CHAPTER I

INTRODUCTION

1.1 Background of the Study

Indonesia is a country that is rich in cultures, traditions as well as possessing an abundant amount of natural resources. These are also the merits that attract investors to compete and plant an investment or establish their business. This serves as an advantage to Indonesia's government as it will bring many opportunities such as creating employment and increasing the government's revenue through the tax deposited.

Tax acts as the biggest contribution to Indonesia's state budget. Citizens of Indonesia are obligated to pay taxes for Indonesia's welfare and prosperity. As stated in the Law on General Provisions and Taxation Procedures Number 28 of the Year 2007 Article 1 paragraph 1, taxes are mandatory contributions to the countries that are owned by individuals or entities that are compulsory under the law, without receiving direct benefits and used for the state for the prosperity of the people. Tax is commonly allocated into variety of fields where it needs the funds. According to Online Pajak (2018), one of the tax functions is providing for state budget where it will be used to improve national developments such as building infrastructure, health and education facilities and other public services. Aside from that, the tax also reflects and balances Indonesia's economic policies as well as income redistribution.

Table 1.1 Realizations of State Budget and Tax Revenue 2015-2020

Year	State Budget (in trillions rupiah)	Tax Revenue (in trillions rupiah)	Percentage
2015	1,496.05	1,240.42	82.91%
2016	1,546.95	1,284.97	83.06%
2017	1,654.75	1,343.53	81.19%
2018	1,928.11	1,518.79	78.77%
2019	1,955.14	1,546.14	79.08%
2020	1,698.65	1,404.51	82.68%

Source: *Badan Pusat Statistik* (2021)

Table 1.1 shows the data of Indonesia's state budget realization and its tax revenue. From the table, it can be concluded that tax indeed dominates the state budget from approximately around 78% until around 83%. This proves how much impacts tax revenue has in the country which will be allocated into improving prosperity and Indonesia's growth. Indonesia adopts a self-assessment system in 1984. This system allows the taxpayer to personally calculate, deposit and report the amount of tax obligation that should be deposited to the government. Indonesia also regulates a system where the higher the income of an individual or an entity, the higher the tax rate that's weighted on them. This is established to create a justified society where those who earn more shall contribute more to the country. The government themselves also issues the target of tax revenue each year.

Table 1.2 Targeted and Realization of Tax Revenue 2015-2020

Year	Targeted Tax Revenue (in trillions rupiah)	Realization of Tax Revenue (in trillions rupiah)	Percentage
2015	1,489.30	1,235.80	83%
2016	1,539.09	1,283.60	83.40%
2017	1,283.60	1,147.50	89.40%
2018	1,424	1,315.93	92.41%
2019	1,577.60	1,332.06	84.44%
2020	1,198.82	1,069.98	89.25%

Source: Data compiled by the writer (2021)

Table 1.2 above shows the targeted and expected tax revenue that has to be collected each year. However, as the data presents, the government fails to meet the number that has been set.

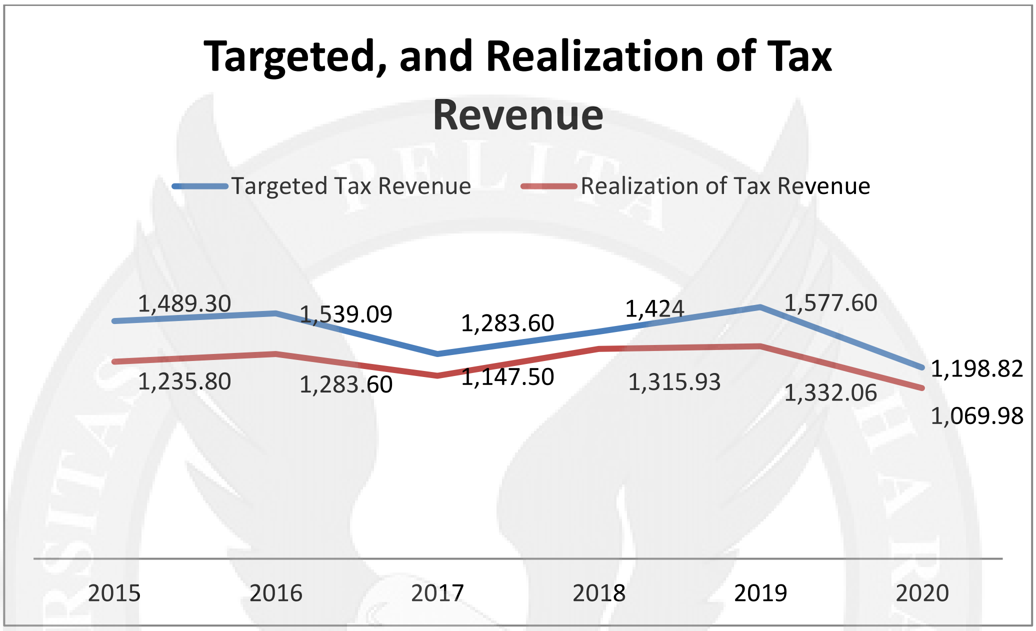

Figure 1.1 Targeted and Realization of Tax Revenue

In Figure 1.1, the gap between targeted tax revenue and realization of tax is illustrated. In 2015 and 2016, the government can only collect approximately 83% and 83.4% of the target they have set and the gap visibly narrow in the year 2017 and 2018, proving that the realization number makes an increase and almost meet its expected mark. However, the gap drifts apart again in 2019. The reasons leading up to this result vary from internal until external excuses with the usage of data not being optimized and 2019 being the presidential election year, which slows down the tax collection (Ramli, 2020). The realization of tax takes up 89% in 2020 which means that it dominates a big portion of the targeted revenue. Through figure 1.1, it can be concluded that the date of targeted and realization of tax for 2016 until 2020 experiences fluctuation or inconsistency.

Normally, the government would set the targeted tax revenue according to and in adjustment to the realization of tax from the prior year. However in 2020, although the tax realization takes up to 89% of its target, the number of targeted tax revenue experiences a drastic drop. As reported by Kurniati (2020), the government decides to decrease the targeted tax revenue by 10% from the tax realization of the previous year. This decision was generally influenced by the weakening of economic growth from the pandemic.

The government hasn't been able to exceed the targeted tax revenue since 2009 (Sembiring, 2020). Increased tax revenue means more funds to be allocated into the country and the government expects to optimize every taxpayer. However, the government and taxpayers are on the different sides of the situation. The entity is caught in between the dilemma of having the obligation to pay their tax and on the other hand, the entity is also expected to maximize their profit and minimize their expense. Paying tax will result in adding another burden into the expense and resulted in a decreased profit. It is only natural for entities in wanting to gain profit as much as possible and thus, entities are motivated to perform tax management to achieve lesser tax payable. This opens up the possibility of the individuals or entities are practicing tax avoidance, tax evasions, or the law is poorly enforced.

Tax avoidance is an attempt of minimizing tax by managing the tax burden and eliminating unnecessary expenses according to the law by finding loopholes. This action may also be encouraged by the self-assessment system that the

Indonesia government adopts. The system allows more freedom and control for its taxpayers hence, tax offenses have a higher possibility to happen. Tax avoidance and tax evasion share a similar intention but different methods. Tax evasions, on the other hand, is the act of minimizing tax payable by practicing and violating taxation regulations (Mentari & Wi, 2019).

Indonesia's mining sector has long been the major driving force in improving Indonesia's economic expansion and plays the role of being a significant contributor on Indonesia's Gross Domestic Product through profitable exports. The development has opened up job opportunities with a diverse landscape. Indonesia is known as a country that is rich in its resources and Indonesia places fourth in coal mining production (Cekindo, 2021).

One of the phenomena that happened in the mining sector is the case of PT. Adaro Energy. Adaro performed transfer pricing through their branch company Coal-trade Services International in Singapore, from 2009 until 2017. The sales and profit reported to the government are less than what they are. Due to this action, Adaro managed to pay less of their supposed tax payable by 125 million US dollars or 1.75 trillion rupiah. While the company didn't violate any law, it is deemed unethical to do (Sugianto, 2019).

PT. Timah is suspected to have performed profit manipulation in which they have lied to the public in the press release and claimed that the financial statement for the first semester of 2015 resulted into positive performance with its efficiency and strategies. However, the truth is the first semester of 2015, PT. Timah generated operating loss amounted to 59 billion (Afrianto, 2016). Frankly, the financial condition of PT. Timah has been concerning for the past three years. In an effort to lessen their debt, the management has given up 80% of PT. Timah mining area to its business partners. This fictitious financial statement was done with the purpose to cover up their unhealthy financial state (Soda, 2016).

Indonesia is included as one of the top five countries in the world to have the largest amount of illegal flow of money after China, Russia, India and Malaysia. In the mining sector itself, the increase in illegal money of flow during 2003 until 2014 reached 102.43% or average annual increase by 8.53%. The total illegal flow of money is estimated to be Rp. 11.8 million and it rose until Rp 23.89 by 2014. Wiko Saputra, Indonesian Publish What You Pay (PYWP) Economic Policy Researcher, stated that the illegal money flow in the mining sector is caused by the trading transaction of fake invoices. This is caused by the rampant of illegal mining operations, untraced export of mining commodities and the high indications of tax avoidance and tax evasion involving mining companies in Indonesia. Overall, the Gross Domestic Product (GDP) of mining sector reaches Rp. 1026 trillion and the number of tax realization only amounted to Rp 96.9 trillion, this indicates that the tax revenue ratio of the mining sector is only at 9.4%. *Komisi Pemberatasan Korupsi (KPK)* found out that plenty mining companies are not compliant with tax payments. The result of survey with the Ministry of Energy and Mineral Resources and relevant agencies shows that out of 7834 companies recorded by the Directorate General of Taxation, 24% don’t own Taxpayer Identification Number (TIN) and 35% don’t report tax return (Nuraeni, 2015).

Profitability is a capability of a company in earning its profits over a certain period (Stawati, 2020). One of the indicators for profitability is Return on Assets (ROA) which can be computed by dividing net income by total assets. The higher the value of Return on Assets (ROA), the higher the value of net profit generated by the company and hence, it increases the profitability. The company that has high profitability value has the opportunity to reduce the amount of tax liabilities expense. According to the previous research conducted by Sulaeman (2021), Riskatari and Jati (2020), Saputri and Sofianty (2020) and Zainudin et al. (2019), profitability has a significant impact on tax avoidance.

Leverage is the illustration of a company's ability to operate their assets with the fixed expense and enlarging the company's level of income with debt-equity ratio as its ratio. Leverage also shows the degree of a company financed by debt with the ability from the company's capital. The measurement of leverage is figured through the debt to equity ratio that uses total liabilities and total assets to compute (Reinaldo, 2017). Great usage of debt by the company will impact the amount of interest expense that should be incurred, resulting in reducing the income before tax that can be obtained and hence, decreasing the amount of tax obligation (Purnama (2020) in Stawati (2020)). The result of the research conducted by Zainudin et al. (2019), Sulaeman (2021), Riskatari and Jati (2020) and Selviani et al. (2019) states that leverage has a significant impact on tax avoidance.

Company size is the scale or value that classifies a company into a large company or small company based on its total assets. The greater the amount of total assets indicates the bigger the company size and the larger the size, the more complicated the transactions will be. Thus, it gives the possibility that the company will take advantage of the loophole to perform tax avoidance from each transaction (Selviani et al., 2019). Company size can be measured by multiplying the natural logarithm with total assets (Reinaldo, 2017). In the previous research conducted by Sulaeman (2021), Riskatari and Jati (2020), Selviani et al. (2019) and Saputri and Sofianty (2020), the result shows that company size has a significant impact on tax avoidance.

With the phenomena of tax avoidance in the mining sector mentioned above, it can be concluded that there are still a lot of companies that are irresponsible in their tax obligation. The previous research conducted by several researchers states that profitability, leverage and company size have a significant impact on tax avoidance. However, the subject of the research is either on consumer goods industry, property and real estate, miscellaneous sector, or chemical sector. Through these reasons, the writer is determined to figure out if profitability, leverage and company size will also have a significant impact on tax avoidance in the mining companies. The writer is hence encouraged to conduct personal research that goes by under the title of: "**The Impact of Profitability, Leverage and Company Size on Tax Avoidance at Mining Companies Listed in Indonesia Stock Exchange.**"

1.2 Problem Limitation

The scope of limitation of this research circulates the impact of profitability, leverage and company size against tax avoidance. The population of this research is the companies of the mining sector listed in the Indonesia Stock Exchange from the year 2015-2019. The sample selection method that is used is the purposive sampling method. The reason the researcher chooses the mining sector as its researching field is that there are occurrences such as transfer pricing, overstated amounts of financial statements as well as the great number of companies that are being not compliant and fail to complete their tax obligations for the past decade.

1.3 Problem Formulation

According to the background of the study that has been stated above, the problem formulation of this research is:

1. Does profitability have a significant impact on tax avoidance at mining companies listed in Indonesia Stock Exchange?
2. Does leverage have a significant impact on tax avoidance at mining companies listed in Indonesia Stock Exchange?
3. Does company size have a significant impact on tax avoidance at mining companies listed in Indonesia Stock Exchange?
4. Do profitability, leverage and company size simultaneously have a significant impact on tax avoidance at mining companies listed in Indonesia Stock Exchange?

1.4 Objective Research

Based on the problem formulation, the objectives of this research are as follows:

1. To determine if profitability has a significant impact on tax avoidance at mining companies listed in Indonesia Stock Exchange.
2. To determine if leverage has a significant impact on tax avoidance at mining companies listed in Indonesia Stock Exchange.
3. To determine if company size has a significant impact on tax avoidance at mining companies listed in Indonesia Stock Exchange.
4. To determine if profitability, leverage and company size simultaneously have significant impact on tax avoidance at mining companies listed in Indonesia Stock Exchange.

1.5 Benefit of the Research

The research is expected to be useful and provide benefits for interested parties as of follows:

1.5.1 Theoretical Benefit

Theoretically, benefits extracted from this research are:

1. For the writer, this research is compiled to expand the knowledge and information of how significant the impact of profitability, leverage and company size on tax avoidance.
2. For the company, this research will provide reference and knowledge about the significance of profitability, leverage and company size on tax avoidance.

3. For the investors, this research is expected to be use as consideration material before investing into a company to avoid investors being aggrieved by company management.
4. For the government, this research is expected to give insights to the regulators in making tax regulations and hence, the potential of tax revenue can be maximized.

1.5.2 Practical Benefit

Practical benefits extracted from this research are as follows:

1. Providing an overview about the implementation of profitability, leverage and company size and the impact of tax avoidance in the mining companies in Indonesia.
2. Providing insights to all mining companies in Indonesia about the importance of fulfilling their tax obligations and the benefits it will bring to the government.
3. Used as future research reference material and hopefully the result of this research may serve as guidance and additional information related to the subject and variables used.