# CHAPTER I

# INTRODUCTION

## 1.1 Background of the Study

As a growing nation, Indonesia consistently pursues national growth, mostly with the financing source of tax revenues. The development of the country depends on taxes. Everyone is required by law to pay taxes to the country. Based on the Law No. 16 of 2009 covering General Provisions and Tax Procedures, tax is defined as an obligation by an individual or corporation to pay to the state under the law without receiving a direct benefit and used to fund public necessities.

**Table 1.1 State Revenue Data**

| Realization of State Revenue (trillion rupiahs) | | | |
|---|---|---|---|
| **Year** | **2020** | **2021** | **2022** |
| **Tax** | 1,069.98 | 1,277.53 | 1,716.76 |
| **Non-Tax State Revenue** | 338.53 | 451.98 | 588.34 |
| **Grant** | 12.29 | 4.57 | 3.54 |
| **Customs and Excise** | 212.79 | 268.98 | 317.78 |

Source: Kemenkeu.go.id (2023)

According to Table 1.1 from kemenkeu.go.id (2023) which contains data from the Directorate General of Financing and Risk Management, Ministry of Finance, taxes account with a percentage of approximately 60% of state revenue. Although taxes are the state's main source of income, they make enterprises having lower net income. The number of taxes a firm must pay increases in line with its profit. The different interests of the government which targets significant and consistent tax revenues certainly conflict with the interests of companies that seek to minimize the tax payments because companies seek to obtain a bigger profit in the order to prosper the owner and maintain viability of company. Because it requires transferring money from the firm (especially the owner) to the state, income tax that a company pays to the state is a hardship for both the company and the company owners. To lower the amount of tax that must be paid, business owners frequently decide to manage current taxes within the company, including by putting into effect tax avoidance strategies.

Tax avoidance is a legal method to decrease tax liability within the boundaries of the law. The theory is supported by Wibawa et al. (2016), saying that tax avoidance is lawful, but the government discourages it since it leads to less money for initiatives that improve citizens' well-being, the opposite of what businesses expect. The primary focus of the company's attention is the conflicting interests between company and government. As stated by Mulyati et al. (2019), tax avoidance is a method of conducting business that aims to pay less in taxes by using weaknesses (loopholes) in a nation's tax regulations. Because tax avoidance tactics rely on tax law gaps, it is claimed that this practice does not violate the law.

The property sector in Indonesia is an industry whose development has been quite highlighted in recent years (Sari, 2023). This is caused by some factors, including rising in prices, the stigma associated with middle-class people being unable to afford housing, and the economy's instability as a result of the pandemic's effects. Nevertheless, it is thought that the real estate industry is still in demand, particularly among investors. As we all know, purchasing a home or apartment serves as both a means of housing and an investment.

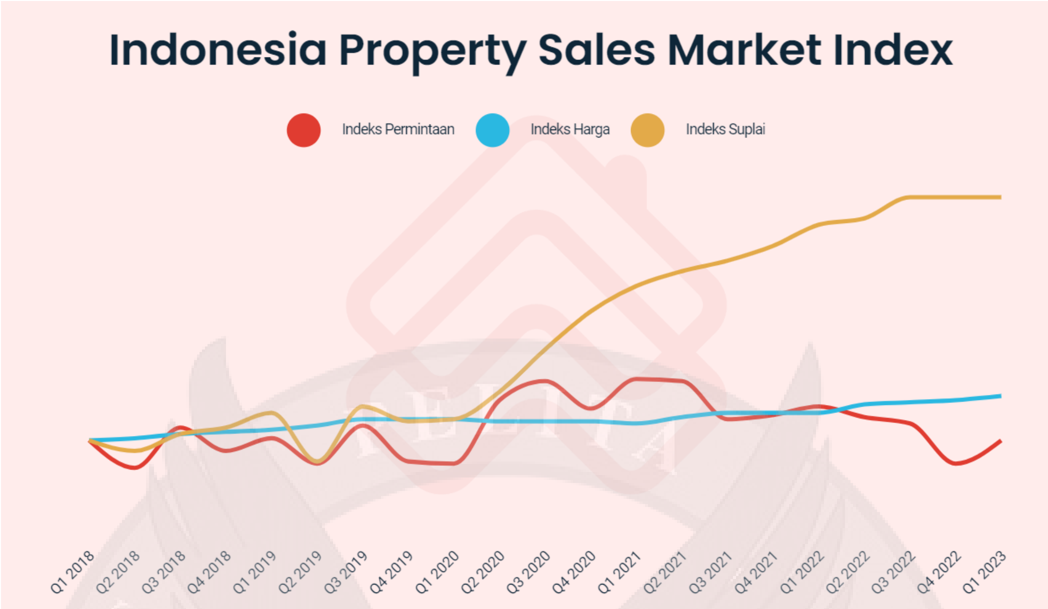


**Figure 1.1 Indonesia Property Sales Market Index**
Source: rumah.com (2023)

Figure 1.1 shows the increase in the demand, price and property supply index in Indonesia over the last few years based on www.rumah.com (2023). The real estate sector was said to be expanding steadily in 2019. Evidently, this growth did not continue very long. The Covid-19 outbreak caused the real estate industry to collapse in 2020. According to Ali Tranghanda, CEO of Indonesia Property Watch (IPW) Advisory Group, the real estate market has plunged 60 percent in 2020 compared to 2019. People's purchasing power for real estate items was at that time relatively low due to unstable financial circumstances and constrained mobility (Cahyani, 2020). After the pandemic crisis ended and people began adjusting to the new way of life, the real estate market is also recovered.

In 2021, the real estate industry saw an increase in growth of 2.78%. Some individuals even dared to repurchase real estate as an investment for the future. The property industry has so far appeared to be expanding, and it is thought to have a crucial strategic part in expanding the country's economy. The property and real estate sector contribute to the gross domestic product (GDP) of IDR 2,349 trillion to IDR 2,865 trillion annually, or the equivalent of 14.63 percent to 16.3 percent of the national GDP, and it generates tax revenues of about IDR 185 trillion annually, or the equivalent of 9.26 percent to the total central government. These findings come from the Institute for Economic and Community Research, Faculty of Economics and Business, University of Indonesia. Real estate increased by 4.54 percent in the third quarter of 2022, with the supply of large type residences growing by 17.8 percent annually (Grahadyarini, 2023).

However, the housing market in Indonesia still faces issues, such as a shortage of houses while demand and prices for real estate increase because of heavy urbanization and rapid population expansion. According to the 2020 National Socio-Economic Survey, as many as 12.75 million households in Indonesia lack a home, and this number could go up since new households are formed by 700,000 to 800,000 people every year (Grahadyarini, 2023).

Additionally, East Kalimantan will soon become the new capital of Indonesia. Stakeholders in the real estate industry participated in the Property Outlook Survey 2023, which was carried out by Knight Frank Indonesia. The Country Capital (IKN) Nusantara is one of the cities with potential for the real estate sector in 2023 and beyond, according to the data from kfmap.asia (2022) article. To begin achieving physical infrastructure development in IKN, the government is working with a variety of investors, both domestic and foreign.

Along with the IKN development process, a significant increase in the demand for real estate is anticipated in the East Kalimantan region. This is caused by the increasing population in the area. An increase in property demand will be followed by an increase in business profits and the amount of state taxes that the company must pay. An increasing tax burden may indicate that the company will look for loopholes to conduct tax avoidance.

**Table 1.2 The Phenomena of Profitability, Liquidity, Capital Intensity, and Tax Avoidance in Property and Real Estate Companies Listed on the IDX from Period 2020-2022**

| Company | Year | Profitability (NPM) | Liquidity (Current Ratio) | Capital Intensity | Tax Avoidance (ETR) |
|---|---|---|---|---|---|
| PT Pakuwon Jati Tbk. (PWON) | 2020 | 0.281 | 1.981 | 0.089 | 0.026 |
| | 2021 | 0.271 | 3.794 | 0.080 | 0.009 |
| | 2022 | 0.306 | 4.653 | 0.077 | 0.005 |
| PT Summarecon Agung Tbk. (SMRA) | 2020 | 0.049 | 1.422 | 0.013 | 0.441 |
| | 2021 | 0.099 | 1.870 | 0.012 | 0.273 |
| | 2022 | 0.135 | 1.504 | 0.013 | 0.242 |
| PT Ciputra Development Tbk. (CTRA) | 2020 | 0.170 | 1.778 | 0.066 | 0.174 |
| | 2021 | 0.215 | 1.997 | 0.062 | 0.129 |
| | 2022 | 0.219 | 2.186 | 0.061 | 0.133 |

Source: Prepared by Author (2023)

Tax avoidance can occur due to several factors, including profitability, liquidity, and capital intensity. The values of net profit margin, current ratio, capital intensity, and effective tax rate are shown in Table 1.2 above for certain companies in the property and real estate sectors that are listed on IDX for the 2020–2022 period. According to applied theory and industry phenomena, the table above demonstrates that there are disparities in profitability, liquidity, and capital intensity in connection to the ETR. The ETR value, in accordance with Sari et al. (2021), displays the degree of tax avoidance that the company is capable of. As the ETR value rises, the levels of tax avoidance decline. On the other side, there are more tax avoidance strategies used when the ETR value is low.

The ability of a company to make a profit in relation to its total assets, sales, and owned capital is measured by its profitability. Profitability can be measured by some ratios, one of them which is Net Profit Margin (NPM). A high NPM shows that the business can make large earnings at a specific sales level, which is a sign of strong financial health, or a company can effectively control its costs and provide goods or services at a price significantly higher than its expenses. It was inconsistent between net profit margin and effective tax rate in PT Pakuwon Jati Tbk. (PWON). NPM decreased from 0.281 in 2020 to 0.271 in 2021 and then increased to 0.306 in 2022. Meanwhile, effective tax rate changed from 0.026 in 2020 to 0.009 in 2021 and to 0.005 in 2022. The relationship between the NPM and ETR is the net profit, which the numerator of the NPM is affected by the profit after income tax and income tax expense on the ETR.

Lower ETR can be typically the result of higher NPM, which suggests that the corporation may be taking tax avoidance measures. As supported by the previous study by Darsani & Sukartha (2021), profitability plays a role in determining the tax burden because companies that make more money will have to pay more taxes, but companies certainly do not prefer to pay high taxes. Due to the company's increased income, it is increasingly engaging in tax avoidance. A company that is more profitable will be more inclined to use tax avoidance strategies to avoid paying greater taxes. They stand a better chance of positioning themselves to lower their tax obligation.

Based on previous research done by Darsani & Sukartha (2021), Lestari & Solikhah (2019), and Jaeni et al. (2019), profitability has significant impact on tax avoidance. Meanwhile, research conducted by Umar et al. (2021) found that profitability has insignificant impact on tax avoidance. Thus, based on the research gap the author will examine whether profitability has an impact on tax avoidance.

Tax avoidance can also be affected by liquidity. Liquidity can measure how efficiently or easily the assets held by the company be liquidated to meet short-term debt. Good cash flow can be seen from a high level of liquidity. Liquidity can be measured by some ratios, one of them which is Current Ratio (CR). A company's ability to pay short-term debt that will mature when it is collected is gauged by its current ratio (Damsut & Shanti, 2023). In PT Summarecon Agung Tbk. (SMRA), it also showed inconsistency between current ratio (CR) toward effective tax rate. During 2020 to 2021, Current Ratio increased from 1.422 to 1.870 and then decreased to 1.504 in 2022. Meanwhile, effective tax rate changed from 0.441 in 2020 to 0.273 in 2021 and to 0.242 in 2022.

A company has strong liquidity if its current assets are much more than its current liabilities. A business with high liquidity typically has a healthy cash flow and is more likely to fulfil its commitments, including making required tax payments. Conversely, the company with lower liquidity may struggle to meet its short-term obligations, which can lead them to resort the tax avoidance. As supported by previous research done by Sarasati & Asyik (2019), lower tax avoidance will emerge from the company having a better liquidity ratio, which indicates that its finances are strong enough for it to meet its tax obligations.

Based on previous research done by Pasaribu & Mulyani (2019), Sarasati & Asyik (2019), and Abdullah (2020), liquidity has significant impact on tax avoidance. When a company's liquidity is limited, preserving cash flows takes precedence above paying taxes. The amount of effort put into tax avoidance will decrease the more liquid the firm is. Furthermore, Gultom (2021) concluded that tax avoidance is insignificant influenced by liquidity. It is crucial to conduct a retest of liquidity against tax avoidance because of the inconsistent results of earlier research.

Capital intensity, or the investment activities carried out by businesses that are linked to investments in the shape of inventories and fixed assets, is one of the other variables that has an impact on tax avoidance. A company's capital intensity ratio indicates how much of its wealth is allocated to fixed assets (Siregar & Widyawanti, 2020). In PT Ciputra Development Tbk. (CTRA), it also showed inconsistency between capital intensity toward effective tax rate. The capital intensity decreased from 0.066 to 0.062 to 0.061 during 2020 to 2021 to 2022. Meanwhile, tax avoidance also decreased from 0.174 to 0.129 during 2020 to 2021 but increased to 0.133 in 2022.

The level of investment in fixed assets that a company makes is referred to as capital intensity. Depreciation costs are directly related to the ownership of fixed assets. The depreciation costs related to fixed assets cause the company's tax liability to decrease as the financial period concludes. This is so that the company's profits, which are impacted by the inclusion of depreciation costs, are reduced, lowering taxable income. Companies with high capital intensity generally tend to incur higher depreciation expenses, which in turn, decrease their taxable income, consequently leading to a lower tax expense. Thus, high capital intensity companies will result lower ETR to indicate high tax avoidance practice. As supported by previous research done by Aryatama & Raharja (2021), companies with higher capital have more opportunities to do tax avoidance. If an investment business has a high concentration of fixed assets, there are numerous alternatives for it to select tax-efficient fixed asset financing. Additionally, since fixed asset investment costs like depreciation are deductible expenses, it can affect the amount of tax paid.

Based on previous research done Aryatama & Raharja (2021), Darsani & Sukartha, (2021), and Suciarti et al. (2020), capital intensity has significant impact on tax avoidance. The corporation will have to pay less tax because of having a greater capital intensity ratio. Furthermore, Faradisty et al. (2019), Marsahala et al. (2020), and Masrurroch et al. (2021) concluded that capital intensity has insignificant impact with tax avoidance. Thus, based on the research gap, the author will examine whether capital intensity has an impact on tax avoidance.

Therefore, tax avoidance itself is impacted by multiple factors, such as profitability, liquidity, and capital intensity. In PT Pakuwon Jati Tbk. (PWON), it also showed inconsistency between NPM, current ratio, and capital intensity toward effective tax rate. During 2020 to 2021, Net profit margin of PT Pakuwon Jati Tbk. (PWON) decreased from 0.281 to 0.271, but the current ratio increased from 1.981 to 3.794, however the capital intensity and effective tax rate decreased from 0.089 to 0.080 and 0.026 to 0.009, respectively. Meanwhile, during 2021 to 2022, Net profit margin of PT Pakuwon Jati Tbk. (PWON) increased from 0.271 to 0.306 and the current ratio increased from 3.794 to 4.653, however the capital intensity and effective tax rate decreased from 0.080 to 0.077 and 0.009 to 0.005, respectively. Furthermore, profitable company generally can fulfil the short-term obligations. A high level of liquidity enhances a company's ability to garner support from other entities. This, in turn, contributes to improved profitability. A profitable company can typically be indicated by a higher Net Profit Margin value. Companies with high capital intensity may also have higher profits, as they often require investments in fixed assets, which contribute to generate revenue from sales. As a company's profit increases, its income tax liabilities also escalate. Consequently, the company may resort to tax avoidance practices to avoid paying higher taxes with the aim of maximizing profits.

The author's interest in this topic comes from the fact that taxes are the backbone and main income source of a nation to meet its needs. However, despite the importance of taxes, many companies continue to use tax avoidance practice. This inspires the author to conduct research titled **"The Impact of Profitability, Liquidity, and Capital Intensity on Tax Avoidance in Property and Real Estate Companies Listed on the Indonesia Stock Exchange."**

## 1.2 Problem Limitation

This research paper focuses on the impact of independent variables, which are profitability, liquidity, and capital intensity, toward dependent variable, which is tax avoidance. The research is limited on property and real estate companies listed on the Indonesia stock exchange for the period from 2020 to 2022.

## 1.3 Problem Formulation

The problem formulation of this study defined as follows:

1. Does profitability have significant impact towards tax avoidance in property and real estate companies listed on the Indonesia Stock Exchange?

2. Does liquidity have significant impact towards tax avoidance in property and real estate companies listed on the Indonesia Stock Exchange?
3. Does capital intensity have significant impact towards tax avoidance in property and real estate companies listed on the Indonesia Stock Exchange?
4. Do profitability, liquidity, and capital intensity have significant impact towards tax avoidance in property and real estate companies listed on Indonesia Stock Exchange?

## 1.4 Objectives of the Research

The main aim of this research is to accomplish the following objectives:

1. To examine the significant impact of profitability towards tax avoidance in property and real estate companies listed on the Indonesia Stock Exchange.
2. To examine the significant impact of liquidity towards tax avoidance in property and real estate companies listed on the Indonesia Stock Exchange.
3. To examine the significant impact of capital intensity towards tax avoidance in property and real estate companies listed on the Indonesia Stock Exchange.
4. To examine the significant impact of profitability, liquidity, and capital intensity towards tax avoidance in property and real estate companies listed on the Indonesia Stock Exchange.

## 1.5 Benefit of the Research

The objectives of this research are as follows:

### 1.5.1 Theoretical Benefit

By adding new data or resources, especially in the areas of accounting and taxation, this research is expected to advance scientific understanding. In addition, this study may be compared to future research on the factors influencing tax avoidance and used as a reference. A more thorough theoretical knowledge of the impact of profitability, liquidity, and capital intensity on tax avoidance in the property and real estate companies is anticipated because of this research.

### 1.5.2 Practical Benefit

This research has also practical benefits which are:

1. Benefits for companies

   This study is anticipated to provide a broader perspective on how the independent variables influence the dependent variable. The result of this research is expected to provide insights about the tendency of property and real estate companies practicing tax avoidance.

2. Benefits for users of financial statements

   Insights from this study are intended to assist stakeholders, particularly those in the real estate and property industries, in making decisions.

3. Benefits for other researchers

   Similar research can be conducted in other industries to shed more light on how profitability, liquidity, capital intensity, and tax avoidance are related. By doing research with additional variables, it is also possible to generate more studies to acquire a more thorough understanding.