

CHAPTER I

INTRODUCTION

1.1 BACKGROUND OF STUDY

A good business management can be realized with the availability of required information, both financial information and non-financial information to interested parties and decision-makers. Financial information is divided into two, namely accounting information and non - accounting information. Accounting information consists of operational information, financial accounting information, management accounting information and tax accounting information. All accounting and non - accounting information can be obtained from the financial statements prepared by the company.

Financial statement is fundamental and must be presented by each company to inform the company's financial condition to the users, both from the internal and external parties of the company. Public traded companies that are listed in the Indonesian Stock Exchange are required to file audited annual financial statements, prepared in conformity with Financial Accounting Standard. Statement of Financial Accounting Concepts No. 8 explained that the objective of financial statement is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about resources allocation to the entity. Statement of Financial Accounting Concepts No. 1 mentioned that the primary focus of financial reporting is information about earnings and its components.

The information contained in the profits is used by parties who are interested about the company as an indicator to measure the company's financial condition. While for government, profit reported by the company becomes the basis for tax imposition. Therefore,

company calculates profit for each period for two reporting purposes, which are for financial reporting and taxation purposes. There are 2 versions of financial statements that are recognized which are commercial financial statements and fiscal financial statements. However, those do not indicate that the company should make two bookkeeping at once. Companies only need to make commercial financial statements. When, the company needs fiscal financial statement then correction/ reconciliation can be made toward the commercial financial statement. The differences of them are the regulation applied. Commercial financial statements are prepared in accordance with the Statements of Financial Accounting Standards (SAK), while Fiscal financial statement is prepared referring on General Provisions and Procedures Taxation (KUP). Generally, the differences between the recognition in commercial accounting and tax accounting regulation lie especially in the recognition of income and expenses. The intended goal of Financial Accounting Standard is to produce an objective, accurate description of the company's financial operations and results. In contrast, Income Tax Provision is established by Directorate General of Tax. Tax reflects the multiple goals of the government, such as generating tax revenue and encouraging selected economic and social goals and activities.

Due to the differences of preparation in both financial statements, it results in differences in the calculation of profits which then results in a different amount of profit between accounting profit and fiscal profit or otherwise known as "book-tax differences". The different recognition and measurement terms between financial accounting standards and tax regulations are generally grouped into permanent differences and temporary differences. Permanent differences are some revenues or expenses that are recognized by Financial Accounting Standard but these revenues or expenses aren't recognized by Income Tax Provision. Temporary differences result

from timing differences based on when revenue or expense items are recognized. The temporary differences are projected to affect the profit in the future because these temporary differences will result in deferred tax assets and deferred tax liabilities. Book tax differences are predicted to affect the company's performance because of the different mechanisms in the calculation of income and expenses. Permanent differences and temporary differences cause a positive fiscal correction and negative fiscal correction that can affect the profit. Therefore, positive accounting theory can underlie the problems that occur in this study.

Users of financial statement such as investors need accurate information before making decision to buy certain stock. Those information can be obtained from financial statement and usually profit is utilized as the indicator to measure the company's financial condition. The changes in the profits earned by the company in a certain period are compared with the previous year, which is called as profit growth. It is assumed that the higher the profit generated the better the performance of the company (Kodriyah and Artiwiya, 2016). If the company has good profit growth, the investor will get high dividend in future and in turn it will also increase the company's value since dividend distribution is a strategy used by the company to increase the company's stock price (Fadilla and Alteza, 2016). The increment of company's value will give a good perspective for investors so that they will be interested to invest in the company.

Hence, knowledge of profit is very important for users of financial statements because it can indicate the financial performance of a company. One of the ways to evaluate company's performance is through book-tax differences analysis. The information contain in book-tax differences can affect the profit growth and it can help to assist investors in determining the quality of profit and value of the company. The reason that book-tax differences can be used as an

indicator in this study because it is considered relevant in providing additional information in the form of financial information about the temporary components of profit and cash flow and provides information on the quality of financial variables (Tang in (Putri and Sary, 2017)).

Book-tax differences can give information about profit quality and evaluate company's performance because there is little freedom of accounting that is allowed in determining taxable income with result that the book-tax differences can give information about discretion of management in accrual process (Riyana and Mildawati, 2015). Hanlon in (Brolin and Rohman, 2014) also stated that if there are great differences between accounting profit and fiscal, it shows that there is "red flag" for users of financial statements. Penman in (Salsabiila, Pratomo, and Nurbaiti, 2016) also stated that the book-tax differences can be used to diagnose the manipulation of the cost in the company.

Several related studies have conducted research and provided evidence of the impact of book-tax differences on profit growth. Waluyo (2016) investigate the relationship between book-tax differences and profit growth within Indonesian manufacturing firms and it results further indication that permanent differences are significantly associated with profit growth in positive direction, while temporary differences are in negative direction. Same research was also conducted by Amos Rico Brolin and Abdul Rohman (2014) and Riyana and Titik Mildawati (2015), however the research conducted by Amos Rico Brolin and Abdul Rohman (2014) gives the opposite results from the Waluyo (2016). It showed that temporary differences have significant effect on the profit growth and the permanent differences don't have significant effect on the profit growth one period ahead. While, Riyana and Titik Mildawati (2015) gives results that permanent differences have impact to profit growth in negative direction and the temporary differences have influence positively.

This research will investigate the impact of book-tax differences which is proxied by permanent differences and temporary differences on profit growth on consumption industry companies registered in Indonesia Stock Exchange with observation period from 2014 to 2016. The consumption industry companies are chosen because these companies' have strong business competition. Therefore, their shares are actively traded in the stock market which also means that the stock price also moves actively.

Based on this background study, then the writer is interested to conduct the research with the title as follows: “**The Impact of Book-Tax Differences on Profit Growth (An Empirical Study on Consumption Industry Companies Registered in Indonesia Stock Exchange)**”

1.2 PROBLEM LIMITATION

The scope and limitation of this research are as follows:

1. The independent variables are permanent differences and temporary differences while the dependent variable is profit growth.
2. The research is done on consumption industry companies in Indonesia Stock Exchange.
3. The research period is year 2014-2016.

1.3 PROBLEM FORMULATION

Based on the background of study that has been described previously, the problem identified by the writer in this research is:

1. Do the permanent differences have impact on profit growth on consumption industry companies registered in Indonesia Stock Exchange?

2. Do the temporary differences have impact on profit growth on consumption industry companies registered in Indonesia Stock Exchange?
3. Do the permanent & temporary differences have impact on profit growth simultaneously on consumption industry companies registered in Indonesia Stock Exchange?

1.4 OBJECTIVE OF RESEARCH

The objective of doing this research is:

1. To know whether are there any impact of permanent differences on profit growth on consumption industry companies registered in Indonesia Stock Exchange.
2. To know whether are there any impact of temporary differences on profit growth on consumption industry companies registered in Indonesia Stock Exchange.
3. To know whether are there any impact of temporary & permanent differences on profit growth simultaneously on consumption industry companies registered in Indonesia Stock Exchange.

1.5 BENEFIT OF THE RESEARCH

The benefits of this research can be seen as follows:

1.5.1 THEORETICAL BENEFIT

Theoretical benefits of this research are as follows:

1. This research has benefit for development of knowledge theoretically and as knowledge about taxation, capital market and investment.
2. This research can give benefit as study materials for student in university.

1.5.2 PRACTICAL BENEFIT

Practical benefits of this research are as follows:

1. This research can provide information and knowledge in analysis of profit growth.
2. This research can be used as material consideration for investor in making transaction in Indonesia Stock Exchange.
3. This research is expected to contribute as a reference which is additional information useful for readers and can give thought contribution for parties who have the same problem or want to conduct further research.

1.6 SYSTEM OF WRITING

The systems of writing in this paper will be as follows:

CHAPTER I: INTRODUCTION

This chapter consists of background of the study that explain about the importance of financial statement for investors, what is book-tax differences, how book-tax differences have an impact on the profit growth and the variety of result from previous research. The problem limitation stated the limitation of the variables, population and the period use for this research in order to give a clear boundaries regarding which part should be assess to prevent too broad discussion. In problem formulation, it consists of questions that will be answered through this research which will become the objective of the research. This research is also expected to be beneficial for investors, further researches as well as academics. Lastly, the system of writing will consist of summary of each chapter.

CHAPTER II: LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

This chapter consists of theoretical background which is related to the topic of this research such as definition of tax, financial

statement, differences of commercial financial statement and fiscal financial statement, reconciliation, positive and negative correction, book-tax differences, definition of profit and profit growth. Besides that, it also consists of previous research to support the hypothesis development. Lastly, there are research model and framework of thinking are designed to simplify or explain the research.

CHAPTER III: RESEARCH METHODOLOGY

This chapter discusses about the method used in this research which is a quantitative descriptive method because researcher measure and analyze the relationships between the variables. Next is the population used which is the consumption industry companies registered in Indonesia Stock Exchange and several criteria that must be fulfilled to be choose as a sample. The data is collected through documentation method from the secondary data which is the website of Indonesia Stock Exchange. Lastly, this chapter is explaining the definition of each variable and analysis method used in this research.

CHAPTER IV: DATA ANALYSIS AND DISCUSSION

This chapter describes the general view of consumption industry companies registered in Indonesia Stock Exchange. In data analysis, the data will be processed through statistical tests such as descriptive statistical test, classical assumption test, and hypothesis testing which will give results in tables or graphs. Lastly, the results obtained are discussed in narrative way.

CHAPTER V: CONCLUSION

This chapter presents the conclusion that contains the summary and some explanation on the result. Then, it also written to whom this research will be expected to contribute which is stated in the implication. Lastly, it is about the recommendation given for people who are interested in this field.