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The Effects of Leverage, Executive Characters, and Institutional Ownership to Tax Avoidance With Political Connection as Moderation

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ABSTRACT

This study aims to examine the effects of leverage, executive character, and institutional ownership on tax avoidance with political connection as moderating variable. The population was 48 mining companies listed in the Indonesia Stock Exchange during the period of 2014-2017. The sampling method was purposive sampling method and selected 52 units of analysis from 14 companies. Analysis of research data used descriptive statistics and inferential statistics. The hypothesis testing used a moderating regression analysis with an absolute difference test. The results show that leverage has a significant negative effect while executive character and institutional ownership have no effect on tax avoidance. Then, political connection significantly moderates the effect of leverage and executive character but it does not significantly moderate the effect of institutional ownership on tax avoidance. The conclusion of this research is only leverage which has effect on tax avoidance and political connection only moderates the effect of leverage and executive character on tax avoidance.

INTRODUCTION

The definition of tax according to the Law of the Republic of Indonesia Number 16 Year 2009 article 1 paragraph 1 is a mandatory contribution to the state owed by individuals or entities that are forced based on the law, with no direct compensation and used for the needs of the state for the greatest prosperity of the people. Countries (tax authorities) and companies (taxpayers) have different interests. One of the sources of state revenue to fund its expenses is from taxes but tax for the company is an expense. Expenses can reduce net income so companies try to minimize taxes. Therefore, companies tend to reduce tax burden both illegally and legally (Suandy, 2017).

Efforts by legal means are called tax avoidance while illegal efforts are called tax evasion (Suandy, 2017). Furthermore, Suandy (2017) explained that tax avoidance is a tax engineering that still remains in the taxation regulations (lawful). One of the efforts of tax avoidance is reflected in the realization of tax revenues each year that never reach the target. In addition, the achievement of tax revenue realization from 2013 to 2016 also decreased. Swingly & Sukartha (2015) said that the realization that was less than this target could be interpreted that the Director General of Taxes still needed to optimize their tax revenue.

In 2016, the Director General of Taxes revealed the motives of 2000 multinational companies that were identified as not compliant with taxes. On the average, the companies did not deposit income tax articles 25 and 29 because they were experiencing continuous losses even though the company still exists (Sari, 2016). Other indications that show the existence of tax avoidance practices in Indonesia can also be seen from the existence of the tax amnesty program. Based on the 2018 state budget, the results of the tax amnesty program include a repatriation of assets amounted to Rp 146 trillion and a ransom of Rp 116 trillion (Ministry of Finance, 2018).

Richardson et al. (2016) have examined the effect of leverage on tax avoidance. The findings show that leverage has a positive effect on tax avoidance. Their results are supported by research conducted by Lestari & Putri (2017). On the other hand, research from Turyatini (2017); Swingly & Sukartha (2015) and Wang et al. (2014) found that leverage has a negative effect on tax avoidance.

Research on the effect of executive character on tax avoidance was conducted by Swingly & Sukartha

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(2015). The results of this study indicate that executive character has a positive effect on tax avoidance. The research is in line with research from Dyreng et al. (2010). However, research conducted by Tandean & Winnie (2016) and Praptidewi & Sukartha (2016) show the opposite result, which is a negative effect on tax avoidance.

Research conducted by Jamei (2017) and Tandean & Winnie (2016) has resulted in findings that institutional ownership has no significant effect on tax avoidance. Their findings were caused by the lack of adequate supervision to the performance of institutional investors which are mostly companies and government institutions. Meanwhile, research conducted by Khurana & Moser (2013), Putri & Putra (2017) and Mappadang et al. (2018) show the negative effect.

This study aims to examine the effects of leverage, executive character, and institutional ownership on tax avoidance with political connections as a moderator in mining companies in the 2014-2017 period. The novelty of this research is the presence of political connections as the moderating variable. Adhikari, et al. (2006) defined political connections as to whether there is a direct ownership from the government or not in a company. Political connection is chosen as the moderation variable because according to Tehupuring & Rossa (2016) the business world is very closely related to politics. When a company is politically connected, the company will be monitored directly by the government in each manager's behavior and business decisions made.

The implication of agency theory related to tax avoidance is a conflict of interest between shareholders and managers and a conflict of interest between tax collectors (tax authorities) and taxpayers (companies). Managers will make every effort to increase the compensation they get while shareholders will try to increase their return. On the other hand, tax collectors (tax authorities) want to increase the source of state revenue in the form of tax while taxpayers (companies) want to reduce tax burden by maximizing profits.

The trade off theory states that the use of debt is indeed a tax deduction because debt will incur interest costs. However, if the debt is too high, the level of cost of financial distress will also increase (Brigham & Houston, 2013). The higher the level of debt, the higher the interest costs incurred by the company which will cause a small opportunity to be able to repay its debts (Wulansari & Dewi, 2017). Companies will report earnings well in order to remain considered healthy by creditors. Therefore, companies may use debt to reduce the tax burden, but only up to a certain point.

One of the ways to avoid taxes is leverage because there is an element of interest expense in it. According to the Law Number 36 Year 2008, interest derived from debt can reduce profits due to tax burden. Agency theory in the relationship of leverage with tax avoidance is the existence of interests between principals and agents where the principals want optimal company performance as reflected in earnings while the agents want higher compensation. One of the ways to achieve optimal earning is to use debt to fund the company.

The trade off theory in this case is that a company may increase its debt level if the benefits are getting higher and remain balanced with the cost of financial difficulties that the company will incur. As long as there is a balance between the use of debt and the cost of financial difficulties, leverage can be used to avoid taxes because there is an interest expense. When the company's interest expense increases, the earning before tax of the company will decrease. This resulted in a lower tax burden. This hypothesis is in line with the results of the studies conducted by Richardson et al. (2016), Lestari & Putri (2017) and Putri & Putra (2017) which indicate that leverage has a positive effect on tax avoidance.

H_1: Leverage has a positive significant effect to tax avoidance.

Company executives greatly contribute to the running of the company because they have the highest position in decision-making. Executives have two characters namely risk taker or risk averse. This is reflected in company risk. The greater the risk of the company, the more executives are risk takers (Paligorova, 2010).

In agency theory, principals will try to maximize profits while agents will try to increase compensation. Principals will assign agents to realize their goals. Then, company executives (agents) as the highest-ranking leaders will be more willing to decide risky things, one of which is avoiding taxes to reduce tax burden. The more executives are risk takers, the braver they are to realize their goals despite the risks. Profit after tax can increase when the agents manage to reduce the tax burden. This will make the compensation received by the agents increase. This hypothesis is supported by research conducted by Surachman (2017), Swingly & Sukartha (2015) and Dyreng et al. (2010) which say that executive character has a positive effect on tax avoidance.

H_2: Executive character has a significant positive effect on tax avoidance.

Investors always want maximum profit so that they receive large dividends. However, it is different from institutional investors. They will continue to supervise managers in generating profits because they prefer the company to remain abiding by the rules (Wulansari, 2015). Institutional ownership in agency theory plays an important role regarding agency problems (Jensen & Meckling, 1976). One of the efforts to minimize this problem is the presence of an external party or institution.

Institutional ownership is company external which is able to influence manager's actions because the institution has the role to oversee the manager's opportunistic actions including taxation. The higher level of institutional share ownership will encourage managers to be more compliant with taxation rules. The role of the institution encourages managers to present the correct tax burden. This hypothesis is supported by studies conducted by Khurana & Moser (2013), Putri & Putra (2017), and Mappadang et al. (2018) which found that institutional ownership has a negative effect on tax avoidance.

H_3: Institutional ownership has a significant nega-

tive effect on tax avoidance.

The relationship of leverage with tax avoidance in agency theory is the different interests between principals and agents where they both want to prosper themselves. One of the strategies is to use a fixed burden in the form of interest arising from debt to minimize tax burden. Some companies have political connections signed by direct ownership from the government (Adhikari et al., 2006). Companies that are more controlled by the government is that having political connections.

One of the policies monitored by the government is funding policy through debt. The government as a principal will ensure that the debt owned by the company does not exceed the provisions, even though the company with political connections will get benefits such as the ease of getting a loan. The government has issued a policy regarding the limitation of capital structure comparison owned by companies, namely PMK Number 169/PMK.010/2015 Regarding Determination of the Amount of Comparison between Debt and Company Capital for the Need for Income Tax Calculation. The amount of the ratio limit of the corporate capital structure is 4: 1. Therefore, political connection is able to encourage the level of corporate leverage to remain in accordance with applicable regulations.

H_4: Political connection significantly moderates the effect of leverage on tax avoidance.

Company executives play an important role to the running of the company in terms of decisions to practice tax avoidance. Based on agency theory, principals and agents will try to maximize their personal benefits. Principals will try to increase earnings while managers will try to increase compensation. Then, to increase compensation, executives as leaders will dare to decide on something risky such as avoiding taxes to reduce the tax burden.

The business world is very closely related to politics (Tehupuring & Rossa, 2016). When a company is politically connected, it will be directly monitored by the government in every behavior and decision made. Therefore, executives will tend not to take high-risk actions, one of which is the tax burden paid by the company. Executives will be more careful in deciding something especially regarding taxation and will tend to obey the applicable taxation rules. This has an impact on the low practice of tax avoidance within the company.

H_5: Political connection significantly moderates the effect of executive character on tax avoidance.

Every investor definitely would expect a high return but different from institutional investors. They will continue to supervise the managers because they prefer the company to obey the rules (Wulansari, 2015). Institutional ownership plays a role in minimizing agency conflicts between principals and agents (Jensen & Meckling 1976). The higher the institutional ownership, the higher the supervision to the manager's performance, one of which is the company's tax burden. Thus, high institutional ownership will result in high corporate tax burden (Putri & Putra, 2017).

The indications of political connection according to Adhikari et al. (2006) marked by the existence of direct ownership from the government. When a company is connected politically, it will be directly monitored by the government. The existence of supervision from institutional and government investors will encourage managers to avoid their opportunistic behavior so that managers will remain compliant with applicable taxation rules. Thus, companies tend to have low tax avoidance.

H_6: Political connection significantly moderates the effect of institutional ownership on tax avoidance.

RESEARCH METHOD

The population in this study were mining companies listed on the Indonesia Stock Exchange (IDX) for the 2014-2017 periods with a total of 48 companies. The sample selection was carried out by applying purposive sampling technique, so that 14 companies were obtained. Outlier data detection was done with a limit value of 2.5. Unit of analysis data is declared outlier if the variable z-score was more than 2.5 and less than -2.5. Sample selection criteria can be seen in Table 1.

The dependent variable in this study is tax avoidance. The independent variables are leverage, executive character, and institutional ownership and political connections as moderation variable. The variable of tax avoidance in this study will be multiplied by -1 to make it easier to interpret the results of the study. This is due to the lower the ETR means the higher the practice

Table 1. Sample Selection Criteria

Criteria of Sample	Beyond Criteria	Meeting criteria
Mining companies listed on the IDX in 2017		48
Mining companies listed on the IDX successively in 2014-2017	(5)	43
Companies that disclosed annual reports for 2014-2017	(6)	37
Companies that experienced profits during 2014-2017	(21)	16
Companies that did not receive tax benefits during 2014-2017	(2)	14
Number of Samples		14
Number of research analysis units (14 x 4)		56
Outlier data during the observation year		4
Final amount of research analysis units year 2014-2017		52

Source: secondary data processed, 2019

Table 2. The Operational Definitions of Variables

No	Variables	Operational Definitions	Measurement
1	Tax Avoidance (TA)	Tax engineering that still remains in the tax regulations (lawful) (Suandy, 2017).	(Hanlon & Heitzman, 2010)
2	Leverage (LEV)	Financial ratio that describes the relationship between a company's debt to capital and assets (Putri & Putra, 2017)	(Putri & Putra, 2017)
3	Executive Character (RISK)	The character of a company leader who has a role as a policy maker characterized as a risk taker or risk averse (Low, 2006)	(Paligorova, 2010)
4	Institutional Ownership (KI)	The proportion of share ownership held by an institution such as insurance, banks, or other institutions (Tandean & Winnie, 2016)	(Khurana & Moser, 2009)
5	Political Connection (KP)	Circumstances where in the company there is direct ownership from the government (Adhikari et al., 2006).	- Score 1 if there is a minimum of 25% government ownership of shares - Score 0 if there is no government share ownership of at least 25%(Lestari & Putri, 2017).

Source: processed from various sources, 2019

of tax avoidance, and vice versa (Lanis & Richardson, 2012). The operational definitions of each variable are explained in Table 2.

The data collection method used the documentation method. Data obtained from the IDX website and the site of each company in the form of annual reports in the observation period, 2014-2017. Hypothesis testing used descriptive statistical analysis techniques and inferential statistical analysis techniques. Before testing hypotheses, the research data was examined on classical assumptions first. The hypothesis is tested using a moderation regression analysis, namely the test of absolute difference value with a significance level of 5%. In testing the absolute difference value, the data values on the independent and moderation variables are changed to the z-score.

RESULTS AND DISCUSSIONS

Descriptive statistics of this study use the maximum, minimum, mean, and standard deviation values. TA has a maximum value of -0.070, a minimum value of -2.300, a mean value of -0.411, and a standard deviation value of 0.315. LEV has a maximum value of 2.226, a minimum value of 0.169, a mean value of 0.803, and a standard deviation of 0.490. Furthermore, RISK has a maximum value of 0.089, a minimum value of 0.002, a mean value of 0.025, and a standard deviation 0.013. The KI variable has a maximum value of 0.978, a minimum value of 0.260, a mean value of 0.733, and a standard deviation of 0.218. Then, politically connected mining companies as many as 8. Mining companies that are not connected by politics are 44 companies.

Furthermore, the results of descriptive statistical analysis are divided into 5 interval classes, namely very low, low, medium, high, and very high. Based on this division, the highest percentage of TA of 84.62% is in the high category. The highest percentage of LEV of 48.08% is in the low category. The highest percentage of RISK is in the low category at 46.15%. Then, the highest presentation of KI at 46.15% is in the very high category while the rest is distributed in various categories.

The classical assumption test aims to examine the feasibility of the regression equation model. The normality test uses one-sample Kolmogorov-Smirnov shows the value of Asymp.Sig. equal to 0.20 which means more than the 0.05 significance level so that the data are normally distributed. The multicollinearity test shows that the tolerance value> 0.10 and VIF value <10 so that it can be concluded if the independent variable does not have multicollinearity problems. The heteroscedasticity test which uses white test concludes that there is no heteroscedasticity problem due to the value of c^2 count (45.084) smaller than c^2 table (68.67). Then, the result of autocorrelation test with the Durbin Watson test shows that there is no autocorrelation because the dw value is 1.924. The dw value is between the dU value (1.6769) and 4-dU (2.3231).

The results of the coefficient of determination indicate that the adjusted R^2 value of 0.29 means that the variables of LEV, RISK, KI, and KP are able to explain the variation of tax avoidance by 29% while the remaining 71% is explained by other variables outside the model. Based on the hypothesis testing, it can be written regression equation 1 as follows:

$$TA = -0.537 - 0.173\ ZLEV - 0.077\ ZRISK + 0.053\ ZKI + 0.147\ |LEV\text{-}KP| - 0.174\ |RISK\text{-}KP| + 0.15 \quad (1)$$

Table 3. The Results of Hypothesis Test

No	Hypothesis	Regression Coefficient	Sig.	Decisions
1	H_1: Leverage has a significant positive effect on tax avoidance.	-0.173	0.007	Rejected
2	H_2: Executive character has a significant positive effect on tax avoidance.	-0.077	0.125	Rejected
3	H_3: Institutional ownership has a significant negative effect on tax avoidance.	0.053	0.226	Rejected
4	H_4: Political connection significantly moderates the effect of leverage on tax avoidance.	0.147	0.029	Accepted
5	H_5: Political connection significantly moderates the effect of executive character on tax avoidance.	-0.174	0.002	Accepted
6	H_6: Political connection significantly moderates the effect of institutional ownership on tax avoidance.	0.150	0.070	Rejected

Source: secondary data processed, 2019

The results of the hypothesis testing in this study are presented in Table 3.

The Effect of Leverage to Tax Avoidance

The result of the study shows that leverage has a negative effect on tax avoidance. The result gives the meaning that when leverage increases, the practice of tax avoidance also increases. This finding is contrary to agency theory where principals employ agents to take care of companies in order to achieve maximum profits. In addition, this result is also not in accordance with the trade off theory which states that companies can use debt to save tax.

The frequency distribution in the research results supports this negative relationship where the level of debt is mostly in the low category (48.08%) while the level of tax avoidance is mostly in the very high category (84.62%). This shows that there is a possibility that the benefits of fixed costs appear is a little so that the company decided not to use debt to fund the company. Companies that have low levels of debt do not have the obligation to provide creditors with broader and more detailed information (Turyatini, 2017) so they have the ease of doing tax avoidance. The results of this study are in line with research conducted by Irianto et al. (2017) finance and management which may disperse production, yet need (relatively few, Turyatini (2017), Swingly & Sukartha (2015), and Wang et al. (2014).

The Effect of Executive Character to Tax Avoidance

The result of the study shows that the executive character does not significantly influence tax avoidance. This finding is contrary to agency theory which explains that principals and agents will try to maximize their personal profit by maximizing profits. Thus, they tend to be more courageous in making decisions despite the high risk.

Then, every company has a goal to maximize profits, one of the strategies is to minimize the tax burden. So, whatever the character of the executive (risk taker or risk averse) will still make the executives take the policy to do tax avoidance even though there is a risk of sanctions or a decline in reputation (Kartana & Wulandari, 2018). The result of this study is in line with studies conducted by Kartana & Wulandari (2018), Mayangsari (2015) and Kiswanto et al. (2016) which found that executive character has no significant effect on tax avoidance.

The Effect of Institutional Ownership on Tax Avoidance

The result of the study shows that institutional ownership has no significant effect on tax avoidance. The result of this study contradicts the agency theory which states that institutional ownership plays a role in supervising the performance of managers. In the frequency distribution of research data, institutional ownership in most of the companies is in the very high category (46.15%) and the rest (53.85%) is distributed in various categories in all categories (very low, low, medium, and high). Meanwhile, the level of tax avoidance is mostly in the very high category (84.62%). It is assumed that the institutions do not carry out its supervisory function sufficiently.

Putri & Suryarini (2017) state that this happens because institution is an external party of the company so that its existence cannot directly influence management regarding tax avoidance actions. The existence of institutional ownership will make managers increasingly avoid tax because of the responsibility to investors (Tandean & Winnie, 2016). Management considers that the company must provide feedback on the shares owned by the institution remains high. The results of this study are in line with research conducted by Tandean & Winnie (2016), Jamei (2017), Turyatini (2017), and Putri & Suryarini (2017).

The Effect of Leverage on Tax Avoidance moderated by Political Connections

The result of the study shows that political connection is able to moderate the effect of leverage on tax avoidance. This result is in line with agency theory that explains the interests between principals and agents who both want to prosper themselves which can be realized by maximizing profits. One of the ways to achieve maximum profit is by utilizing interest expense arising from debt to minimize tax burden.

Leverage has a negative effect on tax avoidance. Then, the presence of political connection in this study is able to weaken the negative effects. Companies with political connections have a low risk in terms of tax avoidance so that it can reduce the tax burden compared to companies that are not connected by politics (Tehupuring & Rossa, 2016). Although the government is also on duty to monitor the companies, the government also wants to get high returns in the form of dividends. Therefore, the level of tax avoidance of politically connected companies tends to be high when the level of leverage is also high. This can be proven in this research data where the leverage of PT TINS (has political connections) is higher than politically unconnected companies. However, based on the research data, the leverage on the companies that have political connections does not exceed the provisions. This means that the government also continues to play a role in controlling the level of corporate leverage to remain in accordance with the provisions.

The Effect of Executive Character to Tax Avoidance moderated by Political Connection

The result of the study shows that political connection is able to moderate the relationship between executive character and tax avoidance. This finding is in line with agency theory that explains the differences in interests between agents and principals in maximizing profits. However, the government in this case as the principal and the state apparatus expects the company to comply with the rules. Therefore, the executives will be encouraged to be very careful in deciding matters because of political connections.

The executive character has a negative but insignificant effect on tax avoidance. Then, the presence of political connection is able to strengthen the negative effect so that the more executives with the character of risk takers, the lower the practice of tax avoidance. The financial statements will be presented as the factual conditions if the company tends to be at high risk. That is because the principal knows how the company's performance is, so the opportunity to do tax avoidance is low (Praptidewi & Sukartha, 2016). Furthermore, companies that are politically connected will be supervised directly by the government. Thus, executives will tend not to do tax avoidance. The government, as the principal, will oversee the company executives so that decisions made in tax avoidance do not jeopardize their reputation.

The Effect of Institutional Ownership to Tax Avoidance moderated by Political Connection

The result of the study proves that political connection does not moderate the relationship between institutional ownership and tax avoidance. This finding contradicts agency theory that the higher institutional ownership will lead to increasingly stringent supervision to agents. This means that the existence of government ownership will not affect the level of the institution's role in overseeing the company's tax avoidance actions. The presence or absence of government ownership will still make the institution want a high return so that it will make managers avoid taxes because of the responsibility to investors.

This finding is supported by research data where one of the sample companies, namely PT BSSR in 2015, has only 0.26 shares and no government ownership. The company has tax avoidance with a very high category of -0.277. Then, the ownership of PT PTBA institutions in 2017 amounted to 0.9789 and there was a political connection in the form of government ownership of 0.6502. However, it still makes this company do tax avoidance without being affected by government ownership. PT PTBA has a tax avoidance level with a very high category that is equal to - 0.256.

CONCLUSIONS

This study examines the effects of leverage, executive character, and institutional ownership on tax avoidance with political connection as moderator. The result of the study proves that the lower the leverage, the tax avoidance by the company will be higher. The result indicates that companies with low debt levels do not have the obligation to provide detailed information to creditors so they have the ease of doing tax avoidance. Then, executive character and institutional ownership do not affect tax avoidance. Furthermore, political connections moderate the effects of leverage and executive character on tax avoidance, but do not moderate the effect of institutional ownership on tax avoidance.

The existence of political connections will encourage companies to increase tax avoidance because the government also wants to get high dividends. Nevertheless, political connections also play a role in controlling the level of leverage in order to remain in compliance. Then, the existence of political connections will make executives who risk takers tend to reduce tax avoidance because of direct supervision from the government.

Suggestions for the government are expected to supervise mining companies regarding tax avoidance practices because these companies tend to do tax avoidance to maximize after-tax profits. Then, companies with high leverage are expected to avoid tax avoidance practices because of tighter controls from creditors. In addition, this research has limitations, namely only obtaining information on political connections from the annual report. Thus, the suggestion for further researchers is to try to use other proxies in measuring political connections as suggested by Adhikari et al. (2006) where political connections can be measured based on the presence or absence of agents or principals who are political officials or former political officials.

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