CHAPTER I

INTRODUCTION

1.1 Background of the Study

Indonesia is a developing country that continuously implements national development to realize people's welfare. National development funding sources come from tax and non-tax sources of funding. The source of tax funding is the largest state revenue besides revenues from natural resources.

Tax is a compulsory contribution to the state that is owned by an individual or entity based on the law, with no direct remuneration, and is utilized for the state's purposes for the maximize people’s prosperity. Taxes are the largest source of revenue in almost all countries in the world. Taxes are compulsory levies from citizens on behalf of the government. The function of the tax is to finance expenses. Tax benefits are used to carry out development to pay civil workers’ salaries. Tax payments are an expression of governmental obligations and taxpayer participation in directly and jointly carrying out tax obligations for state financing and national development. Tax money is spent for the common good, not for its own benefit. Taxation is one of the sources of government finances for central and regional development, such as infrastructure construction, health, and education budget spending, and other constructive activities. Tax collection can be compelled because it is a legal requirement.

Taxation, according to tax law philosophy, participating in government finance and national development is not just a responsibility but also a right that everyone possesses. The obligation to pay tax benefits is borne by community members as a reflection of state commitments in the taxation field. This is following the self-assessment system used in Indonesia's tax system. Following its function, the government, in this case, the Directorate General of Taxes, is required to give guidance or counseling, services, and monitoring.

Tax avoidance is a transaction technique used by taxpayers to lower or even utilize loopholes in the tax regulations to reduce their tax burden. Although there is a tax avoidance strategy that is regarded as legitimate or does not violate the law, it can still harm the state. According to James Kessler, a tax attorney from England, tax avoidance is an action that can be divided into two types. The first is Acceptable Tax Avoidance — Efforts to avoid legally acceptable taxes. This practice is so named because it is considered to have a good purpose and is not carried out with fake transactions. Moreover, the second one is Unacceptable Tax Avoidance — Efforts to avoid taxes that are not legally acceptable. This tax avoidance cannot be said to be legal because it is based on malicious purposes and is carried out with fraudulent transactions to avoid the obligation to pay taxes.

There are many measurements for measuring tax avoidance, one of which is by using the Cash Effective Tax Rate (CETR). Cash Effective Tax Rate (CETR) is the amount of cash tax paid divided by total profit before tax. CETR aims to accommodate the amount of cash taxes that the company currently pays. CETR is the effective tax rate calculated using the cash taxes paid by the company in the current year. Cash position is essential for the consumer goods industry, that is why the author chose Cash Effective Tax Rate as the indicator of tax avoidance. The consumer goods industry is one of the industrial fields that continues to grow from time to time. This is because the consumer goods industry is an industry that is urgently needed to fulfill basic needs and to ensure the survival of all people in any part of the world. In the company's operations, there must be sufficient cash available. The author chose CETR because CETR reflects how the cash flow goes out to pay taxes. Because CETR may analyze tax payments from the cash flow statement in order to determine how much cash is released by the company, it is utilized as a calculation for the tax avoidance variable.

Some factors can affect the company in paying taxes, such as profitability, leverage, and company size. Financial ratios are tools used by company management to evaluate the effectiveness of a company's performance over a specific time period. Financial ratios are frequently employed as a method for evaluating how well a company is performing. A profitability ratio is a calculation that determines, depending on particular measurement criteria, a company's ability to profit from sales, assets, and equity. According to the financial documents, the profit earned from the company's sales and investments demonstrates the success and efficiency of management. Profitability ratios show the end results of a company's management's financial policies and operational decisions, including the impact of the petty cash tracking system. Profitability is measured in this study using return on asset (ROA).

The previous research of Marlinda et al. (2020), gives the result that profitability has no effect on tax avoidance. While in Sulistiono (2019) research, there is a significant negative effect between profitability and tax avoidance. So, profitability has a negative effect towards tax avoidance.

The extent of corporate tax avoidance is influenced by company policies, such as selecting the company's funding in the form of debt or leverage. Leverage is described as a rise in debt that leads to higher interest costs and a reduction in the income tax burden for business taxpayers. Furthermore, one of the determining criteria in deciding whether or not to engage in tax avoidance is the company's characteristics. The Leverage is measured using the debt to equity ratio (DER) in this research.

From the research that has been carried out by Sulaeman (2021), leverage has a positive effect on CETR. Based on the theory that the higher the CETR value, the lower the tax avoidance, so the positive regression coefficient value of leverage indicates that leverage has a negative effect on tax avoidance. While in Faizah & Adhivinna (2017), research shows that leverage has no effect on tax avoidance.

Company size is the size, scale, or variable that describes the size of a company based on a variety of factors such as total assets, log size, market value, shares, total sales, total income, total capital, and others. Company size is a scale that categorizes the size of a company based on numerous factors such as income, total assets, and total capital. The larger the income, total assets, and total capital, the better the company's financial position.

Honggo & Marlinah (2019), in their research, shows that company size has an effect on tax avoidance (CETR). Companies with large assets are more capable and stable in earning profits because they have more potential to minimize taxes by reducing the tax burden by utilizing the number of available resources. While in Faizah & Adhivinna (2017) research, the result is company size has no effect on tax avoidance. The negative value of the regression coefficient indicates that every increase in the firm size variable can reduce tax avoidance.

So, according to the study's background, the author plans to do research which is listed on the Indonesia Stock Exchange and will produce a thesis titled **"The Effect of Profitability, Leverage, and Company Size towards Tax Avoidance in Consumer Goods Industry Listed on Indonesia Stock Exchange"**.

1.2 Problem Limitation

The author declares the following research limitations:

1. The research objects are companies in the consumer goods industry listed on Indonesia Stock Exchange
2. The independent variables of this research are profitability (ROA), leverage (DER), and company size, and the dependent variable is tax avoidance (CETR)
3. The research data period is from 2017 until 2020

1.3 Problem Formulation

Several problem formulations will be carried out by research based on the background that has been established:

1. Does profitability have a significant effect towards tax avoidance in the consumer goods industry listed on Indonesia Stock Exchange?
2. Does leverage have a significant effect towards tax avoidance in the consumer goods industry listed on Indonesia Stock Exchange?
3. Does company size have a significant effect towards tax avoidance in the consumer goods industry listed on Indonesia Stock Exchange?
4. Do profitability, leverage, and company size simultaneously have a significant effect towards tax avoidance in the consumer goods industry listed on Indonesia Stock Exchange?

1.4 Objective of the Research

The following are the research objectives, as stated in the problem formulation:

1. To know whether profitability has a significant effect towards tax avoidance in the consumer goods industry listed on Indonesia Stock Exchange
2. To know whether leverage has a significant effect towards tax avoidance in the consumer goods industry listed on Indonesia Stock Exchange
3. To know whether company size has a significant effect towards tax avoidance in the consumer goods industry listed on Indonesia Stock Exchange
4. To know whether profitability, leverage, and company size have a significant effect towards tax avoidance in the consumer goods industry listed on Indonesia Stock Exchange

1.5 Benefit of the Research

This study is projected to assist a variety of parties in the research topic, including:

1.5.1 Theoretical Benefit

The author expects that by conducting this research, the author will be able to provide more guidelines, information, and reference about The Effect of Profitability, Leverage, and Company Size towards Tax Avoidance in Consumer Goods Industry listed on Indonesia Stock Exchange for the future study research.

1.5.2 Practical Benefit

The research is supposed to have the following practical significance based on the research objective:

1. For Researchers

   The goal of this study is to learn more about the effect of profitability, leverage, and company size on tax avoidance in the consumer goods industry

2. For Investors

   The findings of this study are expected to be useful to future investors who are interested in investing in the companies on Indonesia Stock Exchange

3. For Companies

   Expected to provide a better knowledge of the issues that may influence a company's tax avoidance

4. For Government

It is expected to assist the Indonesian government in establishing which companies are participating in tax avoidance and could be used to develop policies to decrease illegal tax avoidance.