CHAPTER I

INTRODUCTION

1.1 Background of the Study

Indonesia as a developing country needs to increase the country's economic growth to align with other nations. To achieve this, the country requires significant sources of funding, with one of the primary sources being taxation, as it constitutes the largest portion of the government's revenue. Taxation plays a crucial role in contributing approximately 70% of the total government revenue. This is evident from the contribution of tax revenues as reported in the data from the Indonesian Ministry of Finance's State Budget for the year 2022. The Ministry of Finance Indonesia reported that the realization of state revenue reached Rp2,626.4 trillion throughout 2022. Most of this revenue in 2022 came from tax collections, totaling Rp1,716.8 trillion which is 65.37%.

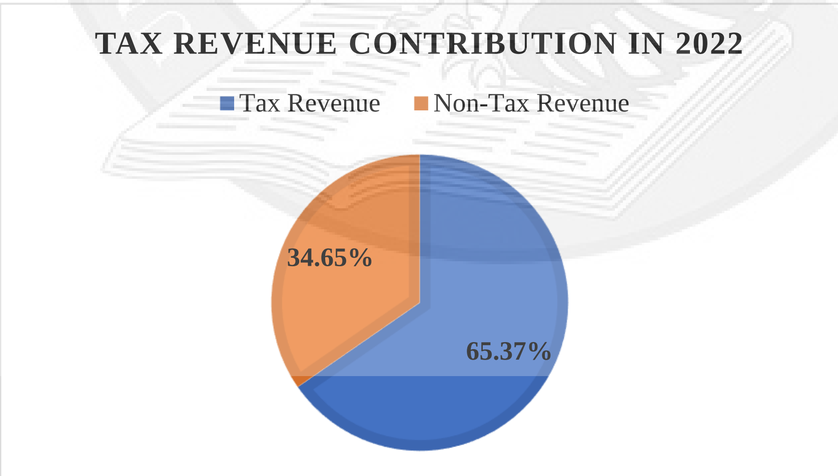

Figure 1.1 Tax Revenue Contribution in 2022
Source: Prepared by Writer (2023)

Taxation serves as the largest source of funding for Indonesia's State Budget. State revenue plays an important role in fostering economic growth and infrastructure development, with taxation being a significant contributor. Infrastructure development, such as roads and bridges, subsidies for essential commodities like food, rice, seeds, and fertilizers, as well as public sector expenses like teacher and police salaries, among others, as well as social assistance for impoverished families and education, heavily rely on tax revenue contributions (Direktorat Jenderal Pajak, 2013).

Taxes are mandatory contributions paid by the citizens to the government and are used for the benefit of the government and society. Tax payment is not solely an obligation but also a right of all citizens to participate in financing state and national development. It constitutes a duty for every Indonesian citizen, as enshrined in the 1945 Constitution. The public is sustained through state funding derived from taxes that are utilized for the welfare of the entire Indonesian population. Taxes play a significant role in contributing to government revenue and, therefore, require efforts to ensure their effective collection.

Taxes are constantly evolving and must be managed effectively. For companies, taxes represent costs or expenses that reduce net profits. When a company generates substantial profits, there is income tax payable to government. Given the tax burden imposed on companies and their owners, efforts are made to minimize tax liabilities. A company can boost its profits by reducing the tax burden it should have paid to the government. One of the tax planning strategies employed by companies is tax avoidance, a method that is legal as it exploits the loopholes in tax laws and regulations, thus not conflicting with the applicable tax provisions. Tax avoidance can generally be distinguished from tax evasion. Legal attempts to reduce tax payments are known as tax avoidance, while tax evasion involves the use of illegal methods to reduce or eliminate the tax burden.

Tax avoidance has both advantages and disadvantages in the relationship between taxpayers and governments. Governments create financial rules to make tax laws better and more accurate to prevent tax avoidance. In the view of tax authorities, tax avoidance is viewed negatively because it leads to a reduction in the tax revenue collected by the government. While companies engage in practices to minimize their tax burdens through tax avoidance strategies. However, the negative consequences may include the risk of the company incurring penalties and damage to its reputation. The conflict of interests between the government and companies is a prevalent issue. These conflicting interests can drive taxpayers to apply legal and illegal methods to lower their tax burdens.

Assessing tax avoidance can be accomplished through the examination of the Cash Effective Tax Rate (CETR). A high CETR implies minimal tax avoidance, while a low CETR indicates a greater level of engagement in tax avoidance activities.

Official data from Indonesia's Directorate General of Taxation reveals a consistent decline in the country's tax ratio since 2017. The tax ratio, signifying the proportion of tax revenue relative to the Gross Domestic Product, serves as a pivotal gauge for assessing a nation's tax revenue performance. Presented below are Indonesia's tax ratios for the span of 2020-2022:

Table 1.1 Indonesia Tax Ratio of 2020-2022

No	Year	Tax Ratio
1	2020	8,33 %
2	2021	9,11 %
3	2022	10,38 %

Source: Prepared by Writer (2023)

Acknowledging the prevailing low tax ratio, the Indonesian government has based its assessments on data concerning the country's 2022 economic growth, released by the Central Statistics Bureau. This data allows for the calculation of Indonesia's tax ratio for the year 2022. Given an economic growth rate of 5.31% and a Gross Domestic Product amounting to Rp19,588.4 trillion, Indonesia's projected tax ratio for 2022 is 10.38%. This represents an increase compared to previous years, during which Indonesia's tax ratio failed to reach the 11% threshold. Compared to other ASEAN countries, this number is relatively low, demonstrating that the public's participation in tax payment is not optimal. Low tax ratio in Indonesia indicates a high level of tax avoidance in certain companies.

Director of the IMF Fiscal Affairs Department, Vitor Gaspar, emphasized that every nation must uphold a minimum tax ratio of 15%. Indonesia has witnessed a fluctuating tax ratio over the last five years, hovering within the range of 8-10%. This range emphasizes the need for a comprehensive examination of the factors contributing to this relatively low tax ratio.

Based on data from the Statistics Central of Bureau, the manufacturing sector in Indonesia has become the largest tax contributor within Indonesia's industrial sectors in 2022, accounted for 29.8% of the total tax revenue. This is reflected in its consistent and positive performance in terms of productivity, investment, exports, and job creation, as evidenced by its stock price movement.

This research is using manufacturing companies as they engage in the entire range of business activities linked to taxation. Moreover, the manufacturing sector dominates the Indonesia Stock Exchange. The consumer goods industry is one of the leading industries in the manufacturing sector. One of the contributing factors to Indonesia's low tax ratio, according to the report, is the decrease in tax revenue from the consumer goods industry. Consumer goods companies have a significant market share and are involved in supporting community needs, highlighted for its potential financial challenges and instances of tax avoidance. The Ministry of Industry stated that the consumer goods industry is a key contributor to national economic growth and has significant potential for successful development. Hence, the writer used the consumer goods sector in this research.

Tax avoidance is one of the management policies in tax planning. In this context, several factors can influence tax avoidance practices, namely profitability, institutional ownership, and sales growth.

Profitability is one of the factors that influence tax avoidance, functioning as a measure of a company's performance. Profitability ratios assess a company's capacity to generate profits. One of these ratios is the return on assets (ROA), which is a ratio indicating the return on assets employed by the company. Higher ROA values correlate with greater company profits. The agency theory motivates agents to boost company earnings. As profits rise, so does income tax, encouraging companies to engage in tax avoidance strategies.

Institutional ownership represents ownership of a company's shares by institutions or large organizations, such as insurance companies, banks, investment firms, and other similar institutional investors. High levels of institutional ownership can result in increasing monitoring of a company's tax strategies. This discourages the company from implementing tax avoidance. On the other hand, when a company has lower levels of institutional ownership, it may have greater flexibility in implementing tax avoidance strategies.

Another factor that could affect tax avoidance is sales growth. Sales have a strategic influence on a company, as sales activities require the support of assets. Sales growth indicates a company's year-to-year sales progress. By analyzing past sales, companies can optimize resources. This growth significantly influences working capital management. By assessing sales growth, companies can predict profits. Greater sales growth usually leads to greater profits, encouraging tax avoidance practices. Principals entrust agents with profit management from these sales, which can lead to the implementation of tax avoidance strategies.

Previous studies have explored the relationship between profitability, institutional ownership, and sales growth in tax avoidance. However, these studies have yielded varying findings. Harahap (2021) found that profitability, institutional ownership, and sales growth have a significant influence on tax avoidance. Agustiana & Kusumawati (2022) found that profitability has influence on tax avoidance, while institutional ownership and sales growth have no influence on tax avoidance. Wulansari & Nugroho (2023) found that profitability and sales growth have a negative significant influence on tax avoidance, while institutional ownership has no influence on tax avoidance.

To address this issue, the government, particularly the tax authorities, has initiated monitoring measures to minimize tax avoidance activities by companies. Based on the gaps in the previous research, the issue of tax avoidance stands out as an important area to perform further research to enhance the findings of previous research. Factors such as profitability, institutional ownership, and sales growth have been identified by researchers as influential factors that drive company management to engage in tax avoidance practices. Hence, the writer is urged to research topic with title "**The Effect of Profitability, Institutional Ownership, and Sales Growth toward Tax Avoidance in Consumer Goods Companies listed on the Indonesia Stock Exchange**".

1.2 Problem Limitation

The following is the problem limitation of this research:

1. The object used is limited to consumer goods companies that were listed on the Indonesia Stock Exchange.
2. The variables used are limited to profitability, institutional ownership, sales growth, and tax avoidance.
3. The period used for the research is from 2020 to 2022.

1.3 Problem Formulation

Based on the research, the problem formulation are as follows:

1. Does profitability have a significant effect toward tax avoidance in consumer goods companies listed on the Indonesia Stock Exchange?

2. Does institutional ownership have a significant effect toward tax avoidance in consumer goods companies listed on the Indonesia Stock Exchange?
3. Does sales growth have a significant effect toward tax avoidance in consumer goods companies listed on the Indonesia Stock Exchange?
4. Do profitability, institutional ownership, and sales growth simultaneously have significant effect toward tax avoidance in consumer goods companies listed on the Indonesia Stock Exchange?

1.4 Objective of the Research

The objectives of this research are as follows:

1. To determine whether profitability has a significant effect toward tax avoidance in consumer goods companies listed on the Indonesia Stock Exchange
2. To determine whether institutional ownership has a significant effect toward tax avoidance in consumer goods companies listed on the Indonesia Stock Exchange
3. To determine whether sales growth has a significant effect toward tax avoidance in consumer goods companies listed on the Indonesia Stock Exchange
4. To determine whether profitability, institutional ownership, and sales growth have a significant effect toward tax avoidance in consumer goods companies listed on the Indonesia Stock Exchange

1.5 Benefit of the Research

This research gives benefits to individuals interested in the topic of this research. The benefits of this research are as follows:

1.5.1 Theoretical Benefit

This research is expected to help academics in developing research in the future, and this research will be used as reference material for future research related to tax avoidance or similar topics.

1.5.2 Practical Benefit

This research is expected to contribute to some parties, including:

1. For Companies

   This research is expected to be used as consideration and evaluation material related to tax avoidance.

2. For Readers

   This research is expected to provide empirical evidence regarding the relationship between financial ratios and tax avoidance that can be used as material for future research.

3. For Investors

   This research is expected to offer valuable insights and help investors in their decision-making when choosing companies for investment.