Relationship of political connection and tax aggressiveness: empirical evidence from Indonesia

Eko Arief Sudaryono*, Rahmawati, Djuminah, Wartono and Wahyu Widarjo

Accounting Study Program,
Faculty of Economics and Business,
Universitas Sebelas Maret,
Jl. Ir. Sutami No. 36A, Kentingan, Surakarta, Indonesia
Email: ekoarief_fe@staff.uns.ac.id
Email: rahmawati_fe@staff.uns.ac.id
Email: djuminah.feb@staff.uns.ac.id
Email: wartono@staff.uns.ac.id
Email: widarjo@staff.uns.ac.id
*Corresponding author

Abstract: We analyse the determinants of tax aggressiveness practices on companies which listed on the Indonesia Stock Exchange. Literature shows the political connection is an important factor that affects the company tax policy making. The analysis results of 844 companies which were listing on the Indonesia Stock Exchange period 2012–2016 indicate that the directors who have political connection tend to avoid tax aggressiveness. This indicates the existence of ‘bureaucratic incentive effect’. However, in large companies, directors who have political connections is more aggressive in tax practice. It indicates the existence of ‘political favouritism effect’ in large companies, because executives may be able to utilise their political connections to lobby the government about tax aggressiveness practices (e.g., avoiding tax audits and asking fine reduction). In addition, large companies have relatively higher bargaining power on the government, because they have a larger contribution in the national economy than small companies.

Keywords: political connection; tax aggressiveness; effective tax rate; firm size.

Reference to this paper should be made as follows: Sudaryono, E.A., Rahmawati, Djuminah, Wartono and Widarjo, W. (2019) ‘Relationship of political connection and tax aggressiveness: empirical evidence from Indonesia’, *Int. J. Economic Policy in Emerging Economies*, Vol. 12, No. 5, pp.453–465.

Biographical notes: Eko Arief Sudaryono is an Associate Professor in the Accounting Study Program at the Faculty of Economics and Business, Universitas Sebelas Maret, Indonesia. His research interests include taxation and corporate governance. He has published his research in various journals and conferences, both national and international.

Rahmawati is a Professor in the Accounting Study Program at the Faculty of Economics and Business, Universitas Sebelas Maret, Indonesia. She holds a Doctoral degree from Universitas Gadjah Mada in Yogyakarta, Indonesia. Currently, she has published his research in various journals and conferences, both national and international.

Copyright © 2019 Inderscience Enterprises Ltd.

Djuminah is an Assistant Professor in the Accounting Study Program at Faculty of Economics and Business, Universitas Sebelas Maret, Indonesia. She holds a Doctoral degree from Universitas Padjadjaran in Bandung, Indonesia. Currently, She has published his research in various journals and conferences, both national and international.

Wartono is an Assistant Professor in the Accounting Study Program at the Faculty of Economics and Business, Universitas Sebelas Maret, Indonesia. He has published his research in various journals and conferences.

Wahyu Widarjo is an Assistant Professor in the Accounting Study Program at the Faculty of Economics and Business, Universitas Sebelas Maret, Indonesia. He holds a Doctoral degree from Unviersitas Sebelas Maret, Indonesia. His research interests include disclosure, intellectual capital and taxation. He has published his research in various journals and conferences, both national and international.

This paper is a revised and expanded version of a paper entitled 'Relationship of political connection and tax aggressiveness: empirical evidence from Indonesia' presented at The 5th Sebelas Maret International Conference on Business, Economics, and Social Sciences (SMICBES), Bali, Indonesia, 17–19 July 2019.

1 Introduction

Tax is a compulsive contribution to a country that is indebted by an individual or a institution which is coercive under the law, by not being directly reciprocated and used for state purposes for the greatest people wellbeing (Article 1 paragraph 1 of Law No. 28 of 2007). One type of tax imposed in Indonesia is income tax, i.e., tax imposed on a tax subject on accepted or obtained income within one year tax. Tax paid by the taxpayer is a transfer of wealth to the state. Thus the amount of tax paid is an economic sacrifice or expense for an individual or the company owner whose value is directly proportional to the earned income (Sari, 2010).

The literature indicates that the company owner tends to take aggressive tax actions by profit managing (lowering profit) to reduce the amount of tax paid (see Chen et al., 2010). However, this action is not necessarily without consequences for the company. The practice of profit management by lowering profit can adversely affect the reputation of the company management and for the overall company. This means that low profit can be perceived negatively by external stakeholders (e.g., potential investors and creditors).

Theoretically, these conditions indicate a trade-off between the tax aspects and the performance appraisal aspects of management as well as the overall company performance (Shackelford and Shevlin, 2001). On the one hand the owner wants minimum tax payments, but on the other hand a small tax payment can reflect the low profitability of the company. However, in practice, companies do not always have a trade off on both aspects. The literature shows empirical evidence of a positive correlation between the aggressiveness of taxation and the aggressiveness of financial reporting (see Frank et al., 2009; Ridha and Martani, 2014). According to Frank et al. (2009), the company may do tax aggressiveness and financial reporting aggressiveness simultaneously. This is due to differences in revenue recognition and cost between

accounting standards with taxation legislation. The difference between the two regulations makes the difference between commercial profit and fiscal profit (book tax gap).

The gap between these regulations is often utilised by the company management in Indonesia to manage profit by reporting high commercial profits, but the amount of taxable income is low (Ridha and Martani, 2014). Thus the tax burden which is assured by the company becomes low. These practices may result in a decrease in the amount of received taxes by the state and implicate for national development, 70% to 80% of the state revenues come from taxes (Ministry of Finance of the Republic of Indonesia, 2017).

Indonesia government through the Ministry of Finance has actually made efforts to reduce tax avoidance and tax evasion practices by conducting more comprehensive tax reformation (through policy reform and administrative reform). Policy reforms which are conducted by the government include the revision of the Law on General Provisions and the Procedure of Taxation (KUP), the revision of the Income Tax Law (PPh) and the revision of the Value Added Tax (VAT) Law. Administration reformation include improving the effectiveness of law enforcement, improving the quality of taxation information technology, making better management of tax base data, and improving the capacity and capability of human resources (Ministry of Finance of the Republic of Indonesia, 2017).

Although the government has made efforts to reduce tax avoidance and evasion practices, but the practices are still happened. For example tax evasion case by PT. Asian Agri. In that case, the company manager was sentenced to imprisonment and the company was fined 2.5 trillion rupiah. Another phenomenal case is the Panama Papers that appear in national and international media. In that case some of the names of big businessmen in Indonesia are in the list (CNN Indonesia, 2016). Tax avoidance and evasion cases are conducted by establishing branches or subsidiaries in tax heaven countries in order to accommodate income or as a profit centre (usually called a special purpose vehicle). This means that company income from Indonesia is transferred to a country with minimum tax rate or no income tax (e.g., Mauritius and Hong Kong).

The problem of tax aggressiveness does not only happen in Indonesia, but also occurs in various countries. Theoretically, determinant factor of taxpayer compliance in fulfilling tax obligations are tax rates, sanctions, and possible detection of tax avoidance (Hanlon and Heitzman, 2010). According to Swingly and Sukarta (2015) the factors that affect tax aggressiveness are company size and executive character, whereas according to Li et al. (2016) factors that affect tax aggressiveness is a political connection. The results of this study indicate a negative relationship between political connection with tax aggressiveness.

Previous researchers have studied the relationship between political connection and tax aggressiveness (Adhikari et al., 2006; Wu et al., 2012; Kim and Zhang, 2016; Wahab et al., 2017), but the study results is still not consistent. The results of Adhikari et al. (2006) suggest that political connections have a negative and significant effect on tax aggressiveness it means that the company with political connection pays tax at effective rates much lower than other companies. These results are supported by Wu et al. (2012) which indicates that politically connected companies have lower ETR levels. Further research results of Kim and Zhang (2016) and Wahab et al. (2017) also show that companies with political connections have greater tax aggressiveness than companies which have no political connections. But several studies show different results, Zhang (2012) provides evidence that political connections have negative relation to tax

aggressiveness. This means that companies with political connections are more compliant with tax regulations than companies with no political connections. The results of this study indicate the existence of bureaucratic incentive effect. The results are supported by Pranoto and Widagdo (2016) which show a negative relationship between political connections and tax aggressiveness.

The inconsistency of the results of these studies indicates a possible problem which is caused by differences in indicators and measurements of used research variables by previous researchers. In addition, environmental and regulatory characteristics are also suspected to influence the results of the studies. The research about the relationship of political connection with the practice of tax aggressiveness become important to do in Indonesia for several reasons, firstly the democratic system in Indonesia has developed since the fall of Soeharto (new order) in 1998. In the new order era, transparency and accountability the government and companies are still considered low, especially in the taxation context. Therefore, companies which have political connection with the government tend to get a lot of incentives in taxation practices. In addition, law enforcement is also considered not optimal, so companies which have political connection tend to be more flexible in tax avoidance and tax evasion. Although in the reformation era the government has made various efforts to reduce the practice of tax avoidance and tax evasion, but the practice of tax avoidance and tax evasion still occurs. The second argument is related to corporate governance systems that are different from countries in America and Europe. Indonesia uses the two-tier board system while America and Europe use the one-tier board system. The two-tier board system separates the role of the board of commissioner and director in the company's organisational structure. The board of director has a role to carry out the company's business operations, while the board of commissioner has monitoring function of the director in carrying out the company's management duties. In relation to taxation practice, director and board of commissioner may have different interests. Directors have a tendency in aggressive taxation practice because they have an interest in getting bonuses or incentives for high performance (earnings after tax) of the company, while board of commissioners tend to be more conservative in taxation practices to avoid legal cases and maintain the good name of companies in the sustainability context. Based on these arguments, this study attempts to analyse the relationship between political connection of the board of director and commissioner with tax aggressiveness in companies which are listing in Indonesia Stock Exchange. The next section explains the theoretical background and research hypothesis, followed by a discussion of research methods. Discussion of the research results and conclusions is described at the end of this paper.

2 Literature review and hypothesis

Political connections are commonly found in state-owned companies. Zhang's research (2012) shows a negative relationship of political connections to the practice of tax aggressiveness in state-owned enterprises (stated-owned enterprises). Politically connected companies are less aggressive in taxation practices than with other companies. The results of this research is supported by Pranoto and Widagdo (2016) and Iswari et al. (2019) which shows the existence of Bureaucratic Incentive Effect on companies which have a political connection.

Member of the board of commissioner and director of the state-owned enterprises generally have political connection. Most of them are ex-government officials (ex-ministers, ex-generals), ex-member of the House of Representatives, and volunteers of political parties supporting the government. Therefore, state-owned enterprises that are politically connected tend to maintain good relations with the government and maintain the good image of the company by becoming obedient taxpayers, even though the research results of Kim and Zhang's (2016) on companies in America show different results. The research shows that political connection has a negative effect on tax aggressiveness.

The literature also indicates a difference of interest between management (directors) and the company owner (commissioner) in the taxation context. Management has an interest to show the performance of a managed company through a high level of profitability, although it may result in high tax payments. Watts and Zimmerman (1986) explain that managers tend to try to increase company profits because they are motivated to get bonuses or incentives for the company's financial performance.

In this context, company directors will try to manage earnings to show optimal performance. One of them is by utilising the political connection held by directors to lobby politics for the government to obtain funding facilities and government projects. Therefore, directors who have political connection tend to maintain good relation with the government through compliance in tax payments. In addition, increasingly stringent government regulations in limiting tax avoidance practices have made company directors more careful in taking company taxation policies. Furthermore, the literatures show that the tax aggressiveness practices can negatively affect stock performance and company value (see Desai and Dharmapala, 2006; Hanlon and Slemrod, 2009). The possibility of future litigation risks and the possibility of a negative market response to the company's stock price can affect taxation policies taken by company management. Thus it can be assumed that the higher the level of political connection of the company's directors, the level of tax aggressiveness is lower.

This condition is contrary to the interests of the company owners who want the level of welfare not to decrease due to the tax burden paid. This means that the lower the tax burden paid by the company, the higher the level of earnings per share received by the owner. The Commissioner as part of the company owner will try to utilise their political connection to minimise the tax burden paid. Based on the previous research results and arguments, we formulated two hypotheses that are different direction related to the relationship between the political connection of the directors and the board of commissioners with the tax aggressiveness practices.

H1 Political connections of directors are negatively related to tax aggressiveness.

H2 Political connections of the board of commissioners are positively related to tax aggressiveness.

3 Research method

3.1 Sample and research data

The population in this study are all companies which listed on Indonesia Stock Exchange. The research sample is non state-owned enterprises listed on Indonesia Stock Exchange

in 2012–2016. The state-owned companies are excluded from the research sample with consideration of reducing sample selection bias, as most state-owned enterprises have political connections. In addition, previous research results are relatively consistent in providing evidence of a strong influence between the political connections of government companies and the practice of tax aggressiveness (see Zhang, 2012).

The sample period of the study was chosen with consideration of the current data and establishment of taxation regulation in Indonesia. Law no. 36 of 2008 on Income Tax start effective in 2009 and Law no. 42 of 2009 on Value Added Tax on Goods and Services and Sales Tax on Luxury Goods start effective in 2010. In 2011 is not included in the analysis period because it is considered as a transition period. In the transition period, the company likely make adjustments to the tax policy regarding the law. The data of the company financial reports and stock prices are obtained from the Capital Market Reference Center (PRPM) of the Indonesia Stock Exchange and the Investment Gallery of the Faculty of Economics and Business, Universitas Sebelas Maret.

3.2 Research variables

3.2.1 Tax aggressiveness

Tax aggressiveness is measured by the effective tax rate (ETR). The ETR value is obtained by dividing the income tax burden by profit before tax (Minnick and Noga, 2010; Lanis and Richardson, 2012). ETR is the applicable rate on company earnings and applicable to all types of industries. Therefore, ETR is often used as an indicator of tax aggressiveness practices. When the value of ETR is lower, then the level of tax aggressiveness is higher. This means that the company which have tax aggressiveness is the ETR value is below the prevailing tax rate. The negative marked ETR coefficient means that companies are getting more aggressive in tax practices, and vice versa.

3.2.2 Political connection

Political connection is usually measured by assigning value 1 for a company whose commissioner has a political connection with a political party or government institution and assigning value 0 if it does not fulfil the criteria. However, in this study, political connection variables do not use categorical measurements such as previous studies, but measured by the proportion of commissioners who have a political connection with the number of commissioners in the company sample. Thus it can be known how much influence the political connection variable to tax aggressiveness variable. The value of the board of directors' political connection variable is obtained by dividing the number of directors who have political connection with the total number of the board of director members, while the value of the board of commissioners' the political connection variable is obtained by dividing the number of commissioners who have political connection with the total number of commissioners.

In this study we consider several control variables, namely firm size, firm age, leverage, growth, and audit quality. Firm size is measured by total assets. Company size is measured by the number of days since the company was established until the date of the issuance of the financial reports on the Indonesia Stock Exchange. To avoid high variability of data, the values of company size and company age are transformed in natural logarithms. Audit quality is a dummy variable which is measured by giving value

1 for a company which audited by a public accounting firm affiliated with the big four and 0 for others. Leverage was measured as the ratio of total debt to total assets, and growth was measured by market to book value of equity.

3.3 Data analysis technique and hypothesis testing

The research data analysis uses multiple regression analysis. The analysis is conducted after the fulfilment of classical assumptions, including normality test, multicollinearity test, autocorrelation test and heterokedastisity test. The regression equation is developed to test the hypothesis in this study as follows:

$$ETR = \alpha_0 + \beta_1 PC_DIR + \beta_2 PC_COM + e \quad (1)$$

$$ETR = \alpha_0 + \beta_1 PC_DIR + \beta_2 PC_COM + \beta_3 SIZE + \beta_4 AGE + \beta_5 LEV + \beta_6 GROWTH + \beta_7 AUDIT + e \quad (2)$$

$$ETR = \alpha_0 + \beta_1 PC_DIR + \beta_2 PC_COM + \beta_3 SIZE + \beta_4 AGE + \beta_5 LEV + \beta_6 GROWTH + \beta_7 AUDIT + \beta_8 PC_DIR * SIZE + \beta_9 PC_COM * SIZE + e \quad (3)$$

Remark:

ETR	effective tax rate
PC_DIR	political connections of director
PC_COM	political connection of commissioner,
SIZE	firm size
AGE	firm age
LEV	leverage
GROWTH	growth opportunities
*AUDI*T	audit quality
*PC_COM * SIZE*	the political connection interaction of director with firm size
*PC_DIR * SIZE*	the political connection interaction of the board of commissioners with firm size
e	error term.

4 Results and discussion

This research analyses 844 non-state-owned companies listed on the Indonesia Stock Exchange period 2012–2016. The result of descriptive statistic analysis in Table 1 shows the average value of effective tax rate (ETR) is 27% with a minimum value of 1% and a maximum value of 100%. The results give an illustration that on average (in general) the company does not have tax aggressiveness, because the average ETR is higher than the prevailing income tax rate, which is 25%. The average value of the proportion of

director's political connection is 2% and the maximum value is 50%, while the average proportion of the board's political connection is 15% with a maximum value of 100%. This means that the composition of directors and board of commissioners of companies that have a relatively small political connection than those who do not have a political connection. Based on these data, it can be said that the average proportion of the board of commissioners' political connection is higher than the average proportion of the board of directors. The board of commissioners who have political connection are found in several types of industries, such as banking, manufacturing, logistics, real estate, and mining. Whereas directors who have political connections are only found in a number of industries, such as banking, hotels and properties and telecommunications (e.g., Bank BCA, MNC Land, Jakarta International Hotels & Development, and Media Nusantara Citra). The firm size variable (SIZE) is measured by total assets has a minimum value of Rp. 39.839.011.116 and a maximum value of Rp. 676,738,753,000,000 with an average of Rp. 14.806.459.075.427, while the firm age variable (AGE) has an average value of 12.271 days or 34 years old. The leverage variable (LEV) has an average value of 51%, while growth and audit quality have an average value 13.46 and 0.38. In addition, correlation analysis results do not show the existence of multicollinearity among independent variables.

Table 1 Statistic descriptive and correlation

	ETR	*PC_DIR*	*PC_COM*	*SIZE*	*AGE*	*LEV*	*GROWTH*	*AUDIT*
Min	0.01	0.00	0.00	24.41	6.40	0.01	0.06	0.00
Max	1.00	0.50	1.00	34.15	10.47	3.24	97.00	1.00
Mean	0.27	0.02	0.15	28.67	9.31	0.51	13.46	0.38
SD	0.17	0.07	0.21	1.75	0.48	0.28	19.23	0.48
ETR	1.000							
PC_DIR	0.084*	1.000						
PC_COM	–0.027	0.043	1.000					
SIZE	–0.039	0.104**	0.184**	1.000				
AGE	–0.033	–0.122**	0.021	–0.019	1.000			
LEV	0.073*	–0.026	0.146**	0.192**	0.034	1.000		
GROWTH	–0.093**	–0.71*	0.024	0.283**	–0.039	–0.102**	1.000	
AUDIT	0.017	0.016	0.074*	0.381**	0.035	–0.032	0.228**	1.000

Notes:*, **indicate significance at the 5% and 1% levels, respectively. ETR = effective tax rate; PC_DIR = Political connection in the board of directors; PC_COM = political connection in the board of commissioners; SIZE = log firm size; AGE = log firm age; LEV = leverage; GROWTH = firm growth and AUDIT = audit quality.

The result of regression analysis in Table 2 shows the coefficient of political connection of director with positive and significant sign in equation (1). It shows that directors who have political connection have positive effect on ETR. This means that the higher the political connection of company directors, so the ETR is also higher. Therefore, it can be concluded that companies which have a higher proportion of political connections of directors, so the level of tax aggressiveness is lower. The results of the analysis are consistent in equation (2) and equation (3). Thus the first hypothesis (H1) in this study is

supported. This indicates the existence of bureaucratic incentive effect. Directors who have political connection tend to comply with tax regulations to foster good relations with the government. Directors as managers responsible for the existence and sustainability of companies tend to be conservative in tax policy making. Thus, the good image of the company can increase and the chances of getting a project or tender from the government can increase. In addition, the company's chances of getting help or loan financing when financial difficulties or when it wants to develop a business will also be easier. Research Pranoto and Widagdo (2016) illustrate that lenders or bankers are often forced to lend to finance projects run by political connections even though the project is unlikely to be profitable.

Table 2 Regression results

Variable	*Equation (1)*		*Equation (2)*		*Equation (3)*	
	Coeff.	*t-value*	*Coeff.*	*t-value*	*Coeff.*	*t-value*
Constant	0.276	38.328***	0.522	3.387***	0.453	2.546***
PC_DIR	0.192	2.476**	0.189	2.402***	3.511	3.317***
PC_COM	–0.025	–0.895	–0.027	–0.974	–0.461	–0.940
SIZE			–0.006	–1.553*	–0.005	–1.048
AGE			–0.011	–0.914	–0.007	–0.576
LEV			0.053	2.432**	0.061	2.755***
GROWTH			–0,001	–2.065**	–0.001	–2.182**
AUDIT			0,022	1.684	0.024	1.853*
PC_DIR * SIZE					–0.115	–3.150***
PC_COM * SIZE					0.015	0.893
R^2	0.008		0.026		0.038	
Adj. R^2	0.006		0.018		0.027	
F-value	3.375		3.171		3.615	
Sig	0.035		0.003		0.000	
N	844		844		844	

Notes: *, **, ***indicate significance at the 10%, 5% and 1% levels, respectively.
ETR = effective tax rate; PC_DIR = political connection in the board of directors; PC_COM = political connection in the board of commissioners; SIZE = log firm size; AGE = log firm age; LEV = leverage; GROWTH = firm growth; AUDIT = audit quality; PC_DIR * SIZE = interaction political connection in the board of directors and PC_COM * SIZE = interaction political connection in the board of commissioners.

Table 2 also shows the analysis result of the political connection of the board of commissioners with the variable of tax aggressiveness. The analysis result shows that the coefficient of political connection of the board of commissioners is negative but not significant at the level of 1%, 5% and 10%. The results are also consistent in equation (2) and equation (3). Therefore, it can be concluded that the second hypothesis (H2) in this study is rejected. Although the second hypothesis is rejected, the negative direction of the relationship between the variable of political connection and the tax aggressiveness indicates conformity with the hypothesis. It indicates that there is a difference of interest between company management and the owner. This means that the

owner wants to pay minimum tax but management wants to comply with tax regulations by paying taxes according to regulation in force. However, the role of the owner (in this case the board of commissioners) is not very strong in intervening taxation policies which is taken by the company management. This is probably due to the political connection level of company directors are stronger than the political connections of the company board of commissioners.

Furthermore, the analysis results show that company size affect significantly in the relationship between political connection of directors and tax aggressiveness. In the second model (second equation) political connection of directors have a positive effect on ETR, which means there is a negative relationship between the political connection of directors and the tax aggressiveness. However, the interaction analysis result of political connection of directors' variable with company size variable shows different direction [see result of equation (3) analysis in Table 2]. These results indicate a difference in the behaviour of company directors which have political connection in the taxation policies determination, especially with company size. This means that on average, directors who have political connection tend not to do aggressive taxation practices, but the directors who have political connection in large companies tend to adopt aggressive tax policies, and vice versa. This indicates the existence of a political favouritism effect, because the executives in large companies may be able to utilise their political connections to lobby the government which related to tax aggressiveness practices (e.g., avoiding tax audits and asking fines reduction). In the taxation context, directors of companies have more interests than the board of commissioners, because directors are directly related to the company's operating activities and have an interest with the level of executive compensation to be received.

In addition, large companies have relatively higher bargaining power on the government, because they have a large contribution in the national economy. These arguments are reinforced by the results of further analysis which are presented in Table 3. In the large company sample, the regression coefficient of the political connection variable of the directors is negative and significant on the level 10%, but in the small company sample the regression coefficient remains positive as the analysis results on the whole sample.

This study results support political power theory which states that large companies have more opportunities to influence the political process that are profitable to them (see Belz et al., 2019). Political power theory is very relevant to economic and political conditions in Indonesia as a developing country with a relatively low level of transparency, accountability and law enforcement. Indonesia is in the category of countries with a relatively high level of corruption. In 2018 the Indonesian corruption perception index was still at number 38 with a ranking of 89. The score was same as Bosnia and Sri Lanka. At the ASEAN level, Indonesia is still below Singapore, Brunei Darussalam, and Malaysia (Taher, 2019; Siddiq and Widiastuti, 2019). Low level of government transparency and accountability are often used by business people to get tax incentives through political lobbies. In addition, large-sized companies have more competent human resources in conducting tax management, so that they can take advantage of the regulatory loopholes that give advantages to the company. The argument is supported by several research results which show that ETR rates in large companies are relatively lower than small-sized companies (Kern and Morris, 1992; Nicodeme, 2007). Furthermore, the research results by Mills et al. (2013) provide evidence that large companies that have political power tend to have a low ETR.

Table 3 Regression results

Variable	*Big firm*		*Small firm*	
	Coeff.	*t-value*	*Coeff.*	*t-value*
Constant	0.214	1.477	0.365	2.101**
PC_DIR	–0.179	–1.690*	0.567	5.039***
PC_COM	–0.009	–0.263	–0.070	–1.604
AGE	0.005	0.342	–0.013	–0.680
LEV	–0.012	–0.326	0.101	3.860***
GROWTH	–0.001	–0.079	–0,001	–1.020
AUDIT	0.054	0.164***	–0,025	–1.220
R^2	0.037		0.109	
Adj. R^2	0.023		0.096	
F-value	2.675		8.421	
Sig	0.015		0.000	
N	844		844	

Notes: *, **, *** indicate significance at the 10%, 5% and 1% levels, respectively.
ETR = effective tax rate; PC_DIR = political connection in the board of directors; PC_COM = political connection in the board of commissioners; AGE = log firm age; LEV = leverage; GROWTH = firm growth and AUDIT = audit quality.

5 Conclusions

This study provides some empirical evidence of taxation practices in companies with political connection. In general, the study results indicate a negative relationship between the political connections of directors with tax aggressiveness practices. In addition, the study results also indicate that company size is an important factor in determining taxation policy. Large companies and directors who have political connection with government tend to do aggressive taxation practices. The study results provide an overview to the company stakeholders, especially tax regulators to be more careful in evaluating the taxation practice of large companies and directors who have political connection with the government.

Nevertheless, this study has some limitations that may affect the analysis results. First, this research only uses data of political connection of directors and commissioners from the available information on the annual financial report and company website. Thus there is still possibility of companies that do not disclose information which related to a comprehensive political connection to the two sources of information. Second, this study has not considered the condition of national politics in the period of observation, because in the period of observation (in 2014) there is a national political agenda, namely the President of Republic Indonesia election. Third, this study has not considered the company aggressive measurement methods, such as Cash ETR or abnormal book tax differences (ABTD) as an alternative measurement.

Based on the limitation of the research, so further research can develop the research by doing observation and deeper analysis to obtain data of political connection of company, for example by doing confirmation to company or data request about bio data

directors and company commissioners. In addition, researchers can further compare the company taxation practices between the period before and after the presidential election. Furthermore, further research can conduct robustness check by analysing with several alternative methods of aggressive tax measurement.

References

Adhikari, A., Derashid, C. and Zhang, H. (2006) 'Public policy, political connections, and effective tax rates: longitudinal evidence from Malaysia', *Journal of Accounting and Public Policy*, Vol. 25, No. 5, pp.574–595.

Belz, T., Hagen, D.V. and Steffens C. (2019) 'Taxes and firm size: political cost or political power?', *Journal of Accounting Literature*, Vol. 42, No. 1, pp.1–28.

Chen, S., Chen, X., Cheng, Q. and Shevlin, T. (2010) 'Are family firms more tax aggressive than non-family firms?', *Journal of Financial Economics*, Vol. 95, No. 1, pp.41–61.

CNN Indonesia (2016) *'Panama Papers dan Praktik Penghindaran Pajak* [online] https://www.cnnindonesia.com/ekonomi/20160412112445-79-123307/panama-papers-dan-praktik-penghindaran-pajak (accessed 9 April 2018).

Desai, M.A. and Dharmapala, D. (2006). 'Corporate tax avoidance and high-powered incentives', *Journal of Financial Economics*, Vol. 79, No. 1, pp.145–179.

Frank, M., Lynch, L. and Rego, S. (2009) 'Tax reporting aggressiveness and its relation to aggressive financial reporting', *The Accounting Review*, Vol. 84, No. 2, pp.467–496.

Hanlon, M. and Heitzman, S. (2010) 'A review of tax research', *Journal of Accounting and Economics*, Vol. 50, Nos. 2–3, pp.127–178.

Hanlon, M. and Slemrod, J. (2009) 'What does tax aggressiveness signal? Evidence from stock price reactions to news about tax shelter involvement', *Journal of Public Economics*, Vol. 93, No. 1, pp.126–141.

Iswari, P., Sudaryono, E.A. and Widarjo, W. (2019) 'Political connection and tax aggressiveness: a study on the state-owned enterprises registered in Indonesia Stock Exchange', *Journal of International Studies*, Vol. 12, No. 1, pp.79–92.

Kern, B. and Morris, M. (1992) 'Taxes and firm size: the effect of tax legislation during the 1980s', *The Journal of the American Taxation Association*, Vol. 14, No. 1, pp.80–96.

Kim. C. and Zhang, L. (2016) 'Corporate political connections and tax aggressiveness', *Contemporary Accounting Research*, Vol. 33, No. 1, pp.78–114.

Lanis, R. and Richardson, G. (2012) 'Corporate social responsibility and tax aggressiveness: an empirical analysis', *Journal of Accounting and Public Policy*, Vol. 31, No. 1, pp.86–108.

Li, C., Wang, Y., Wu, L. and Xiao, J. Z. (2016) 'Political connections and tax induced earnings management: evidence from China', *The European Journal of Finance*, Vol. 22, Nos. 4–6, pp.413–431.

Mills, L., Nutter, S. and Schwab, C. (2013) 'The effect of political sensitivity and bargaining power on taxes: evidence from federal contractors', *The Accounting Review*, Vol. 88, No. 3, pp.977–1005.

Ministry of Finance of the Republic of Indonesia (2017) *Perekonomian Indonesia dan APBN 2017* [online] https://www.kemenkeu.go.id/apbn2017 (accessed 9 April 2018).

Minnick, K. and Noga, T. (2010) 'Do corporate governance characteristics influence tax management?', *Journal of Corporate Finance*, Vol. 16, No. 5, pp.703–718.

Nicodeme, G. (2007) *Do Larges (SIC) Companies Have Lower Effective Corporate Tax Rates? A European Survey*, Working Paper 07/001, Centre Emile Bernheim.

Pranoto, B.A. and Widagdo, A.K. (2016) 'Pengaruh koneksi politik dan corporate governance terhadap tax aggressiveness', Paper presented at the *Seminar Nasional and The 3rd Call for Syariah Paper*, Fakultas Ekonomi dan Bisnis, Universitas Muhammadiyah Surakarta, Indonesia.

Ridha, M., and Martani, D. (2014) 'Analisis terhadap agresivitas pajak, agresivitas pelaporan keuangan, kepemilikan keluarga, dan tata kelola perusahaan di Indonesia', Paper presented at the *Simposium Nasional Akuntansi 17*, Universitas Mataram, Indonesia.

Sari, D. (2010) *Karakteristik Kepemilikian Perusahaan, Corporate Governance, dan Tindakan Pajak Agresif*, thesis, Program Studi Magister Akuntansi Fakultas Ekonomi Universitas Indonesia, Depok, Indonesia.

Shackelford, D. and Shevlin, T. (2001) 'Empirical tax research in accounting', *Journal of Accounting and Economics*, Vol. 31, Nos. 1–3, pp.321–387.

Siddiq, T. and Widiastuti, R. (2019) *Indeks Persepsi Korupsi Indonesia 2018 Naik Jadi 38 Poin* [online] https://nasional.tempo.co/read/1170330/indeks-persepsi-korupsi-indonesia-2018-naik-jadi-38-poin (accessed 28 April 2019).

Swingly, C. and Sukarta, I.M. (2015) 'Pengaruh karakter eksekutif, komite audit, ukuran perusahaan, leverage dan sales growth pada tax avoidance', *E-Jurnal Akuntansi*, Vol. 10, No. 1, pp.47–62.

Taher, A.P. (2019) *Indonesia Menduduki Peringkat ke-89 di Dunia Dengan Skor 38 Berdasarkan Indeks Persepsi Korupsi* [online] https://tirto.id/indeks-persepsi-korupsi-2018-indonesia-peringkat-ke-89-dunia-dfl9 (accessed 28 April 2019).

Wahab, E.A.A., Ariff, A.M., Marzuki, M.M. and Sanusi, Z.M. (2017) 'Political connections, corporate governance, and tax aggressiveness in Malaysia', *Asian Review of Accounting*, Vol. 25, No. 3, pp.424–451.

Watts, R.L. and Zimmerman, J.L. (1986) *Positive Accounting Theory*, Prentice Hall, Englewood Cliffs.

Wu, W., Wu, C., Zhou, C. and Wu, J. (2012) 'Political connections, tax benefits and firm performance: evidence from China', *Journal of Accounting and Public Policy*, Vol. 31, No. 3, pp.277–300.

Zhang, H. (2012) *How Does State Ownership Affect Tax Avoidance? Evidence from China*, Working Paper, School of Accountancy, Singapore Management University.