tandean & Winnie, 2016). In companies with good corporate governance, tax avoidance activities in conditions of having financial restrictions are less likely to be carried out (Bayar et al., 2018).

Previous research has shown differences in results because corporate governance characteristics are mostly still partially assessed. In contrast, Widiiswa and Baskoro (2020) stated that corporate governance characteristics such as independent commissioners and external auditors positively affect tax avoidance. However, institutional ownership and audit committees do not affect tax avoidance in multinational companies in Indonesia. Hence, the influence of corporate governance on tax avoidance still needs to be reinvestigated.

The investigation of corporate governance influences transfer pricing aggressiveness, thin capitalization, and political connections have been conducted, but the study is quite rare, so the relevant literature is quite limited. Previous research has shown that corporate governance represented by independent commissioner variables and institutional ownership negatively affects transfer pricing aggressiveness (Dinca & Fitriana, 2019), corporate governance characterized by director independence, institutional ownership, and the use of Big-4 auditors negatively affect companies with thinly capitalized capital structures (Taylor & Richardson, 2013), as well as corporate governance represented by cash flow deviations from voting rights, share liens agreements, the duality of the board of directors, and board independence negatively affecting political connections (Shen et al., 2015). Previous research has explained corporate governance with variables related to partially assessed companies' structure and policy-making process. This study uses corporate governance guidelines based on the Circular Letter of the Financial Services Authority (OJK) in 2015, aligned with the New G20/OECD Corporate Governance Manual for more comprehensive and integrated measurement.

Multinational companies incorporated in Indonesia must be legal entities, subject to the Law of Limited Liability Companies, allowed to list on the Indonesia Stock Exchange with minimum ownership of 7.5% of public shares (Gintoe, 2019). Public share ownership indicates that multinational companies need to account for their business activities to Indonesia's People as stakeholders through compliance with the Financial Services Authority's governance rules. As a monitoring mechanism for the performance and activities of management within the company, good corporate governance is expected to reduce tax avoidance activities by utilizing transfer pricing aggressiveness, thin capitalization, and political connections in multinational companies contrary to stakeholder interests.

This research has contributed to complete accounting research related to tax avoidance by testing the influence of transfer pricing aggressiveness, thin capitalization, and political connections to tax avoidance in multinational companies. The Directorate General of Taxation can also consider this research to improve anti-tax avoidance rules and develop competencies necessary to combat tax avoidance activities in multinational corporations. Besides, the Financial Services Authority can also use this research as an evaluation material for implementing corporate governance and considerations in improving the guidelines for implementing corporate governance to be optimally applied.

The study used company size, leverage, and profitability as control variables. Large companies tend to use accounting procedures that lower profits than smaller companies because taxes are a political expense that companies must bear (Zimmerman, 1983). Meanwhile, Park et al. (2013) stated that multinational companies outside the United States tend to implement higher leverage policies than multinational companies in the United States. On the other hand, Park et al. (2013) are also aware

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that multinational companies can have low leverage levels due to agency costs and lack of investment due to ownership of intangible assets. Gupta and Newberry (1997) found a positive influence on leverage levels on tax avoidance because interest expense can reduce taxable income.

Furthermore, profitability could control the impact of the company's operating performance variability. Multinational companies with high profitability are more likely to commit tax avoidance and have lower effective tax rates (Rego, 2003). Companies with high profitability bear a more significant tax burden, thus maximizing tax planning to lower the burden (Prabowo, 2020). These three control variables are kept constant for accurate analysis of independent variables' effect on dependent variables.

Literature Review and Hypothesis Development

Positive Accounting Theory

Positive accounting theory uses a framework to explain accounting practices through observation and empirical approaches to answer accounting practices in different situations or companies. Positive accounting theory stems from dissatisfaction with normative accounting theory that adheres only to ideal practices, easy access to empirical data, and increased economic arguments in the accounting literature. Based on Godfrey et al. (2010), positive accounting theory aims to explain and predict accounting practices in the real world. Watt and Zimmerman (1986) compiled predictions based on positive accounting theory in three commonly used hypotheses: bonus plan, debt covenant, and political cost hypothesis.

The political cost hypothesis under positive accounting theory is one of the critical views used in accounting. Positive accounting theory creates a political dimension in the relationship between the company and other parties interested in its operations, such as certain governments, trade unions, or communities (Godfrey et al., 2010). The Political Cost Hypothesis predicts that companies subject to government investigations have an incentive to manage their revenues to reduce the possibility of transferring wealth to the government (Makar & Alam, 1998). In the political cost hypothesis, the company considers that the transfer of wealth to the government from taxation rules, regulations, or policies that impact the company is a political cost.

Taxes for corporations are deductible on income and are direct political costs. Larger companies bear taxes as a political expense more significant than small companies (Zimmerman, 1983). Rego (2003) supported the statement, which proved that companies with larger incomes are more aggressive in tax avoidance, in line with multinational companies that conduct extensive overseas operations showing lower effective tax rates. Political costs play an essential role in encouraging corporate tax aggressiveness (Wang et al., 2019). Companies tend to opt for profit-lowering accounting methods and aggressive tax avoidance strategies to protect themselves from tax authority scrutiny (Cloyd et al., 1996). Thus, managers tend to choose accounting methods that reduce profits to lower the tax paid either in a way that is allowed or not allowed to ensure low corporate political costs.

Stakeholder Theory

One of the managerial concepts of organizational strategy and ethics is stakeholder theory. A stakeholder is a person or group of people who invest in shares, consisting of employees, customers, communities involved with the organization, and the social environment responsible for and interests in a business's success (Cambridge dictionary, n.d.). Stakeholder theory discusses capitalism's view that emphasizes the relationship between business and customers, employees, investors, partners, community communities, and other organizational stakeholders (Freeman, 1984).

Stakeholder theory is a widely accepted concept, though there is still a debate in some aspects, especially the term stakeholder (Miles, 2017). The dispute arises because stakeholder theory is not a single theory but an amalgamation of the eclectic narrative, choosing the best from various sources (Gilbert & Rasche, 2008). Stakeholder theory is sourced and applied to business ethics, corporate social responsibility, to corporate and financial governance. The importance of stakeholder theory prompted Miles (2017) to mediate the debate on stakeholder understanding. Miles (2017) classifies stakeholders into four groups such as the claimant (parties who have a personal interest in the company), influencers (parties who can support or

hinder the purpose of the company), collaborators (parties who participate in creating corporate value), and recipients (parties who bear the risk of corporate activities), as well as a combination of the two-three groups.

The company's management aims to support stakeholder groups and balance their interests while creating an organization where stakeholders maximize their profits over time (R. E. E. Freeman & Phillips, 2001). Argadona (2011) expanded the view on stakeholder theory by Freeman and Velamuri (2008) by introducing the concept of value creation for all stakeholders. Management plays a role in creating maximum value for stakeholders that is not limited to economic value but can also be associated with social activities and evaluative learning related to ethical values and virtues (Argandoña, 2011). This theory believes that the company's ability to survive in the industry is because management considers the needs of many parties, incorporates ethical values and virtues, and can evaluate the impact of its decisions on interested parties. Thus, managers' strategic decision-making in various aspects should consider the importance and impacts inflicted on each stakeholder in the corporate governance process, not limited to the interests of shareholders.

Institution-Based View

The institution-based view is related to the international business strategy that explains that rules of the game on what is allowed and not allowed based on institutional conditions could influence companies' behavior worldwide (Gokalp et al., 2017). This view is the third paradigm in strategy management after industry-based views (Porter, 1990) and resource-based views (Barney, 1991). Institutional rule-based views are rooted in institutional economics and institutional theory, representing two economic and social points (Garrido et al., 2014).

The emergence of the institution-based view results from the movement of strategy management researchers who focus on the theory of neo-institutionalism and realize that institutional rules are a condition and a determining factor in the formulation and implementation of strategies (Peng et al., 2009). The choice of strategy has been viewed only based on industry conditions and its internal resources capabilities. The birth of an institution-based view brings a new view that in addition to these two factors, the limitations of formal and informal rules and the interaction between institutional and organizational rules influence strategic choices in the company (Jarzabkowski & Whittington, 2008).

Institutional rules are boundaries created by regulatory, normative, and cognitive structures and create balanced and meaningful social behaviors (Scott, 1995). There are two essential pieces of evidence in an institution-based view to reducing uncertainty when making international business decisions on emerging market economies. The two fundamental propositions are:(1) individuals and companies make rational decisions based on formal and informal institutional rules (2) relaxed institutional rules play an essential role to give direction in gaining legitimacy when formal institutional rules are not qualified or ambiguous (Peng & Khoury, 2009). Formal rules consist of constitutions, contracts, government rules, while informal rules consist of traditions, customs, moral values, beliefs, and norms that have been agreed upon for a long time (Kaufmann et al., 2018). Suppose corporate strategy cannot be limited by official rules, conventions, or laws in a country; the suitability strategy choice with social fitness in a country determines the acceptance of organizational strategy to gain legitimacy. Thus, an institution-based view gives direction to companies that internationalize to understand the rules of play in the country in which it operates. Conformity with the formal rule of law and social values in a country determines the company's choice of strategy and behavior.

Hypothesis Development

As part of a positive accounting theory, the political cost hypothesis explains that taxes are political costs that companies must bear. Managers are likely to opt for accounting policies that lower profits to reduce political costs. Multinational companies can minimize tax payments through transfer pricing activities to distribute profits to other countries at lower tax rates based on these political cost hypotheses. Aggressive transfer pricing activities can reduce the total tax burden within the group.

Manipulation of transfer pricing prices in a group can be done through sales prices, purchase

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prices, allocation of general administrative and overhead costs, payment of license commissions, franchises, royalties, leases, and service rewards, transfer of property by the owner of the company to a party with a special relationship at a lower price, or sale to a third party that has no business substance (Setiawan, 2014). The company's management can engineer the transfer price of raw materials on transactions with related parties at a price higher than the market price. When a subsidiary is located in a country with a high tax rate, raw materials at the transfer price are marked up well above the market price. The burden of purchasing raw materials will increase and reduce the company's profit. Low company profit means less income tax paid.

Conversely, when a subsidiary is located in a country with a low or non-taxable tax rate, the purchase of raw materials will take advantage of the lowered transfer price below the market price, resulting in a low raw material purchase burden and high corporate profits. Despite the company's high profits, subsidiaries did not subject to tax. With the scheme, the accumulation of tax payments across the group becomes lower, and the company's profit is left intact but only moved between countries.

Taylor and Richardson (2012) and Amidu et al. (2019) empirically proved the effect of transfer pricing aggressiveness on tax avoidance. Taylor and Richardson (2012) investigated public companies in Australia, while Amidu et al. (2019) investigated multinational companies in Ghana. Both test results show that companies that conduct transfer pricing activities aggressively manipulate transfer prices and lower their reported profits.

Transfer pricing aggressiveness in multinational companies is one of the main ways to make profit shifting for tax purposes. Moving profits between companies to lower the group's total tax is how multinational companies utilize transfer pricing. Although it is one of the main ways, using transfer pricing aggressiveness to manage profits with tax motives on multinational companies considers many factors. The world's attention to Base Erosion Profit Shifting (BEPS) is regarded as a factor that might affect strategic choices and the complexity of multinational companies' policies. BEPS Action Plan encourages the growth of rules and restrictions related to transfer pricing and how companies behave over institutional rules' limitations. Companies with low profits and effective tax rates may use various strategies, including aggressive transfer pricing and excess tax avoidance. Thus, aggressive transfer pricing at multinational companies is associated with minimizing profits and tax avoidance. Therefore, the first hypothesis in this study is:

H1: Transfer pricing aggressiveness positively affects tax avoidance

Positive accounting theories, particularly the political cost hypothesis, regard taxes as a political expense for companies. Companies that make enormous profits will be taxed more, so the political cost will reduce shareholder wealth. The company's management will use various ways to reduce the amount of profit reported to avoid reducing shareholder wealth. The method of lowering reported profit can be done by utilizing debt in the company's capital structure.

Thin capitalization is an investment decision that prioritizes debt compared to equity funding its operations (Taylor & Richardson, 2012). The priority of using debt in the capital structure aims to obtain interest expense incentives to reduce taxable income. The debt's interest expense will help reduce the reported profit and the political costs to be paid. Multinational companies have an advantage in utilizing thin capitalization. Related parties or their subsidiaries in other countries could be the debtholder. Under the same group, they could adjust payment obligations and debt agreements. Companies may lend to subsidiaries in other countries to influence debt structure, receive interest expense reduction incentives, and reduce taxes payable on the country of residence. However, the limitation rule of thin capitalization as an institutional rule also needs to be considered as one factor that may influence corporate strategy choice related to utilizing thin capitalization to avoid taxes.

Empirically, research on the influence of thin capitalization on tax avoidance at the international level was conducted by Taylor and Richardson (2012), which proved the positive influence of thin capitalization on tax avoidance on multinational corporations in the United States. In Indonesia, Falbo and Firmansyah (2018) researched manufacturing companies referring to the size of Taylor and Richardson (2012) with the provisions of Indonesian taxation and obtained the results that thin capitalization positively affects tax avoidance. Bandiyono and Murwaningsari (2019), who used

property company data, and Prastiwi and Ratnasari (2019), using data from manufacturing companies in Indonesia, proved that thin capitalization positively affects tax avoidance. Previous research has shown that companies can use thin capitalization to avoid tax avoidance by increasing debt composition in their capital structure.

Multinational corporations' thinly capitalized corporate capital structure has a positive relationship with tax avoidance. The composition of large debts in the capital structure impacts companies' taxes through interest debt financing, reducing taxable income. By utilizing subsidiaries in different countries, companies can manage and shift debt between companies to pay taxes according to the country's low rate. Thus, multinational companies with high debt and interest structures exceeding the thin capitalization rules indicate tax avoidance. Therefore, the second hypothesis in this study is:

H2: Thin capitalization positively affects tax avoidance

According to positive accounting theory, tax is a political expense, especially the political cost hypothesis. Companies subject to government power will pay a political fee from the government's policies, rules, and regulations. Companies aiming to maximize shareholder wealth will try to avoid paying huge political costs. The way to avoid paying political costs is to have a political connection with the government or politicians.

According to Godfrey et al. (2010), companies with political connections will have an information advantage compared to other companies. The political process is a competition to transfer wealth, so companies exposed to political connections are more likely to report lower profits. The considerable influence of business operations on various aspects in developing countries causes multinational companies to leverage political connections to influence a policy and protect companies from detecting tax authorities. Companies' political costs are lower than they should be. Lin et al. (2017) tested the board of directors who have political connections with tax authorities effectiveness to prevent tax avoidance. The test result proved that companies use political connections to impede tax law enforcement in developing countries where the economy is politically controlled. Besides, developing countries with higher levels of corruption are more prone to exploit political connections (Faccio, 2006).

Empirically, testing the influence of political connections on tax avoidance has been widely done. Adhikari (2006) tested the influence of political connections in Malaysian companies on tax avoidance, and the test results proved a positive influence of political connections on tax avoidance. Sudibyo and Jianfu (2016) have investigated the influence of political connections in State-Owned Enterprises and Ferdiawan and Firmansyah (2017), and Purwanti and Sugiyarti (2017) on manufacturing companies in Indonesia, with test results proving that political connections have a positive effect on tax avoidance. Previous research has shown that companies with political connections tend to use their political connections to lower the probability of being detected by tax checks or lobbying activities to the government to launch tax avoidance activities.

Political connections have a positive influence on tax avoidance. The statement is supported by Indonesia's high level of corruption, politically controlled economy, and multinational corporations' influence on revenues that become weapons to exploit political relations to protect from tax checks by the authorities. Nevertheless, in multinational corporations, the purpose of having political connections and putting government officials in directors can consist of various motivations. In addition to tax motives, the motives include transparency of the company's strategic policy towards local representatives or countries where it is domiciled to suppress government intervention, knowing the country's socio-cultural conditions in which the business is located, or reducing transaction costs to obtain subsidies from the government. The company's strategy and behavior related to political connections may vary depending on the company's motivation. Therefore, the third hypothesis in this study is:

H3: Political connections have a positive effect on tax avoidance

The company's management will make economic decisions based on stakeholder theory by balancing all stakeholders' interests, not limited to shareholders. Company managers are responsible for balancing the interests of shareholders, customers, partners, communities, and legal entities such as founders—responsibility delivered by behaving ethically and making decisions that

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align with the objectives of all stakeholders. Corporate governance is created for the benefit of shareholders and maximizes its contribution to overall stakeholders (Claessens & Yurtoglu, 2013). The direction of stakeholder theory related to corporate governance is in line with the OECD report's concept that good corporate governance should adhere to the principle of inclusivity, i.e., companies are encouraged to protect all stakeholders better (Widiiswa & Baskoro, 2020). Managers at multinational companies meet various corporate governance challenges due to the diversity of governance rules, regulations, and stakeholders' expectations in different countries (Luo, 2005). Multinational companies need to be responsible for two or more countries' governance rules, so the standard of governance in multinational companies tends to be higher than domestic companies because it bears pressure from many stakeholders (Madhani, 2015). The country's corporate governance standards in which multinational companies operate is a supervisory mechanism. It existed to ensure that managers at multinational companies remain ethical, responsible, and transparent to the public, the Financial Services Authority, and shareholders as stakeholders, especially for multinational companies listed on the Indonesia Stock Exchange.

Previous research by Suardana and Maharani (2014) and Armstrong et al. (2015) showed that corporate governance characteristics negatively affect tax avoidance. The influence of corporate governance on transfer pricing aggressiveness has been tested by Dinca and Fitriana (2019). The test results by Dinca and Fitriana (2019) concluded that independent commissioners and institutional ownership in the company could suppress transfer pricing aggressiveness. Compliance with transfer pricing activities to the rules is crucial in the relationship with two main stakeholders: shareholders and tax authorities (Cools, 2005). Research by Suardana and Maharani (2014), Armstrong et al. (2015), and Dinca and Fitriana (2015) shows that good corporate governance can suppress tax avoidance activities and aggressiveness transfer pricing strategies used for tax avoidance. When connected with stakeholder theory, corporate governance can suppress tax avoidance that is considered unethical in corporate decision-making and contrary to stakeholder interests. However, in multinational companies with experience in implementing governance in different companies, the rule of law and social conditions in a country are likely to affect implementing good governance, either real or simply a strategy to gain a good legitimacy reputation.

Transfer pricing aggressiveness in multinational companies indicates the utilization of tax avoidance because there is an overseas network. Transactions can identify tax avoidance with transfer pricing aggressiveness at unreasonable prices. Before international rules governing the restriction of unnatural transactions, corporate governance is the leading controller to keep the company's business operations ethical and per the stakeholders' objectives. Corporate governance can suppress tax avoidance through aggressive transfer pricing as a monitoring mechanism for the company's operations and prevent the management from carrying out unnatural activities. Therefore, the fourth hypothesis in this study is:

H4: Corporate governance weakens the positive influence of transfer pricing aggressiveness on tax avoidance

The company's management decision on capital structure and financing is a strategic economic decision. Stakeholder theory explains that the company's strategic economic decisions are taken, considering the balance of all stakeholders' interests. Based on the political cost hypothesis, the company's management seeks to lower political costs by choosing policies that can reduce profits. Nevertheless, stakeholders expect that the company's managers' business operations follow ethical values and align with all stakeholders' objectives.

The main goal of shareholders is to maximize wealth. Thus, companies will generally reduce the political costs that reduce wealth. A thinly capitalized capital structure will help reduce taxes by imposing debt interest on taxable income. However, for other stakeholders such as the community, customers, partners, and legal entities that enforce business rules, tax avoidance is an act that is considered detrimental, especially to the people of the country where the company is located. When managers of multinational corporations deliberately regulate the proportion of debt in the capital structure for tax avoidance purposes, its reputation deteriorates and impacts its business continuity. The statement is supported by Christian and Henry (2015), who

stated that the practice of thin capitalization is an illicit flow of funds that can reduce the right of government in a country.

Research by Suardana and Maharani (2014) and Armstrong et al. (2015) has proven that corporate governance negatively affects tax avoidance. Corporate governance serves as a supervisory mechanism to reduce unethical activities, such as tax avoidance (Pratama, 2017). Taylor and Richardson (2013) proved that corporate governance could be a supervisory mechanism to suppress tax avoidance in companies with debt structures that crossed the line of thin capitalization rules. As a supervisory mechanism, good corporate governance can improve the company's reputation in stakeholders' eyes and prevent the utilization of thin capitalization strategies for tax avoidance through transparency of capital structure information (Boateng & Vitenu-Sackey, 2019). Implementing sound corporate governance through corporate debt management supervision can prevent thin capitalization practices (Safrudin & Suryaningrum, 2020). Research by Suardana and Maharani (2014), Armstrong et al. (2015), and Taylor and Richardson (2013) showed that corporate governance as a supervisory mechanism should be able to suppress thin capitalization strategies to avoid taxes because corporate governance serves as a supervisory mechanism for activities that threaten the company's reputation.

Good corporate governance can effectively reduce corporate tax avoidance efforts through a thinly capitalized capital structure. Good governance through information transparency can be a policy control mechanism and a strategic choice taken by the company's management. As a policy control mechanism, corporate governance can reduce companies' potential to utilize debt structures beyond thin capitalization limits as a strategy to conduct tax avoidance that is considered unethical. The fifth hypothesis in this study is:

H5: Corporate governance weakens the positive influence of thin capitalization on tax avoidance

Corporate governance is a mechanism used to align all stakeholders' interests over the company's business operations. The statement is in line with the stakeholder theory, which explains that management's economic decisions must align with all stakeholders' objectives. Political connections are the company's long-term strategy of controlling government policy, improving job achievements, and gaining a competitive advantage (Dicko, 2016). Political connections are valuable to companies because politicians facilitate their supporters' affairs (Shen et al., 2015). A supporting statement by Godfrey et al. (2010) explained that companies with political connections tend to show lower profits than companies without political connections. Political activities and parties with political connections can significantly influence certain decisions or policies within the company, including tax planning strategies so that political connections and corporate governance can influence each other.

Research by Suardana and Maharani (2014) and Armstrong et al. (2015) shows that corporate governance negatively affects tax avoidance. Meanwhile, research that tests the direct relationship between political connections and corporate governance is still rarely investigated. Shen et al. (2015) explained that corporate governance could complement the limitations and ambiguity of rules and regulations to maintain stakeholders' objectives and establish a good reputation. Political connections are not essential in companies with good governance. Limited government regulation of corporate political activities makes the code of conduct drafted by corporate governance the first form of self-regulation and defense to reduce political activity (Dahan et al., 2013). Ozer and Alakent (2013) stated that companies with good corporate governance would increase control over their executives so that the tendency of political activity that can harm stakeholder interests decreases. Extreme political action in a company can create a negative reputation and decrease the company's prestige in external parties' eyes (Kamasak et al., 2019). Therefore, companies with political connections tend to have poor corporate governance and vice versa. Companies with good corporate governance do not prioritize the existence of political connections (Shen et al., 2015).

Multinational corporations can leverage their political influence and connections to commit tax evasion. Simultaneously, management in multinational companies also has a responsibility to meet stakeholders' governance standards, namely the Financial Services Authority and the public. Corporate governance can suppress the influence of political connections in tax avoidance efforts. Because political connections and governance have

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an opposite relationship, political connections on tax avoidance could be minimized when they follow good corporate governance guidelines. However, in multinational companies with experience in implementing governance in different countries, enforcement of law and social conditions in a country is very likely to affect actual corporate governance. It symbolizes the reality in the company or simply as a strategy to attract stakeholders' trust. Therefore, the sixth hypothesis in this study is:

H6: Corporate governance weakens the positive influence of political connections to tax avoidance

RESEARCH METHODS

This study is quantitative research. The research uses the data of multinational companies listed on the Indonesia Stock Exchange from 2016 to 2019. They are considering determining the initial year of study starting in 2016 based on the effective implementation of corporate governance guidelines by the Financial Services Authority. The corporate governance guidelines by the OJK were published on November 17, 2015, and provide the latest guidance that has been aligned with the New G20/OECD Corporate Governance Manual international governance standards. Thus, these guidelines offer a better picture of corporate governance, so that research after 2015 on corporate governance can refer to one comparable standard. Multinational companies have unique characteristics due to geographical flexibility and more channels to conduct tax avoidance in other countries. Besides, the proportion of multinational companies contributing to state revenues reached 42% of the Indonesian Agency Income Tax (OECD, 2020). Companies listed on the Indonesia Stock Exchange are selected because companies listed on the Indonesia Stock Exchange must submit audited public financial statements, allowing research data to be obtained ultimately.

The research data was collected using documentation methods through the Indonesia Stock Exchange's official website and potentially sampled companies' official websites. The information used is the financial statements and annual reports of multinational companies listed on the Indonesia Stock Exchange from 2016 to 2019. In addition to the Indonesia Stock Exchange website, this study also utilizes other relevant sources such as biographical information sourced from articles on the internet. The study investigated several companies for 2016-2019 but used data from 2015-2019 due to the need for lagged year data for tax avoidance variables. The following criteria employed the purposive sampling technique to obtain the research samples.

Table 1 Research Sampling

No	Criteria	Total	Unit
1	Companies conducting Initial Public Offering (IPO) at IDX before January 1, 2015	481	Companies
	Elimination:		
2	Financial sector companies	(76)	Companies
3	Companies that do not have a parent or subsidiary abroad (non-multinational)	(277)	Companies
4	Multinational companies with negative pre-tax profits	(64)	Companies
5	Multinational companies with financial years other than January-December	(2)	Companies
6	Multinational companies with incomplete financial statements and annual reports for the period 2015-2019	(1)	Companies
Total Sample		61	Companies
Period		4	Year
Total		244	Observation

Source: data processed

The dependent variable in this study is tax avoidance. It is an activity conducted by companies to reduce the amount of income tax paid or the effective tax rate by legal to illegal methods. The central proxy used is Effective Tax-Rate Differential (DiffETR). According to Hanlon and Heitzman (2010), ETR Differential can reflect non-conforming tax avoidance. Non-conforming

tax avoidance is a manager's strategy to reduce taxable income and raise accounting revenue (Lee et al., 2015). Besides, ETR Differential can illustrate the difference between the tax rate in a country and its effective tax rate to capture the business of corporate tax savings by eroding its tax base. ETR Differential concept is in line with the permanent difference between the company's accounting profit and corporate tax profit without separating the elements of discretionary decisions and not from non-discretionary decisions (Hanlon & Heitzman, 2010). The use of permanent differences in accounting profits and tax returns to measure tax avoidance can reflect ideal tax planning activities and tax avoidance that tend to be more aggressive. This measure refers to the research of Lietz (2013), Amidu et al. (2019), and Irawan et al. (2020). ETR Differential calculations are as follows.

$$\text{DiffETR} = \mathit{Statutory\ Tax\ Rate} - \frac{\mathit{Income\ tax\ expense}}{\mathit{pretax\ income}}$$

The discretionary permanent book-tax difference (DTAX) is an alternative measure used for sensitivity models. Hanlon and Heitzman (2010) stated that permanent book-tax difference (DTAX) could reflect non-conforming tax avoidance. Frank et al. (2009) revealed that permanent book-tax difference (DTAX) is a better measure because permanent differences are more symbolic of tax shelter activity that shows aggressiveness to conduct tax avoidance and overcome bias differences caused by accounting policies. The permanent book-tax difference (DTAX) is adopted in Rachmawati and Martani (2017) and adapted to the Indonesian conditions of Frank et al. (2009) with the following calculations:

$$PERMDIFF_{i,t} = \alpha_0 + \alpha_1 INTANG_{i,t} + \alpha_2 \Delta NOL_{it} + \alpha_3 LAGPERM_{i,t} + \varepsilon_{i,t} \ldots\ldots (1)$$

Description:

$PERMDIFF_{i,t}$ = total difference of accounting and tax profit minus the difference in temporary profit (*PTBIit - (CTEit / STRit) - (DTEit / STRit*)
$PTBI_{it}$ = accounting pretax income
CTE_it = current tax expense
STR_{it} = statutory tax rate
DTE_{it} = deferred tax expense
$INTANGi_{,t}$ = total of intangible assets and goodwill
ΔNOL_{it} = changes on *net operating loss carryforward* (deferred tax assets)
$LAGPERM_{i,t}$ = $PERMDIFF_{i,t}$ in preceding period
$\varepsilon_{i,t}$ = discretionary permanent difference (DTAX)

The above variables are divided by the average total assets this year by the previous year based on Rachmawati and Martani (2017). Tax avoidance (DTAX) is calculated by residual regression or εi,t from the regression equation based on the above formula.

Independent variables in this study consisted of transfer pricing aggressiveness, thin capitalization, and political connections. Amidu et al. (2019) used an index to measure transfer pricing aggressiveness at multinational companies in Ghana. In this study, we used multinational companies' data in Indonesia, a developing country like Ghana, the understanding of transfer pricing aggressiveness might correspond to each other. The index of Amidu et al. (2019) is developed based on four factors from previous research, the price of transactions between subsidiaries in the group, export prices for related parties in fair transactions, differences in tax rates between countries, and the absence of direct markets to determine the value of intangible assets. The advantage of the Amidu et al. index (2019) is the ability to capture multinational companies' profit shifting channels by including elements of tax haven countries, utilization of differences in tax rates between countries, and transactions related to intangible assets that are difficult to measure in fair value.

Tax haven countries are the 33 countries determined by the OECD (2006) combined with the Tax Justice Network's Corporate Tax Haven Index 2019. Measurement of transfer pricing aggressiveness is done by analyzing financial report information and annual report using Amidu et al. index (2019) a checklist. For each input in the financial statements that meet the checklist criteria, a value of 1 is given. If it does not meet is assigned a value of 0. The highest score obtained is 5, indicating aggressively conducting transfer pricing manipulation efforts. The criteria met will be divided by the total maximum value of the criteria, five, as the following formula.

$$TPA_{i,t} = \frac{\text{index criteria score met}}{\mathit{maximum\ score\ of\ index\ criteria\ met}}$$

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Thin capitalization in this study is measured based on the maximum allowable debt (MAD) ratio, which is the only measure used to measure thin capitalization compiled by Taylor and Richardson (2012), modified as Falbo and Firmansyah (2018), with the following two steps:

1. Calculate the safe harbor debt amount (SHDA), a required limit to declare fair transaction allowed to reduce income tax, creating certainty for tax administration (OECD, 2020). SHDA is calculated by subtracting average non-interest-bearing liabilities from average total assets, multiplying by 75% (comparing allowed debt-to-equity ratios or 3:1 in Australia). Under PMK 169/ PMK.010/2015, the maximum limit of debt-to-equity ratio allowed to be 4:1 or 80% in Indonesia, so the formula becomes.

   SHDA = (Average total assets – Average non-interest-bearing liabilities) x 80%

2. Calculate the MAD ratio by dividing the total debt (interest-bearing debt) against the SHDA to determine whether the debt with interest on the company's capital structure exceeds the limits of thin capitalization provisions as follows:

$$MAD\ ratio = \frac{Average\ interest{-}bearing\ debt}{Safe\ Harbor\ Debt\ Amount}$$

A high MAD ratio exceeding 1 indicates that the company uses a debt structure exceeding the rule limit. A high MAD ratio is an indication of violations of thin capitalization rules that lead to tax avoidance practices to see the level of utilization of debt structures within the company formulated:

$THINCAP_{i,t} = MAD\ ratio$

This study's political connection is the relationship between top-level corporate management, such as commissioners and directors, politicians, or government officials based on their history in government. Thus, the proxy used in this study uses a calculation formula based on Lin et al. (2017), and the terms are categorized as politically connected based on justification from Faccio (2006), Adhikari et al. (2006) research specifically for personal level factor proxies (cronyism), and Sudibyo and Jianfu (2016). The proxy used by Faccio (2006), Adhikari et al. (2006), and Sudibyo and Jianfu (2016) use similar criteria, but variables are measured with dummy if they meet any of the conditions. In comparison, Lin et al. (2017) use two measures: natural logarithm one plus the number of board members who have political connections and the percentage of board members who have political connections compared to the total of directors and commissioners.

The moderating variable in this study is corporate governance. Corporate governance level is measured by the Financial Services Authority (OJK) 2015. The policies have aligned to the New G20/OECD Corporate Governance Manual. The measurement of corporate governance by building an index refers to Cheung et al. (2008), Dinah and Darsono (2017), Firmansyah and Triastie (2020), as well as Saksessia and Firmansyah (2020), which measure corporate governance based on the index of corporate governance guidelines by the OECD. Indexes based on corporate governance guidelines by the OJK are used because multinational companies in Indonesia listed on the Indonesia Stock Exchange are responsible to the Financial Services Authority (OJK) and the Indonesian people as owners of at least 7.5% of public shares. Thus, multinational companies' good governance should meet the standards and demands of the public and OJK as stakeholders.

The control variables in this study consisted of company size, leverage, and profitability. Firm size measurement refers to Taylor and Richardson (2012). Leverage is made constant because, generally, high debt-to-equity ratio companies are more efficient at reducing the amount of tax paid (Taylor &Richardson, 2012). This study's leverage refers to Dinca and Fitriana (2019), which are high debt levels in the company's capital structure. Profitability is used as a control variable to control the corporate pre-tax income using Return on Assets (ROA). According to Rego (2003), multinational companies with high ROAs are more likely to commit tax evasion because high revenues align with the company's efforts to reduce political costs. The use of ROA control variables refers to the research of Rego (2003), Taylor and Richardson (2012), Falbo and Firmansyah (2018), as well as Amidu et al. (2019).

Based on the variables described in the previous section and the formulation of research

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problems, there are two models in this study with two alternatives to tax avoidance proxies. The first model follows the model employed by Taylor and Richardson (2012) and Falbo and Firmansyah (2018). Still, this study adds political connection as Lin et al. (2017) and adjusts in the context of multinational companies. All the available data are run with panel data regression.

The first regression model is utilized to test H_1, H_2, and H_3 research as follows:

$$DiffETR_{i,t} = \beta_0 + \beta_1 TPA_{i,t} + \beta_2 THINCAP_{i,t} + \beta_3 POLCON_{i,t} + \beta_4 SIZE + \beta_5 LEV + \beta_6 ROA + \varepsilon_{i,t} \quad (2)$$

While the second regression model adds the role of corporate governance as a moderation variable, the influence of three independent variables on dependent variables to test H_4, H_5, and H_6 is as follows:

$$DiffETR_{i,t} = \beta_0 + \beta_1 TPA_{i,t} + \beta_2 THINCAP_{i,t} + \beta_3 POLCON_{i,t} + \beta_4 CORGOV_{i,t} + \beta_5 (TPA_{i,t} * CORGOV_{i,t}) + \beta_{6(} THINCAP_{i,t} * CORGOV_{i,t}) + \beta_7 (POLCON_{i,t} * CORGOV_{i,t}) + \beta_8 SIZE + \beta_9 LEV + \beta_{10} ROA + \varepsilon_{i,} \quad (3)$$

Keterangan:

$DiffETR_{i,t}$	= difference between the corporate income tax rate and the effective tax rate of the company
$TPA_{i,t}$	= *transfer pricing aggressiveness*
$THINCAP_{i,t}$	= *thin capitalization*
$POLCON_{i,t}$	= political connection
$CORGOV_{i,t}$	= corporate governance
SIZE	= firm size
LEV	= *leverage*
ROA	= profitability (*return on assets)*
β_0	= constant
$\beta_{1,} \beta_2$ s.d. β_{10}	= coefficient of regression equation
$\varepsilon_{i,t}$	= *error*

Sensitivity tests are conducted to compare the results with the main equations in the study. Sensitivity tests are conducted using different proxies on dependent variables, i.e., tax avoidance (DTAX), to see the difference in results if non-discretionary elements of book and tax differences are not included. To test the H_1, H_2, and H_3 sensitivity tests, the equation model is:

$$DTAX_{i,t} = \beta_0 + \beta_1 TPA_{i,t} + \beta_2 THINCAP_{i,t} + \beta_3 POLCON_{i,t} + \beta_4 SIZE + \beta_5 LEV + \beta_6 ROA\ \varepsilon_{i,t} \quad (4)$$

To test H_4, H_5, and H_6 which are extensions of equation 3 using moderation variables in sensitivity tests, the equation model is:

$$DTAX_{i,t} = \beta_0 + \beta_1 TPA_{i,t} + \beta_2 THINCAP_{i,t} + \beta_3 POLCON_{i,t} + \beta_4 CORGOV_{i,t} + \beta_5 (TPA_{i,t} * CORGOV_{i,t}) + \beta_6 (THINCAP_{i,t} * CORGOV_{i,t}) + \beta_7 (POLCON_{i,t} * CORGOV_{i,t}) + \beta_8 SIZE + \beta_9 LEV + \beta_{10} ROA + \varepsilon_{i,t} \quad (5)$$

Keterangan:

$DTAX_{i,t}$	= *discretionary book-tax difference*
$TPA_{i,t}$	= *transfer pricing aggressiveness*
$THINCAP_{i,t}$	= *thin capitalization*
$POLCON_{i,t}$	= political connection
$CORGOV_{i,t}$	= corporate governance
SIZE	= firm size
LEV	= *leverage*
ROA	= profitability (*return on assets)*
β_0	= constant
$\beta_{1,} \beta_2$ s.d. β_{10}	= coefficient of regression equation
$\varepsilon_{i,t}$	= *error*

RESULTS AND DISCUSSION

The results of the descriptive statistical analysis of this study are presented in Table 2 as follows.

Table 2 Descriptive Statistics of Research Data

Variable	Mean	Median	Maximum	Minimum	Std. Dev.	Obs (N)
DiffETR	0.0205	-0.0047	1.8270	-1.8026	0.2784	244
TPA	0.4738	0.4000	1.0000	0.2000	0.2607	244
THINCAP	0.3865	0.4127	1.1498	0.0000	0.2430	244
POLCON	0.6186	0.6931	2.0794	0.0000	0.6034	244
CORGOV	0.7297	0.7600	1.0000	0.2000	0.2007	244
SIZE	30.0202	30.1842	33.4945	25.6405	1.4482	244

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Variable	Mean	Median	Maximum	Minimum	Std. Dev.	Obs (N)
LEV	-0.1572	-0.1113	2.6059	-1.9973	0.7860	244
ROA	0.1053	0.0755	0.6119	0.0019	0.1031	244
DTAX	7.6800E-19	-0.0007	0.1920	-0.1027	0.0315	244

Source: Processed

The results of this study consisted of 4 models, namely models 1 and 3, to test the effect of independent variables on tax avoidance using DiffETR proxies, as well as models 2 and 4 used to test the role of corporate governance in moderating the impact of independent variables on dependent variables. The results of the simultaneous significance test (F test), partial test (T-test), and determination coefficient test (R2) are summarized in table 3.

Table 3 Results of Coefficient of Determination, Model Determination Test, and Partial Significance Test

	Model 1								**Model 2**							
	Main Model (DiffETR)				Sensitivity (DTAX)				Main Model (DiffETR)				Sensitivity (DTAX)			
	Coef	T-stat	Prob		Coef	T-stat	Prob		Coef	T-stat	Prob		Coef	T-stat	Prob	
Cons	-0.1017	-1.175	0.121		-0.0596	-2.623	0.005	***	-0.0496	-0.445	0.329		-0.0449	-1.754	0.040	**
TPA	-0.1223	-10.969	0.000	***	-0.0126	-3.323	0.001	***	-0.2836	-3.822	0.000	***	-0.0565	-3.680	0.000	***
THINCAP	0.0561	1.768	0.039	**	0.0159	1.882	0.031	**	0.3314	4.475	0.000	***	0.0397	2.795	0.003	***
POLCON	-0.0283	-4.413	0.000	***	-0.0012	-0.801	0.212		-0.0588	-2.144	0.017	**	0.0045	0.810	0.210	
CORGOV									-0.0954	-1.510	0.066	*	-0.0032	-0.242	0.404	
CORGOV_ TPA									0.2695	3.078	0.001	***	0.0576	2.898	0.002	***
CORGOV_ THINCAP									-0.4217	-4.422	0.000	***	-0.0334	-1.926	0.028	**
CORGOV_ POLCON									0.0564	1.784	0.038	**	-0.0075	-1.024	0.154	
SIZE	0.0047	1.554	0.061	*	0.0019	2.572	0.005	***	0.0051	1.315	0.095	*	0.0015	1.922	0.028	**
LEV	-0.0084	-0.864	0.194		-0.0046	-1.854	0.033	**	-0.0044	-0.431	0.334		-0.0045	-1.812	0.036	**
ROA	0.1426	4.044	0.000	***	0.0196	2.053	0.021	**	0.0698	1.838	0.034	**	0.0055	0.556	0.289	
R^2		0.3816				0.1019				0.1700				0.1457		
Adj-R^2		0.3659				0.0792				0.1343				0.1090		
F-stat		24.3759				4.4852				4.7724				3.9739		
Prob (F)		0.0000				0.0002				0.0000				0.0000		

Description:

***) affects the significant rate of 1%

**) affects the significant rate of 5%

*) affects the significant rate of 10%

Source: Processed

The Effect of Transfer Pricing Aggressiveness on Tax Avoidance

Based on the result of hypothesis testing, transfer pricing aggressiveness negatively affects tax avoidance. In this study, the negative influence of transfer pricing aggressiveness on tax avoidance showed a strong trend (robust) using DiffETR and DTAX tax avoidance measures. This test confirms the result of previous research by Irawan et al. (2020). However, this study's result is different from previous studies conducted by Taylor and Richardson (2012) and Amidu et al. (2019), which stated that transfer pricing aggressiveness positively affects tax avoidance. The study result is also different from Falbo and Firmansyah (2019). This study may cause the different effects employed by the multinational company's data listed on the Indonesia Stock Exchange, tax avoidance proxies using ETR Differential, and the research period from 2016 to 2019.

The result of this study successfully confirms the hypothesis of political costs. Managers at multinational companies try to minimize the cost of accounting for transfer pricing activities. Tightening transfer pricing rules in Indonesia leads to multinational companies' efforts to reduce the higher costs of cross-border transfer pricing activities. Those costs come from documentation, possible disputes, and sanctions if the company does not determine prices following fair pricing

principles. It also confirms the institution-based view that government institutional rules limit corporate strategy options, as tightening transfer pricing rules alter multinational corporate tax avoidance strategies. Multinational companies that seek to reduce their effective tax rates tend to avoid simultaneously doing transfer pricing aggressively. The concentration of countries on transfer pricing is suspected of making multinational companies that disclose transfer pricing transactions aggressively as a prime target due to the stereotype of transfer pricing carried out by multinational companies with a tax motive through shifting profits to subsidiaries. Multinational companies allegedly do not want to look at excesses from the Indonesian tax authority's point of view by conducting aggressive transfer pricing activities and performing tax avoidance.

The Effect of Thin Capitalization on Tax Avoidance

Based on the result of hypothesis testing, thin capitalization has a positive effect on tax avoidance. With an increase in interest-bearing debt in the company's financing structure, companies tend to engage in tax avoidance activities. In this study, the positive influence of thin capitalization on tax avoidance showed a strong trend (robust) using both DiffETR and DTAX tax avoidance measures. The result of this test confirms the result of Taylor and Richardson (2012) using public company data in Australia, Falbo, and Firmansyah (2018), as well as Pratiwi and Ratnasari (2019), which tested at manufacturing companies in Indonesia. However, the result of this study is not in line with the testing of Ismi and Linda (2018), Salwah and Herianti (2019), Andawiyah et al. (2019), and Bandiyono and Murwaningsari (2019). Differences in research results can occur due to differences in the companies' samples. This research concentrates on multinational companies in Indonesia. Besides, differences in proxies and observation periods might cause differences in this study's results with previous studies.

Based on descriptive statistical analysis, thin capitalization in multinational companies tends to be lower, with an average of 0.3864 of the maximum interest-bearing debt allowed. The average thin capitalization still does not pass the number 1, which means that most multinational companies in Indonesia do not exceed the maximum limit of interest-bearing debt allowed in thin capitalization rules. This result indicates that Indonesia's multinational companies tend to comply with thin capitalization rules and do not use thin capitalization as a critical strategy in their tax avoidance. In determining their capital structure, managers at multinational companies face a trade-off when increasing interest-bearing debt, between debt interest incentives to reduce taxes or the addition of debt costs that could lead to conflicts of interest between stakeholders (Büttner et al., 2008). If the company is too excessive to use interest-bearing debt to reduce taxes, it engages with riskier projects. Stakeholders such as creditors will feel threatened because the ability to pay the company's debt is in doubt, so the option of using interest-bearing debt in the capital structure is exercised with caution (Nguyen, 2018). Although multinational companies tend to have low thin capitalization, the test result proves that the composition of interest-bearing debt close to the maximum amount of debt allowed by thin capitalization rules indicates tax avoidance activities in multinational corporations.

The anti-tax avoidance rules with thin capitalization in Indonesia are not entirely the best version recommended by the OECD. The OECD recommends an interest-capping approach compared to debt-to-equity ratios (Sejati, n.d.). Indonesia still uses the debt-to-equity ratio to determine the allowed debt limit with the provisions of a maximum Debt-to-Equity (DER) ratio of 4:1 as stipulated in Regulation of the Minister of Finance number 169/PMK.010/2015. The use of debt-to-equity ratio limits allows companies to meet the maximum debt limit level. However, it cannot limit the composition of interest directly, so companies can still choose high-interest debt to reduce taxes. Based on the descriptive statistical analysis results, leverage in multinational companies tends to be high to an average of 85.9%, in contrast to thin capitalization that tends to be on the lower side. The analysis result indicates that the limitation of capital structure with DER in Indonesia does not limit interest from debt, but only debt in the capital structure. Besides, Indonesia's composition of accounting standards has not established rules on disclosure obligations that separate debt from interest and debt without interest. The disclosure of debt details on financial statements is still minimal and not uniform when applying interest restriction rules. However, although it is not the most recommended method, DER restrictions are

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thought to lower thin capitalization in multinational companies in Indonesia.

The Effect of Political Connections on Tax Avoidance

Based on the result of hypothesis testing, political connections negatively affect tax avoidance. Robust trends do not support the negative influence of political connections on tax avoidance. There are differences in test results between models and DiffETR and DTAX tax avoidance measures. However, the hypothesis test result still utilizes the primary model (DiffETR) as a reference in the discussion. Many directors or commissioners with political connections can decrease companies' tendency to conduct tax avoidance. This study's result reinforced Butje and Tjondro (2014), which tests non-financial companies in Indonesia. However, the result of this study showed differences with the research of Adhikari et al. (2006), Sudibyo and Jianfu (2016), Ferdiawan and Firmansyah (2017), and Purwanti and Sugiyarti (2017). The different test results result from this study using multinational companies' data with more complex structures and strategies. Besides, the proxy used in previous studies to measure political connections uses dummy variables that only categorize political connections. In contrast, this study uses the number of directors and commissioners with political connections to see the company's level and strength of political connections.

Based on the descriptive statistical analysis result, multinational companies' political connections tend to be low. Only one member of the board of directors or commissioners has political connections on average. The analysis result suggests that multinational companies in Indonesia tend not to place many local government representatives on directors or commissioners. Many local government representatives in directors or commissioners limit management's wiggle room to make strategic choices, so multinational companies cannot completely control economic decisions. Minimizing profits with tax avoidance motives is a financial decision that may be intervened because it is contrary to local governments' interests to collect state revenues. This condition follows the institution-based view in strategic management that there is a dynamic relationship between government institutions and organizations; interaction impacts corporate strategy choice (Peng et al., 2009). In an institution-based view, strategy choices are not solely driven by industry conditions and corporate capabilities but also reflect the institutional framework's formal and informal limitations facing corporate management. Tax planning is a managerial decision-making activity in a business environment (Lee & Yoon, 2020). Therefore, tax avoidance is one of the company's strategic options limited by institutional rules.

Moderating Effect of Corporate Governance on the Influence of Transfer Pricing Aggressiveness on Tax Avoidance

Based on hypothesis testing, corporate governance weakens the negative influence of transfer pricing aggressiveness on tax avoidance. In this study, corporate governance's role in weakening the negative effect of transfer pricing aggressiveness on tax avoidance shows a strong trend (robust) because there is consistency in test results using tax avoidance DiffETR and DTAX. The interaction of corporate governance with aggressive transfer pricing activities increases companies' tendency to conduct tax avoidance. This result contrasts with the view that companies with good corporate governance are less likely to commit tax avoidance (Suardana &Maharani, 2014; Armstrong et al., 2015). On the contrary, in Indonesia, multinational companies with good corporate governance tend to apply tax avoidance (Widiiswa & Baskoro, 2020).

This study is conducted on multinational companies with the provision of having affiliates and subsidiaries in more than one country. The composition of multinational companies observed in this study consisted of 69% of domestic MNE and 31% of foreign multinational companies, indicating that Indonesian multinational companies are dominant. Indonesia is a home country for domestic multinational companies, while Indonesia is a host country for foreign companies. Therefore, companies with overseas holding companies and domestic companies are parents for subsidiaries abroad. The unique structure that multinational companies have has consequences for being subject to the country of origin's rules and subject to institutions, laws, and regulators in the country of origin and the country they operate (Madhani, 2015). As such, both domestic and foreign multinational companies in Indonesia shall be subject to the corporate governance guidelines set forth by the Financial Services Authority (OJK).

The role of corporate governance is to balance economic interests with social interests (Clarke, 2004). The company's economic interest is to maximize profits and avoid political costs, while the company's social interest is to keep transactions ethical and the company's reputation maintained. Multinational companies under public attention for tax avoidance admit that the company's transfer pricing transactions follow the principle of a fair price. Tax savings are derived from legal activities caused by the structure of multinational companies that have subsidiaries in other countries (Rossing et al., 2019). Tax-saving activities are not legally unlawful but cannot stop criticism of corporate morale by the public. Multinational companies that commit tax evasion are considered not to pay proper tax liability (fair share), so the behavior invites criticism for being considered unethical (Windsor, 2017). Criticism of the company may arise because transfer pricing activities benefit the company as a whole but jeopardize the interests of minority shareholders and other stakeholders who want investment security and a good reputation (Paredes & Crespillo, 2017).

Corporate governance does not weaken the effect of transfer pricing aggressiveness on tax avoidance. Instead, it encourages tax avoidance by transfer pricing aggressiveness. Corporate governance might put economic interests above its own by making tax savings through transfer pricing and utilizing good governance to reduce such activities' focus. Good corporate governance is allegedly treated as a strategy to address the possibility of pressure to act ethically on taxation practices by all stakeholders (Rossing et al., 2019).

The test result suggests that the most widely fulfilled governance items are the points of the public company's relationship with shareholders in guaranteeing shareholder rights with an average of 78% and information disclosure with 86%, which symbolizes that the company emphasizes transparency and communication stakeholders. In particular, a communication policy to shareholders obtained a compliant score of up to 93%. The focus of corporate governance on transparency, a guarantee of shareholder rights, and communication is managers' effort at multinational companies to show that all-important information has been disclosed to stakeholders. Companies that communicate and promote good corporate governance will attract stakeholders' trust and generate sustainable business activities (Islam, 2019). Multinational companies might promote good corporate governance to create bias in stakeholder assessment of companies based solely on existing information. Information that is less publicly available, such as transfer pricing information, tends to be overlooked in assessing the company's performance. Excessive disclosure of information to highlight transparency indicates violations to create confusion and uncertainty for information readers so that information providers can cover up dishonesty (Oats & Tuck, 2019).

Moderating Effect of Corporate Governance on the Effect of Thin Capitalization on Tax Avoidance

Based on hypothesis testing, corporate governance weakens the positive influence of thin capitalization on tax avoidance. In this study, corporate governance's role in weakening the positive effect of thin capitalization on tax avoidance shows a strong trend (robust) because there is a consistency of test results utilizing DiffETR and DTAX tax avoidance measures. Good corporate governance can suppress the utilization of large debt composition in the corporate capital structure to avoid taxes. In public companies in Australia, companies with good corporate governance tend not to be thinly capitalized or prioritize debt in their capital structure (Taylor & Richardson, 2013). Manufacturing companies in Indonesia also tend not to implement thin capitalization policies if they have good corporate governance (Pratama, 2017)

Based on the descriptive statistical analysis result, multinational companies' thin capitalization tends to be lower, with an average of 0.3864. In contrast, corporate governance tends to be high, with an average of 0.7296. The data illustrates that most multinational companies could keep interest-bearing debt in their capital structure, not violate thin capitalization rules to avoid taxes. The existence of good corporate governance encourages companies to reduce the potential of tax avoidance with thin capitalization practices. The research data also shows multinational companies with large company sizes with an average of 30.0202 and high profitability with an average of 0.1053 in Indonesia have a good debt management strategy because it tends to have low thin capitalization. Implementing good corporate governance of special arrangements, such as determining the composition of debt in the capital structure, aims to safeguard stakeholders' interests (Verhenzen et al., 2016).

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Research data shows that multinational corporate governance guarantees shareholder rights with a 78% compliance score and information disclosure with an 86% compliance score. The data interpretation is that managers at multinational companies encourage transparency to shareholders and other stakeholders over the company's business activities. Transparency is not limited to governance issues but also the openness of capital structure information supported by institutional rules in accounting standards and OJK rules. Information disclosure is intended to meet stakeholders' interests. Stakeholders assume that companies that disclose relevant information transparently are less likely to commit tax evasion (Mangoting et al., 2019). Thus, stakeholders' economic interests and the company's reputation are guaranteed by the communication and transparency of quality information related to the capital structure as evidence that managers of multinational companies conduct business operations ethically.

Moderating Effect of Corporate Governance on the Effect of Political Connection on Tax Avoidance

Based on the result of hypothesis testing, it is known that corporate governance weakens the negative influence of political connections to tax avoidance. In this study, corporate governance's role in weakening political connections' negative effect on tax avoidance is not supported by solid trends (robust). However, the discussion of this hypothesis's test result continues to use the main model (DiffETR) as a reference in the discussion. There are differences in test results between models and DiffETR and DTAX tax avoidance measures. The interaction of corporate governance with the number of directors or commissioners who are politically connected increases companies' tendency to conduct tax avoidance. Widiiswa and Baskoro (2020) stated that multinational companies with good corporate governance in Indonesia do not effectively suppress tax avoidance activities. This condition is different from the views of Dahan et al. (2013) and Ozer and Alakent (2013) because corporate governance failed in carrying out the role of first defense to reduce political activities that could potentially threaten the interests of stakeholders.

Based on descriptive statistical test results, corporate governance is described as good enough with an average of 0.7296. This pattern result from 69% of domestic multinational companies and 31% of foreign multinational companies. Although research data shows that global corporate governance tends to be good, corporate governance encourages tax avoidance by leveraging political connections. When reviewed based on corporate governance guidelines by the OJK, disclosure of the company's political connections is not explicitly regulated in the guidelines, so political connections are not a significant issue at the level of corporate governance in Indonesia. Multinational companies might meet the Financial Services Authority's governance requirements as a strategy to address government intervention in strategic choices, as corporate governance generally places independent commissioners to address agent conflict issues (Armstrong et al., 2015). Besides, fulfilling institutional obligations in the country of origin by domestic multinational companies in good corporate governance hints at recognized business practices in all subsidiaries (Hobdari et al., 2016). It attempts to adopt the country's rules to operate for foreign multinational companies (Alpay et al., 2005).

Based on the result of descriptive statistical analysis, the political connections of multinational companies in this study tend to be low, with at least one government representative for a total of 5 to 23 members of directors and commissioners. The board of directors or commissioners who bring the Indonesian government's interests into a minority party at the level of governance to oppose the majority party's decision contrary to the government's claims becomes difficult (Ethicalboardroom.com). In minority conditions, the supervisory function of directors or commissioners with political connections becomes like independent commissioners in domestic companies in Indonesia, only limited to formalities and less effective because of the firm control of the company's founders' majority shareholders (Saputro, 2016). Directors with political connections in minority conditions can turn around forming coalitions with the majority parties in the decision-making process so that unethical strategic policies to benefit the company can be agreed upon. Such conditions may occur because governance rules in developing countries have weaknesses. In developing countries, especially Indonesia, governance rules do not consider socio-

political conditions, coalitions of various parties, or close relationships with government institutions (Verhenzen, 2019).

CONCLUSION

Transfer pricing aggressiveness in multinational companies is carried out if there is a belief that the company has met the provisions of the principle of reasonable pricing regulated by the taxation authority. The increasing worldwide attention and the rule of law of the Indonesian government regarding transfer pricing shows that transfer pricing has a negative stigma associated with tax motives. Companies that commit tax evasion will suppress their transfer pricing aggressiveness to not invite checks by tax authorities that allow additional political costs. In contrast, thin capitalization is a multinational company's strategy for tax avoidance activities. The composition of interest-bearing debt in a capital structure close to the debt threshold allowed in thin capitalization rules creates an attractive incentive that can be deducted from taxable income, thus lowering corporate taxes.

Multinational companies use political connections to the board of directors and commissioners to share strategies with the governments in which they operate to prove that multinational companies are not a threat to the domestic market. These political connections become supervisors and barriers to the company's strategic policies so that efforts to conduct tax avoidance contrary to local governments' interests are limited. The power of political connections to the large board of directors and commissioners suggests that the company's move to take tax avoidance decisions is increasingly limited by the number of government representatives in which it operates. Hence, companies with significant political connections are less likely to avoid taxes.

In this study, good governance in multinational companies is a strategy to distract stakeholders from other possible issues and focus on the company's reputation. Tax avoidance activities utilizing transfer pricing aggressiveness are less noticed. Good corporate governance creates bias over assessing the company's operational activities solely on available information. Corporate governance is used to show stakeholders that the company cares about stakeholders' interests to introduce a good corporate image to gain legitimacy from the government. Furthermore, multinational companies have experience and ability in implementing governance on funding decisions. Debt management in the capital structure is crucial to ensure stakeholders' interests and business continuity. Disclosure of capital structure information on financial statements is a supervisory mechanism by multinational corporate governance to provide transparent information to meet the demands of ethical business activities and stakeholders' good reputations. Thus, special tax avoidance activities that utilize interest-bearing debt in the capital structure can be suppressed by corporate governance. Governance does not suppress tax avoidance by utilizing political connections as it relates to transfer pricing.

On the contrary, corporate governance is only in reaction to the government's pressures in which the company operates to gain legitimacy and social fitness and prove alignment of objectives with the government in which it works. Compliance with governance rules is used to distract stakeholders on reputational issues and information transparency. With this strategy, stakeholders will focus on less disclosed activities, such as utilizing political connections to obtain regulatory-related information or ease tax avoidance activities.

This study has some limitations. First, the study results cannot be generalized for different periods, another scope of multinational companies not listed on the Indonesia Stock Exchange, or multinational companies in other countries. Second, the political connections observed in this study are limited to indirect personal relationships and are measured based on the history of the positions of members of directors or commissioners in government based on annual reports, excluding active lobbying political activity. Third, corporate governance variables are measured using index scores using content analysis methods that utilize the search feature to search for the necessary keywords. However, some financial statements are scanned and protected, so the keywords in question are difficult to find. Besides, companies in financial statements often make claims that meet the requirements but do not disclose enough about how they fulfill these conditions, making it difficult to prove their compliance in real terms. There may be an element of subjectivity.

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Further research can use research samples of multinational companies listed or not listed on the Indonesia Stock Exchange to obtain more representative research results. Besides, research can also focus on multinational companies with Multinational foreign enterprises and exclude domestic multinational companies to further highlight foreign companies' behavior patterns in tax avoidance. A study can also be conducted on multinational companies in countries other than Indonesia to investigate multinational companies' behavior patterns that tend to be complex in different countries. Further research could also expand the interval of research periods to observe the effect of transfer pricing aggressiveness, thin capitalization, and political connections to tax avoidance on multinational corporations in the long run. Further research can also use the second edition of the corporate governance guidelines index issued by the Indonesia Financial Services Authority in collaboration with the International Finance Corporation (IFC) in 2018 as a proxy.

From the results of this study, the Indonesia Tax Authority should focus on inspection resources on multinational companies with large interest debt structures on the list of priorities in tax inspection policy. This study's results can also be an input for formulating and improving anti-tax avoidance rules. One of those improvements is changing the thin capitalization rules that still use a pure debt-to-equity ratio. The OECD's alternative recommendation is to measure the intensity of interest on debt to EBITDA to limit debt interest utilization for tax purposes.

Besides, in conjunction with the regulations related to massive transfer pricing, the Directorate General of Taxation needs to ensure that account representatives and tax inspectors have sufficient qualifications and competencies to analyze transfer pricing transactions and reasonable pricing properly. Improved qualifications and analytical capabilities related to transfer pricing can make it easier to detect tax avoidance activities detrimental to the state and reduce the potential for defeating appeal disputes with taxpayers. One of the standards that need to be drawn up is disclosing the interest payable and the amount of interest from the interest payable on the financial statements. Companies need to separate interest-bearing and non-interest-bearing debt on disclosure in financial statements. The Directorate General of Taxation may also work with the Indonesian Institute of Accountants to homogenize disclosures related to thin capitalization through accounting standards to identify tax avoidance activities by utilizing debt interest reduction. With such cooperation, if the tax authority intends to change the thin capitalization rules from debt-to-equity restrictions to the OECD-recommended debt interest restrictions, information on its debt and interest is readily available on financial statements and presented uniformly to all companies.

From the findings of this study, the Financial Services Authority can improve its corporate governance rules not limited to formal disclosure of policy documentation. Still, it can work with the government to mandate optimal corporate governance implementation in official rules, not limited to compliance and explanation. The Financial Services Authority can expand corporate governance by implementing risk management for transactions with limited public information, such as transfer pricing transactions or descriptions of corporate political activities. The Indonesia Financial Services Authority can also cooperate with international institutions, such as the ASEAN CG Scorecard, or domestic institutions, such as The Indonesian Institute of Corporate Governance (IICG). These institutions conduct ratings and assessments of corporate governance based on its corporate governance's implementation within a certain period. The results of rating and evaluation of corporate governance implementation can be used as material to develop corporate governance guidelines following the implementation of corporate governance in Indonesia.

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