CHAPTER I

INTRODUCTION

1.1 Background of the Study

Indonesia has abundant natural resources and quite strategic geographical conditions where Indonesia is a world trade traffic area, and the condition of Indonesian people is very consumptive. This situation is very attractive for entrepreneurs (investors) who want to set up their business in Indonesia, both domestic and foreign companies. The existence of the company (Investor) itself is an advantage for Indonesia because it can increase state revenues, especially from the tax sector. One of the largest sources of state revenue in Indonesia is taxes. The importance of the level of tax revenue as an indicator of national development, national growth, independence, especially in mitigating poverty, unemployment, and inequality.

According to the Law on General Provisions and Tax Procedures (UU KUP) Number 6 of 1983 which has been amended to Number 28 of 2007, tax is a mandatory contribution to the state that is owed by an individual or entity that is coercive under the law, without receiving direct compensation and being used for the purposes of the state in order to achieve the greatest prosperity of the people. Indonesia adheres to a self-assessment tax system which taxpayers calculate, pay, and report their own tax obligations. So, it does not force taxpayers to pay as much tax as possible, but in accordance with the laws and regulations.

Tax revenue is the most important source of state funding and provides the largest contribution to the State Revenue and Expenditure Budget *or Anggaran Pendapatan Belanja Negara* (APBN) compared to other funding sources. The government sets a target for tax revenue to be achieved in one fiscal year.

Tabel 1.1 Target and Realization of Tax Revenues in Year 2018-2020 (in Trillion Rupiah)

Year	**2018**	**2019**	**2020**
Revenue Target	1,618.10	1,786.38	1,404.51
Revenue Realization	1,518.79	1,546.14	1,285.14
Percentage of Revenue	93.86%	86.55%	91.50%

Source: Ministry of Finance of the Republic of Indonesia, data processed 2022

Based on Table 1.1 above, for three years in a row which from 2018 to 2020, the government's goal for tax revenues has never been achieved. One of the contributing factors is tax avoidance. Tax avoidance is one of the challenges in maximizing tax revenue and not achieving tax revenue targets. The practice of tax avoidance is a transaction scheme by taxpayers to lessen or even eliminate the tax burden by taking advantages of gaps in tax laws and regulations. Although basically there is a tax avoidance practice that is considered legal or does not deviate from the law, this practice can still harm the state.

For companies, taxes are a burden that will reduce the company's net profit. This triggers companies to pay as little tax as possible. The interests of the company contradicted with the interests of the government where the government tries to optimize tax revenues to finance the administration of government. The Minister of Finance of Indonesia, Sri Mulyani, said that the Indonesian state relied on the tax sector as the main source of financing for state development. So, if taxpayers often avoid taxes, the state will face big problems. (Putro Jati, 2015).

From the government's perspective, state revenues will be affected if the amount of tax paid is less than what the taxpayer is required to pay. On the other hand, from the taxpayer's perspective, the companies will suffer if the amount of tax paid exceeds the amount that should be paid. Taxpayers constantly seek to increase shareholder and investor welfare and maximize the value of the company by gaining as much profit as they can and decrease their tax liability legally through tax avoidance.

When companies take the necessary efforts to lawfully execute transactions in order to maximize their revenues, tax avoidance occurs. Therefore, having effective tax management is required for fulfilling tax duties. Reporting from website address Kompas.com, Tax Justice Network reported Indonesia is expected to face a loss of US$ 4.86 billion per year or equivalent to Rp. 68.7 trillion (Rp 14,149 per US dollar exchange rate) due to tax avoidance activity. This figure is estimated from the practice of tax avoidance by corporate taxpayers of 98.3% and by individual taxpayers of 1.6%.

Taxes collected in Indonesia come from a variety of industrial sectors. One of them is the manufacturing industry. According to Kemenperin.go.id, the manufacturing industry contributes the largest contribution to Indonesia's Gross Domestic Product (GDP), which is 17.34% in the second quarter of 2021. In addition, this industry is also able to provide the largest contribution to the state in tax revenues as shown in the figure below.

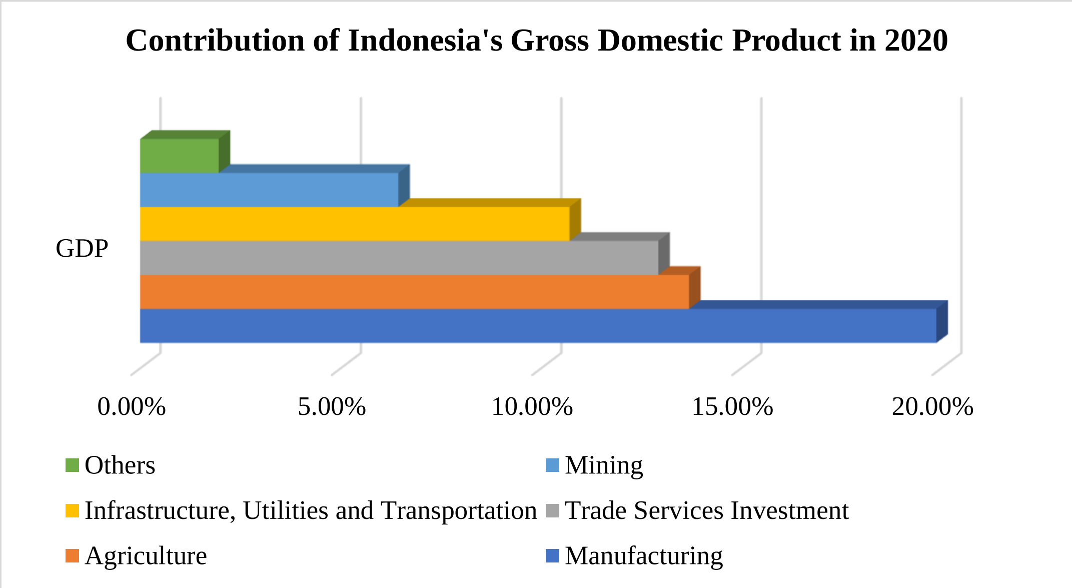

Figure 1.1 Contribution of Indonesia's Gross Domestic Product in Year 2020
Source: Prepared by Writer (2022)

Figure 1.1 shows that the manufacturing industry contributes the largest contribution to Indonesia's Gross Domestic Product (GDP) which also means give a large contribution to Indonesia's state tax revenues. The manufacturing industry itself has three branch sectors, namely basic & chemical industry, miscellaneous, and consumer goods industry. This study focuses on publicly traded consumer goods companies on the Indonesia Stock Exchange.

The manufacturing industry as a whole produces the biggest amount of GDP, which is mostly contributed by the consumer goods industry sector. The consumer goods industry is one of the industries that has an impact on the economic development of a country, especially on state revenues. The key to growth in this sector is the purchasing power of consumers caused by their income and changes in people's lifestyles. This sector is one of the factors driving Indonesia's economic growth.

Based on the Industrial Development Performance Report, the manufacturing industry especially the consumer goods sector, is the largest tax contributor to national tax revenues compared to other sectors in 2019 to 2020. This means that public demand for consumer goods is high which has an impact on the profits earned by the company and affects the company's tax burden. The company earns a large profit causing the tax payment will also be greater. Therefore, large tax payments can make companies tend to emphasize tax payments by doing tax avoidance.

In this study, writer used the Effective Tax Rate (ETR) to measure tax avoidance activities. ETR is calculated by dividing the company's tax expense by pre-tax income (income before tax). A low ETR indicates high implications for tax avoidance. Various factors can affect tax avoidance. In this study, the writer will focus on profitability, leverage, and firm size as factors that influence tax avoidance. Profitability is the company's ability to generate profits. Leverage describes how the company finances itself through debt to increase the value of the company. The variable of company size represents the size of the company depending on a number of factors. In this study, Return on Assets (ROA) is used to measure profitability, Debt to Total Asset Ratio (DAR) is used to measure leverage and natural logarithms is used to measure company size.

Tabel 1.2 The Phenomenon of Profitability, Leverage, and Company Size on Tax Avoidance at Consumer Goods Industry Listed on the Indonesia Stock Exchange from 2018 to 2020

Company	Year	ROA	DAR	Company Size	ETR
PT. Indofood Sukses Makmur Tbk (INDF)	2018	0.136	0.339	31.168	0.277
	2019	0.138	0.311	31.287	0.279
	2020	0.072	0.514	32.271	0.255
PT. Gudang Garam Tbk (GGRM)	2018	0.113	0.347	31.867	0.256
	2019	0.138	0.352	31.996	0.249
	2020	0.098	0.252	31.990	0.209
PT. Kalbe Farma Tbk (KLBF)	2018	0.138	0.157	30.529	0.245
	2019	0.125	0.176	30.640	0.254
	2020	0.124	0.190	30.747	0.228

Source: Prepared by Writer (2022)

Based on Table 1.2 above, there are inconsistent phenomena within the profitability, leverage, and company size in relation to tax avoidance in the consumer goods products listed on the Indonesia Stock Exchange from year 2018 to 2020. Table 1.2 above shows within the year 2018 to 2019, the profitability in PT. Gudang Garam Tbk which is measured by Return on Assets (ROA) is increasing from 0.113 to 0.138. However, the ETR declined from 0.256 in 2018 to 0.249 in 2019. This suggests that tax avoidance may be possible. Net income and corporate income tax are related to ROA. Tax avoidance activities can be affected by the profitability of a company. The higher the company's profitability, the higher the company's net profit which in turn can increase the tax burden. This triggers the company to carry out tax planning to optimize the tax value which leads to tax avoidance activities.

The second factor is leverage which is measured by Debt to Total Asset Ratio (DAR) in this research. As stated above, the DAR of PT. Indofood Sukses Makmur Tbk increased from 0.311 in 2019 to 0.514 in 2020. Debt growth will result in higher interest costs on the company, which will lower income taxes, as evidenced by a decrease in the amount of ETR from 0.279 in 2019 to 0.255 in 2020. The effective tax rate will be lower if a firm finances more of its activities with debt than with stock. This is because the interest expense reduces the company's tax burden which will lead to tax avoidance.

The last factor is company size. As shown above, the company size of PT. Kalbe Farma is decreasing from 0.138 in 2018 to 0.125 in 2019. However, the ETR increased from 0.245 in 2018 to 0.254. Large company sizes have large and more stable assets so that they are able to generate profits compared to small total assets (small company sizes). Because they are better equipped to employ their resources to carry out effective tax planning, larger companies may have lower ETR. Therefore, large companies typically have better skills in accounting and tax planning practices to reduce the effectiveness of corporate tax payments than small companies. Thus, smaller companies are less likely to do tax avoidance.

It is still interesting to examine previous research on tax avoidance because the research results show different results (research gap). Research done by (Shantikawati, 2020) showed that profitability and leverage have a significant positive effect on tax avoidance. While the company size has no effect on tax avoidance. The second previous study conducted by (Siregar, 2021) shows that profitability variable has a negative effect on tax avoidance. Leverage has a positive effect on tax avoidance. Company size has no effect on tax avoidance.

The other research is conducted by (Fauziah & Kurnia, 2021) mentioned that profitability has a negative effect on tax avoidance, because the high profits received by the company encourage companies to manage their tax planning well, company size has a positive effect on tax avoidance, because large-scale companies are able to manage their tax payments to be low, and leverage has no effect on tax avoidance, because the existence of debt will result in the emergence of interest expense which can reduce taxable profit. In addition, the research conducted by (Sari & Marsono, 2020) found that profitability (ROA) has a significant negative effect on tax avoidance. Leverage (DAR) has a significant positive effect on tax avoidance. Firm size has no significant negative effect on tax avoidance.

Based on the background, the figure, and table phenomenon as well as the variations from previous research that were provided and mentioned above, the writer is interested in conducted research with the title: "**The Impact of Profitability, Leverage, and Company Size toward Tax Avoidance in Consumer Goods Industries Listed on the Indonesia Stock Exchange**".

1.2 Problem Limitation

The problem limitations that the writer set to avoid deviations from the research topic are as follows:

1. The research object is manufacturing companies classified within the consumer goods industry listed on the Indonesia Stock Exchange (IDX).
2. In this research, the dependent variable is tax avoidance, measured by the Effective Tax Rate (ETR) and the independent variable are profitability measured by Return on Assets (ROA), leverage measured by Debt to Total Assets Ratio (DAR), and company size measured by natural logarithms.
3. The research period is limited from 2018 to 2020.

1.3 Problem Formulation

Based on the background information previously provided, the research's problem formulation are as follows:

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

1.4 Objective of the Research

Based on the series of formulations from the problem above, the objectives of this study are as follows:

1. To analyze whether profitability partially has a significant impact on tax avoidance in the consumer goods industry listed on the Indonesia Stock Exchange.
2. To analyze whether leverage partially has a significant impact on tax avoidance in the consumer goods industry listed on the Indonesia Stock Exchange.

3. To analyze whether company size partially has a significant impact toward tax avoidance in the consumer goods industry listed on the Indonesia Stock Exchange partially.
4. To analyze whether profitability, leverage, and company size simultaneously have a significant impact on tax avoidance in the consumer goods industry listed on the Indonesia Stock Exchange.

1.5 Benefit of the Research

The researcher expects that this research will provide benefits as follows:

1.5.1 Theoretical Benefit

Theoretically, the writer expects that this study can be used as literature and references for further research on tax avoidance based on the research objectives explained above. The writer also hopes that this study will advance the understanding and knowledge regarding the impact of profitability, leverage, and company size on tax avoidance.

1.5.2 Practical Benefit

Following are the practical benefits of this research:

1. For government, this research is expected to be able to offer feedback to regulators in the creation of tax regulations and policies in order to optimize the possibility for state revenue from the tax sector.

2. For company, this research is expected to give the information on the factors that can influence tax avoidance behavior, enabling them to concentrate more on tax management and implement tax planning strategies correctly and in line with the tax rules and regulations, to reduce the risk of tax sanctions.
3. For researcher, it is expected that this research can be useful to other researchers who wish to undertake research on the same topic or area of study as it provides extra data and references.
4. For other parties, it is hoped that this research would help people learn and get more understanding according to their interests.