

CHAPTER I

INTRODUCTION

1.1 Background of the Study

According to the tax definition of general provisions and taxation procedures in Article 1, paragraph 1, of Law No. 16 of 2009, taxes are taxes that individuals or entities compulsorily pay to state-owned enterprises by the law, without direct incentives, and used for the country's greatest prosperity for the people. Tax is one of society's obligations to the state and community participation in developing the country. Tax is a state revenue source aiming to meet a country's needs (Dewinta and Setiawan, 2016). Taxpayer refers to a person or entity that matches the definition as a tax subject and receives or obtains a taxable object. No rule states that a taxpayer is a person who already has a tax identification number and is obliged to pay taxes. Even a person who does not have a tax identification number can be categorized as a taxpayer if he has tax rights and obligations.

Tax plays a key role as the main source of income for a country which is also a driving force for a country's economy. Taxes can play a role in supporting national development. Through fees, the government can provide funds for regional development to create community welfare, so the government must manage it appropriately. So the government will keep trying to turn all potentials available into an income source to finance all the nation's expenditures and uses the taxes to provide the public facilities which the people of a country can enjoy.

Even though the tax is a compulsory contribution, tax revenue is not optimal, and it can be seen from the state revenue that comes from taxes. It can be proven that the tax collected at the end of 2020 is around 1,865 trillion rupiahs, which is far below the target set by the Ministry of Finance (*Kemenkeu*). Apart from tax revenue, based on the Financial Audit Agency (BPK), the tax ratio in 2020 is 11.6 percent. The mentioned tax ratio shows the government's success in collecting taxes. The tax ratio of a country is aligned with the country's tax collection performance, which means that a high tax ratio equals fair tax collection performance. In terms of implementing tax payments, there are major differences between the government and taxpayers. For taxpayers, tax is a cost or expense that will cut down the net income. If the taxpayers get a significant profit, the state treasury's income tax is also hefty. Therefore taxpayers try to pay the smallest tax possible. On the other hand, the government needs funds to finance the government's administration, mainly tax revenues (Budiasih & Rusung, 2019). Tax is indeed considered a significant burden for companies, so it is common knowledge that many companies do various ways to avoid taxes that must be paid both legally and illegally (Mayang, 2018).

The taxation in Indonesia has faced primary changes in early 1984 from an official assessment system to a self-assessment system. The self-assessment system is a tax collection system that gives individual and corporate taxpayers authority and trust to calculate, deposit, and report taxes owed to the state (Hutagaol, 2003). The self-assessment system's success is highly dependent on public awareness and

participation and the honesty of taxpayers in reporting their tax obligations. The taxpayer's willingness to pay taxes is a commitment to creating social balance and social justice in society.

The difference in interests between the tax authorities and the taxpayer can lead to taxpayers' non-compliance, impacting companies to do tax avoidance. Taxpayers carry out tax avoidance to minimize tax burden in various ways that do not violate the law and tend to be considered legal. Lim (2011) in Sari (2014) defines tax avoidance as tax savings that arise by utilizing legal tax provisions to minimize tax liabilities. By law, tax avoidance does not prohibit even though it often gets unfavourable attention from the tax office because it negatively connotes. What distinguishes tax avoidance and tax evasion is its legality; tax avoidance is legal while tax evasion is illegal. In practice, the grouping between the two depends on the tax authorities' interpretation in each country. Both can conclude that what distinguishes a tax planning scheme, including tax avoidance or tax evasion, is its legality. Whereas from an ethical perspective, these two practices contradict the intent of the law.

Tax avoidance is a unique and complicated thing; from one point of view, tax avoidance is allowed, but from another point of view, it is undesirable. The government makes various rules to prevent tax avoidance. One of these regulations is, for example, related to transfer pricing, namely regarding the application of fairness and business practices in transactions between taxpayers and parties who have a special relationship (*Perdirjen No. PER-32 / PJ / 2011*). Taxpayers will also

use various ways by taking advantage of the government's loopholes in regulations to carry out tax planning, leading to the reduction of tax payments or so-called tax avoidance. Based on the previous research by Diandri and Ulupui (2018), Alviyani (2016), and Ardianti (2019), the audit committee, the proportion of independent commissioners, and the proportion of institutional ownership are some factors that bring out to the effort of doing tax avoidance. Hidayat (2018), Susanti (2019), and Dewi and Noviari (2017) also undertook similar research towards tax avoidance with other factors, such as profitability, leverage, firm size, company age, executive character and corporate social responsibility. Other factors that are assumed to have a significant effect on tax avoidance, such as company age, sales growth, and audit committee, have been researched by Dewinta and Setiawan (2016) and Ardianti (2019). This research has been carried out by many parties, which have yielded mixed results. Therefore, this study will focus on several factors to provide more stable results.

One of the factors in this research that affects tax avoidance practices is profitability. Profitability describes the company's financial performance in generating profit from asset management calculated using Return On Assets (ROA), Dewi and Noviari (2017). Companies that have high net income and profitability will also have high ROA values. According to Dewinta and Setiawan (2016), ROA is often highlighted in financial statement analysis because it can show its success in generating profits. The higher the ROA level so the company's profits higher and the company's taxes will be higher the company will take tax

avoidance measures. According to Susanti (2019), the number of the company's profits will affect the taxes paid by the company; the greater the profit the company gets, the greater the taxes that the company must pay and vice versa.

In conclusion, the company's profitability can affect the return of assets (ROA) ratio. High profitability will also have high ROA and high tax liabilities; such conditions can be used to take tax avoidance measures to reduce the tax burden that the company must pay. According to Dewinta and Setiawan (2016), profitability positively affects tax avoidance, following Dewi and Noviari (2017) results. However, according to Hidayat (2018) and Susanti (2019), profitability negatively affects tax avoidance.

Another factor that researchers also try to look for is the relationship to see whether there is any effect between leverage and tax avoidance. Leverage is a company's policy related to its investment or the source of the company's funds. Leverage is related to the expenses or costs that the company must pay in the future, where these expenses will affect the company's taxes. Kasmir (2014) stated in Hidayat (2017) that the leverage ratio is used to measure how its assets are financed by debt. It means that the company's debt is more or less than its assets, or the ratio is used to measure its ability to repay all debts in the short and long term (total debt/total assets). As a matter of fact, to meet the lack of funds, the company has various sources of funds available, for instance loan capital (debt), or also known as relative loan capital. The number is not limited, and it motivates managers to work more actively and creatively because they bear their obligations.

Leverage policies that generate corporate profits before taxation that use debt as a source that causes the emergence of interest expenses can certainly reduce corporate tax obligations and classify tax avoidance measures. It shows that the greater the debt value, the lower the tax avoidance practices that the company will carry out. This research is in line with the study conducted by Dewinta and Setiawan (2016), Hidayat (2018), and Susanti (2019), which shows that leverage does not affect tax avoidance and in the other hand, Dewi and Noviari's research (2017) shows that leverage has a negative effect on tax avoidance.

Previous research conducted by Alviyani (2016) showed that the institutional ownership of companies would encourage better management performance monitoring. Compared with other shareholders, institutions that control more shares can supervise more important management policies to avoid harmful company behavior. The size and voting power of institutional owners can oblige managers to concentrate on economic performance and prevent any possibility for selfish behavior in order to minimize tax avoidance. According to Diandri and Ulupui (2016), the proportion of institutional ownership does not significantly affect tax avoidance, which means that the proportion of institutional ownership does not make tax avoidance practices carried out by the company avoided. Institutional ownership should play an important role in supervising, disciplining, and influencing managers to enforce management in order to prevent selfish behaviour. Institutional ownership that acts as a party that monitors the

company cannot necessarily provide reasonable control over management's actions over its opportunistic practices in tax avoidance.

The last factor that the researchers will seek is firm size. According to Susanti (2019), firm size does not affect tax avoidance, considering the greater its size, the lower its tax avoidance. Prokasa (2014) in Suanti (2018), because generally, greater-scale companies have acquired assets, in which there are enough cash and capital to be used for company performance activities. Various studies on the current ratio have been carried out. Meanwhile, Dewinta and Setiawan (2016) research show there is an effect of firm size on tax avoidance. Companies that are grouped into large sizes (having significant assets) will tend to be more capable and more stable to generate profits when compared to firms that have a smaller total of assets (Indriani, 2005 in Rachmawati and Triatmoko, 2007)

The occurrence of tax avoidance in Indonesia and various parts of the world is increasing from time to time. Secretary-General of the Indonesian Forum for Budget Transparency (FITRA), Yenny Sucipto, stated that tax evasion is a serious problem in Indonesia. It does suspect that each year there is 110 trillion rupiahs, which is a tax avoidance figure. Most are business entities; around 80% of business entities, in particular, are mostly engaged in the mineral and coal mining sector, the remaining 20% are individual taxpayers (Suara.com, 2017).

A phenomenon related to tax avoidance does post on the online news site (<https://katadata.co.id>) on Thursday, March 28, 2019. Indonesia is a crucial player in the world coal mining industry. For decades, the coal industry has always

favoured the state because of its enormous contribution to the national economy. When the 2008 global economic crisis hit, Indonesia's economic condition was still growing thanks to the coal industry's contribution. This position makes the coal mining industry relatively not get adequate supervision so that there are often cases of environmental damage and immoral practices in tax avoidance (tax avoidance).

Coal is the most excellent source of energy. Currently, almost 40% of the world's electricity generation does source from coal. Although renewable energy utilization is high and the energy mix originating from water, wind, sunlight, and geothermal with "dirty" energy sourced from coal and petroleum, coal will still be the primary choice in producing energy. According to the BP Energy Outlook 2018, coal will still contribute at least 30% as the world's electricity generation energy source. Besides being used as an energy source for electricity generation, coal is also a material for various other industrial commodities. Coal is used as a mixture of paper, fertilizer, plastic, steel, and ceramics. Also, coal is used as a source of heat to produce cement and natural gas. To date, Indonesia is the fifth-largest coal manufacturer in the world. In 2017, Indonesia had around 485 million tons of coal, or in other words, it equals 7.2% of total world coal production. Indonesia is also the second-largest coal exporter in the world after Australia. Approximately 80% of national coal production does intend for export. According to Central Statistics Agency, during 2014-2018, the coal and lignite mining industry contributed an average of 2.3% to the gross domestic product (GDP) per year or equivalent to 235 trillion rupiahs.

Besides, coal is the second contributor to the extractive sector after the oil, gas, and geothermal group. The coal mining industry's substantial economic value will undoubtedly make the coal business produce great wealth coffers. Forbes (2018) noted that 7 of the 50 wealthiest people in Indonesia could not separate from the coal business's profits. Of the 2018 coal production target of 485 million tons, around 271 million tons, or 55%, will come from only eight companies. Some large-scale coal companies include Adaro Indonesia, Baramulti Suksessarana, Berau Coal, Bumi Resources, Bukit Asam, Golden Energy, Indika Energy, and Indo Tambangraya Megah. Minimal Mining Tax Behind the fantastic economic value generated by the coal mining industry, it turns out that the tax contribution is very minimal. Ministry of Finance data shows that the tax ratio contributed in 2016 from the mineral and coal mining sector was solely 3.9%; meanwhile, the national tax ratio inhabited 10.4%. This low tax ratio certainly cannot be disconnected from the issue of tax avoidance by coal industry players. Tax avoidance is a practice that utilizes legal loopholes and weaknesses of the existing taxation system.

Although it does not violate the law, it is morally unjustified. The Ministry of Finance noted that the number of taxpayers owned mining and mineral mining business licenses exceeds those who did not report their annual tax return than those reported. In 2015 of 8,003 taxpayers in the coal industry, 4,532 taxpayers did not report their tax returns. This figure certainly does not include small-scale coal players who do not register as taxpayers. It should also be noted that among taxpayers who report their Annual Tax Return, there is the potential to not report

according to the field's facts. Not a few reported their tax returns correctly but resulted from tax avoidance and tax savings such as aggressive tax planning, corporate inversion, profit shifting, and transfer mispricing. Piles of coal in the stockpile area near the pier of Bakungan Village, Kutai Kartanegara Regency, East Kalimantan, (1/17/2019). (Ajeng Dinar Ulfiana | Katadata) As a result, Dark Financial Flows tax revenue from the mineral and coal sector, especially coal, is still far from its true potential. A study by Prakarsa (2019) found the massive flow of illicit financial flows in the coal commodity sector during 1989-2017 originating from export activities. Prakarsa noted that there was an illicit coal flow from exports of 62.4 billion US dollars. Of this value, approximately 41.8 billion US dollars in the form of illicit financial outflows from Indonesia (illicit financial outflows) and the 20.6 billion US dollars in illicit financial inflows into Indonesia (illicit financial inflows).

There is a net illicit financial outflow of 21.2 billion US dollars or 25% of the total value of coal exports. This estimation does obtain from the mismatch of export values recorded in Indonesia with countries' import values claiming to import coal from Indonesia. It means that Indonesia lost a potential GDP of 21.2 billion US dollars during 1989-2017. Simultaneously, the potential for illicit finance originating from coal commodity export activities can do used as a basis for potential sources of state revenue that can be mobilized for health, education, infrastructure, and other development activities. Illicit financial flows in the Indonesian coal mining industry indicate tax avoidance.

Besides, this is a sign that taxation in the coal sector is not okay. This phenomenon raises a big question considering that there are already many regulations regulating strictly from operating licensing to sharing coal sales profits. Nevertheless, the existing regulations still have many weaknesses, mainly due to overlapping regulations. In 2018, the government proposed a 6th Amendment Plan to PP No. 23/2010 concerning the Implementation of Mineral and Coal Mining Business Activities to promote a more hospitable investment climate so that justice could be felt, especially for companies PKP2KB (Coal Mining Work Agreement) agreements. However, the proposed amendment has drawn much rejection because it is considered contrary to the Minerba Law No. 4 of 2009 concerning concession areas where the RPP allows PKP2KB to expand concessions beyond the IUP provisions. Also, it does indicate that the RPP is prepared to facilitate contract extension and transition to IUPK.

This amendment does also considered for prioritizing coal entrepreneurs over national interests. The Minerba Law No. 4 of 2009 is inseparable from the problems in its implementation, so that it does consider to cause many problems in coal management. Some regulations at the Ministry or Institution level consider colliding with the Minerba Law. Another matter that has raised many disputes is the authority of the Regional Government to grant mining permits. However, contrary to this, existing regulations at the regional level stipulate that the Provincial Government can only grant mining permits. The Legal Gap of Tax Avoidance In

addition to overlapping regulations and legal loopholes that coal businesses can exploit to avoid tax.

On the other hand, the coal sector's low tax revenue do cause by the tax authority and tax authorities' weak capacity in examining taxpayers. Various allegations of tax avoidance or tax disputes submitted by tax authorities always lose in the tax court. Tax avoidance is part of tax planning. According to Black's Law Dictionary, tax avoidance is an effort to minimize tax liability by utilizing tax avoidance opportunities (loopholes) without violating tax laws. Tax avoidance is different from tax evasion. The taxpayer carried out this action to reduce the amount of tax owed or not pay taxes through illegal means.

One example is when the Directorate General of Taxation (DGT) is issuing the coal company PT Multi Sarana Avindo (MSA) for the alleged transfer of Mining Authorities resulting in a lack of obligation to pay Value Added Tax (VAT). Lawsuits three times in 2007, 2009 and 2010 with a case of 7.7 billion, the Directorate General of Taxation (DGT) lost in court. Until now, the Directorate General of Taxation (DGT) is still filing the same lawsuit. A search of KataData and Prakarsa in 2018 shows that the allegation of the Directorate General of Taxation (DGT) is materially not proven. The practices carried out by PT MSA are practices that do not violate the provisions. Directorate General of Taxation (DGT) suspicion is not entirely wrong because there is a striking difference between the number of products produced and the number of tax payments made.

However, the Directorate General of Taxation (DGT) should reveal more deeply and uncover the things behind the report numbers presented by PT MSA. What is commonly done by the coal industry is tax avoidance, in which the perpetrators exploit loopholes or loopholes of regulations. The PT MSA case is one of the cases that indicated tax avoidance practices. One of the unusual cases related to tax disputes occurred in 2005, where the Directorate General of Taxation (DGT) sniffed out the alleged mispricing transfer by the multinational company Toyota. At that time, the Directorate General of Taxation (DGT) demanded that Toyota pay 1.22 trillion rupiahs because of alleged mispricing transfer practices, but the lawsuit does reciprocate. Toyota demands the government to return the overpayment of tax payments worth 412 billion rupiahs.

Until now, the case has not found a bright spot. Learning from experience, the Directorate General of Taxation (DGT) often experiences defeat in tax disputes in tax courts. That shows that the tax authority is still weak in terms of the evidence and human resources capacity adequacy, both in investigations and in legal remedies in tax courts. Of the various tax issues in Indonesia, fundamental reforms need to be carried out in terms of regulation, institutional and capacity building of the apparatus. Hopefully, in the future, matters related to supervision, prosecution, investigation, and prosecution of tax crime cases in Indonesia will be better. The government needs to develop regulations and brighter systems so that the grey area does not utilize by coal businesses to avoid taxes.

The phenomena above prove that tax avoidance is a crucial issue to get more attention because it is not only an example for the wider community, including related companies. It can also be a benchmark for the government to continue making efforts to reduce taxpayers' non-compliance. Hence, the writer is encouraged to conduct personal research by the title of: **"The Effect of Profitability, Leverage, Institutional Ownership, and Firm Size Toward Tax Avoidance in Mining Companies Listed in Indonesia Stock Exchange."**

1.2 Problem Limitation

The problem limitation in this research as follows:

1. The research object is limited to mining companies listed on the Indonesia Stock Exchange.
2. The variable of profitability ratio is limited to Return on Asset, leverage ratio is limited to Debt to Asset Ratio, institutional ownership ratio is limited to Ownership of Institutional, firm size is limited to Size Company, and tax avoidance is limited to Effective Tax Rate.
3. The selection period is in the year 2015-2019.

1.3 Problem Formulation

Based on the background of the study, the formulation of the problem from this research is as follows:

1. Does profitability have a significant effect towards tax avoidance in the mining industry listed on Indonesia Stock Exchange partially?
2. Does leverage have a significant effect towards tax avoidance in the mining industry listed on Indonesia Stock Exchange partially?
3. Does institutional ownership have a significant effect towards tax avoidance in the mining industry listed on Indonesia Stock Exchange partially?
4. Does firm size have a significant effect on tax avoidance towards the mining industry listed on Indonesia Stock Exchange partially?
5. Do profitability, leverage, institutional ownership, and firm size have a significant effect toward tax avoidance in the mining industry listed in Indonesia Stock Exchange simultaneously?

1.4 Objectives of the Research

From the above formulation, this research aims:

1. To know whether profitability has a significant effect towards tax avoidance in the mining industry listed in Indonesia Stock Exchange partially.
2. To know whether leverage has a significant effect towards tax avoidance in the mining industry listed in Indonesia Stock Exchange partially.
3. To know whether institutional ownership has a significant effect towards tax avoidance in mining industry listed on Indonesia Stock Exchange partially.

4. To know whether firm size has a significant effect towards tax avoidance in the mining industry listed on Indonesia Stock Exchange partially.
5. To know whether profitability, leverage, institutional ownership, and firm size have significant effects toward tax avoidance in the mining industry listed in Indonesia Stock Exchange simultaneously.

1.5 Benefit of the Research

The theoretical and practical uses that are expected to obtain from this research are as follows:

1.5.1 Theoretical Use

The research result will be expected to verify the theory used in this study, provide the knowledge, and provide empirical evidence about the effect of profitability, leverage, institutional ownership, and firm size toward the tax avoidance of mining companies listed on the Indonesia Stock Exchange. This research is also expected to be used as literature and bring up new ideas for future research and reference in economic development, especially in accounting about profitability, leverage, institutional ownership, firm size, and tax avoidance.

1.5.2 Practical Uses

1. For Academics

Can add insight and knowledge of academics about any factors that can affect tax avoidance and become material for study or reference in subsequent research to increase knowledge, information, and insights about taxation in the academic environment.

2. For the Company

Can provide awareness that companies' practice of tax avoidance carried out will result in decreased state revenue. So it is expected that the company could be wiser in making tax planning decisions that do not harm the country and will be expected to pay taxes accordingly to General Provisions for Taxation and Taxation Procedures.

3. For Investors or Creditors

Can provide information on how the company's management takes policies related to taxation to help potential investors and prospective creditors consider investment decisions and grant credit to the company.

4. For the Directorate General of Taxes

Can provide information and input and evaluation tools to policymakers in taxation to pay attention to factors that can affect tax avoidance practices carried out by companies in tax planning, which gives a significant impact and risk to the state.