

## ANALYSIS OF TAX ELIMINATION WITH THIN CAPITALIZATION

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**Abstract:** This study aims to analyze thin capitalization which is used as a way of tax avoidance. This study uses independent variables namely multinational, managerial ownership, audit committee, while the control variables are effective tax rates, profit growth, asset returns, company size, current ratio, capital intensity, and inventory intensity. The study population consisted of all non-financial companies listed on the Indonesia Stock Exchange from 2015-2019. The sample of this research is a multinational non-financial company which means having a subsidiary outside Indonesia. The statistical method used in this study is multiple linear regression analysis. The results of this study indicate that multinationality, managerial ownership, and audit committee have no significant effect on thin capitalization. As for the control variables, return on assets and company size have a significant effect on thin capitalization.

**Keyword:** thin capitalization, multinasional, managerial ownership

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### INTRODUCTION

One of the tax evasion conducted by companies that have operations across national borders is thin capitalization (Benshalom, 2007). Thin capitalization is a tax avoidance that places loans to subsidiaries or affiliates abroad. Thin capitalization is a funding structure that increases the proportion of debt rather than equity to avoid excessive tax burdens. The tax treatment of returns from funding through debt is different from the returns from funding through capital (equity). If the source of funding is interest expense, then interest is a deduction from taxable income, whereas funding from dividends is no deduction. This difference drives companies to create funding sources from debt that are greater than from capital (thin capitalization). This statement is supported by Mardan's research (2013) that investment funding between interest (debt) and dividends (share capital) has different tax treatment, thus triggering the practice of thin capitalization. The thin capitalization rule in Indonesia is stipulated in KMK Number 1002 / KMK.04 / 1984 which was revised again

to PMK No.169 / PMK.010 / 2015. The rule governs the calculation of thin capitalization by using a debt to equity ratio, as well as a maximum capitalization limit of 4: 1. This means that interest costs above 80% are still subject to tax. The rules regarding thin capitalization have been implemented since 1984, but the rules do not work effectively because according to the government the rules prevent foreign investors from investing in Indonesia. According to Mardan (2013) the practice of thin capitalization can be detected by measuring Debt to Equity Ratio. Companies that avoid tax using the thin capitalization method are proven to have a high debt to equity ratio (Beuselinck et al., 2005; Dyreng et al., 2008; Graham & Tucker, 2006). Therefore, developed countries that are members of the European Union formulate rules to counteract thin capitalization by using a ratio of debt to equity ratio (Debt to Equity Ratio). Tax avoidance can be seen from the Global Financial Integrity records which show the flow of illicit or illegal funds resulting from tax avoidance and business activities in Indonesia which were sent abroad

reached US \$ 6.6 trillion for 10 years in a row (<http://finance.bisnis.com>, 2015). Only in the period 2003 to 2012, the flow of illegal funds from Indonesia more than tripled from US \$ 297.41 billion to US \$ 991.3 billion, or an average increase of 9.4% per year (<http://financial.bisnis.com>, 2015). In addition, the Directorate General of Tax of the Ministry of Finance (DGT of the Ministry of Finance) stated that as many as 2,000 foreign investment (FDI) companies operating in Indonesia did not pay Article 25 and Article 29 Corporate Income Tax (PPH) for reasons of loss for the last ten years from 2007- 2016 with total state losses of Rp. 500 trillion (<https://www.liputan6.com>, 2016). Quoted from one of the media stating that the Director General of Taxes detected that of 2000 foreign investment companies that stated losses to avoid taxes, 50% of them stated that the loss was not due to business activities and production, but very high corporate debt (<https://www.liputan6.com>, 2016). If the tax director general's identification results show that foreign investment companies manipulate losses by increasing debt to avoid taxes, then tax avoidance is referred to as a thin capitalization scheme.

Valeria et al. (2015) empirically examined the effect of state tax rate policies on thin capitalization. Valeria et al. (2015) explained that thin capitalization is based on state policy in setting tax rates, the higher the state tax rates the higher thin capitalization. Desai & Dharmapala's (2006) research resulted in the finding that debt can be used to increase company value, because loan interest can be used as a deduction from the income tax burden. In the study of Desai & Dharmapala (2006) analyze the company's trade-offs in increasing company debt due to tax savings, but on the one hand debt causes bankruptcy costs. According to Desai & Dharmapala (2006) optimal thin capitalization occurs because of the

trade-off process between tax savings (tax shield of leverage) and the cost of using debt (cost of financial distress and agency cost of leverage). This statement is supported by the results of research by Fuest and Hemmelgarn (2005) that the higher the debt can reduce the tax burden, then the emergence of cost of financial distress makes the company get compensation for not paying taxes. Based on this theory it can be concluded that companies that do thin capitalization will ignore the costs of bankruptcy because they have obtained tax savings (tax shield). Thin capitalization is an efficient tax avoidance if the company operates globally and has other entities in different jurisdictions (Huizinga et al, 2005). This is intended because each country has different tax rate rules, so companies can take a gap on these different rules to avoid tax (loopholes). Therefore, this study analyzes the effect of multinationality on the practice of thin capitalization. Taylor & Richardson (2012) conducted research on determinants of thin capitalization, one of which is multinationality in which companies that have subsidiaries or affiliates that are increasingly in other countries tend to practice thin capitalization. Beuselinck (2015) conducted a study on the practice of tax avoidance on multinational companies, it was found that multinational companies in some countries tend to avoid tax by increasing corporate debt (thin capitalization). Tax uncertainty can be used by company management as a tool to cover tax avoidance activities, including the application of thin capitalization to reduce the total value of corporate tax debt (Brown et al., 2017). This study uses tax uncertainty as a detector in the practice of thin capitalization because, according to Desai and Dharmapala (2007), there are tax advantages if the company reports tax position uncertainty based on complexity and camouflage to avoid detection, so that the practice can

maintain the opportunities owned by management in implementing the practice tax evasion. When a company enters a "gray area" where the boundary between implementing tax planning and tax avoidance becomes unclear, there is an accompanying tax uncertainty. Rahayu (2010) conducted a study on thin capitalization that was influenced by tax uncertainty which showed that the rules regarding taxation in Indonesia were quite complex and more different from international tax rules that made companies report uncertainty about tax positions that were only used as imaging as a company obedient to tax.

This study adds foreign operations as determinants that influence the practice of thin capitalization. The reason this research uses foreign operations is because companies whose activities cross national borders mean they have ample opportunity to avoid tax because they can take a gap from different cultural, political, economic environments and different tax laws (Ariffin, 2013). Several studies on foreign operations show that the greater the company's foreign operations there is a tendency for companies to be more aggressive in tax avoidance practices (Desai et al., 2004; Graham & Harvey, 2001; Huizinga et al., 2008; Rego, 2003; Stickney & Mcgee 1982). However, the results of this study differ from studies conducted by Stickney and Mcgee (1982) that companies with high foreign operations do not affect the practice of tax avoidance. Measurement of foreign operations in this study me Based on the description above, this study will analyze thin capitalization which is influenced by multinationality, tax uncertainty, foreign operation, company size (control variable), and company growth (control variable).

Theory of Reasoned Action Theory of Reasoned Action (TRA) was first introduced by Martin Fishbein and Ajzen (Fishbein & Ajzen, 1975) in (Ajzen, 1987). This theory discusses

behavior that is determined by the intention (intention) with certain motivations, then this theory is related to beliefs, attitudes, norms, intentions, and individual behavior (behavior). This theory has important conceptual elements to explain and predict moral behavior, including behavioral beliefs, outcome evaluations, attitudes towards the behavior and normative beliefs, motivation to comply, subjective norms. The components of this theory play sequential roles that become personal and social variables in moral behavior.

Motivational Postures Theory (Motivational Posture Theory) Braithwaite in 1995 developed the Motivational Postures Theory, in which this theory did not differ greatly from the theory of reasoned action, which is the motivational posture describing the five main attitudes in doing tax compliance. The description of the motivational posture is the mental attitude of the taxpayer to show the tax authorities regarding the system, structure, and procedures for taxation that apply or in other words comply with taxes (Braithwaite, 2003). Motivational posture is used in this study because it is indicated that it can detect attitudes possessed by taxpayers on the taxation rules applied.

Thin Capitalization According to Oecd (2012), thin capitalization refers to a situation in which a company is financed by a higher level of debt compared to capital. This understanding is also in line with the notion of thin capitalization contained in the article Taylor and Richardson (2013) and Taylor et al. (2011) which states that companies that implement this practice are also called "highly-leveraged" or "highly-g geared".

Multinationality Multinational companies are companies that have significant operations in two or more countries simultaneously, but the main decisions and controls are made by companies in their home countries

(Buettner et al., 2012; Taylor & Richardson, 2013).

**Uncertainty Tax** The company's uncertainty in reporting the company's tax position can be used to avoid taxes. According to Desai & Darmapala (2006) that tax uncertainty can be used by company management as a tool to cover tax avoidance activities. According to previous research conducted by Beck & Lisowsky (2013), there is a positive relationship between companies that provide disclosure of uncertainty on the company's tax position with thin capitalization. Taylor & Richardson (2013) also produced research that tax uncertainty has a significant influence on the practice of thin capitalization.

**Foreign Operation** Foreign Operations are activities or operations of companies that cross national or international borders. Stickney and Mcgee (1982) analyze that cross-border activity can expand opportunities in tax avoidance practices, because these companies have the opportunity to take advantage of differences in the rule of law compared to domestic companies. Basically there are several aspects of tax avoidance for companies involved in overseas activities.

**Company Size (SIZE)** Taylor & Richardson's research (2013) regarding company size on thin capitalization led to the finding that both variables have a very strong influence. Zimmerman's research (1983) explains that a company with a large scale tends to be more sensitive in avoiding taxes. This indicates that the larger the size of the company, the lower the value of thin capitalization as measured by the debt to equity ratio. This variable is measured using the natural asset logarithm (Ln Asset).

**Company Growth** Company growth is obtained from the calculation of the natural logarithm of operating profit. Operating profit is profit before interest expense and tax. The greater the profit of the company there are indications of the more avoiding taxes

that show that the company's growth reflects the manifestation of the company's success in improving financial performance and can be used as a tool for the company to maintain the company's performance before investors. The measurement of company growth uses operating profit because the profit before interest expense and tax expense can be used as a predictor of the company to avoid tax.

## METHODS

The model used in this study was adapted and modified from the research model developed by Taylor and Richardson (2013) to measure the relationship between thin capitalization and its determinants. There are several model modifications made. First, the proxy measurement of the dependent variable used in this study was replaced. In this study the THINCAP variable is measured using the ratio of debt to capital owned by the company. The second modification is the researcher adds a foreign operation variable. Profit growth and company size as control variables. These models are:

$$THINCAP_{i,t} = \alpha_0 + \beta_1 MULTI_{i,t} + \beta_2 FOREKS_{i,t} + \beta_3 UNCERT + \beta_4 SIZE_{i,t} + \beta_5 GROWTH_{i,t} + e_{i,t}$$

## Population and Research Samples

Population is a whole element that meets certain conditions, related to the problem under study, and is made an object in research. The population in this study were all foreign investment companies listed on the Indonesia Stock Exchange during the period 2007 to 2016. The sample in this study was determined using the purposive sampling method, namely the selection of samples according to certain criteria. The companies that became the sample in this study were selected based on certain criteria (purposive sampling),

namely: Foreign investment companies listed on the IDX.

Registered companies are all foreign investment companies except banking, insurance, and mining. Companies that do not experience losses in a certain period Companies that have a positive debt to equity ratio

### **Data Collection Sources and Techniques**

The data source of this research is secondary data from data obtained from foreign investment companies listed on the IDX in 2015-2019. The variables studied were available in full in the 2015-2019 financial financial reporting. Data sources were obtained from the Indonesian Capital Market Directory and IDX website: <http://www.idx.co.id>.

### **Data Analysis Techniques**

This research model is estimated by using OLS (Ordinary Least Square) in testing each hypothesis. In order for the model to be analyzed and provide repressive results, the model must meet the assumptions of classical assumptions, namely normality (normally distributed data), heteroscedasticity, autocorrelation, and multicollinearity. In this study the data analysis technique was started by doing a Ghozali descriptive statistical test

(2013: 19). Data analysis in this study used multiple linear regression assisted with SPSS software version 20. To perform data analysis, data processing is carried out by multiple linear regression assisted with SPSS version 20. The Thin Capitalization is

positioned as the dependent variable associated with multinationality, tax uncertainty, and foreign operations as independent variables. The method of multiple linear regression is used to test variables that have a direct influence on the research model that is built on the basis of a strong theory.

## **RESULTS AND DISCUSSION**

### **Overview of Research Objects**

The object under study in this study is companies that have foreign capital listed on the Indonesia Stock Exchange except banking, insurance, and mining companies for the period 2015-2019. Based on the sample selection criteria that refer to the limitations described in chapter 3, a sample of 74 companies was obtained with a total of 460 observations.

### **Descriptive Analysis Results**

Descriptive statistical analysis in this study aims to describe the description of the variables used both independent variables namely multinationality (MNC), Tax Uncertainty (UNCERT), and Foreign Operations (FOREKS), firm size control variables (SIZE) and company growth (GROWTH), as well as the independent variable, thin capitalization (THINCAP / DER). Based on the results of the study it can be seen the minimum, maximum and average values of each variable from the company that were sampled during the years 2007-2016 are presented in

**Table 1. Descriptive Test Results**

	N	Minim	Maks	Mean	Std. Dev
Thin Cap	460	.007	3.5960	1.024984	.8028130
MNC	460	0	1	.75	.433
UNCERT	460	0	1	.75	.433
FOREKS	460	.000	.9998	.207915	.288
SIZE	460	20.040	33.5950	25.03259	2.578
GROWTH	460	14.535	32.6040	24.08708	1.961
Valid N (listwise)	460				

Source: Data processed (2020)

### ***Thin capitalization***

The value of thin capitalization proxied by the debt to equity ratio in table 4.1 shows that thin capitalization in this study has an average of 1.024984 with a standard deviation which shows the variability of the variable thin capitalization of 0.8028130. In this study the highest thin capitalization of 3.5960 is owned by the company Kokoh Inti Arebama Tbk, while the lowest thin capitalization of 0.0070 is owned by the company Davomas Abadi Tbk.

### ***Multinationality***

Multinationality is measured using a dummy, which shows that multinationality in this study has an average value of 0.75 with a standard deviation that shows the variability of the multinationality variable of 0.433. In this study multinationality with a value of 0 was 7.8% and a value of 1 was 92.17%. This means that companies that do not have subsidiary companies or affiliates in different jurisdictions are 19 foreign investment companies, while companies that have subsidiary or affiliated entities in different jurisdictions or abroad as many as 56 companies.

### ***Uncertainty Tax***

Uncertainty Tax in the study was measured by using a dummy, which showed an average value of 0.75 with a standard deviation that showed variable variability of 0.433. In this study the value of 0 is 25% and the value of 1 is 75%. This means that companies that do not disclose tax position uncertainty

are 18 companies and companies that disclose uncertainties tax position certainty in the financial statements of 60 companies.

### ***Foreign Operation***

Foreign operations in this study were measured using a calculation of total foreign income divided by total income, which shows an average value of 0.207915 with a standard deviation showing variable variability of 0.2886948. In this study the maximum value of foreign operations was .9998 owned by Hexindo Adiperkasa Tbk company and the lowest value was 0.00 which was owned by several companies. The meaning of the value 0 is that the company does not have income or sales abroad.

### ***Company Size (SIZE)***

Size is a variable from the calculation of the total natural logarithm of assets, which has an average value of 25.032539 with a standard deviation that indicates variable variability of 2.5783858. In this study the highest size was 33.5950 and the lowest was 20.0400 owned by the company Ades Water Indonesia tbk.

### ***Profit Growth (GROWTH)***

Earnings growth is a calculation of the natural logarithm of LnEBIT operating profit which has an average value of 24.087048 with a standard deviation that shows the variable variability of 1.9619315. In this study the

highest profit growth was 32.6040 and the lowest was 14.5350.

**Analysis of Research Results**

Analysis of the model in this study was carried out using multiple linear regression test. This test was chosen because it aims to examine the effect of more than one independent variable on the dependent variable.

**Classic assumption test**

This test is carried out in order to get the results of the regression model that can be estimated accurately and without bias or called BLUE (Best Linear Unlimited Estimation). This classic assumption test consists of 4 tests including normality test, multicollinearity test, heterokedactivity test, and autocorrelation test.

**Normality test**

The normality test aims to test whether in the regression model, the dependent variable and the independent variable have a normal distribution

(Ghozali, 2012). If this test does not meet the assumptions then the statistical test becomes invalid. The way to test data normality is by analyzing the Normal P-Plot chart. The basis for decision making from the P-Plot graph are: If the point spreads around the diagonal line and follows the direction of the diagonal line, the regression model meets the normality assumption. If the point spreads away from the diagonal line and or does not follow the direction of the diagonal line, the regression model does not meet the normality assumption. Statistical analysis that can be used to test normality is the non-parametric Kolmogrov-smirnov test. Data is said to be normally distributed if the significance (2-tailed) shows more than 0.05. In this study, the normal distribution can be fulfilled after transforming the dependent variable in the form of natural logarithms. Following are the results of the Kolmogrov-Smirnov test after transforming.

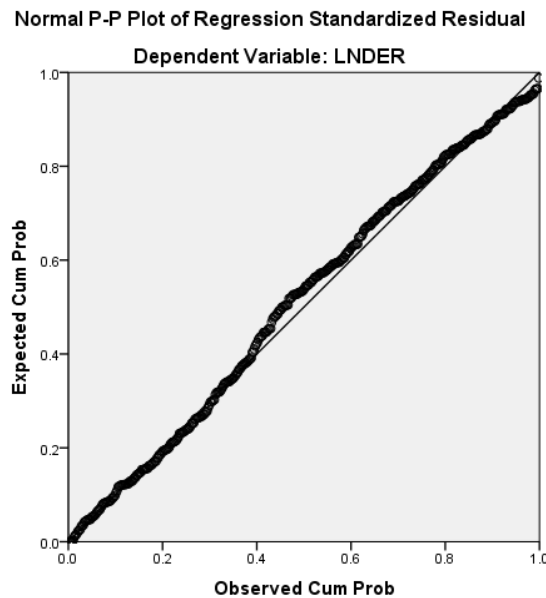
**Tabel 2. Hasil Uji Kolmogrov-smirnov**

Kolmogorov-Smirnov Z	.914
Asymp. Sig. (2-tailed)	.374

Source: Data processed 2018

Data is said to have normal distribution if significance shows more than 0.05. Based on Table 4.3 the value of Kolmogrov-smirnov. 914 is obtained

with a significance level of .374. This significance value is more than 0.05. This shows that the data is normally distributed.



Source: Data processed 2018

**Figure 1. Normal P-P Plot of Regression Standardized Residual**

Based on Figure 1, it can be seen that the data spreads around the diagonal line and follows the direction of the diagonal line. It can be concluded that the P-P plot graph shows the data normally distributed.

**Multicollinearity Test**

Multicollinearity is needed to test whether in the regression model there is a high correlation between independent

variables. This test shows that there is a perfect or definite linear relationship between variables. To detect the presence of multicollinearity symptoms in the regression model can be seen from the value of tolerance and Variance Inflation Factor (VIF). Multicollinearity does not occur if the tolerance value > 0.1 and the VIF value < 10. The results of multicollinearity testing in this study are shown in the following table.

**Table 3. Multicollinearity Test Results**

Variable	Collinearity Tolerance	Statistic VIF	Information
MNC	,963	1,038	Multicollinearity free
UNCERT	,984	1,016	Multicollinearity free
FOREKS	,973	1,028	Multicollinearity free
SIZE	,956	1,046	Multicollinearity free
GROWTH	,954	1,049	Multicollinearity free

Source: Data processed 2018

Table 3 shows the results of the multicollinearity test. Based on Table 4.4 it is known that all independent variables, namely multinationality (MNC), Uncertainty Tax (UNCERT), Foreign Operations (FOREKS), control

variables namely company size (SIZE) and company growth (GROWTH), have tolerance values > 0.1 and VIF < 10. It can be concluded that all independent variables in the regression model tested

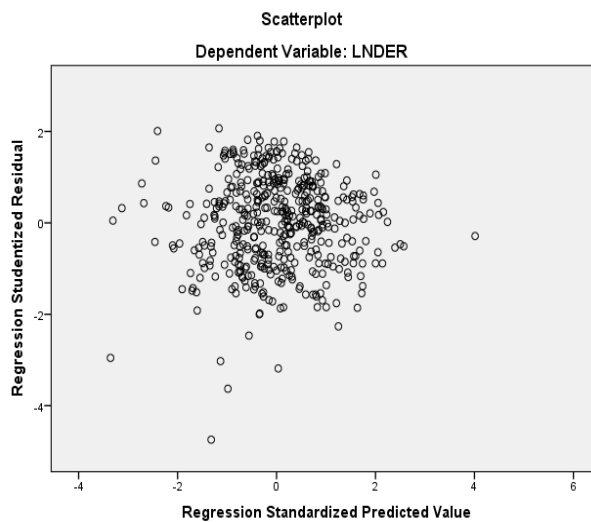


in this study did not occur Multicollinearity.

**Heterokedasticity test**

Testing for heteroscedasticity symptoms is performed to determine whether there is a relationship between confounding variables and independent variables. If there is a symptom of homoscedasticity, it means that there is no relationship between the confounding

variable and the independent variable, so that the dependent variable is really only explained by the independent variable Heteroscedasticization symptom test can be known using a scatter plot graph. If the points spread and do not form a distinctive pattern, the regression test is not subject to the assumption of heteroscedasticity. The results of heteroscedasticity test in this study can be seen as follows.



Source: Data processed, 2018  
**Figure 2. Scatterplot**

Figure 2 shows that the scattered points do not collect and do not form a distinctive pattern. Thus it can be concluded that there is a symptom of homoscedasticity or there is no relationship between the dependent variable with the independent variable, so that the dependent variable is really only explained by the independent variable. The results of this test state that the regression model is free from symptoms of heteroscedasticity.

**Autocorrelation Test**

Autocorrelation test aims to test the correlation between errors between bullies in period t and errors in period t-1 (previous). To find out whether or not this autocorrelation was used the Durbin Watson test. Testing is free of autocorrelation free if it is between -2 to +2.

**Table 4. Durbin Test – Watson**

Model	Durbin – Watson
1	0.847

Source: Data processed 2018

Based on the Durbin-Watson test presented in Table 4.5, the regression

for equation 1 shows a value of 0.847 which means that the Durbin-Watson

value is still in the autocorrelation free range because it is between -2 to +2.

### Model Analysis and Hypothesis Testing

Following are the results of multiple linear regression tests for the first model where this regression

examines the effect of independent variables consisting of multinationality, tax uncertainty, foreign operations and control variables consisting of size and growth of the company (growth), so we get the results of multiple linear regression as follows :

**Table 5. Multiple Linear Regression**

Variable	Model Regression			
	Koefisien	t	Sig	Conclusion
Independen (constant)	3,474		.000	
MNC	-,189	-1,951	,052	Not significant
UNCERT	,289	3,006	,003	significant
FOREKS	,354	2,439	,015	Significant
SIZE	-,036	2,192	,029	significant
GROWTH	-,127	-5,897	,000	significant
R square	.131			
F statistic	13,668			
F Sig	.000 <sup>b</sup>			

Source: Data processed 2018

Information:

= statistically significant at the 5% significance level

$$\text{THINCAP}_{it} = 3,474a - ,189 \text{ MNC} + ,289 \text{ UNCERT} + ,354 \text{ FOREKS} - ,036 \text{ SIZE} - ,127 \text{ GROWTH} + ,88450$$

Based on the summary results of multiple linear regression analysis in Table 4.6, the regression coefficients of the study showed the same results, namely positive. The coefficient marked positive indicates a direct change between the independent variable and the dependent variable. The following are interpretations of the regression coefficient values: Constant value of 3.474 which means that if there are no other variables, the value of thin capitalization is 3.474. The multinationality variable has a regression coefficient of -.89. This means that if multinationality increases by one unit, the thin capitalization variable will increase by -, 189 and vice versa assuming other variables are constant. The variable tax uncertainty has a coefficient of, 289. This means

that if tax uncertainty increases, thin capitalization will increase by 289, and vice versa assuming other variables are constant. The foreign operation variable has a regression coefficient of .354. This means that if the foreign operation variable increases by one unit, thin capitalization will increase by 354 and vice versa assuming other variables are constant. The company size variable has a regression coefficient of -.036. This means that if the foreign operation variable increases by one unit, thin capitalization will increase by -, 036 and vice versa assuming other variables are constant.

The company size variable has a regression coefficient of -.127. This means that if the foreign operation variable increases by one unit, thin capitalization will increase by -, 127 and

vice versa assuming other variables are constant. After interpreting the regression coefficient, hypothesis testing can then be performed. Hypothesis testing is done by looking at the value of t test which aims to determine the effect of independent variables on the dependent variable partially. The t test value of the multinationality variable is -1,951 with a significance level, 052. The significance value does not exceed 0.05 so it can be concluded that multinationality has a significant positive effect on thin capitalization. Thus the hypothesis in this study was not proven, because H1 was rejected. T test value of the variable tax uncertainty (UNCERT) is equal to 3.006 with a significance level of 0.003. This significance value is greater than 0.05 so it can be concluded that tax uncertainty has a significant positive effect on thin capitalization. The t test value of the variable tax uncertainty (FOREKS) was 2,439 with a significance of 015. The significance value does not exceed 0.05 so it can be concluded that company size has a significant negative effect on thin capitalization. The t test value of the firm size variable (SIZE) of -2,192 is by significance, 029 . The significance value does not exceed 0.05 so that it can be concluded that company growth has a significant negative effect on thin capitalization. The t-test value of the company's growth variable (GROWTH) of -5,897 is significance, 000. The significance value does not exceed 0.05 so that it can be concluded that company growth has a significant negative effect on thin capitalization.

The coefficient of determination (R<sup>2</sup>) shows how much all the independent variables explain the dependent variable. In Table 4.7, the R<sup>2</sup> value of 0.131 shows that multinationality, tax uncertainty, foreign operations, company size, and company growth are able to explain variations in thin capitalization.131 or 13.1% while the remaining 87% is explained by other

variables outside the independent variables and the control variables used in research.

The following is a discussion of the results of data analysis tests to develop research hypotheses.

### **Effect of Multinationality on thin capitalization**

Based on the results of research that has been tested shows that multinationality has an insignificant effect on thin capitalization as an act of tax avoidance, the results of these studies are supported by research conducted by (Desai et al., 2004). However, the results of this study are not in accordance with the research of Taylor and Richardson (2013) and Mills and Newberry (2004), where multinationality has a significant effect on thin capitalization.

The results of this study are closely related to Theory of Reasoned Action, namely the existence of positive beliefs about taxes, so that the attitude is tax-compliant. This attitude is based on the intention of multinational companies to maintain corporate performance by not doing (behavioral) tax avoidance. The more companies that have branches in more than two countries, the more to minimize the debt to equity ratio. In addition, the results of this study can also be linked to the Motivational Posture Theory developed by (Braithwaite 2003), where multinational companies have compliance with tax payments as a positive orientation (compliant) which results in commitment and capitulation. The commitment of multinational companies reflected in this research is that companies realize that the taxation facilities provided by the Indonesian government have benefited multinational companies, so that multinational companies are committed to be involved in the role of the tax authorities to fight tax avoidance practices. Then, the capitulation of multinational companies that is reflected in this research is the

cooperative attitude of the company by utilizing tax facilities provided by the government without tax avoidance.

The results of the study that show that multinationality has a significant effect on thin capitalization have several theoretical reasons, including stating that multinational companies have the flexibility to conduct financing which consists of debt and capital to affiliates or companies that have a special relationship based on tax rates in the country or region where branches are established. the company (source country) (Klassen et al., 1993; Mills & Newberry, 2004; Mintz & Weichenrieder, 2005). If an affiliate or branch company is established in a source country that has a low tax rate, the parent company will transfer capital with a higher proportion of debt than equity. Conversely, affiliates or branch companies are established in source countries that have high tax rates, the parent company will transfer capital with a higher proportion of debt than equity. Klassen et al. (1993) in his research added that multinational companies have many strategies in avoiding taxes because the business activities of multinational companies are able to cross national borders, which basically have an incompatibility between domestic tax rules and international taxes, so they are able to exploit loophole tax regulations (loophole).

The explanation of the above research is different from the results of this study, where this study shows that multinationality does not significantly influence the practice of thin capitalization. The results of this study are consistent with the research of Dewi and Jati (2014) and Schwarz (2009) that multinational companies have no significant effect on tax avoidance. Multinational companies are companies that have a major influence on economic growth, especially in developing countries (Parjiono & Fitrah F. H, 2018). Indonesia is a country with low investment performance compared to

other developing countries in Asia, meaning that Indonesia must do various ways to attract foreign investors (multinational companies) to be interested in investing in Indonesia (<https://ekonomi.kompas.com>, 2018) . One of Indonesia's strategies to attract multinational company investment by providing tax incentives. In addition, tax incentives are policies to encourage companies not to avoid taxes. The government provides several tax facilities for foreign companies that invest their capital in Indonesia, including tax holidays, tax sparing credits, investment allowances and tax credits, accelerated depreciation, and tax rate reductions (Parjiono & Fitrah F. H, 2018). Multinational companies included in this research are relatively few in number as many as 56 companies, so it can be said that when the government withdraws the investment of multinational companies by providing tax incentives it will not reduce state revenue

### **The Effect of Foreign Operations on Thin Capitalization**

Foreign operations in this study have a significant effect on thin capitalization. The results of this study are consistent with research conducted by Rego (2003), Mills and Newberry (2004), Beuselinck et al. (2005), and Taylor and Richardson (2013) that the higher the level of overseas sales the higher the practice of thin capitalization.

The results of this study illustrate the relationship with the Theory of Reason Action where companies with high export levels tend to have the beliefs (beliefs) that the company will get high profits, causing high tax burden. On the basis of these beliefs, it raises an attitude to avoid taxes with various events through tax management. Then, if this theory is associated with the Motivational Posture Theory developed by Braithwaite (2003) there is a defiance category as a form of corporate resistance to high tax rates.

Foreign operations in this study are measured by foreign sales of total sales, so in other words companies that have high export values tend to avoid taxes. The results of this study are supported by Modigliani and Miller (1963) theory that companies that not only operate in the domestic market have more space to increase the debt ratio in order to increase the value of the company. The value of the company referred to in this case is the company is able to save the cost of tax expenditure (tax shield) and maximize corporate profits (Pohan, 2013). In addition, Ariffin (2013) argues that the more extensive the operations carried out by companies abroad, the more likely it is to undertake tax avoidance.

#### **Effect of Company Size (control variable) on Thin capitalization**

The size of the company in the study has a significant effect on thin capitalization. The results of this study indicate a negative direction, which means that the larger the company, the less likely it is to practice thin capitalization. Companies that are grouped into large sizes (have large assets) will tend to be more capable and more stable to generate profits when compared to companies with small total assets (Desai & Dharmapala, 2008). Large companies that are measured based on total assets will disclose greater information to attract the interest of the community so that the public's view of the company seems good (Buettner et al., 2012). This allows companies to comply with tax regulations and is less likely to avoid tax avoidance.

Large companies are more able to do tax management, therefore, even if large companies avoid tax, they certainly use other tax avoidance strategies that are difficult for tax authorities to detect. Large size companies that are reflected in the size of assets indicate that the company is able to carry out business activities

across countries and must maintain the company's performance in the eyes of investors. The practice of thin capitalization is characterized by a higher level of debt ratios compared to equity ratios which makes the company's financial statements not attractive according to investors.

The results of this study illustrate that companies with large sizes tend to have positive beliefs so that they can influence positive attitudes and behaviors. Positive beliefs referred to in this study are companies having beliefs that with a low debt level will be able to attract investors and the company has confidence that by making fair tax payments will avoid tax sanctions. The size of the company in this study reflects that at the stage of the size of the company the larger the company tends to be compliant to be committed to the company as a company that has a large contribution to the country (the area where the company was founded), so that they feel they have a role in the vision and mission government and regulator.

#### **Effect of Company Growth (control variable) on Thin Capitalization**

Earnings growth in this study has a significant effect on thin capitalization. The negative direction in this study shows that the faster the company's growth the smaller the practice of tax avoidance. The results of this study are consistent with research by Taylor and Richardson (2013) that earnings growth has a significant effect on thin capitalization.

If the results of this study are developed according to Theory Reasoned of Action and Motivational Posture Theory, reflecting that companies with the ability to obtain stable profits have the beliefs (beliefs) to report taxes fai the company can build credibility and trust.

## CONCLUSION

Based on the analysis and testing of data in this study, the following conclusions are obtained: Companies that have subsidiaries or affiliates in jurisdictions that are different from the parent company or can be called a multinationality company do not have a significant influence on the practice of thin capitalization. Companies that disclose tax uncertainty position (tax uncertainty) have a significant influence on the practice of thin capitalization. Companies that have greater income from other countries (foreign operations) tend to practice thin capitalization. Companies with the size of the regular logarithm of total assets have a significant influence with a negative direction on the practice of thin capitalization. The larger the size of the company the greater the more avoid the practice of thin capitalization. Companies with firm growth have a significant influence with a negative direction on thin capitalization. The more rapid the company's growth, the more it avoids the practice of thin capitalization.

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