CHAPTER I
INTRODUCTION

1.1 Background of the Study

Indonesia is a developing country that has large population. Indonesia itself has abundant amount of natural wealth and lies in strategic geographical position. It is not surprising that many domestic and foreign companies residing in Indonesia. Such conditions can benefit the government in terms of state revenue from the tax sector. For the government, tax is the main source of income for a country that is used to finance the development of the country. However, for companies, taxes are things to avoid and be seen as a burden as it can reduce the net income of a company, moreover there is no direct reward or benefits that can be felt by them.

According to Law Number 28 Year 2007, tax means mandatory contribution to the state of the individual or entity, which is coercive under the Law, without any direct return and shall be utilized for the need of the state for the greatest prosperity of the people.sx

Efforts to reduce the tax burden can be done by companies in various ways such as tax planning, tax avoidance and tax evasion. Most of companies will likely to be involved in an aggressive tax planning strategy to minimize, postpone or even eliminate tax liabilities. Initially, tax planning is allowed within the tax laws as it is considered as a legal tax avoidance scheme.

John E. Karayan and Charles W. Swenson (2007), in the book of Strategic Business Planning, stated that to measure how well a company manages its taxes can be seen on its effective tax rates. "ETR has long been used by policy makers and interest groups in tax reform debates, especially those related to corporate tax provisions" (Gupta & Newberry, 1997, p. 1)

According to the United States Government Accountability Office (GAO), Effective Tax Rates (ETR) differ from statutory tax rates in that they attempt to measure taxes paid as a proportion of economic income, while statutory rates indicate the amount of tax liability relative to taxable income, which is defined by tax law.

The effectiveness of the company's efforts to minimize its tax burden can be seen through its effective tax rate. According to Pricewaterhouse Coopers (2011), the effective tax rate is defined as the ratio between total income tax expenses divided by pretax income. The lower the percentage of ETR, the better the performance of a company in managing its tax effectiveness.

This study will use ETR as the dependent variable. The reason is because ETR briefly shows the effectiveness of tax planning in a simple calculation. In broad terms, ETR is actually a measure of the company's tax burden because it expresses the rate of tax paid on the company income. (Noor *et al*, 2010)

Previous research related to ETR shows mixed results. For example, research conducted by Rodriguez and Arias (2012) found significant differences in the effective tax rate of companies registered in China and the United States. U.S. companies have significantly higher ETRs than China companies. This is because the adopted tax policy is different between in China and the United States. In China, corporate income tax rate is 25%, but the tax rate could be reduced to 15% for qualified enterprises engaged in industries encouraged by the China government. Meanwhile, the corporate income tax rate in the U.S. was one of the highest rates (35%) in the world. Although, since January 1, 2018 the corporate income tax rate has been changed to a flat rate of 21%. The tax burden is determined by the characteristics of each company (size, capital structure, asset mix, profitability) and the tax policy of the government.

Furthermore, to see the several factors that impact the variation of Effective Tax Rate (ETR) between companies, the author will use several independent variables that might affecting ETR, such as Firm Size, Leverage, Capital Intensity Ratio, and Profitability.

Size of the companies is one of the factors that depict the capabilities of the companies to undertake tax planning activities. In other words, not all companies have the same opportunities to carry out tax planning. That is why only some companies involved greatly in tax planning, while others involved moderately. In this study, tax planning is proxied by effective tax rate (ETR).

According to Sudarmadji and Sularto (2007), the greater the assets, the more capital invested and the greater the velocity of money. The size of the company can determine the size of the assets owned by the company, the greater the assets owned also increased the amount of productivity. It will generate profits that will affect the level of payment of taxes.

Leverage is a financing strategy of using borrowed money or debt. Leverage can also refer to the amount of debt used to finance assets. When one refers to something (a company, a property or an investment) as "highly leveraged," it means that item has more debt than equity. Leverage might affect the Effective Tax Rate through the interest expense.

The proportion of fixed assets to the total assets within the company can also be an option for companies to reduce the tax burden. It can be measured using the capital intensity ratio. Companies with large amounts of fixed assets tend to have a lower tax burden compared to firms with smaller fixed assets because they are benefited from the depreciation expenses that the company bears (Noor and Sabli, 2012). Therefore, usually companies with large amount of fixed assets tend to do tax planning in order to have a lower effective tax rate.

Profitability might also affect the ETR because companies that earn greater profits tend to have higher tax burden. Companies that have the ability to earn profits must prepare the tax to be paid for the revenue earned. But at the same time, companies who earn greater profit have more motivation to lowering their tax burden. One of the ratios to measure company's profitability is ROA (Return on Asset). ROA measures the ability of the company as a whole in generating profits by using assets owned by the company (Syamsuddin, 2009: 63)

Table 1.1 The Phenomena Table of Firm Size, Leverage, Capital Intensity Ratio, Profitability and Effective Tax Rate (ETR) on Consumer Goods Sector of Manufacturing Company listed in IDX from 2016-2018

Company's code	Year	Firm Size	Leverage	Capital Intensity Ratio	Profitability	Effective Tax Rate
ICBP	2016	30.995	0.360	0.246	0.173	0.272
	2017	31.085	0.357	0.257	0.165	0.319
	2018	31.168	0.339	0.313	0.188	0.277
GGRM	2016	31.773	0.372	0.326	0.142	0.253
	2017	31.832	0.368	0.321	0.156	0.257
	2018	31.867	0.347	0.329	0.152	0.256
INDF	2016	32.040	0.465	0.313	0.090	0.343
	2017	32.113	0.470	0.449	0.086	0.326
	2018	32.200	0.483	0.439	0.078	0.334

Source: Prepared by writer (2019)

From table 1.1, there are inconsistent phenomena happened in some consumer goods sector of manufacturing company listed in Indonesia Stock Exchange in period of 2016-2018 that depicted the interrelation between firm size, leverage, capital intensity ratio, profitability, and effective tax rate (ETR).

Based on the table, for PT Indofood CBP Sukses Makmur Tbk (ICBP), from 2016 to 2017, the firm size increase and also its ETR but from 2017 to 2018, the firm size increase while the ETR decrease. The same condition happened in PT Gudang Garam Tbk (GGRM) from 2016 to 2018. However, for PT Indofood Sukses Makmur Tbk (INDF), from 2016 to 2017, the firm size increase but the ETR decreases and from 2017 to 2018, the firm sizes increase and also its ETR. This shows inconsistent phenomena happened between the firm size and ETR.

Another inconsistency also happened between leverage and ETR. For PT Indofood CBP Sukses Makmur Tbk (ICBP), from 2016 to 2018, the leverage keeps decreasing but the ETR fluctuates; increase in 2016-2017 and decrease in 2017-2018. For PT Gudang Garam Tbk (GGRM), from 2016-2018, the leverage keeps decreasing but the ETR also fluctuates, increase in 2016-2017 and decrease in 2017-2018. For PT Indofood Sukses Makmur (INDF), from 2016 to 2018, the leverage keeps increasing but the ETR fluctuates differently; decrease in 2016-2017 and increase in 2017-2018.

Similar inconsistency phenomena also happened between capital intensity ratio and effective tax rate. For PT Indofood CBP Sukses Makmur Tbk (ICBP), from 2016 to 2018, the capital intensity ratio keeps increasing but the ETR fluctuates; increase in 2016-2017 and decrease in 2017-2018. For PT Gudang Garam Tbk (GGRM), from 2016-2017, the capital intensity ratio decreases and the ETR increase but from 2017-2018, the capital intensity ratio increases and the ETR decrease. For PT Indofood Sukses Makmur (INDF), from 2016-2017, the capital intensity ratio increases and the ETR decrease but from 2017-2018, the capital intensity ratio decreases and the ETR increase.

In addition, the phenomena also happened between profitability and ETR. For PT Indofood CBP Sukses Makmur Tbk (ICBP), from 2016 to 2017, the profitability decreases and the ETR increases and from 2017 to 2018, the profitability decreases and the ETR increases. For PT Gudang Garam Tbk (GGRM) from 2016 to 2017, the profitability increases and the ETR increases and from 2017 to 2018, the profitability decreases and the ETR decreases. For PT Indofood Sukses Makmur Tbk (INDF), from 2016 to 2017, the profitability decreases and the ETR decreases and from 2017 to 2018, the profitability also decreases but the ETR increases.

Therefore, based on the discussion and various contradicting phenomena, thus, writer is interested to conduct the research to find more defined result about the impact of firm size, leverage, capital intensity ratio and profitability on the effective tax rate (ETR).

The development of taxation system and the increasingly tight government regulation on taxation system in Indonesia, and based on previous studies, the author will examine the factors that affect the ETR on consumer goods sector of manufacturing companies listed in the Indonesia Stock Exchange (IDX). This study only focuses on manufacturing companies, especially consumer goods sector, due to time limitation and consumer goods sector is chosen to obtain unbiased and accurate results, as each type or sector of business has different activities, rules and policies. Thus, the author would like to conduct research with the title: **"The Impact of Firm Size, Leverage, Capital Intensity Ratio, and**

Profitability on Effective Tax Rate (ETR) of Consumer Goods Sector of Manufacturing Company listed in Indonesia Stock Exchange (IDX)"

1.2 Problem Limitation

In order for the writing of this paper not to deviate and far from the original objective of the research and to ease the collection of necessary data and information, the authors set the boundaries as follows:

1. This study will be focused on annual financial statements on consumer goods sector of manufacturing companies listed on the Indonesia Stock Exchange (IDX) within the period of 2016-2018
2. In this study, the author will focus only on one dependent variable, which is Effective Tax Rate (ETR), and four independent variables, which is Firm Size, Leverage, Capital Intensity Ratio, and Profitability.

1.3 Problem Formulation

Based on the description of the background of the study that has been proposed, then the problem formulation in this study are:

1. Does the firm size affect the effective tax rate (ETR) on consumer goods sector of manufacturing companies listed in IDX in year 2016-2018?
2. Does the leverage affect the effective tax rate (ETR) on consumer goods sector of manufacturing companies listed in IDX in year 2016-2018?
3. Does the capital intensity ratio affect the effective tax rate (ETR) on consumer goods sector of manufacturing companies listed in IDX in year 2016-2018?
4. Does the profitability affect the effective tax rate (ETR) on consumer goods sector of manufacturing companies listed in IDX in year 2016-2018?
5. Do the firm size, leverage, capital intensity ratio, and profitability simultaneously affect the effective tax rate (ETR) on consumer goods sector of manufacturing companies listed in IDX in year 2016-2018?

1.4 Objective of the Research

Based on the problem formulation that has been described before, the objectives to be achieved in this study as follow:

1. To examine the impact of size of the company on effective tax rate (ETR) on consumer goods sector of manufacturing companies listed in IDX in year 2016-2018
2. To examine the impact of leverage on effective tax rate (ETR) on consumer goods sector of manufacturing companies listed in IDX in year 2016-2018
3. To examine the impact of capital intensity ratio on effective tax rate (ETR) on consumer goods sector of manufacturing companies listed in IDX in year 2016-2018
4. To examine the impact of profitability on effective tax rate (ETR) on consumer goods sector of manufacturing companies listed in IDX in year 2016-2018
5. To examine the impact of size, leverage, capital intensity ratio, and profitability simultaneously on the effective tax rate (ETR) on consumer goods sector of manufacturing companies listed in IDX in year 2016-2018

1.5 Benefit of the Research

This study is expected to provide benefits for various parties related to the research topic, including:

1.5.1. Theoretical Benefit

For the author, this study is expected to add insight and knowledge especially about the impact of firm size, leverage, capital intensity ratio, and profitability on effective tax rate (ETR).

For the literature, this study is expected to contribute more understanding about the impact of firm size, leverage, capital intensity ratio, and profitability on effective tax rate (ETR).

For the next researcher, this study is expected to provide help as the comparison of study material and to be a reference for the research that will be conducted in the future.

1.5.2. Practical Benefit

For investors, this study could be an influential input related to the impact of firm size, leverage, capital intensity ratio, and profitability on effective tax rate (ETR).

For companies, this study is expected to provide information for companies related to factors that might affecting the effective tax rate, so that the related companies could pay more attention to the tax management and tax planning strategy in order to minimize their ETR appropriately, in accordance with the taxation law and regulation.

For Directorate General of Tax and Government, this study is expected to contribute to the government's efforts to cover the potential losses of the state, by identifying factors affecting the effective tax rate of companies in Indonesia which still have the potential to pay more taxes, especially companies listed on the Indonesia Stock Exchange (IDX).

Furthermore, the results of this study are expected to increase insight for the community to know the impact of size, leverage, capital intensity ratio, and profitability to effective tax rate (ETR).

1.6 Systems of Writing

The purpose of systems of writing is to make it easier for readers to understand the content of this research. The outline of research is organized as follow:

CHAPTER I INTRODUCTION

This chapter contains a description about the Background of the Study that underlying the importance of this study, the Problem Limitation, the Problem Formulation, the Objective of the Research, the Benefit of the Research and the Systems of Writing.

CHAPTER II LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

This chapter contains an overview of the Theoretical Background, the Previous Research, the Hypothesis Development, the Research Model, and the Framework of Thinking.

CHAPTER III RESEARCH METHODOLOGY

This chapter contains description of the Research Design, the Population and Sample, the Data Collection Method, the Operational Variable Definition and Variable Measurement, and the Data Analysis Method.

CHAPTER IV DATA ANALYSIS AND DISCUSSION.

This chapter contains the General View of "Research Object", the Data Analysis, the Descriptive Statistic, the Result of Data Quality Testing, the Result of Hypothesis Testing, and the Discussion.

CHAPTER V CONCLUSION.

This chapter contains the Conclusion, Implication, and Recommendation related to the results of the study.