CHAPTER I

INTRODUCTION

1.1 Background of the Study

Essentially, tax is an inherent part of nearly all countries' economic activities. Whether it is a developed or developing country, majority of them do rely heavily on their tax revenue. In Indonesia itself, tax has been the backbone of state finances over the last few decades. As time passes by, its contribution to the state revenue is becoming increasingly vital. Up to this day, tax is still the largest contributor to Indonesia's state revenue in which the total tax revenues takes up about 80% of the total government revenue. This figure alone shows how important tax is as a source of funding for Indonesia's economy.

The definition of tax itself has been stated in Law Number 16 Year 2009 Article 1 Paragraph 1, in which it addresses tax as an obligatory contribution to the state owed by individual taxpayers as well as corporate taxpayers. By paying taxes in accordance with the tax provisions, every taxpayer has circumstantially redounded to the national development. These funds received from taxpayers will then be allocated to several fields and further utilized by the government such as to pay off debts, build infrastructure, provide health and education service, and other public services. Faced by the fact that tax is such an essential element of the state's revenue, it is no wonder if the government strives to employ a variety of policy as a step to generate maximum revenue from tax sector, such as the Tax Amnesty Policy in 2015. In fact, many strategies have been placed into effect, still

and all, nothing has improved considerably over the last few years. The graph below shows the tax revenue performance from 2016-2019 (*Badan Pusat Statistik* [BPS], 2020).

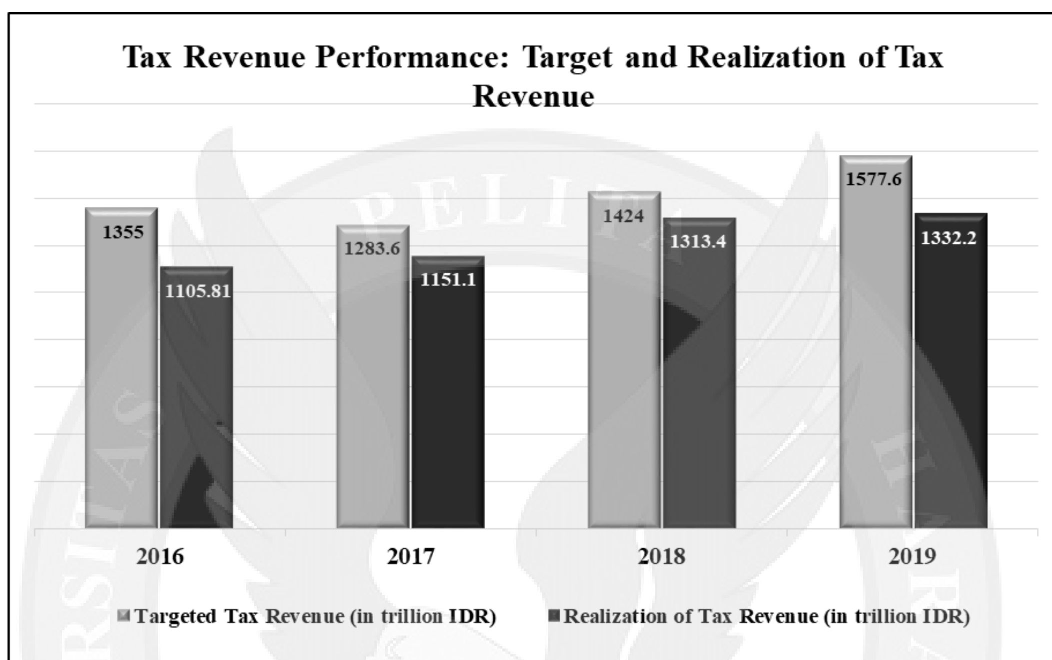

Figure 1.1 Tax Revenue Performance: Target and Realization of Tax Revenue
Source: Prepared by writer (2021)

Through the data presented in Figure 1.1, it can be seen that from 2016-2019, the realization of tax revenue was experiencing a rise in amount every year. Despite experiencing an increase every year, Indonesia has yet to meet its targeted tax revenue set by the government in the state budget after considering every potential source of tax. As seen from the data of 2019, at the end of December 2019, DGT was merely able to collect IDR 1,332.2 trillion tax revenues which is equal to only 84.44% of the target set in the state budget. As a result, there is a shortfall of IDR 245.5 trillion which is the largest amount since 2016. The gap between the target and realization could hardly get narrower, and the realization continues to fall short of its target throughout the years. Twelve years have passed

since the last time Indonesia's tax revenue reached its target in 2008 during the first administration of the 6th President Susilo Bambang Yudhoyono and Vice President Jusuf Kalla, with a surplus of IDR 36 trillion (Sembiring, 2021). Furthermore, when compared to the previous year, tax revenue of 2019 which is IDR 1,332.2 trillion was only able to grow as much as 1.43% from IDR 1,313.4 trillion of 2018, making it the lowest growth rate over the last decade.

The phenomenon above indirectly indicates that there are some issues underlying this situation, such as low tax compliance level of which can also point to tax aggressive practices carried out by taxpayers. Tax aggressive action itself arises as a consequence of the different perception between government and firms toward tax. Unlike the government which regards tax as income, firms perceive tax as an expense or burden that can reduce the company's net earnings (Chen et al., 2010). At the end of the day, the main purpose of establishing and running a company is always to generate profits as large as possible, and also to suppress losses as much as possible. With this purpose in mind, it has become a natural thing if companies take some measures to minimize their tax burden through tax planning. These measures taken are commonly referred to as tax aggressive actions (Ogbeide and Obaretin, 2018).

Balakrishnan et al. (2017) defined tax aggressiveness as aggressive tax planning that capitalizes on tax law uncertainty which aims to minimize corporate tax liabilities. Furthermore, according to Frank et al. (2009), tax aggressive firms manage their taxable income through tax planning that may or may not be considered fraudulent tax evasion. Chen et al. (2010) in their paper also viewed

tax aggressiveness as tax planning activities that are legal, or that may fall into the gray area, as well as activities that are illegal. In other words, tax planning generally can be done through two ways, which are tax avoidance and tax evasion. The difference of these two mainly lies on the legality issue. Tax avoidance practice is done within the laws. Companies will employ every available strategy to minimize tax payable in a legal way. While tax avoidance is permitted by taxation law and is considered lawful, tax evasion is not. Tax evasion is carried out using illegal methods that are contradicted by tax laws and is considered unlawful. The practice of tax evasion is classified as criminal acts that are against the law (Yauris and Agoes, 2019). In sum, a company will be considered more aggressive toward taxes when there are more tax loopholes utilized, or in other words, greater tax savings made.

With respect to the tax aggressiveness' issue, there is a tool that is used worldwide to assess the tax performance of a certain country, namely the tax-revenue-to-GDP ratio, or often known as the tax ratio. Tax ratio is the comparison of tax revenue to Gross Domestic Product (GDP) in a certain period of time, generally one year. To put it simply, a declining tax ratio can signal a worsening tax performance. The degenerating tax performance itself is closely related to the low tax compliance level. Therefore, a country’s tax ratio can be used by the public to measure the level of tax compliance of companies operating within it (Wijaya and Saebani, 2019). Based on the data published by OECD, Indonesia’s 2017 tax ratio of 11.5% was the lowest in the whole Asia Pacific region. Even when compared to fellow ASEAN countries, Indonesia's tax ratio was still lower

than Laos' which was 12.3%, the Philippines' 17.5%, and Vietnam's 18.7% despite being a country with high GDP. In addition, data from *Kemenkeu,* which use a different calculation method, shows that during 2016-2017, Indonesia's tax ratio kept struggling at a rate of 10%, where the tax ratio was 10.8% and 10.7%, respectively. Although it had increased to 11.5% in 2018, Indonesia's tax ratio has again dropped dramatically in 2019 to 10.7%. To add up, Indonesia's tax ratio is even still below the ideal figure according to the international standard which is 15% (Kevin, 2019). This extremely unsatisfying figure can be a sign of high tax aggressive practices.

According to Ah Maftuchan, a Public Policy Researcher of *Perkumpulan Prakarsa*, banks are estimated to be one of the business sectors that are evading a significant amount of taxes in which the potential loss of the state on tax revenue from this sector can reach up to approximately IDR 10 trillion - 12 trillion each year regardless of the considerably high income from the sector. He further stated that this loss was mostly caused by the aggressive tax planning carried out by banking taxpayers. The management usually avoid corporate taxes by circumventing existing tax regulations. Many banks have been suspected of being tax aggressive, but no specific name of banks were called out in relation to the case. It is only emphasized that this practice is often conducted by both small and large-scale banks, and that it should be quickly acted upon by the government by improving the whole taxation system (Praditya, 2014).

In regard to the case of aggressive tax planning mentioned above, writer has selected three companies in the banking sector to conduct a preliminary

observation. The three companies are chosen based on their total assets from 2017 to 2019.

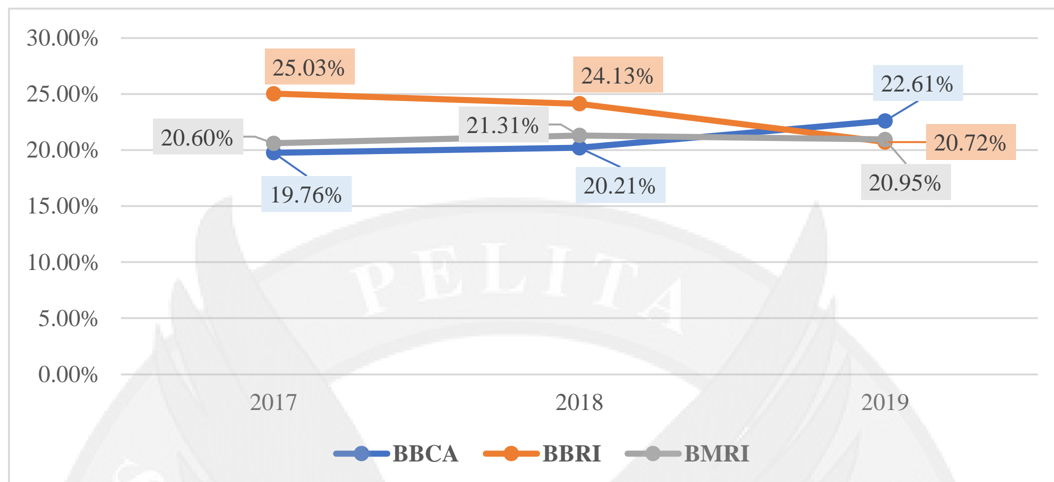

Figure 1.2 Current Effective Tax Rate of Banking Companies for the period 2017-2019
Source: Prepared by writer (2021)

Figure 1.2 above illustrates the current ETR percentage of BBCA, BBRI, and BMRI for the period of 2017 to 2019. The figure reveals how BBCA and BMRI did not pay taxes above the statutory tax rate of 25% for three consecutive years. Meanwhile, BBRI in 2017 recorded a current ETR of around 25%, but then recorded a declining percentage every year after 2017. Based on the Income Tax Provision Number 36 of 2008 Article 17 Paragraph 2a, the general corporate tax rate is set at 25%. Hence, any current effective tax rate below 25% will indicate that the companies are being aggressive toward taxes by conducting tax aggressive activities.

As tax aggressive practice becomes more and more inevitable within the business world, it eventually urges the tax authorities to conduct a more thorough and strict tax audit. However, when a tax audit activity involves banking taxpayer as the audited party, it is not easy to execute or follow up on the audit. In order to

proceed with the tax audit of banking companies, approval is required from several authorities. The complicated procedure often resulted in many tax auditors facing problems obtaining banking companies' information. This situation creates misalignment of information and further provides opportunities for banking taxpayers to do tax minimization through tax avoidance and even tax evasion.

In the banking industry, there is a term named 'banking secrecy' that is often mentioned. In terms of convenience in the business world, banking confidentiality is very important as it involves the security of clients' assets. As stated by Kencana (2017), this confidentiality is so prudent that the Indonesian government guarantees it through provisions regulated by both the banking and taxation authorities. Bank Indonesia Regulation (PBI) Number 2/19/PBI/2000 states that banks must keep secret of every information related to the clients and their deposits. In addition, OJK Regulation also specifies that tax officials who intend to obtain data or information on client's bank accounts for tax purposes, must begin the process by requesting for a permission from the OJK commissioner. In relation to the banking and OJK provisions, the Law concerning General Provisions and Tax Procedures (UU KUP) Article 35 paragraph (2) also regulates that banking secrecy can only be waived upon a written request from the Minister of Finance.

In its implementation, the existence of these provisions concerning banking secrecy have indirectly facilitated banks in conducting tax aggressive practices. They have the potential to be utilized by banking companies for the wrong purpose and for their own interests. To put it differently, these provisions

have provided banking companies a shield against tax audits that require clients' information, for instance the withholding slip of Income Tax Article 4 Paragraph (2) on Savings or Deposit Interest. The validity of this tax withholding needs to be examined to detect if there is any tax aggressive or non-compliance behavior. However, conducting tax audits with the aforementioned prevailing laws is quite troublesome. As a consequence, there will be a greater likelihood of banking companies to carry out tax aggressive actions since the chance to be put under audit by the tax authorities is getting smaller.

A company's tax aggressive behavior is generally viewed by the public as unethical, immoral, and irresponsible. According to Freedman (2003) in Wijaya and Saebani (2019), a company's attempt in minimizing tax payments are not in accordance with the expectations of the community, for tax payments made by companies are considered by the wider society as a corporate participation in improving the welfare of the community through the provision, construction, development and maintenance of public facilities carried out by the government. With that said, any tax aggressive measures taken may change people's perception of the company and adversely impact a firm’s reputation, an invaluable asset. Consequently, a negative public image might pose a great risk on the sustainability of banking companies since the biggest asset of a bank is in the form of public trust (Dangnga and Haeruddin, 2019). Thus, all tax aggressive actions must be addressed immediately because apart from posing a negative impact on the bank itself, the State will also be harmed by the shrink in tax revenue as well as economic condition. Additionally, the complexity and

uniqueness of the banking tax aggressiveness issue further motivate writer to conduct a study regarding tax aggressiveness on banking sector, and also to explore deeper about what factors that can potentially lead banks to increase or decrease the intensity of their tax aggressive practices.

Numerous prior studies have shown various factors that could possibly affect the tax aggressiveness of a company. In this research, writer tries to analyze capital intensity as one of the factors affecting corporate tax aggressive behavior. Capital intensity is often associated with how many property, plant and equipment a company owns in comparison to its total assets. According to Nugraha and Meiranto (2015), capital intensity reflects the intensity of a company's investment activity on fixed assets. A company's fixed assets can reduce the tax burden that must be paid, with the existence of fixed assets depreciation that reduce the company's taxable income. This proves that companies with larger fixed assets have the possibility to pay lower taxes than companies with fewer fixed assets. Previous research conducted by Legowo et al. (2021) showed that capital intensity affected tax aggressiveness significantly. Meanwhile, different results were obtained by Nugraha and Meiranto (2015) who found that capital intensity had an insignificant effect on corporate tax aggressiveness which means that the tax aggressiveness of a company is not really influenced by capital intensity.

Another factor that is also a determining factor in bank tax aggressiveness is profitability. Hery (2016) stated that profitability is a company's ability to gain profits in relation to sales, own capital or total assets. Low profitability can reflect that the company is having difficulty fulfilling its short-term obligations.

Companies with high profitability values are often better at managing company resources to do optimal tax planning and minimize the tax burden that must be paid, usually indicated by a low current ETR value. The higher the profitability of a company is, the greater the profits obtained along with its obligations in the taxation sector which in turn encourage companies to take tax aggressive actions. However, companies with high profitability may also want to maintain a good public image, thereby becoming more risk averse and opting for a safer tax-related transactions. Salaudeen and Ejeh (2018) in their research stated that profitability posed a significant impact on tax aggressiveness. Conversely, Chan et al. (2013) found an insignificant influence of profitability on tax aggressiveness.

In order to provide a deeper understanding of how capital intensity and profitability affect corporate tax aggressiveness, writer have prepared the data of three companies from the previously given example.

Table 1.1 Capital Intensity, Profitability and Tax Aggressiveness of Banking Companies Listed at IDX for the period 2017-2019

Company Code	Year	Capital Intensity (CAPINT) (%)	Profitability (ROA) (%)	Tax Aggressiveness (Current ETR) (%)
PT Bank Rakyat Indonesia (Persero) Tbk (BBRI)	2017	2.20	2.58	25.03
	2018	2.08	2.50	24.13
	2019	2.22	2.43	20.72
PT Bank Mandiri (Persero) Tbk (BMRI)	2017	3.26	1.91	20.60
	2018	3.20	2.15	21.31
	2019	3.38	2.16	20.95
PT Bank Central Asia Tbk (BBCA)	2017	2.25	3.11	19.76
	2018	2.34	3.13	20.21
	2019	2.27	3.11	22.61

Source: Prepared by writer (2021)

First of all, it should be noted that tax aggressiveness and current ETR as the indicator have an inverse relationship, in which a decrease in current ETR will

signify a higher degree of tax aggressiveness. Throughout 2017 to 2019, BBRI's data of capital intensity and current ETR had been showing some inconsistencies. While in most cases a decrease in capital intensity ratio often leads to an increase in current ETR, BBRI's data during 2017-2018 shows otherwise. The data showed that when the capital intensity experienced a decline, the current effective tax rate declined as well. Current tax expense as the numerator in current ETR ratio increased by only 8.73% in 2018, whereas earnings before tax as the denominator increased by 12.78%. The unproportional increase caused the current ETR to decrease. This was mainly due to the positive fiscal correction in the temporary difference section that decreased drastically in 2018, one of which is the allowance for credit losses provided by the bank. The decrease in the amount of positive fiscal correction which was quite dramatic in 2018 has led to a suppression of increase in fiscal income (taxable income) even though there is quite a great deal of increase in commercial income (earning before tax).

As for the profitability case, data of BMRI throughout 2017 to 2019 had been displaying inconsistent relationship between profitability and current ETR. Observing from BMRI's data during 2017-2018, when the profitability rate increased to 2.15%, the current effective tax rate increased to 21.31% as well, indicating a lower level of tax aggressiveness. Looking at the profitability data of BMRI from 2017-2018, it can be seen that the increase in ROA was significantly caused by the drastic rise in the amount of earning after tax as the numerator of ROA. This means that BMRI did have better efficiency in utilizing their assets and making plans in 2018. This efficiency was also reflected in the amount of

fiscal income in 2018 based on BMRI's tax planning. While BMRI's tax planning for fiscal income was significantly enhanced in 2018, the fiscal income in 2018 was still higher than that in 2017 due to the large gap of earning before tax between 2017 and 2018. This resulted in a higher current tax expense as well and eventually led to a slight increase in current effective tax rate.

In addition to capital intensity and profitability, the decision to take tax aggressive action is often associated with the governance of a company as well. Generally, the implementation of good corporate governance will help to strike a balance between the achievement of economic purposes and community goals. It will further keep companies away from poor management, including being engaged in any kind of risky tax aggressive practice. This is because several risks might be borne by companies for being tax aggressive, such as fines and reputation decline in the public opinion (Armstrong et al., 2012). In addition, agency theory as one of the main theories of corporate governance can address how corporate governance is correlated with the issue of corporate tax aggressiveness. It is generally believed that the tax aggressive behavior of managers is induced by the divergent interests between them and the shareholders. The two parties' different interests will lead to a conflict later on. As suggested by agency theory, the existence of corporate governance can reduce this conflict and further suppress the opportunistic behavior of managers to conduct tax aggressive practices for their own good. By implementing a good corporate governance, the processes and structures of decision making can then be supervised more thoroughly. Therefore, managerial ownership as one of the good corporate

governance mechanism is predicted to be able to affect the corporate tax aggressiveness.

According to Suaidah (2020), managerial ownership is the percentage of shares owned by management, where the management is actively involved in making corporate decisions, one of which is taxation decisions. In some cases, managerial ownership can cause the manager-shareholder to be more tax aggressive in order to increase the company's net profit. This happens because an increase in company's net profit may result in a higher dividend for the shareholders themselves. Meanwhile in other cases, managerial ownership can also be a reason for the management to be careful in taking actions that can possibly threaten the business continuity, such as tax aggressive action. Regarding managerial ownership, several prior studies have shown different results. Research conducted by Boussaidi and Hamed (2015) revealed that managerial ownership had a significant effect on tax aggressiveness, whereas research by Yauris and Agoes (2019) showed that managerial ownership did not affect tax aggressiveness significantly.

Taxation problem in Indonesia has been a familiar topic in the public. However, there are still no universal approach regarding the term tax aggressiveness to date. Based on the phenomenon, theories and previous studies that have been explained, writer is therefore motivated to do a research titled **"The Effect of Capital Intensity, Profitability and Corporate Governance on Tax Aggressiveness of Companies in the Banking Sector Listed at Indonesia Stock Exchange".**

1.2 Problem Limitation

In order to prevent this research from getting off track and deviating from the research objectives, problem limitation is created. This research will be conducted only on the companies in the banking sector listed at the Indonesia Stock Exchange using the data of a five-year period (2015-2019). Variables used in this research are: corporate governance, capital intensity, and profitability as the independent variables, and also tax aggressiveness as the dependent variable. There are several instruments to identify the level of corporate tax aggressiveness, but writer will be using only Current Effective Tax Rate (Current ETR). In addition, it is important to know that the term tax aggressiveness does not have a universally accepted definition and measurement. Therefore, writer on her own needs to clarify at the outset the scope of tax aggressiveness in this study. Tax aggressiveness in this paper includes a broad range of activities (legal, grey as well as illegal tax planning activities). Firms will be deemed to be tax aggressive if they carry out any tax planning activities that could reduce the firm's current effective tax rate. Degree of tax aggressiveness may vary depending on the intensity and legality of the tax planning performed. It should also be noted that this research is not able to determine whether a specific current effective tax rate is considered as tax avoidance or tax evasion. Firms can only be classified as "more aggressive" or "less aggressive" throughout the paper.

1.3 Problem Formulation

Based on the background of the study that has been explained before, the problem formulations of this research are as follows:

1. Does capital intensity have significant effect on tax aggressiveness of companies in banking sector listed at Indonesia Stock Exchange partially?
2. Does profitability have significant effect on tax aggressiveness of companies in banking sector listed at Indonesia Stock Exchange partially?
3. Does corporate governance have significant effect on tax aggressiveness of companies in banking sector listed at Indonesia Stock Exchange partially?
4. Do capital intensity, profitability and corporate governance have significant effect on tax aggressiveness of companies in banking sector listed at Indonesia Stock Exchange simultaneously?

1.4 Objective of the Research

Based on the problem formulations stated above, therefore the objectives of this research are as follows:

1. To examine, analyze and get the empirical evidence of the effect that capital intensity partially has on tax aggressiveness of banking companies listed at Indonesia Stock Exchange.
2. To examine, analyze and get the empirical evidence of the effect that profitability partially has on tax aggressiveness of banking companies listed at Indonesia Stock Exchange.

3 To examine, analyze and get the empirical evidence of the effect that corporate governance partially has on tax aggressiveness of banking companies listed at Indonesia Stock Exchange.

4 To examine, analyze and get the empirical evidence of the effect that capital intensity, profitability and corporate governance simultaneously have on the tax aggressiveness of banking companies listed at Indonesia Stock Exchange.

1.5 Benefit of the Research

1.5.1 Theoretical Benefit

Based on the objectives of the research, this research is expected to provide a better understanding and a deeper insight to the writer herself regarding corporate tax aggressiveness along with the factors that influence it. In addition, this research is expected to help the development of tax accounting theories, to enrich the taxation knowledge of public readers and also to become a reference for the next researcher of this topic.

1.5.2 Practical Benefit

This research is expected to generate practical benefits as follows:

1. For company

   This research is expected to provide an illustration of the impact that tax avoidance and evasion bring on companies so that companies can be wiser and more prudent in making tax decisions. Furthermore, this research also

gives alternative solutions to control tax aggressive behavior of the companies.

2. For investor

This research is expected to provide information regarding tax aggressive actions taken by companies so as to help investors in making better and more appropriate investment decisions.

3. For government or DGT

This research can be used by DGT as a reference in establishing appropriate and proper taxation policies which aim to increase public participation in fulfilling their tax obligations.