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The effect of earnings management on tax avoidance with political connections as a moderating variable

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ABSTRACT

This study aims to determine the effect of earnings management on tax avoidance and the role of political connections in moderating those relationships. The population in this study are manufacturing companies listed on the Indonesia Stock Exchange for the 2016-2020 period. There are 234 samples out of 835 total observations, produced by using purposive sampling. This study was tested by using Multiple Linear Regression Analysis and Moderated Regression Analysis. The results show that earnings management has a significant positive effect on tax avoidance and political connections strengthen the effect of earnings management on tax avoidance. This research used several control variables as well, which are firm size, leverage, profitability, firm value, firm age, and the results show that profitability has a significant negative effect on tax avoidance, the firm value partially have a significant positive effect on tax avoidance, while firm size, leverage, and firm age have no significant effect on tax avoidance.

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Introduction

Basically, a company was founded to achieve certain goals, one of which is to achieve maximum income (Harjito and Martono, 2010). In this era of globalization, companies are required to be more competitive. In order to increase competitiveness, apart from improving the quality of the goods/services produced, managers must also be able to manage their resources well. Various kinds of policies made must be able to ensure the survival of the company, and this is shown by the amount of income that can be generated (Negara and Suputra, 2017). However, in terms of accounting, there are elements that can reduce the amount of net income in the financial statements, one of which is the tax expense. This is certainly contrary to the company's goal to achieve maximum income.

Tax is a mandatory contribution to the state owed by an individual or entity that is coercive in nature based of the law, with no direct compensation, and is utilized by the state for the greatest prosperity of the society (UU KUP No 28 of 2007, Article 1, Paragraph 1). The company as a taxpayer has an obligation to pay income tax in accordance with the applicable tax provisions, which is calculated from the amount of earnings before tax multiplied by the applicable tax rate. The government uses taxes to carry out national development in order to achieve general welfare in various sectors of life. But on the other hand, managers perceive taxes as a problem that can hinder their efforts to maintain large income. In public companies, shareholders want financial management to increase the firm value and wealth (Arieftiara et al., 2015). This is what ultimately can trigger managers to do tax avoidance. The topic of tax avoidance is always a debate. On the one side, the taxpayers argue that as long as there are no rules that are violated, it is okay to do tax planning that can reduce tax obligations. However, on the other side, the tax authorities consider that, although no broken laws, there is a fundamental substance that is bypassed in tax avoidance, namely tax benefits. From this substance, the tax authorities consider tax avoidance as a violation (Huda, 2016). Tax avoidance causes the state to lose tens to hundreds of billions rupiah every year on the state revenue (www.ekonomi.inilah.com).

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In Indonesia, the cases of tax avoidance that have been handled by the Directorate General of Taxes include the cases of PT Bumi Resources Tbk, PT Kaltim Prima Coal, PT Arutmin Indonesia, PT Asian Agri, PT Adaro, PT Indosat, PT Indofood, and PT Airfast Indonesia. While the cases on an international scale, including Google, Amazon, and IKEA (Rusydi, 2013). This shows that tax avoidance activities will tend to occur in large companies that have high public oversight. In early 2016, The International Consortatium of Investigative Journalists (ICIJ) issued a report called the "Panama Papers" which contained 11.5 million classified documents produced by a law firm called Mossack Fonseca from the country of Panama. These documents reveal the financial secrets of officials, politicians, and the super-rich about how they hide their wealth, which is by setting up shell companies in tax haven countries. Although not always aimed at breaking the law, investing or establishing a company in tax haven countries is almost certainly aimed at tax evasion. Although legal, this action is seen as unethical because it conflicts with the purpose of the tax law, that taxes should be paid in the country where the income is earned (source: www.cnnindonesia.com).

Many companies are trying to find ways to reduce tax payment, one of them is by committing earnings management. Supported by the theory of Scott (2009), one of the purposes of earnings management is related to the political aspect in the form of tax motivation. Scott (2015) defines earnings management as the selection of accounting policies or methods in presenting earnings information that has been adjusted to the interests of managers in order to achieve certain goals. Managers can be involved in several forms of earnings management, such as taking a bath, income minimization, income maximization and income smoothing (Scott, 2015). In order to reduce taxable income, managers will carry out earnings management by means of income minimization or reducing income reported in financial statements (Surahman and Firmansyah, 2017).

The research of Arief et al. (2016), Setiorini et al. (2017), Novitasari (2017), Machdar (2019), and Wardani et al. (2019) found that earnings management has a significant effect on tax avoidance. Management is motivated to do earnings management in order to reduce tax expense, so the managers use various methods to reduce company income (Setiorini et al, 2017). The greater the decrease of income reported, the more likely company to behave aggressively towards company's taxes (Novitasari, 2017). This is in line with the theory stated by Scott (2000), that the companies which are faced with political costs tend to reduce their income with the aim of minimizing the political costs they have to bear. However, several studies showed different results, such as research of Alam (2018), Handayani (2019), Rahmadani et al. (2020), and Hendi (2021) which found that earnings management had no significant effect on tax avoidance.

Previous studies that examined the effect of earnings management on tax avoidance always showed varied and uncertain results. This indicates if there are other factors that may affect the inconsistency of the research results. So in this study, political connection is placed as a moderating variable because it is suspected to strengthen the influence of earnings management on tax avoidance. According to Phie and Ng (2020), companies that have Commissioners or Directors from a political party and are involved in the government will have a greater opportunity to avoid tax. This is because when companies do tax avoidance, they can take refuge in power possessed by the Commissioners and Directors, because the level of tolerance between the two parties may be high so that the risk of corporate tax audits is low and encourages companies to be bolder in tax avoidance. In line with this opinion, Ferdiawan & Firmansyah (2017) reveal that the existence of political connections is also utilized by putting pressure on tax authorities to reduce the amount of tax paid and to minimize penalty if the tax avoidance proven violating the taxation rules.

Politics and business are two interrelated things. Stable political conditions will provide a positive climate in the business world, and political funding can be obtained from business activities. A politically connected company will get a number of advantages such as the ease of obtaining bank loans and obtaining project contracts from the government. However, political connections can be a potential source of tax avoidance (Kim and Zhang 2016). This is related to the political connection will reduce the level of government supervision and better information on tax regulations. Apart from this, the aspect of political connections is also considered to have a high enough role in increasing the use of earnings management for tax avoidance.

Literature Review

Theoretical and Conceptual Background

Agency Theory

Agency theory explains the agency relationship, which is a set of contracts or agreements between principals (stakeholders such as shareholders, creditors, government) and agents (executors or managers) within the company (Jensen and Meckling, 1976). The problem that often arises from the agency relationship is the asymmetric information where the agent has more information about the company's internal conditions than the principal (Scott, 2012). Asymmetric information creates a tendency for agents to take inappropriate actions, such as manipulating earnings in the making of financial statements or commonly known as earnings management.

The separation of corporate control between the principal and the agent also often creates a conflict which is referred as a conflict of interest. The government wants a large state revenue from the tax collection. Meanwhile, the manager has the opposite desire that the company must generate large income with low tax obligations. This difference of interests underlies the behavior of managers to take deviant actions such as tax avoidance.

Positive Accounting Theory

Positive accounting theory was first proposed by Watts and Zimmerman (1978). It seeks to explain observed accounting phenomena based on the reasons that led to the occurrence of an event (Watts and Zimmerman, 1990). This theory explains and predicts the consequences that occur if managers make certain choices. Watts and Zimmerman (1986) relate positive accounting theory to the phenomenon of manager's opportunistic behavior by forming three hypotheses that underlie the behavior. First, The Bonus Plan Hypothesis, it states that on the companies which have a bonus plan, managers will tend to use accounting methods that can manage numbers in the financial statements, because the success of the manager's performance is measured by the level of income earned by the company. Second, The Debt to Equity (Debt Covenant) Hypothesis, it relates to the conditions that the company must meet in the debt agreement. When the company begins to be threatened by violating the debt agreement, the manager will try to avoid this violation by choosing an accounting method that can increase income. Third, The Political Cost Hypothesis, it states that the companies which is dealing with political costs tend to manage income reduction with the aim of minimizing the political costs they have to bear. Political costs include all costs related to government regulations, subsidies, tax rates, labor demands, and so on.

Rent Seeking Theory

Rent Seeking Theory was first discussed by Anne Kreuger in 1973. This theory explains the behavior of stakeholders in companies who seek to gain privilege from authorized parties such as the government or institutions that have authority in related fields. Special treatment and other facilities can be in the form of tax relief, regulations, and so on. A simple example of this behavior is the use of shares in return for the privileges granted by the authorities to business actors. Giving in the form of rewards to parties who have political connections becomes something valuable because it can influence political decisions regarding the economy.

Empirical Review and Hypothesis Development

Earnings Management and Tax Avoidance

Earnings management is an act of managers who choose accounting policies to achieve some specific goals (Scott, 2012). Earnings management is a managerial activity to influence and intervene financial reports, which uses certain deliberate steps to manage income (Sulistyanto, 2008). Some patterns of earnings management according to Scott (2000) include taking a bath, income minimization, income maximization, and income smoothing. The relationship between earnings management and tax avoidance is shown by several studies including research by Arief et al. (2016) which found that earnings management has a positive effect on tax avoidance, because the amount of tax expense is based on the amount of company's income. If a high income is obtained, the company tends to carry out earnings management by minimizing the profit (income minimization) obtained so that the tax expense is low. Novitasari (2017) and Machdar (2019) also argue that the greater the decline in income indicates that the company is increasingly aggressive in avoiding taxes. Based on theoretical considerations and previous research, the researcher predicts a positive influence between earnings management and tax avoidance. Based on this explanation, the first hypothesis can be proposed:

H1: Earnings management has a positive effect on tax avoidance.

Moderating Role of Political Connections on the Effect of Earnings Management on Tax Avoidance

According to Gomez and Jomo (2009), companies with political connections are those that have close relations with the government. It can be the owner of the company is a prominent political figure, is a member of the government council or a member of a political party, or the company is a government-owned company. Political connections are believed to be an invaluable resource for many companies (Leuz and Gee, 2006). The political connections make the company receive special treatment, from the ease of obtaining capital loans to the low risk of tax audits. The back-up from the government also makes companies more aggressive in determining tax planning which results in decreased transparency of financial statements (Butje and Tjonro, 2014). Ferdiawan and Firmansyah (2017) in their research found that the average of the companies uses their political connections to reduce tax payments either through lobbying activities or looser supervision. Similarly, research by Phie and Ng (2020) which reveals that when a member of the Commissioners or Directors is a politician, or is a family member of state officials, they certainly have closeness to the government and have influence in the government. This closeness can then trigger tax avoidance. When there is a close relationship between the Commissioners or Directors and the government, the level of tolerance between the two parties may be high. The political connections owned by the company make the company braver to do tax avoidance because the company feels protected by the power it has. Based on this explanation, the second hypothesis is stated as follows:

H2: Political connection strengthens the effect of earnings management on tax avoidance.

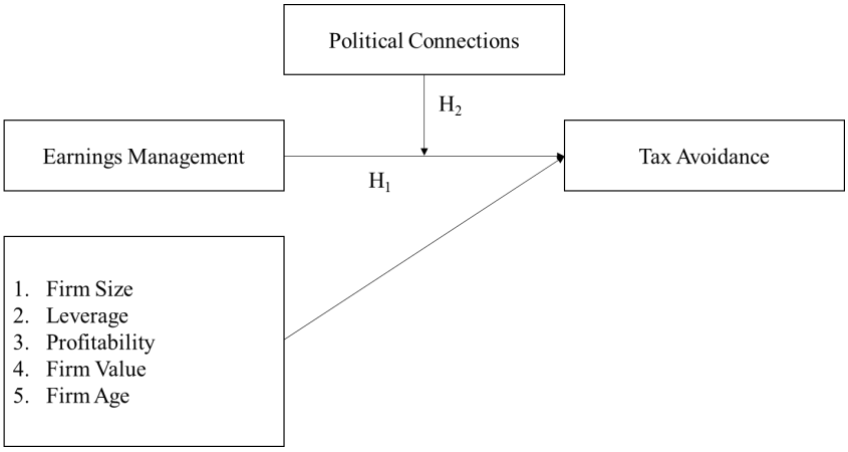

Figure 1: Research Model

Research and Methodology

This study uses a quantitative approach to empirically examine the effect of earnings management on tax avoidance and the ability of political connections to moderate the effect of earnings management on tax avoidance. The population in this study are all manufacturing companies listed on the Indonesia Stock Exchange for the period 2016-2020. Sampling in this study using purposive sampling technique with some criteria as follows:

i. Manufacturing sector companies listed on the IDX for the period 2016 to 2020;

ii. Not reporting loss before tax in the income statement;

iii. Shows a pattern of decreasing income as seen from the results of the calculation of negative discretionary accruals;

iv. The necessary data and information related to the research variables are available in full.

The population in this study amounted to 835 observations and the sample obtained was 234 observations.

Operational Definition and Measurement of Variables

The variables used in this study include the independent variable that is earnings management, the dependent variable that is tax avoidance, the moderating variable that is political connections, and control variables that are firm size, leverage, profitability, firm value, and firm age.

Dependent Variable

The dependent variable in this study is tax avoidance. The measurement of tax avoidance in this study uses Current ETR and Cash ETR. The Current Effective Tax Rate (Current ETR) measures the total tax expense minus deferred tax expense (Ayers et al, 2009). This measurement is useful for seeing ETR for its current tax expense regardless of deferred and final tax. The effective tax rate can be calculated by dividing the current tax expense by the earning before tax. The closer the ratio scale to zero, the more it shows the existence of tax avoidance (Maulana, et al, 2021).

Current ETR = Current Tax Expense / Earnings Before Tax

Cash Effective Tax Rate (Cash ETR) is best used to describe tax avoidance activities by companies because Cash ETR is not affected by changes in estimates such as valuation allowance or tax protection. Cash ETR describes all tax avoidance activities that reduce tax payments to the tax authorities, because Cash ETR is directly calculated from cash paid for taxes divided by earning before taxes (Dyreng et al, 2008). The closer the ratio scale to zero, the more it shows the existence of tax avoidance (Maulana, et al, 2021).

Cash ETR = The Amount of Taxes Paid / Earnings Before Tax

Independent Variable

Earnings management is an accounting policy or actions chosen by managers to achieve some specific objectives in earnings reporting (Scott, 2009). This study measures the level of earnings management on an accrual basis, which is a form of earnings management that is carried out by utilizing freedom in choosing accounting policies. Accruals earnings management are proxied by discretionary accruals using the performance matched discretionary accruals measurement model proposed by Kothari et al, (2005). The calculation model for discretionary accruals using the performance matched discretionary accruals model is:

$TAC_{it} = NI_{it} – CFO_{it}$

Furthermore, the total accrual value is estimated using multiple linear regression equations based on Ordinary Least Square (OLS) as follows:

$TAC_{it} / TA_{it-1} = \beta_1 (1 / TA_{it-1}) + \beta_2 (\Delta REV_{it} / TA_{it-1}) + \beta_3 (PPE_{it} / TA_{it-1}) + \beta_4 (ROA_{it})$

Based on the above equation, NDA (non-discretionary accruals) can be calculated by re-entering the coefficients :

$NDA_{it} = \beta_1 (1 / TA_{it-1}) + \beta_2 ((\Delta REV_{it} - \Delta REC_{it}) / TA_{it-1}) + \beta_3 (PPE_{it} / TA_{it-1}) + \beta_4 (ROA_{it})$

Then discretionary accruals which are part of the total unexplained accruals with the company's activities can be obtained by the following formula:

$DA_{it} = (TAC_{it} / TA_{it-1}) - NDA_{it-1}$

Description:

TAC_{it} : Total accruals of company i in year t
NI_{it} : Net income from operating activities of company i in year t
CFO_{it} : Cash flow from operating activities of company i in year t
TA_{it-1} : Total assets of company i in year t-1 (previous year)
ΔREV_{it} : Change in earnings of company i from year t-1 to year t
PPE_{it} : Value of net fixed assets of company i in year t
ROA_{it} : Return on Assets of company i in year t
NDA_{it} : Non Discretionary Accruals of company i in year t
ΔREC_{it} : Changes in receivables of company i from year t-1 to year t
DA_{it} : Discretionary Accruals of company i in year t
β : The coefficient obtained from the regression results in the calculation of total accruals

Moderation Variables

According to Faccio (2006), a company is said to have political connections if at least one major shareholder (a person who has at least 10% of the voting rights based on the number of shares owned) or one of the leaders (CEO, president director, vice president director, section chief or secretary) is a member parliament, ministers, or have close ties to political figures or parties. The measurement of political connections in this study uses a dummy variable, which a score of 1 is given to companies that have political connections and a score of 0 is given to companies that do not have political connections.

Control Variables

Firm Size

Firm size can be measured based on total equity, total sales, total employees, and total assets of the company (Saifudin & Yunanda, 2016). The more total assets owned by the company, it shows that the size of the company is large (Hormati, 2009). Derazhid and Zhang (2003) state that large-scale companies pay lower tax obligations than small-scale companies. Where large companies tend to have many gaps to do good tax planning (Rodriguez and Arias, 2012). In line with the opinion of Rego (2003), it is undeniable that the large size of the company means that the transactions that occur within the company are also very complex. This condition triggers companies to carry out tax avoidance by taking advantage of weaknesses of the tax law (Rego, 2003). Firm size can be measured by using the formula used by Hanlon, 2005:

Firm Size = Ln Total Assets

Leverage

Leverage is one of the financial ratios which is the relationship between debt to assets and equity. This ratio aims to assess how much the company's assets and equity are financed by debt. Financial leverage arises because the company is given funds that cause a fixed expense, namely debt with interest as a fixed expense. The greater the company's debt, the greater the interest expense that will arise. That way, high interest is able to cause the effect of decreasing income as the cause of corporate taxes to decrease (Aminah, et al, 2017). The higher the value of the company's debt, the inversely proportional to the company's ETR, which will be lower (Richardson, et al, 2015). The leverage ratio is also called the Debt to Equity Ratio (DER) which shows how much of the total equity obtained from debt, and is formulated as follows:

DER = (Total Liabilities / Total Equities) x 100%

Profitability

Company profitability is a tool that can be used to measure the company's ability to generate profits in a certain period. Profitability can be measured by several ratios, one of which is the Return On Assets (ROA) ratio. Sugiono (2016) states that the ROA ratio compares income after tax and total assets owned by a company. ROA has a relationship with the company's net income with the imposition of income tax (Kurniasih and Sari, 2013). Chen et al (2010) stated that the high value of profitability provides an

opportunity for companies to carry out tax planning with the aim of minimizing tax obligations. According to Derazhid and Zhang (2003), if the efficiency level of the company is getting better, the company will pay a smaller tax liability, or the effective tax rate will be lower. The ROA formula is as follows:

ROA = Net Income / Total Assets

Firm Value

Firm value is an investor's perception on the level of success of the company which is often associated with stock prices (Sujoko and Soebiantoro, 2007). The value of the company can provide maximum shareholder prosperity if the company's share price increases. The higher the share price, the higher the prosperity of shareholders. Jensen and Meckling (1976) stated that the company in operating the company's activities combines the limitations of relevant conditions by considering the output and input with the aim of maximizing the company's income or value. Therefore, to maximize the income or value of the company, it is necessary to consider managerial behavior, agency costs, and ownership structure in the company. So, tax planning was done in order to minimize costs and to increase the value of the company. Firm value in this study is measured using Tobin's Q. Tobin's Q calculation formula is as follows:

Tobin's Q = ((EMV+D))/((EBV+D))

EMV = Closed Share Price x Number of Outstanding Shares
EBV = Total Assets – Total Liabilities
Description:
Tobin's Q= Company Value
EMV = Equity Market Value
EBV = Book Value of Total Equity (Equity Book Value)
D = Total Debt

Firm Age

Firm age is used to measure the effect of the length of time the company operates on company performance (Savitri, 2014). Companies that have been established in a long time also have the ability to minimize costs and improve the quality of their production, so that they are more able to generate income (Yunietha and Palupi, 2017). Aging companies must reduce costs including tax costs due to their experience and other influences, both in the same industry and in different industries. The firm age in this study uses the age of the company from the date of establishment of the company (Hariyanto and Juniarti, 2014).

Data Analysis Model

The test of the hypothesis was done by using multiple linear regression and moderated regression analysis. This regression model must pass the classical assumption test, including normality, heteroscedasticity, multicollinearity and autocorrelation test. The test model is carried out by:

$$TA_{it} = \alpha + \beta_1 EM_{it} + \beta_2 Size_{it} + \beta_3 Lev_{it} + \beta_4 ROA_{it} + \beta_5 TobinQ_{it} + \beta_6 Age_{it} + \varepsilon \text{.....(model 1)}$$

$$TA_{it} = \alpha + \beta_1 EM_{it} + \beta_2 PC_{it} + \beta_3 EM*PC_{it} + \beta_4 Size_{it} + \beta_5 Lev_{it} + \beta_6 ROA_{it} + \beta_7 TobinQ_{it} + \beta_8 Age_{it} + \varepsilon \text{.....(model 2)}$$

Description:

TA = Tax Avoidance (Current ETR; Cash ETR)
EM = Earnings Management
PC = Political Connection
Size = Firm Size
Lev = Leverage
ROA = Profitability
TobinQ = Firm Value
Age = Firm Age
α = Constant
β1,β2,β3,β4,β5,β6,β7 = Regression coefficient
i = Company i
t = Year t
ε = Error

Empirical Findings and Discussion

The results of the Descriptive Statistical Analysis are shown in Table 1.

Table 1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
CurrentETR	234	0.04091	0.54299	0.2524017	0.06328252
CashETR	234	0.00014	0.76072	0.2676634	0.13337082
EM	234	-0.61087	-0.00061	-0.1136562	0.09026371
PC	234	0	1	0.23	0.422
SIZE	234	25.24837	33.49453	28.7537007	1.63836344
LEV	234	0.04533	4.94830	0.8603325	0.74905525
ROA	234	-0.06675	0.52670	0.0842779	0.08019305
TOBINQ	234	0.35801	16.26333	1.9821569	2.37968096
AGE	234	4	99	41.02	16.818

From the results of the descriptive statistical tests presented in table 1, tax avoidance as measured by Current ETR and Cash ETR shows a minimum value of up to 0.04091 and 0.00014, where the smaller the ETR value or close to 0, the greater the possibility of tax avoidance committed. Earnings management (EM) shows an average value of -0.1136562, this shows that the average company observed during the 2016-2020 period decreased income by -11.3%. Based on data of political connections, statistical results show that there are 54 samples who have political connections out of 234 samples. The firm size shows an average value of 28.7537007, this value is greater than the standard deviation of 1.63836344. This shows that the majority of the sample are large companies. Leverage shows an average value of 0.8603325. This shows that most of the assets owned by the company are financed through debt, which is 86.03%. Profitability shows a negative minimum value of -0.06675. The existence of a negative ROA value indicates that there are samples that experience poor profitability during the study period. However, the standard deviation value is 0.08019305 which is smaller than the average value, which is 0.0842779, indicating that the majority of the samples have good profitability. The firm value shows an average of 1.9821569. This shows that the average sample obtains a market value greater than the book value of its assets. The firm age has an average of 41 years, which means that the average sample is a company that has been around for a long time.

The Results of Regression Analysis

On the independent variable earnings management, from the results of Model 1 testing, a positive beta value of 0.126 was obtained, with a significance of 0.007 on the Current ETR (0.007<0.05 = significant), and a positive beta value of 0.192 with a significance of 0.049 on the Cash ETR (0.049<0.05 = significant). From the results of Model 2 testing, the positive beta value is 0.185 with a significance of 0.000 on Current ETR (0.000<0.05 = significant), and a positive beta value of 0.273 with a significance of 0.011 on Cash ETR (0.011<0.05 = significant). These results prove that earnings management has a significant positive effect on tax avoidance, so that **Hypothesis 1 is accepted.**

On the moderating control political connection, from the results of Model 2 testing, a negative beta value of -0.318 was obtained, with a significance of 0.007 on Current ETR (0.007<0.05 = significant), and a negative beta value of -0.459 with a significance of 0.063 on Cash ETR (0.063>0.05 = not significant). That is, political connections negatively moderate the positive effect of earnings management on tax avoidance (Current ETR). The value of discretionary accruals and Current ETR have a positive or unidirectional relationship. The bigger the DA, the bigger the Current ETR. The smaller the DA, the smaller the Current ETR. So with a political connection that moderates negatively, it will push the value of discretionary accruals in a direction that is further away from 0 or smaller, so that the Current ETR value is also getting smaller or closer to 0. In other words, political connections strengthen the influence of earnings management on tax avoidance. Companies that are politically connected have a great possibility to carry out earnings management in order to avoid taxes. On the other hand, when proxied by Cash ETR, the results show that political connections are not able to moderate the effect of earnings management on tax avoidance. Based on this explanation, it can be concluded that **Hypothesis 2 is partially accepted.**

From the test of firm size, the Model 1 test results obtained a positive beta value of 0.0002 with a significance of 0.940 on Current ETR (0.940>0.05 = not significant), and a positive beta value of 0.002 with a significance of 0.758 on Cash ETR (0.758>0.05 = not significant). From the results of Model 2 testing, the positive beta value is 0.002 with a significance of 0.570 on Current ETR (0.570>0.05 = not significant), and a positive beta value of 0.001 with a significance of 0.805 on Cash ETR (0.805>0.05 = not significant). These results prove that firm size has no significant effect on tax avoidance.

From the test of leverage, the Model 1 test results obtained a negative beta value of -0.0003 is obtained with a significance of 0.959 on Current ETR (0.959>0.05 = not significant), and a positive beta value of 0.007 with a significance of 0.530 on Cash ETR (0.530>0.05 = not significant). From the results of Model 2 testing, the positive beta value is 0.001 with a significance of 0.868 on

Current ETR (0.868>0.05 = not significant), and a positive beta value of 0.009 with a significance of 0.473 on Cash ETR (0.473>0.05 = not significant). These results prove that leverage has no significant effect on tax avoidance.

From the test of profitability, the Model 1 test results obtained a negative beta value of -0.0241 was obtained with a significance of 0.005 on Current ETR (0.005<0.05 = significant), and a negative beta value of -0.594 with a significance of 0.001 on Cash ETR (0.001<0.05 = significant). From the results of Model 2 testing, it was found that a negative beta value of -0.214 with a significance of 0.013 on the Current ETR (0.013<0.05 = significant), and a negative beta value of -0.565 with a significance of 0.002 on Cash ETR (0.002<0.05 = significant). These results prove that profitability has a significant negative effect on tax avoidance. From the test of firm value, the Model 1 test results obtained a positive beta value of 0.006 was obtained with a significance of 0.040 on the Current ETR (0.040<0.05 = significant), and a positive beta value of 0.012 with a significance of 0.051 on the Cash ETR (0.051> 0.05 = not significant). From the results of Model 2 testing, it was found that a positive beta value of 0.005 with a significance of 0.126 on Current ETR (0.126>0.05 = not significant), and a positive beta value of 0.010 with a significance of 0.125 on Cash ETR (0.125>0.05 = not significant). These results prove that firm value has a significant positive effect on Current ETR only on Model 1 testing, and has no significant effect on Cash ETR.

From the test of firm age, the Model 1 test results obtained a positive beta value of 0.000087 was obtained with a significance of 0.748 on the Current ETR (0.748>0.05 = not significant), and a positive beta value of 0.001 with a significance of 0.297 on Cash ETR (0.297>0.05 = not significant). From the results of Model 2 testing, a positive beta value of 0.000037 was obtained with a significance of 0.892 on the Current ETR (0.892>0.05 = not significant), and a positive beta value of 0.0004 with a significance of 0.511 on the Cash ETR (0.511>0.05 = not significant). These results prove that the firm age has no significant effect on tax avoidance.

The results of the regression analysis that have passed the classical assumption test are shown in Table 2.

Table 2: Results of Regression Analysis

Model	**Variable**	**Current ETR**		**Cash ETR**		**Test**
		Beta Coefficient	**Sig.**	**Beta Coefficient**	**Sig.**	
Model 1	Constant (α)	0.266	0.001	0.237	0.136	
	EM	0.126	0.007	0.192	0.049	Hypothesis 1
	SIZE	0.0002	0.940	0.002	0.758	
	LEV	-0.0003	0.959	0.007	0.530	
	ROA	-0.241	0.005	-0.594	0.001	
	TOBINQ	0.006	0.040	0.012	0.051	
	AGE	0.000087	0.748	0.001	0.297	
	Adj R^2	0.063		0.074		
Model 2	Constant (α)	0.238	0.002	0.260	0.115	
	EM	0.185	0.000	0.273	0.011	
	PC	-0.040	0.012	-0.027	0.420	
	EM*PC	-0.318	0.007	-0.459	0.063	Hypothesis 2
	SIZE	0.002	0.570	0.001	0.805	
	LEV	0.001	0.868	0.009	0.473	
	ROA	-0.214	0.013	-0.565	0.002	
	TOBINQ	0.005	0.126	0.010	0.125	
	AGE	0.000037	0.892	0.0004	0.511	
	Adj R^2	0.095		0.091		

Description of variables: Tax Avoidance (Current ETR; Cash ETR), Earnings Management (EM), Political Connections (PC), Interactions of Earnings Management with Political Connections (EM*PC), Firm Size (SIZE), *Leverage* (LEV), Profitability (ROA), Firm Value (TOBINQ), Firm Age (AGE).

Conclusions

The results found empirical evidence that earnings management has a positive effect on tax avoidance. These results support the research of Arief et al (2016), Novitasari (2017), Setiorini et al (2017), Machdar (2019), and Wardani et al (2019). In line with agency theory that earnings management actions are influenced by the existence of information asymmetry between shareholders and managers. Conflicts of interest also arise because each is trying to achieve conflicting goals. The results of this study also prove positive accounting theory in the bonus plan hypothesis and the political cost hypothesis where managers prefer to get the maximum bonus and tend to manipulate income to avoid government regulations. So the manager will try to reduce the tax expense that must be paid to maximize net income in order to pursue bonuses. The results showed that the smaller the reported income, the smaller the calculation of the ETR value. An ETR value that is small or close to 0 gives a signal about tax avoidance activities that are being

carried out by the company, as a manager will certainly report the amount of income in accordance with policies made based on utility which will have an impact on tax avoidance actions. As stated by Machdar (2019), if earnings management actions increase, then tax aggressiveness will also increase. Arief et al (2016) also stated that companies use accounting choices that reduce income as a form of tax avoidance. The results also find empirical evidence that political connections strengthen the effect of earnings management on tax avoidance. That is, the existence of political connections will increase the company's opportunities to avoid tax. The results of this study prove the truth of the rent seeking theory that stakeholders in companies seek preferential treatment, such as tax breaks, regulations, and so on from authorized institutions. As stated by Ferdiawan and Firmansyah (2017) that on average, companies use their political connections to reduce tax payments, either through lobbying activities or the use of looser supervision. In line with this opinion, Phie and Ng (2020) also argue that the political connections owned by the company make the company more daring to do tax avoidance because the company feels protected by the power it has.

This study also proves that profitability has a significant negative effect on tax avoidance. This shows that the higher the company's profit, the smaller the ETR value obtained, meaning that the more likely the company to avoid tax. Firm value has a significant positive effect on tax avoidance on the Current ETR, but has no significant effect on the Cash ETR. This indicates that market conditions respond more to the amount of tax derived from income compared to the real amount of tax paid. The positive effect can be explained that the higher the firm value, the higher the Current ETR obtained. Companies with high values have a small probability of avoiding tax. Meanwhile, firm size, leverage, and firm age have no significant effect on tax avoidance.

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