CHAPTER I

INTRODUCTION

1.1 Background of the Study

One of the state's income is tax. According to Undang-Undang No 28 Tahun 2007, tax is a mandatory contribution by individuals or entities to the state. The tax is collected coercively with the basis of law and the contributors will not receive direct compensation. But the tax will be used for the necessity of the state and the prosperity of the people. According to Nurmantu, (2005), generally there are two functions of tax. The first function is budgetair function or fiscal function, which becomes the main function, where taxes are being used as a tool to optimally insert funds into the state treasury based on applicable regulations. Based on this function, the government that needs funds to finance various matters will collect taxes from the people. The second function is regulerend function or control function, which becomes the additional function. Regulerend function is a function in which taxes are used by the government as a tool to achieve certain goals. Examples of regular end functions are import duty, sales tax, etc.

The General Provisions and Tax Procedure Law in article 12 paragraph 1 mentioned that every taxpayer is obligated to pat tax payable in accordance with the provisions of tax laws and regulations, without relying on the existence of tax assessment letter. By this regulation, the Indonesian government implement the self-assessment system, which require the citizen to calculate and pay the tax by him or herself. But this system might be misused by the taxpayer.

On the other side, every company that run business always has the competition with other company and company are expected to grow among the competition. Oftentimes, the profit obtained by the company becomes the indicator of company performance. But the profit will be taxed by the government, which will directly could decrease the net profit of the year obtain by the company. If the company obtain a greater amount of profit, the company also need to pay a higher amount of tax. Therefore, the tax will be an additional cost for the company and most company will try to minimize their tax burden.

Therefore, most company tries to minimize their tax burden that mostly carried out by the practice of tax avoidance. According to Phyllis Lai Lan Mo (2003), tax avoidance is a legitimate responsibility of corporate management in safeguarding the company's assets, without hiding any transaction or fraudulent claims or misrepresentation, thus no law violation. Meanwhile, Kevin G. Inkiriwang (2017), defines tax avoidance as a legal action in minimizing the tax burden, since the tax minimization practice is executed without violating the tax provision.

The aims of company to do tax avoidance triggers many researchers to do study about the tax avoidance practice. The previous researcher found out that there are factors that may affect tax avoidance. These factors include thin capitalization and capital intensity.

According to Taylor and Richardson (2012), thin capitalization is a measurement to determine how a company manage the debt as the part of tax deductible expenses to reduce the tax burden. Besides that, according to Prastiwi and Ratnasari (2019), defines thin capitalization as a practice of tax avoidance through managing the debt structure become bigger than capital. With a larger debt ratio, the company will have a large interest expense as well. This interest expense can be used to reduce profit before tax, so that in the end it can reduce the tax burden.

In accordance with the thin capitalization practice, the government through Income Tax Law Article 18 Paragraph 1, give the authority to the Minister of Finance to set ratio between debt and capital for tax calculation purpose. The first regulation issued by the Minister of Finance in accordance with the debt and capital ratio is 1002/KMK.04/1984, but this regulation was suspended with the issuance of 254/KMK.01/1985. Presently, the Minister of Finance issued 169/PMK.010/2015 that revoke those two regulations before. Through the newest regulation, the minister of finance set the ratio of debt and capital become 4:1 sequentially, which is equal to 80% of debt and 20% of capital. The debt and capital ratio are applied since the 2016 fiscal year.

Another loophole that company often used to manage the tax avoidance is capital intensity. According to Ross et al. (2019), capital intensity is a ratio that tells the amount of assets needed by the company to generate profit. A research done by Cahyani et al. (2021) mentioned that capital intensity shows the amount of capital needed to generate profits. The researchers also describe capital intensity as an investment activity that is carried by company that invest in fixed assets because fixed assets have depreciation expenses that can be used to reduce the tax burden.

Salwah and Herianti (2019) mentioned that the practice of tax avoidance done by company does not mean that the company does not have ethical behavior.

But it is basically because the company are carrying out a long-term strategy in managing the tax burden. The strategy is executed by the company in order to maximize the welfare through maximum profit by minimizing the tax burden. The reason why the company need to minimize the tax in order to maximize the profit is basically because the tax burden will reduce the profit earned by the company.

Many researchers tried to find the relationship between thin capitalization, capital intensity, and tax avoidance. However, the existing research is forming two groups that are contradicted towards each other. Hence are the results of data processed in analyzing the research gap:

Table 1.1 Research Gap

Research Gap	Researcher	Result
The result of previous studies regarding the impact of thin capitalization towards tax avoidance are different.	1. Alya Zulfa Cahyani, Syahril Djaddang, Mombang Sihite, and Yayan Hendayana (2021) 2. Dewi Prastiwi and Renni Ratnasari (2019) 3. Memed Sueb (2020)	Thin capitalization has impact on tax avoidance.
	1. Melinia Istiqfarosita and Fadlil Abdani (2022) 2. Tesa Anggraeni and Rachmawatu Meita Oktaviani (2021)	Thin capitalization does not have impact on tax avoidance.
The result of previous studies regarding the impact of capital intensity towards tax avoidance are different.	1. Alya Zulfa Cahyani, Syahril Djaddang, Mombang Sihite, and Yayan Hendayana (2021) 2. Ida Ayu Intan Dwiyanti and I Ketut Jati (2019) 3. Memed Sueb (2020)	Capital intensity has impact on tax avoidance.
	1. I Putu Putra Wiguna and I Ketut Jati (2017) 2. Sevi Lestya Dewi and Rachmawati Meita Oktaviani (2021)	Capital intensity does not have impact on tax avoidance.

Source: Prepared by the writer (2022)

Based on the data shown in the table, it could be seen that the research about the impact of thin capitalization and capital intensity towards tax avoidance generate different results. Therefore, further research is needed to study more about the impact of thin capitalization and capital intensity toward tax avoidance. Since the previous research are forming two groups that are contradicted to each other, therefore the to maximize the research, the writer adds another intervening variable, namely profitability.

According to Ehrhardt and Brigham (2011), profitability is the net result of numerous numbers of policies and decision. A research done by Rahmadani et al. (2020), defines profitability as one of the measurements to the company performance. While a researcher, namely Bratakusuma (2021), explains that profitability can describe the company's ability to utilize its assets efficiently in generating company profits from assets management.

Profitability, as the intervening variable, will act as an intervention between the relationship of thin capitalization and capital intensity towards tax avoidance. The writer chooses profitability as the intervening variable in this research with the reason that, profitability is one of the indicators that being used to measure the company performance. Besides that, in some research, profitability successfully influences the tax avoidance practice, such as the research by Anggraeni and Oktaviani (2021), Dewi and Noviari (2017), and Rahmadani et al. (2020). But besides those researchers, there are some researchers that revealed that profitability does not have any impact towards tax avoidance, namely Dwiyanti and Jati (2019), Nugrahitha and Suprasto (2018), and (Bratakusuma, 2021). The existence of research gap and the potential of tax avoidance practice by doing thin capitalization, managing the capital intensity, and with the profitability measurement become the motivation for the author to do further research.

This research will be focused on the healthcare sector companies that listed on the Indonesia Stock Exchange. The writer chooses healthcare sector companies as the research object because since the COVID-19 pandemic emerged in Indonesia, the awareness about health has started to increase among the Indonesian citizens. Therefore, the demand for health products increases. By this situation, the profit for healthcare sector companies will be increased, if with the tax. And to minimize the tax burden, the aims of healthcare sector companies to do the tax avoidance become higher. With, this paper entitled **"The Impact of Thin Capitalization and Capital Intensity Toward Tax Avoidance Through Profitability on The Healthcare Sector Companies Listed on The Indonesia Stock Exchange."**

1.2 Problem Limitation

Problem limitation is used to avoid any deviations or widening discussion, so that the research is more focused and could achieve the research objective. In order to achieve those goals, this research had some limitations as following:

1. The indicators were only limited to thin capitalization, capital intensity, and profitability. There are other factors outside this research that can bring impact on tax avoidance.
2. The research only examines the time span of five years, which is from 2017 until 2021. Therefore, it causes the research result will not be very accurate.
3. The research only being done on the healthcare sector companies listed on the Indonesia Stock Exchange. Thus, it may not cover all other companies.

4. The measurement of thin capitalization with the MAD ratio only can be done with the availability of the company's financial statements.
5. The measurement of capital intensity was done by diving total assets to the sales, which require the availability of the company’s financial statement.
6. The measurement of profitability was done by using ROA (return on assets), which was done by dividing the net income with the total assets. This profitability measurement requires the availability of the company’s financial statement.

1.3 Problem Formulation

In accordance with the background of study that has been described, then the research problem formulation was as following:

1. Does thin capitalization have impact on tax avoidance on the healthcare company listed on the Indonesia Stock Exchange?
2. Does capital intensity have impact on tax avoidance on healthcare company listed on the Indonesia Stock Exchange?
3. Does thin capitalization have impact on tax avoidance through profitability on the healthcare company listed on the Indonesia Stock Exchange?
4. Does capital intensity have impact on tax avoidance through profitability on the healthcare company listed on the Indonesia Stock Exchange?

1.4 Objective of the Research

From the problem formulated above, then the research objective for this research will be as follows:

1. To find out the impact of thin capitalization toward tax avoidance on the healthcare company listed on the Indonesia Stock Exchange.
2. To find out the impact of capital intensity toward tax avoidance on the healthcare company listed on the Indonesia Stock Exchange.
3. To find out the impact of thin capitalization toward tax avoidance, with the intervention of profitability on the healthcare company listed on the Indonesia Stock Exchange.
4. To find out the impact of capital intensity toward tax avoidance, with the intervention of profitability on the healthcare company listed on the Indonesia Stock Exchange.

1.5 Benefit of the Research

The research carried out is encouraged to provide benefits to the parties who need it. This research was expected to have a positive impact in developing economics, especially in the field of accounting. The benefits of writing research include the following:

1.5.1 Theoretical Benefit

1. For the next research

   This research was expected to be able to provide directions and provide information for future researchers who will use similar topics related to thin capitalization, capital intensity, profitability, and tax avoidance. Therefore, it can be able to provide a clear picture and can be a comparison of the results obtained by further researchers.

2. For the academics

   This research was expected to be able to contribute to the development of thin capitalization practices, capital intensity influence and profitability in the development of accounting theory. In addition, the research is expected to be able to help develop the concept of thinking in the economic field, especially in the accounting field by providing empirical evidence.

1.5.2 Practical Benefit

This research was expected to increase the insight of the readers about thin capitalization, capital intensity, profitability, and tax avoidance. In addition, this research was also expected to be useful for the public, so the public could have an overview about the factor. Especially for company, investors, and government.

1. For company

   This research may help the company to execute the proper way to reduce the tax burden that in line with the law and regulation. Therefore, the company can avoid the practice of tax evasion.

2. For investors

   Through this research, investors could increase their insight about thin capitalization, capital intensity, profitability, and tax avoidance. Thus, with that additional insight, it can help the investors in decision-making process to identify the worth company to invest.

3. For government

   Hopefully this research could help the Indonesian government to provide some overview on some factors that can increase the tax avoidance practice in the healthcare sector companies.