CHAPTER I

INTRODUCTION

1.1 Background of the Study

Indonesia is a developing country with 4th highest population in the world. To improve national development such as maintaining state security and stability, improve infrastructure, health facilities and more public services, there will be significant amount of funds needed by the government. Hence, state revenue is very important because it is the budget to finance and develop a country. Based on Law of the Republic of Indonesia Number 17 of 2003 on State Finances Article 11 paragraph (3) expresses that state revenue consists of tax revenue, non-tax revenue and grants.

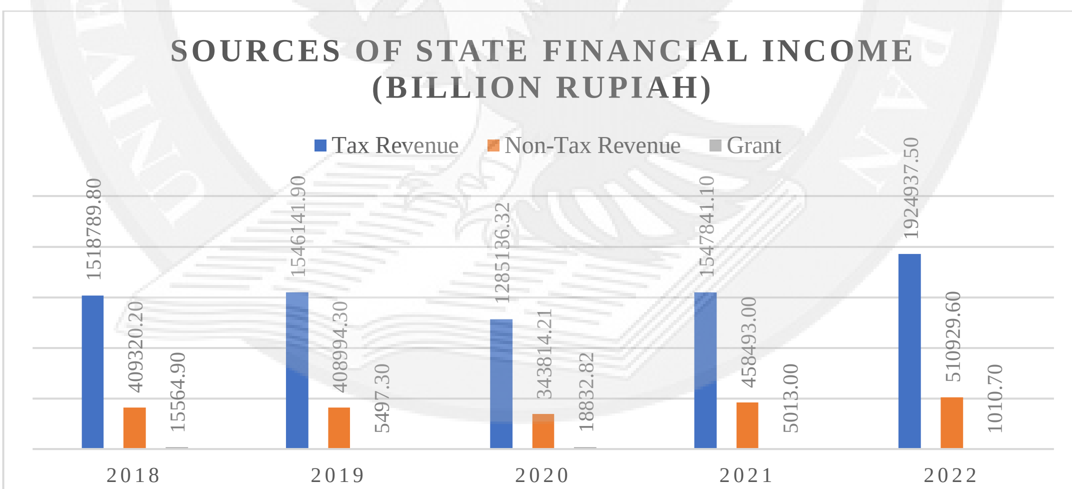

Figure 1.1 Sources of state revenue for the past 5 years
Source: bps.go.id

Figure 1.1 shows Indonesia's national income for the year 2018-2022 from Statistics Indonesia (BPS) official website. For the past 5 years, national income received by the state has been dominated by tax revenue. From the provided data by

Statistics Indonesia above, tax revenue dominates the source of state revenue with an average of 78% contribution for the past 5 years, while non-tax revenue averaging 21%, and grants averaging only 1% for the past 5 years. As a result, the author concludes that majority of Indonesia's state income are derived from tax revenue.

According to Law Number 28 of 2007 Article 1 paragraph (1) regarding the third amendment to Law Number 6 of 1983 on General Provisions and Procedures for Taxation, tax is a mandatory contribution to the state that is owed by individuals or businesses which is unavoidable based on the law and is utilized for state purposes and the welfare of citizens. In other words, tax including every type of tax such as income tax, property tax, and value added tax are obligated contributions paid by subjects who are held accountable to pay taxes and may be legally punished if the tax obligations are not met. Essentially, tax is not a punishment but there will be consequences if the tax obligations are not fulfilled.

Since tax revenue generates the most to national income in Indonesia, the government has become highly concerned about tax issues. As a result, the government has continually reviewed tax laws to reduce the risk of tax evasion. Contrary to the state seeing tax as an income, tax is considered as burden for individual and entity taxpayers since it reduces their profits, which affects their net income directly. As a result, tax subjects that are liable to pay tax proceeds to conduct tax planning. According to Nursari et al., (2017), tax planning is an attempt by taxpayers to reduce their tax obligations in order to save more cash paid. Essentially, reducing tax obligations in tax planning is not completely illegal nor legal.

There are two common terms in tax planning which are tax avoidance and tax evasion. According to Sulaeman (2021), the main difference between tax evasion and tax avoidance are the legality. While tax avoidance is legal, tax evasion is illegal. According to Cahyono et al. (2016), tax evasion is classified when tax avoidance exceeds limit or violates the laws and regulations. This definition is supported by Mardiasmo (2016 p. 275) in Sari et al. (2022), which explains that tax avoidance is an attempt to pay taxes without violating the current tax regulations, so that taxpayers who comply with tax laws are not penalized. Hence in practice, the tax authorities in each nation are the ones who determine the differences between tax avoidance and tax evasion. Even though tax avoidance is legal, it is not expected by the government. Mahdiana & Amin (2020) states that tax avoidance reduces the state revenue because it is an obstacle for tax collection.

According to PricewaterhouseCoopers (PwC) Indonesia in its publication titled Mine 2021 Great Expectation, Seizing Tomorrow, only 30% of the 40 largest mining companies have implemented tax transparency reporting by 2020. And the rest of the companies' tax reports were not transparent yet. As a result, there is a suspicion against mining sector companies on why they do not implement tax transparency reporting, which one of the suspicions is tax avoidance. At the same time, it increases the suspicion of tax avoidance practice on energy sector companies since the majority of them are mining sector companies.

A case of tax avoidance happened in energy sector is by PT Adaro Energy Tbk which paid 125 million USD less than the expected amount. PT Adaro Energy Tbk is suspected to do transfer pricing method through its subsidiary in Singapore from the year 2009 to 2017 (Global Witness, 2019). Tax revenues in energy sector remained negative 42.78% as global oil price began to climb in September 2020 (Kurniati, 2020).

There are different factors that may influence corporations to conduct tax avoidance, which some of the factors are profitability, leverage and liquidity. A company's profitability is a measure of management's performance in managing the company's wealth, that is proven by the profit made (Kimsen et al., 2018), or in other words, profitability is a company's investment ability to generate profits. The measure of profitability used in this research is Return on Asset (ROA). According to Mahdiana & Amin (2020) Return on Assets is a ratio that measures a company's financial performance. If the ROA is greater, the profitability is higher. At the same time, the increase in profits directly increases the tax liability. Other than that, higher profitability companies may have more resources to invest in tax planning strategies such as tax avoidance. As a result, there is a great chance that profitability does affect tax avoidance. These statements are supported by previous research done by Sulaeman (2021), Jaya (2018), and Irianto et al. (2017), where they found out that profitability has significant positive affect towards tax avoidance.

The other factor that may influence firms to conduct tax avoidance is leverage. According to Dharmayanti (2021) leverage is a measure of a company's ability to finance assets by using debt. Companies with significant amount of debt may use interest payments that are tax deductible to lower taxable income. Debt to Asset Ratio (DAR) is one of the ratios that can be used to measure leverage. Debt to Asset Ratio

(DAR) indicates how much debt is used to fund the company's assets or how much debt impacts asset management (Sari, 2019). According to research done by Mahdiana & Amin (2020), leverage has a positive significant impact on tax avoidance, on the other side study made by Kimsen et al. (2018) stated that leverage has a significant negative impact on tax avoidance.

Liquidity is the other factor that may affect corporations to do tax avoidance. According to Novitasari et al. (2020) current ratio can be used as a measure for liquidity. The current ratio measures the company's ability to cover short-term debt, indicating how much of the company's debts are guaranteed by its own capital (Ramadhan et al., 2023). According to Rosalia (2017) a firm with a high liquidity level has a stable cash flow would not be hesitant to pay all its obligations, including tax obligations. Study done by Jaya (2018) states that liquidity has a significant positive influence toward tax avoidance, but another study done by Dharmayanti (2019) is completely different where liquidity has a significant negative influence on tax avoidance.

Table 1.1 The Phenomena of Profitability, Leverage, Liquidity, and Tax Expense of Energy Sector Companies Listed in Indonesia Stock Exchange in period of 2019 – 2022

Company	Year	Profitability	Leverage	Liquidity	Tax Expense
Adaro Energy Indonesia Tbk.	2019	0.06	0.45	2.23	224,101
	2020	0.02	0.38	2.63	63,660
	2021	0.14	0.41	2.43	457,658
	2022	0.26	0.39	2.53	1,645,096

Indo Tambangraya Megah Tbk.	2019	0.45	0.27	3.72	59,406
	2020	0.29	0.27	3.71	34,725
	2021	0.03	0.28	3.59	145,699
	2022	0.10	0.26	3.83	345,447
Rukun Raharja Tbk.	2019	0.04	0.32	3.13	2,710,906
	2020	0.01	0.26	3.84	1,960,841
	2021	0.02	0.49	2.04	1,254,935
	2022	0.04	0.49	2.04	2,184,537

Source : Prepared by writer (2022)

The table above are the phenomena of profitability, leverage, liquidity, and tax expense from 3 energy sector companies listed Indonesia Stock Exchange from the year 2019 to 2022. Table 1.1 shows that PT Indo Tambangraya Megah Tbk increases in profitability from 2019 to 2021, but tax expense only increases from 2019 to 2020 but decreases from 2020 to 2021. Similar happens in PT Rukun Raharja Tbk where when profitability decreases from 2019 to 2020, tax expense decreases align with profitability, but when profitability increases in 2020 to 2021, the tax expense decreases contrary against profitability when it is expected to increase because an increase of profit directly increase tax owed. Hence, there is seen an inconsistency between profitability and tax expense.

Phenomena also seen on PT Adaro Energy Indonesia Tbk. Its tax expense increases on year 2020 to 2021, aligned with the leverage, while on year 2021 to 2022, when there is a decline in leverage, tax expense increases significantly almost four times from 2021 to 2022. The same happens on PT Rukun Raharja Tbk where tax expense declines, aligned with leverage in 2019 to 2020. However, from 2020 to 2021 when leverage increases, tax expense declines against leverage. Therefore, there is seen an inconsistency between leverage and tax expense. Furthermore, similar phenomena can be seen between liquidity and tax expense which seen on PT Rukun Raharja Tbk and PT Adaro Energy Indonesia Tbk. When there is an increase on liquidity from 2019 to 2020, tax expense decreased. While from 2020 to 2021 when there is a decrease of liquidity, tax expense decreased, aligned with liquidity. Hence, there has been seen inconsistency too between liquidity and tax expense.

In Indonesia, there is growing suspicion that energy companies are using tax avoidance strategies. A case study of PT Adaro Energy Tbk showed that the company used transfer pricing to reduce its tax bill by 125 million USD. Tax avoidance is a legal attempt to minimize taxes without breaking the law. It is a common practice for businesses, but it is a burden for the government because it reduces income from tax. There are many factors that can affect tax avoidance, which in this study are profitability, leverage and liquidity. Profitable businesses have more resources to invest in tax planning strategies, while higher liquidity businesses can use interest payments to reduce their taxable income. And higher liquidity businesses are most likely to pay their taxes on time since they have healthy cash flows. The government is concerned about tax avoidance, as it reduces tax revenue and makes it harder to finance national development expenditure.

Previous research and phenomena showed gaps and inconsistencies among the influence of profitability, leverage, and liquidity towards tax avoidance. As a result, this research is conducted to find the truth between the gaps and inconsistencies between independent variables towards tax avoidance. And since there is a lot of energy and mining companies that have not implement transparent tax reporting, hence the research will be focused on energy companies and the research is carried out with the title **"The Influence of Profitability, Leverage, and Liquidity Toward Tax Avoidance on Energy Companies Listed on the Indonesia Stock Exchange".**

1.2 Problem Limitations

Due to limited time and resources, the following research limitations are declared by the author:

1. The object of the research are energy sector companies that are listed in Indonesia Stock Exchange with the period only ranging from 2019 to 2022.
2. The independent variables of this research are profitability (ROA), leverage (DAR), and liquidity (CR), and the dependent variable is tax avoidance (ETR).

1.3 Problem Formulation

The problem formulations of this research are:

1. Does profitability have a significant influence toward tax avoidance on energy companies listed on the Indonesia Stock Exchange?
2. Does leverage have a significant influence toward tax avoidance on energy companies listed on the Indonesia Stock Exchange?
3. Does liquidity have a significant influence toward tax avoidance on energy companies listed on the Indonesia Stock Exchange?

4. Do profitability, leverage, and liquidity simultaneously influence tax avoidance on energy companies listed on the Indonesia Stock Exchange?

1.4 Objectives of the Research

According to the formulation above, several goals are listed below:

1. To find out if profitability have a significant influence toward tax avoidance on energy companies listed on the Indonesia Stock Exchange.
2. To find out if leverage have a significant influence toward tax avoidance on energy sector companies listed on the Indonesia Stock Exchange.
3. To find out if liquidity have a significant influence toward tax avoidance on energy sector companies listed on the Indonesia Stock Exchange.
4. To find out if profitability, leverage, and liquidity simultaneously influence tax avoidance on energy sector companies listed on the Indonesia Stock Exchange.

1.5 Benefit of the Research

Below are the theoretical and practical benefit that can be gained from the result of this research:

1.5.1 Theoretical Benefit

The result of this research for author and readers, theoretically will provide new evidence and better understanding relating to the influence of profitability, leverage, and liquidity towards tax avoidance on energy sector companies listed on the Indonesia

Stock Exchange. The author also hopes that this research is useful and can be used as reference for future researchers regarding tax avoidance.

1.5.2 Practical Benefit

Based on the objective of the research, the author hopes that the result of this research is useful and can be used by other party, including:

1. Researcher, this research is meant to provide further knowledge as a reference for other researchers conducting research in a similar subject.
2. Companies, the findings of this study are intended to help company owners to make better tax-planning decisions. As a result, the corporation may raise their tax compliance in accordance with the regulations.
3. Government, this research result will hopefully help the government in paying greater attention to the loopholes that indirectly allow companies to lower their tax payments. As a result, the government could implement additional regulations to prevent or reduce tax avoidance in the future.