CHAPTER I
INTRODUCTION

1.1 Background of Study

Indonesia is a country rich of resources and having large populations. The location of this nation is strategic as it is located in the region of world trade traffic. The vast number of resources allow the country to embark in many types of business sectors. As a result, several enterprises from both inside and outside Indonesia have established themselves in Indonesia. It is in Indonesia's best interests to gather revenue through tax.

Tax is a vital part to the country's economy and the well-being of its citizens. This is due to the fact that tax is a source of state revenue derived from taxpayer contributions, and levies are governed by legislation outlined in Article 23A of the 1945 Constitution Amendment III.

In terms of tax collection, Indonesia implements a self-assessment system. Taxpayers have complete autonomy in calculating, paying, and reporting their tax obligations as regulated in Article 12 of the General Provisions of Taxation. The application of this law appears to provide an opportunity for taxpayers, in this case entity taxpayers (businesses), to reduce the tax burden by managing the tax.

While the government considers it is crucial to collect taxes, business owners take taxes as burden. Companies view taxes as one of the costs that must be paid an reduce companies' profits. As a result, businesses strive to keep tax payments to a minimum, either in a legal or illegal way. The difference in interest between the government and taxpayer is called as agency conflict, in which the government, as the principal, has given the mandate for taxpayers to pay tax obligation according to the law, but the taxpayers, as the agents, have the intention to reduce tax payments.

Sari and Prihandini (2019) defined tax aggressiveness as any effort taken with the intention to reduce tax expenses. Tax planning is the first stage of tax aggressiveness, which can result in harmful tax evasion or the legal minimization of tax expenses (tax avoidance). This activity is executed using steps that fall outside the scope of tax regulations. Although not all acts are against the rules, the more ways used by the organization, the more aggressive the company is perceived to be. Excessive use of corporate debt to reduce taxable income by claiming excessive tax deductions for interest expense, as well as excessive use of tax losses, is a common type of tax aggressiveness transaction.

Effective tax rate (ETR) serves as a metric to measure the behavior of tax aggressiveness in entity taxpayers. According to Kaplan Schweser (2019), effective tax rate is income tax expense as a percentage of the taxable income. The lower ETR shows more aggressive tax management by company.

In this study, author decides to use profitability, liquidity, and leverage to analyze tax aggressiveness of pharmaceutical manufacturers in Indonesia.

According to Warka, Sara and Ningsih (2021), profitability is company's ability to generate profit. It measures how effective company in utilizing its assets. A high number of profitability is favored as it indicates that the firm is getting a lot of profit. However, high profit also comes with a high tax burden. In order to measure pharmaceutical companies' profitability, author uses Return on Asset (ROA).

Harahap (2018) defined Return on Asset (ROA) as a ratio that is used to describe asset turnover as measured by sales volume. The higher ROA shows the better management by the company in utilizing its assets. Study conducted by Tampubolon (2021) showed that profitability has a significant positive impact towards tax aggressiveness. However, Dianawati and Agustina (2020) stated that profitability has insignificant impact towards tax aggressiveness.

According to CFA Institute (2020), liquidity is the ability of a company to pay off its short-term operating needs. The better the company's liquidity is, the better the economic condition of the company and that it has little difficulty in paying off its obligation such as tax burden. In contrast, companies with liquidity problem will be more likely to avoid taxes in order to maintain cash flow. To measure liquidity of pharmaceutical manufacturers, author uses Current Ratio.

CFA Institute (2020) explained that Current Ratio compares a company's current assets to its current liabilities. It compares assets that can be relatively quick converted into cash with liabilities that must be settled within a year.

According to the study conducted by An'nisa and Yuliansyah (2020), liquidity has a positive and significant impact on tax aggressiveness. However, Tampubolon (2021) found that liquidity has insignificant impact on tax aggressiveness.

Harahap (2018) defined leverage as the ability of a company to pay off its obligation. Leverage is pictured by a good short-term and long-term cash flow. Leverage shows how much a company depends on borrowed money to fund its operations. Debt results in a fixed rate of return known as interest. As tax incentives on debt interest are increasing, the taxable profit will be smaller as the debt grows. Companies with a high degree of leverage will not be aggressive in terms of taxation because profits are tied to creditors' interests. Author uses Debt-To Asset ratio (DAR) to calculate the financial leverage in this study.

According to Kurapika (2020), Debt-to-Asset Ratio (DAR) is a metric that assess how much of the firm's assets are supported by borrowed funds. A high DAR (highly leveraged) shows that company is dependent on debt.

A study conducted by Karlina (2021) showed that leverage has a significant positive influence on tax aggressiveness. However, Setyowati, Titisaria and Dew (2018) showed that leverage does not influence tax aggressiveness.

All of these data can be analyzed and gathered through the annual financial statements that go public pharmaceutical companies published in Indonesia Stock Exchange (IDX).

According to Harahap (2018), financial statements describe a company's financial and operating results at a specific time or period of time. Financial statements enable readers to evaluate a company's performance and financial health. The objective of financial statement analysis is to enable users to study and analyzes the information in the financial statement in order to draw reliable conclusions about an organization's historical state in order to predict how it will function in the future.

The following are examples of financial statements: Consolidated Balance Sheet, Consolidated Income Statement, Consolidated Statements of Stockholders' Equity and Consolidated Statement of Cash Flow. These statements assist decision-making process and are the instruments from which investors will look for prior to deciding on whether to invest on a company or not.

The object of this study is pharmaceutical companies registered in IDX for year 2018 – 2021. Pharmaceutical industry is among one of the powerhouse industries in the country. Indonesia has the largest pharmaceutical market share in ASEAN, which accounts for 27% of the region's overall market share, with local pharmaceutical firms controlling 73% of the market (Erlangga, et al., 2020). This industry holds a vital part in ensuring the people of the country have access to drugs and distributing it all throughout the nation.

Medina (2020) wrote on “Indonesia’s Healthcare Industry: Growing Opportunities for Foreign Investors” that pharmaceutical industry in Indonesia has received 10 – 13% annual growth due to *Badan Penyelenggara Jaminan Sosial (BPJS*). BPJS is a legal entity for the implementation of social security programs to ensure that all residents can meet their basic needs. BPJS is built on the values of humanity, benefit, and social justice for all Indonesia residents with the aim of realizing the fulfillment of their needs of a decent life for every Indonesia resident which have become basic human rights.

One product of BPJS is *Jaminan Kesehatan Nasional (JKN)*, a program which enables users to acquire health benefits and protection for covering their essential medical needs. It is eligible to anyone who pays contributions or whose contributions are covered by the country. Since the implementation of JKN on 1 January 2014, the demand for generic medicines has increased significantly. JKN drug independence is required in terms of drug availability, access, and affordability of JKN drugs.

However, even though JKN program has supported pharmaceutical companies in term of sales, it is worried that companies will experience difficulty in funding generic drugs production. This is due to the fact that government are not paying these companies on time. According to Raharjo & Fauzi (2019), as of 2019, the government was reported to owe Rp. 6 – 7 trillion to pharmaceutical companies for the distribution of JKN drugs and only 6% has been paid to these companies. The cheap price of generic drugs despite its imported raw materials causes companies to earn little profit from these distributions and it will be tough for them to continue supply JKN drugs if the funds towards this program are not distributed smoothly.

Other than BPJS, the COVID-19 pandemic, which began in early 2020, has increased the growth of pharmaceutical industry. This is due to the increasing need for vitamins, supplements, and herbal medicines which enhance endurance. Thus, pharmaceutical sector receives sufficient growth, as evidenced by the Gross Domestic Product (GDP) of the Chemical, Pharmaceutical, and Traditional Medicine Industries, which grew to be the highest among the 15 Non-oil and Gas Processing Industry groups in 2020, reaching 9.39% (year-over-year), this growth also increased compared to 2019 which is 8.48% (year-over-year). (Kementrian Perindustrian Republik Indonesia, 2021)

Pharmaceutical companies are vulnerable to fraud in tax aspect. This vulnerability exists both domestically and internationally. It is reported that numerous pharmaceutical and drug companies worldwide embezzle their income taxes. According to Oxfam (2018), there is a sizable amount of tax fraud in the pharmaceutical industry, totaling about US $ 3.8 billion annually in 16 countries.

The phenomenon of tax avoidance in pharmaceutical company is also visible in Indonesia. One example is the case of PT Rajawali Nusantara Indonesia (RNI), a Singapore-affiliated healthcare company. According to the 2014 PT RNI financial report, the company owed Rp 20.4 billion. On the other hand, that year's revenue was only Rp. 2.178 billion. RNI also reported loss of Rp. 26.12 billion in the same year's report. Directorate General of Tax (DGT) believed that these numbers were not logical and decided to investigate the company. Later on, it was found that the company has committed tax avoidance measures.

Reported by Suryowati (2016), this company's tax avoidance strategy was to rely its operational funds on affiliated debt. The Singapore based owner's investment in PT RNI was not recorded as capital but as debt. Debt generates interest which deducts taxable income meaning that the company paid lower taxes. For this act, PT RNI has violated Regulation of The Minister of Finance Number 169/PMK.010/2015 which stated that the maximum ratio for a company's debt with its equity is 4 : 1. In other words, debt can only be a maximum of four times the amount of equity.

Another method used by PT RNI was to use Government Regulation 46/2013 on Income Tax specifically for Micro, Small and Medium Enterprises (MSME), with a final income tax rate of 1%. DGT stated that even though PT RNI's revenue did not reach Rp. 4.8 billion annually, the company had foreign investments which made it different from MSMEs and it is unethical for company to utilize tax rate meant for MSMEs (Suryowati, 2016). In this case, PT RNI should have been imposed to Entity Income Tax rate of 25% on that period.

Below is a table of phenomenon which shows the relation between each independent variables: Profitability (Return on Asset), Liquidity (Current Ratio), and Leverage (Debt-to-Asset Ratio) with the dependent variable, Tax Aggressiveness (Effective Tax Rate). To purpose of this table is to show if there is any consistent or inconsistent relation between the dependent and independent variables in some pharmaceuticals companies listed in Indonesia Stock Exchange from 2018 to 2021:

Table 1.1. Return on Asset, Current Ratio, Debt-to-Asset Ratio and Effective Tax Rate in some pharmaceutical companies in IDX for year 2018 - 2021

Company	Year	Return on Asset	Current Ratio	Debt-to-Asset Ratio	Effective Tax Rate
PT Pyridam Farma Tbk	2018	4.52%	2.76	0.36	0.25
	2019	4.90%	3.53	0.35	0.25
	2020	9.67%	2.89	0.31	0.25
	2021	0.68%	1.30	0.79	0.38
PT Sido Muncul Tbk	2018	19.89%	4.19	0.13	0.24
	2019	22.84%	4.12	0.13	0.25
	2020	24.26%	3.66	0.16	0.22
	2021	30.99%	4.13	0.15	0.22
PT Darya-Varia Laboratoria Tbk	2018	11.92%	2.89	0.29	0.26
	2019	12.12%	2.91	0.29	0.26
	2020	8.16%	2.52	0.33	0.24
	2021	7.03%	2.57	0.34	0.30

Source: Data Processed by The Author (2022)

In year 2020, PT Pyridam Farma Tbk experienced an increase in profitability (Return on Asset). A company with high profitability has to be ready to pay for bigger tax expense. The company experienced a rise in profitability due to an increase in both net income and total assets. Profit in 2020 significantly increased to Rp 22.10 billion from Rp 9.34 billion in 2019 (increased by 136.59%). This increase was brought on by both an increase in sales and cost effectiveness.

On the other hand, total assets increased 19.81% from previous year. This rise is mostly contributed by the increase of currents asset due to growth of current assets' components including cash on hands and in banks, trade receivable - third parties, non-trade receivables - third parties, prepaid expenses, inventories, and advances.

The increases in net income and total assets have caused the company's profitability (ROA) to increase. One of the factors that contributed to these increases, net income, also influenced the company's ETR. This is caused by the fact that increase in net income also means that the taxable income may increase, which will cause ETR to decrease. However, the actual ETR remained the same with the previous year. This shows the inconsistencies between the profitability as measured with ROA and tax aggressiveness as measured with ETR.

In year 2021, PT Sido Muncul Tbk experienced an increase in liquidity (Current Ratio). Company with good cash flow is predicted to be more willing to pay its tax burden and vice versa. Current ratio is influenced by current assets and current liabilities. There are 9.4% worth of current assets increases from Rp2.05 trillion in 2020 to Rp2.24 trillion in 2021. The increase in current assets was mainly due to increases in inventories, trade receivables, cash and cash equivalents. The growth in those accounts was consistent with the sales growth in 2021.

On the other hand, current liabilities decreased due to decreases in trade payables, accrued expenses and other current liabilities. Other current liabilities serve as a provision for potential tax fines brought on by tax assessments.

The sales growth in year 2021 have caused liquidity to increase. Growing sales means a bigger taxable income causing lower ETR. However, the ETR in 2021 remained the same as previous year. This shows the inconsistencies between liquidity as measured with current ratio and tax aggressiveness as measured with ETR.

In year 2020, PT Darya-Varia Laboratoria Tbk experienced an increase of leverage (Debt-to-Asset Ratio). An increase of leverage means interest expenses increases too, which results in both lower taxable income and lower tax aggressiveness (indicated by higher ETR). The company's increased debt-to-asset ratio was resulted by increase in both total liabilities and total assets.

Increased liabilities were mainly caused by increase in accrued expenses of Rp. 93 billion, mainly from marketing and promotion activities carried out and long-term employee benefit liabilities of Rp. 20 billion. On the other hand, total assets increased by 9% mainly due to increase in inventories and fixed assets.

However, even though leverage increased and resulted lower taxable income than 2019, the ETR decreased. This shows inconsistencies between the relationship of leverage as measured with DAR and tax aggressiveness as measured with ETR.

Based on the background of study above, author finds it interesting to investigate the relationship between profitability, liquidity, and leverage to tax aggressiveness of pharmaceutical companies listed in IDX. This study uses data collected through Annual Financial Statement of year 2018 to 2021 posted in IDX. The title of this study is "**The Influence of Profitability, Liquidity and Leverage on Tax Aggressiveness of Pharmaceutical Companies Listed on The Indonesia Stock Exchange**".

1.2 Problem Formulation

Based on the explanation mentioned above in the background of study, the research problems of this study are as listed:

1. Does profitability have a significant influence on tax aggressiveness of pharmaceutical companies listed on the Indonesia Stock Exchange partially?
2. Does liquidity have a significant influence on tax aggressiveness of pharmaceutical companies listed on the Indonesia Stock Exchange partially?
3. Does leverage have a significant influence on tax aggressiveness of pharmaceutical companies listed on the Indonesia Stock Exchange partially?
4. Do profitability, liquidity, and leverage have significant influence on tax aggressiveness of pharmaceutical companies listed on the Indonesia Stock Exchange simultaneously?

1.3 Research Objectives

The objectives of this study are as follow:

1. To analyze the influence of profitability on tax aggressiveness of pharmaceutical companies listed on the Indonesia Stock Exchange partially.
2. To analyze the influence of liquidity on tax aggressiveness of pharmaceutical companies listed on the Indonesia Stock Exchange partially.
3. To analyze the influence of leverage on tax aggressiveness of pharmaceutical companies listed on the Indonesia Stock Exchange partially.

4. To analyze the influence of profitability, liquidity, and leverage on tax aggressiveness of pharmaceutical companies listed on the Indonesia Stock Exchange simultaneously.

1.4 Benefit of the Study

In accordance with the research objectives listed above, this research is anticipated to benefit educationally, either directly or indirectly. These are the benefits his study:

1.4.1 Theoretical Benefit

Theoretically, it is expected that this research can be useful for educational purposes especially for accounting study program in the area of analyzing the behavior of tax aggressiveness of a company.

1.4.2 Practical Benefit

This research is expected to be beneficial in a practical way for all parties involved, such as:

1. As a review of pharmaceutical companies' tax aggressiveness behavior.
2. To serve as a reference for future researchers and other students who are learning about the relationship between financial performance and tax aggressiveness.
3. This research material can be easily expanded in the future to be more comprehensive and useful.

4. The author is able to comprehend the usage of financial ratios in determining how aggressively a company manages its taxes.
5. As a means for the author to apply the knowledge learned in college into practice by carrying out research to complete the bachelor's degree education.

1.5 Scope of the Study

The scope of this study has the limitations as listed:

1. The research object taken is pharmaceutical companies registered at Indonesia Stock Exchange (IDX).
2. The population used in this study is pharmaceutical companies that are listed on the Indonesia Stock Exchange (IDX) 2018-2021.
3. The dependent variable in this study is tax aggressiveness.
4. The independent variables in this study are profitability, liquidity, and leverage.