# CAPITALIZATION ON LISTED COMPANIES IN INDONESIA

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## ABSTRACT

*Thin capitalization is tax planning that carry out by improving as much as possible related to big business money owed. This tax planning will increase the interest expense and increase decrease in tax expense, by that/in that way increasing net income and firm value. Thin capitalization is measured by the ratio of total money owed to capital. This study analyses the factors that influence thin capitalization in companies in Indonesia and Australia. The moving backward test results show that companies with across-the-ocean smaller companies owned by larger companies, companies with smaller companies owned by larger companies in safe place countries, and companies that carry out export activities have a smaller thin capitalization value. The results of the study are usually not in line with previous research which states that these all numbers that change/things that change increase thin capitalization. The studies also find that foreign ownership has been proven to strengthen the relationship of foreign exposure to thin capitalization.*

**Keyword:** Tax Avoindace, Tax Shield, Thin Capitalization Rule, Listed Companies.

### INTRODUCTION

Taxes are people's things that are given to the state which are based on state rules and are used to finance state activities. The tax paid by the company is a heavy load, so the company tries to make tax wasting very little while working or producing something. According to Blaufus et al. (2015) tax avoidance is a tax management practice that is still within the legal scope. On the other hand, not paying taxes is an illegal tax management practice. Both not paying taxes and tax avoidance produce will produce in reducing tax expense or tax payable (Neck et al., 2012).

One of the tax avoidance practices is the use of a tax shield or the use of money owed which will increase interest expense and will reduce taxes. Besides reducing of taxes paid, interest expense also has the effect of increasing firm value. In the Modigliani-Miller I explanation of why something works or happens the way it does, the use of money owed as a source of money/giving money to is neutral with firm value, because it is assumed that there is no tax. However, when tax exist, such as in the Modigliani-Miller II explanation of why something works or happens the way it does, companies that have high money owed will have a higher company value because of the benefit of interest expense as a tax deduction.

The use of money owed legal documents to avoid taxes and increase company value can also be termed thin capitalization, because a company that increases its money owed will make its equity or capital become smaller or thin. According to research by Egger et al. (2010) and Moen et al. (2011), the practice of thin capitalization is commonly carried out by different companies. Therefore, the tax people in charge try to control the interest expense arising from money owed. One of the recommendations for regulation of money owed interest was brought across by the OECD (2015) to countries in the world through Action Plan 4. The regulation is one of fifteen recommendations to prevent based wearing away proft shifting.

Indonesia responded to this recommendation by issued the thin capitalization rule (TCR). TCR is a rule that limits the reduction of interest above a certain level of money owed. Buttner et al. (2012), using data from German connected companies, found that limiting creditable interest effectively reduces the use of the company's internal money. Blouin et al. (2014) found that countries with tighter TCRs were more successful in lowering the money they owe-to-valuable thing ratio. Almost the same results were also found by Wamser (2014), debt-to-equity ratio (DER) have positive relation with value of companies. Therefore, the use of TCR is still an extremely important policy legal document for different countries.

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