

# CHAPTER I

## INTRODUCTION

### 1.1. Background of the Study

For every country, national development of its country is considered very essential in improving the quality of the country itself, including the welfare of the citizens. To carry out the national development, plentiful of funds are required by the state in providing health facilities, education, infrastructure and other public services that is usually financed through the allocation of State Budget (*Anggaran Pendapatan dan Belanja Negara*). With reference from Ministry of Finance or *Kemenkeu*'s official website, in the 2018 state budget (APBN) posture, state revenues are projected at Rp1,894.7 trillion. This portion comes from tax revenues amounting Rp1,618.1 trillion, non-tax revenues amounting Rp275.4 trillion and grant revenue amounting Rp1.2 trillion. This is exactly a proof of tax revenue being the major contributor of funds to the state budget (APBN), which was around 85,4% was derived from the state tax revenue. Other than national development, tax revenue also participates in stabilizing the country's economic condition, for instance, in overcoming inflation and deflation faced by the country. This condition is reflecting the importance of tax income's contribution to the state's economic growth that also gives impact in the process of a long-term country development.

According to Law of the Republic of Indonesia Number 17 of 2003 on State Finances, Article 11 (3) says that "*Pendapatan negara terdiri atas penerimaan pajak, penerimaan bukan pajak, dan hibah*". Meanwhile, the definition of tax according to Prof. Dr. Djajadiningrat in Siti Resmi (2013) is an obligation to grant a portion of one's property to the state due to a circumstance, event, or act in which the contribution is not a punishment, but an obligation under various

government-imposed and coercive rules with the goal to maintain the welfare of the community. In other words, taxes, which includes property tax, resource tax, income tax, and value added tax, are inherently mandatory contribution paid by the subjects who are held accountable to pay taxes, and moreover could be legally prosecuted if the tax obligations are not satisfied.

Due to the fact that revenue from taxes has the largest contribution to state income is making the government to have critical concern regarding the tax issue. Hence, government constantly changing and improving the tax regulations in order to minimize the possibility of tax evasion. And because the country's largest source of income highly depends on tax revenues obtained from tax payers, government also attempted to carry out various means by implementing several tax related programs to encourage taxable subjects in order to increase tax compliance.

On contrary to the state that sees tax as its source of revenue, tax is perceived as something unwanted by taxable subjects due to many reasons. Often people have the motivation to pay, however, the process from calculating to reporting the tax is still considered complicated for some people. Other than that, most people also reason that the amount of tax they have to pay was unreasonable and not fair that they choose not to pay instead. Nevertheless, the predominant reason behind the low tax compliance is mainly because tax acts as a burden or expense that reduces the profit of individuals or entities, affecting in the decrease of net income generated. Although the taxes paid by the people in the country is used by the government to build and provide public facility to be enjoyed by citizens, which also known as infrastructure development, it just will not change the mindset of majority of people that paying tax does not benefit them at all. This indirect benefit makes people think that they pay tax for nothing, when in fact the tax revenue received by government is to provide facility for the citizens

themselves, such as building harbors, airports, ports, roads, and many more. This is the reason why government always try to raise citizens' awareness to accomplish their tax obligations. The tax rate charged to the taxable person also varies depending on the prevailing tax regulation and condition, but in general, the greater the income received, the greater the amount of tax expense to be paid and vice versa.

As the government tries to maximize their tax revenues, people strive to find various ways to minimize their tax expenses borne through a well-planned tax management, whether it be legal or illegal way. People with income aim to seek loopholes of the tax regulations to reduce the amount of tax payable, this is also known as Tax Planning. Nursari et al., (2017) explains that tax planning is the attempt of the tax payers to minimize tax payable in order to save the amount of cash outflow. Tax Avoidance and Tax Evasion are the common terms that are usually found in the study of Tax Planning. People tend to find it difficult to differentiate tax avoidance and tax evasion and eventually misunderstand both as a same thing because the borderline between these two is quite uncertain. Actually, tax avoidance and tax evasion have a similarity in which both bring major harms for the state through lower tax proceeds, whereas the difference is one is a legal doing (lawful) and the other is an illegal doing (unlawful). According to N.A. Barr, S.R. James, A.R. Perst in Zain (2007, p. 50),

*"Penghindaran pajak diartikan sebagai manipulasi penghasilannya secara legal, yang masih sesuai dengan ketentuan peraturan perundang-undangan perpajakan untuk memperkecil jumlah pajak yang terutang".*

Meanwhile, Devi Marta Adi et al., (2016) explains that tax evasion is intentionally manipulating or falsifying financial data on financial statements not in accordance to the taxation regulations, by

increasing the amount of expense in order to lower the profit so that the amount of tax paid is smaller.

Himawan (2016) states that tax avoidance is a serious problem in Indonesia. It is predicted that around Rp110 trillion of tax revenue being evaded every year, which is mostly done by business entity (about 80 percent) and the rest are individual tax payers. Based on a report in 2016, made by IMF Investigator, Ernesto Crivelly, which was later reanalyzed by UN University using the International Center for Policy and Research (ICTD) database, and the International Center for Taxation and Development (ICTD), Indonesia took the 11<sup>th</sup> place as the country with the most practice of tax avoidance, with estimation around 6.48 billion US Dollars of corporate tax liabilities not paid to the government. Other proof of the high tendency of tax avoidance in Indonesia is the successful programs carried out by government, namely Tax Amnesty that was effective since 1<sup>st</sup> June 2016 to 31<sup>st</sup> March 2017 according to *Undang-undang nomor 11 tahun 2016*, and was followed by another program called *Pengungkapan Aset secara sukarela dengan tarif Final (PAS Final)* which was effective since 11<sup>th</sup> September 2017 according to *Peraturan Pemerintah Nomor 36 Tahun 2017*. Both Tax Amnesty and PAS Final are the programs created by government to increase tax compliance as it allows the elimination of taxes owed, administrative sanction, and criminal sanctions in the field of taxation that should have been charged for the previously unreported assets within certain period of time. This highly participated programs by the tax payers have proven that they are inclined to do tax avoidance before. The case of tax avoidance does not only happen in Indonesia, in fact it is happening around the world and most of the time, it is committed by big international companies. Setiawan (2017) explains that one of the giant companies trapped in tax avoidance case is the household and office furniture company, known as IKEA. From this case, the EU suspected this big company has avoided taxes of nearly € 1

billion or about Rp15.9 trillion over the past 4 years, from 2009 to 2014.

There are many factors that may influence the aggressiveness of tax avoidance, some of the factors are the company's liquidity, profitability, and institutional ownership. Company's liquidity ratio, which is a predicted factor that could affect the aggressiveness of tax avoidance, is a ratio that measures a company's ability to pay its short-term debt, or debt or liabilities that have matured. According to Rahmani (2017), current ratio is a part of the liquidity ratio that determines to which extent the company's current assets can be used to cover its short-term liabilities or current liabilities. The greater the ratio of current assets to current debt, it is assumed that the company has higher ability to cover its current liabilities. Rosalia (2017) explains that a company with a high liquidity level signifies the company's smooth cash flow and thus the company is not reluctant to pay all its obligations including paying taxes in accordance with the applicable taxation law and regulation. According to the research done by Jaya (2018) and Indradi (2018), liquidity that is proxied by current ratio has a positive influence with tax avoidance.

The other variable that may affect the aggressiveness of tax avoidance is the level of profitability of the company. Profitability ratio is a ratio that measures the capability of company in generating profit within certain period. Return on Asset (ROA) that can be used as a tool to measure company's profitability, is a part of profitability ratio that measures how efficient a company in generating revenue based on their economic resources or assets on their balance sheet and it is usually shown as a percentage. Therefore, the higher the percentage implies the more tendency of the company doing tax planning in order to reduce its tax obligation. According to the result of research by Ifandi (2016) and Yunanda (2016), profitability proxied through return on asset has significant influence on the tax avoidance.

Institutional ownership is another factor that might also related to tax avoidance. Institutional ownership is the amount of a company's available stock owned by mutual or pension funds, insurance companies, investment firms, private foundations, endowments or other large entities that manage funds on the behalf of others. Institutional ownership plays an important role because they are the major shareholders, thus they have the right to intervene the actions and decisions of the management, meaning they have the right to monitor and control the management policy to prevent harming the other shareholders. Therefore, it is assumed that companies with huge institutional ownership are less likely commit tax avoidance. Previous research carried by Prasetyo & Pramuka (2018) has proved that institutional ownership has positive influence on tax avoidance. On contrary, Hidayat (2017) have proved in their research that institutional ownership does not significantly influence tax avoidance.

In addition, researcher is interested to do this observation because of the phenomena that are presented in the table below:

**Table 1.1 The Phenomena of Current Ratio, Return on Asset, Institutional Ownership, and Tax Expense of Basic Industry and Chemical Companies Listed in Indonesia Stock Exchange in period of 2015 – 2017**

Code	Year	Current Ratio	Return on Asset (%)	Institutional Ownership (%)	Tax Expense (in Rupiah)
WTON	2015	<b>1,3688</b>	3,86	69,81	<b>27.749.539.294</b>
	2016	<b>1,3091</b>	6,05	68,45	<b>58.691.974.024</b>
	2017	<b>1,0320</b>	4,82	67,92	<b>79.042.760.767</b>
IGAR	2015	4,9610	<b>13,39</b>	84,82	<b>11.820.161.899</b>
	2016	5,8220	<b>15,77</b>	84,82	<b>26.468.958.222</b>
	2017	6,5022	14,11	84,82	23.388.107.927
IMPC	2015	2,2713	7,75	67,37	17.445.790.361
	2016	3,7723	5,53	<b>67,37</b>	<b>38.973.036.457</b>
	2017	3,6056	3,98	<b>89,32</b>	<b>20.120.487.307</b>

Source: [www.idx.co.id](http://www.idx.co.id) (2019)

From Table 1.1, it can be seen that the phenomena of current ratio, return on asset, institutional ownership and tax expense happen in three companies of basic industry and chemical companies listed in Indonesia Stock Exchange from 2015 – 2017. The table above shows that PT Wijaya Karya Beton Tbk has higher current ratio in 2015 compared to 2016, however the tax expense of the company in 2015 is lower compared to 2016. In 2017, the condition reverses when the current ratio is lower compared to 2016, but the tax expense in 2017 increases compared to 2016. Different condition also happens in PT Champion Pacific Indonesia Tbk where the current ratio increases from 2015 to 2016 and is followed by the increment of tax expense from 2015 to 2016. This result expresses the inconsistency between the current ratio and tax expense.

As for PT Champion Pacific Indonesia Tbk, inconsistency occurs when the return on asset in 2016 increases compared to 2015, but the tax expense also increases in 2016 following the increment of return on asset when it should be decreasing as company with high return on asset is predicted to have the tendency of doing tax avoidance. However, reversed condition happens in PT Impack Pratama Indonesia Tbk where the return on asset in 2016 is lower than in 2015, but the tax expense of this company is higher in 2016 than in 2015. This result expresses the inconsistency between the return on asset and tax expense.

Furthermore, phenomena also occur in PT Impack Pratama Indonesia Tbk where there is increment of institutional ownership in 2017 compared to 2016, but the amount of tax expense declines in 2017 compared to 2016. Meanwhile in PT Wijaya Karya Beton Tbk, the increment of institutional ownership from 2015 to 2016 and from 2016 to 2017 is followed by the rise of the tax expense from year to year as well. This result expresses the inconsistency between the institutional ownership and tax expense.

Those previous researches and phenomena have shown different results between the influence of current ratio, return on asset, and institutional ownership towards tax avoidance. Therefore, this research is conducted to find out a consistent result of the independent variables toward tax avoidance and also to see how the independent variables influence the dependent variable. Hence, author will examine those variables in the Basic Industry and Chemical Companies listed in Indonesia Stock Exchange in period of 2015 – 2017 to find more defined result from the most recent period of time. A different sector is chosen by author with the intention of achieving a neutral and unbiased result. Thus, author is interested to do a research about “**The Influence of Current Ratio, Return on Asset, and Institutional Ownership towards Tax Avoidance of Basic Industry and Chemical Companies Listed in Indonesia Stock Exchange in Period of 2015-2017**”.

### **1.2. Problem Limitation**

Problem limitation of this research which will be the focus of the analysis are the basic industry and chemical companies listed in Indonesia Stock Exchange along with the annual financial statements of the company from period of 2015 - 2017. Another limitation is that this research is only conducted using three variables which are current ratio, return on asset, and institutional ownership.

### **1.3. Problem Formulation**

To raise the issues discussed in this study, the author makes the formulation of the problem as follow:

1. Does current ratio have significant influence towards tax avoidance of the basic industry and chemical companies listed in Indonesia Stock Exchange partially?
2. Does return on asset have significant influence towards tax avoidance of the basic industry and chemical companies listed in Indonesia Stock Exchange partially?

3. Does institutional ownership have significant influence towards tax avoidance of the basic industry and chemical companies listed in Indonesia Stock Exchange partially?
4. Does current ratio, return on asset, and institutional ownership have significant influence towards tax avoidance of the basic industry and chemical companies listed in Indonesia Stock Exchange simultaneously?

#### **1.4. Objective of the Research**

In accordance with the formulation of the problem, this study aims to find empirical evidence on:

1. To know whether there is any significant influence of current ratio towards tax avoidance of the basic industry and chemical companies listed in Indonesia Stock Exchange partially.
2. To know whether there is any significant influence of return on asset towards tax avoidance of the basic industry and chemical companies listed in Indonesia Stock Exchange partially.
3. To know whether there is any significant influence of institutional ownership towards tax avoidance of the basic industry and chemical companies listed in Indonesia Stock Exchange partially.
4. To know whether there is any significant influence between current ratio, return on asset, and institutional ownership towards tax avoidance of the basic industry and chemical companies listed in Indonesia Stock Exchange simultaneously.

#### **1.5. Benefit of the Research**

Through the research conducted by the author, it is expected to be useful for various parties as follows:

### **1.5.1. Theoretical Benefit**

The result of research could provide better knowledge for the author and readers related to the impact of current ratio, return on asset, and institutional ownership towards tax avoidance studied on Basic Industry and Chemical Companies Listed in Indonesia Stock Exchange. In addition, this research is expected to be used as reference and to give more information that may be useful for a similar research conducted in the future.

### **1.5.2. Practical Benefit**

#### **1. For the Company**

The result of this research is expected to provide a better understanding to a company in term of making decision about tax planning. Thus, the company may increase their tax compliance in accordance to the applicable regulation.

#### **2. For the Government**

This research is expected to help government so that they would pay more attention to the things or loopholes that indirectly give opportunity for company to reduce their tax payable. Hence, the government may set new regulation that will prevent or minimize the practice of tax avoidance in the future.

### **1.6. System of Writing**

In order to ease the readers, this system of writing is concluded the content of this research as follow:

#### **CHAPTER I: INTRODUCTION**

This chapter explains the background of the study that triggers problems which will be discussed in this study. With this background, the main issues to be examined will be

formulated and as a reference for determining the hypothesis for this study. This chapter also describes the purpose and objectives of the research and the system of writing.

## **CHAPTER II: LITERATURE REVIEW**

This chapter contains theoretical basis relating to research which is the basis of reference in conducting research and becomes the logical basis to discover evidence and solutions to the hypothesis determined, previous studies related to this research, and framework of thinking.

## **CHAPTER III: RESEARCH METHODOLOGY**

This chapter describes the variables in this research and its operational definitions, population and research samples, types and sources of data and data collection methods, and the analytical methods used in this study.

## **CHAPTER IV: DATA ANALYSIS AND DISCUSSION**

This chapter consists of the research hypothesis testing which is composed of descriptions of research objects, analysis of data, and interpretation of test results.

## **CHAPTER V: CONCLUSION**

This chapter contains about the conclusions on the results of research, reveals limitations in conducting research, and suggestions that can later be used as reference material in future research.