# CHAPTER II

# LITERATURE REVIEW

## A. Theoretical Framework

### 1. Stakeholder Theory

According to Pradipta and Supriyadi (2015), stakeholder theory shows that firms are not only responsible for company welfare, but also must have social responsibilities of all interest parties affected by the company's actions or policies. Gray et al. (1997) argue that stakeholder theory is a market force approach, in which the supply or withdrawal of economic resources will determine type of social and environmental disclosure at certain time. Beside that, stakeholder theory ignores widespread influence of society on information provision in financial reporting, include existence of laws and regulations requiring disclosure of certain information.

Stakeholders are individuals or groups of people who have business interests with companies or organizations (Sutiyok and Rahmawati, 2014). Sutiyok and Rahmawati (2014) stated that existence of company can not be separated from the influence of people or groups that have relationships with organization. The existence of stakeholder theory explains that the company is not individualistic and selfish in carrying out its operations. Stakeholder theory can influence company to disclose its annual report widely and transparently. It is because intervention of others is needed for continuity of its operational activities or going concern.

**2. Tax**

According to Law No.28 of 2007 on KUP, definition of tax is:

"Taxes shall be compulsory contributions to the state, which are indebted forcefully by individuals or bodies on the basis of law, without obtaining compensation directly and used for the need of the state for the people's welfare maximally."

There are four factors inherent in definition of tax (Ilyas, 2010:5), namely:

a. Tax payments must be based on law.
b. It can be forced.
c. There are no rewards that taxpayers can immediately perceive.
d. Tax collection is done by state either by central or regional government (not allowed to be collected by private sector).

According to Mardiasmo (2016), functions of tax include:

a. Budgetary Functions

   Budgetary functions is that taxation is a tool (or a source) to include as much money into the state treasury which in time will be used to finance state expenditure, like routine expenditure and development.

b. Regulerend Function

Ragulerend is also referred to as a regulation function. The tax is used as a tool to achieve certain goals which were located outside the financial sector and regulate the function of many directed against the private sector, like economic, political, cultural, defence and security such as:

1) Enacting tariff changes and
2) Providing exceptions, remission or otherwise, addressed to specific problems.

Mardiasmo (2016) also explained tax divided based on category, characteristic and collector agencies.

a. Tax based on the category

1) Direct Tax

   Direct tax is taxes which can not be imposed on others so that taxpayer must bears the burden of it. The examples are Land and Building Tax (PBB).

2) Indirect Tax

   Indirect tax is taxes which payments can be transferred to other parties. The examples include customs duty, stamp duty, and advertisement tax.

b. Tax based on the characteristic

1) Subjective Tax

Subjective tax is type of tax which tax liability is strongly determined by subjective of tax subject, though to determine obligation of tax payers depends on tax object. Types of tax include in this group is income taxes.

2) Objective Tax

Objective tax is type of tax which tax liability is strongly determined by tax object. Subjective of the tax subject is irrelevant, although in certain cases it is considered. Types of tax include in this group are Value Added Tax (VAT), Land and Building Tax, Motor Vehicle Tax.

c. Tax based on collector agencies

1) Tax Center

Tax center is taxes collected by the government and used to finance the state's households. The examples are PPh, PPn, PPnMB, and Stamp Duty.

2) Local Tax

Local tax is taxes collected by the local government and used to finance local households. For example, in provincial taxes such as motor vehicle taxes. Thus for local taxes, the example are hotel taxes, restaurant taxes and entertainment tax.

**3. Tax Avoidance**

Tax management efforts by taxpayers to minimize the tax burden can be done by tax avoidance and tax evasion. According to Pradipta and Supriyadi (2015), the category of tax avoidance is a legal tax management action because it utilizes more loopholes in existing tax laws.

Tax evasion may pose a risk to a company such as a fine or loss of a company's reputation. This may occur if tax avoidance measures have violated or exceeded the limits of the taxation provisions which then belong to tax evasion.

Tax evasion is a business that leads to a criminal act in the field of taxation illegally and is outside the frame of taxation provisions (unlawfull) (Santoso and Ning, 2013: 21). So it can be clearly distinguished between the practice of tax avoidance and tax evasion. A good tax planning is required for tax burden borne by taxpayer. The actions or efforts of company to conduct tax avoidance efforts indicate the degree of aggressiveness to tax. The greater the company's efforts to avoid taxes, the company is increasingly aggressive against taxes.

Companies as one of tax subjects often make tax savings for the achievement of profit after higher tax. According Pradipta and Supriyadi (2015), it is done because there is a conflict of interest between stakeholders with the management. Such misalignment makes managers do things for stakeholder satisfaction, one of which is to minimize the amount of profit, so the amount of tax paid is low, both through legal and illegal means often called tax aggressiveness.

Tax aggressiveness can be done due to the company's non-compliance with tax regulations and tax-saving activities according to the regulations. Companies that utilize regulatory loopholes to reduce the tax burden are considered to have tax aggressiveness despite not violating existing rules (Kamila, 2014). Prayogo (2015) states that to reduce tax payments can be done by enlarging the amount of costs incurred by companies or minimize revenue.

### 4. Derivative Transactions

Musyarofah (2016) describes the meaning of derivatives. The derivative effect is a derivative effect of the main effect, either of the investment or the debt. Derivative effects can mean a direct derivative of the main effect and the subsequent derivative. Derivatives are contracts or agreements that value or profit opportunities are related to the performance of other assets. These other assets are referred to as underlying assets.

In a more specific sense, a derivative is a financial contract between two or more parties to fulfill a pledge to buy or sell an asset / commodity as traded object at a time and a price which is a mutual agreement between the seller and the buyer. The future value of the traded object is heavily influenced by its parent instrument in the spot market.

Derivatives in the stock exchanges are financial derivatives. Financial derivatives are derivative instruments, where the underlying variables are financial instruments, which may be stocks, bonds, stock indexes, bond indices, currency, interest rates and other financial instruments (www.idx.co.id, 2017).

According to Oktavia and Martani (2013), initially the tax on these derivative transactions is not regulated in the rule of law, but is regulated in a Circular of the Director General of Taxation and the Letter of the Director General of Taxes. However, in line with the development of derivative use and the enactment of Law No. 36 year 2008 concerning Income Tax, tax on derivative transactions status becomes "a little more clear" with the imposition of a final tax (in accordance with article 4, paragraph 2) on income from share transactions and other securities, as well as exchange-traded derivative transactions.

Based on Law no. 36 of 2008 on Income Tax, the Government of Indonesia issued Government Regulation No. 17 year 2009 on Income Tax on Income from Derivative Transactions in the Form of Futures Traded Futures at the Exchange. This Government Regulation (PP) provides that income from derivative transactions in futures traded on the exchange, subject to a final income tax of 2.5% of the initial margin.

However, the government regulation was rejected by the Association of Futures Brokers and the Association of Indonesian Futures Traders. So the government issued Government Regulation Number 31 Year 2011 stating that Government Regulation Number 17 Year 2009 revoked and no longer valid.

**5. Corporate Social Responsibility Disclosure**

According to Law Number 40 Year 2007, Corporate Social responsibility is a commitment of the company to participate in sustainable economic development in order to improve the quality of life and environment that is beneficial both for the company itself, local community, and society in general. Meanwhile, Law Number 25 Year 2007 defines CSR as an inherent responsibility for every investment company to keep creating a harmonious, balanced, and appropriate relationship with the environment, values, norms and culture of the local community.

From the set of definitions above, it can be concluded that CSR is interpreted as a form of corporate commitment to improve the quality of life of employees, local communities and society more broadly as a form of its contribution to sustainable economic development as reflected through good business practices. Disclosure of CSR then becomes a medium for companies to provide information from various aspects other than financial such as social and environmental aspects that can not be explained implicitly in each component in the company's financial statements to stakeholders or shareholders of the company (Lindawati and Puspita, 2015).

CSR disclosure according to Lindawati and Puspita (2015) is a signal given by management to all stakeholders including potential investors regarding prospect of company in future as well as showing more value owned by company for its concern on economic, social and environmental impact arising from company's activities. According to Patten (1990), disclosure of CSR can provide distinct advantage for company in terms of funding based on tendency of investors to invest in companies that have good business ethics, good employee practices, care about environmental impact and have social responsibility. As a result, CSR disclosure is one of the important things that should be presented in financial statements.

The better disclosure of CSR conducted by company then stakeholders will increasingly provide full support to company for all its activities aimed at improving performance and achieve expected profit of company (Lindawati and Puspita, 2015). Meanwhile, according to Femitasari (2014) some items of CSR that become expenditures such as waste processing costs, internships, scholarships, and training, donations in the context of national disaster relief, etc. can be charged as deductible expenses to reduce gross income. Therefore, CSR disclosure is done by company as form of report to stakeholders and also as tool to reduce gross profit to minimize the tax burden.

In Indonesia in Law no. 40 Year 2007 Article 74 has been regulated corporate obligations to carry out activities of social and environmental responsibility. To raise awareness of business entities on environmental concerns, in Indonesia through the Ministry of Environment conducts an assessment of environmental management known as the Corporate Performance Rating Program (PROPER). The existence of PROPER aims to enhance the company's role in environmental management as well as to effect in compliance with environmental regulations and added value to the maintenance of natural resources, energy conservation, and community development.

In addition to requiring CSR activities in Law No.40 Year 2007 article 66 (2c) states that the Limited Company is required to report on the implementation of social and environmental responsibilities in the annual report. One of known CSR information reporting concepts in Indonesia is reporting under the Global Reporting Initiative (GRI). In the concept of reporting CSR information according to GRI there are six dimensions of disclosure, namely: economy, environment, labor practices, human rights, society, and product responsibility.

### 6. Political Connections

Purwoto (2011) states that the Indonesian state and President Soeharto have become popular in the early development of literature of political connections. Political companies are companies that in certain ways have political bond or seek closeness with politicians or government (Purwoto, 2011). Therefore, political connections are believed to be an invaluable resource for many companies.

Faccio (2006) explains that firms are considered to have a political connection if at least one of the major shareholders (someone who controls at least 10% of the total shares with voting rights) or one of the company's directors (CEO, president, vice president, chairman or secretary) are members of parliament, ministers, or persons closely affiliated with top politicians or political parties. Political connections can also be seen from the presence or absence of direct ownership by the government at the company.

## B. Literature Review and Hypotheses Development

### 1. The Influence of Financial Derivatives toward Tax Avoidance.

According to Donohoe (2015), derivatives are used to avoid taxes on companies because derivatives can smooth out or refine taxable income, mimic virtually the economic position, obscure economic substance, and increase ambiguity in tax reporting. Research conducted by Donohoe (2012) finds empirical evidence that derivatives can be used as a means of tax avoidance because tax rules on derivative transactions in the United States are still ambiguous.

In Indonesia, the rules or definitions of derivative transactions are still unclear, so companies may use financial derivatives as a means of tax avoidance. According to Oktavia and Martani (2013), to determine whether derivative loss is either deductible or non-deductible, clear definition of tax regulation concerning whether or not a derivative is required. Therefore, it can be concluded that rate of tax avoidance in financial derivative users is higher than firms that do not use derivatives. This is supported research by Oktavia and Martani (2013), Donhoe (2012) and Musyarofah (2016). Based on the above description, then developed the following research hypothesis.

$H_1$: Derivative transactions have positive effects towards tax avoidance.

**2. The Influence of Corporate Social Disclosure towards Tax Avoidance.**

Watson (2011) argues that low-ranking firms in Corporate Social Responsibility (CSR) are perceived as socially irresponsible companies that can make tax strategies more aggressive than socially conscious companies. The same is expressed by Hoi et al. (2013) where companies with irresponsible CSR activities are more aggressive in avoiding taxes.

According to Femitasari (2014), some CSR items such as waste processing costs, apprenticeships, scholarships, and training, donations in the context of national disaster relief, etc. can be expenses that can be deductible expenses, Minimize corporate tax burden. So it can not be denied that many companies do CSR activities as form of taxable income to be reduced.

Pradipta and Supriyadi (2015) argue that stakeholder theory shows that company is not only responsible for the welfare of the company, but must have social responsibility considering the interests of all parties affected by the company's strategy or action. Sriviana and Asyik (2013) states that implementation and disclosure of CSR activities is one way to maintain good relations with stakeholders. Implementation and disclosure of CSR activities is expected to bridge stakeholder desire to company, so that will produce harmonious relationship and in future company can achieve sustainability or sustainability of company.

Companies that do not disclose CSR activities are considered to have higher tax avoidance rates when compared to similar companies that disclose CSR activities. This is supported by the research of Hoi et al. (2013) and Pradipta and Supriyadi (2015). While research conducted Fetmisari (2014) and Rahmawati et al. (2016) stated that CSR has a significant positive effect on tax evasion activities. Based on the above description, this research hypothesis is as follows:

$H_2$: CSR disclosure has negative effects towards tax avoidance.

**3. The Influence of Political Connection towards Tax Avoidance.**

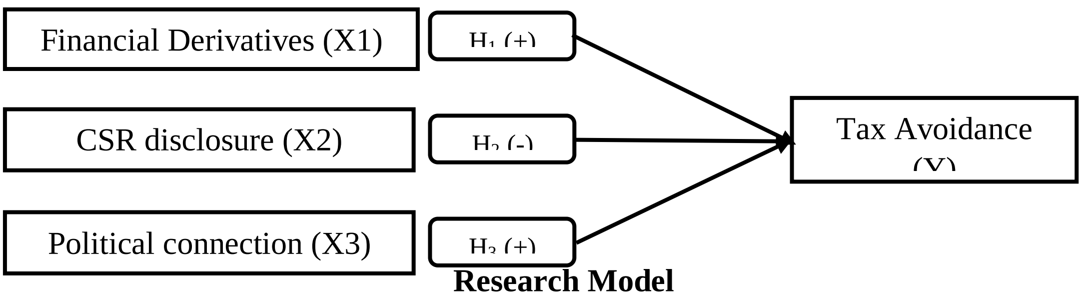
Butje and Tjondro (2014) stated that political connections they have make company get special treatment, such as ease in obtaining capital loans, low tax audit risk that makes the company more aggressive in applying tax planning resulting in decreased transparency of financial statements. In addition, losing investors due to decreased transparency of financial statements can be replaced with the role of government as the main funder.

Companies that have a political connection with the government in power have proven to have a high level of tax avoidance that is high compared to similar companies that have no political connections. This is supported by research by Mulyani et al. (2014), Butje and Tjondro (2014), Kim and Zhang (2013) and Christensen et al. (2014). While research conducted Nugroho (2011), Fatharani (2012), and Marfu'ah (2015) concluded political connections have no significant effect on tax evasion activities. Based on the above description, this research hypothesis is as follows:

$H_3$: Political connections have positive effects towards tax avoidance.

## C. Research Model

Based on hypothesis development above, the research model of this study is as follows:




**Research Model**