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The Role of Political Connection in the Influences of Transfer Pricing, Thin Capitalization, Return on Assets toward Tax Avoidance

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Abstract:- This study aims to examine the influences of transfer pricing, thin capitalization, and return on assets toward tax avoidance that are moderated by political connections. The sample used in this research was manufacturing companies listed on the Indonesian Stock Exchange (IDX) from 2019 to 2021 (3 years), which were 62 companies. The determination of the research sample was the purposive sampling method and the analysis employed panel data with multiple regression methods. The results of the study show that transfer pricing had a positive effect on tax avoidance, but thin capitalization and return on assets had a negative effect on tax avoidance. In addition, Political connections weakened the positive effects of transfer pricing on tax avoidance (Moderation Predictor). However, the political connection did not moderate the influences of thin capitalization and profitability on tax avoidance (Moderation Homologizer).

Keywords:- *Transfer Pricing, Thin Capitalization, Return on Assets, Tax Avoidance, Political Connection.*

I. INTRODUCTION

Tax avoidance is not a brand new issue, but has been a long-lasting global issue. It has emerged in previous years from the development of conventional business to digital business. Tax avoidance is one of the legal strategies and techniques to avoid tax since it does not conflict with the provisions of tax. The method is to take benefit of the weaknesses or gray areas contained in tax regulations (Pohan, Chairil, 2018). (Sawyer et al., 2004) defined tax avoidance as an arrangement to reduce, eliminate, or postpone tax obligations that did not violate the law. Shortly, tax avoidance is a measure to reduce payable tax payable which is still within the limits of the justified provisions of tax, particularly through tax planning. Mis-pricing of intra-company trade, strategic location of affiliate companies, valuable intellectual property (IP), and debt transfers are the scheme of tax avoidance that is conducted by multinational companies (MNES) – (Riedel, 2018).

Similarly, in line with the phenomenon of tax avoidance in Indonesia, the substance of tax avoidance is due to business management in one business group, which includes subsidiaries or sister companies, so that transactions between companies within the business group often occur and become an opportunity to practice tax avoidance. Moreover, manufacturing companies, which have several branches, do not only incorporate domestically but also establish in several different countries. The case of tax avoidance that occurs at Google, Starbucks, and Amazon is an international case of tax avoidance that may damage the country's source of income. However, some cases of tax avoidance in manufacturing companies are more complex, and these issues attract the writer to observe tax avoidance in manufacturing companies. In addition, the selection of manufacturing companies as the research objects was based on various sectors that reflect complex transactions and the possibility of tax avoidance practices.

The development of the industrial revolution 4.0 age or popularly known as the cyber-physical system has changed the structure of companies and international-based global business, where the ease of innovation and transactions can also provide opportunities to minimize taxes. Additionally, the Covid-19 pandemic, which has not ended yet, has driven the growth of the digital economy, which has supported the Indonesian economy during the lockdown process due to the high number of cases of the Covid-19 outbreak. Indeed, the pandemic has had a major impact, especially on manufacturing companies and aviation, tourism, and SME industries. Undeniably, digital and globalization have greatly affected the world economy, and it creating challenges related to regulations of income tax on an international scale (OECD, 2022). However, a country's unpreparedness in anticipating global development and issues leads the opportunities for the practice of base erosion and profit shifting (BEPS), such as transfer pricing, which companies can use to perform the scheme of tax avoidance scheme (OECD, 2022). The practice of transfer pricing is an opportunity for companies to set transfer values to increase personal gain. Also, there is a contribution to avoid paying taxes (Sikka & Willmott, 2010). Multinational enterprises (MNEs) manipulate transfer pricing to take benefit of differences in cross-border tax rates, and its implication of regulations counters profit shifting (Choi et al., 2020). Further, it is said that Foreign Direct Investment (FDI) in source countries with high tax rates will transfer profits to countries with low tax rates when the application of regulations is firm. Based on World Bank Data, 60% of global transactions also use affiliate companies, so this supports Choi's research. In Indonesia, in the 1st quarter of 2022, the increase in FDI was 34% yoy.

Previous studies have proven that there was an effect of transfer pricing variables on tax avoidance. (Rogers & Oats, 2022) found that ALP theory has dominated for adaptability of the transfer pricing case, that means transfer pricing is always being concern in tax avoiding scheme. Research (Dinda Nurrahmi et al., 2020) showed that the size of the value of transfer pricing influences companies to perform tax avoidance. (Widiyantoro & Sitorus, 2019) also shared the same opinion that their research showed the effects of transfer pricing on tax avoidance, but it was not significant. In line with the research conducted by (Suhendra, 2020), transfer pricing has an effect on tax avoidance and is not significant, and companies do not use transfer pricing practices as the biggest scheme to avoid taxes paying. Concerning the variable of thin capitalization, research (Nadhifah et al., 2020) displayed that thin capitalization has a positive effect on tax avoidance. This is in line with the results of research conducted by (Utami & Irawan, 2022), stating that thin capitalization is one of the driving factors for companies to conduct tax avoidance. The higher the value of thin capitalization, the higher the tendency for companies to use debt as the largest composition in their financing. Contrastingly, research performed by (Anggraeni & Oktaviani, 2021) argued that thin capitalization does not affect tax avoidance. Thin capitalization is the debt extent performed by the company as financing. If the company uses debt, there will be interest expenses that must be paid by the company. This is in line with research performed by (Olivia et al., 2019), describing that thin capitalization does not affect tax avoidance. Thin capitalization will indirectly affect the company’s profitability. The greater the paid interest expense, the larger the effect on company profits. It can be said that profitability can trigger tax avoidance. Research (Kismanah et al., 2018) showed that profitability (ROA) affects tax avoidance. The higher the ROA value, the better the company’s value. Better profit companies have the opportunity to conduct tax planning, which aims to reduce the value of the tax levy. Similarly, research (Olivia et al., 2019) also demonstrated that profitability has a positive effect on tax avoidance. However, it is different from (Apriatna & Oktris, 2022), describing that profitability does not affect tax avoidance. This is in line with research performed by (Putri Maidina et al., 2019), arguing that profitability does not affect tax avoidance. When ROA increases, the company has effective assets to pay for the company’s incurred costs, including tax levies. Another factor that also creates opportunities for the scheme of tax avoidance is political connection. Business is very closely related to politics. It is because the success of a business cannot be separated from political influence. Companies that have political connections enjoy benefits from the government and this political benefit provides greater opportunities for companies to increase their wealth (Azmi et al., 2020). (Putri Maidina et al., 2019) found that political connection has a positive effect on tax avoidance. Their study assessed whether or not a company’s political connection using a proxy and whether or not there was direct ownership by the government of the company. Companies owned by the government could be identified by looking at the company’s share ownership, which was above 50%. Likewise, the research of (Khoirunnisa Asadanie & Venusita, 2020) also depicted that political connection affects tax avoidance. In their research, conglomerates, who are the owner of companies and have close relationships with the government, are interpreted to have space for tax avoidance practices. Research (Pengutipan: Istiqfarosita & Abdani, 2022) also postulated that political relations have a significant effect on tax avoidance.

Therefore, research gaps from previous studies encourage the writer to evaluate the same variables, by considering economic activity during the Covid-19 pandemic.

II. LITERATURE REVIEW

Several studies have proven that company management still performs tax avoidance in reducing its tax obligations. Heckemeyer & Overesch (2013) (Darussalam & Danny) stated that the manipulation of transfer pricing is a strategy of tax avoidance that is most dominantly used. Furthermore, Clemens Fuest *et al*. (2013) (Darussalam & Danny.) argued that multinational companies can simultaneously use various schemes of tax avoidance in their business activity. The abuse of transfer pricing has a positive relationship with tax avoidance (Amidu et al., 2019). Transfer pricing for tax purposes is the pricing of transactions between companies that have special relationships or are affiliated (Feinschreiber, 2009). The process of transfer pricing determines the amount of income by each party that transacts with each other. Then, tax avoidance is an arrangement to reduce, eliminate or postpone tax obligations that do not violate the law. Meanwhile, Sears, in his book “Minimizing Tax” in 1922, said that tax avoidance or reduction is the same thing that has been applied to this day in America (E-book: The Routledge Companion to Tax Avoidance Research, 2018). Research (Dinda Nurrahmi et al., 2020) argued that the size of the transfer pricing value influences companies to conduct tax avoidance. Transfer pricing is a reasonable action and is utilized for tax avoidance. (Widiyantoro & Sitorus, 2019) also held the same opinion, stating that transfer pricing affects tax avoidance, but it is not significant. Similarly, research performed by (Suhendra, 2020) described that transfer pricing has an effect on tax avoidance and is not significant, and companies do not use transfer pricing practices as the biggest scheme to avoid taxes paying. Transfer pricing affects tax avoidance because there are transactions between parties who have special relationships (affiliates) to transfer profits. Transfer pricing is the most popular taxation issue and is the main scheme used by companies, especially multinational enterprises (MNEs), and the practice of transferring profits leads to tax avoidance. MNEs manipulate transfer pricing to take advantage of differences in cross-border tax rates, and the implications counter profit shifting (Choi et al., 2020).

- *H1. Transfer Pricing Affects Tax Avoidance*

In terms of thin capitalization, Taylor & Richardson also stated that companies try to avoid taxes by increasing the level of leverage (Taylor & Richardson, 2013). Thin capitalization is one of the international mechanisms of tax avoidance. This practice is a phenomenon where companies increase interest-bearing debt so that the capital structure becomes small. The use of thin capitalization, according to the OECD, is identified as one of the methods that facilitate BEPS, due to interest costs on loans that can be recognized as deductible expenses (Mukarromah, 2019-ddtc). It can be said that the application of thin capitalization is basically to reduce the total tax liability. Increasing the value of debt, the company has loan interest expense, which can be a deduction for income tax because it is used in business activities. It indicates that thin capitalization can be used by taxpayers in performing the scheme of tax avoidance. Research (Nadhifah et al., 2020) showed that thin capitalization has a positive effect on tax avoidance. This is in line with the results of research by (Utami & Irawan, 2022), describing that thin capitalization is one of the driving factors for companies to conduct tax avoidance. The higher the value of thin capitalization, the higher the tendency for companies to use debt as the largest composition in their financing. Increasing the value of debt, the company has loan interest expense, which can be a deduction for income tax because it is used in business activities. This indicates that thin capitalization can be used by taxpayers in performing the scheme of tax avoidance.

➢ *H2. Thin Capitalization Affects Tax Avoidance*

Thin capitalization will indirectly affect the company's profitability. Profitability is net income from a series of policies and decisions that can be determined by calculating various relevant benchmarks. One of these benchmarks is the financial ratios as one of the analyzes in analyzing the financial condition, operating results, and level of profitability of a company (Brigham & Houston: 2006). One way is through return on assets (ROA). It can be said that profitability can trigger tax avoidance. Research (Kismanah et al., 2018) showed that Profitability (ROA) affects Tax avoidance. The higher the ROA value, the better the company value. Companies with better profits have the opportunity to perform tax planning, which aims to reduce the value of the tax levy. Similarly, research (Olivia et al., 2019) also explained that profitability has a positive effect on tax avoidance. The better the profitability of a company, the higher the value of income tax that must be paid, and the company’s tendency to conduct tax avoidance will be higher (Nathania et al., 2021). The results of the research (Kismanah et al., 2018) stated that Profitability (ROA) affects Tax avoidance. The company’s ability to generate profits is closely related to tax avoidance.

➢ *H3. Profitability Affects Tax Avoidance*

Political connection as a moderating variable also influences the practices of tax avoidance. Political connection is if the shareholder or company officials are members of parliament, ministers or heads of state, related to state officials, or state institutions (Faccio, n.d.). Political connection strengthens the practice of transfer pricing on tax avoidance. Companies that have political connections enjoy benefits from the government and the political connection provides greater opportunities for companies to increase the wealth of shareholders’ company (Azmi et al., 2020). Political connection tends to influence every decision taken by the company’s management, so the decision to execute a scheme of transfer pricing will also be intervened by politicians related to the company’s performance and expenses (Newton & Uysal, 2019). Research (Dinda Nurrahmi et al., 2020) showed that the size of the transfer pricing value influences companies to conduct tax avoidance. (Putri Maidina et al., n.d.) found that political connection has a positive effect on tax avoidance. Further, in their research, they assessed whether or not a company’s political connections used a proxy and whether or not there was direct ownership by the government of the company. Likewise, the research by (Khoirunnisa Asadanie & Venusita, 2020) also depicted that political connection affects tax avoidance. Also, their research found that conglomerates, owners of companies, that have close relationships with the government have room for the practices of tax avoidance. Research (Pengutipan: Istiqfarosita & Abdani, 2022) also stated that political relations have a significant effect on tax avoidance.

➢ *H4. Political Connection Moderates The Influences Of Transfer Pricing On Tax Avoidance*

The political connection also strengthens the influence of thin capitalization on tax avoidance. Research (Nadhifah et al., 2020) showed that thin capitalization has a positive effect on tax avoidance. This strengthens the results of previous research (Falbo & Firmansyah, 2018) and (Utami & Irawan, 2022). Political connection as moderator strengthens thin capitalization as seen in the research (Khoirunnisa Asadanie & Venusita, 2020), describing that political connection affects tax avoidance. Further, in this study, conglomerates as owners of companies that have close ties with the government are interpreted to have room for tax avoidance practices.

➢ *H5. Political Connection Moderates The Influence Of Thin Capitalization On Tax Avoidance*

Political connection as a moderator strengthens the effect of profitability on tax avoidance. Research (Kismanah et al., 2018) stated that profitability (ROA) affects tax avoidance. Likewise, the research (Olivia et al., 2019) also displayed that profitability has a positive effect on tax avoidance. A major intervention by the board of directors, who have a political connection in managing capital (company’s performance), which refers to profitability, will depend on politicians in making decisions (Khoirunnisa Asadanie & Venusita, 2020). In this case, it will strengthen the company’s management to practice tax avoidance to reduce tax liability so that shareholders’ profit increases.

➢ *H6. Political Connection Moderates The Effect Of Profitability On Tax Avoidance*

III. DATA AND METHOD

This research used panel data, which was 172 data from 62 companies listed on the Indonesian Stock Exchange (IDX). Also, it employed data from time series from 2019 to 2021. The data analysis technique utilized the Stata version 12, where the regression model from this research was used to test the influences of transfer pricing, thin capitalization, and return on assets toward tax avoidance as follows:

$$TA = \alpha + b1\ TF + b2TC + b3ROA + b4TF*PC + b5TC*PC + b6ROA*PC + e$$

Where:

TA = Tax Avoidance
α = Constant
TF = Transfer pricing
TC = Thin capitalization
ROA = Profitability
PC = Political connection
E = Error Standard

The proxy used to measure the transfer pricing variable was through accounts receivable using the formula of account receivable affiliation compared to total receivables (Panjalusman et al., 2018). For the thin capitalization variable, the used proxy was through the maximum allowable debt (MAD) with the formula of average debt compared to the safe-harbor debt amount (Taylor & Richardson, 2013). Then, for the return on assets variable, it utilized the earning after-tax proxy compared to total assets (Olivia et al., 2019). For the tax avoidance, the proxy used effective tax rate (Jamei, 2017). Furthermore, the dependent variable of tax avoidance used a proxy for the actual rate of tax through the difference formula between the statutory tax rate and the actual tax rate. The moderation variable was measured through shareholders by giving sign 1 for companies that had political connections and zero for companies that were not politically connected.

IV. RESULTS AND DISCUSSION

➢ *Results*

Table 1 Descriptive Statistics

	TP	TC	ROA	TA
Min	0.0001	-1.3853	0.6312	-2.9392
Max	0.9857	1.6965	0.3636	16.4741
Mean	0.2426	-0.1488	0.0253	0.1492
Std. Dev	0.3260	0.3647	0.1107	1.3737

Based on the results of descriptive statistical tests with 172 observations and a data variation range of 0.3260, the average value of 0.2426 explained that most companies were indicated to practice transfer pricing. Meanwhile, according to the thin capitalization (TC) variable with a data variation range of 0.3647, the average value of -0.1488 described that a small number of companies were indicated to practice thin capitalization. Meanwhile the average value of Probability (ROA) variable was 0.0253, explaining that the company's profits had not been large. It was due to unfavorable economic conditions, especially with the pandemic that occurred in 2020-2021. The dependent variable of tax avoidance which had a variation of 1.3737 and an average value of 0.1492, indicated that the ETR was smaller than the STR, which stated that the percentage of the tax levy was smaller, so the existence of tax avoidance was available.

Furthermore, for the political connection variable, based on share ownership by the government, of the 172 observed panel data, 24 of them had political connections, while 148 of the data had no political connection.

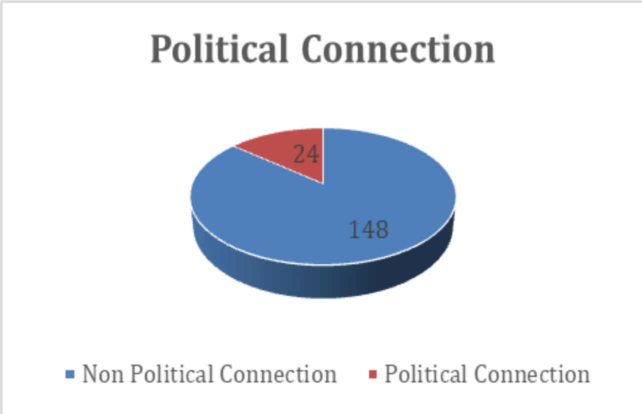

Fig 1 Political Connection

Regarding the selection of the research model, the Common effect model was the best model used in this research by using the General Least Squared (GLS) approach. In the Chow test, the significance level was 0.7740 so the common effect model (CEM) was better than the fixed effect model (FEM). Moreover, in the Hausman test, the probability value of the chi-square was 0.7705 so the random effect model (REM) was better. In the Lagrange Multiplier test, the common effect model was better, where the probability value of the chi-square was more than 0.05, which was 1.00. Thus, it can be concluded that the common effect model was more appropriate to be used in this research. Then, related to the classical assumption test, the multicollinearity value was 1.12, which was between 0 and 10, so this regression model was accepted. However, in the heteroscedasticity test, the regression model did not pass, where the F-value was 0, which was smaller than the significance of 0.05. This was in line with the autocorrelation, which produced F-value = 0. It was less than the significance of 0.05 so the regression model for the two tests was rejected. To overcome these violations, praise and robust tests were used, and the result was a value of 0.1784 > 0.05 so that the model was acceptable.

Table 2 Results of Hypothesis Test on Common Effect Model

Tax avoidance (Y)			**Coefficient**	**Prob t-stat**	**Conclusion**
Transfer pricing (X1)			0.7055	0.039	H1 accepted
Thin Capitalization (X2)			-0.1218	0.675	H2 rejected
Profitability (X3)			-0.2120	0839	H3 rejected
N	172				
R-Square	0.0295				
Prob F	0.2842				
Note: *Significant by 10%, **Significant by 5%, ***Significant by 1%					

- Where the Prob t-stat value of 0.039 was smaller than 0.05, transfer pricing had a significant effect on tax avoidance, so hypothesis 1 was accepted. Where the coefficient value was 0.7055, the direction of influence was positive, meaning that transfer pricing had a positive effect on tax avoidance.
- Where the Prob t-stat value of 0.675 was greater than 0.05, thin capitalization had no significant effect on tax avoidance, so hypothesis 2 was rejected.
- Where the Prob t-stat value of 0.839 was greater than 0.05, probability had no significant effect on tax avoidance, so hypothesis 3 was rejected.

Table3 Results of Hypothesis Test on Moderation

Tax avoidance (Y)			**Coefficient**	**Prob t-stat**	**Conclusion**
TP*PC			0.4999	0.081	H4 accepted
TC*PC			-0.0729	0.776	H5 rejected
PF*PC			0.2339	0.745	H6 rejected
N	172				
R-Square	0.0204				
Prob-F	0.3233				
Note: *Significant by 10%, **Significant by 5%, ***Significant by 1%					

- Where the Prob t-stat value of 0.081 was smaller than 0.10, transfer pricing moderated by political connections had a significant effect on tax avoidance, so hypothesis 4 was accepted. Where the coefficient value was 0.4999, the direction of influence was positive, meaning that transfer pricing moderated by political connection had a positive effect on tax avoidance. When compared with the results of hypothesis 1 where the significant value of the effect of transfer pricing on tax avoidance is 0.039 while when moderated by a political connection the significance value is 0.081, the moderating effect of the political connection is to weaken the effect of transfer pricing on tax avoidance.
- Where the Prob t-stat value of 0.776 was greater than 0.10, thin capitalization moderated by political connections had no significant effect on tax avoidance, so hypothesis 5 was rejected.
- Where the Prob t-stat value of 0.745 was greater than 0.10, profitability moderated by political connection had no significant effect on tax avoidance, so hypothesis 6 was rejected.

V. DISCUSSION

Based on the results of hypothesis testing, transfer pricing had a significant effect on tax avoidance. The transfer pricing practices conducted by the company's management authorized by the company's owners could be the selected scheme in the tax avoidance strategy. Management conducted this scheme to minimize the payment of tax obligations by the company so that the company's expenses could be reduced and it became a distinct advantage for the company's management and owner.

In practice, conducting transactions with related parties was one way to transfer profits, but the risks arising from transfer pricing practices were quite high. The scheme of transfer pricing could increase the company's expenses. For example, it prepared transfer pricing documents through third parties who might be outside the knowledge of the company's owner. The existence of asynchronous information obtained by the principal (owner) and management (agent) could cause problems (asymmetric information, Jensen & Meckling, 1976).

From the results of the descriptive statistical tests, it is also seen that most of the companies practiced transfer pricing. With panel data of manufacturing companies that had branches and subsidiaries overseas and transacted with each other, the company's management would likely perform a tax avoidance scheme through transfer pricing.

The finding of a positive effect of transfer pricing on tax avoidance in this research was in line with research (Amidu et al., 2019), showing that non-financial companies and financial multinational firms in Ghana have a positive effect of transfer pricing on tax avoidance. Also, the results of this research were in line with research (Choi et al., 2020), where multinational enterprises manipulated transfer prices. Research (Dinda Nurrahmi et al., 2020) also stated that the size of the transfer pricing value influenced companies to carry out tax avoidance. Meanwhile, Beebeejaun's research (2018) found that transfer pricing is not used as a tax avoidance scheme, but is still implemented to minimize tax avoidance practices. This was in line with the research by (Widiyantoro & Sitorus, 2019) and (Suhendra, 2020), stating that the effect of transfer pricing is not significant on tax avoidance so companies do not use transfer pricing as a tax avoidance scheme.

Based on the results of hypothesis testing, thin capitalization did not affect tax avoidance. Interest-bearing loan schemes that exceeded the maximum allowable debt might increase the company's expenses (interest expense) and reduce the tax debt. However, management's decisions provided a high risk for creditors. For example, the bankruptcy of a company provided a different view so that creditors would consider granting loans to the company. In addition, the 4:1 ratio rule in using debt liability in calculating Taxable Income according to PMK No.169/PMK.010/2015 also limited taxpayers from making many business loans.

The results of the descriptive statistical test also explained that a small proportion of companies were indicated to practice thin capitalization. Further, based on the total panel data, there was a company's management policy in considering interest-bearing loans from creditors. The results of this research were in line with the research of (Shevlin et al., 2019) and (Anggraeni & Oktaviani, 2021), where thin capitalization did not affect tax avoidance in manufacturing companies. Terrence stated that bank loans have a negative effect on tax avoidance. However, this test was contradicted by the results of the research from (Nadhifah et al., 2020) and (Utami & Irawan, 2022), stating that thin capitalization has a positive effect on tax avoidance.

The results of testing the hypothesis found that profitability did not affect tax avoidance. The company's working capital management by the management, the recipient of the delegation from the company's owner related to the company's management, would strive for maximum profit for the company (profitability) so that it could return working capital properly. Furthermore, if the structure of the capital ownership was dispersed agency, problems could occur between the company's owner and management. This was related to a strong control mechanism to increase the commitment of the board of directors to internal control, which referred to the objective of profitability.

The higher the ROA value, the better the company's value so that the company's management would take action to not reduce the profits that had been obtained and have the opportunity to run a scheme to minimize the tax levy. The results of descriptive statistics showed that the profitability of the studied manufacturing companies was low so the profitability did not affect tax avoidance. This was in line with research (Apriatna & Oktris, 2022), which showed that profitability did not affect tax avoidance. This research used sample data from chemical industry companies registered on the Indonesian stock exchange. Also, similarly, the results of this research were in the same vein as (Putri Maidina et al., 2019)'s research, arguing that profitability (ROA) did not affect tax avoidance. However, it was different from the research from (Kismanah et al., 2018) and (Olivia et al., 2019) stating that profitability has a positive effect on tax avoidance. Other research has found that tax avoidance no influences on corporate performance (Prayitno et al., 2023). That means the company performance in the financial report did not influence on the tax avoidance and vice versa.

Based on the results of hypothesis testing, it was found that political connection as a moderating variable weakened the effect of transfer pricing on tax avoidance. Of the total companies studied, the percentage of shares that have political connections or share ownership by the government is smaller than share ownership by non-government. So it is possible to greatly affect the test results.

The government as the owner of the company and at the same time as the regulator has different interests whereas the government the maximum state revenue from the tax sector is a priority but on the other hand, the owner of the company also wants the company's profits to be as high as possible, so that it becomes a conflict of interest which ultimately capitalize on existing political connection.

The result of the hypothesis test stated that political connection weakened the influence of transfer pricing which had a positive effect on tax avoidance. This was not in line with research (Azmi et al., 2020), describing that the sample data of 156 companies listed on the Malaysian stock exchange during 2012-2017 shows that political connection affects the company's performance, but not the company's value. Similarly, this was in line with research (Idris et al., 2020), emphasizing the importance of the board of directors' connections in improving the company's performance. The existence of political connections within the company tends to divert managers from their basic goal of becoming the self-interest of politicians. In addition, companies that are politically connected tend to incur higher audit fees which demand higher governance (Wahab et al., 2011). Thus, it can be concluded that political connections could weaken the influence of transfer pricing on tax avoidance because it demanded high governance. In this case, the occurring moderating variable was predictor moderation, where transfer pricing had a positive and significant effect on tax avoidance but the political connection weakened this effect.

Moreover, the results of the hypothesis testing found that political connection did not moderate the influence of thin capitalization on tax avoidance. In line with the insignificant effect of thin capitalization on tax avoidance, the existence of political connections within the company did not affect management's actions in increasing the amount of interest-bearing debt, which aimed to reduce the tax burden. Companies that had political connections tended to have regulations that had to be applied and it made it difficult for the company's management in submitting an interest-bearing debt to creditors because it would create a burden for the company. Hence, it can be said that the consideration of a company's financing is not influenced by the presence of political connections. This was in line with the main effect of thin capitalization on tax avoidance where this variable had a negative effect on tax avoidance. However, this was contrary to research by (Azmi et al., 2020), which stated that political connection would provide convenience or benefits to the government. In this case, the occurring moderating variable was the moderation homologizer, where both the coefficients of thin capitalization on tax avoidance and the political connection that affected them were equally insignificant.

Meanwhile, the results of the hypothesis testing demonstrated that political connection did not moderate the effect of profitability on tax avoidance. Dominant share ownership by the government in the company could influence management in managing the company's working capital to increase profitability. The higher the level of profitability, the greater the assets owned by the company, so the company's ability to pay the company's expenses including tax expenses was also high. Connected to politics, the company had the benefits of access to financing because politics was an important determinant of profitability.

The results of the hypothesis test stated that political connection did not moderate the effect of profitability on tax avoidance. High profitability would trigger large political costs because politicians tended to influence the company's decision-making and control managers for the advancement of their political interests. This was in line with research conducted by Asadanie *et al.*, arguing that that major intervention was by the boards of directors, who have a political connection so that capital management (company's performance) which refers to profitability will depend on politicians' decision-making (Khoirunnisa Asadanie & Venusita, 2020).

Considering that political connection did not moderate the influence of ROA on tax avoidance, it concluded that the type of occurring moderation was moderation homologizer, where the coefficients of both ROA and political connection moderation variables did not have a significant effect on tax avoidance.

VI. CONCLUSION

Transfer pricing has a significant effect on tax avoidance, but is weakened by the moderating variable of political connection (predictor moderation). The political connection has not been used to influence management in operating the company. Meanwhile, thin capitalization and return on assets have not affected tax avoidance practices. This is also reinforced by political connection where it is found that political connection has not affected two variables of tax avoidance (homologizer moderation). The results of this research have contradicted previous research due to the decline of economic activity during the Covid-19 pandemic in 2020 and 2021. Therefore, this pandemic has affected the company's performance as shown in the company's financial statements.

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