

# CHAPTER I

## INTRODUCTION

### 1.1 Background of Study

Every country is required to engage in continual development to become more developed and advanced in the future. Its implementation entails participation from all citizens as well as the government. Every country will operate well if its citizens are aware and support each other such as awareness of paying tax (Malini, 2020). In terms of both size and population, Indonesia is a massive country. With a land area of 1,919,440 km<sup>2</sup> and a sea area of 3,273,810 km<sup>2</sup>, Indonesia has a population of over 268 million people (Faradisty et al., 2019). Indonesia is one of the developing countries that rely on a substantial source of revenue that comes from tax (Malini, 2020).

According to Wulan (2020), tax is a compulsory contribution to the state that is owed by an individual or entity based on the law, with no direct compensation, and is utilized for the state's purposes for the maximum prosperity of the people.

In developing or developed countries, tax is one of the primary sources of revenue and a lever of control over the macroeconomic growth of economic processes. Tax guarantees that the state's, legal entities', and individuals' economic interests are balanced, as well as that undue tax pressure is avoided (Bashyrova, 2020).

Compared to the other sources of revenue, taxes are the most important source of state funding and contribute the highest percentage of the State Budget (*Anggaran Pendapatan dan Belanja Negara*).

**Table 1.1 Indonesia Tax Revenue Realization Year 2017 - 2021 (in Billion Rupiah)**

Source of Revenue	2017	2018	2019	2020	2021
<b>Tax Revenue</b>	<b>1.343.529,90</b>	<b>1.518.789,80</b>	<b>1.546.141,90</b>	<b>1.285.136,32</b>	<b>1.375.832,70</b>
<b>Domestic Tax</b>	1.304.316,30	1.472.908,00	1.505.088,20	1.248.415,11	1.324.660,00
- Income tax	646.793,50	749.977,00	772.265,70	594.033,33	615.210,00
- Value Added Tax and Sales Tax on Luxury Goods	480.724,60	537.267,90	531.577,30	450.328,06	501.780,00
- Property tax	16.770,30	19.444,90	21.145,90	20.953,61	14.830,00
- Land and Building Rights Acquisition Fee	1,20	-	-	-	-
- Duty	153.288,10	159.588,60	172.421,90	176.309,31	182.200,00
- Other Taxes	6.738,50	6.629,50	7.677,30	6.790,79	10.640,00
<b>International Trade Tax</b>	39.213,60	45.881,80	41.053,70	36.721,21	51.172,70
- Import duty	35.066,20	39.116,70	37.527,00	32.443,50	33.172,70
- Export Tax	4.147,40	6.765,10	3.526,70	4.277,71	18.000,00

Source: (Badan Pusat Statistik, 2022)

Based on table 1.1 shown above, the realization of tax revenues continues to fluctuate, dynamically, and changes throughout the year as shown in the table. The fluctuation amount in tax revenue indicates that there might lack of awareness from the taxpayer in Indonesia in paying taxes and the practice of tax avoidance is probably existed (Dwi, 2019).

According to Yulyanah & Kusumastuti (2019), many companies in Indonesia do tax avoidance. The practice of tax avoidance by companies in Indonesia has an impact on the decline in the achievement of tax revenues. The decline in the percentage of tax revenue achievement was triggered by the number

of companies that did tax avoidance. Tax is a burden on the company because it can reduce net income (Kurniasih & Sari, 2013), that's why taxpayers aim to minimize their tax liabilities through both tax avoidance and tax evasion (Darsani & Sukartha, 2021).

Based on a survey conducted by IMF investigator Ernesto Crivelly in 2016 using the International Center for Policy and Research (ICTD) and International Center for Taxation and Development (ICTD) databases on companies in 30 countries. Indonesia is ranked 11th out of 30 countries with losses of around US\$6.48 billion due to companies that do tax avoidance (Yulyanah & Kusumastuti, 2019).

Tax avoidance is a tactic used by taxpayers to lawfully avoid paying taxes by not violating tax rules. The method of avoidance is to take advantage of tax law's flaws and loopholes (Pohan, 2016). Tax avoidance is an attempt to decrease a company's tax burden that may be carried out by companies of all sizes (Reinaldo, 2017). Tax avoidance is a way for companies or taxpayers to reduce their tax payments to the state treasury (Kurniasih & Sari, 2013).

According to Yulyanah & Kusumastuti (2019), there are three characters of tax avoidance:

1. There is an artificial aspect in which many arrangements look to be included but they are not, and this is done due to the absence of tax elements.
2. Use legal loopholes in the law and tax rules for a variety of objectives.

3. The presence of a secrecy element, often a consultant engaged by the firm to handle its taxation, will give a mechanism to avoid tax on the condition that the taxpayer maintains confidentiality.

The Taxation Law explains that paying taxes is the obligation of the taxpayer as a citizen to participate in developing the country. However, many taxpayers such as tax businesspeople do tax avoidance, because for them taxes are a burden for the company which will reduce the company's net profit (Yulyanah & Kusumastuti, 2019). There are many possible factors influencing tax avoidance to be happened in Indonesia, such as profitability (Darmayanti & Merkusiwati, 2019) and Irianto et al. (2017); institutional ownership (Astuti et al. (2020) and M. Saputra et al. (2017) and leverage (Kimsen et al., 2019).

Profitability is a measure of management's effectiveness in managing the company's wealth, as demonstrated by the profit created. The higher a corporation's degree of profitability, the bigger the profits made by the company. As a result, the amount of taxes paid by the corporation will rise. ROA is one of the profitability considered in this study. The greater the value of ROA, the better the company's performance through utilizing assets to generate a significant profit. Earnings growth leads to an increase in ROA. Profit increases influence the amount of tax pay (Kimsen et al., 2019). According to Hariani & Waluyo (2019), Profitability is a factor in determining the tax burden since firms with larger earnings pay more taxes, yet corporations do not want to pay high taxes. Research by (Darmayanti & Merkusiwati, 2019) and Irianto et al. (2017), profitability has a positive impact on tax avoidance.

Institutional ownership is also seen to be capable of lowering agency expenses. This is because institutional ownership represents a resource that may be utilized to support or oppose the manager's policies. Institutional investors frequently acquire a majority stake in a company. This is because institutional investors have more resources than ordinary shareholders and are thus seen to be capable of running a competent monitoring process (Sari et al., 2020).

Competitive ownership is demonstrated through institutional ownership. The higher the monitoring system in an organization, the greater the investment value placed into it. In practice, institutional ownership has a far more effective monitoring role than management ownership (Sari et al., 2020). Research by Astuti et al. (2020) and M. Saputra et al. (2017) shows institutional ownership has an impact on tax avoidance.

Leverage is a ratio that reflects how much external money a firm utilizes to carry out its operations. The results of the leverage ratio calculation show how much of the company's assets are derived from its loan capital (Sasiska et al., 2018). If the corporation has a high-interest loan fund, the company will pay creditors a high-interest expenditure. Interest expenditure reduces profit, therefore lower profits reduce tax expense in a single quarter (Kimsen et al., 2019). Research by Annisa (2017) and Tampubolon & Kartikaningdyah (2016) shows evidence that leverage has a positive effect on tax avoidance. Companies that have a high tax burden will choose to owe as an act of tax avoidance. Companies with high leverage will have a high level of tax avoidance (Kimsen et al., 2019).

Fail to achieve the tax revenue target each year is an indication of the high practice of tax avoidance by taxpayers. One of the expectations of the Directorate General of Taxes in tax revenue is the manufacturing industry. According to the State Revenue and Expenditure Budget (*Anggaran Pendapatan dan Belanja Negara*) report shows that tax revenues from January to April 2020 amounted to Rp 376.67 trillion. Based on the type of industry, the realization of tax revenue for the manufacturing industry sector was Rp 108.36 trillion, equivalent to 29.5% of the total realized tax revenue.

On the other hand, tax revenue from the trade sector was Rp. 73.92 trillion, down 4.83% yoy, the construction and real estate sector was worth Rp. 22.52 trillion, down 4.61% yoy, the transportation and warehousing sector reached Rp. 16.97. Trillion with a decline of 2.95% yoy. Meanwhile, the mining sector recorded the deepest contraction of 27.55% with realized revenues of Rp 16.46 trillion (Santoso & Rahmawati, 2020). By being the sector that is most affected and has the biggest impact on the development of the country, the discussion on tax avoidance by companies in this sector deserves to be explained more deeply through this study.

The phenomenon example related to the tax avoidance case in Indonesia was the phenomenon that occurred in PT. Toyota Motor Manufacturing Indonesia (TMMIN). The phenomenon of tax avoidance in Indonesia occurred in 2014 in the various industry sector in the automotive subsector carried out by PT.Astra Internasional Tbk which was reported by Astra International Tbk (ASII) which one of its subsidiaries is PT. Toyota Astra Motor (TAM). The Directorate General of Taxes at the Ministry of Finance has suspected Toyota Astra Motor of using



transactions between domestic and foreign affiliated companies to avoid paying taxes. Tax avoidance by PT. TMMIN is related to the purchase of raw materials and large royalty fees which cause the company's revenue to decrease. With reduced income, profits will also decrease and will lead to smaller taxes to be paid to the State.

PT. Toyota Motor Manufacturing Indonesia (TMMIN) case occurred due to the separation of the car assembly company by TMMIN, while the marketing and distribution was carried out by PT Toyota Astra Motor (TAM). TMMIN sold the car that had been produced to TAM which was then resold to AUTO 2000.

From AUTO 2000, these cars were resold to consumers. In addition, PT. TMMIN recorded a record of 70% of total vehicle exports from Indonesia. According to Law Number 36 of 2008, the tax rate for corporate income tax is 25%, so the lower the CETR, the higher the tax avoided on PT.Astra Internasional Tbk. PT. Toyota Motor Manufacturing Indonesia (TMMIN), this case occurred due to corrections made by the Director General of Taxes on the sales value and royalty payments of TMMIN.

This dispute occurred around 2008 tax report. At that time, 95% of TMMIN's shareholders were Toyota Motor Corporation and the remaining 5% was owned by PT. Astra International Tbk. In its tax report, TMMIN stated that the sales value reached Rp. 32.9 trillion, but the Director General of Taxes corrected the value to Rp. 34.5 trillion or there was a correction of Rp. 1.5 trillion. With a correction value of Rp. 1.5 trillion, TMMIN must add tax payments of Rp. 500

billion. Before splitting, TAM's gross margin increased 11% to 14% per year. However, after being separated, TMMIN's gross margin is only around 1.8% to 3% per year. Meanwhile at TAM, the gross margin reached 3.8% to 5%. If the gross margin of TAM is combined with TMMIN, the percentage is still 7%. This means that it is 7% lower than when they were still joining which reached 14%. The reduction in profit was due to royalty payments and unreasonable purchases of raw materials and the sale of cars to affiliated parties below the cost of production to reduce business circulation (Idris, 2013).

This research focus on manufacturing companies listed at the Indonesia Stock Exchange (IDX) with the object of research on tax avoidance that occurs in Indonesia. Therefore, the author is interested to conduct research entitled “**The Impact of Profitability, Institutional Ownership, and Leverage Towards Tax Avoidance in the Sector of Manufacturing Companies Listed at Indonesia Stock Exchange**”.

## **1.2 Problem Limitation**

From the explanation in the background of study, the writer declares his problem limitations of this research with one dependent variable, which is Tax Avoidance and three independent variables, which is Profitability, Institutional Ownership, and Leverage. The population of this research is the companies of manufacturing sector that listed at Indonesia Stock Exchange (IDX) from year 2017 to 2021. The reason the writer chooses manufacturing sector as its researching field because this sector pays the largest tax for the state and other occurrences such as transfer pricing and overstated amount in the companies' financial statement.



### **1.3 Problem Formulation**

According to the background of study, there are several problem formulations in this research as follows:

1. Does profitability have significant impact on tax avoidance at the sector of manufacturing companies that listed at Indonesia Stock Exchange?
2. Does institutional ownership have significant impact on tax avoidance at the sector of manufacturing companies that listed at Indonesia Stock Exchange?
3. Does leverage have significant impact on tax avoidance at the sector of manufacturing companies that listed at Indonesia Stock Exchange?
4. Do profitability, institutional ownership, and leverage simultaneously have significant impact on tax avoidance on the sector of manufacturing companies that listed at Indonesia Stock Exchange?

### **1.4 Objective Research**

From the problem formulations mentioned above, therefore the objective as follows:

1. To determine if profitability have significant impact on tax avoidance at the sector of manufacturing companies that listed at Indonesia Stock Exchange.
2. To determine if institutional ownership have significant impact on tax avoidance at the sector of manufacturing companies that listed at Indonesia Stock Exchange.
3. To determine if leverage have significant impact on tax avoidance at the sector of manufacturing companies that listed at Indonesia Stock Exchange.

4. To determine if profitability, institutional ownership, and leverage have significant impact on tax avoidance at the sector of manufacturing companies that listed at Indonesia Stock Exchange.

## **1.5 Research Benefit**

The following are the theoretical and practical applications that are likely to result from this research:

### **1.5.1 Theoretical Benefit**

In terms of theoretical, the benefits are:

1. From the writer perspective, this research should be able to validate the hypothesis used in this study as well as include data about the impact of profitability, institutional ownership, and leverage on tax avoidance.
2. For the academic, this research will provide explanation towards the tax avoidance, and it can become the additional information to widen up the knowledge about the taxation in the academic environment.
3. For companies, this research will provide the information to companies not to do tax avoidance because it results in decreased income or state turnover which can harm the country and slow down the progress of the country such as in the construction of facilities within the country.
4. For government, this research will provide the feedback and evaluation to law policymakers regarding tax avoidance to pay

attention to several factors that can create loopholes for tax subjects to do tax avoidance.

### **1.5.2 Practical Benefit**

From the practical, the benefits are:

1. Provide the explanation about the implementation of profitability, institutional ownership, leverage, and the impact of tax avoidance in manufacturing companies that listed at Indonesia Stock Exchange.
2. Provide the insights to all manufacturing companies that listed at Indonesia Stock Exchange about the importance of obey and fulfill all their tax obligations that benefits the state.
3. May this research use by future researcher material and the results can serve as a comparison of study material and serving as guidance and additional information that related to the variable used.