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***Correspondence:**
nurulaisyah@universitas-trilogi.ac.id

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Office:
Department of Accounting
University of Muhammadiyah Malang
GKB 2 Floor 3.
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DETERMINATS OF THE AMOUNT OF RELATED PARTY TRANSACTION: TAX EXPENSE AND INSTITUTIONAL OWNERSHIP

Lia Rahmawati Soraya[1], Nurul Aisyah Rachmawati[1*]

Afiliation:
[1]Department of Accounting, University of Trilogi, Jakarta, DKI Jakarta, Indonesia

ABSTRACT

This research is testing whether tax expense and institutional ownership have an influence on the amount of Related Party Transactions (RPT) both related to sales and expense (RPTSE). The population in this research is manufacturing companies listed on the Indonesia Stock Exchange with a total sample of 174 out of 58 manufacturing companies with research period in 2016-2018. By using panel data regression analysis, the results showed indicate that the tax expense of the previous year has a significant positive effect on the amount of related party transactions related to sales and expenses (RPTSE). This shows that the tax expense can encourage companies to conduct related party transactions in the following year. Meanwhile, institutional variables do not have a significant effect on related party transactions related to sales and expense (RPTSE).Practically, related party transactions are relatively complex, so that institutional ownership does not guarantee tomonitor of these transactions.

KEYWORDS: Institutional Ownership; Related Party Transaction; Tax Expense.

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INTRODUCTION

Most of the companies in Asia have a concentrated ownership structure, one of which is Indonesia. Concentrated ownership illustrates that most company ownership is concentrated in one party or a few parties, so that party has control of business activities in the company (Pangesti et al, 2019). The existence of ownership concentration makes the majority shareholder have a big enough role in decision making.

Ownership concentration can play a role in reducing agency problems that arise from the difference in interests between the principal (shareholder) and agent (management) (Jensen and Meckling, 1976). It is said to reduce agency problems because the majority shareholder has the control to supervise the management in managing the company in accordance with the objectives desired by shareholders (Hope and Thomas, 2008 in Utama, 2015).

However, the more concentrated an ownership will lead to another agency conflict, namely between majority shareholders and minority shareholders. With control rights that are owned by the majority shareholder, they can carry out practices that can harm minority shareholders through related party transactions (RPT) (Utama, 2015; Pangesti and Hidayat, 2019).In order to minimize this, there is anOtoritasJasaKeuangan (OJK) Regulation, Number IX.E.1 concerning Affiliated Transactions and Conflict of Interest Transactions that require disclosure of information to the public.

According to PSAK No. 7 which is effective as of January 1, 2018,a related party transaction is a transfer of resources, services or liabilities between the reporting entity and related parties, regardless of whether a price is charged.Kohlbeck et al., (2010) in Sari et al., (2018) state that related party transactions can be profitable (efficient related party transactions) or harmful (abusive related party transactions). Related party transactions are one of the ways to make transactions more efficient. It is said to be efficient because companies that are affiliated with a business group can utilize resources together, both tangible and intangible resources so as to obtain the benefits of economies of scale and economies of scope.

On the other side, arelated party transaction is said to be abusive because there will be parties who are disadvantaged when the related party transaction occurs. One of the related party transaction activitiesthat can harm the company is when the transaction indicates cash flow tunneling. According to Atanasov et al., (2015) in Pangesti et al., (2019) cash flow tunneling is a transaction thattransfers cash or other current assetsout of public company to a related party. For example, is making a sale with a related company at a lower price than an unrelated company.

This transaction can also be called transfer pricing. Transfer pricing is a transaction with privileged parties, which determines the transfer price of a transaction, be it goods, intangible assets, or financial transactions conducted by the company (Setiawan, 2013).In the case of transfer pricing is taking advantage of different tax rates in each country. Manipulate transfer prices by increasing the purchase price and reducing the selling price between affiliated companies and transfer profits to companies located in countries with low tax rates (tax heaven) to minimize the taxes imposed. This will be detrimental to minority shareholders because the impact is that the company becomes a loss so that it affects the value of the shares of minority shareholders because the profits are transferred to related parties. It was also detrimental to the state for taxes received is reduced.

Tiwa et al., (2017) found that taxes have a significant positive effect on related party transactions but in the context of transfer pricing. This indicates the amount of tax expense

that must be paid by the company as a benchmark for management to carry out transfers pricing or related party transactions as an effort to reduce the amount of tax to be paid. It can be said that the related party transactions contain a tax factor. In this research is, does not look at whether related party transactions are only carried out domestically or across countries, so that the rate is irrelevant if used as an excuse. Then to solve this problem used the difference on the year'sthus using the previous year's tax expense.

Based on the background, the purpose of this study is to test empirically the correlation between the tax expense and institutional ownership on the amount of related party transactions. Research on related party transactions is still slightly,so that it attracts researchers to research it. This research develops or expands Utama (2015) about factors that affect the amount of related party transactions, namely taxes. So the results of this study are to determine whether the amount of related party transactions in a companycontains tax expense factor.

For business people, taxes are considered burdensome to companies because having a direct effect on operating profits so that can reduce profits earned by the company.Tax expense is the combined amount of current tax and deferred tax calculated in determining profit or loss for a period. The tax expense is proxied by ETR (effective tax rate). According to Putri (2016), when the tax expense is small then the ETR percentage is getting smaller. This is good for the company because it shows that the company has succeeded in doing tax planning. However, the low ETR is not always for the efficiency of the company becauseit can also be driven the opportunistic actions of the majority shareholder.

Pangesti et al. (2019) explain that control right control rights owned by the majority shareholder in decision making, can push management to perform opportunistic actions that fulfill the interests of the majority shareholder. The coalition between management and majority shareholders that occurs can cause information bias and harm minority shareholders. Related party transaction activities that may harm minority shareholders are transfer pricing, in order to minimize the tax expense that must be paid. Efforts made by increasing the cost of raw materials or reducing revenue from sales of goods with related parties. Increasing the cost of raw materials will result in higher purchasing costs charged. Then, reducing the income from the sale of goods will result in a lower income earned by the company. Both of these things make the profit reported by the company low so that the tax burden paid is low (Rahayu, 2013).Tiwa et al., (2017) found that taxes significantly positive effect on the application of transfer pricing within a manufacturing company. This indicates the amount of tax expense that must be paid by the company as a benchmark for management to carry out transfer pricing or related party transactions as an effort to reduce the amount of tax to be paid.In the case of transfer pricing as in research conducted by Tiwa et al, (2017), it takes advantage of differences in tax rates in each country and conduct transactions with affiliated companies in countries with low tax rates.But, in this research, it does not look at whether related party transactions are only carried out domestically or across countries, so that the rate is irrelevant if used as an excuse. Then to solve this problem used the difference on the year'sthus using the previous year's tax expense to see whether the actions that management will take when facing high etr in the previous year will tend to conduct abusive related party transactions. Based on this explanation, the first hypothesis is:

H1: *The previous year's tax expense has a positive effect on the current amount of related party transactions*

The existence of institutional parties in a company is expected to suppress abusive related party transaction activities. Faisal (2004) in Ngadiman et al., (2014) explains that institutional ownership is a party that can monitor companies with large institutional ownership (more than 5%) making their ability to monitor management greater. Institutions can be in the form of insurance companies, foundations, pension funds, banks, limited liability companies (PT), and other institutions.

Wijaya et al., (2011) found that institutional ownership has a negative effect on debt RPT and does not show any significant effect on receivable RPT. Debt and receivable from related parties arises as a result of sales or purchase transactions with related parties (Wong, 2003 in Wijaya et al., (2011). This shows that institutional ownership can affect the behavior of management because high debt policies make the company supervised by debtholders. Thus, the strict control of the company, making the manager will act as desired debt holder and shareholder. Then the amount of related party transactions will be lower with the supervision carried out by the institution. Based on this explanation, the second hypothesis is:

H2: *Institutional ownership has a negative effect on the amount of related party transactions.*

METHOD

This type of research used in this research is a quantitative research by using secondary data. Secondary data used are financial reports and annual report from manufacturing companies listed in Indonesia Stock Exchange (BEI) for the 2016-2018 period. The sampling technique used purposive sampling with the following criteria:

a. Companies whose shares are listed on the IDX in the 2016-2018periodand were not delisted during the observation period
b. Companies that provide complete data related to the data needed in research.
c. Companies that do not losses during the observation period.

The data obtained were 174 samples out of 58 companies with an observation period of three years. The analysis method used is panel data regression analysis. To accommodate variations in the amount of RPT from each company, it is converted into logs (1+ RPT). Then the equation is as follows:

$$\boldsymbol{Log(1+RPT)_{it} = \alpha + \beta 1ETR_{it-1} + \beta 2OWN_{it} + \beta 3DER_{it} + \beta 4SIZE_{it} + e_{it}}$$

where:

RPT_{it} = Related Party Transactions (RPT)

ETR_{it-1} = Previous year's tax expense

OWN_{it} = Institutional Ownership

DER_{it} = Laverage

$SIZE_{it}$ = Size

e_{it} = error

Operational Definition and Variable Measurement

Dependent Variable

The independent in this research is related party transactions (RPT). The measurement refers to Utama (2015) which uses two measurements, namely relative share of RPT assets and liabilities to book value of equity (AL) and relative share of RPT sales and expense to book value of equity (SE). But in this research only focuses on one measure, namely the relative share of RPT sales and expense to book value of equity (SE) or RPTSE which looks at the proportion of sales and company expenses related to related party transactions in the financial statements and compared to the total equity of the company. Measurement of the relative share of the RPT compared to total equity to examine the effects of related party transactions on shareholders and only uses RPTSE because in the research year, in Indonesia there were more related party transactions that occurred in (SE). The measurements are as follows:

$$RPTSE_{it} = \frac{RPT\ sales_{it} + RPT\ expense_{it}}{Equity_{it}}$$

Independent Variable

a. Tax expense in this study is to use the tax expense in the previous year which is proxied by ETR_{it-1}. Because this research, it does not look at whether related party transactions are only carried out domestically or across countries, so that the rate is irrelevant if used as an excuse. Then to solve this problem used the difference onthe year's thus using the previous year's tax expense. Referring to Alfandia(2018), ETR is measured usingtotal ratio by comparing the total income tax expense and profit before tax. Total income tax expense is the sum of current tax expense and deferred tax expense. The measurements are as follows:

$$ETR_{it-1} = \frac{Total\ income\ tax\ expense\ i,t}{profit\ before\ tax\ i,t}$$

b. The measurement of institutional ownership is measured using the proportion of share ownership by the institution to the number of shares outstanding (Fadli, 2016):

$$OWN_{it} = \frac{number\ of\ shares\ owned\ by\ institutional\ \ i,t}{total\ number\ of\ shares\ i,t}$$

Control Variable

a. Leverage is measured by DER (*debt to equity*) (Rezky (2018).

$$DERit = \frac{Total\ debt\ i,t}{Total\ equity\ i,t}$$

b. Size is measured by the natural logarithm of total assets (Hartono, 2016).

$$Sizeit = \mathrm{Ln}(Total\ aset\ i,t)$$

RESULTS AND DISCUSSION

Descriptive Statistics

Descriptive statistical analysis was carried out to determine the characteristics of the values which include the average value, standard deviation value, minimum value and maximum

value of each research variable. Table 1 presents the results of the statistical analysis as follows:

Variable	N	Mean	Median	*Std. Dev*	*Min*	*Max*
$RPTSE_{it}$	174	0,121	0,034	0,164	0,000	0,762
ETR_{it-1}	174	0,243	0,252	0,074	0,012	0,489
OWN_{it}	174	0,791	0,855	0,219	0,019	0,999
LEV_{it}	174	0,700	0,561	0,538	0,001	2,654
$SIZE_{it}$	174	8,337	8,228	0,720	7,046	10,379

Table 1. Descriptive Statistics

Based on the results of the descriptive analysis in Table 1, the first variable which is$RPTSE_{it}$. The average value oflog(1+$RPTSE_{it}$) is 0,121with a median value of 0.034.This shows that the manufacturing companies used as samples tend to carry out related party transactions, especially transactions related to sales and expenses. Because the calculation is kept on the value of equity, it can illustrate the impact felt by shareholders on related party transactions resulting from sales and expenses. Furthermore, the average value of the variable tax expense in the previous year, which is proxied by$ETR_{it-1}$is 0,243with a median value of 0.252. This shows that companies tend to conduct related party transactions to reduce their tax expense because the average value is smaller than the company's effective tax rate, which is 25%, although the tendency is not too large. The institutional ownership variable has an average value of 0.791 with a median value of 0.855. This shows that ownership of manufacturing companies tends to be owned by institutions. The average value of leverage is 0.700 with a median value of 0.561 it means that manufacturing companies have a high enough leverage to the value of equity. The average value of firm size is 8.337 with a median value of 8.228 which is close to the average value, so it can be interpreted that the manufacturing company has a large asset value.

Data Analysis and Discussion

The results of the panel data regression analysis in Table 2 aim to determine the effect of tax expense and institutional ownership on the amount of related party transactions.

Variable	Coefficient	z	P>[z]
ETR_{it-1}	0.0777258	4.18	0.019**
OWN_{it}	-0.0422824	-1.20	0.275
LEV_{it}	0.0593917	12.32	0.000***
$SIZE_{it}$	-0.0471179	-3.72	0.032**
_cons	0.4864251	4.66	0.010**
R-square (R^2)	: 0.3135		
Prob(F-statistic)	: 0.0000		

*** significant level 1%

** significant level 5%

* significant level 10%

Table 2. Statistical Test Results Using Random Effects

Based on Table 2, the panel data regression equation model is obtained as follows:

$$Log(1+RPT)_{it} = 0.4864251 + 0.0777258ETR_{it-1} - 0.0422824\,OWN_{it} + 0.0593917LEV_{it} - 0.0471179\,SIZE_{it} + e_{it}$$

The determination coefficient test aims to determine how much the ability of the variable tax expense and institutional ownership can explain the amount of related party transactions. Based on Table 2, it can be seen that the R-Square value is 0.3135. This shows that the ability of the variable tax expense and institutional ownership as independent variables and leverage and size as control variables can explain the RPTSE amount of 31.35% while the remaining 68.65% is explained by other variables outside the equation.

The F test aims to test the significance of the coefficient as a whole or simultaneously. Based on the results of hypothesis testing in table 2, it shows that the Prob (F-Statistic) value of 0.0000 is smaller than 0.05. This shows that in this research the variables of the previous year's tax expense and institutional ownership, as well as leverage and size together have a significant effect on the amount of related party transactions.

Tax Expense on the Amount of Related Party Transactions

Based on the t-test results from the panel data regression analysis in Table 2, the previous year's tax expense on the amount of related party transactions shows a coefficient value of 0.0777258 with a probability value of 0.019 <0.05. It can be concluded that the tax expense in the previous year had a positive and significant effect on the amount of related party transactions in the current year. The high tax expense of the previous year can encourage companies to conduct related party transactions in the current year. The amount of the tax expense that the company must pay is the company's consideration in order to get more profit. So that if the company's tax expense in the previous year was high, then in the current year the company tends to conduct related party transactions. The amount of related party transactions here is related to sales and expenses. This shows that an effort to reduce tax expense is to make sales transactions with related parties.

This often happens in the case of transfer pricing, by reducing the income from sales by selling below the fair price so that it will affect the small company profits that will be taxed. Transfer pricing is one example of related party transaction actions. The results of this research are in line with Tiwa et al., (2017) but in the context of transfer pricing which found that taxes have a significant positive effect on the application of transfer pricing in manufacturing companies. This indicates the amount of tax expense that must be paid by the company as a benchmark for management to carry out transfer pricing or related party transactions as an effort to reduce the amount of tax to be paid.

Institutional Ownership on the Amount of Related Party Transactions

Then the results of the t-test of the second hypothesis in the panel data regression analysis in Table 2 show that institutional ownership of the number of related party transactions has a coefficient value of -0.0422824 with a probability value of 0.275 <0.05. It can be concluded that institutional ownership had a negative and not significant effect on the amount of related party transactions so this research cannot prove this effect. In theory, institutional ownership should be able to play a role in overseeing management's actions in carrying out abusive related party transactions. Practically, related party transactions are relatively complex, so that institutional ownership does not guarantee to monitor of these transactions. However, active monitoring can turn into passive and opportunistic when institutional shareholding is high. With large voting power, institutional investors can side

with management or even force them to make decisions according to their personal interests and ignore the goal of increasing firm value (Rahma, 2014). This may be the cause of the non-effect of institutional ownership variables in this research because it involves the company in general not just a financial company.So that supervision tends to be lower than companies that only use financial companies as institutional ownership.

If seen from the average institutional ownership in this study is quite large that is 79%, so it is suspected that the high institutional ownership does not strengthen supervision, but instead becomes less optimal because it encourages opportunistic actions from related party transactions. This is in accordance with the strategic alignment hypothesis stated in Rahma (2014) that institutional investors with majority shareholdings are more likely to side with and cooperate with management to prioritize their personal interests over those of minority shareholders.

The results of the panel data regression test on the control variables showed a significant effect. In table 2, the coefficient value of the leverage is 0.0593917 and the probability value is 0.000 which shows that the leverage has a significant positive effect with a significant level of 1%. Companies that have high leverage will pay less tax because when additional debt occurs, it will generate interest expenses which will reduce profit before tax. By transferring debt from affiliated companies to a debt structure scenario that will benefit the company (Rezky et al., 20180. In the variable size the coefficient value is -0.0471179 and the probability value is 0.032 ($P <0.05$). The larger the company size, the lower the amount of related party transactions. This result is in line with Wijaya et al., (2018), Khotimah (2018) and Refgia (2017) which found a negative correlation between size and related party transactions. This is presumably because the larger the size of a company, the more it makes the company in the public spotlight, so that the company will be more careful in conducting various activities, including related party transactions that can be abused.

CONCLUSION

Based on the results of statistical tests and discussion of results, we can conclude that the previous year tax expense has a positive effect on the amount of related party transactions in sales and expense (RPTSE). The results of this research provide empirical evidence that the high tax expense in the previous year can motivate companies to conduct related party transactions in the current year to reduce the tax expense that must be paid by the company. However, the institutional ownership hypothesis is rejected, so this research cannot prove this effect. This is presumably because in this study it involves companies in general, not just financial companies. So that supervision tends to be lower than companies that only use financial companies as institutional ownership.

The limitation of this study is that only manufacturing companies are used as samples, institutional ownership involves the company in general, not only using financial companies. Therefore, the suggestion for further research is to expand the research sample and measure institutional ownership to focus more on financial companies only.

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