

RELATED PARTY TRANSACTIONS AND TAX AVOIDANCE: STUDY ON MINING COMPANY IN INDONESIA

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ABSTRACT

This study aims to provide empirical evidence of the effect of related party transactions on tax avoidance on mining sector companies listed on the Indonesia Stock Exchange. The research sample consists of 73 observations. We used Discretionary Permanent Book Tax Differences to measure the ratio of tax avoidance. We used the composite value of merging sales, purchase, liability, and receivables to related parties through principal component analysis to measure related party transactions variables. The results of panel regression analysis show that related party transactions have a positive and significant effect on Discretionary Permanent Book Tax Differences. After re-testing, these results are consistent using a variable measurement of different tax avoidance, namely the Cash Effective Tax Rate. Furthermore, the analysis result per component of related party transactions shows that only receivable transactions significantly affect tax avoidance. This study results indicate that company policy in related party transactions is not conducted partially per component in the taxation context. Company management is likely to use all related party transactions methods so that stakeholders, particularly revenue officers, do not easily detect the tax avoidance practices.

Keywords: tax avoidance, related party transactions, discretionary permanent book tax differences

Penelitian ini bertujuan untuk memberikan bukti empiris pengaruh transaksi pihak berelasi terhadap penghindaran pajak pada perusahaan sektor pertambangan yang terdaftar di Bursa Efek Indonesia. Sampel penelitian terdiri dari 73 observasi. Kami menggunakan *Discretionary Permanent Book Tax Differences* untuk mengukur rasio penghindaran pajak. Kami menggunakan nilai gabungan dari penggabungan penjualan, pembelian, kewajiban, dan piutang kepada pihak berelasi melalui analisis komponen utama untuk mengukur variabel transaksi pihak berelasi. Hasil analisis regresi panel menunjukkan bahwa transaksi pihak berelasi berpengaruh positif dan signifikan terhadap *Discretionary Permanent Book Tax Differences*. Setelah dilakukan pengujian ulang, hasil tersebut konsisten dengan menggunakan pengukuran variabel penghindaran pajak yang berbeda yaitu *Cash Effective Tax Rate*. Selanjutnya, hasil analisis per komponen transaksi pihak berelasi menunjukkan bahwa hanya transaksi piutang yang berpengaruh signifikan terhadap penghindaran pajak. Hasil penelitian ini menunjukkan bahwa kebijakan perusahaan dalam transaksi pihak berelasi tidak dilakukan secara parsial per komponen dalam konteks perpajakan. Manajemen perusahaan kemungkinan besar akan menggunakan semua metode transaksi pihak berelasi agar pemangku kepentingan, khususnya pejabat penerimaan, tidak mudah mendeteksi praktik penghindaran pajak.

Kata kunci: penghindaran pajak, transaksi pihak berelasi, *discretionary permanent book tax differences*

INTRODUCTION

Tax is one of the highest state revenue. It was applied in some countries in the world, including Indonesia. The state relies on tax revenues to fund its operational activities. For ten years, data from the Finance Minis-

try of the Republic of Indonesia show differences between target and realization. It shows an indication of non-compliance from Indonesian taxpayers. In Indonesia, one of the industrial sectors of public concern is the mining sector. Indonesia is one

of the countries that has the largest natural resource potential. The mining industry sector may be one sector that is vulnerable to tax avoidance in Indonesia. The Corruption Eradication Commission (KPK) indicated an underpayment tax in the mining industry of 15.6 trillion rupiahs per year, and until 2017 there were arrears of Non-Tax State Revenues (PNBP) in coal mining and mineral metal up to 25.5 trillion rupiahs (DDTCNews, 2019; Novriansa, 2019).

One tax avoidance phenomenon in Indonesia is occurring in PT. Adaro Energy Tbk. Tax avoidance practices carried out by PT. Adaro Energy Tbk is transferring some of the profits from coal mining activities in Indonesia to other company networks, which results in reduced company tax payments (Florentin, 2019; Friana & Putsanra, 2019). Tax avoidance can lead to doubt in the business culture that companies in their business groups have formed if the tax avoidance is conducted improperly (Bailing & Rui, 2018; Sikka & Willmott, 2013). In that case, PT. Adaro Energy Tbk sells mining products to Coaltrade Services International under international prices standard with an average sales of US \$ 26.3 per ton. Meanwhile, the mining products are sold to different countries at relatively high prices. This behavior affects Indonesia's lower taxable income and profits in Indonesia (Friana & Putsanra, 2019).

Transfer prices are carried out from a company in one country to its relations in another country because of the opportunity to avoid tax. In the context of tax avoidance, related party transactions are among the issues that have been attended by the government, accounting standard setters, and researchers over a few years. The results of several studies show a positive and significant effect of related party transactions on tax avoidance (Amidu, Coffie & Acquah, 2019; Anouar & Houria, 2017; Barker, Asare & Brickman, 2017; Cazacu, 2017; Chan, Mo & Tang, 2016; Herianti & Chairina, 2019; Kurniawan & Nuryanah, 2017; Maulana, Marwa & Wahyudi, 2018; Park, 2018; Taylor & Richardson, 2012). However, some researchers show different results. Sari & Hunar (2015); Sari, Utama & Rossietta (2017); and Darma (2019) found

that transfer prices and related party transactions have no significant effect on tax avoidance.

The inconsistency of the research results is probably caused by several reasons, for example, differences in regulations and characteristics between countries and industrial sectors. In addition, the inconsistency of research results is also probably caused by differences in the measurement of the variables used. In line with the measurement of variables, previous research generally used Effective Tax Rate, Cash Effective Tax Rate, and Book Tax Differences (Herawati, Rahmawati, Bandi & Setiawan, 2021; Abdullah, Furqan, Made & Parwati, 2019; Aronmwan & Okafor, 2019; Bailing & Rui, 2018; Chan *et al.*, 2016; Dyreng, Hanlon & Maydew, 2008; Kiesewetter & Manthey, 2017; Kismanah, Masitoh & Kimsen, 2018; Kurniawan & Nuryanah, 2017; Lee, Dobiyaniski & Minton, 2015; Li, Luo, Wang & Foo, 2016; Liu, Schmidt-Eisenlohr & Guo, 2020; Miah, 2016; Rosa, Andreas & Savitri, 2018; Tang & Firth, 2011; Vahdani, Najafabadi, Kermani & Farhadi, 2019; Zeng, 2019), only a few used Discretionary Permanent Book Tax Differences (DTAX). The measurement of tax avoidance with DTAX has an advantage over others because it controls non-discretionary items in the permanent difference between accounting income and fiscal profit (Frank, Lync & Rego, 2009). Non-discretionary items that are not related to tax planning that causes permanent differences and adjustments to the laws and regulations are considered to be able to show tax avoidance activities in companies.

This research develops the previous research in the following matters. First, this research analyzes tax avoidance in the mining sector in a country with enormous natural resource potential. Second, this study uses DTAX as a tax avoidance measure to reduce research gaps in tax avoidance variables measurement because it controls non-discretionary items that cause permanent differences and adjustments to laws and regulations in the permanent difference between accounting income and fiscal profit. Third, this research combines

sales, purchase, liability, and receivables transactions to related parties through principal component analysis to measure related parties' transactions variables. In addition, we also carry out additional analysis using a different tax avoidance measurement, namely the Cash Effective Tax Rate (CETR), to test the consistency of research results. Furthermore, this research analyzes per component of related parties' transactions to determine which component has the most potent effect on tax avoidance. Thus, the results of this research can contribute to the development of the taxation literature, particularly in developing countries with high natural resource potential. The second part of this paper explains the theoretical review and hypotheses formulation. Next, in the third part, the data analysis and hypothesis testing methods are explained. In the fourth part, the data analysis and discussion results are explained. Finally, conclusions and suggestions for further research are presented in the fifth part of this paper.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Agency theory assumes that agency problems arise due to a compensation system involving contractual relationships in the behavior of agents (managers) and principals (owners of economic resources). This relationship causes asymmetric information because managers control financial information and arise conflicts of interest due to inequality of objectives between the two parties (Jensen & Meckling, 1976; Ross, 1973). For example, the difference between accounting income and fiscal profit can cause a conflict of interest.

The conflict between agent and principal can occur between manager and owner (type I agency theory) and between owners (type II agency theory). The conflict between owners generally occurs in concentrated ownership structures. The ownership structure is usually found in developing countries, including Indonesia, because the diversion of corporate resources from the corporation, minority shareholders, to the controlling shareholder can be substantial (La Porta, Lopez-de-Silanes &

Shleifer, 1999). Type II agency theory states that conflict between controlling and non-controlling shareholders can occur because the resources transferred between entities cause loss to minority shareholders. Generally, companies have affiliated groups or entities. Companies can conduct resource transfer activities to affiliated entities to get higher profits. Companies can conduct resource transfer activities to affiliates to get higher profits. When agency problems occur, Controlling shareholders can join the shareholders' influence on tax avoidance (Ouyang, Xiong & Huang, 2020). This research shows that multiple shareholders significantly affect tax avoidance when the companies have a high agency problem.

Related party transactions happen through companies that have relations with affiliates. Companies are encouraged to transfer some of their income and profits from countries with high tax rates to affiliates in other countries with lower tax rates (Lin, Mills, Zhang & Li, 2017; Liu, Shi & Ferrantino, 2016; Ouyang *et al.*, 2020). Although tax regulations have set the fulfillment criteria for company transfer pricing, tax avoidance behavior continues (Awodiran, 2014; Maulana *et al.*, 2018). If the transactions are carried out in one country, related party transactions do not affect the company's tax burden. However, if the transactions are carried out in other countries with different tax rates, it will affect the tax burden. Other researches show that companies in business groups will avoid taxes through related party transactions. (Anouar & Houria, 2017; Chan *et al.*, 2016; Liu *et al.*, 2019; Maulana *et al.*, 2018; Park, 2018). Transfer pricing companies usually create an agreement in determining the price of a transaction involving manipulation reports about transactions that can cause a burden. Based on the perspective of agency theory and the results of previous researches, the research hypothesis is formulated as follows.

H1: Related party transactions have a positive effect on tax avoidance.

RESEARCH METHODS

The sample of this research is the mining sector companies listed on the Indonesia

Stock Exchange in 2014-2018 that required the following criteria: 1) Not delisting during the observation period. 2) Not accumulated losses during the observation period. Mining sector companies were chosen as research objects because of the following considerations: 1) The mining sector has become the center of the Indonesian government's attention because the target of state revenue from the sector is relatively high. 2) There is an indication that the underpaid tax from the mining sector is relatively high. In addition, there has been a phenomenal case of tax avoidance in the mining industry sector, which is the case of PT. Adaro Energy (Florentin, 2019; Friana & Putsanra, 2019). The period of 2014-2018 was chosen considering that there is a government policy on tax amnesty and a new regulation on financial information access for tax purposes, namely Law Number 1 of 2017. The regulation empowers the tax-

tion authority to obtain taxpayer information and financial data.

Operational Definition and Variable Measurement

Dependent Variable

Tax avoidance is proxied by using DTAX, referring to the research (Aryotama & Firmansyah, 2019; Frank *et al.*, 2009). In this research, non-discretionary items used are goodwill and other intangible assets, the difference in operating loss, and final tax. The variable value of DTAX is calculated using regression panel data of the following formula.

$$PERMDIFF_{it} = \alpha_0 + \beta_1 INTANG_{it} + \beta_2 NOL_{it} + \beta_3 LAGPERM_{it} + \beta_4 FINAL_{it} + e_{it}$$

Where, $PERMDIFF_{it}$: the difference between the total of LTD and the company's temporary LTD that is obtained from the calculation $BI_{it} - [(CFTE_{it} + CFOR_{it}) / STR_{it}] - (DTE_{it} / STR_{it})$; BI_{it} : Pre-tax book income; $CFTE_{it}$

Table 1.
Definition of Variable Operations

Name of variable	Description	Measurement
Dependent variable		
DTAX	Discretionary Permanent Book Tax Differences	By regression panel data of the formula : $PERMDIFF_{it} = \alpha_0 + \beta_1 INTANG_{it} + \beta_2 NOL_{it} + \beta_3 LAGPERM_{it} + \beta_4 FINAL_{it} + e_{it}$
Independent variable		
RPT	Related party transactions	Analysis of the main components of the 4 components of related party transactions, such as sales transactions, purchases transactions, liabilities transactions, and receivables transactions
RPT-Sales	Related party transactions on sales transactions	$RPT\ Sales = \frac{Related\ party\ sales}{Total\ Sales}$
RPT-Purchase	Related party transactions on purchase transactions	$RPT\ Purchase = \frac{Related\ party\ purchase}{Total\ Operating\ Costs}$
RPT-Liability	Related party transactions on liability transactions	$RPT\ Liability = \frac{Related\ party\ liability}{Equity}$
RPT-Receiveable	Related party transactions on receiveable transactions	$RPT\ Receiveable = \frac{Related\ party\ receiveable}{Total\ Asset}$
Control variable		
SIZE	Firm size	$SIZE = \ln\ Total\ Asset$
ROA	Profitability	$ROA = \frac{Net\ Income}{Total\ Asset}$

+CFOR_{it} : Current tax expense; DTE_{it} : Deferred tax expense; STR_{it} : Statutory tax rate in year; INTANG_{it} : Goodwill and other intangibles; NOL_{it} : Change in net operating loss carryforwards; LAGPERM_{it} : The lagged value or the difference between the permanent income book differences and fiscal profits of company t years and year t-1; FINAL_{it} : Final tax.

Independent Variable

This research uses four related party transaction components. There are sales, purchase, liability, and receivables transactions (Chan *et al.*, 2016; Darma, 2019). The principal component analysis is used to simplify the components of related party transactions by reducing the dimensions of the four components of the transactions. Analysis of the main components is conducted by combining the variables of sales, purchase, liability, and receivables transactions to obtain new variables that are not correlated. Thus, the score of the new component formed is a composite score is calculated by linearly combining the old variables (Gudono, 2014).

Control Variable

The control variables of this research are firm size and profitability. The firm size is used to determine the company's performance based on the total assets (Warsono & Ardianto, 2015). Big companies have high operational activities and higher income or profits. Nevertheless, most companies avoid increasing profits that are too high so that the tax profits spent are not too high. The company will prefer to build an

affiliate to expand its reach from that condition. The firm size variable of this research was measured by the natural logarithm form of total assets. The ratio of Return on Assets (ROA) is used to determine profitability through calculations with the division of net income on total assets. ROA can measure the quality of income and the company's power to generate income from its assets and assess its performance.

RESULTS AND DISCUSSION

This research uses 73-panel data based on the selected sample. The results of the descriptive statistical analysis are presented in Table 2. Variable DTAX has an average of 6.28E-27 (0.000114). Some companies do not conduct sales transactions on the related party, indicated by a minimum value of 0. Companies that conduct sales transactions to the related party fully are shown with a maximum value of 1. However, the average value of the company shows a percentage of 37% in conducting sales transactions on the related party. Companies conducting transactions on related parties have an average of 12%, although some companies do not conduct purchase transactions on related parties. On average, each company in the sample has liability transactions and receivable transactions on the related party of 5%. Meanwhile, the firm size control variable has an average of 10.4 trillion rupiahs and an average ROA variable of 8%.

Hypothesis test

Before the panel regression analysis was carried out, we conducted the model speci-

Table 2.
Results of Descriptive Statistics Analysis

Variable	Mean	Maximum	Minimum	Std. Dev.
DTAX	6.28E-27	3.20E-26	-2.87E-26	1.40E-26
RPTS	0.388	1.000	0.000	0.381
RPTP	0.123	0.574	0.000	0.148
RPTL	0.059	0.408	0.000	0.096
RPTA	0.050	0.232	0.000	0.056
SIZE	29.081	32.258	26.626	1.227
ROA	0.083	0.394	0.000	0.090

Note: DTAX = Discretionary Permanent Book Tax Differences; RPTS = sales transaction on related party; RPTP = purchase transaction on related party; RPTL = liability transactions on related party; RPTA = receivable transaction on related party; SIZE = firm size; ROA = return on asset.

fication test with the Chow Test, the Hausman Test, and the lagrange multiplier test. The model specification test results show that the most appropriate model is the common effect. Next we conducted a classic assumption test which consisted of a normality test, a heteroscedasticity test, and a multicollinearity test. Based on the classic assumption test, the analysis result shows that there is no classic assumption problem in the research model.

The results of hypothesis testing in Table 3 show that the regression coefficient value of the related party transactions variable is 2.59E-27, with a probability of 0.049. It means that related party transactions positively and significantly affect tax avoidance. Thus, the research hypothesis is accepted. This research supports the research (Cazacu, 2017; Chan *et al.*, 2016; Maulana *et al.*, 2018; Park, 2018; Sari *et al.*, 2017). Companies tend to potentially transfer resources that generate profits to affiliated companies to minimize tax payments. This research also indicates the existence of tunneling practices through related party transactions. The indication is based on research by Johnson *et al.* (2000), which states that the tunneling practice is usually carried out by controlling shareholders through transactions to a related party by selling assets and goods or services at special prices, obtaining or providing collateral for loans, giving excessive compensation and bonuses to core management, and acquiring additional stocks at special prices.

Related party transactions can be beneficial for the management and owner of the company because they can provide

efficiency in the company's operations and reduce the tax burden. On the other hand, related party transactions can cause the loss of minority shareholders (El-Helaly, Georgiou, & Lowe, 2018; Jian & Wong, 2010; La Porta *et al.*, 1999; Maury & Pajuste, 2005; Nekhili & Cherif, 2011; Ouyang *et al.*, 2020). Table 3 also shows the results of the control variable analysis of firm size and profitability as measured by return on assets. In this study, the firm size has no significant effect on tax avoidance, while profitability has a positive and significant effect on tax avoidance. These results provide in supporting for several previous kinds of research, such as Kismanah *et al.* (2018); Waruwu & Kartikaningdyah (2019); Abdullah, Furqan, Made & Parwati (2019); Pratama (2018); Zeng (2019) which show that return on assets affects tax avoidance and the public ownerships have a significant effect in improving the tax avoidance practice. In addition, the greater company's profitability ratio caused a decrease in the reported and paid tax.

Additional Analysis

We conducted additional analysis by examining the effect of each component of related party transactions on tax avoidance and re-analyzing the research model using measurements of different tax avoidance variables, namely the cash effective tax rate (CETR). Research by Park (2018) uses CETR to measure the tax avoidance at the company. The additional analysis results in Table 4 show that the related parties' sales, purchase, and liability transactions do not significantly affect tax avoidance. In contrast, receivable transactions on the related

Table 3.
Hypothesis Testing Results (Common Effect)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	7.31E-26	3.77E-26	1.941	0.056
RPT	2.59E-27	1.30E-27	1.997	0.049
SIZE	-2.06E-27	1.28E-27	-1.608	0.112
ROA	4.77E-27	2.23E-27	2.133	0.037
Adjusted R-squared	0.091			
F-statistic	3.413			
Prob. (F-statistic)	0.022			

Note: DTAX = Discretionary Permanent Book Tax Differences; RPT = composite value of the combined sale, purchase, liability and receivable transactions on related party; SIZE = firm size; ROA = return on asset.

party have a positive and significant effect on tax avoidance. This analysis illustrates that the receivable transactions to a related party are the component that has the most powerful effect on tax avoidance practices. Non-cash sales transactions with a related party cause receivable transactions. High receivable transactions will increase the allowance for receivable losses and risk the losses of the uncollectible receivable that can increase costs, making the company's profits lower. Therefore, it will have an impact on lower tax payments. Furthermore, the results of this additional analysis also indicate that related party transactions activities carried out by the company are not partially per component but simultaneously. It means that there are indications that companies use all methods of transactions on the related party so that the stakeholders, particularly revenue officers, do not easily detect the practice of tax avoidance. It is proved in the analysis results of combining all components of related party transactions that have a positive and significant effect on tax avoidance. In addition, these results also proved consistent in testing using measurement of different tax avoidance, namely the cash effective tax rate as presented in an appendix.

CONCLUSION

This research empirically examines the effect of related party transactions on tax avoidance in mining sector companies in Indonesia. The analysis results show that related party transactions positively and significantly affect tax avoidance. It means that the higher the company's related party transactions, the higher the tax avoidance ratio. The results, as mentioned above, are consistent after re-testing using the measurement of different tax avoidance variables. Furthermore, the additional analysis conducted by examining each component of the related party transaction shows that only the receivable transaction on the related parties has a significantly affect tax avoidance. In contrast, related parties' sales, purchase, and liability transactions do not significantly affect tax avoidance. This research indicates that each component of related party transactions is not

strong enough to affect tax avoidance practices. However, all related party transaction components have been proven to affect tax avoidance significantly. In the taxation context, company policy on related party transactions is not carried out partially. It indicates that company management likely uses all related party transaction methods so that stakeholders, particularly revenue officers, do not easily detect tax avoidance. So, the government and policymakers can use the research implication to make an effective and regulatory quality based on related party transactions. It is also used by company management and investors to analyze company reports to make decisions because that affects minority and majority shareholding and the quality of company reports.

LIMITATIONS AND SUGGESTIONS

This research has several limitations. First, this research only analyzes related party transactions information listed in the annual financial statements. Even though in the practice, the disclosure of related party transactions conducted by companies is still relatively low. Second, this research has not considered the presence or absence of tax incentives specifically provided by the government in each mining industry. Based on the limitations, further research can develop by considering the following points. First, it is necessary to check the website or survey of each company to explore information about related party transactions conducted by the company. Second, it is necessary to gain a deeper analysis of government policies on tax incentives that are provided to the mining industry sector.

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Table 4.
Additional Analysis Results

Variable	C	RPTS	RPTP	RPTL	RPTA	RPT	SIZE	ROA	Adj. R.Squared	F-Stat	Prob. (F-Stat)	
DTAX	Coef.	6.72E-26	2.55E-27				-1.89E-27	4.93E-27	0.044	2.096	0.109	
	Prob.	0.086	0.556				0.156	0.039				
	Coef.	6.30E-26		-1.03E-27				-1.76E-27	4.67E-27	0.041	2.037	0.117
	Prob.	0.126		0.668				0.201	0.046			
	Coef.	6.98E-26			-2.75E-27			-2.12E-27	4.71E-27	0.070	2.796	0.047
	Prob.	0.071			0.135			0.109	0.041			
	Coef.	7.67E-26				3.5E-27		-2.00E-27	3.86E-27	0.114	4.096	0.010
	Prob.	0.043				0.018		0.118	0.088			
	Coef.	7.31E-26					2.59E-27	-2.06E-27	4.77E-27	0.091	3.413	0.022
	Prob.	0.056					0.049	0.112	0.037			
	Coef.	0.004	-0.044					0.017	-0.944	0.102	3.741	0.015
	Prob.	0.995	0.525					0.421	0.002			
CETR	Coef.	-0.233		-0.038			0.024	-0.962	0.110	3.951	0.012	
	Prob.	0.723		0.332			0.290	0.002				
	Coef.	-0.034			0.003			0.018	-0.922	0.097	3.588	0.018
	Prob.	0.957			0.910			0.402	0.003			
	Coef.	0.011				0.013		0.017	-0.969	0.101	3.684	0.016
	Prob.	0.987				0.610		0.419	0.002			
	Coef.	-0.140					-	0.021	-0.792	0.140	4.907	0.004
	Prob.	0.821					0.041	0.319	0.009			

Notes: DTAX = Discretionary Permanent Book Tax Differences; CETR = Cash Effective Tax Rate; RPTS = sales transactions on related party; RPTP = purchase transactions on related party; RPTL = liability transactions on related party; RPTA = receivable transactions on related party; SIZE = firm size; ROA = return on assets