The Effect Of Related Party Transactions on Tax Avoidance: Mediating Role of Real Earnings Management

Audia Cendekiawati[a,*], Puji Harto[b]

[a,b] Department of Accounting, Diponegoro University, Semarang, Indonesia
*Corresponding author. Email: audia.cendekiawati@gmail.com

Abstract

This study aims to examine the effect of related party transactions (RPT) on tax avoidance using real earnings management as a mediating role. This research used Book Tax Differences (BTD) as the proxy of firm's tax avoidance while real earnings management is measured with real activities manipulation. Population of this research was taken from companies listed in Indonesian Stock Exchange (IDX) in the year of 2012-2014. The samples of this research were listed manufacturing company which have at least three transactions between related parties. Manufacturing companies were selected because real earnings management can only be identified through real operating activities conducted by the company. The research's result showed that real earnings management have full mediation in the relationship between related party transactions and tax avoidance. Therefore, companies utilize related party transactions as strategy to lower their tax and this can be done through real earnings management activities.

Keywords: related party transactions; real earnings management; tax avoidance; real activities manipulation

1. Introduction

Tax is the primary source of income for the government's expenditure in Indonesia. In 2015, The Ministry of Finance of Indonesia reported that tax revenue contributed almost 67% of total Indonesian's income which income tax revenue contributed the majority portion (46%). The function of tax to a country is very crucial to finance the state budget for national development such as improving infrastructure, subsidy, health insurance and other prosperity of the people.The sources of income tax revenue in Indonesia are categorized into corporate taxes and personal taxes. Corporate taxes and personal taxes are the amount of money that must be paid to the government as an obligation of conducting taxed activities. This research focus on corporate taxes which taxes from companies located and operated their activities in Indonesia. The company's tax rate in Indonesia is 25% from their profit.

The higher the profit generated, the higher the taxes should be paid. In dealing with this situation, some companies employ tax strategy in preparing their financial statements to pay the tax as low as possible. The strategy that conducted by those companies in order to minimize the amount of paid tax is known as tax avoidance (Desai and Dharmapala, 2006). Mangunsong (2002) stated that the reduction of the tax burden or tax avoidance is a tendency that no one likes to pay taxes. Moreover Mangoting (2004) explained that the nature of the tax which does not provide direct benefit to the taxpayers makes them avoid paying it.

Tax avoidance in Indonesia may occurs because companies tend to take advantages of the loopholes and weaknesses of the tax legislation. For example, a company which is deliberately manipulates the report of financial statements causing the fiscal losses is compensated their losses until the next five consecutive years. The absence of strict sanctions on tax avoidance causing unconsciously losses to the state. According to Arnold and McIntyre (2002), tax avoidance or tax savings are still classified in order to comply with the statutory provisions. Furthermore, Mangoting (2004) stated that the government (in this case Directorate General of Taxes Indonesia) cannot impose the legal sanctions to companies although this behavior will burden Government revenue from tax source.

The phenomenon of tax avoidance by some companies in Indonesia mostly conducted using two techniques. The first one is a transaction between related parties or in the research called the Related Party Transactions (RPT). It is mentioned in Statement of Financial Accounting Standard (PSAK 07) that the transactions with Related Parties is the relationship of the parties are considered related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operational decisions. Furthermore, the transaction between related parties is a transfer of resources or obligations between related parties, regardless of a price calculation.

The facts show that RPT is a threat to the tax authority in Indonesia or even other countries around the world. The practice of RPT arises as the transfer price used in the transaction tends to be unnatural and

unreasonable that leads to minimize the amount to be paid. In fact, it is common practice to fix the price above or below the fair price. If a company's profit declines, the tax burden paid will also be smaller. The transactions of RPT creates the intention of the companies to do tax avoidance (Trisnawati and Ompusunggu, 2014).

The second technique of tax avoidance is using the benefit of accounting policy. A company has an ability to establish policies that lead to financial statement called earning management practice. Earnings management is a manager's action to raise or lower the profits on financial statement to impress stakeholders of the company's performance (Hayn, 1995). Meanwhile, Sulistiyanto (2008) defined earnings management as an action conducted by a company by abusing components of the financial statement through accounting methods used in accordance with the person who record the transaction and prepare the financial statement.

Earnings management can be categorized into real earnings management and accrual earnings management. Jones (1991) defined earnings management as a value determined by policies or management discretion using accrual incomes, receivables, plant, property, and equipments (PPE). Meanwhile Roychowdhury (2006) stated that earnings management is a deviation activity from normal business practices conducted by management in order to gain the targeted profit by manipulating sales, discretionary expenditure, and overproduction.

As a consequence, the capability of RPT in minimizing taxes to be paid and manipulating earnings may trigger a conflict of interest between management, shareholders, and other stakeholders. RPT is not only one indicator of tax avoidance; it also becomes the reason of a company to do earnings management. Gordon et al., (2004) stated that the RPT is a natural part of a business, and many companies have high volume of transactions without committing financial fraud. On the other hand, Ryngaert and Thomas (2007) stated that affiliated RPT is one way to do earnings management in Japanese companies. This finding is supported by a research conducted by the Warfield et al. (1995) which stated that the motivation of earnings management is to minimize the burden of the tax to be paid to the government.

So far, previous researches only examined those three main topics partially. There has been no research integrates three related variables of party transactions, real earnings management, and tax avoidance into one research. Therefore, this research intended to fill the research gap and provide an empirical study related to RPT, real earnings management, and tax avoidance. Moreover, this study aimed to build a better knowledge and to examine the mediating role of real earnings management on the relationship between RPT and tax avoidance.

The samples of this study were manufacturing companies listed on the Indonesian Stock Exchange (IDX) during 2012 – 2014. The companies should have at least 3 transactions among related party transaction in assets, liabilities, sales, and purchases. The manufacturing companies were sampled as Roychowdhury (2006) suggested that there is a tendency that real earnings management only occurs in manufacturing companies.

The remainder of this paper is organized as follows: in section 2, we review the basic concepts of related party transaction, real earnings management, and tax avoidance from some relevant studies and development of hypotheses. In section 3, we describes research design, variables and method to do data analysis. Section 4 reports the result of analysis, while section 5 presents the conclusions of the research.

2. Prior research and hypotheses

2.1 Underlying theories and previous studies

Agency according to Jansen and Meckling (1976) is defined as the relationship between two parties that has been approved, in which one party acts as an agent conducting on behalf of the interests of the other party which is called pricipal. In addition, Alnajjar and Belkaoui (2001) stated that agency theory describes shareholders as a pricipal and management as an agent. Management as an agent and shareholders as an principal have their individual motivation to get maximum prosperity from businesses conducted by the company. This condition may occurs because of the three asumptions of human nature such as; self interest, bounded rationaly, and risk averse (Eisenhardt, 1989). This condition may lead to a conflict of interest between the principal and the agent.

Conflict of Interest between the principal and the agent may occurs because of several reasons. First, conflict may arise because management as an agent have more information about the business more than the principal.This condition called Asymmetrical Information (Kohlbeck and Mahyew, 2004). Asymmetrical information may include information which is distributed unevenly among the agent and the principal also inability the principal to determine the activities conducted by the agent about its business. Therefore, the principal assume that agent will maximize its prosperity by hiding some information.

Related Party Transaction as an opportunistic transactions may increase the conflict of interest between the agent and the principal (Kohlbeck and Mahyew, 2004). RPT also may cause irregularities the activity of the company so the transactions may impede the non-controlling shareholders to maximizing their prosperity. Thus, the transactions between related party presented a potential takeover (expropriation) of the company's resurces and be the one of conflict in agency theory (Gordon et al., 2004).

Agency theory is not only be the underlying theory about RPT, but also used to underlie the earnings management activity and tax avoidance activity conducted by the company. The relationship between agency theory and earnings management is according to research conducted by Richardson (2002) stated that the

asymmetri information may lead conflict because the principal assumes if agent will maximize its prosperity by hiding some information which is related with the operating or non-operating activities conducted by the company.

Furthermore, the agency theory can underlie the relationship between tax avoidance and the agency theory because according to previous research conducted by Desai and Dharmapala (2011) stated that tax avoidance conducted by the management can be beneficial and detrimental to the management also the shareholders. The benefit of tax avoidance for both is the company will get a high profit during that year. But, if it is detected by the tax authorities, company will get tax penalties which is reduce the profit next year.

2.2 Hypotheses development

We proposed four main hypotheses that will be explained, and for the second and third hypotheses are broken down into three sub hypotheses in order to find better understanding regarding with the topic.

One of tax management that may be conducted by company is tax avoidance. Tax avoidance aims to minimizing the amount of tax to be paid with legal methods. Tax avoidance can be triggered presence of abnormal transfer prices between companies which have a special relationship. According to previous research conducted by Trisnawati and Ompusunggu (2014) stated that the transations between related party creates an intention of the company to avoid the taxes

The other previous research conducted by Subagyo and Kurniawati (2012) found that the existence of related party transactions have a significantly negative effect on the company's effective tax rate. The existence of related party transactions caused the company's tax expense reduced, in other words, these findings reinforce the notion that the related party transactions have negative impact on state revenue. To test the effects of related party transactions on tax avoidance, this research will examine H1 which is formulated as follows:

Hypothesis 1. Related party transactions have a positive effect on tax avoidance

Management tends to manage their earnings in order to achieve severals target or to attract the stareholders. According to the prior researches, related party transactions is the one method used by the management to manage their earnings. Kang (2014) found that related party transactions (RPT) positively associated with control-ownership in order to control the operating and non-operating activities in Korean companies. The other research conducted by Thomas et al. (2004) stated that related party transactions is a one way to do earnings management in Japanese company. This result supported by Lo et. al (2010) that found growing number of independent directors in parent and subsidiary companies in China have a negative effect on manipulate the transfer pricing. To test the effect of party transaction related to earnings management, so in this study will test the H2 which is formulated as follows:

Hypothesis 2. Related party transactions have a positive effect on real earnings management

Real earnings management can be conducted by using three methods, and company may choose the one of them. This study will examine the effect of related party transaction on each real earnings management activity and this study breakdown the second hypothesis into:
H2a : Related party transactions have a positive effect on sales manipulation
H2b : Related party transactions have a positive effect on overproduction
H2c : Related party transactions have a positive effect on reduction of discretionary expense

The one motivation of real earnings management conducted by the company is to minimize their taxes (Richardson, 2000). The higher company's profit, the higher the company's tax expense. The existence of tax may reduce the profit of the company. Research conducted by Mc.Vay (2006) states that management tend to do income shifting as a tool to manage their earnings which aims to forecast the future profit and minimize their profit in order to minimize their taxes. According to the previous researchs, this study will test the effect of real earnings management on tax avoidance which is formulated as H3 as follows:

Hypothesis 3. Real earnings management have a positive effect on tax avoidance

As have been discussed earlier, real earnings management is divided into three activities which management may choose one of them to conduct their interest. This study also examines the effect of each real earnings management activity on tax avoidance. This study breakdown the third hypothesis into:
H3a : Sales manipulation has a positive effect on tax avoidance
H3b : Overproduction has a positive effect on tax avoidance
H3c : Reduction of discretionary expense has a positive effect on tax avoidance

There is no previous research intergrate 3 variables such as; related party transactions, real earnings

management, and tax avoidance in one research. According to the previous research, related party transactions, real earnings management, and tax avoidance only discussed partially, whereas theoritically they have possibility to conduct the tax avoidance through earnings management and related party transactions.

Earnings management conducted by management may be the most possible reason why companies tend to avoid the taxes through several activities, one of them is through related party transactions where the management have their interest to achieve something or to maximizing their prosperity . This study will test the H4 which is formulated as follows:

Hypothesis 4. Real earnings management mediates the relationship between related party transactions and tax avoidance

3. Data and research model
3.1 Data and sample

The data used in this study is secondary data taken from financial reports of manufacturing company listed on the Indonesia Stock Exchange in the year 2012-2014. The data can be accessed or obtained from www.idx.com. The sample chosen for this study is the manufacturing company which operate in Indonesia because there are differences in characteristics between companies in manufacturing and other industries. The purposive sampling method was used to select sample for this study by using criteria such as; companies that go public and listed on Indonesian stock exchange, companies that publish their financial statements and annual report which have at least 3 activities in related party assets, liabilities, sales, purchases, and also using Indonesia currency (Rupiah) in their financial statement.

3.2 Analysis method

This study analysed the data by PLS (Partial Least Square) analysis using software SmartPLS 3.0. The use of PLS was considered to be appropriate for this study because the model of study was the development of previous research model, so this study's model is still a prediction to seek the relationship among the new paths formed. PLS is one method for implementing the model Structural Equation Modelling (SEM) . Partial Least Square (PLS) is a powerful analytical method therefore not based on many assumptions (Ghozali,2006). Data should not normally distributed multivariate, the number of samples should not be much, it can be applied to all the data scale, and residual distribution (Ghozali, 2006). PLS model can be used when the design of the model theoretical basis is weak and measurement indicators were not an ideal measurement model (Ghozali, 2006). PLS can be used as a confirmation of the theory and also can be used to build a relationship that is no theoretical basis for testing or preposition (Ghozali, 2006). Moreover, Jogiyanto and Abdullah (2009) stated some advantages of using PLS as an analysis method such as: PLS is able to analyse a complex model with many dependent and independent variables, it is able to handle multicollinearity problems among independent variables, the result of analysis is however still reliable even there were abnormal or missing data, it produces independent latent variables directly based on cross-product that involve the dependent latent variables as the prediction force, able to be used in reflective and formative construct, it can be used for small sample size of research, it doesn't require the normal distributed data, and it can be used for the different types of data, which are nominal, ordinal, ratio, and continuous data.

The analysis of PLS is divided into two parts, the outer model and inner model analysis. First, analysis of outer model explains the relationship between construct and their indicator with variable. For a research that using formative indicators, the measurement model is assessed in two ways; by evaluating the significance value of outer weights, and examining the multicollinearity problem. The significance value of outer weights can only be checked for indicators or variables that measured by more than one construct since the variable that only has one construct can not be weighted. Second, inner model is mostly referred to the inner relationship or the structural substantive model based on substantive theory. Inner model describes the relationship between latent variables in a study. The inner or structural models are evaluated by the R-square for the dependent variable, the T-statistics test and significance of the coefficient parameters of structural lines. In assessing the models with PLS begins to see the R-square for every dependent latent variables. Intepetation is the same as the intepetation of the regression. Changes in R-square value can be used to assess the effect of independent latent variables to the dependent latent variable (Ghozali, 2014).

3.2.1 Variable definition

Tax Avoidance (TA). The dependent variable in this study is tax avoidance that may be conducted by companies in Indonesia. (Crocker and Slemrod, 2005) defined tax avoidance as an explicit tax reduction that reflects all transactions that have an influence on the company's tax debt explicit or in simpler language, tax avoidance is an activity to minimize the amount of tax payable. Meanwhile Arnold and McIntyre (2002) stated that tax avoidance is an effort to reduce or minimize the tax payable but still within the framework to comply with

legislation. The dependent variable used in this research is Tax Avoidance. Tax avoidance can be calculated through Book Tax Difference (BTD). BTD is the difference value between accounting profit with taxable profit. The large of differences between accounting income and taxable income in the companies generally show aggressive behavior towards greater tax (Desai and Dharmapala, 2006).

BTD was calculated as follow:

$$BTD = \frac{Pretax\ Income - Taxable\ Income}{Total\ Assets\ t-1}$$

Explanation:
BTD   = BTD illustrates the differences between accounting profit with taxable income
Pretax Income   = Company's earnings before tax expense
Taxable Income = Company's profit that taxed in current year
Total Assets $_{t-1}$ = Total assets of company in preceding year

Related Party Transactions (RPT). Independent variables used in this research is a related party transactions (RPT). RPT according to the Indonesian Institute of Accountants in PSAK 07 (revised 2007) are parties that have a special relationship when one party has the ability to control the other party or has significant influence over the other party in making financial and operational decisions. Referred to Gordon (2007) with additional the related party transactions was measured by 4 (three) indicators, which were:

1. Related Party Assets (RPT-A) is calculated by:

$$RPT - A = \frac{total\ RPT\ assets}{total\ assets}$$

2. Related Party Liabilities (RPT-L) is calculated by:

$$RPT - L = \frac{total\ RPT\ liabilities}{total\ liabilities}$$

3. Related Party Sales (RPT-S) is calculated by:

$$RPT - L = \frac{total\ RPT\ sales}{total\ sales}$$

4. Related Party Purchases (RPT-P) is calculated by:

$$RPT - P = \frac{total\ RPT\ purchases}{total\ purchases}$$

Real Earnings Management (REM). Real Earnings management is defined as a deviation from normal operational practice which is driven by the manager's desire to mislead at some of the stakeholders in order to believe that the purposes of certain financial reporting has been fulfilled in normal operations. (Roychowdhury, 2006). Real earnings management is divided into three activities, such as; sales manipulation, overproduction, and reduction of discretionary expense.

First, management may manipulate the sales. Sales manipulation may conducted by the sales manager with raising the volume of sales during the accounting period in order to achieve the profit's target and the other way to manipulate the sales is by offering the loan easily so that volume of credit sales will getting higher but the cash inflow getting lower. Roychowdhury (2006) used Abnormal Cash Flow Operation (ABN-CFO)

to measure the sales manipulation. Abnormal CFO is a difference between Actual CFO and CFO prediction. The level of prediction of cash flow operation is measured as follow:

$CFO_t/A_{t-1}= \alpha_0 + \alpha_1(1/A_{t-1})+ \beta_1(S_t/A_{t-1}) + \beta_2(\Delta S_t/A_{t-1}) + \varepsilon$

Explanation:
CFOt   : Company's Cash Flow Operation on the year t
At-1   : Company's Total Assets in the preceding year
St   : Company's Net Sales on the year t
ΔSt   : Company's change in net sales on the year t

Secondly, Overproduction is an activity to producing the goods more than needed in order to achieving the expected market demands so the profit will increase. Roychowdhury (2006) used Abnormal Production Cost (ABN-PROD) to measure the overproduction. Abnormal CFO is a difference between actual production cost and production cost prediction The level of prediction production cost is measured as follow:

$$PROD_t/A_{t-1} = \alpha0 + \alpha1(1/A_{t-1}) + \beta1(S_t/A_{t-1}) + \beta2(\Delta S_t/A_{t-1}) + \beta3(\Delta S_{t-1}/A_{t-1}) + \varepsilon$$

Explanation:

PRODt: Company's Cost of Goods Sold + Δ Inventory on the year t

At–1 : Company's Total Assets in the preceding year

St : Company's Net Sales on the year t

ΔSt : Company's change in net sales on the year t

ΔSt–1 : St-2 – St-1

Third, reducing the discretionary expense is a decisions taken by the manager by reducing the cost of advertising, the cost of research and development, selling cost, and general and administrative cost such as employee training cost, repair cost, and travel cost. Roychowdhury (2006) used Abnormal Discretionary Expense (ABN-DISEXP) to measure the reduction of discretionary expense. Abnormal discretionary expense is a difference between Actual discretionary expense and discretionary expense prediction. The level of prediction discretionary expense is measured as follow:

$$DISEXP_t/A_{t-1} = \alpha0 + \alpha1 (1/A_{t-1}) + \beta1(S_{t-1}/A_{t-1}) + \varepsilon$$

Explanation:

DISEXPt: Company's RnD expense + advertising expense + sales expense + general and administrative expense on the year t

At–1 : Company's Total Assets in the preceding year

St-1 : Company's Net Sales in the preceding year

4. Empirical Result

4.1 Descriptive statistics

The descriptive statistic is used to define a research data from the average (mean), maximum, minimum, and standard deviation value. According to **Table 1**, the variable of RPT is divided into RPT Assets, RPT Liabilites, RPT Sales, and RPT Purchases. From the among of RPT, RPT Liabilities has the minimum value on 0.001 and RPT sales has the maximum value on 0.904. The larger number of transaction in RPTs indicates the higher possibility of the company to manipulate earnings through real activities and minimize their tax expense.

The second construct is real earnings management which is defined by ABN CFO, ABN Prod Cost, and ABN Disexp. From among of them, ABN CFO has the minimum value on -0.918 and ABN Disexp has the maximum value on 2.387. The minimum value of ABN CFO, ABN Prod, and ABN Disexp among 150 samples is 0.200, -1.780, and 0.215. Then, tax avoidance conducted by the companies in Indonesia can be measured by using Book Tax Differences (BTD). Among 150 samples used in this study, the mean value of BTD is 0.020, the minimum value of BTD is -0.582, the maximum value is 0.277, and the STDEV is 0.077. The larger number of BTD, the higher possibility of the company to avoid the tax paid.

Table 1.
Descriptive statistics of samples

Variables	N	Min	Max	Mean	STDEV
RPT-A	150	0.003	0.469	0.047	0.086
RPT-L	150	0.001	0.867	0.093	0.162
RPT-S	150	0.003	0.904	0.166	0.251
RPT-P	150	0.002	0.867	0.196	0.230
ABN-CFO	150	-0.918	1.350	0.019	0.208
ABN-PROD	150	-2.036	2.283	0.068	0.546
ABN-DISEXP	150	-2.422	2.387	0.050	0.421
BTD	150	-0.582	0.277	0.020	0.077

4.2 SMART-PLS results
4.2.1 Outer model

The first step to analyze the model is measured the outer model. Measurement model or outer model explains the relationship between constructs and their indicator or variable. For a research that using formative indicators, the measurement model ia assessed in two ways; by evaluating the significance value of outer weights, and examining the multicollinearity problem. The significance value of outer weights can only be checked for indicators or variables that measured by more than one construct since the variable that only has one construct can not be weighted. **Table 2**. shows the outer weights measurement of the research model.

Table 2.
Outer weight of financial performance variable

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (|O/STDEV|)	P Values*
ABN CFO -> REM	1.691	1.704	0.258	6.563	**0.000**
ABN Prod-> REM	-1.270	-0.215	0.229	5.557	**0.000**
ABN Disexp -> REM	-0.230	-1.237	0.174	1.327	0.093
RPTA -> RPT	0.481	0.454	0.232	2.074	**0.020**
RPTL -> RPT	0.077	0.111	0.166	0.463	0.322
RPTS -> RPT	0.504	0.469	0.192	2.628	**0.005**
RPTP -> RPT	0.090	0.086	0.240	0.240	0.354

*significance level : 5%

According to Ghozali (2014), to examine formative measurement model that has more than one indicator, the value of T statistic and P Value of each indicator must be significant. In this research, the significance level is 5%, therefore T statistic is should be more than 1.64 and P value is maximum 0.05. From the **Table 2**, it can be concluded that real earnings management variable is significantly explained by ABN CFO and ABN Prod, moreover RPT is significantly explained by RPT-A and RPT-S. Another way to evaluate the outer model is by assessing multicollinearity problems. The multicollinearity problems are assessed from Variance Inflation Factor (VIF) value. A research model has multicollinearity problems if VIF>10. **Table 3** presents the outer VIF for the research model. Based on **Table 3**, this research model has no multicollinearity problem since the VIF value for each variable is below the maximum perceived value.

Table 3.
Outer VIF values.

	VIF
RPT-A	2.910
RPT-L	1.889
RPT-S	2.162
RPT-P	2.687
ABN CFO	2.889
ABN Prod	2.884
ABN Disexp	1.132
BTD	1.000

4.2.2 Inner model (structural)

The evaluation of inner model consists of R Square (R^2) assessment, and estimation of path coefficients values. The R square value shows how good a research model is. In other words, R square value reflects how well the dependent variable is explained by all other variables in a model. While the path coefficients show the relationship among the variables. Fig 1 shows the R square value for this research models.
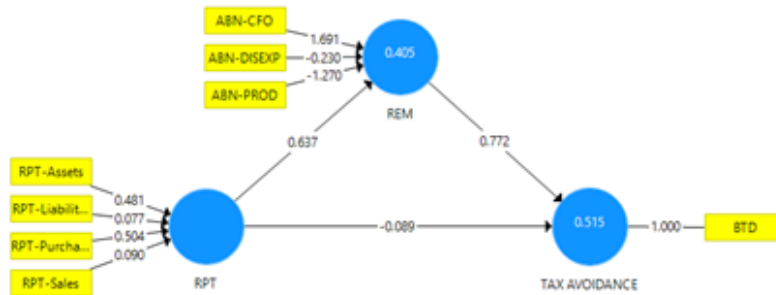

Fig 1. R square value for overall research model

Fig.1 shows the value of R square in the construct of real earnings management is 0.405 which is means that the research variability in this study about real earnings management can be explained by RPT in amount of 40.5% whereas the other 59.5% is explained by other variables were not examined in this study. Furthermore, the value of R square in the construct of tax avoidance is 0.515 which is means that the research variability in this study about tax avoidance can be explained by the RPT and real earnings management in amount of 51.5% whereas the other 48.5% is explained by other variables were not examined in this study.

4.2.3 Hypotheses Test Result

In testing the hypotheses, the path coefficient output is taken as the reference. This output is resulted from bootstrapping procedure in SmartPLS 3.0 software. The significance of estimated parameter coefficient from the output is the basis to determine the relationship among the research variables. **Table 4** presents the result of bootstrapping method for overall and partial direct effect of research model. Moreover, **Table 5** presents the result of bootsraping for examine the indirect effect of related party transactions to tax avoidance through real earnings management as mediating variable.

Table 4.
Path Coefficients Direct Effect of Research Model

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (|O/STDEV|)	P Values*
RPT -> Tax Avoidance	-0.089	-0.102	0.078	1.152	0.126
RPT -> REM	0.637	0.645	0.109	5.831	**0.000**
RPT -> ABN CFO	0.385	0.399	0.084	4.590	**0.000**
RPT -> ABN Prod	0.036	0.002	0.191	0.190	0.425
RPT -> ABN Disexp	-0.110	-0.113	0.076	1.449	0.075
REM -> Tax Avoidance	0.772	0.792	0.078	9.906	**0.000**
ABN CFO -> Tax Avoidance	0.334	0.338	0.083	4.021	**0.000**
ABN Prod -> Tax Avoidance	0.012	0.009	0.074	0.164	0.435
ABN Disexp -> Tax Avoidance	0.016	-0.018	0.097	0.163	0.435

*significance level: 5%

In this one-tail research, the significance level is 5%. The T-statistic must be more than 1.64 and the and the P value must be less than 0.05. According to table 4 above, the value of original sample RPT to Tax avoidance is -0.089, the T-statistics is 1.152, and the P values is 0.126. As the result, RPT has a negative effect and not significant to the tax avoidance. **Hypothesis 1 is rejected.**

The second hypothesis is mainly focused to examine the effect of related party transactions on real earnings management overall and partially. Overall, Table 4 shows that the value of original sample RPT to real earnings management is 0.637, the T-statistics is 5.831, and the P value is 0.000. Based on the table, the original sample shows a positive value, the T-statistics is more than 1.64 and the P value is less than 0.05. As the result, RPT has a positive effect and significant on earnings management. **Hypothesis 2 is accepted.**

Meanwhile, if the data tested partially, only ABN CFO which significantly represent that RPT has a positive effect on real earnings management. According to table 4, The value of original sample RPT to real earnings management through sales manipulation (ABN-CFO) is 0.385, the T-statistics is 4,590, and the P value is 0.000. As the result, RPT has a positive effect and significant on real earnings management through sales manipulation **Hypothesis 2a is accepted.**

Next, The value of original sample RPT to real earnings management through overproduction (ABN-PROD) is 0.036, the T-statistics is 0.190, and the P value is 0.425. Based on the table, the original sample shows a positive value, the T-statistics is less than 1.64 and the P value is more than 0.05. As the result, RPT significantly have not an effect on real earnings management through overproduction. **Hypothesis 2.b is rejected**

Furthermore about the second hypothesis, the value of original sample RPT to real earnings management through reduction of discretionary expense (ABN-DISEXP) is -0.110, the T-statistics is 1.449, and the P value is 0.075. Based on the table, the original sample shows a negative value, the T-statistics is less than 1.64 and the P value is more than 0.05. As the result, RPT has not an effect on real earnings management through reduction of discretionary expense. **Hypothesis 2.c is rejected**

The third hypothesis focused on examine the effect of real earnings management overall and partially to the tax avoidance. According to table 4, The value of original sample real earnings management to tax avoidance is 0.772 , the T-statistics is 9.906, and the P value is 0.000. Based on the table, the original sample shows a positive value, the T-statistics is more than 1.64 and the P value is less than 0.05. As the result, real earnings management has a positive effect and significant on tax avoidance. **Hypothesis 3 is accepted.**

Next on third hypothesis, the value of original sample real earnings management through sales manipulation on tax avoidance is 0.334, the T-statistics is 4.021, and the P value is 0.000. As the result, only sales manipulation represent that real earnings management through sales manipulation has a positive effect and significant on tax avoidance. **Hypothesis 3a is accepted.**

Moreover, The value of original sample real earnings management through overproduction (ABN-PROD) on tax avoidance is 0.012, the T-statistics is 0.164, and the P value is 0.435. Based on the table, the original sample shows a positive value, the T-statistics is less than 1.64 and the P value is more than 0.05. As the result, overproduction has not an effect on tax avoidance. **Hypothesis 3.b is rejected.**

Last, The value of original sample real earnings management through reduction of discretionary expense on tax avoidance is 0.016, the T-statistics is 0.163, and the P value is 0.435. Based on the table, the original sample shows a positive value, the T-statistics is less than 1.64 and the P value is more than 0.05. As the result, reduction of discretionary expense has not an effect on tax avoidance. **Hypothesis 3.c is rejected.**

Table 5.
Path Coefficients of Indirect Effect

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (|O/STDEV|)	P Values*
REM -> Tax Avoidance					
RPT -> REM					
RPT -> Tax Avoidance	0.491	0.551	0.105	4.689	**0.000**

*significance level: 5%

RPT has been proven that have no direct effect on tax avoidance conducted by the companies in Indonesia, but the another purpose of this study is to examine the indirect effect of RPT to tax avoidance through earnings management as a mediating role. The result of earnings management as a mediating role between RPT and tax avoidance can be seen from the Table 5. The result of the indirect effect shows that the value of original sample is positive at 0.491, the T-statistics is 4.689, and the P values is 0.000. From the table above, it can be concluded that earnings management significantly mediates the relationship between RPT and Tax avoidance. RPT has a positive and significant effect to tax avoidance through earnings management as a mediation variable. **Hypothesis 4 is accepted.**

5. Interpretation and Conclusion
5.1 The Effect of Related Party Transactions on Tax Avoidance
Based on the hypotheses test result on Table 4, the effect of related party transactions on tax avoidance significantly negative to tax avoidance. This finding is consistent with previous studies conducted by Subagyo and Kurniawati, (2012) that found found the existence of related party transactions have a significant and negative effect on the company's effective tax rate. However, the previous research conducted by Prebble (2012) stated that an entity typically entail transactions that transfers assets from one person to other person or to other entities in order to minimize or sometimes to avoid the tax on such income. This result is supported with research conducted by Trisnawati and Ompusunggu (2014), stated that the transactions of RPT creates the intention of the companies to do tax avoidance.

In fact based on the statistical test, RPT does not directly have a significant effect to tax avoidance conducted by the companies in Indonesia. This condition may occurs because of the small nominal in RPT among the other transactions in company's financial statements so it is not directly reflected if the company avoid the tax. Furthermore, transactions between related party is regulated by Taxation Regulation No. PER-32 / PJ / 2011 of the Principles of Fairness and Prevalence Enterprises (Arm's Length Principle) stated that transactions between taxpayers with related parties, company must apply the principle of fairness and the predominance of business in terms of reporting the transaction value as the basics for calculating its taxable income, the transactions between related-parties should be comparable to the market value.

Related party in Indonesia can be conclude that have not an effect to tax avoidance directly because Indonesia is already have a regulation about taxation which is aims to minimizing the possibility of tax avoidance through the transfer pricing mechanism among the related party conducted by companies. It is supported by the low nominal of RPT in Indonesian's company that make it does not reflected directly if they avoid the taxes.

5.2 The Effect of Related Party Transactions on Real Earnings Management
According to the hypotheses test result, related party transactions significantly have a positive effect on real earnings management. The previous researches examined about RPT used as a mechanism for tunneling propping, the results was RPT positively associated with control-ownership in order to control the operating and non-operating activities in Korean companies (Kang et al, 2014). This result supported by Cheung et al. (2008) that RPT representing tunneling are accompanied by significantly less information disclosure compared to RPT representing propping. The less information disclosed in company's annual report indicates that company manipulating or hiding something (Gray, 2011).

The other research conducted by Aharony (2005) stated that related party transactions between parent's company managers in China manipulated the earnings of their newly issued firms during the IPO period. This result is supported by research conducted by Lo et al. (2010) that related-party sales transactions can deter the earnings manajemen and transfer pricing manipulation conducted by companies in China.

According to the result of the statistical test, RPT has a positive effect and significantly affect the earnings management. It can be explained that transactions between related party may raise an internal political agreement to determine their transfer price due to operating or non-operating activities. Research conducted by McCahery and Vermeulen (2005) stated that in order to control the shareholders and directors in management, related party

may establish a mechanism to extract private benefits for each party. RPT is one way to do earnings management in Japanese companies. It happened because the higher the volume of transaction in related party, the higher possibility company to manipulate their financial statements (Thomas at al., 2004). Meanwhile, Hwang et al. (2013) found that RPT, have a positive and significant effect to accrual earnings management which is measured by DACC.

In this case, the relationship between RPT and real earnings management can be explained through the Roychowdhury's prior research. There are several methods to conduct the earnings management through real activities. Based on previous research conducted by Roychowdhury (2006), earnings management through real activities is a deviation from normal operating activities of the company which is motivated by the managemen's desire to give the wrong understanding to the stakeholders if the financial reporting purpose of the company have been achieved through the company's normal operating activities.

Real earnings management separated into three manipulation activities, such as; sales manipulation, overproduction, and discretionary expenses. According to result of the outer weights test, real earnings management is significantly explained by ABN CFO and ABN PROD which is the proxy to measure the sales manipulation and overproduction. In this study, sales manipulation which is measured by ABN CFO positively has an influence to real earnings management. It means that sales manipulation conducted by related party may occurs because among related party offering the loan easily so that volume of credit sales will getting higher but the cash inflow getting lower.

5.3 The Effect of Real Earnings Management on Tax Avoidance

Based on the hypotheses test result on Table 4, the effect of real earnings management on tax avoidance significantly positive to tax avoidance. Research conducted by Mc.Vay (2006) stated that management tend to shift the income or usually called income shifting as a tool to manage earnings which aims to make a lower profits so the tax that companies should be paid is also getting lower. This result is supported by Warfield et al. (1995) that stated the motivation of earnings management is to minimize the burden of the tax payable. Meanwhile, Suyanto (2012) found that earnings management significantly have a positive effect on tax aggresiveness

The previous research conducted by Richardson (2000), motivations of earnings management divided into six motivations, such as: bonus purpose, political motivation, taxation motivation, subtition of CEO, initial public offering (IPO), and the importance of giving information to the investors. In this case, earnings management conducted by company is one of motivation to decrese or minimize their taxes which is can be classified into taxation motivation. Managers will decrease their profit in order to minimizing their taxes through the pattern of earnings management.

The pattern of earnings management probably conducted by company in four ways such as; taking a bath, income minimization, income maximization, and income smoothing. In this case, the one way to minimizing the profit of the company, management will apply the income minimization which expects that the company's profit will decrease so their taxes is also getting smaller. There are several methods to conduct the earnings management through real activities. Based on previous research conducted by Roychowdhury (2006), earnings management through real activities is a deviation from normal operating activities of the company which is motivated by the managemen's desire to give the wrong understanding to the stakeholders if the financial reporting purpose of the company have been achieved through the company's normal operating activities

5.4 Real Earnings Management Mediates the Relationship between Related Party Transactions and Tax Avoidance

There is no previous research intergrate 3 variables such as; RPT, real earnings management, and tax avoidance in one research. According to the previous research, research about RPT, real earnings management, and tax avoidance only discussed partially, whereas theoritically they have possibility to conduct the tax avoidance through earnings management and related party transactions. Earnings management may be the most possible reason why companies tend to avoid the taxes through several activities, one of them is through related party transactions.

According to the statistical result from the test, real earnings management has a positive and significant effect to mediates the relationship between RPT and tax avoidance conducted by the company. This result can be concluded as a novelty because RPT does not directly have an effect to tax avoidance conducted by the companies in Indonesia, but need real earnings management as a mediating role.

5.5   Conclusions

The purpose of this study is to examine the direct effect of related party transacions to tax avoidance and the indirect effect of related party transactions to tax avoidance through real earnings management. The data used in this study was secondary data obtained from the financial statement of manufacturing company listed in

Indonesian Stock Exchange (IDX) in the year 2012-2014. The samples used in this study was 150 manufacturing companies which have at least 3 transactions in RPT, and report their financial statements in Indonesian currency.

Based on the partial least square analysis using software SmartPLS 3.0, this study shows that RPT which is consists of RPT-Assets, RPT-Liabilities, RPT-Sales, and RPT-Purchases does not have a direct effect to tax avoidance significantly. However, the other statistical result shows that real earnings management which is consists of Abnormal CFO, Abnormal Production Cost, and Abnormal Discretionary Expense, mediates the relationship between RPT and tax avoidance. In other words, it can be concluded that RPT has a positive and significant effect to tax avoidance through real earnings management as a mediating role.

There are several factors may be affect why the effect of RPT to tax avoidance does not significant. The one factor is because the portion of RPT in company's operational activity is too small than other transactions so the tax avoidance conducted by the companies were not reflected in RPT. The other reaon why RPT does not reflect on tax avoidance because management may conduct tunneling and propping in order to abuse the regulation. This condition leads the mediating role of real earnings management to prove that RPT has the ability to minimize the payable tax of the company.

REFERENCES

Aharony, J., Yuan, H., & Wang, J. (2005). Related party transactions: A "real" means of earnings management and tunneling during the IPO process in China. *Social Science Research Network, Working Paper Series.*

AlNajjar, F., & Riahi-Belkaoui, A. (2001). Growth opportunities and earnings management. *Managerial Finance*, 27(12), 72-81.

Arnold, B. J., & McIntyre, M. (2002). *International tax primer*. Kluwer Law International.

Arnold, B. J., & McIntyre, M. (2002). *International tax primer*. Kluwer Law International.

Cheung, Y. L., Jing, L., Lu, T., Rau, P. R., & Stouraitis, A. (2009). Tunneling and propping up: An analysis of related party transactions by Chinese listed companies. *Pacific-Basin Finance Journal*, 17(3), 372-393.

Crocker, K. J., & Slemrod, J. (2005). Corporate tax evasion with agency costs. *Journal of Public Economics*, 89(9), 1593-1610.

Desai, M. A., & Dharmapala, D. (2006). Corporate tax avoidance and high-powered incentives. *Journal of Financial Economics*, 79(1), 145-179.

Eisenhardt, K. M. (1989). Agency theory: An assessment and review. *Academy of management review*, 14(1), 57-74.

Ghozali, I. (2006). Statistik Nonparametrik. *Semarang: Badan Penerbit Universitas Diponegoro*.

Ghozali, I. (2006). Structural Equation Modelling, Metode alternatif Dengan Partial Least Square PLS, Badan Penerbit Undip.

Gordon, E. A., Henry, E., & Palia, D. (2004). Related party transactions and corporate governance. *Advances in Financial Economics*, 9(1), 1-27.

Hayn, C. (1995). The information content of losses. *Journal of accounting and economics*, 20(2), 125-153.

Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of financial economics*, 3(4), 305-360.

Jogiyanto, & Abdullah, W. (2009). *Konsep dan Aplikasi PLS untuk Penelitian Empiris.* Yogyakarta: BPFE. KPMG. (2013). *The KPMG Survey of Corporate Responsibility Reporting: Executive Summary*

Jones, J. J.. (1991). Earnings Management During Import Relief Investigations. *Journal of Accounting Research*, 29(2), 193–228

Kang, M., Lee, H. Y., Lee, M. G., & Park, J. C. (2014). The association between related-party transactions and control–ownership wedge: Evidence from Korea. *Pacific-Basin Finance Journal*, 29, 272-296.

Kohlbeck, M. J., & Mayhew, B. W. (2004). Agency costs, contracting, and related party transactions. *Contracting, and Related Party Transactions (December 31, 2004)*.

Lo, A. W., Wong, R. M., & Firth, M. (2010). Can corporate governance deter management from manipulating earnings? Evidence from related-party sales transactions in China. *Journal of Corporate Finance*, 16(2), 225-235.

Mangoting, Y. (2004). Tax Planning: Sebuah Pengantar Sebagai Alternatif Meminimalkan Pajak. *Jurnal Akuntansi dan Keuangan*, 1(1), pp-43.

Mangunsong, S. (2002). Peranan Tax Planning Dalam Mengefisiensikan Pembayaran Pajak Penghasilan. *Jurnal Ilmiah Akuntansi*, 2(1), 44-54.

McVay, S. E. (2006). Earnings management using classification shifting: An examination of core earnings and special items. *The Accounting Review*, 81(3), 501-531.

Prebble, Z. M., & Prebble, J. (2010). The morality of tax avoidance.

Rego, S., & Wilson, R. (2009). *Executive compensation, tax reporting aggressiveness, and future firm performance*. Working paper, University of Iowa.

Richardson, V. J. (2000). Information asymmetry and earnings management: Some evidence. *Review of Quantitative Finance and Accounting*, *15*(4), 325-347.

Roychowdhury, S. (2006). Earnings management through real activities manipulation. *Journal of accounting and economics*, *42*(3), 335-370.

Ryngaert, M. D., & Thomas, S. E. (2007). Related party transactions: Their origins and wealth effects. *Available at SSRN 970689*.

Subagyo, O.S., & Kurniawati, H. (2012). Transaksi Hubungan Istimewa dan Pengaruhnya Terhadap Tarif Pajak Efektif Perusahaan. *Akuntansi Krida Wacana*, *12*(2).

Sulistyanto, S. (2008). *Manajemen Laba (Teori & Model Empiris)*. Grasindo.

Suyanto, D.K. (2012). *Pengaruh Likuiditas, Leverage, Komisaris Independen dan Manajemen Laba Terhadap Agresivitas Pajak Perusahaan* (Doctoral dissertation, Magister Manajemen Program Pascasarjana UKSW).

Thomas, W. B., Herrmann, D. R., & Inoue, T. (2004). Earnings management through affiliated transactions. *Journal of International Accounting Research*,*3*(2), 1-25.

Trisnawati, E., Ompusunggu, A.P. (2014). The Tax Audit, Simplification Of The Tax Return, Perception Of Government Spending and Tax Payer Compliance

Warfield, T., J. Wild, and Wild. (1995). "Managerial Ownership, Accounting Choices, and Informativeness of Earnings." Journal of Accounting and Economics 20, 61–91.

CERTIFICATE

This certificate is awarded to:

Puji Harto

For participating in

The 3rd Sebelas Maret International Conference on Business, Economics and Social Sciences

"EMERGING MARKETS, GLOBAL BUSINESS, AND INCLUSIVE GROWTH"

3rd-4th August 2016, Solo, Indonesia

as

PARTICIPANT

Dean
Faculty of Economics and Business
Universitas Sebelas Maret

Dr. Hunik Sri Runing Sawitri, M.Si.
NIP. 195904031986012001

Conference Chair
The 3rd Sebelas Maret International Conference

Prof. Dr. Asri Laksmi Riani M.S.
NIP. 195901301986012001

LEMBAGA PENJAMIN SIMPANAN

AGBA 2009

FEB UNS