CHAPTER I

INTRODUCTION

1.1 Background of the Study

Tax can be considered as the biggest contributor to the country construction. As the citizen or any people who live in Indonesia, everyone who already has their own income, they have the responsibility to pay the taxes to the government. According to Central Bureau of Statistics (*Badan Pusat Statistik*), most of the government's income are from taxes. It could be inferred that taxes play an important role for the country. However, it has been 12 years that Indonesia has not yet reached the tax target (CNBC Indonesia, 2021). Tax revenue is always below the predetermined target since 2009. In December, 2020, tax revenue only reached IDR 1.070 trillion or 89,3% from the predetermined target which was IDR 1.198,8 trillion in Presidential Decree 72/2020 (*Peraturan Presiden*). One of the factors that caused the target to not reached is because of tax avoidance by the taxpayers. The failure to reach the tax revenue target was stated by Tax Justice Network through the report entitled "The State of Tax Justice 2020: Tax Justice in the time of COVID-19". In that report, it is mentioned that Indonesia is predicted to make a loss of about IDR 68,7 trillion per-year as a result of tax avoidance itself. From the predicted amount, as much IDR 67,7 trillion is a result from tax avoidance, while the rest which is IDR 1,1 trillion is a result from the taxpayers.

In June, 2019, GPFI (Global Partnership for Financial Inclusion) was held that resulted OECD (Organization for Economic Co-operation and Development) / G20 Inclusive Framework on BEPS (Base Erosion and Profit Shifting). The framework consists of the collaboration of implementation 15 steps to overcome tax avoidance, as well as to improve the coherence of international tax regulations, and to make sure that the tax environment is transparent (GPFI, 2019. As the implementation of the tax action steps that became the discussion topic of the forum, the government of Indonesia made such regulations called Omnibus Law. Nevertheless, before the application of Omnibus Law, there was a Covid 19 outbreak that became a pandemic and caused the economic growth hampered. Indonesian president, Joko Widodo madea decision to overcome the pandemic as well as recover the economy by giving the tax incentive with announcing the adjustment of the corporate income taxes' rate.

In 2020, the government released the regulations No. 30/2020 which stated that the corporate income tax that was initially charged by 25% was reduced to 22% by 2020 and 2021. This regulation was released in order to overcome the Covid 19 pandemic and as the government's effort to deal with the threat which endangers the national economy, regarding that the economy sector of Indonesia that was affected significantly because of this pandemic. The policy is also a kind of effort in order to increase the domestic economic industries is by decreasing the corporate tax (Kompas.com, 2020). Yet, the tax reduction does not mean that the corporate would stop in reducing the tax given. Conversely, thetax reduction can stimulate the tax avoidance through the tax aggressiveness.

The Indonesian Ministry of Finance recorded an 8.82% growth in tax revenue for January 2019, increasing from IDR 79 trillion to IDR 86 trillion. Despite the positive growth in tax revenue, the processing or manufacturing industry sector actually declined. Despite contributing 20.8% to tax revenue, the tax revenue from the manufacturing sector was recorded at IDR 16.77 trillion, or a decrease of 16.2% year on year (Kontan.co,id, 2019). This certainly affects the tax revenue, where the low/decreased tax revenue is suspected due to tax avoidance practices through tax aggressiveness.

The tax aggressiveness part of tax management in the case of tax planning. If associated with tax avoidance or tax evasion, the planningof tax aggressiveness would lead to the tax avoidance which is an illegal action in order to reduce the tax that is supposed to be paid by the corporate. However, there is a differentiator between tax avoidance and tax aggressiveness which ison the tax aggressiveness, the planning activity tax to decrease the payable tax is done aggressively (Prawira & Sandria, 2021). The existence of this pandemic makes many corporates experiencing income reduction significantly, hence, the possibility of the incident of tax avoidance to occur is relatively high. The enforcement of new tax regulations aims to help corporates in adjusting to the new situation caused by the pandemic itself. In order to consider this case, the analysis should be done to find out the comparison of tax avoidance between before and during the pandemic. According to the research conducted by (Suhaidar et al., 2021), it is found that there was a difference of tax avoidance between before and during the pandemic, whereas tax avoidance during the pandemic increased significantly.

One of many factors that could affect tax aggressiveness is corporate social responsibility (Fuadah & Kalsum, 2021). The World Business Council for Sustainable Development (WBCSD) defined corporate social responsibility as kind of sustainable commitment by corporates to behave ethically and contribute to the economy improvement by increasing life quality of the employees, their families, and local communities. On the other hand, corporate social responsibility is corporate commitment to contribute in the sustainable improvement of economy by concerning the social responsibility, the balance among economy aspect, social, and environment. Therefore, corporate social responsibility is an obligation in formulating policies, making decision, and taking action that might be beneficial to the people. Corporate social responsibility could affect tax aggressiveness since if corporates do the social responsibility, the expense might be deductible that can be tax reduction, so the tax that should be paid by corporates become less. From that phenomenon, it could be inferred that corporates do the tax aggressiveness in order to engineer profit through the tax planning, either using legal way (tax avoidance) or illegal way (tax evasion).

Tax avoidance can be interpreted as an effort which was done by the taxpayers in order to find the gap of the constitution about tax to get its weakness, so they could pay the tax less than the actual tax amount. This tax avoidance is a kind of effort to reduce the tax obligation legally, which could be done by finding the gap of the tax determination (Suandy, 2016). An example that often be done is utilizing the determination related the exception or unauthorized cuts, things that are not in the regulations, and implementing weaknesses on tax regulations. On the other hand, tax evasion is a kind of tax violation in doing tax evasion scheme that is supposed to be done by the taxpayers in order to reduce the actual tax amount, indeed, some of the taxpayers do not pay owed tax at all that should be paid in illegal way (Jacob, 2014).

There is another factor that might affect the tax aggressiveness is the transfer pricing. According to Choi et al., (2020) transfer pricing is a corporate decision in determining transfer price from the item's price, service, or any other transactions which are determined by the corporate. Hilton dan Eccles, (1987) stated that transfer pricing is the price on a product from a certain division that is given to another division. According to Tippett dan Wright, (2006) transfer pricing is the determined selling price in a trade among divisions to record sales income and cost from a certain division. Hence, the interpretation of transfer pricing is the corporate decision to determine price on items, service, properties, and financial transactions conducted by divisions in the corporate. Hilton dan Eccles, (1987) pointed out that there are two sections on transfer pricing, those are intra-company and inter-company transfer pricing. On intra-company transferpricing is a kind of transfer pricing among sections in the investee. While, inter- company transfer pricing between two corporates in a special relation, where the transactions could be in one country or several countries.

Transfer pricing is a determination of transaction price that is determined by the parties that have special relation as management control for the transaction of items and service among members. Action is usually taken to allocate profit from the corporate entity in a country to another corporate entity of another country in a corporate group in order to minimize instead of avoiding tax (Suandy, 2016) in (Panjalusman et al., 2018). Along with this, Panjalusman et al., (2018) stated that the purpose of transfer pricing is to outsmart the amount of profit so that the payment of tax and the distribution of dividend could be less, and the second purpose is to inflate profit in order to polish the financial statements (window-dressing). Transfer pricing is also used as a way to avoid taxby utilizing the gap of the regulations. Hence, transfer pricing could be used to avoid tax, but still maintain the existing profit. Transfer pricing is also appliedby corporates to minimize the amount of tax that are supposed to be paid through manipulating the price which is transferred among divisions. Therefore, it could be concluded that the more transfer pricing is applied by corporates, the bigger the possibility could be for corporates to minimize tax deposit to the country (Panjalusman et al., 2018). The statement mentioned before is confirmed by the result of the research conducted by Pratama & Larasati, (2021) which stated that transfer pricing could affect tax aggressiveness.

There is another factor that could affect tax aggressiveness itself which is capital intensity as explained by the research done by Pratama and Larasati,

(2021) and Natalya, (2018) that stated capital intensity plays role in affecting tax aggressiveness. According to Natalya (2018) capital intensity ratio is an activity of investment in a form of fixed assets (capital intensity). Capital intensity ratio could show corporate's efficiency level in using its assets to produce sales. Capital intensity which is a corporate investment on fixed assets is a kind of asset which is used by corporates to produce and gain profit. Corporate investment on assets would still cause depreciation burden from fixed assets that are invested. The enormity of depreciation burden for assets are still on the regulations of Indonesian tax that vary depending on the classification of fixed assets. The more amount of fixed assets that corporates have, the more depreciation burden would be, so it would affect profit before the tax reduces. This case would cause taxable income to be smaller or reduced (Pratama & Larasati, 2021).

Corporate social responsibility, transfer pricing, and capital intensity are chosen as variables that affect tax aggressiveness because they are important indicators of a company's financial performance and decision-making. Corporate social responsibility refers to a company's commitment to being socially responsible, which includes not only financial reporting but also the ethical and environmental impact of the company's operations. Transfer pricing refers to the practice of determining the value of goods and services traded between divisions within a company in different countries. Capital intensity refers to the amount of capital required for a company to produce a unit of output. These variables are important in understanding the tax aggressiveness of a company because they can indicate the level of risk a company is willing to take in order to achieve its financial goals. Companies that engage in corporate social responsibility activities may be more likely to comply with tax regulations, whereas those that engage in transfer pricing may use this to minimize their tax obligations. High capital intensity may indicate that a company is investing heavily in capital assets, which may result in lower taxable profits. By examining these variables, it is possible to gain a better understandingof the underlying motivations behind a company's tax behavior and how they may be contributing to tax aggressiveness.

Based on the explanation above, it shows different results regarding the factor that effect tax aggressiveness. In this case, the writer is motivated to research tax aggressiveness with the title **"The Effect of Corporate Social Responsibility, Transfer Pricing and Capital Intensity on Tax Aggressiveness in Manufacturing Companies listed on the Indonesia Stock Exchange".**

1.2 Limitation of the Study

Limitation of the study was done to limit the scope of the research to be more focus and to maintain the research so as not to get off the track. Therefore, the limitation of this study was limited to the research subjects that are manufacturing companies and the chosen period was during 2017-2021. The employed independent variable was corporate social responsibility, transfer pricing, and capital intensity.

1.3 Research Problems

Based on the background of the study and the limitation of the study explained above, hence, the research problems were formulated as follows:

1. Are there any effects between corporate social responsibility on tax aggressiveness in manufacturing companies listed on the Indonesia Stock Exchange during 2017-2021?
2. Are there any effects between transfer pricing on tax aggressiveness in manufacturing companies listed on the Indonesia Stock Exchange during 2017- 2021?
3. Are there any effects between capital intensity on tax aggressiveness in manufacturing companies listed on the Indonesia Stock Exchange during 2017- 2021?
4. Are there any effects between corporate social responsibility, transfer pricing, and capital intensity on tax aggressiveness in manufacturing companies listed onthe Indonesia Stock Exchange during 2017-2021?

1.4 Objectives of the Study

According to the formulated research problems above, the researcher presented several objectives as follows:

1. To determine the effect between corporate social responsibility on tax aggressiveness in manufacturing companies listed on the Indonesia Stock Exchange during 2017- 2021.
2. To determine the effect between transfer pricing on tax aggressiveness

in manufacturing companies listed on the Indonesia Stock Exchange during 2017- 2021.

3. To determine the effect between capital intensity on tax aggressiveness in manufacturing companies listed on the Indonesia Stock Exchange during 2017- 2021.
4. To determine the effect between corporate social responsibility, transfer pricing, and capital intensity on tax aggressiveness in manufacturing companies listed on the Indonesia Stock Exchange during 2017- 2021.

1.5 Significance of the Study

The researcher hopes the result of this study might give both practical andtheoretical benefits.

1.5.1 Practical Benefit

1. For corporates

   This study's findings are designed to serve as a resource for management divisions making tax-related decisions for corporations.

2. For citizens

   The findings of the study are designed to provide evaluation material as well as recommendations for investors making tax accounting decisions in the context of corporate social responsibility, transfer pricing, and capital intensity on tax aggressiveness.

1.5.2 Theoretical Benefit

1. For students

   The findings of this study are expected to be utilized as a reference for further research and to increase knowledge about tax evasion and the factors that influence it.

2. For writer

   The findings of this study are expected to be used as research material to increase public awareness of tax aggressiveness.