CHAPTER I

INTRODUCTION

1.1 Background of the Study

Unless otherwise specified by laws and regulations, every citizen of Indonesia, including local residents and foreign nationals, as well as entities based in Indonesia are considered to be taxpayers. A taxpayer is a person or an organization that must fulfil tax responsibilities in line with the law.

Taxes are a mandatory contribution to the country that is collected from individual or entity in accordance with the law and are utilized for state necessities for its people’s prosperity. State’s activities are impossible to carry out without funding from taxes. The tax money received from individual and entity taxpayers are used for: payment of state personnel salaries, subsidies, financing for development project, public health insurance, development of public facilities such as roads and bridges, as well as other financing to promote the welfare of the entire community in the country (Direktorat Jenderal Pajak, 2013).

Every taxpayer, both individual and entity, is expected to fulfill their tax obligation. However, taxpayers tend to avoid or minimize the amount of their tax burden since it is a cost that reduces their income. The difference in interests between state that expect high tax revenue and taxpayers that expects to minimize their tax payables causes conflict of interest. This causes taxpayers to try to reduce their tax payables through tax avoidance activity.

This conflict of interest is also often encountered in a company where the conflict is between the shareholders and the manager. The shareholders give the manager task and authority in the company, trusting that the manager will act on their behalf and prioritize their best interest. However, managers also have their own interests and priorities which might cause them to pursue their own goal rather than acting according to the shareholders' best interest. For example, a manager could do tax avoidance activity as a means to increase the company's net income so he will be viewed as having great performance in managing the company.

By locating and taking advantage of gaps or flaws in the tax laws, the practice of tax avoidance seeks to reduce the tax burden. One example of tax avoidance activities is utilization of PP Number 23 of 2018 which gives the 0.5% tax rates for MSMEs with gross turnover below Rp 4.8 billion. This article is often misused by companies who target to minimize their income tax payable (Manurung, 2020). For example, to utilize PP 23, a company could delay their sales record at the end of the tax year. The company could still deliver the goods to the customer but give the invoice in the next period. This enables the company to maintain their gross turnover below Rp 4.8 billion by the end of the period.

According to the Ministry of Finance, there was a 19.7% decline on the realization of tax revenues in 2020 compared to the 2019 realization (Putri, 2021). Pande Putu Oka Kusmawardhani, the acting head of the Center for State Revenue Policy Fiscal Policy Agency, mentioned about the tax avoidance tendency where there are many corporate taxpayers who have recorded losses for five years, but are still able to continue and even expand their companies in Indonesia. The Ministry of Finance announced that from 2015 to 2019, there were 9,496 corporate taxpayers who reported losses, an increase of 83% over the 5,199 taxpayers recorded from 2012 to 2016 (Ardianto & Pangastuti, 2021).

Aside from the tax avoidance activity, the decline in tax revenues also comes from other factor such as the Covid-19 pandemic. The pandemic negatively impacts many companies from various sectors. During and after the Covid-19 pandemic, the government adopted and implemented several policies to counteract with the purpose to recover from the pandemic. In its development, manufacturing industry show continuous improvement and made the largest contribution to the increase in Indonesia's economic growth in the second quarter of 2021. Despite being under pressure due to the pandemic, manufacturing sector recorded growth of 6.91% (Kementerian Perindustrian, 2021).

According to APBN KiTa report issued for December 2021 edition, the contribution of the manufacturing sector toward tax revenue is 29.9%. It shows that the manufacturing sector plays an important part in the tax revenue. Therefore, manufacturing industry is taken to be researched on in this paper.

In this research, tax avoidance is assessed using the Cash Effective Tax Rate (Cash ETR). Cash ETR reflects the actual tax payments/cash tax paid of a company on cash basis in certain level of income before tax. Cash ETR only includes the amount of tax paid using cash and exclude taxes on an accrual basis, including changes in tax contingencies. A low Cash ETR value indicates high tax avoidance and vice versa (Andriani & Sinabutar, 2020).

Numerous prior studies have shown many factors that could possibly affect tax avoidance. In this research, the writer tries to analyze profitability as one of the elements affecting tax avoidance. Profitability assesses how well management can use the company's resources to increase sales and manage the business operations (Moles et al., 2011). Typically, high profitability means greater profits and greater tax burden which will inspire companies to do tax avoidance to minimize the tax burden.

Profitability is assessed using the Return on Assets ratio (ROA). ROA is used to assess how effective a company utilizes assets to generate sales. ROA reflects on the management's performance and ability to generate profit by efficiently managing the firm's resources or assets. By dividing the net income to its total assets, ROA can be calculated (Moles et al., 2011).

Another factor that could affect tax avoidance is leverage. Leverage ratios measure how much a company uses debt financing compared to equity financing and show their ability to handle long-term financial obligations like lease payments and interest on debt (Moles et al., 2011). High leverage ratio indicates high use of debt. Interest payment coming from debt enables companies to reduce their tax burden because interest expenses can reduce a company's taxable income.

Leverage is calculated using Debt-to-Equity ratio (DER). DER indicates how much debt relative to the total amount of equity in the company, or how much debt for every dollar of equity. This ratio determines the company's dependency on debt by comparing its total liabilities with shareholder equity (Moles et al., 2011).

Another factor used in this research is capital intensity. Capital Intensity measures the amount of assets needed for a company to produce sales (Ehrhardt & Brigham, 2011). Capital intensity is also often linked with the amount of fixed assets such as plants, property and equipment that a company owns, or associated with capital intensive companies. Companies with significant fixed assets are considered to be capital intensive and have the possibility to pay lower taxes. A company's fixed assets can reduce tax burden through depreciation expenses that can reduce the company's taxable income. By dividing its total fixed assets by its total assets, capital intensity can be calculated.

Below is the table of tax avoidance, profitability, leverage, and capital intensity on several manufacturing companies listed on the Indonesia Stock Exchange for the period of 2019 to 2021:

Table 1.1 Cash ETR, Profitability, Leverage, and Capital Intensity 2019-2021

Company	Year	Tax Avoidance (Cash ETR)	Profitability (ROA)	Leverage (DER)	Capital Intensity
PT Alkindo Naratama Tbk (ALDO)	2019	0,18	0,08	0,73	0,43
	2020	0,30	0,07	0,62	0,43
	2021	0,23	0,08	0,72	0,41
PT Garudafood Putra Putri Jaya Tbk (GOOD)	2019	0,22	0,09	0,83	0,54
	2020	0,29	0,04	1,26	0,51
	2021	0,25	0,07	1,23	0,47
PT Communication Cable Systems Indonesia Tbk (CCSI)	2019	0,31	0,12	0,38	0,38
	2020	0,35	0,06	0,48	0,38
	2021	0,23	0,07	0,44	0,39

Source: Prepared by the writer (2022)

From Table 1.1, in 2021, ALDO experienced an increase in profitability from 7% to 8% due to high demand in food packaging product during pandemic, which leads to increasing sales performance. but the Cash ETR decreased from 30% to 23%. The other two companies, GOOD and CCSI, also experienced an increase in profitability because sales increase, but the ETR decrease in 2021. An increase in income should increase the amount of tax paid, which increases the Cash ETR. However, in this case, the Cash ETR decreased. This indicates that there might be a tax avoidance activity.

Based on previous research done by Artinasari & Mildawati (2018), Profitability has no influence on tax avoidance. However, study by Irianto et al. (2017) indicates that profitability has a positive and significant influence on tax avoidance. Other research done by Tebiono & Sukadana (2019) and Puspita & Febrianti (2017) stated that ROA have influence to tax avoidance. Furthermore, profitability has been proven to have positive effect on ETR through research done by Liu & Cao (2007).

In Table 1.1, the leverage of ALDO increased from 62% to 72% in 2021 due to increases in bank loans and trade payables, while the Cash ETR decreased. The leverage of GOOD and CCSI both decrease in 2021 due to increase in equity and decrease in long-term debt, and also a decrease in Cash ETR. High level of leverage indicates the high use of debt financing, hence greater interest payment. With interest expenses being a deductible expense against taxable income, eventually it will lessen the amount of tax burden

Based on previous research, Puspita & Febrianti (2017) and Tebiono & Sukadana (2019) stated that leverage have no influence to tax avoidance. On the contrary, reseach done by Damayanti & Wulandari (2021) stated that leverage has a significant positive effect on tax avoidance.

In Table 1.1, CCSI experienced an increase in capital intensity from 0,38 to 0,39 in 2021, while the Cash ETR decreased. High level of capital intensity ratio indicates higher amount of assets needed to produce sales, specifically fixed assets. Depreciation expenses from the fixed assets allow companies to decrease tax burden because depreciation expense is a deductible expense against taxable income.

Previous research from Puspita & Febrianti (2017) and Tebiono & Sukadana (2019) stated that capital intensity have no influence on tax avoidance. While Dwiyanti & Jati (2019) and Artinasari & Mildawati (2018) stated that capital intensity has positive effect on tax avoidance.

Based on the research gap from previous research, the issue of tax avoidance is highlighted in this research, with determinants of profitability, leverage, and capital intensity have on it. Hence, the title is **"The Effect of Profitability, Leverage and Capital Intensity toward Tax Avoidance in Manufacturing Companies Listed on the Indonesia Stock Exchange"**.

1.2 Problem Limitation

The following are the issues and restrictions in this research:

1. The object used is limited to manufacturing companies listed on the Indonesia Stock Exchange.
2. The variables used are limited to profitability, leverage, capital intensity, and tax avoidance.
3. The period used for the research is from 2019 to 2021.

1.3 Problem Formulation

The following are the formulations of the research's problems:

1. Does profitability has a significant effect toward tax avoidance in manufacturing companies listed on the Indonesia Stock Exchange?
2. Does leverage has a significant effect toward tax avoidance in manufacturing companies listed on the Indonesia Stock Exchange?
3. Does capital intensity has a significant effect toward tax avoidance in manufacturing companies listed on the Indonesia Stock Exchange?
4. Do profitability, leverage, and capital intensity simultaneously have effect toward tax avoidance in manufacturing companies listed on the Indonesia Stock Exchange?

1.4 Objective of the Research

Based on the problem formulations, the objectives of the research are as follows:

1. To analyse the effect of profitability toward tax avoidance in manufacturing companies listed on the Indonesia Stock Exchange.

2. To analyse the effect of leverage toward tax avoidance in manufacturing companies listed on the Indonesia Stock Exchange.
3. To analyse the effect of capital intensity toward tax avoidance in manufacturing companies listed on the Indonesia Stock Exchange.
4. To analyse the effect of profitability, leverage, and capital intensity simultaneously toward tax avoidance in manufacturing companies listed on the Indonesia Stock Exchange.

1.5 Benefit of the Research

This research is expected to give benefits for the readers interested in the topic discussed in this research. The benefits of the research are as follows:

1.5.1 Theoretical Benefit

This research is expected to give benefit for the development of accounting theories and provide further information pertaining on tax avoidance issues. Additionally, it can be used as a reference for further research about tax avoidance.

1.5.2 Practical Benefit

This research is expected to provide insights regarding tax avoidance to help other parties in understanding about tax avoidance. It is hopefully able to help management in a company to understand better regarding taxation and avoid conducting tax avoidance activity. Additionally, it can give insights and help investors in making decisions for choosing which company to invest in.