CHAPTER I

INTRODUCTION

1.1 Background of the Study

Indonesia is an economically developing country which main source of income is taxes. Law on General Provision and Tax Procedure Article 1 paragraph 1 defines tax as mandatory payments to the state that are owed by individual or entity that are coercive. These payments are indirectly used to fund the state's operations in order to ensure the prosperity of people (Mahkamah Konstitusi, 2020). This definition clearly emphasizes that one of the functions of the tax is as a budgetary, where tax is a tool or source to inject money into the state finance state expenditures, including development and social welfare. Individuals and entities are required to contribute by paying their tax voluntarily to the state. However, taxpayers, in this research focusing on entities, tends to be burden by tax as it reduces company's profit. Therefore, entities could use legal option to utilize tax planning and tax avoidance to reduce the amount of tax the entities owe.

Tax avoidance and tax planning are considered legal in the law where it could reduce tax burden by taking advantage of the country's tax laws' flaws so that they are considered legal and do not violate the law. Tax planning, on the other hand, reduces the amount of tax through a system that is precisely outlined in the laws and does not lead to disagreements between tax subjects and tax authorities (Prawati, 2021).

Companies would minimize their tax payment by taking advantage of flaws in taxation laws and this would benefit the company as they could get tax benefit without violating any regulations. An example of this loophole that could leads to tax avoidance activity is Income Tax Law Article 31E Paragraph 1 where it provides facilities to reduce tax rate by 50% for entities that has a gross turnover between IDR 4.8 billion to 50 billion. This article could be misused by a company where they minimize their income tax payable by delaying sales record at the end of the period. By practice, when companies receiving order from customers at the end of the year, they managed to deliver it in the next period to retain their sales balance not exceeding new limit of income tax charge. Therefore, this could provide a good benefit for company where they would maintain gross turnover between IDR 4.8 billion and IDR 50 billion to gain the tax benefit.

In this research, tax avoidance is being assessed using Effective Tax Rate (ETR) formula where it is calculated by dividing tax burden by the income before taxes. This formula shows all the company's tax burdens including final taxes and debt or deferred tax benefits, therefore ETR is being used because tax avoidance does not only come from income tax, but also from other tax burden that can be borne by the company (Jati et al., 2019). Low effective tax rate is implied by the low tax burden because it means the company pay less in taxes overall.

Several factors could affect companies when engaging in tax avoidance activities and one of the factors that researcher use in this research is profitability. Every goal of a company is to generate more profit and the measurement for it is called profitability. Profitability itself reflect how well management/company's ability to use company resources to produce sales and manage business operations (Parrino, R., 2017). Result of profitability ratio is determined by comparing its profits to the assets or capital that provide those profits. Higher profitability would mean greater profit and higher tax burden which could lead to companies trying to do tax avoidance to minimize those tax burden. To measure profitability, researcher decided to use ROA (Return of Asset), which means ability to generate profit by utilizing its assets and it could show company's efficiency in managing the assets.

Second factor is leverage. Company with high profitability does not always mean that the business is free from debt. Therefore, knowing the company's leverage ratio is crucial since it indicates whether the company finance itself with debt or not. The meaning of leverage itself is a ratio that evaluate to what extent a certain company use debt financing instead of equity financing for its activities (Parrino, R., 2017). Higher leverage ratio means a higher chance that company performed tax avoidance. The reason behind the statement before is because increase in amount of debt that results in additional cost in the form of interest could cause a reduction in the income tax expense of company. In conclusion, this could become one of the strategies to take advantage of debt policies to reduce tax burden.

The third factor is firm size, which is used to classify a company's size based on a variety of variables, including income, total assets, and total capital. Companies that have a larger size will balance their large operational activities so it could also generate a larger profit/income. Large companies typically work to avoid excessive profit increases in order to prevent an excessive increase in income tax. When there is excessive profit increases, larger scale company have the ability to postpone income to the following period so that it will not be recognized directly in the current period. The postponed income effect on earnings that appear lower which resulted in fewer tax payments (Kartikaningdyah, 2019).

This research's focus is on consumer goods companies especially in consumer non-cyclicals goods companies consists of publicly traded businesses that deal with goods purchased by households and also individual. Consumer non-cyclical goods companies will still be able to grow even when the economy condition slows down. In other words, this business is one of those that grows frequently because it is desperately needed to provide basic necessities. Based on CNBC Indonesia, consumer non-cyclical goods industry especially fast-moving consumer goods (FMCG) is one of Indonesia's prominent industries and it gave a significant contribution to national economic development. This industry develop along with the increasing of demand and changes of lifestyle of the consumer.

During the Covid-19 pandemic, all industry in Indonesia is being negatively impacted, but consumer goods companies showed that they are the least impacted. Therefore, researcher chose period 2020 and 2021 for this research. Below is the graph showing the contributed GDP of consumer goods companies:

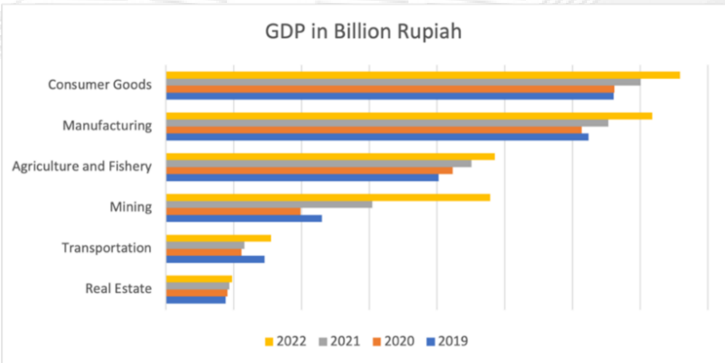

Figure 1.1 GDP of industry in Indonesia during the year 2019-2022
Source: Prepared by researcher (2023)

Other than the GDP contribution of consumer goods industry toward Indonesia, report of APBN KiTa that is being issued in December 2021 showed that manufacturing industry contribution toward tax revenue is 29.9% and consumer goods industry is part of manufacturing industry. Food and beverage, cigarette, pharmaceuticals, cosmetics and household goods, and house appliances are sub-sector under consumer goods.

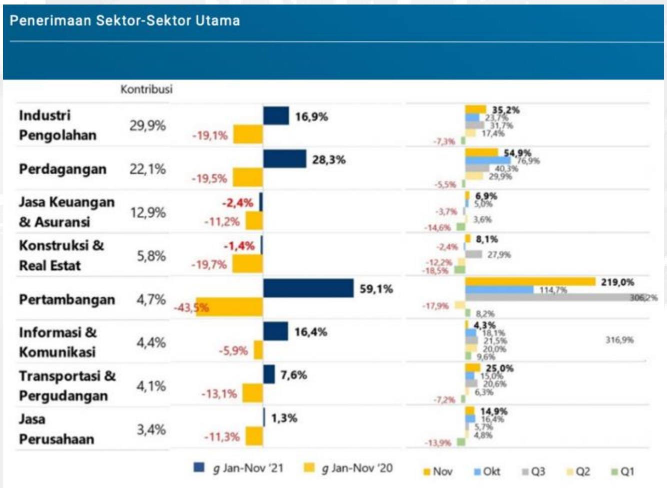

Figure 1.2 Contribution of industry in Indonesia toward tax revenue during the year 2020-2021
Source: APBN KiTa (2021)

Below table shows profitability, leverage, firm size, and tax avoidance result:

Table 1.1 The Phenomena of Profitability, Leverage, Company Size and Tax Avoidance at Consumer Goods Companies Listed in Indonesia Stock Exchange from 2020 to 2021

Company Name	Year	Profitability (ROA)	Leverage (DER)	Firm Size	Tax Avoidance (ETR)
PT Campina Ice Cream Industry (CAMP)	2020	0,041	0,130	27,714	0,225
	2021	0,087	0,122	27,768	0,207
PT Japfa Comfeed (JPFA)	2020	0,047	1,274	30,887	0,272
	2021	0,075	1,182	30,984	0,237
PT Kurniamitra Duta Sentosa (KMDS)	2020	0,11	0,12	25,7	0,237
	2021	0,02	0,29	26,11	0,117

Source: Prepared by researcher (2023)

Based on table above, the profitability (ROA) of PT Campina Ice Cream Industry (CAMP) in 2021 compare to 2020 is increasing from 0,041 to 0,087 due to massive increase in net profit from IDR 44.04 billion to IDR 100.06 billion. The cause of increase in net profit is the increase in net sales, massive decrease in expenses especially in general and administrative expense and other expenses. Based on the note for other expenses, the financial statement stated a decrease in tax from around IDR 5.1 billion to IDR 478 million. Increase in profitability should result in increase in the amount of tax paid (ETR) (Puspitasari et al., 2021). However, ETR result of PT Campina Ice Cream Industry (CAMP) in 2021 compared to 2020 is decreasing from 0,225 to 0,207. This result indicates that there might be tax avoidance activity.

Previous research done by Prapitasari & Safrida (2019) and Novianto (2021) stated profitability effect tax avoidance. Meanwhile, Mulyati et al. (2019), Handoyo et al. (2022), and Alfina et al. (2020) stated profitability has no effect on tax avoidance because result of ROA could indicates that company has been utilizing their assets efficiently and effectively so they could afford to pay the tax burden of the company. Therefore, company would prefer to pay tax burden over having to engage in tax avoidance activity.

Next is the second variable which is leverage. The leverage result of PT Japfa Comfeed (JPFA) is decreasing during the year 2021 compare to 2020. JPFA experienced decrease of leverage from 1,274 to 1,182 because of increase in both liabilities and equity of the company. This is due to the increase in equity around 14.8% but not along with the growth of liabilities which only increase by 6.5%.

Level of leverage could show usage of equity financing compare to the debt financing. Simply put, the higher the leverage, the higher usage of debt financing that could create greater interest payment. Therefore, company could use interest expense that come from interest payment to become the deductible expense which could lessen the amount of tax burden (Puspitasari et al., 2021).

Meanwhile, JPFA's leverage suffer decrease which means company would have a higher ETR due to the decrease in deductible expense. But, the result of Table 1.1 showed that the ETR of the company also decrease from 0,272 to 0,237. Therefore, there might be tax avoidance activities happened in the company.

Research done by Mulyati et al. (2019) and Alfina et al. (2020) stated leverage effect tax avoidance. Alfina et al. (2020) stated that leverage is used to assess how much a firm relies on debt to fund their daily operation because debt owned by the company could be resulted in the emergence of interest expenses that can be a deduction for taxable profits, while dividends that come from equity funding could not be deductible for profit. Therefore, high or low leverage could affect tax avoidance. In contrary, Oktaviani & Zulaikha (2021) and Handoyo et al. (2022) stated that leverage has no effect on tax avoidance. The reason is because the utilization of debt could resulted in lower profit earned by the company. Lower profit could affect company's value and also image. So, company would tend to take a careful decisions regarding the matter of using debt. Meanwhile, previous research by Bayunanda & Ompusunggu (2018) stated that leverage negatively affect tax avoidance because company more likely would choose the source of funding from stocks.

In year 2021 compare to year 2020, PT Kurniamitra Duta Sentosa (KMDS) was experienced increase in total asset from IDR 145.4 billion to IDR 218.2 billion. One of the factor that cause increased in asset is because of the increased in fixed asset. Fixed asset of the company increased from IDR 39 billion to almost IDR 56 billion. Increased in fixed asset could be use as one of the strategy to reduce tax burden by using depreciation expense as deductible expense. Therefore, this phenomena showed that PT Kurniamitra Duta Sentosa might engage in tax avoidance activities. Other than that, it could be seen from Table 1.1 that the firm size of KMDS is increasing but the ETR is decreasing from 0,237 to 0,117. In conclusion, researcher could retrieved that if company size increase, transaction could become more complex and company would want to minimize their taxable profit by using certain method, for example by using the loophole of taxation law.

Based Alfina et al. (2020), Mulyati et al. (2019), Widiatmoko & Mulya (2021), and Sari et al. (2021), firm size effect tax avoidance, but Barli (2018) and Handoyo et al. (2022) stated that firm size has no effect toward tax avoidance because the larger the companies, they will try to maintain their legitimacy in the eyes of the public. So, although complexity of transactions could be used as tax avoidance measure, company would not try to engage in tax avoidance activity.

Based on the different outcomes from previous study, different research period, and phenomena above, researcher decided to make a research with the title **"The Effect of Profitability, Leverage, and Firm Size Toward Tax Avoidance in Consumer Goods Companies Listed on the Indonesia Stock Exchange".**

1.2 Problem Limitation

Researcher has selected to limit this research on consumer goods companies listed on Indonesia Stock Exchange in 2020-2021 based on the background of study above. The independent variables which is profitability (X_1), leverage (X_2), and firm size (X_3) towards tax avoidance (Y). The researcher decided to use the data from 2020 – 2021.

1.3 Problem Formulation

Based on the background of the study, hereby researcher stated the problems that will be identified through this paper, such as:

1. Does profitability have an effect toward tax avoidance in the consumer goods companies listed on IDX?
2. Does leverage have an effect toward tax avoidance in the consumer goods companies listed on IDX?
3. Does firm size have an effect toward tax avoidance in the consumer goods companies listed on IDX?
4. Do profitability, leverage, and firm size have an effect toward tax avoidance in the consumer goods companies listed on IDX?

1.4 Objective of the Research

Below will be the objective of the research:

1. To determine if tax avoidance is affected by profitability in the consumer goods companies listed on the IDX.
2. To determine if tax avoidance is affected by leverage in the consumer goods companies listed on the IDX.

3. To determine if tax avoidance is affected by firm size in the consumer goods companies listed on the IDX.
4. To determine if tax avoidance is affected by profitability, leverage, and firm size in the consumer goods companies listed on the IDX.

1.5 Benefit of the Research

Some benefits from conducting this research are:

1.5.1 Theoretical Benefit

Researcher expect this research could enrich more information about the effect of profitability, leverage, and firm size on tax avoidance especially in consumer goods industry. Other than that, researcher also expect this research could provide additional information and references for other researchers in the future that will conduct the similar topic.

1.5.2 Practical Benefit

Main purpose of this research is to gain more knowledge regarding the topic that has been chosen. Other than that, hopefully this research could bring new insights for investors to choose the company to invest in. Last, for company, researcher expect that this research could be used as a consideration to show more interest on the variable that is being researched in order to create a greater understanding about taxation, beside could also prevent creating any tax avoidance activity.