

The Impact of Political Connection on Tax Avoidance; A Literature Review

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ABSTRACT

Political power has a big impact on tax legislation and tax avoidance methods. The impact of political connections on tax avoidance in Indonesia has raised significant concerns among policymakers, regulators, investors, and stakeholders. The research method is literature review research, using descriptive qualitative data technic analysis. The data used in the study is secondary data obtained through some journals such as national and international that provide previous research, book references, internet site references, news in national references, and international media references as well as various state reports related to understanding the relationship between political connections and tax avoidance is essential for developing a comprehensive framework for addressing possible abuses and ensuring fairness and transparency in the tax system. The research contributes to analyzing the strong correlation between political relations and tax avoidance.

Keywords: Political Connection, Tax Avoidance, Tax Legislation

INTRODUCTION

Analysis of tax avoidance strategies in politically connected firms reveals that these connections provide opportunities for companies to engage in more aggressive tax planning activities, in today's globalized and interconnected economy, the impact of political connections on tax avoidance has raised significant concerns among policymakers, regulators, investors, and stakeholders. By delving into this complex and intricate relationship, we can gain valuable insights into the potential implications for the ethical and financial landscape of the business world. Understanding the dynamics between political connections and tax avoidance is essential for establishing a comprehensive framework to address potential abuses and ensure fairness and transparency within the tax system.

The phenomenon of political connections influencing tax avoidance in Indonesia is a well-documented case. Companies with strong political ties often leverage these relationships to gain benefits that may include reduced risk of tax audits and preferential treatment in tax matters. Political connections can be through direct relationships where a member of the company's board has political influence, or indirectly where there are family ties to government officials. Studies show that in the context of Indonesia, these connections lead companies to become more aggressive in their tax planning, resulting in a decreased transparency of financial statements and a likelihood of engaging in practices that may be considered tax-aggressive. The effect is more pronounced in large companies, which possess higher bargaining power and may contribute more significantly to the national economy. Such companies are also able to use their influence to lobby the government regarding tax policies, contributing to what is referred to as a 'political favoritism effect'. This utilization of political connections to minimize tax liabilities is an example of how political power can intersect with corporate financial practices, potentially leading to issues of fairness and equality in the tax system.

The relation between political connections and tax avoidance in Indonesia has been subject

to various studies which predominantly indicate that political connections can significantly influence the degree of tax avoidance undertaken by firms. Companies with strong political ties may have easier access to favorable tax policies, may anticipate and plan for potential tax rate changes more effectively, and might face a lower risk of tax audits. This could be due to perceived protection from the government and less demand for transparency. As a result, firms with political connections are often found to engage more in tax avoidance strategies compared to those without such connections. Tax avoidance, the practice of minimizing tax liabilities through legal means, has been a prominent issue in various countries, including Indonesia (Hodder, 2000). Numerous studies have examined the factors that contribute to tax avoidance, and one significant factor that has emerged is political connection. Research has shown that companies with political connections in Indonesia are more likely to engage in tax avoidance practices (Purwanto & Indrawan, 2020).

Political influence plays a significant role in shaping tax policy and influencing tax avoidance practices (Amara & Khelif, 2020). This influence is particularly evident in large companies where directors with political connections are more aggressive in their tax practices (Fasita et al., 2022). They can utilize their connections to lobby the government for preferential treatment and to avoid tax audits. Furthermore, large companies also have more bargaining power with the government due to their significant contribution to the national economy. These political connections allow firms to receive benefits such as access to changes in tax policy and the ability to engage in strategic tax planning (Putra & Suhardianto, 2020). They can use their political connections to anticipate and plan for possible tax rate increases, thus reducing their effective tax rates. Additionally, companies with political connections have an information advantage compared to other companies, this advantage allows them to make decisions that result in lower reported profits, reducing their tax liability.

Indonesian laws do not adequately regulate the engagement of directors and commissioners in politics. offerings. This gives rise to the notion that political ties may play a role in tax evasion. Research by (Amalia & Ferdiansyah, 2019) demonstrates the relationship between political ties and tax avoidance, and the typical business leverages these ties to lower tax payments through lobbying and laxer oversight. Political connection has a significant positive effect on tax avoidance (Susanti et al., 2021), the findings indicate that companies with political connections may use them to avoid tax audits and reduce tax payments. Political connections influence tax avoidance in Indonesian companies by providing benefits such as easier loans, low tax audits, and special treatment from the government in taxation matters, allowing companies to avoid tax planning due to reduced tax audits. Companies with political connections tend to engage in tax aggressiveness to lower detection risks and gain better information about tax regulations, potentially reducing political costs related to tax planning activities.

Research by (Putra & Suhardianto, 2020) found that political connections in Indonesian firms have a positive relationship with the amount of a firm's tax, which suppresses tax avoidance activities. Additionally, political connections are found to have a negative relationship with tax avoidance, implying that political connections increase tax payments. the research contributes to the understanding of tax behavior in firms with political connections by showing that political connections have a positive influence on the amount of taxes paid by firms, leading to increased tax compliance. Another research found different results mentioned that political connections of the board of commissioners have an insignificant negative effect on tax avoidance, while variables like leverage and size have a significant influence on tax avoidance behavior (Indarto & Widarjo, 2021). Mostly samples data from previous research using secondary data collected from the Indonesia Stock Exchange.

Some of the previous studies used a lot of sample data obtained from the Indonesian Stock Exchange from various types of companies operating in the fields of manufacturing, mining, infrastructure as well and transportation with quantitative analysis techniques method. Further analysis of this research should also be carried out using qualitative analysis techniques. The exploration of qualitative analysis will also serve as a foundation for policymakers and regulators to design effective measures that mitigate the adverse effects of political connections on tax

avoidance.

LITERATURE REVIEW

The business uses political connections as a means of forming and preserving goodwill with legislators through lobbying, political donations, campaign contributions, and the appointment of officials to boards of directors. To put it another way, companies looking to sway government policy in their favor should consider cultivating political ties as a key tactic. Politically connected businesses will be more likely to be aggressive in their tax planning since they will have easier access to capital loans, government protection, and minimal risk of tax audits. The corporation can reap numerous benefits from its political connections. The business will have no trouble getting government bailout money, even in the event of a financial crisis. (Indarto & Widarjo, 2021) mentioned that Goodwill and trust are the building blocks of a relational political connection (RPC). Because of their common political philosophies, companies have sustained long-term relationships over time and even across governments. Politicians are typically opportunistic since ideology is thought to be the most crucial element in building political connections. Maintaining connections during political regime transitions also requires effective adaptability, even if this diminishes the link when the ruling government does not share the same ideology due to the decreased closeness. By implementing the ideologies, they believe to be suitable, politicians will compete to win in general elections. The incumbent politician aspires to uphold his standing as a law-abiding citizen who has made contributions to the nation and to grow in popularity. To protect their reputation.

Tax avoidance is a legal method that uses loopholes (gray areas) in tax laws and regulations to take advantage of the financial weaknesses of taxpayers. In contrast, tax evasion is an illegal method of tax avoidance that puts taxpayers at risk of financial instability because it goes against the lines of tax laws and regulations. There are two types of resistance to tax avoidance: passive resistance and active resistance. Tax avoidance, often known as resistance to tax, is a problem that hinders tax collection and lowers state cash receipts. An effort to reduce the tax burden while abiding by the law is known as tax avoidance. By directing taxes to non-taxable transactions, tax avoidance aims to reduce the overall tax burden (Pohan, 2016). Tax avoidance is defined as any conduct that obstructs tax collection to reduce state revenue (Sulistiono & Amin, 2019). Resisting in methods that are nonetheless legitimately acceptable by taking advantage of the gaps and vulnerabilities in the relevant laws is consistent with tax evasion.

Previous research (Sumual & Karundeng, 2022) found that political connections influence tax avoidance in Indonesian mining companies by affecting audit delays. Companies with political connections may intervene in the audit report process to achieve the desired outcome, leading to a longer audit process. This delay in the audit process can indicate efforts to engage in tax avoidance. The findings emphasize the importance of regulations on tax collection activities and the consideration of top management connections in decision-making processes within public mining companies in Indonesia.

(Putra & Suhardianto, 2020) in their research found that firms with political connections tend to pay more taxes, indicating a negative relationship with tax avoidance. The studies highlight the impact of management's political experience or intention to maintain a positive image on tax compliance, supporting the upper-echelon theory. Control variables such as profitability, solvency, and corporate governance were considered in the analysis, with results contradicting the rent-seeking theory and previous studies on state-owned enterprises in Indonesia. According to (Hambrick & Mason, 1984) via Upper Echelon Theory, leaders' values and cognition reflect the methods they have selected, as well as the ideas and experiences they have brought from their prior jobs. According to empirical evidence, the upper echelon theory postulates that organizational performance and decision-making are influenced by the characteristics of the upper echelon.

The strategy of the company may be impacted by the management's political background. Political experiences can have an impact on tax avoidance since management can apply decisions and beliefs that are related to their political experiences and can influence the firm's allegiance to the government. The firms' approach to minimizing their tax burden will be less aggressive due to

the loyalty of the management to the government. According to (Krueger, 1974) the rent-seeking hypothesis is consistent with the public choice theory, which holds that certain groups, such as politicians, bureaucrats, or parties affiliated with the government, are seen as having self-interest. Related parties will bargain to influence economic policy to secure advantages for their group, such as simple import and export procedures, product subsidies, or convenient regulations. Government rules are employed to impede the flow of resources or enhance supply, which raises income but does not correspond to higher productivity. According to those theories, businesses position individuals who have a relationship with the government into their corporate structure, either as commissioners or directors, to obtain advantages such as tax payment reduction plans.

The research studies on earnings quality, corporate tax avoidance, tax enforcement, and tax compliance, focus on Indonesia (Mustaqim & Nurhidayati, 2020) have been discussing the impact of tax audits on reducing tax avoidance, especially for companies with political connections. The study analyzes the relationship between audit effectiveness, tax avoidance, and political connections using panel data from publicly traded companies in Indonesia. The findings emphasize the importance of tax audits in minimizing tax avoidance practices and highlight the moderating role of political connections in this relationship. Economic observers pay particular attention to companies that are encouraged to have political ties, according to (Faccio, 2006), because there are signs of preferential treatment from the government, particularly for companies that are directly owned by officials or powerful individuals holding positions in government. Businesses are considered to have political ties if at least one of the primary shareholders individuals holding at least 10% of the total voting rights is involved. If not, one of the leaders the chairman, secretary, president, vice president, CEO, or member of parliament has a connection to a political figurehead or party.

Businesses with political ties will benefit from government protection, easy access to capital loans, or special permissions inside the government administrative system, which will encourage them to take a more proactive approach to tax preparation. Political ties also give businesses the ability to influence ongoing law enforcement procedures concerning tax obligations. Previous studies in China by (Lin et al., 2017) demonstrate that the degree to which business executives are politically connected has a major impact on the efficiency of tax audits in reducing corporate tax avoidance. These are related to the company's main objective is to maximize profit while minimizing expenses when operating its business. For business managers, paying taxes is one of the biggest expenses they can minimize. Since the amount of taxes paid is determined by the company's profit, the more profit made generally translates into larger tax payments. Taxes are perceived as a cost that needs to be subtracted. Tax avoidance is one strategy to lessen the tax burden.

RESEARCH METHOD

The research method is literature review research, using descriptive qualitative data technic analysis. The data used in the study is secondary data obtained through some journals such as national and international that provide previous research, book references, internet site references, news in national references, and international media references as well as various state reports related to understanding the relationship between political connections and tax avoidance is crucial for policymakers, regulators, investors, and stakeholders to address potential abuses and ensure fairness and transparency in the tax system.

RESULT AND DISCUSSION

Studies conducted on the correlation between political connections and tax avoidance have revealed a strong association between the two. Businesses with close ties to the political system typically use more aggressive tax avoidance tactics than do those without. Through these links, businesses may be able to change tax rules and regulations to their advantage and lower their tax burden in several ways. This can involve advocating for tax laws that benefit their particular industry, securing exemptions or loopholes, or getting special consideration during audits and

assessments (Zhang et al., 2020). Furthermore, political links might provide the impression of partiality and undue advantage, which can harm the reputations of the enterprises involved. This can result in public outrage, legal consequences, and, eventually, a detrimental impact on the firm's financial performance and stability. Furthermore, studies have demonstrated that political connections can have an impact on tax law enforcement and compliance.

When tax avoidance methods in politically connected enterprises are examined, it becomes clear that these relationships allow companies to engage in more aggressive tax planning activities. The impact of political connections on tax evasion has alarmed policymakers, regulators, investors, and stakeholders. Delving into this deep and convoluted relationship can provide useful insights into the potential ramifications for the business world's ethical and financial landscape. Understanding the relationship between political connections and tax avoidance is critical for developing a comprehensive framework for addressing possible abuses and ensuring fairness and transparency in the tax system. This research will also serve as a foundation for politicians and regulators to develop effective strategies to limit the negative consequences of political connections on tax avoidance in Indonesia.

Several reasons contribute to the demand for tax avoidance tactics among politically linked corporations. One factor could be the strong link between these corporations and government officials, which may provide them with inside knowledge of tax laws and regulations, as well as the ability to influence policy choices in their favor. Furthermore, the idea of leniency or special treatment from tax authorities because of their political connections may encourage these businesses to engage in more aggressive tax-avoiding techniques.

Politically connected businesses may also look for ways to optimize their financial resources by taking advantage of tax loopholes and using intricate tax structures to reduce their tax bills, all to gain political favor and support. In the context of politics, this might be interpreted as a calculated move to hold onto their position of privilege and authority. The benefits of such techniques outweigh the perceived risks, and the intervention of economic and political interests produces a climate in which tax avoidance becomes the norm. Therefore, to maximize their financial results and take advantage of their political connections to gain a competitive edge, politically connected businesses might keep tax avoidance as a top priority.

Political influence has a variety of shapes on tax policy and avoidance. According to (Sudaryono et al., 2019), by lobbying for tax policy changes, corporations with political connections may utilize their influence to advocate for changes in tax policy that benefit them, allowing for improved tax planning and perhaps lowering their tax payments. The research also indicated that the bargaining power of major corporations has an effect. Because of their significant contribution to the national economy, they have more bargaining power with the government, which they can utilize to negotiate for advantageous tax treatment.

(Putra & Suhardianto, 2020) mentioned in their research other shapes of political influence that shape tax policy and avoidance, which are first, preferential treatment means privileged treatment resulting from political connections can lower the probability of tax audits and allow businesses to pursue more aggressive tax avoidance tactics without worrying about the consequences. Secondly, anticipating tax rate changes means politically connected businesses may be able to obtain insider knowledge about future adjustments to tax rates, enabling them to strategically plan their tax obligations to reduce them. The last one is reduced transparency demands means businesses with political connections may also use their clout to persuade regulators to be less strict with their demands for transparency, which would allow them to evade taxes without being as closely watched. The combination of these elements shows that a company's potential to engage in tax avoidance and the development of tax laws that may favor these related firms can be significantly impacted by political connections.

Companies frequently avoid paying taxes, however, there are a variety of circumstances that can lead to this behavior (Fasita et al., 2022). An element that has been investigated is the existence of political ties within an organization. Research has indicated that businesses with political ties typically employ more aggressive tax planning techniques. This is explained by some benefits that come with having political links, including access to policy changes, less

attention from tax officials, and lower anticipated expenditures associated with tax enforcement (Mustaqim & Nurhidayati, 2020). When compared to corporations that are not politically connected, these benefits increase the probability of tax avoidance in politically connected companies. Politically linked businesses might also experience less pressure from the capital markets to be transparent, which frees them up to use riskier tax-avoiding techniques. In general, political ties seem to have a beneficial impact on corporate tax avoidance.

CONCLUSION

Policymakers and regulators must comprehend the nature of the relationship between political connection and tax avoidance to create effective policies that lessen the negative impact that political ties have on tax evasion, to make wise selections and preserve moral investing standards, investors and stakeholders must also evaluate the degree of political sway over a company's tax policies. It has been discovered that political ties are crucial for alleviating financial hardships and lowering additional tax obligations for businesses, especially those engaged in direct exporting.

Furthermore, to make wise decisions and respect moral investing standards, investors and stakeholders must be aware of the extent of political influence on a company's tax policies. Our objective is to enhance comprehension of the intricate interplay between corporate influence and tax laws by illuminating the role of political relations in tax avoidance, in addition to causing a sense of partiality and unfair benefit, political links can harm the reputation of the participating companies. This may result in a backlash from the general public, legal implications, and eventually a detrimental effect on the company's stability and financial success.

In conclusion, there is a strong correlation between political relations and tax avoidance. Companies can take advantage of favorable treatment under tax laws and regulations by using these ties, which allows them to adopt aggressive tax avoidance techniques. Negative financial repercussions and harm to one's reputation may result from this. Moreover, political ties may affect how tax laws are enforced and followed. To address such abuses and guarantee justice and transparency in the tax system, legislators, regulators, investors, and other stakeholders must all have a thorough awareness of the connection between political relations and tax avoidance.

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