CHAPTER I

INTRODUCTION

1.1 Background of the Study

Tax plays an important role in supporting a country's development. It is the largest sources of government revenue, collected from either individual or corporate taxpayers. Tax revenues are used to support the infrastructure development and distribution of educational and medical facilities.

Tax is ranked highest in the Revenue Budget and State Expenditure (APBN) compared to other revenues, as shown in below table:

Table 1.1 State Revenue in period of 2018 – 2021

	2018	**2019**	**2020**	**2021**
Tax Income	1,519,789.80	1,546,141.90	1,285,136.32	1,375,832.70
%	78.15%	78.84%	77.99%	79.26%
Non-Taxable Income	409,320.20	408,994.30	343,814.21	357,210.10
%	21.05%	20.86%	20.87%	20.58%
Grant	15,564.90	5,947.30	18,832.82	2,700.00
%	0.80%	0.30%	1.14%	0.16%

Source: Badan Pusat Statistik (2021)

Table 1.1 illustrates the data obtained from *Badan Pusat Statistik*, showing that tax income contributed the most to our state revenue compared to other revenues. This data confirms that tax income had a crucial role for national welfare. Tax revenue is mostly generated by the wholesale and retail trade, financial services and insurance sectors, mining sectors as well as information and communication sector. These five sectors contributed to boost Indonesia’s tax revenues (Pajak Online, 2021)

According to Kemenkeu (2007), tax is a mandatory levy imposed on the government by an individual or entity without direct compensation from the government and used for the needs of the government in the public interest. Taxpayer tax liability reflects self-responsibility in the area of taxation, corresponding to the self-assessment system established in Indonesian taxation. But in reality, human nature always seeks to minimize the payment of taxes in various ways and forms.

Table 1.2 Effectiveness of Tax Collection in Indonesia from 2018 to 2021

Year	**Tax Revenue Target (Trillion Rupiah)**	**Tax Revenue Realization (Trillion Rupiah)**	**Effectiveness of Tax Collection (%)**
2018	1,424.00	1,315.00	92.35%
2019	1,577.56	1,332.06	84.44%
2020	1,198.82	1,072.10	89.43%
2021	1,268.50	1,277.50	100.71%

Source: Lokadata (2022)

Based on the data outlined in Table 1.2, the Directorate General of Taxes (DGT) had failed to collect the tax targeted in 2018 to 2020. However, the tax revenue realization in 2021 was 100,71%. This achievement has successfully exceeded the target from the state budget, which reached Rp. 1.277,50 trillion. Furthermore, it is stated that the DGT needed to optimize the collection of tax income for the purpose of accelerating the nation's development. However, the efforts to collect tax effectively still faces significant obstacles, and one of them is the existence of tax avoidance practices carried out by individual taxpayers or corporate taxpayers.

For taxpayers, taxes are a burden that reduces a company's profit margin, so taxpayers tend to try to minimize their taxes. The amount of tax a taxpayer must pay depends on their income. Therefore, businesses do tax planning to have lower tax payments. For tax authorities, taxes help finance state governments and can increase tax revenue realization. (Pohan, 2016).

According to Pohan (2016), tax avoidance is strategy and technique conducted by taxpayers to achieve lesser tax payment in a legal manner and according to the taxation law. This method is used by taking advantage of the loopholes contained in the tax regulation law which can be implemented to minimize the amount of tax burden.

The existence of tax avoidance becomes the obstacle to meet the revenues target in state budget. One sector presumed to practice tax avoidance is mining. Unfortunately, in 2020, Pricewaterhouse Coopers (PwC) Indonesia surveyed that only 30 out of 40 large mining companies had adopted tax transparency reporting. Meanwhile, the rest had not transparent tax reports (Bisnis.com, 2021).

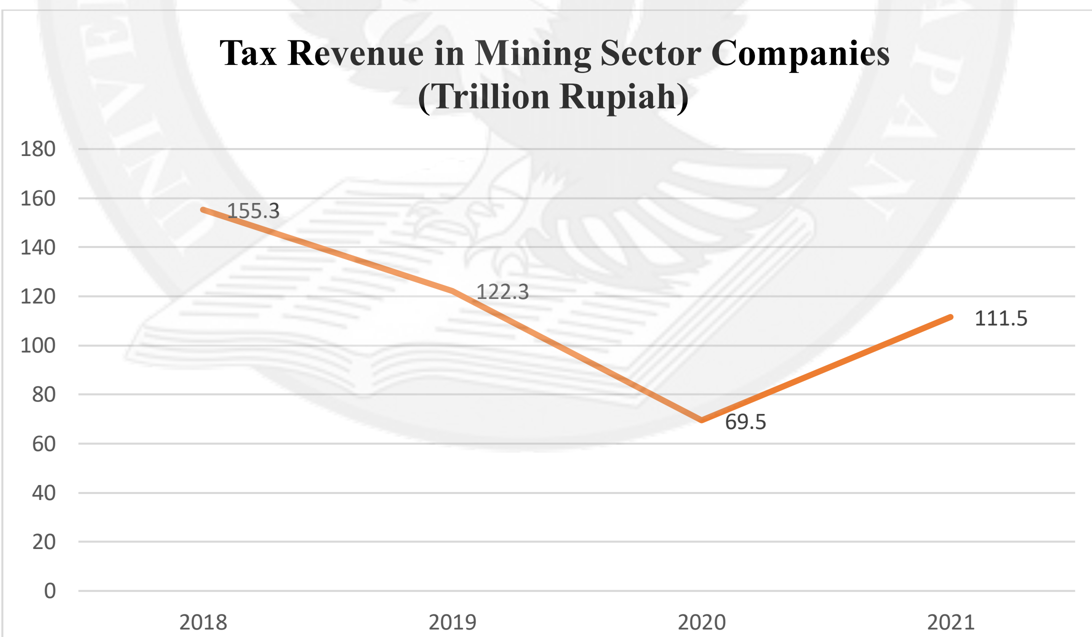

Figure 1.1 Tax Revenue in Mining Sector Companies
Source: Data compiled by the writer (2022)

In the midst of pandemic Covid-19 , the fiscal authorities noted that tax revenue from mining sector companies has fallen to minus 43.4% from 122.3 trillion to 69.5 trillion, in regard to the pressure on the market and coal prices. The effect of the pandemic had brought out the demand or consumption of coal to decreased and limited access of employees and logistics on mining sector companies which this condition had impact to the decline in the revenue (Kontan, 2020).

However, the tax revenue increase drastically by 60.52% or reach 111.5 trillion which previously 69.5 trillion rupiah, due to the rise of raw material prices for coal, lignite and metal on the international market. The production for nickel coal and lignite had jumped drastically which make mining sector was the fastest growing sector. Strong tax collection from mining sector companies was offset by a trend of higher commodity price. The increase of commodity price has added state income in form of Income Tax Article 22 in line with stronger economic growth in 2021 (Pajakku, 2022)

One of tax avoidance cases in mining sectors was performed by PT Adaro Energy Tbk. PT Adaro Energy Tbk minimized their tax burden by taking advantage from loopholes in the international taxation. They had carried out transfer pricing through its subsidiary in Singapore, Coaltrade Services International from 2009 to 2019. They took advantage of a loophole to sell coal to Coaltrade Services International at a lower price, and then sell that coal to other countries at a higher price. As a result, Indonesia's turnover and reported profits fell, and income taxes paid to the government were lower. This action made him pay US$125 million, or the equivalent of Rp 1.75

trillion in taxes, than they should have paid to the Indonesian government. However, tax avoidance is not illegal and unethical as companies use Indonesia's resources to generate profits, but the government's tax revenue is suboptimal (Finance Detik, 2019).

Tax avoidance actions occur based on the company's ability to maintain internal factors such as assets, liabilities and equity. Tax avoidance can therefore be assessed by measuring profitability, leverage and capital intensity.

The variables are chosen as factors that influence tax avoidance include profitability, leverage and political connection. Profitability is used to measure a company's performance. Profitability measures consist of several key figures, in particular Return on Assets (ROA). ROA is used to measure the effectiveness of a company using its resources to generate profit (Ross et al., 2019). High profitable company tend to do tax avoidance because they do not want to pay high taxes.

The next variable used in this study is leverage. Leverage is a metric that reflects the amount of debt used to fund a company's operations. A company's level of leverage can be used as an incentive to minimize a company's tax burden. This is because using debt incurs a cost in the form of interest as a deductible expense. This will reduce the amount of profit generated by the company, which is the base for imposing corporate taxes (Brigham & Houston, 2009). One of the common ratio in measuring leverage is Debt to Equity Ratio (DER). This ratio reflects the ratio of debt to equity in funding the company. The higher the debt ratio, the higher the interest expense, which can reduce the company's taxable income.

The final variable is capital intensity. Capital intensity is a metric used to measure a company's investment activity in the form of property, plant and equipment (PPE) or fixed assets. Capital-intensive businesses allow businesses to reduce tax expenses through annual depreciation of fixed assets. Depreciation of almost all fixed assets can be deducted as an expense when calculating a company's taxable income (Delgado et al., 2012). The ratio used to measure the capital intensity is fixed assets to total assets, which reflects the proportion of fixed assets out of total assets acquired by the company. Therefore, the higher the capital intensity, the greater the amount of depreciation expense, result in lower tax expense.

Table 1.3 The Phenomena of Profitability, Leverage, Capital Intensity and Tax Avoidance in Mining Companies Listed on the Indonesia Stock Exchange from period 2018 – 2021

Company	Year	Profitability (ROA)	Leverage (DER)	Capital Intensity	Tax Avoidance (ETR)
PT Indo Tambangraya Megah Tbk (ITMG)	2018	0,179	0,488	0,085	0,296
	2019	0,105	0,367	0,184	0,320
	2020	0,033	0,369	0,169	0,479
	2021	0,285	0,387	0,099	0,235
PT Golden Energy Mines Tbk (GEMS)	2018	0,143	1,220	0,102	0,258
	2019	0,084	1,180	0,109	0,335
	2020	0,118	1,330	0,100	0,246
	2021	0,428	1,620	0,095	0,232
PT Astrindo Nusantara Infrastruktur Tbk (BIPI)	2018	0,022	2,320	0,081	0,114
	2019	0,022	2,449	0,073	0,244
	2020	0,020	2,362	0,093	0,235
	2021	0,023	1,421	0,116	0,236

Source: Data compiled by the writer from secondary source (2022)

Table 1.3 above describes the value of return on assets, debt to equity, capital intensity and effective tax rate found in mining sector companies listed on the Indonesia Stock Exchange for the 2018-2021 period. From the table above, it shows that there are differences between profitability, leverage, and capital intensity in relation to the effective tax rate in the view of applied theory and the phenomena in the industry.

In PT Indo Tambangraya Megah Tbk (ITMG), it showed inconsistency between return on asset toward effective tax rate. During 2020 to 2021, the ROA was increasing drastically from 0.033 to 0.285, however the ETR was decreasing almost by half, namely from 0.479 to 0.235. The increase of ROA was caused by the increase of net income. ITMG successfully generated net profit of USD 475.4 million in 2021 compared to net profit of USD 37.8 million in 2020, a rise of 1105% year-on-year of improved selling prices. This excellent sales performance was supported by strong production performance with 18.2 millions tons of coal produced in a year. The connection of the ROA and ETR is net profit, as numerator of ROA, is affected by the profit before income tax and income tax expense on the ETR. The decline of ETR was led by the growth of 756% for profit before income tax in year of 2021 but was not along with the growth of income tax expense only reached by 320% in year of 2021. The difference of growth related to the slump of adjustment in respect of prior year of current and deferred tax and non-taxable income .

The higher ROA followed with the decrease ETR in PT Indo Tambang Raya TBK, indicated that there is a possibility of tax avoidance action taken by company. It was supported by the previous research done by Darsani & Sukartha (2021) stated that the higher the profitability of the company, tax avoidance actions conduct by the company are getting higher. The higher tax avoidance action is showed by the lower effective tax rate value. Thus, the higher the company profitability, the lower current effective tax rate value.

The Debt to Equity Ratio (DER) of PT Golden Energy Mines Tbk increased continuously from 1.180 to 1.330 to 1.620 in three consecutive years starting from 2019 to 2021. The increase of DER is followed with the decline of effective tax rate from 0.335 to 0.246 to 0.232, which describes the higher debt, the lower of income taxes paid by the company. The rise of debt-to-equity ratio is mainly caused by the rise of total liabilities amount. In addition, increase of total liabilities means increase of the interest expense as the component of deductible expense, in which can reduce the tax expense of the company. The reduce of ETR in 2020 is due to the growth of 26.70% for profit before income tax, as the opposite of the drop of income tax expense by 6.85%, which due to the adjustment of prior year tax and decrease of deductible expense. Meanwhile in 2021, the decline of ETR is caused by the growth of profit before income tax by 262.49% while the growth of income tax expense only reached 241.53% due to adjustment of prior corporate income tax.

The higher liabilities used to finance their business operational with the lower of effective tax rate exhibit that the company has indicated to the occurrence of tax avoidance. It is supported by the previous research conducted by Nomura (2017) specified that a company with more debt is tend to perform higher tax avoidance. It is because it could reduce its tax burden through the deduction of interest expenses. The higher tax avoidance action carry out by a company is illustrated by lower effective tax rate. Thus, the higher amount of liabilities reflects the lower effective tax rate.

The inconsistency movement is occurred between the capital intensity and effective tax rate at PT Astrindo Nusantara Infrastruktur Tbk (BIPI). The result shows that, there is increasing of capital intensity ratio from 0.073 in 2019 to 0.093 in 2020, but the effective tax rate declines in 2019 and 2020 at 0.244 to 0.235 respectively. This can be affected by the the increase in the fixed assets as the numerator of capital intensity. The value of fixed assets owned by BIPI in 2020 is USD 124.7 million, compared to fixed asset of USD 91.4 million in 2019, the rise of 36%. The factor of the increase in fixed assets, come from the additions of fixed assets in form of ports, mine equipment, vehicles, and assets under construction. Besides, increase in fixed assets means an increase of the depreciation expense carried out in the current year, which will effect to the profit before income tax and income tax expense as the ETR's components. The decline of ETR is caused by the drop of income tax expense on 6.60% while the drop of profit before income tax only on 2.69%.

The higher capital intensity is simultaneous with the decline of ETR in PT Astrindo Nusantara Infrastruktur Tbk, and it illustrates that the company has a higher tendency to involve in tax avoidance activity. It is supported by the previous research conduct by (Noviyani & Muid, 2019) imply that companies with high capital intensity would like to have a high level of tax avoidance. The depreciation expense from the fixed assets can reduce fiscal profit which yield to the decrease in corporate tax expense. The lower tax expense can effect to the lower effective tax rate. Thus, the higher intensity of fixed asset by company, the lower effective tax rate.

In other hand, this research is analyzed caused by the inconsistency of result or research gap on factors that affect tax avoidance from previous research. The results of research by Nomura (2018), Zhu et al. (2019) and Darsani & Sukartha (2021) found that profitability has a positive effect on tax avoidance. Chytis et al. (2018) and Noviyani & Muid (2019) found that profitability has a negative effect on tax avoidance. Meanwhile, according to Masrurroch et al. (2021) and Aryatama & Raharja (2021) stated that profitability has no significant effect against tax avoidance.

Other factor affecting tax avoidance is leverage. Research by Nomura (2018), Anouar (2018) and Noviyani & Muid (2019) found that leverage has positive effect on tax avoidance. However, Chytis et al. (2018), Masrurroch et al. (2021) and Darsani & Sukartha (2021) found that leverage has no significant effect on tax avoidance.

Besides of the two factors above, capital intensity is also an important factor affect tax avoidance. Research by Noviyani & Muid (2019), Darsani & Sukartha (2021) and Aryatama & Raharja (2021) (Khoirunnisa Asadanie & Venusita, 2020)(Khoirunnisa Asadanie & Venusita, 2020)results capital intensity has positive effect on tax avoidance while according to Nomura (2018) and Masrurroch et al. (2021), capital intensity has no significant effect on tax avoidance.

From the phenomenon of tax avoidance in the mining sector described above, the author is motivated to conduct research titled **"The Impact of Profitability, Leverage and Capital Intensity Toward Tax Avoidance in Mining Sector Companies Listed on the Indonesia Stock Exchange."**

1.2 Problem Limitation

Problem limitation aims to obtain the research result that in line with objective of the research in order to achieve the successful research and the problems are not expected to spread or expand. Therefore, the writer limit the problem, as follows:

1. This research covers financial statements of companies in the mining sector listed on the Indonesian Stock Exchange from 2018 to 2021.
2. This research will utilize three independent variables and one dependent variables. The independent variables are Profitability, Leverage and Capital Intensity and the dependent variable is Tax Avoidance.

1.3 Problem Formulation

The writer set the problem formulation as below:

1. Does the profitability of companies in the mining sector listed on the Indonesian Stock Exchange have partial significant impact on tax avoidance?
2. Does the leverage of companies in the mining sector listed on the Indonesian Stock Exchange have partial significant impact on tax avoidance?

3. Does the capital intensity of companies in the mining sector listed on the Indonesian Stock Exchange have partial significant impact on tax avoidance?
4. Does profitability, leverage, and capital intensity of companies in the mining sector listed on the Indonesian Stock Exchange have simultaneously significant impact on tax avoidance?

1.4 Objective of the research

The objective of the research, as follows:

1. To identify whether profitability has a significant impact on tax avoidance on mining sector companies listed in the Indonesian Stock Exchange.
2. To identify whether leverage has a significant impact on tax avoidance in mining sector companies listed in the Indonesian Stock Exchange.
3. To identify whether capital intensity has a significant impact on tax avoidance in mining sector companies listed in the Indonesian Stock Exchange.
4. To identify whether profitability, leverage, and capital intensity have significant impact on tax avoidance in mining companies listed in the Indonesian Stock Exchange.

1.5 Benefit of the Research

The result of the research is expected to bring contribution in term of benefits, which the benefits will be classify into theoretical benefit and practical benefit.

1.5.1 Theoretical Benefit

1. For the company:

   The result of this research is expected to support mining sector companies to increase the understanding towards tax avoidance behavior, so the company do not avoid their obligation as entity taxpayer by taking consideration of the existing variable.

2 For investors:

   The outcome of this research is expected to support investor in making investment decision in mining sector.

3 For government

   The results of this research are expected to contribute to the regulation of tax law in order to maximize potential government revenues from the tax sector.

1.5.2 Practical Benefit

1. To provide insights and knowledge on implementing profitability, leverage and capital intensity impact on tax avoidance in companies in the mining sector listed on the Indonesian Stock Exchange.
2. Used as literature material or reference for other researcher in conducting future research related to tax avoidance with profitability, leverage, and capital intensity as the variable.