CHAPTER I

INTRODUCTION

1.1 Background of the Study

In every country, tax is regarded as the very important resources for government income. Tax can also be said as the fees that are imposed by the government to taxpayers, either the individuals or companies, to finance their activities. The taxes that the government imposes usually is used to fund public services or even to maintain and build the infrastructure. Some types of taxes that are commonly known are income tax, value-added tax, corporate income tax, and others. Each country has its own rules in taxation systems so that the taxpayers need to follow the tax regulations that have been set by the government.

The government of Indonesia has tried to continuously improve the tax regulations so that they can increase the tax revenue. The effort of the government to amend the tax law and regulations to boost tax revenue is known as tax reform. The implementation of this tax reform is to make the taxpayer raises their awareness in paying taxes. In the Indonesian tax law system, it has not been regulated about tax avoidance. However, in fact, taxpayer has tendency to avoid or minimize the tax that they need to pay. For some taxpayer, by doing so, they can reduce the amount that they need to pay which result in increasing their profit and minimizing their tax burden by making the use of tax provisions.

The background for taxpayers to do tax avoidance is that there are loopholes in the taxation law. So, in this case, the practice done by taxpayers does not violate the law. One example of tax avoidance is corporate taxpayers who take advantage of loopholes in international tax legislation. This case also happened in Indonesia in which PT Indosat Tbk uses the tax treaty between Netherlands and Indonesia for tax avoidance purposes. By establishing a Dutch letterbox company to issue US$300 million in bonds, the corporate takes advantage of 0% withholding taxes on interest due to loans for two years, or loans that are associated with sales credit of industrial, commercial, or scientific equipment as agreed in Indonesia-Netherland's tax treaty.

PT Indosat Tbk intended to issue a US$ 300 million bond in 2003 to fund its operation in Indonesia. So, at first, the company makes the comparison, if they issue the bond in Indonesia they have 20% withholding taxes on their interest payment from the bond, but if they are issued in the Netherlands, 0% of withholding tax will be applied on their interest payments. As the bondholders would demand a higher return on their bond from PT Indosat Tbk, the company came with a plan in which they set up a letterbox company which is "Indosat Finance Company BV" in Amsterdam with zero employees. This letterbox company is managed by entrusted firm called Intertrust. The letterbox company is a company or group of companies where the general and financial management, as well as the company location, has different domicile compared with the company's legal registration. This letterbox business then issued US$300 million bonds on November 5, 2003, which were guaranteed by the Indonesia parent company, PT Indosat Tbk, and several of its subsidiaries. The bond has a 7.75% interest rate and costs the Dutch letterbox firm more than US$ 23 million each year in interest. On the same day, the Dutch letterbox business and the Indonesian parent company signed a loan agreement in which the bond had a maturity date on 5 November 2010 with an interest rate of 7.75% and has the same interest for the repayment schedules. The funds are then transferred from the Amsterdam bond to Indonesia by the parent business. By putting the Dutch letterbox company (bondholders) between the bond financiers (Indosat Finance Company BV) with the Indonesia recipients, PT Indosat Tbk can get the benefit from 0% withholding tax on interest as applied in the Indonesia and Netherlands tax treaty (Aidha et al., 2019, Chapter 7).

In this sophisticated era, the consumer products business is one of the industries that impact a country's economic development, including Indonesia. The important key that has grown in this sector is from the consumer purchasing power which was because of their income and the change of people's lifestyle. The manufacturing industry includes the consumer goods business. The consumer goods business is a category of stock and companies that deals with goods bought by individuals and households rather than the manufacturers and industries. In this consumer goods industry, there are several sub-sectors which are cosmetics and household sub-sector, food and beverages sub-sector, houseware sub-sector, pharmaceuticals sub-sector, tobacco manufacturers sub-sectors, and other sub-sectors that consists of two companies, which are PT Hartadinata Abadi Tbk and PT Sunindo Adipersada Tbk.

Products of consumer goods industry have three types which are services, durable goods, and nondurable goods. Nondurable items have a shelf life of less than one year, while durable ones have a shelf life of three years or longer. Fast-Moving Consumer Goods (FMCG) are products that are sold in a short period of time at a low price. This FMCG is the largest segment of consumer goods and is part of the nondurable goods category. These FMCG products are consumed immediately and have a short shelf life. The FMCG can be divided into several categories such as food and beverages, cleaning products, toiletries, office supplies, and medicines as well as cosmetics.

According to FMCG Business in Indonesia (2017), Indonesia's FMCG industry is an enticing business, with revenues exceeding USD 10 billion. The sales correspond to country's growing middle-class. Consumer goods provided 18.5% of national GDP in 2016, and this ratio is predicted to climb up to 30 percent by 2030. Mr. Djatmiko Bris Witjaksono, Director of Bilateral Negotiation of Ministry of Trade of the Republic of Indonesia, indicated that the government has been neglecting the Indonesian economy, particularly in the FMCG industry. In both the domestic and international areas, the Minister of Trade has set the groundwork. The government is increasing its efforts in domestic law enforcement to ensure consumer protection and adherence to trade norms. Through a succession of fiscal and monetary policy reforms, infrastructure growth, and the development of Small and Medium Enterprises (SME), the government also promotes ease of doing business. While in the global market, the government secures negotiations with trade organizations, and bilateral agreements with various nations have been carried out to boost the country's position in the global FMCG market.

For the years 2017 to 2019, the following are some statistics from consumer goods businesses listed on Indonesia Stock Exchange:

Table 1.1 The Phenomenon of Profitability, Leverage, and Capital Intensity on Tax Avoidance at Consumer Goods Industry Listed in Indonesia Stock Exchange from 2017 to 2019

Company Name	Year	Profitability (ROA)	Leverage (DER)	Capital Intensity (CAPINT)	Tax Avoidance (ETR)
PT Indofood Sukses Makmur Tbk (INDF)	2017	0.0859	0.8768	0.4467	0.3289
	2018	0.0771	0.9340	0.4391	0.3337
	2019	0.0910	0.7748	0.4477	0.3254
PT Gudang Garam Tbk (GGRM)	2017	0.1563	0.5825	0.3207	0.2569
	2018	0.1517	0.5310	0.3294	0.2563
	2019	0.1842	0.5442	0.3226	0.2490
PT Hanjaya Mandala Sampoerna Tbk (HMSP)	2017	0.3916	0.2647	0.1597	0.2500
	2018	0.3854	0.3180	0.1564	0.2462
	2019	0.3587	0.4267	0.1434	0.2485

Source: Prepared by Writer (2021)

Table 1.1 above shows some inconsistent phenomena between the profitability, leverage, and capital intensity towards tax avoidance in the consumer products business listed in Indonesia Stock Exchange from 2017 to 2019.

The profitability in PT Indofood Sukses Makmur Tbk (INDF) is decreasing in 2018 compared to 2017, while the effective tax rate is increasing in the same period. Different situations happen from 2018 to 2019 in which the profitability is increasing, but the effective tax rate is decreasing. According to Kasim and Saad (2019), the profitability and effective tax rate have a negative relationship in which the highly profitable company will pay lower taxes or have a lower effective tax rate. This is because the highly profitable company will have greater resources and incentives to employ in tax avoidance tactics and declare lower effective tax rates.

PT Indofood Sukses Makmur Tbk (INDF) shows that the leverage from 2017 to 2018 is increasing and the effective tax rate is increasing as well. Meanwhile, the contradicting situation happens in the next period from 2018 to 2019 in which the leverage is decreasing, and the effective tax rate is also decreasing. The company that relies more on its debt financing will have higher in its debt. As the debt increase, it will lower the effective tax rate. Kasim and Saad (2019) stated that the greater leverage ratio is linked to tax avoidance since corporations can benefit from the tax deduction. This is because the company that uses the debt financing can cause its interest tax higher so that the company can reduce the effective tax rate.

The other inconsistency also happens between the capital intensity and tax avoidance at PT Gudang Garam Tbk (GGRM) in which the capital intensity from 2017 to 2018 is increasing, but the effective tax rate is decreasing in the same period. However, for the next period, which is from 2018 to 2019, the capital intensity of PT Gudang Garam Tbk (GGRM) shows it is decreasing and the effective rate in the same period is also decreasing. This can be caused by the increase in the fixed assets that are followed by the increase in the depreciation expense. As the net income decrease, it will also decrease the tax payment that making the effective tax rate become lower.

The effective tax rate (ETR) is used to calculate tax avoidance. Tax avoidance can be affected by many elements like leverage, profitability, capital intensity, and others. Profitability is a metric for determining the business's capacity to earn income from the total assets. Research done by Irianto et al. (2017), Kasim and Saad (2019), Delgado et al. (2018), and Poli, S. (2019) showed that profitability had a positive significant impact on tax avoidance. While Atmaja et al. (2021) showed that profitability had a negative significant impact on tax avoidance. A different result had been done by Sari, D. (2021) which stated that profitability has a negative and insignificant influence towards tax avoidance.

If the amount of the return on assets is greater, it can represent the better performance of company in managing its assets. The company with lower profitability would have the opportunity to avoid paying taxes because the corporation can use the loopholes in tax law to lessen its tax burden. Companies with higher earnings are thought not to engage in tax avoidance because they manage their assets well. On the other hand, if the company has high profitability, it also has the opportunity that the company can reduce its tax burden by increasing its debt-to-equity ratio.

It has been argued by many financial managers that financial leverage is very essential in capital structure management. The capital structure of a firm is typically the connection between debt and equity that the company uses to finance its assets. So, the company management needs to make the right choice in choosing their debt and equity option. To see how the company business is financed through its debt is known as leverage. According to Delgado et al. (2018), leverage had a positive influence on tax avoidance. Contrarily, Kasim and Saad (2019) and Poli, S. (2019) found that leverage has a negative impact towards tax avoidance. The different outcomes done by Atmaja et al. (2021) stated that the leverage had a positive and insignificant impact on tax avoidance. Meanwhile, Irianto et al. (2017) and Sari, D. (2021) found that leverage had a negative and insignificant influence on tax avoidance.

If the company has a smaller ratio in its leverage, the creditors who invest in their company anticipate a smaller risk. This leverage may be beneficial depending on the company's condition. It is recommended for the company to take the leverage if they are stable in their income and revenue because it can give them the tax benefits. The company can reduce its tax payment to get more profit using leverage. A company relying heavily on debt financing rather than its equity financing will have lower tax avoidance purposes. This is because a corporation with a higher debt level will have to pay a higher tax rate.

Tax avoidance also can be influenced by capital intensity. The quantity of money invested in fixed assets is referred to as capital intensity. This is used to measure how much fixed assets make up a company's total assets. Research done by Kasim and Saad (2019) showed that capital intensity had a negative significant influence on tax avoidance. Conversely, Irianto et al. (2017), Maulana et al. (2018), and Poli, S. (2019) stated that capital intensity had a positive and insignificant influence towards tax avoidance. Whereas Delgado et al. (2018) found that capital intensity had a negative and insignificant impact on tax avoidance.

This capital intensity has an impact on tax avoidance in which the depreciation expense of the fixed assets will influence the taxable income for income taxes calculation. The company's productivity and income will both benefit from the increase in fixed assets. A company that increases fixed assets may experience a fall in its profit because of the increasing depreciation expense. Because of the decrease in the net income, it will decrease the company tax payment. Increases in net income and fixed assets will increase the tax expense.

Based on the background, examples, the table phenomenon as well as differences of previous research that have been provided and explained above, the writer is encouraged to research with the title "**The Impact of Profitability, Leverage and Capital Intensity on Tax Avoidance at Consumer Goods Industry Listed in Indonesia Stock Exchange**".

1.2 Problem Limitation

To avoid any deviations from the research topic, the problem limitations set by the writer are as follows:

1. This research object is the consumer goods industry listed on Indonesia Stock Exchange (IDX).
2. In this research, the dependent variable is tax avoidance, measured by the effective tax rate (ETR).
3. In this research, the independent variables are profitability measured by return on assets (ROA), leverage measured by the debt-to-equity ratio

(DER), and capital intensity is calculated by dividing the total fixed assets with the total assets.

4. The research period is limited from 2017 to 2019.

1.3 Problem Formulation

Based on the previously given background, the problem formulation for this research are as follows:

1. Does profitability partially give a significant impact on tax avoidance in the consumer goods industry listed in Indonesia Stock Exchange?
2. Does leverage partially give a significant impact on tax avoidance in the consumer goods industry listed in Indonesia Stock Exchange?
3. Does capital intensity partially give a significant impact on tax avoidance in the consumer goods industry listed in Indonesia Stock Exchange?
4. Do profitability, leverage, and capital intensity simultaneously give a significant impact on tax avoidance in the consumer goods industry listed in Indonesia Stock Exchange?

1.4 Objective of the Research

Referring to the problem limitations that have been described above, the objective of this research to solve the problems that have been found are:

1. To find out the significant impact of profitability on tax avoidance in the consumer goods industry listed in Indonesia Stock Exchange (IDX) partially.

2. To find out the significant impact of leverage on tax avoidance in the consumer goods industry listed in Indonesia Stock Exchange (IDX) partially.
3. To find out the significant impact of capital intensity on tax avoidance in the consumer goods industry listed in Indonesia Stock Exchange (IDX) partially.
4. To find out the significant impact of profitability, leverage, and capital intensity on tax avoidance in the consumer goods industry listed in Indonesia Stock Exchange (IDX) simultaneously.

1.5 Benefit of the Research

This study is expected to be advantageous for all the interested parties, in which can be separated into two kinds of benefit, such as:

1.5.1 Theoretical Benefit

Theoretically, based on the research objectives that have been explained above, the writer expects that this study can be used as literature and references for further research on tax avoidance. The writers also expect that this research can enhance the knowledge and insight about the impact of profitability, leverage, and capital intensity on tax avoidance.

1.5.2 Practical Benefit

Practically, based on the research objectives that have been provided above, the writer expects that this research can be useful as follows:

1. For the researcher, in which it is expected that this research is anticipated to be utilized as additional information and references for the other researchers that would like to conduct research in the same topic or study field.
2. For companies, in which it is expected that this research can be used as additional information about several factors that might affect their tax calculation so that the company can make their decisions wisely without violating the law and regulations.
3. For the other parties, in which it is expected that this research can be used to enhance the knowledge and insight based on their interests.