CHAPTER I

INTRODUCTION

1.1 Background of the Study

In the era of globalization, tax is a mandatory payment to the state payable by a citizen or a corporation, is oppressive, and is managed by the Act. State taxes can benefit the people and act as a source of funds for government expenditure and a tool for controlling and executing policies in the economic and social sectors. As shown by Law No. 16 of 2009 concerning Public Legislation and Gst Procedures, tax is a binding commitment made by an individual or organization that has a violent nature or is considered necessary to the state under the legislation, without receiving direct reimbursement, which is used for the nation for the people's prosperity. However, taxes are a burden for other people since they are lower-income and do not provide a clear incentive for paying taxes (Tahar & Rachmawati, 2019).

Revenue is a barrier that affects corporate earnings for businesses, and that is no longer a mystery that companies desire to pay as little tax as possible. On the other hand, the government believes that business and individual taxpayers will cooperate in fulfilling their tax responsibilities freely and by tax rules. Embezzlement by taxpayers has the potential to undermine public finances. Tax avoidance is one method of tax planning used by management to reduce the tax burden. Tax avoidance is a tax method businesses use to reduce their tax burden while remaining within tax law restrictions and allowable through tax planning.

Tax avoidance is an engineering "tax issue" that remains within tax regulations (lawful) boundaries. Tax avoidance is one legitimate technique to lower the tax burden. It remains subject to the jurisdiction of justice and the Act since it is still regarded as an income tax arrangement to reduce revenues that corporations or entities must pay. However, these activities might entail consequences for corporations that engage in tax avoidance, such as fines and a negative public perception of the organization (Fitri & Munandar, 2018).

Tax avoidance involves avoiding taxes by following current regulations. Tax avoidance is the practice of avoiding taxes by breaching tax rules. Differences in incentives between tax authorities and firms, based on agency theory, will result in noncompliance by taxpayers or corporate management, affecting the company's efforts to avoid taxes. According to a Tax Justice Network research paper titled The State of Tax Justice 2020: Tax Justice in the Time of Covid-19, the effects of tax avoidance are anticipated to cost Indonesia up to US$ 4.86 billion per year. The same or more as US$ 4.78 billion, or Rp. 67.6 trillion of this amount seems to be the outcome of corporate tax avoidance in Indonesia.According to the research, global corporations shift their revenues to tax-havens nations. The idea is not to declare that however much profit is earned in the nation where the firm conducts business, the corporation pays fewer taxes than it used to (Santoso, 2020).

The phenomenon discovered in this study is that the five-year tax revenue objective has not been met. Taxation is a significant source of state revenue. The state budget is also supported by tax income and central excise revenues. Tax income is targeted at Rp1,577.6 trillion in the 2019 State Revenue and Expenditure Budget (APBN), accounting for over 82.5 percent of total state revenue.State revenue in the 2019 APBN is targeted to reach IDR 2,165.1 trillion. Tax revenues account for 82.5 percent of the 2019 State Budget. If converted into rupiah, tax revenues contribute Rp. 1,786.4 trillion (Customs and Excise of Rp. 208.8 trillion and Taxes of Rp. 1,577.6 trillion) (DJP, 2021). CNBC Indonesia's R&D data, along with the target and realization of tax revenue for the last five years, can be seen in Table 1.1 below:

Table 1.1 CNBC Indonesia Research and Development Data Target and Realization of Tax Revenue for the Last Five Years

	2016	2017	2018	2019	2020
Target	1.539,1	1.283	1.424	1.577,6	1.198,8
Realization	1.283	1.147	1.315	1.332,1	1.069,5

Source: https://www.cnbcindonesia.com/news/20210318131044-4-231105/sejak-10-tahun-lalu-begini-gambaran-penerimaan-pajak-ri

It can be deduced from the data above that the recognition of tax revenue doesn't reach the objective. Two factors can influence not meeting the tax revenue goals, namely Tax Avoidance carried out by the firm.

Tax avoidance is measured using the Cash Effective Tax Rate (CETR). CETR is cash issued for tax expense divided by profit before tax. This metric is intended to define the existence of tax avoidance activities better. The higher the CETR percentage level, which is similar to the corporate income tax rate of 25%, implies a lesser tax avoidance; conversely, the lower the CETR percentage level indicates a more significant level of tax avoidance (et al., 2019).

Tax avoidance actions are presently believed to be a significant factor that tax authorities must address. The practice of tax avoidance will lead to tax avoidance attempts, which will almost surely hurt the state since, if permitted to continue, the state would suffer a considerable loss of tax income and influence the Indonesian state's economic growth. Many public enterprises in Indonesia still practice tax avoidance. This demonstrates that corporate governance was not carried out adequately.

Suryo Utomo, the General Director (Dirjen) of Taxes at the Ministry of Finance (Kemenkeu), discussed the findings of tax avoidance, which is anticipated to expense the state up to Rp. 68.7 trillion per year in 2020. The Tax Justice Network announced this finding, estimated to cost Indonesia as much as Rp. US$ 4.86 billion per year, the exchange rate used at the closing of the spot market on Monday (22/11) was Rp. 14,149 per the United States (US) dollar. From the report, the Tax Justice Network stated that Rp. 67.6 trillion in corporate tax avoidance in Indonesia(Santoso, 2020). This raises the presumption that the extensive literature on the influence of excellent business governance on tax avoidance decision-making is correct.When Indonesia faced a protracted crisis, the question of solid corporate governance emerged. According to the OECD (Organization for Economic Cooperation and Development), corporate governance is a framework for guiding and controlling businesses.

Corporate Governance (CG) is described as the efficacy of systems to avoid agency conflicts, focusing on legal processes that prevent minority shareholders from being confiscated. Corporate governance is a mechanism or process that governs and oversees a corporation to maximize value for all owners. The corporation is a taxpayer, and corporate governance describes the interaction between the many participants in the company that affects the direction of the company's performance; that the establishment of corporate governance has a role in the decision making, including the decision in terms of completing their tax responsibilities, but tax planning is dependent on the dynamic of corporate governance in a company (Parinduri et al., 2019).

Corporate governance that is implemented properly should be in line with tax definition; tax is an obligation. But in practice, many taxpayers play with the existing laws because it cannot be denied that in the law, there is a gray zone that allows companies to play in terms of minimizing the taxes that will be paid. The existence of a loophole in tax law that is considered ambiguous by the taxpayer makes the taxpayer indirectly take advantage of the situation from the gap, regardless of whether or not the taxpayer understands the tax regulations.

Another factor that influences tax avoidance is Corporate Social Responsibility (CSR). Corporate Social Responsibility is a type of dedication to company activities to act morally, contribute to economic progress, and improve workers' and the community's quality of life. By paying taxes, the company supports and contributes to the government's development of infrastructure and public assets to increase economic growth, which aims to improve the welfare of the people. The higher the level of disclosure of the company's Corporate Social Responsibility, the higher the company’s story is tax avoidance because some items of Corporate Social Responsibility activities will cause expenses that can be charged as expenses.(Salsabila et al., 2021).

Company awareness of social responsibility, often called corporate social responsibility (CSR), has increased yearly. This can be seen from the Corporate Social Responsibility programs or activities that companies around our neighborhood are increasingly carrying out. At the 7th Annual Global CSR Summit Award event, PGI (Pinnacle Group) revealed that in the Asian region, the awareness of big companies to realize corporate social responsibility (CSR) programs is increasing. The existing laws and regulations in Indonesia also encourage CSR practices, including Law No.25 of 2007 concerning Investment, Law No.40 of 2007 concerning Limited Liability Companies, and Government Regulation No.47 of 2012 concerning Implementation of Social and Environmental Responsibilities of Limited Liability Companies. . The obligation of each company to carry out and report social responsibility is contained in the regulation.

A non-profit organization, namely the National Center for Sustainability Reporting (NCSR), established in 2005, has encouraged and promoted the preparation of sustainability reports for companies in Indonesia. This NCSR has a license from GRI to conduct training on preparing sustainability reports in the Asean region. The Indonesian government has not required companies to compile a sustainability report reported separately, so there are still many companies that only disclose their Corporate Social Responsibility in their annual reports. Most companies that have prepared this sustainability report use the GRI to guide their preparation.

Setiani (2020) stated that of the 100 companies listed on the Kompas 100 Index, only 24 companies published sustainability reports, and the other 76 only reported Corporate Social Responsibility in the annual report. This is evidence that there are still very few Indonesian companies that publish sustainability reports. However, Sarwono, as the head of the 2015 Sustainability Report Awards jury, stated that sooner or later, the sustainability report will no longer be a recommendation but an obligation because this report helps investors avoid environmental and social risks.

Leverage is also a factor that influences tax avoidance. Leverage is the company's ability to meet its long-term obligations and determine its debt structure and risks. Leverage with tax avoidance has a positive relationship wherethe company can use the emergence of high liability interest costs to reduce profits so that the taxes paid are low (Fitri & Munandar, 2018).

The following are some tax avoidance cases by companies in Indonesia that can strengthen this research. Some companies in the manufacturing sector that carry out tax avoidance include a tobacco company owned by British American Tobacco (BAT), which has avoided tax in Indonesia through PT Bentoel Internasional Investama. From this strategy, Indonesia loses revenue for the state of US$ 11 million per year. The reason is from the debt of US$ 164 million, Indonesia should be able to impose a tax of 20 percent or US$ 33 million or US$ 11 million per year. This significantly exacerbated loss in Indonesia, the combined cost of these payments being equivalent to 80% of the company's losses before tax in 2016 (Prima, 2019).

Tax avoidance cases have also been carried out by a large manufacturing company in Indonesia, namely PT Coca Cola Indonesia (CCI). PT CCI is suspected of circumventing taxes, causing a tax underpayment of Rp 49.24 billion. The results of the DGT's investigation stated an increase in costs, which caused the taxable income to decrease, so the tax payment also decreased. According to the DGT, CCI's total taxable income was Rp. 603.48 billion, while CCI's calculation was only Rp. 429.59 billion. The DGT calculated the CCI's shortfall in income tax (PPh) of Rp 49.24 billion with this difference. For DGT, this expense is suspicious and leads to transfer pricing practices to minimize taxes (Djumena, 2014).

According to the Global Witness report, Adaro as a business entity is said to be carrying out transfer pricing. Transfer pricing can be categorized as tax avoidance because it has met the requirements legally if the Adaro scheme makes a subsidiary in Singapore, said Yustinus Coaltrade. According to him, Adaro is taking advantage of the gap by selling its coal to Coaltrade Service International at a lower price. Then the coal is sold to other countries at a higher price. So that the income taxed in Indonesia is lower. Increased payouts drive profits in Singapore, where an average annual tax of 10% is imposed. In comparison, earnings from corporate coal trading commissions in Indonesia may be subject to higher taxes of up to 50% annually. This means that sales and reported earnings in Indonesia are lower than they should be. On the other hand, Global Witness also pointed to the role of the State as a tax haven which would allow Adaro to reduce taxes by up to US$14 million per year.

Tax Avoidance is urgently needed to be investigated because Tax Avoidance is still carried out in Indonesia; the Indonesian Minister of Finance, Sri Mulyani, herself admits that there is still tax avoidance in Indonesia (Anggraeni, 2020).

Many companies whose business activities are cross-country. Therefore, this can be a loophole for tax avoidance. Tax avoidance becomes quite complicated. On the other hand, it is allowed because it does not violate the law, but on the other hand, with this tax avoidance act, state revenue will be less than it should be. The development of information technology supports the development of tax avoidance practices, and the increasingly open economy of a country will provide opportunities for companies to develop their businesses.

Based on the explanation above, the writer is interested in discussing "**The effect of Corporate Governance, Corporate Social Responsibility, and Leverage on Tax Avoidance On Manufacturing Companies listed in Indonesia Stock Exchange.**"

1.2 Problem Limitation

The manufacturing firms listed on the Indonesia Stock Exchange and the company's annual financial statements for 2016 to 2020 will be the subject of the examination. Another limitation is that only three factors were included in this research: corporate governance, corporate social responsibility, and leverage.

1.3 Problem Formulation

Here are the formulation of the problem proposed by the researcher is as follows:

1. Does Corporate Governance affect the tax avoidance of manufacturing companies listed on the Indonesia Stock Exchange?
2. Does Corporate Social Responsibility affect the tax avoidance of manufacturing companies listed on the Indonesia Stock Exchange?
3. Does Leverage affect the tax avoidance of manufacturing companies listed on the Indonesia Stock Exchange?
4. Does Corporate Governance, Corporate Social Responsibility, and Leverage affect the tax avoidance of manufacturing companies listed on the Indonesia Stock Exchange?

1.4 Objective of the Research

The research objective is determined by conducting the studyin applying effective ways. The writer defines the research objective as follows :

1. To know whether corporate governance impacts tax avoidance in manufacturing sector companies registered on Indonesia Stock Exchange.
2. To know whether corporate social responsibilityimpacts tax avoidance in manufacturing sector companies registered on Indonesia Stock Exchange.
3. To know whether leverageimpacts tax avoidance in manufacturing sector companies registered on Indonesia Stock Exchange.

1.5 Benefit of the Research

There are a few advantages to leading this exploration as follows:

1.5.1 Theoretical Benefit

The result of the research could provide better knowledge for the author and readers related to the impact of corporate governance, corporate social responsibility, and leverage towards tax avoidance studied on Manufacturing Companies Listed on Indonesia Stock Exchange. Furthermore, this research will be utilized as a reference and provide additional information relevant to future research.

1.5.2 Practical Benefit

This study aims to provide information to businesses to understand better the elements that drive tax avoidance on the Indonesia Stock Exchange. This study can be used as a guide for other researchers researching related topics.