

CHAPTER I

INTRODUCTION

1.1 Background

In recent years, Indonesia has extensively developed the infrastructure of Indonesia to remote areas. With the vision of providing the connectivity networks and eliminating economic disparities throughout the country, Indonesia's government has made infrastructure project as the priority. However, the rapid development of Indonesia's infrastructure should be accompanied by enough funding. Without sufficient funding, the development of infrastructure cannot be performed effectively and efficiently.

One of the approaches to fund the infrastructure project is through tax revenue. Tax revenue is considered as the largest source of state revenue (Turyatini, 2017). It is become the main sources of fund for the national development, especially in this recent year. Tax is an obligation that must be paid by taxpayers, which can be either by an individuals or company. However, there are different assumptions on taxes between government and company. Government assumes tax as the source of fund for the nation's growth and development. On the other hand, company assumes tax as cost that reduces profit.

Company's assumption toward tax is based on the expectation of company, which is to gain a maximum profit. As company assumes tax can reduce their profit, many companies try to discover and use several methods to reduce the tax obligations legally and illegally. The illegal act is called tax

evasion, which is occurred when a company tries to reduce the tax obligations that is forbidden by the tax laws. Meanwhile, the legal action is known as tax avoidance, in which the company tries to reduce the tax obligations as the company discovered that there is a weakness or loophole in tax laws that can be exploited. As tax avoidance is considered as a legitimate act, the practice has been used by many companies throughout the world. One of the common methods of tax avoidance is transfer pricing. With the transfer-pricing method, the company can do markup or mark-down the selling price. For instance, a company in Indonesia can sell below market price products to a subsidiary in another country which has lower statutory tax rates, thus reduce company's profit in Indonesia and increase the profit in another country. Even a well-known company such as Starbuck, Google, and Amazon reportedly have been practiced tax avoidance. In 2013, Starbuck was investigated for the tax avoidance practiced by the company. Starbuck which gained sales of £400 million paid no corporation tax. Starbuck was reported doing tax avoidance practices by transferred some money to a Dutch sister company which is in form of royalty payments, bought coffee beans from Switzerland, and paid high-interest rates. (Barford and Holt, 2013).

In Indonesia, there are so many cases of tax avoidance practices. There are nearly 2000 multinational companies that operated in Indonesia practiced tax avoidance by using either transfer-pricing method or transferring firm's profit to other countries that have lower statutory tax rates (Ariyanti, 2016).

In 2015, the realization of Indonesia's tax revenue is only IDR 1,055 trillion, which is only 81.5% of the target amounted IDR 1,294.3 trillion. On the

other hand, in 2016, Sri Mulyani as Indonesia's minister of finance reported that the realization of tax revenue still had not achieved the target. The realization of tax revenue is only IDR 1,106 trillion, which is only 81.54% of the target amounted IDR 1,355 trillion. She also added that Indonesia's tax ratio is only 10.3%, which is very low compared to other countries. Therefore, based on the considerations, the researcher is interested to analyze the practice of tax avoidance in Indonesia.

This research is using manufacturing firms that are listed on the Indonesia Stock Exchange period 2015 to 2017 as the sample of this research. It is because manufacturing firms are considered as the biggest sector contributed to Indonesia's tax revenue. In 2017, the realization of tax revenue is around IDR 1.151 trillion, in which half of the tax revenue, amounted to IDR 570 trillion, came from the manufacturing industry. In addition, tax avoidance that is practiced by 2000 multinational corporations, mostly came from the industry and trade sector (Ariyanti, 2016). As result, if most of the manufacturing firms doing the practice of tax avoidance, tax revenue will drop significantly. Therefore, the researcher considered interested to analyze tax avoidance practices performed by manufacturing firms.

Firm's performance provides a big picture related to the financial conditions of a company, it also reflects the management's decisions related to the actions taken by the firm. Thus, the researcher wants to analyze firm's performance as factors that influence tax avoidance. According to the previous research conducted by Turyatini (2017), titled "The Analysis of Tax Avoidance

Determinant on the Property and Real Estate Companies”, there are two factors that influence tax avoidance in Indonesian property and real estate companies, which are leverage and company size. Meanwhile, the other independent variables in the research, such as sales growth, institutional ownership, and the independent commissioner did not influence the practice of tax avoidance.

However, this research uses a different indicator of a firm’s performance to analyze the practice of tax avoidance, which are liquidity, profitability, leverage, company’s size, and sales’ growth.

Profitability is considered as an important predictor variable on the practice of tax avoidance, it is because profitability reflects the ability of the firm to generate profit. A firm with high profitability will be borne with higher tax expense, which will lead to the practice of tax avoidance.

Meanwhile, liquidity is used to measure the firm’s ability to pay the short-term debts. As tax payable is one of the elements of short-term debts, a firm with low liquidity represent the firm’s inability to pay short-term debts, which include tax payable, thus lead to the practice of tax avoidance. Therefore, liquidity is used as a predictor variable to analyze tax avoidance practice.

Trade-off theory underlying leverage as the variable that influence tax avoidance. Trade-off theory stated firms will use debts up to optimum leverage ratio for the sake of interest tax shield benefit (Moyo, Wolmarans, and Brummer, 2013). Thus, a firm that has a high leverage to fund the company will indicate the practice of tax avoidance.

Firm's size is used as predictor variable that influence tax avoidance because the company that higher total asset tends to produce a higher and stable profit compared to company that has lower total asset. (Dewinta and Setiawan, 2017). A higher profit will impose a higher tax that should be paid by the company. Thus, will increase the tax avoidance practice by the company.

Sales' growth is used as it can provide a big picture to firm's profitability, it can predict profit that will be obtained by the company (Dewinta and Setiawan, 2017). As sales' growth of company increase, the profit of a company will also increase which resulting in an increment in taxable income and amount of tax that should be paid by the company. Therefore, sales' growth is used to analyze the practice of tax avoidance.

Based on the considerations above, the researcher created a research, titled "ANALYSIS OF FIRM'S PERFORMANCE ON THE PRACTICE OF TAX AVOIDANCE".

1.2 Research Question

Based on the background mentioned above, the research problems are stated as follows:

1. Does a firm's profitability influence the practice of tax avoidance?
2. Does a firm's leverage influence the practice of tax avoidance?
3. Does a firm's liquidity influence the practice of tax avoidance?
4. Does a firm's sales' growth influence the practice of tax avoidance?
5. Does a firm's size influence the practice of tax avoidance?

1.3 Research Objectives

Pursuant to the research questions, the objectives in conducting the research are:

1. To evaluate whether a firm's profitability influence the practice of tax avoidance in a company
2. To evaluate whether a firm's liquidity influence the practice of tax avoidance in a company
3. To evaluate whether a firm's leverage influence the practice of tax avoidance in a company
4. To evaluate whether a firm's sales' growth influence the practice of tax avoidance
5. To evaluate whether a firm's size influence the practice of tax avoidance

1.4 Research Limitations

There are several limitations imposed in this research, which are discussed as follows:

1. The sample of this research is limited to manufacturing firms that are listed on the Indonesian Stock Exchange under a period of 2015 to 2018.
2. This research only analyzes profitability, liquidity, leverage, firm's sales
3. The measurement of tax avoidance is using cash effective tax rates (CETR)

1.5 Research Contributions

The contributions of this research are discussed as follows:

1. For education

The researcher believes this research will provide a deeper understanding and knowledge related to the factors that influence tax avoidance. The researcher also hopes that this research can educate about a firm's practice of tax avoidance. The result of this research is expected can be used for educational purposes related to tax avoidance practices.

2. For the next research

This research is intended to solve the problems that arise in the previous research. In the future, the researcher expected that this research can be the source of reference in conducting further research related to the factors that influence the practice of tax avoidance in Indonesia.

1.6 Systematic Discussion

This chapter is divided into several chapters with the discussion as follows:

CHAPTER I - INTRODUCTION

In this chapter, the researcher evaluates the reason behind the chosen topics which is stated in the background of the research. From the background of the research, the researcher then analyzes the problems that arose which is included in the research problems. Research problems can be used as guidance in doing the research and lead to the research objectives. The research limitations and research contributions are also added to this chapter.

CHAPTER II - THEORETICAL FRAMEWORK

This chapter explains theoretical framework which includes definition and general concept of tax, principles of good tax policy, taxation system in Indonesia, tax

planning, tax avoidance, tax evasion, trade-off theory, agency theory, profitability, leverage, and liquidity. The previous study, conceptual framework, and hypothesis development are also explained in this chapter. CHAPTER III - RESEARCH METHODOLOGY

In this chapter, it discussed all the variables that were used in this research and the operationalization of the variables. In addition, there are also the models of the research, populations, samples, type, and sources of data, methods of obtaining the data, and methods of analyzing the data. CHAPTER IV - RESULTS AND DISCUSSION

This chapter explained the research data, results on the hypothesis testing which composed of the descriptive statistics results, data analysis, and the interpretation of the research's results.

CHAPTER V - CONCLUSIONS AND RECOMMENDATION

In this chapter, it covers the conclusions for the research that have been conducted, limitations of this research, and recommendations for further research.