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Association of Tax Haven and Corporate Tax Avoidance: Does Political Connection Matter?

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ABSTRACT

This study specifically examines the association between tax haven and corporate tax avoidance, along with the role of political connection in the association. We use two types of corporate tax avoidance measurements to capture corporate tax avoidance as a whole and the specific profit-shifting scheme. Based on the data of Indonesian multinational companies (MNC) over the 2010–2019 period, we find that MNC with tax haven affiliation is positively associated with corporate tax avoidance. Moreover, our result indicates that political connection significantly moderates the association of tax haven affiliation and corporate tax avoidance.

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Keywords: Political connection; tax avoidance; tax haven

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INTRODUCTION

Corporate tax avoidance is a global issue. In general, the tax system in almost all countries, both developing and developed, has loopholes in its regulations, which create incentives for companies to avoid paying tax. Different standards, requirements on tax policies, and significantly different tax rates encourage unethical behavior, which may be legal under the law. Previous studies found an increase in tax avoidance in public companies and a substantial variation in the levels of this avoidance (Dyreng et al., 2017; Frank et al., 2009). One scheme used by multinational companies (MNC) is to shift profits from one jurisdiction to another by adopting transfer pricing and/or thin capitalization (West, 2017).

Base erosion and profit shifting (BEPS) have been a special agenda initiative at the Organization for Economic Cooperation and Development (OECD). High tax rates might drive multinational companies to shift their profits from countries with high levels of tax rates to their affiliate companies in low/no tax countries (tax haven). Torslov et al. (2020) documented that, in 2015, almost 40% of multinational profits were shifted by MNC to their affiliates in a tax haven country. Information leakage about the investment and wealth of people and companies in tax haven countries has been widespread by anonymous sources, i.e., Swiss/HSBC leaks in 2015 (https://projects.icij.org/swiss-leaks/), Luxembourg leaks in 2014 (LuxLeaks (www.icij.org/project/luxembourg-leaks), Panama Papers leaks in 2016 (https://panamapapers.icij.org/), and the Paradise Papers leaks in 2017 (www.icij.org/investigations/paradis-papers/), all of which show that multinational companies practice tax avoidance.

Indonesia is a developing country that faces tax avoidance problems. In fact, as many as 2248 Indonesian companies are included among the list of Panama Paper leaks (https://www.suara.com/bisnis/) of suspected practicing profit-shifting organizations. The Directorate General of Taxation also reported the increasing number of tax investigation cases year by year in its annual report. Low enforcement regulations and poor investor protections in Indonesia enable companies to perform tax avoidance practices (Habib et al., 2017b). This low legal enforcement gives opportunities for political connections to play important roles in tax avoidance (Kim and Zhang, 2016; Polsiri and Jiraporn, 2012).

Indonesia has a strong history of political connections in business and this connections thus effect firms business transaction and activities. Many studies had documented the correlation between politically connected firm with its ability to get better financing, business governance, earning management and tax avoidance (Fu et al., 2017; Harymawan and Nowland, 2016; Harymawan, 2018; Atwood and Lewellen, 2019; and Joni et al., 2020). Harymawan and Nowland, (2016) in their study examine how political stability and government effectiveness affect the earnings quality in Indonesia. Their results reported that the benefits of political connections are reduced when government effectiveness increased, thus requiring politically connected firms to be more responsive to market pressures and resulting in higher earnings quality. Meanwhile, Joni et al. (2020) argue, for example, that two political factors create more opportunities for companies to approach politicians and lobby them for beneficial business policies: (1) fundamental changes in the political power base from concentration of power to decentralization; (2) military-based government that gives opportunities for active military officers to obtain political positions. Corporate board members are typically connected with politicians, military, and senior government officials (Fisman, 2001; Habib et al., 2017b). The involvement of politicians, military and senior government officials in a corporation do give effect in business transactions. Harymawan (2018) reveals that connected firms significantly enjoy lower interest rates on debt than non-connected firms. His study uses a sample of 1,818 firm-year observations of firms listed on the Indonesian Stock Exchange (IDX) from 2004 to 2012. Study by Fu et al. (2017) also reported political connections have effects of on firms financing and performance where they find that politically connected firms have high probability in getting financing from state-owned banks. Being connected to the government a firm has high probability to receive the full loan amount it applied for. In earlier study by Fisman (2001) reveals that politically connected companies in Indonesia depend on advantages from their connections. Furthermore, Habib et al. (2017b) and Joni et al. (2020), in accordance with companies listed in Indonesia Stock Exchange, documented that 36% of companies in their sample had political connections.

This study complements and extends previous literature that correlates political connection and tax avoidance practice (Adhikari et al., 2006; Sudibyo and Jianfu, 2017; Wahab et al., 2017) by examining the role of political connections in the association between tax haven and tax avoidance practice of Indonesian

MNC. Using the MNC data listed in the Indonesia Stock Exchange over the 2010–2019 period, this study makes the following contributions: First, it enriches the association of tax haven and tax avoidance research by using the transfer pricing scheme as a measurement of tax avoidance, which is correlated directly with the issue of BEPS. Second, this study investigates the role of political connection in moderating the correlation of tax haven and corporate tax avoidance, which is not explicitly examined in prior studies. Our result suggests that MNC with tax haven affiliates conduct corporate tax avoidance more than nontax haven MNC. MNC use their tax haven affiliation as a vehicle to shift their profits to evade paying taxes. Moreover, political connection significantly increases the association between tax haven and corporate tax avoidance.

The remainder of this paper consists of the following sections. Section 2 reviews previous empirical literature and develops hypotheses. Section 3 provides variable measurements and a methodological approach. Section 4 analyzes the statistical result and discussion. Section 5 conclude the paper.

LITERATURE AND HYPOTHESES DEVELOPMENT

Factors that encourage tax avoidance include the human trait of possessing immoral tendencies. Allingham and Sandmo (1972) argue that taxpayers can be immoral, showing in their model the effort to avoid taxation in decision-making quantities and how to use utility-maximization options. Crocker and Slemrod (2005) state that tax avoidance benefits taxpayers but at the risk of being caught. Therefore, optimal tax avoidance from the side of taxpayers will depend on the possibility of being caught and imposing penalties, penalty size, and the level of risk aversion from taxpayers. The authors' analysis of 30 years of data shows that tax avoidance will continue as long as possible until one is caught.

Tax haven and political connection could be important factors that influence tax avoidance practice for MNC. Characteristics of tax haven countries enable MNC to impede the risk of detection in avoiding taxation, while political connection could have an impact on two different sides; it also might mitigate tax avoidance or, on the contrary, become a protection for MNC to augment tax avoidance.

Tax Haven and Tax Avoidance

Many MNC minimize their tax payments by using a tax haven country as a vehicle. Tax havens peddle avoidance, not evasion (Bucovetsky, 2014). Hanlon and Slemrod (2009) view tax havens as "parasitic" because they "sell protection from national taxation." The authors argue that tax havens do not level production by lowering taxes. Nevertheless, this creates "tax haven firms" that produce output in nontax-haven countries then take concealment of taxable income from tax havens. Tax havens become one of the significant tools of international tax avoidance (Bucovetsky, 2014).

Atwood and Lewellen (2019) define a "tax haven firm" as an organized corporate group in which the parent firm is incorporated into a tax haven country; however, the group's headquarters or significant operations are located in a different country. Tax havens have characteristics that encourage utilization for tax avoidance. The tax haven country prioritizes data confidentiality, limits information exchange with other countries, and offers lack of transparency regarding financial and tax arrangements (Taylor and Richardson, 2013).

Moreover, tax haven incorporation may reduce the effectiveness of external monitoring by tax and regulatory authorities (Atwood and Lewellen, 2019). Tax haven countries oblige low- or no income tax on foreign corporations. Companies can minimize their overall tax burdens significantly by shifting income from operations in other countries to tax haven affiliates (Dharmapala, 2008; Taylor and Richardson, 2013; Richardson et al., 2013). Tax havens also "facilitate" tax avoidance by decreasing domestic taxes levied on foreign income and allowing the shifting of taxable income from countries with high tax rates (Hanlon and Slemrod, 2009). Corporations with subsidiaries in tax havens are predicted to accommodate corporate tax avoidance for special purpose transactions in finance, investment, or insurance (Taylor and Richardson, 2013). Their study, which uses samples of 203 Australian firms publicly listed over the 2006–2009 period (812 firm years), found that tax avoidance by thin capitalization is positively significant with tax havens and multinationality, which indicates that multinational corporations tend to exercise tax avoidance more than corporation operations in a single country. These corporations also use tax havens as an instrument of tax avoidance activities.

Moderating Role of Political Connection

Corporate political connection is defined as a special relationship between a firm and authorities in a government where the firm is located (Trinugroho, 2017). The existence of a political connection can result from an owner or management being a state official, politician, or having closeness with the ruling party at that time. Various researchers have documented that political connections are valuable in developing and developed countries, as they can influence government policies toward companies, including tax-related policies. Companies establish links to the government to obtain advantages regarding import licensing, taxes, and supply funds (Sudibyo and Jianfu, 2017).

Prior literature documented the correlation between political connections and corporate tax avoidance. Faccio (2016) argued that companies with political connections pay lower taxes than companies without political connections. Adhikari et al. (2006) examined the correlation between political connection and tax avoidance measured by effective tax rate (ETR). Their study revealed that politically connected firms had lower ETR than nonpolitically connected firms, indicating aggressive tax avoidance. Kim and Zhang (2016) documented that connections in past employment between politicians have a significant impact on tax avoidance. Furthermore, political connections based on hometowns between a CEO and local government officials have an influence on tax avoidance, per Shen et al. (2019). Via examining sample private firms in China, the study result shows that political connections based on hometown ties have positive and significant influence on tax avoidance. This influence is stronger for cities with low public governance.

In Indonesia, several researches also documented significant influence of political connections. Sudibyo and Jianfu (2017) examined the correlation between political connections and tax avoidance behavior in Indonesian listed firms. Results from the 2007–2013 period showed that firms with politically connected independent commissioners have a tendency to execute tax avoidance. The data showed that lesser corporate income tax is paid by politically connected companies compared with nonpolitically connected companies. Hanny and Niandari (2018) also documented the same result, using listed banks in the Indonesia Stock Exchange in the 2014–2016 period, which revealed significantly positive influence of political connection to corporate tax avoidance.

Tax avoidance practice will happen as long as the possibility of being detected is low (Allingham and Sandmo, 1972; Crocker and Slemrod, 2005). The existence of political connections might open opportunities for companies to avoid paying tax because of their confidence in not being caught by legal authorities. The self-interest of government officials and their collusion with companies would induce such tax avoidance; this situation is more severe with corruption and weak governance. Politicians act as a “grabbing hand” that ignores their main function to maximize social welfare (Shleifer and Vishny, 1994).

Tax haven and political connection could be important factors that influence tax avoidance practice for MNC. The characteristics of tax haven countries enable MNC to impede the risk of detection in avoiding taxation, while political connection could also become a protection for MNC to augment tax avoidance. Atwood and Lewellen (2019) stated that tax monitoring by government is often ineffective for companies with tax haven affiliation due to lack of transparency and data confidentiality. Moreover, political factors in Indonesia give opportunities for companies to exploit their political connection for beneficial business policies (Joni et al., 2020), including policies pertaining to tax. The power of politically connected companies to influence government policies and prevent detection of tax authorities become an “incentive” for tax haven affiliation companies to hide their wealth to avoid paying tax, which suggests that companies with political connections perform more tax avoidance by utilizing tax haven affiliations.

Tax haven countries oblige low- or no income tax on foreign corporations. Companies can minimize their overall tax burdens significantly by shifting income from operations in other countries to tax haven affiliates (Dharmapala, 2008; Taylor and Richardson, 2013; Richardson et al., 2013). Tax havens also facilitate tax avoidance by decreasing domestic taxes levied on foreign income and allowing the shifting of taxable income from countries with high tax rates (Hanlon & Slemrod, 2009). This opportunistic behavior by using the transfer pricing scheme to shift income is severe for tax haven companies with political connections regarding lobbying power with the tax official staff. Based on Fisman (2001) and Habib et al. (2017b), an institutional characteristic of Indonesia companies is that corporate board members are highly connected with politicians, military, and senior government officials. Political connection will offer more advantages for companies that use tax haven affiliation as a vehicle to avoid tax. Data confidentiality in a tax haven country

and "protection" from political connections are complementary features that encourage companies to avoid paying tax. Based on the above review, the following hypothesis is tested:

H1: The association of tax haven and corporate tax avoidance is higher for politically connected MNC than for nonpolitically connected MNC

METHODOLOGY

Sample Selection and Data Source

Our sample is nonfinancial MNC year 2010–2019. We restricted MNC, which can shift profits from high-tax-rate to low-tax-rate countries. MNC in this research is defined as a firm that has foreign affiliation, whether it is a parent or subsidiary. Data of the variables were hand-collected from companies' annual reports, which are published in IDX or on a company's website. We started our sample with 1700 observations. After eliminating observations with incomplete data and negative income, we derived a final sample of 1315 observations for corporate tax avoidance measurement using book tax difference (BTD) and 1309 observations for abnormal sales-related party transactions (RPT).

Variable Measurement

Corporate Tax Avoidance

Corporate tax avoidance is the dependent variable of our study. We determined corporate tax avoidance using two types of measurements, i.e., abnormal sales RPT, which describe profit-shifting between affiliations, and BTD, which has been widely used as a corporate tax avoidance measurement. Tax havens provide opportunities to shift profits between affiliations in MNC. We specify one of our measurements of corporate tax avoidance on a transfer pricing scheme based on Sikka and Willmott (2010), which states that 60% of corporate tax avoidance is conducted through a transfer pricing scheme. West (2017) argues that the most significant way for MNC to avoid tax between jurisdictions is by shifting profits using a transfer pricing scheme, which involves a related party transaction. One possible way to avoid tax is income-shifting (Lin et al., 2018), which could be performed by using a related party transaction (RPT). Moreover, more than 90% of listed firms in Indonesia executed various forms of related party transactions (Habib et al., 2017b). Thus, we use abnormal sales RPT as one method of tax avoidance that involves profit-shifting through transfer pricing schemes.

RPT may comprise normal business to obtain abnormal RPTs; transactions occurring from the normal part of business should be removed (Habib et al., 2017b). Dysfunctional behavior through transfer pricing occurs when the abnormal transfer pricing values are greater than zero (Ming and Wong, 2010). Abnormal sales RPT is measured by the residual from (Habib et al., 2017b; Ming and Wong, 2010):

$$Abn\_sales_{it} = \alpha_0 + \alpha_1 Size_{it} + \alpha_2 Leverage_{it} + \alpha_3 Growth_{it} + \varepsilon_{it} \quad (1)$$

where Abn_sales = related party sales/total revenue; size = natural log of total assets; leverage = total debt divided by total assets; growth = market capitalization/shareholder equity

Our second measurement is BTD, which previous studies have used as a corporate tax avoidance measurement (Armstrong et al., 2015; Badertscher et al., 2019; Taylor and Richardson, 2014). BTD is measured as the difference between pre-tax income and less-taxable income scaled by total assets.

Tax Haven

In general, a tax haven is defined as a country or region that charges a low tax rate, even to 0%, or does not impose taxes at all and provides a guarantee of confidentiality of the assets it holds. We use tax haven country classification, as in Atwood and Lewellen (2019) adopted from Dyreng and Lindsey (2009). A country is classified as a tax haven if three of the four following sources identify the country as a tax haven: (i) Organization for Economic Co-operation and Development (OECD); (ii) the U.S. Stop Tax Havens Abuse Act; (iii) The International Monetary Fund (IMF); and (iv) the Tax Research Organization. A list of tax haven

countries is provided in Appendix A. A tax haven country variable is a dummy variable; it is coded 1 if a firm's affiliation is in one of the tax haven countries and 0 otherwise.

Political Connection

Politically connected firms' criteria are based on Faccio et al. (2006), which is followed and modified in the Indonesia context by Nys et al. (2015) and Habib et al. (2017). Samples are categorized as politically connected if at least one large shareholder (controlling at least 10% of the votes directly or indirectly) or board member or commissioner is (a) a current or former member of parliament, (b) a minister or head of local government, or (c) closely related to a politician or party. Connection with government ministers is extended to close relatives (spouse, sons or daughters, and other immediate family relationships). We code this as 1 if firms have a political connection and 0 otherwise.

Control Variables

This study uses two types of control variables, i.e., company financial characteristic and corporate governance. Company financial characteristics have been widely studied and documented as having significant influence on tax avoidance. We use five financial characteristics of companies to control variables: size, profitability, growth, intangible assets, and capital intensity of the company, as previously documented. Size influences how companies implement their tax planning strategies (Gallemore and Labro, 2015; Lismont et al., 2018; Stickney and Mcgee, 1982; Tang, 2016). Prior studies documented how a firm's operating performance affects its behavior in avoiding taxes (Hsieh et al., 2018; Lismont et al., 2018; Tang, 2016). This study uses return on asset (ROA) to capture a firm's profitability. Growth also has significant influence on how tax management is applied (Leung et al., 2019; Tang, 2016). The fourth control variable we use is intangible asset, following Gallemore and Labro (2015), Jiménez-angueira (2018), and Lismont et al. (2018). Last, we control for a firm's capital intensity (Chan et al., 2013; Wegener and Labelle, 2017). The second type of control variable is corporate governance. We use two variables as corporate governance practice in companies, i.e., independent board and auditor. An independent board and auditor could increase monitoring, which can prevent a company's tax avoidance. Many studies have documented the significance of these variables (Armstrong et al., 2015; Chan et al., 2013; Tang, 2016). Variable measurement is provided in Appendix B.

Hypotheses Testing

Hypotheses is tested using multivariate panel regression analysis. The regression models to test H1 [Eq. (2)] are as follows:

$$TA_{it} = \alpha_0 + \beta_1 TaxHaven_{it} + \beta_2 LnSize_{it} + \beta_3 Growth\ i_t + \beta_4 ROA_{it} + \beta_5 Intangible_{it} + \beta_6 Cap\_Intens_{it} + \beta_7 Ind\_board_{it} + \beta_8 Auditor_{it} + \varepsilon_{it} \quad (2)$$

$$TA_{it} = \alpha_0 + \beta_1 TaxHaven_{it} + \beta_2 PolCon_{it} + \beta_3 PolCon*TaxHaveni_t + \beta_4 LnSize_{it} + \beta_5 Growth\ i_t + \beta_6 ROA_{it} + \beta_7 Intangible_{it} + \beta_8 Cap\_Intens_{it} + \beta_9 Ind\_board_{it} + \beta_{10} Auditor_{it} + \varepsilon_{it} \quad (3)$$

where TA = abnormal sales RPT (abn_sales) and BTD; TaxHaven = tax haven country affiliation; PolCon = political connection; LnSize = company size; Growth = company growth; ROA = return on asset; Intangible = intangible asset; Cap_intens = capital intensity; In_board = percentage of board independence; Auditor = auditor Big 4 or non Big 4.

RESULT AND DISCUSSION

Descriptive Statistics, Correlation Matrix, and Univariate Analysis

Descriptive statistics reported in Table 1 reveal that the mean (median) of Abn_sales is 0.132 (0.134). Abn_sales RPT, which is more than 0 describing abnormal transaction of a related party and which facilitates a profit-shifting practice for MNC. Meanwhile, BTD shows the mean (median) of -0.027 (-0.010). Moreover,

from the descriptive statistics, we can see that more than 60% of MNC in our samples have affiliation in tax haven countries, and more than 49% of MNC have political connection.

Table 1 Descriptive Statistics

Variables	Mean	Median	Standard deviation	25th percentile	75th percentile
Abn_sales	0.132	0.134	0.0275	0.119	0.149
Ind_board	0.230	0.222	0.089	0.182	0.286
LnSize	15.527	15.564	1.515	14.493	16.643
ROA	0.075	0.059	0.095	0.021	0.110
Growth	2.556	1.363	3.944	0.654	3.083
Intangible	0.015	0.0001	0.039	0	0.009
Cap_Intens	0.352	0.311	0.225	0.176	0.521

Panel A Summary Statistics for Abn_sales Sample

	Dummy 1	Dummy 0
TaxHaven	60.81%	39.19%
PolCon	49.73%	50.27
Auditor	52.71%	47.29%

Panel B Summary Statistics for BTD Sample

Variables	Mean	Median	Standard deviation	25th percentile	75th percentile
BTD	-0.275	-0.010	0.064-	0.044	0.004
Ind_board	0.229	0.2222	0.898	0.176	0.286
LnSize	15.524	15.562	1.512	14.493	16.638
ROA	0.075	0.059	0.095	0.021	0.110
Growth	2.547	1.356	3.938	0.645	3.071
Intangible	0.015	0.0001	0.039	0	0.009
Cap_Intens	0.352	0.311	0.225	0.176	0.519

	Dummy 1	Dummy 0
TaxHaven	60.84%	39.16%
PolCon	49.81%	50.19%
Auditor	52.62%	47.38%

The correlation matrix table is shown in Table 2. Panel A provides a correlation matrix for Abn_sales as a dependent variable. The correlation matrix shows significance correlation among tax haven, ln_size, growth, cap_intens, and abn_sales. Meanwhile, Panel B presents a correlation matrix for BTD as a dependent variable. The table shows a significance relationship among tax haven, ln_size, ROA, intangible, ind_board, and BTD.

Table 2 Correlation Matrix

Panel A Correlation Matrix for Abn_sales

	Abn_sales	TaxHaven	PolCon	LnSize	Growth	ROA	Intangible	Cap_Intens	Ind_board	Auditor
Abn_sales	1									
TaxHaven	-0.0987***	1								
PolCon	-0.0516	0.135***	1							
LnSize	-0.189***	0.278***	0.387***	1						
Growth	-0.510***	-0.0255	0.0353	0.0511	1					
ROA	-0.0531	-0.0721**	-0.00800	0.000198	0.514***	1				
Intangible	-0.00548	0.0903**	-0.00842	0.202***	0.0416	0.0315	1			
Cap_Intens	-0.146***	-0.0229	-0.0486	0.0119	0.0531	-0.0507	-0.114***	1		
Ind_board	-0.0290	0.180***	0.0239	-0.0332	0.0766**	-0.0549*	0.0384	0.0298	1	
Auditor	-0.0152	-0.108***	0.241***	0.297***	0.220***	0.202***	0.102***	0.0272	-0.00859	1

Panel B Correlation Matrix for BTD

	BTD	TaxHaven	PolCon	LnSize	Growth	ROA	Intangible	Cap_Intens	Ind_board	Auditor
BTD	1									
TaxHaven	0.0983***	1								
PolCon	0.0437	0.132***	1							
LnSize	0.131***	0.277***	0.385***	1						
Growth	0.0199	-0.0264	0.0346	0.0521	1					
ROA	-0.174***	-0.0735**	-0.00716	0.000466	0.514***	1				
Intangible	-0.0659*	0.0900**	-0.00919	0.202***	0.0422	0.0318	1			
Cap_Intens	0.0406	-0.0224	-0.0488	0.0125	0.0532	-0.0510	-0.114***	1		
Ind_board	0.104***	0.179***	0.0320	-0.0338	0.0892**	-0.0510	0.0453	0.0282	1	
Auditor	0.0324	-0.109***	0.239***	0.298***	0.220***	0.202***	0.102***	0.0288	-0.0130	1

Table 3 provides univariate analysis for politically connected firms versus nonpolitically connected firms and tax haven versus nontax-haven firms. We test the data using parametric and nonparametric tests. Based on the univariate analysis result, there are significance differences between tax haven versus nontax haven firms for all analysis of parametric and nonparametric tests for both measurements of corporate tax avoidance. Meanwhile, for political connected firms versus nonpolitical connected firms, we found significance using a nonparametric test for BTD measurement and a parametric test for Abn_sales measurement.

Table 3 Univariate Analysis

Panel A Univariate Analysis for Abn_sales

	Test Groups					
	Parametric test		Non Parametric test			
Abn_sales	t-test		Mann-Whitney (Wilcoxon rank-sum)		Kruskall-Wallis	
	Mean	t	Mean Rank	Z	Mean Rank	X^2
Non PolCon	0.1332	1.8670*	736.308	1.316	736.308	1.732
PolCon	0.1303		602.599		602.599	
Non Tax Haven	0.1351	3.5863***	668.678	6.247***	668.678	39.029***
Tax Haven	0.1295		641.175		641.175	

Panel B Univariate Analysis for BTD

	Test Groups					
	Parametric test		Non Parametric test			
BTD	t-test		Mann-Whitney (Wilcoxon rank-sum)		Kruskall-Wallis	
	Mean	t	Mean Rank	Z	Mean Rank	X^2
Non PolCon	-0.0303	-1.5842	623.262	-3.330***	623.262	11.088***
PolCon	-0.0247		693.003		693.003	
Non Tax Haven	-0.0353	-3.5787***	626.089	-2.445**	626.089	5.977**
Tax Haven	-0.0224		678.543		678.543	

Regression Result and Discussion

The result of estimating Eqs. (2) and (3) in answering the hypothesis is presented in Table 4 and Table 5. First, we test which model is more fit in each equation. Based on the Chow test, we find that the fixed effect model is better than pooled OLS. We decide to use fixed effect regression (Table 4) as our main analysis to control firm-specific unobserved heterogeneity (Jiménez-angueira, 2018) and random effect regression (GLS) (Table 5) as our sensitivity analysis.

We test Eq. (1) to confirm the association between tax haven and corporate tax avoidance, as a baseline to our political connection hypothesis. The result is shown in Model 1 and Model 2 from Table 4. We document a positive association between tax haven and tax avoidance for both of our measurements for tax avoidance. This association is significant at 5% for tax avoidance measured by abnormal sales RPT and 10% for tax avoidance measured by BTD. The result suggests that companies with tax haven affiliation tend to conduct more related party transactions in their operation if they have affiliations in a tax haven country. This gives us evidence that companies use tax haven affiliation as a vehicle to avoid tax by practicing RPT opportunistically. A tax haven facilitates companies to retain their wealth by paying low tax, as described in higher BTD. Our result is consistent with Taylor and Richardson (2013) who find that tax havens become incentives for companies to engage in tax avoidance. Profit-shifting from high-tax-rate jurisdiction to low-tax jurisdiction can be implemented by conducting abnormal related party transactions with affiliates located in tax haven countries.

Table 4 Fixed Effect Model Regression Result

Model	(1)	(2)	(3)	(4)
VARIABLES				
Tax Avoidance	Abn_sales	BTD	Abn_sales	BTD
TaxHaven	0.00757**	0.0163*	0.00602	0.00726
	(0.00362)	(0.00901)	(0.00456)	(0.00950)
PolCon			0.00526	0.00213
			(0.00564)	(0.00959)
TaxHaven*PolCon			0.00321	0.0193*
			(0.00576)	(0.0114)
Ind_board	0.0298***	0.0168	0.0299***	0.0160
	(0.00821)	(0.0371)	(0.00831)	(0.0369)
Auditor	0.00467	-0.00457	0.00458	-0.00430
	(0.00423)	(0.0130)	(0.00429)	(0.0130)
LnSize	-0.00844***	-0.000170	-0.00861***	0.000271
	(0.00321)	(0.00341)	(0.00318)	(0.00348)
Growth	-0.00357***	0.000491	-0.00361***	0.000546
	(0.000276)	(0.000697)	(0.000268)	(0.000705)
ROA	0.0239**	-0.0218	0.0256**	-0.0237
	(0.0101)	(0.0631)	(0.0104)	(0.0634)
Cap_Intens	-0.0105	0.0375*	-0.0106	0.0400*
	(0.00830)	(0.0223)	(0.00825)	(0.0223)
Intangible	0.0473*	-0.0688	0.0446*	-0.0748
	(0.0240)	(0.0641)	(0.0248)	(0.0663)
Constant	0.254***	-0.0568	0.255***	-0.0650
	(0.0490)	(0.0518)	(0.0490)	(0.0529)
Observations	1,309	1,315	1,309	1315
R^2	0.238	0.042	0.241	0.047
Year Fixed Effect	Yes	Yes	Yes	Yes
Firm Fixed Effect	Yes	Yes	Yes	Yes

Note: Robust standard errors in parentheses: *** p<0.01, ** p<0.05, * p<0.1.

The role of political connection in moderating the relationship between tax haven and tax avoidance [Eq. (3)] for the hypothesis is provided in Table 4 under Model 3 and Model 4. We document positive influence of political connection on the association between tax haven and tax avoidance by using BTD as a tax avoidance measurement at the significance level of 10%. Accordingly, political connection encourages tax haven MNC to conduct tax avoidance, suggesting that political connection plays a role in the enhancement of tax avoidance in a tax haven MNC. Although this influence is not significant for abnormal sales RPT as our profit-shifting tax avoidance measurement; however, the coefficient has the same positive direction. The positive coefficient of political connection suggests that political connection also takes advantage of profit-shifting tax avoidance, which is practiced by tax haven MNCs. Some government officials are involved in rent-seeking behavior when the government's "grabbing hand" role dominates, by colluding to help companies avoid paying tax (Li and Ma, 2015).

Our control variables for corporate governance are significant for independent boards with positive coefficients. This interesting result is contra from the formal obligation of an independent board and most previous research, which suggest that an independent board could minimize corporate tax avoidance. This might indicate that an independent board of our sample firms have political connections that encourage corporate tax avoidance. Meanwhile, our firms' financial characteristics control variables all are significant, except for capital intensity.

Sensitivity Analysis

To perform the sensitivity analysis of our result, we estimate our model using GLS, as shown in Table 5. Our results are robust with the same directions for both tax haven variables and moderating roles of political connection but only the correlation of tax haven and BTD, which is significant.

Table 5 Regression Model with GLS

Model	(1)	(2)	(3)	(4)
VARIABLES				
Tax Avoidance	Abn_sales	BTD	Abn_sales	BTD
TaxHaven	0.00283	0.0125*	0.00243	0.00658
	(0.00268)	(0.00679)	(0.00348)	(0.00826)
PolCon			0.00384	0.000715
			(0.00470)	(0.00878)
TaxHaven*PolCon			0.000628	0.0125
			(0.00489)	(0.00966)
Ind_board	0.0238***	0.0258	0.0239***	0.0251
	(0.00803)	(0.0325)	(0.00810)	(0.0325)
Auditor	0.00780***	-0.000713	0.00747***	0.000125
	(0.00282)	(0.00768)	(0.00285)	(0.00768)
LnSize	-0.00654***	0.00277	-0.00682***	0.00325
	(0.00205)	(0.00244)	(0.00204)	(0.00257)
Growth	-0.00360***	0.000611	-0.00364***	0.000616
	(0.000254)	(0.000572)	(0.000248)	(0.000580)
ROA	0.0322***	-0.0358	0.0336***	-0.0368
	(0.00964)	(0.0598)	(0.00983)	(0.0603)
Cap_Intens	-0.0109	0.0269*	-0.0109	0.0273*
	(0.00685)	(0.0160)	(0.00681)	(0.0161)
Intangible	0.0407**	-0.0722	0.0406**	-0.0771
	(0.0198)	(0.0605)	(0.0204)	(0.0612)
Constant	0.226***	-0.0977***	0.228***	-0.105***
	(0.0307)	(0.0375)	(0.0307)	(0.0389)
Observations	1,309	1,315	1,309	1,315
R^2	0.231	0.040	0.235	0.069
Year Fixed Effect	Yes	Yes	Yes	Yes
Firm Fixed Effect	Yes	Yes	Yes	Yes

Note: Robust standard errors in parentheses: *** p<0.01, ** p<0.05, * p<0.1.

CONCLUSION

This study examines the association between tax haven affiliation MNC and corporate tax avoidance, along with the role of political connection as a moderating variable. Our corporate tax avoidance measurement provides two types of corporate tax avoidance measurement: first is that BTD has been widely used to describe corporate tax avoidance regardless the method used to avoid paying tax; second is abnormal sales RPT, which specifically represents profit-shifting to avoid tax by exploiting a related party transaction scheme, which is a concern of OECD in the BEPS issue. Our results show that MNC with tax haven affiliation utilizes their affiliations to avoid tax by shifting profits to a tax haven country. Furthermore, MNC with political connections takes this connection opportunistically to evade tax. A board with government official connections increase secureness of MNC from being detected and caught via collusion and bribery. Thus, our result supports the “grabbing hand” theory developed by Shleifer and Vishny (1994).

Our findings are important given that political connection plays a significant role of enhancement in the association between tax haven MNC and corporate tax avoidance. To the best of our knowledge, it appears that our study is one of the first to explicitly examine the role of political connection in moderating the association of tax haven MNC to tax avoidance specifically by profit-shifting.

This study is also subject to several limitations. First, our study did not differentiate whether political connections are sought by the MNC or imposed by the government as in SOEs, which might have different impacts. Second, our tax avoidance measurement did not cover profit-shifting by using loans between RPT. Finally, our sample is drawn from publicly listed Indonesian MNC. To determine the generalizability of our findings, it may be useful to conduct analysis in other jurisdictional settings that have different government and country characteristics, such as in developed countries.

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APPENDIX

Appendix A List of Tax Haven Country

No.	Country	No.	Country
1	Antigua	11	Jersey
2	Bahama	12	Liberia
3	Bermuda	13	Luxemborg
4	British Virginia Island	14	Malta
5	Cayman Island	15	Marshall Islands
6	Cyprus	16	Mauritius
7	Gibraltar	17	Netherlands Antilles
8	Guernsey	18	Panama
9	Ireland	19	Singapore
10	Isle of Man	20	Switzerland

Appendix B Variable Measurement

Variable	Measurement
Coporate Tax Avoidance	1. $Abn\_sales_{it} = \alpha_0 + \alpha_1 Size_{it} + \alpha_2 Leverage_{it} + \alpha_3 Growth_{it} + \varepsilon_{it}$ Abn_sales = related party sales/total revenue; Size = natural log of total assets; Leverage = total debt divided by total assets; Growth= market capitalization/shareholder equity 2. BTD = (pre-tax income - taxable income)/total assets
Tax Haven	Tax haven is coded 1 if MNC have affiliation in tax haven countries, 0 otherwise
Political Connection	Political Connection is coded 1 if MNC have political connection, 0 otherwise
Independent board	Independent board/board size
Auditor	Auditor is coded 1 if MNC is audited by Big 4, 0 otherwise
Size	Logarithm natural of total assets
Growth	Market capitalization over the book value of total shareholders' equity
ROA	After tax income/total assets
Intangible	Intangible assets/total assets
Capital intensity	Property Plant Equipment/total assets