CHAPTER I

INTRODUCTION

1.1 Background of the Study

Currently the business sector has an important role in the development process of the country for the better. The economic order in Indonesia is developing from time to time, which process is inseparable from the synergy of all parties that turn the wheels of the economy from various sectors. These business sectors include industry, manufacturing, trade and services carried out by various companies both domestically and abroad. The company has the goal to get profit and maximize welfare. The company's goal is to increase the value of the company, which is reflected in the company's stockprice. In addition, the company's goals include continuous growth, survival and a positive impression in the eyes of the public. For this purpose, the company must try to maximize all the resources owned by the company and minimize all the burdens that must be incurred by the company to support the operation to run well.

Financial reporting is one media to communicate the financial condition of the company's operating results within a certain period to various interested parties. Financial reports liaise company managers and stakeholders to communicate each other. Earnings management is carried out when managers use judgment in financial reporting. Managers compiles transactions into financial statements for stakeholders to obtain information about the economic performance of the company. Earnings management is defined as an opportunistic effort by company management to manage the impact of the information contained in the financial statements. (Febrian, et.al., 2018). Managers select, utilize, or change any existing accounting methods and procedures. This is because earnings management involves the manager's efforts to hide or change information by playing with the number of components of the financial statements carried out when recording and compiling the information. Earnings management can be a tool used by management within the company to communicate with investors.

Even though there are already accounting standards that have been made, company managers still take advantage of gaps in existing accounting standards to present financial statements that do not reflect theactual state of the company. Profits reported by management are not only reported to shareholders but for the benefit of the tax authorities as well. If the profit reported by the management is large, it will also be good news not only for stakeholders but for the tax authorities, because what is used as the basis for calculating taxes is the profit generated by the company. If the profit generated is large, company will seek for the way to reduce the tax burden so that is does not reduce the profits obtained by the company. (Sinaga and Tipa, 2020).

Deferred tax is a tax effect that is recognized when an adjustment is made to the income tax expense of a future period. Recognition of deferred tax in the company's financial statements is a relatively new thing in the accounting world in Indonesia. Although the option of applying deferred tax in income tax accounting has been permitted, many still do not understand the deferred tax, both in terms of conceptual understanding or its application to the financial statements of companies in Indonesia. In doubt, the public means thatthere has been a deferred tax to be paid back. The public's understanding is contrary to the concept of deferred tax after being applied, namely when deferred tax is imposed, it turns out to be completely unrelated to tax payments. (Hilmy, 2020).

Income tax expense is calculated using the taxation rules for the company's operating results for the period of the year concerned. These tax regulations require companies to make fiscal corrections (permanent/ temporary differences) because there are differences in the way to recognize and measure income and costs and the method to allocate cost. Tax regulations continue to use accounting data and information that have been regulated by the Financial Accounting Standards as the basis for determining these corrections based on the applicable tax rules. The difference between commercial profit and taxable profit (book-tax differences) can inform management's discretion in the accrual process. The difference is called as a fiscal correction in the form of a negative correction and a positive correction. A negative correction will result in a deferred tax liability, while a positive correction will result in a deferred tax asset.

The management conduct earnings management by reducing the profit figure and paying more tax in the current period so that the profit generated in the coming year is greater and pays less tax. Accountants must improve their judgmental abilities in determining past and future earnings. These considerations will affect the valuation of deferred tax which may be used as an indicator of earnings management. Deferred tax has effect on earnings management This indicates that deferred tax is used as a loophole by management to maximize profits or reduce a loss for the company it manages.

Deferred tax expense resulted in a decrease in earned profit. Deferred tax expense can be used to predict earnings management practices by management with two objectives, namely, to avoid decreasing profits and to avoid losses. This can be done by delaying income and accelerating to save taxes, which is by engineering the deferred tax expenses related to accruals in order to allow management to manage earnings. Temporary differences can be sourced from depreciation expense, doubtful accounts expense, prepaid expenses, pension expense, purchase of goodwill, long-term construction contracts, unearned income, and profits that are not distributed to investors. If it is seen from the explanation above, the estimates that cause temporary differences indicate the manager's authority in recognition and income to change the profit figure (earnings management).

The tax authorities are aware that there is a tendency for taxpayers to minimize the amount of tax that must be paid by carrying out tax planning or tax planning, both legally (tax avoidance) and illegally (tax evasion).

In the matter of taxation, there are different views between taxpayers and the tax authorities. Taxpayers try to minimize the taxes that should be paid, while the tax authorities are the opposite. In general, companies carry out tax planning so that the amount of taxes that must be paid can be minimized or pay taxes with the minimum amount possible. Tax planning is actually an act of tax preparation in a structured manner related to potential tax consequences. (Pohan, 2020). This emphasizes the control of transactions that have tax consequences. This condition aims to control the amount of tax so that it reaches the minimum possible value, through what is known as tax avoidance. Tax evasion itself is an illegal tax action. It is distinguished by what is called a tax evasion which clearly violates the tax laws and regulations.

Basically, the company will try to optimize the company's profit as much as possible, therefore the company is required to always be able to anticipate every need of the customers. For example, by providing products with competitive prices and quality, satisfactory service, so that sales are expected to increase, and costs can be reduced to a minimum (cost reduction). In addition to maximizing profit, the company tries to minimize tax payments. To achieve the minimization of tax payments, a careful tax planning is needed.

This research is conducted at trade, service and investment the company in Indonesia Stock Exchange. The tax planning, deferred tax expense and earning management of some companies are as follows:

Table 1.1 Tax Planning, Deferred Tax Expense and Earning Management in Year 2018-2020

Company	Year	Tax Planning	Deferred Tax Expense	Earning Management
PT Prodia Widyahusada, Tbk	2018	79.14%	0.14%	0.70%
	2019	79.40%	0.24%	1.61%
	2020	59.84%	0.48%	1.70%
PT Supra Boga Lestari, Tbk	2018	83.44%	-0.10%	0.44%
	2019	86.59%	-0.16%	1.11%
	2020	80.60%	0.07%	3.92%
PT Multipolar	2018	70.33%	-0.30%	-0.13%

Technology, Tbk	2019	70.90%	0.43%	2.37%
	2020	71.58%	0.89%	4.22%

Source: Indonesia Stock Exchange (2022)

In the summary of the financial statements of the company above, it can be seen that from year-to-year, tax planning and deferred tax expense tend to increase while earning management are increasing from year to year. This indicates that if the value of tax planning and deferred tax expense increase, earning management will also increase. In this case, management allows increasing profits by utilizing deferred figures so that the financial statements look stable. Management performing earnings management will consider several factors that can affect profit figures. The management way to conduct earnings management is to change the accrual by accelerating or slowing the company's expenses and revenues. If there are many differences in terms of accruals made by the commercial and fiscal parties, then the tax impact recognized by fiscal and commercial are also different. The difference will result in a deferred tax expense which will increase the deferred tax assets or deferred tax liabilities. Therefore, the relationship between accruals, deferred tax assets and deferred tax expense is very closed in detecting earnings management namely to maximize the bonuses they get by managing the accrual figures and trying to minimize the taxes that companies have to pay.

This paper observes the trade, service and investmentcompany in Indonesia Stock Exchange as it is the sector conducting earning management in order to provide positive information to many parties. The company expects to maintain trust from investor. The value of company is the factor that the investor plans to buy the company’s stock. The company maintain its value in Indonesia Stock Exchange. The company manages to reduce the payment of tax as the company’s expenditure.

The tax planning has impact in maintaining the company’s cash flow. The deferred tax expense can show the method in reducing the profit. Based on the its purpose, company conduct the earning management and determine its profit.

1.2 Problem Limitation

This research has limitation in the trade, service and investment company on the Indonesia Stock Exchange year for year 2018-2020. The variable of the research is tax planning, deferred tax expense and earning management.

1.3 Problem Formulation

Problem formulation in this research is as follows:

1. Does the tax planning has impact on earning management in trade, service and investment companies at Indonesia Stock Exchange?
2. Does the deferred tax expense has impact on earning management in trade, service and investment companies at Indonesia Stock Exchange?
3. Do the tax planning and deferred tax expense has impact on earning management in trade, service and investment companies at Indonesia Stock Exchange?

1.4 Research Objective

The objective of the research is as follows:

1. To determine the impact of tax planning on earning management in trade, service and investment company on the Indonesia Stock Exchange.

2. To determine the impact of deferred tax expense on earning management in trade, service and investment company on the Indonesia Stock Exchange.
3. To determine the impact of tax planning and deferred tax expense on earning management in trade, service and investment on the Indonesia Stock Exchange.

1.5 Benefit of the Research

The benefits of research is as follows:

1.5.1 Theoretical Benefit

1. Accounting student

   Academically this research provides benefits to the development of science in the field of corporate finance. This research is expected to be material for readers from academia to broaden their horizons and develop research related to tax planning, deferred tax expense and earning management.

2. For researcher

   This research can be a source of literature and can be a reference to be refined in further research which shows the effect of tax planning and deferred tax expense on earnings management.

1.5.2 Practical Benefit

1. The government

   The results of this study will provide evaluation and input regarding the impact of tax planning and deferred tax expense on the company's earnings management.

2. The companies

   This research is expected to be able to provide an overview to the company of the factors that are important to consider in making earnings management decisions.

3. The investors

   This research is expected to be used by practitioners as a tool to determine earnings management in companies listed on the Indonesia StockExchange.