CHAPTER I

INTRODUCTION

1.1 Background of the Study

Taxes are generally regarded as one of the most vital sources of state revenue in Indonesia (Wibowo et al., 2023). The contribution of tax as the main national revenue can be seen from the data published by Indonesia's Ministry of Finance from 2018-2022. During these years, tax revenue had consistently made up most of the national revenue with an average of 78,58%. According to Law Number 16 Year 2009, taxes are obliged contributions to the government made by individuals or organizations that are forceful under the law, which do not directly compensate taxpayers, and are used to fund public needs for the benefit of the society. Tax revenues are utilized to finance government expenditures which spending managed to increase Indonesia citizens welfare.

Given that taxes are the main revenue source, it is understandable for government to use a variety of measures to increase tax collection. However, the government plan to optimize tax revenues has always been inhibited as businesses view taxes as burdens that will lower the net profit, they earn (Hasyim & Jiwayana, 2021). As a result, businesses will attempt to minimize their tax payments by engaging in aggressive tax planning activities. Additionally, tax aggressiveness could also be contributed by tax collection system Indonesia employed, which is self-assessment system, which provides taxpayers the authority, trust, and responsibility to calculate, pay and report its tax expense in accordance with the law.

Tax aggressiveness is an action of tax planning that is used to manipulate profits in order to reduce the burden of taxes. According to Amarissa et al. (2023), companies may conduct tax aggressiveness in two ways: by tax evasion and tax avoidance. The difference between tax evasion and tax avoidance lies in their legal standpoint. Tax avoidance is described as the legal practice of minimizing or reducing tax liabilities through cautious arrangements that exploit loopholes in tax regulations (Putra & Zahroh, 2023). Tax evasion, on the other hand, is regarded as an illegal practice to lower tax burdens. Aggressive tax evasion reduces potential income from the taxation sector. This will decrease the amount of funding available to support community welfare activities (Sari & Prihandini, n.d., 2019).

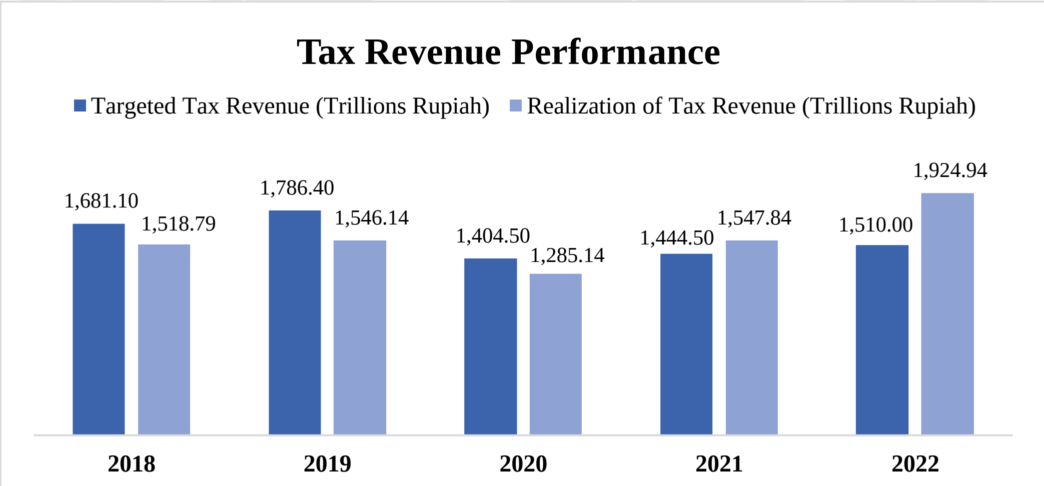

Figure 1.1 Tax Revenue Performance
Source: Ministry of Finance of the Republic of Indonesia (2018-2022)

As indicated by the information in Figure 1.1, it described that the amount tax revenue realized improved from year 2018 to 2019. Regardless of the yearly improvement, Indonesia continues failure to reach the government's objective for tax revenue set in the state budget. In 2020, to face the challenges due to COVID-19, the Indonesian government established a tax revenue objective modification. Namely, Presidential Decree Number 72 Year 2020, which decreases the targeted tax revenue from IDR 1.865.702.816.382.000 to IDR 1.404.507.505.772.000. Even with this modification, Indonesia remains below its targeted tax revenue. The sequence of events from 2018 until 2020 indirectly suggests that there are certain factors that underpin these conditions, such as low tax compliance, which may provide additional clues that individuals may engage in tax aggression.

Although in 2021 and 2022 Indonesia has exceeded its targeted tax income with surpluses of 7,15% and 27,48%, correspondingly. This does not eliminate the occurrence of tax aggressiveness of taxpayers, which is indicated by tax ratio. As a comparison between the amount of tax collected and the Gross Domestic Product (GDP), tax ratio measures public's compliance in tax payment (Purnomolastu N, 2021). OECD in presented Revenue Statistics in Asia and the Pacific (2023), tax ratio for Indonesia was 10.9% in 2021, which was 8.9% lower than the 19.8% average for Asia and the Pacific. Additionally, Sri Mulyani Indrawati, Indonesia's Minister of Finance, stated that Indonesia's overall tax ratio fell below both regional and international benchmarks which is 15% (Kevin, 2019). It indicates a high possibility of tax aggressive approaches by taxpayers in Indonesia.

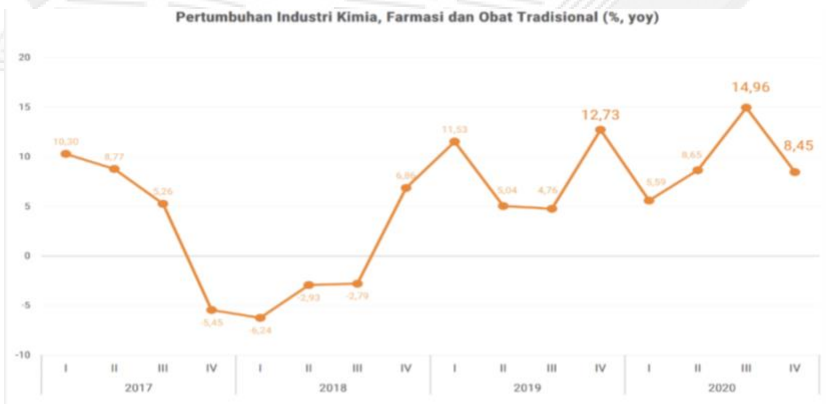

Figure 1.2 Development of Chemical, Pharmaceuticals and Traditional Medicine Industries (%, yoy)
Source: Ministry of Industry of the Republic of Indonesia (2021)

Based on Figure 1.2 it shows that in Q3 to Q4 of 2018, Pharmaceuticals sector in Indonesia has grown 9,65%, this growth continues on to 2019 and 2020. The Chemical Industry, Pharmacy, and Traditional Medicine (*IKFOT*) GDP contribution on Non-Oil and Gas Industry GDP has also increased, and as of 2019, this industry's contribution ranks second after the Food and Beverage Industry, at 9.6% (Kementrian Industri, 2021). The COVID-19 pandemic, which emerged in early 2020, increased the need for supplements, vitamins, and herbal medicines. As a result, the pharmaceutical industry experienced substantial development to survive the pandemic, as indicated by the Industrial GDP of Chemistry, Pharmacy, and Traditional Medicine (*IKFOT*) grew the most out of the fifteen non-oil and gas industries, which is 9,39% (Kementrian Industri, 2021). According to the same publication made by the Ministry of Industry in 2021, the contribution of the Chemical Industry, Pharmacy, and Traditional Medicine to the GDP (excluding oil and gas) grew by 10,75% in 2020.

When discussing tax aggressiveness, pharmaceutical companies should also be taken into consideration. According conducted by Sihombing & Dalimunthe (2022) states that Indonesian KPK has estimated potential state income from pharmaceutical industry taxes of IDR 32 trillion to IDR 40 trillion. However, only 40% of the total estimated figure was received by the government. This amounts to an expected loss of IDR 19,2 trillion to IDR 24 trillion in tax income from the pharmaceutical industry.

There are several factors known to affect tax aggressiveness. However, in this study, only three factors are identified and used in this research by the author as having the potential to result in tax aggressiveness in pharmaceutical industry, with the first factor being profitability. Profitability ratio shows the ability of a company to earn profits by measuring the value of investment and sales of the company (Anggraini & Agustina, 2022).

Usually, the higher profitability ratio of a company means they generate a larger profit. As the total amount of tax paid by a company and the amount of profit it generates are usually proportionate, businesses that generate a lot of revenue often have to pay a considerable amount of taxes (Wibowo et al., 2023). This theory could explain the tax aggressiveness act in the pharmaceutical industry considering the sector's enormous growth, which might suggest more revenue flow.

The second factor is liquidity. Liquidity is known as a ratio that shows how well a company manages their short-term debt (Anggraini & Agustina, 2022). According to Anggraini & Agustina (2022) when a company has high liquidity, it means that cash flow is strong, allowing it to meet short-term obligations including tax payable. On the contrary, if company has low liquidity, which indicates weak cash flow, it is unwilling to pay the appropriate taxes. According to Kementrian Industri (2021) even though Indonesia’s pharmacy sector grows, the production of medicine as of May 2020 is low, due to dependency on raw materials approximately 60% imported from China. This import activity can be an indicator that obligations in pharmaceutical industries are growing.

The third factor is capital intensity. Capital intensity can be used to determine the amount of money the firm has spent on fixed assets (Amarissa et al., 2023). Fixed asset value will continue to decrease each year through depreciation, which can be used by an organization to reduce its gross income and minimize its tax liabilities (Yahya et al., 2022). Patents, products, and competencies are some of the assets pharmaceutical businesses rely on (PwC, 2023). These resources are crucial to the pharmaceutical industry's value growth and can produce a long-lasting competitive advantage. Kementrian Industri (2021) states in pandemic era, the demand for pharmaceutical commodities and medical devices in Indonesia experienced a significant increase. This could indicate that most pharmaceuticals companies have increased their fixed asset investment. Additionally, companies can acquire assets through mergers and licensing deals, and they can also spend money on innovation by buying up smaller businesses (Jiang et al., 2021). In 2021 and 2022, PT. Pyridam Farma Tbk adopts this strategy by acquiring PT. Holi Pharma and 100% of the shares of PT Ethica Industri Farmasi (pyfadmin, 2022).

To further explain the tax aggressiveness with the factors suggested above, the author has chosen three pharmaceutical companies as below:

Table 1.1 The Phenomenon of Profitability (ROA), Liquidity (CR), and Capital Intensity (CIR) toward Tax Aggressiveness (ETR) of Several Pharmaceutical Companies listed on the Indonesia Stock Exchange from 2018 to 2022

Company	Year	ROA	CR	CIR	ETR
PT. Tempo Scan Pasific Tbk	2018	0,0687	2,52	0,3481	0,257
	2019	0,0711	2,78	0,3512	0,253
	2020	0,0916	2,96	0,3475	0,216
	2021	0,0910	3,29	0,3531	0,201
	2022	0,0916	2,48	0,3217	0,220
PT. Kalbe Farma Tbk	2018	0,1376	4,66	0,4132	0,245
	2019	0,1252	4,35	0,4462	0,254
	2020	0,1241	4,12	0,4205	0,228
	2021	0,1259	4,45	0,3878	0,220
	2022	0,1266	3,77	0,3866	0,226
PT. Merck Tbk	2018	0,0296	1,37	0,2294	0,256
	2019	0,0868	2,51	0,2509	0,378
	2020	0,0773	2,55	0,2705	0,322
	2021	0,1283	2,71	0,2515	0,309
	2022	0,1733	3,33	0,2333	0,244

Source: Prepared by Author (2023)

As indicated in Table 1.1, profitability is determined by ROA, liquidity by CR, capital intensity by CIR, and tax aggressiveness is determined by ETR (Effective Tax Rate). It should be noted that the higher ETR is, the less tax aggressive is done by the company. PT. Tempo Scan Pasifik Tbk (TSPC) reported an improvement in profitability from 2018 to 2022 due to a positive increase in net income as well as total assets. Net income as a numerator has risen by an average of 18,43%, while total assets as a denominator have increased by an average of 9,63%. As mentioned before, companies with greater profitability typically have larger tax obligations. However, from 2018 to 2021, ETR for TSPC declined.

From 2018 to 2022, liquidity (current ratio) in PT. Merck Tbk (MERK) increased. Current assets and current liabilities both have impact on the current ratio. MERK's current liabilities as denominator decreased throughout the year by 18,09%, while current asset as the numerator also experienced an overall decrease of 3,34%. As the decrease in liabilities is higher than assets, the liquidity of MERK keeps on increasing. Thus, it is believed that the business can fulfill its short-term obligations on schedule. As previously explained, a rise in liquidity indicates that businesses would be more eager to settle their tax obligations, which will result in a rise in ETR. However, MERK had a decline in ETR from 2019 to 2022.

In most circumstances, a rise in the capital intensity ratio usually results in a fall in ETR. Data from PT. Kalbe Farma Tbk (KLBF) from 2018 to 2021, however, contradicts this. It demonstrates that as capital intensity rises, ETR rises as well, and vice versa. In 2019, the ETR increased by an unbalanced 6,91% in the numerator (tax expenses) and 2,91% in the denominator (income before tax). Tax expenses grew as a result of permanent differences in the fiscal reconciliation, which increased taxable income by nearly 11,36% from the previous year. These cases from PT. Tempo Scan Pasifik Tbk, PT. Kalbe Farma Tbk, and PT. Merck Tbk demonstrates the inconsistent relationship that exists between profitability, liquidity, and capital intensity toward tax aggressiveness.

Additionally, prior research has sought to correlate tax aggressiveness with profitability, liquidity, and capital intensity. However, those studies conducted were unable to provide one conclusive result. Research conducted by Anggraini & Agustina (2022) states that profitability, liquidity, and capital intensity affect tax aggression, this result contradicts with the research conducted by Sumiati & Ainniyya (2021) that states profitability and capital intensity does not affect tax aggressiveness and research by Amalia (2021) that states liquidity does not affect tax aggressiveness. Due to the inconsistency of the results of previous research and cases suggested above, the author conducts this research titled **"The Influence of Profitability, Liquidity, and Capital Intensity toward Tax Aggressiveness of Pharmaceuticals Companies Listed on the Indonesia Stock Exchange"**.

1.2 Problem Limitation

1. The object of this research is limited to pharmaceuticals companies listed on the Indonesia Stock Exchange.
2. The variables for this research are profitability, liquidity, and capital intensity as independent variables and tax aggressiveness as the dependent variable.
3. The period of this research is 2018-2022.

1.3 Problem Formulation

1. Does profitability have significant influence toward tax aggressiveness on pharmaceuticals companies listed on the Indonesia Stock Exchange?
2. Does liquidity have significant influence toward tax aggressiveness on pharmaceuticals companies listed on the Indonesia Stock Exchange?
3. Does capital intensity have significant influence toward tax aggressiveness on pharmaceuticals companies listed on the Indonesia Stock Exchange?
4. Do profitability, liquidity, and capital intensity have significant influence toward tax aggressiveness on pharmaceuticals companies listed on the Indonesia Stock Exchange?

1.4 The Objective of the Research

Some objectives of this research according to the problem formulation stated above, are listed below:

1. To analyze the significant influence of profitability toward tax aggressiveness of pharmaceuticals companies listed on the Indonesia Stock Exchange.
2. To analyze the significant influence of liquidity toward tax aggressiveness of pharmaceuticals companies listed on the Indonesia Stock Exchange.
3. To analyze the significant influence of capital intensity toward tax aggressiveness of pharmaceuticals companies listed on Indonesia Stock Exchange.

4. To analyze the significant influence of profitability, liquidity, and capital intensity toward tax aggressiveness of pharmaceuticals companies listed on the Indonesia Stock Exchange.

1.5 Benefit of the Research

The Benefit of conducting this research is stated below:

1.5.1 Theoretical Benefit

This study will hopefully be useful as a guide in the advancement of economics, particularly in tax accounting. In addition, it is anticipated that this research will be recognized in the literature and provide fresh perspectives and ideas for future studies on tax aggressiveness, profitability, liquidity, and capital intensity.

1.5.2 Practical Benefit

The study is anticipated to produce information that might be used as a resource by a number of parties in regard to the decisions or policies taken. By offering viewpoints on tax evasion, this research can assist businesses in preventing it and avoiding tax fines. Investors may use this information to better understand how business management addresses tax rules. This report may be used to help the Directorate General of Taxes make future tax policy choices.