CHAPTER I

INTRODUCTION

1.1 Background of Study

Tax acts as the state's major source of revenue to finance the state's expenditures in realizing infrastructure projects to support the development and welfare of a country. Tax is a mandatory contribution from every individual and entity taxpayer in the form of payment to the state for earning income.

Table 1.1 State Revenue Realization

Source of Revenue	Realization of States Revenue (Billion Rupiah)			
	2019	2020	2021	2022
Tax Revenue	1,546,141.90	1,285,136.32	1,547,841.10	1,924,937.50
Non-Tax Revenue	408,994.30	343,814.21	458,493.00	510,929.60
Grant	5,497.30	18,832.82	5,013.00	1,010.70
Total Revenue	1,960,633.50	1,647,783.35	2,011,347.10	2,436,877.80

Source: Badan Pusat Statistik (2023)

Data displayed in Table 1.1 obtained from *Badan Pusat Statistik* (BPS) indicates that tax revenue realization contributes the largest amount approximately 76% to 78% to Indonesia's revenue compared to the other type of realization. Additionally, from the table above, the tax revenue realization has signified improvement in 2021 and 2022 since the last fall in 2020 due to the outbreak of Covid-19.

The performance of tax revenue can be determined by measuring the ratio of tax revenue to Gross Domestic Product (GDP) (Mappadang, 2020). According to the Directorate General of Tax, the tax ratio of Indonesia decreased to 9.76% in 2019, dropped to 8.33% in 2020, started to elevate to 9.12% in 2021, and grew to

10.39% in 2022. The tax ratio successfully increased in 2021 and 2022, but it is low compared to the ideal tax ratio according to the International Monetary Fund (IMF) standard of 15%. Hence, a lower tax ratio indicates that the government still can't optimize tax revenue realization.

The government has been working on optimizing tax revenue to meet the targets of realization over the years, one of which is through taxation reformation. By enhancing the efficiency of the taxation system along with amendment of tax regulation to improve the collection of tax. However, the government is said to have failed to achieve the target of tax revenue realization in the last decade (KataData.co.id, 2020). One of the government's obstacles in collecting taxes is because of tax avoidance practices.

According to Tax Justice Network (2020), Indonesia recognized losses of US$ 4.75 billion from corporate tax avoidance. Different perspectives and goals of government and companies lead to tax avoidance practice. The government tends to optimize tax revenue while the company as a taxpayer conversely considers tax as an expense that needs to be reduced (Sarra, 2017). Consequently, tax avoidance practices arise as a strategy for the company to avoid paying high taxes. On the other hand, tax avoidance exploitation could harm the state's revenue.

Different from tax evasion which is defined as an illegal act of embezzling taxes, tax avoidance is carried out by taxpayers as a legal act to minimize tax payment by utilizing loopholes in tax regulations (Suciarti et al., 2020). Apart from legal and illegal, tax avoidance is still one of the most concerning issues that need to be reviewed.

Consumer goods companies are one of the essential industries in terms of supporting the daily needs of consumers ranging from processed foods, beverages, personal care, primary goods retail, agricultural, and tobacco. Moreover, this sector is associated with the income and consumption of consumers which will affect the production and contribute to the consumption of Indonesia's Gross Domestic Product (Putri, 2021).

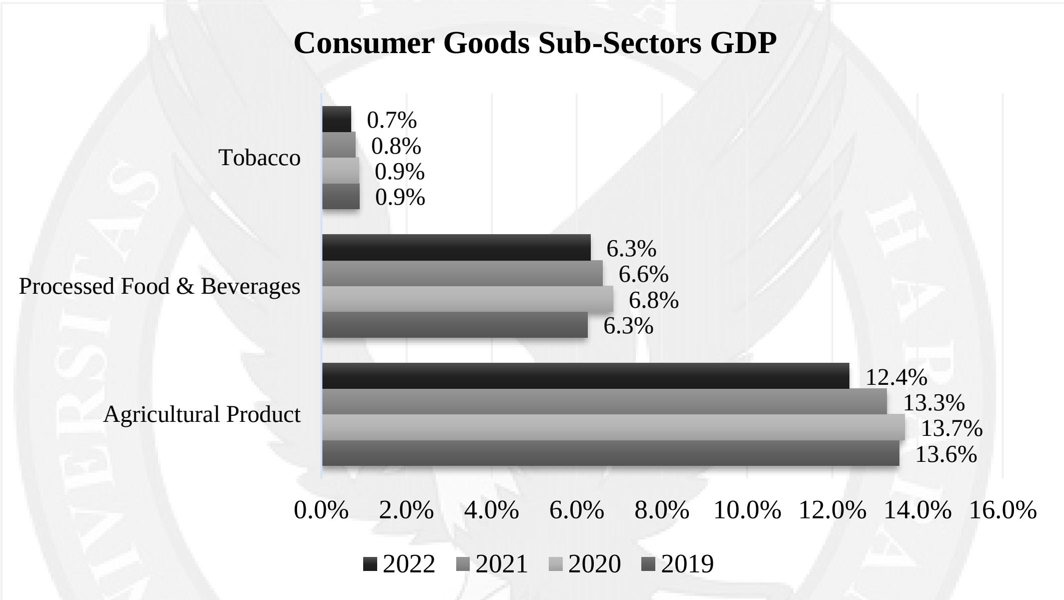

Figure 1.1 Consumer Goods Sub-Sectors GDP
Source: Badan Pusat Statistik (2023)

As represented by each sub-sector in Figure 1.1, despite the outbreak of Covid-19 in 2020 that has driven a decline in economic activity, and affected commodity prices as well as consumption of consumers, the consumer goods sector could show its unwavering position. Director of Schroders Indonesia, Irwanti implied that the consumer goods sector could be stable in the weakening economy condition because there is a surging demand and massive buying from consumers (CNBC Indonesia, 2020).

Tax avoidance phenomena that occurred in Indonesia specifically in the consumer goods industry was done by British American Tobacco (BAT) through the subsidiary company of PT Bentoel Internasional Investama Tbk (RBMA), one of the tobacco manufacturers. The scheme of tax avoidance was carried out through intra-company loans. Bentoel made loans through company located in the Netherlands namely Rothmans Far East BV which the source of loan funds was derived from another subsidiary of BAT in Jersey, UK-centric. Technically, Bentoel was supposed to make the payment of interest to the subsidiary in Jersey which owns the funds. This practice was motivated by the tax treaty agreement of Indonesia and the Netherlands for imposition of withholding tax on interest payments was 0% while England didn’t make such agreement with Indonesia. Consequently, Indonesia faced a loss of revenue of US$ 11 million per year for the imposition of tax amounted to 20% based on Indonesia taxation regulation (Kontan.co.id, 2019).

Another tax avoidance case that occurred in Indonesia was conducted by PT Coca-Cola Indonesia (CCI) during the fiscal years 2002 to 2006. The Directorate General of Tax found a large advertising expense for finished beverage products overrun in that year which is questionable and led to practices of transfer pricing to minimize taxes. Naturally, Coca-Cola Indonesia is divided into three companies that specialize in concentrate, packaging, and distribution. Therefore, the advertising cost incurred during that year was supposed to be borne by other Coca-Cola companies because CCI focuses on concentrated products. Eventually, the amount of taxable income declined as a result of large advertising expenses. DGT stated that CCI had taxable income amounting to IDR 603.48 billion at that time. However, CCI only reported IDR 492.59 billion of their taxable income. Thus, the difference in income tax imposed on CCI was IDR 49.24 billion (Kompas.com, 2014).

The case of tax avoidance is motivated by the desire to get high profits from the business activity. Consequently, companies seek opportunities to maintain profit along with reducing tax expenses. Thus, profitability, leverage, and transfer pricing can influence tax avoidance practices.

Profitability measures the company's performance in generating profits from available resources (Marsahala et al., 2020). The higher profits that a company can gain, the higher the tax imposed on the income. Profitability can be measured by using Return on Assets (ROA). Increasing ROA value will cause the Effective Tax Rate (ETR) to increase (Mappadang, 2020). Hence, a high level of profitability followed by lower effective tax rates indicates a high tendency for a company to conduct tax avoidance in minimizing tax payments.

There are two sources of funds in financing business activities such as liabilities and equity. Leverage indicates the extent of debt used to finance the company's business activities (Sadeva et al., 2020). Interest expense that arises from debt can be carried as a deductible expense in the fiscal reconciliation. As a result of interest expenses, the taxable income will decrease. The leverage ratio is assessed using the Debt-to-Equity ratio to reflect the portion of debt utilized by a company. A high ratio of leverage indicates that the company relies more on debt financing and is prone to conduct tax avoidance.

Transfer pricing is a price determination on transactions of goods or services to related parties. Transfer pricing is done by selling lower prices to the related parties and enabling the company to shift sales profit. In the scale of a multinational, the parent company can sell lower prices to companies in another country with lower tax rates as the strategy to report lower profit and be imposed with lower tax in the domiciled country (Novira et al., 2020). Transfer pricing is measured by comparing the number of receivables from related parties with total receivables. Eventually, higher trade receivable of related parties indicates a high probability for a company to engage in tax avoidance through transactions with related parties.

Table 1.2 Table of Phenomena Profitability, Leverage, Transfer Pricing, and Tax Avoidance in Consumer Goods Companies Listed on the Indonesia Stock Exchange

Company Name	Year	Profitability (ROA)	Leverage (DER)	Transfer Pricing	Tax Avoidance (ETR)
PT Bisi International Tbk (BISI)	2019	0.104	0.270	0.012	0.242
	2020	0.095	0.186	0.016	0.245
	2021	0.122	0.148	0.006	0.202
	2022	0.153	0.118	0.005	0.189
PT Indofood CBP Sukses Makmur Tbk (ICBP)	2019	0.138	0.451	0.737	0.279
	2020	0.072	1.059	0.549	0.255
	2021	0.067	1.157	0.521	0.205
	2022	0.050	1.005	0.490	0.253
PT Sinar Mas Agro Resources and Technology Tbk (SMAR)	2019	0.032	1.725	0.554	0.229
	2020	0.044	1.797	0.509	0.262
	2021	0.070	1.798	0.535	0.213
	2022	0.139	1.213	0.750	0.191

Source: Prepared by the Writer (2023)

Table 1.2 indicates that PT Bisi International Tbk (BISI) experienced increasing profitability as shown by the increase in ROA value in 2021 and 2022. BISI successfully generated net income of IDR 380,992 million in 2021 and IDR 523,242 million in 2022. Increasing ROA value of BISI is supported with increasing net sales by 19.8%. However, this circumstance shows inconsistency growth of increasing ROA from 0.095 to 0.122 and 0.153 followed by decreasing ETR value from 0.245 to 0.202 and 0.189 consecutively within the years 2020 to 2022. Generally, the value of ETR will increase in line with the increasing value of ROA because the higher net income is being imposed with higher income tax. This phenomenon also can be seen in PT Sinar Mas Agro Resources and Technology Tbk (SMAR) which experienced increasing ROA value from 2020 to 2022 followed by decreased ETR. Thus, the inconsistent growth of ROA followed by the declining ETR indicates the tendency for a company to conduct tax avoidance. Previous research conducted by Pangaribuan et al. (2021), Widyastuti et al. (2022), and Darsani & Sukartha (2021) found that profitability has a negative significant impact on tax avoidance. On the other hand, research conducted by Alfarizi et al. (2021) and Aya et al. (2022) found that profitability has no significant effect on tax avoidance.

PT Indofood CBP Sukses Makmur Tbk (ICBP) showed increasing debt-to-equity ratio (DER) from 0.451, 1.059, to 1.157 consecutively from 2019 to 2021. The rise of DER is caused by increasing short-term bank loans, long-term bank loans, and bonds payable. The high value of DER indicates the company engages more in debt to finance the business operation. As a result of the high portion of debt used by ICBP, the ETR showed a decreased ratio from 0.279 to 0.255 to 0.205. A high ratio of leverage will result in rising interest expenses derived from the liabilities. The interest expense that is incurred can be carried as a deductible expense in the fiscal reconciliation which causes the taxable income to be lower. Consequently, the higher value of DER followed by lower value of ETR indicates the possibility of a company to conduct tax avoidance. According to research conducted by Pangaribuan et al. (2021) and Widyastuti et al. (2022), leverage has a positive significant impact on tax avoidance. Meanwhile, Whardhany et al. (2021) found that leverage has a negative significant impact on tax avoidance. On the contrary, research conducted by Darsani & Sukartha (2021) and Lianawati (2021) found that leverage has no significant impact on tax avoidance.

PT Sinar Mas Agro Resources and Technology Tbk (SMAR) showed an increasing ratio of transfer pricing from 2020 to 2022 followed by decreasing ETR. SMAR recorded trade receivables of related parties about 53.5% in 2021 and 75% in 2022 from total trade receivables. Furthermore, one of the highest compositions related to parties' receivables about 52.53% in 2021 and 83.07% in 2022 is Golden Agri International Pte Ltd located in Singapore, which is the parent company of SMAR. Hence, the higher value of transfer pricing resulted in lower ETR representing the possibility of tax avoidance practices. Previously, research conducted by Alfarizi et al. (2021) and Lianawati (2021) found that transfer pricing positively significantly affects tax avoidance. Otherwise, research conducted by Aya et al. (2022) found that transfer pricing has a negative significant impact on tax avoidance. On the contrary, research conducted by Pangaribuan et al. (2021) and Whardhany et al. (2021) found transfer pricing has no significant impact on tax avoidance.

This research is carried out with the existence of a research gap from previous research on factors influencing tax avoidance along with the phenomena described. Therefore, the writer is encouraged to conduct research titled **"The**

Impact of Profitability, Leverage, and Transfer Pricing Toward Tax Avoidance in Consumer Goods Companies Listed on the Indonesia Stock Exchange."

1.2 Problem Limitation

This research is limited to problems such as:

1. The research specifically focused on consumer goods companies listed on the Indonesia Stock Exchange from 2019 to 2022.
2. This research utilized 3 independent variables and 1 dependent variable. The independent variables are profitability, leverage, and transfer pricing. While the dependent variable is tax avoidance.

1.3 Problem Formulation

Based on the background of the study presented, the problem formulations are established as follows:

1. Does profitability have a partial significant impact toward tax avoidance in consumer goods companies listed on the Indonesia Stock Exchange?
2. Does leverage have a partial significant impact toward tax avoidance in consumer goods companies listed on the Indonesia Stock Exchange?
3. Does transfer pricing have a partial significant impact toward tax avoidance in consumer goods companies listed on the Indonesia Stock Exchange?

4. Do profitability, leverage and transfer pricing have simultaneous significant impact toward tax avoidance in consumer goods companies listed on the Indonesia Stock Exchange?

1.4 Objective of the Research

Based on the problem formulations, the objective of this research aims to:

1. To determine whether profitability has a partial significant impact toward tax avoidance in consumer goods companies listed on the Indonesia Stock Exchange.
2. To determine whether leverage has a partial significant impact toward tax avoidance in consumer goods companies listed on the Indonesia Stock Exchange.
3. To determine whether transfer pricing has a partial significant impact toward tax avoidance in consumer goods companies listed on the Indonesia Stock Exchange.
4. To determine whether profitability, leverage and transfer pricing have simultaneous significant impact toward tax avoidance in consumer goods companies listed on the Indonesia Stock Exchange.

1.5 Benefit of the Research

This research is expected to deliver benefits in terms of theoretical and practical benefits as follows:

1.5.1 Theoretical Benefit

This research is expected to deliver information and improve the writer's understanding regarding profitability, leverage, and transfer pricing as the factors influencing tax avoidance in consumer goods companies listed on the Indonesia Stock Exchange.

1.5.2 Practical Benefit

1. This research is expected to raise awareness and consideration for companies regarding the implementation of tax avoidance with relation to variables of profitability, leverage, and transfer pricing.
2. This research is expected to provide as reference for future researchers in conducting study on the topic of tax avoidance with related variables.