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ANTECEDENTS OF TAX AVOIDANCE PRACTICES Cases in Indonesian Manufacturing Companies

By

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Abstract

Tax avoidance is a phenomenon of efforts made by taxpayers to minimize the tax burden. This research was conducted on manufacturing companies listed on the IDX in 2017-2023. Sampling was carried out using a purposive sampling method, and 105 data were produced. The variables studied are firm size, family ownership, profitability, and tax avoidance. Five hypotheses were tested with partial least squares using SmartPLS to determine direct and indirect relationships. Path coefficient show successfully supported three hypotheses. Firm size and profitability are proven to influence tax avoidance. Family ownership has only been proven to affect profitability, but it does not affect tax avoidance. Firm size and family ownership have yet to be proven indirectly related to tax avoidance.

Keywords: *firm size, family ownership, profitability, tax avoidance*

INTRODUCTION

Taxes are levies imposed on taxpayers by the state to help contribute some of their assets to benefit the people and the state. The definition of tax is a mandatory contribution to the state owed by an individual or entity that is coercive based on law and is used for state needs. as well as the prosperity and well-being of its people (Bauer et al., 2018).

For taxpayers, tax is a burden that must be paid every year, especially if the income or income obtained by the taxpayer is high, the higher the tax that must be paid to the state. Therefore, there are many tax avoidance practices, or what is usually called tax avoidance, carried out by taxpayers to avoid or reduce the nominal tax that must be remitted to the state.

Tax avoidance is an explicit tax reduction, where tax avoidance is a series of tax planning activities. Tax planning is the process of organizing the operations of a taxpayer or group of taxpayers so that the tax debt is at the lowest level for both income tax and other taxes, as long as both allow this by the provisions of tax and commercial laws and regulations (Belz et al., 2019).

The case of tax avoidance is a phenomenon that continues to be researched. Previous findings showed that many companies are indicated to be evading taxes, both multinational and domestic. Tax avoidance is an effort made by taxpayers to minimize the tax burden. Tax avoidance is considered legal because it still complies with tax laws and regulations, but the government objects because this act of tax avoidance can harm the state.

Several factors influence taxpayers to practice tax avoidance, namely profitability. Profitability is one of the benchmarks companies use to see the company's ability to generate net income while running a business. Because the company's main goal is to obtain maximum net income, profitability is used as a benchmark. The profitability ratio is a ratio that assesses an ability to earn net income.

Apart from profitability, firm size is also a determinant of tax avoidance. Firm size is the size or scale of the company, which can be measured by looking at how a company carries out its activities, whether stable or unstable. Firm size can be classified based on total assets, share price on the market, market capitalization, and several other factors (Yuniarwati et

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al., 2017). The higher the value of these factors, the larger the firm size.

Companies that fall into the large category will have greater resources. Of course, this will result in a greater tax burden, so companies try to manage it efficiently. Large and complex companies have many loopholes that can be exploited to avoid taxes, such as using accounting methods to defer current net income to future periods to obtain a lower tax burden.

Family firms incur lower agency costs due to high family ownership and have long investment prospects or are inherited for several generations. Family companies also reflect the implementation of good governance because they can reduce the level of managerial opportunism. Managers are part of the family and, therefore, have the same views and goals as the "owners" of the company.

Aggressive tax actions taken by family companies are lower than those of non-family companies (Clemente-Almendros & González-Cruz, 2023). They also fear that the company's reputation will decline, considering the presence of the next generation and their concern for the family name (Ejeh & Salaudeen, 2018; Gallemore et al., 2014). The decline in reputation due to tax avoidance in family-owned companies will be higher than in non-family companies.

The trade-off between the benefits derived from tax savings that resulting from corporate tax avoidance and the costs arising from reputational damage is higher for owners of families than for non-family firms. Families have significant ownership, long-term investment views, and major reputation problems, indicating that tax avoidance in family firms is still an empirical problem (Maron, 2016).

Tax Avoidance

Tax avoidance is a legal reduction effort carried out by making optimal use of provisions in the field of taxation, such as permitted exceptions and deductions, benefits from things that have not been regulated, and weaknesses in the applicable taxation regulation. Tax avoidance is a practice by taxpayers to avoid or reduce the tax paid to the state (Mocanu et al., 2021). This practice is not considered to violate the law but still violates compliance norms as a taxpayer in carrying out its obligations to pay taxes. This practice is also not regulated in tax laws and regulations, so there are no binding regulations regarding anyone who carries out this practice.

Tax avoidance is an aggressive tax strategy companies carry to minimize tax burdens so that this activity can pose risks for the company. Tax avoidance is carried out legally and safely for taxpayers because it does not conflict with tax provisions (Kimsen et al., 2019). The methods and techniques used in this effort take advantage of the gray areas contained in tax laws and regulations, which are used to minimize the amount of tax owed.

The main goal of tax avoidance is to ensure that the tax burden paid is lower than it should be paid (Putra et al., 2018). Companies consider paying taxes a substantial additional cost or a transfer of wealth from the company to the government, which can reduce the company's net income.

Firm Size, Profitability and Tax Avoidance

Firm size can be compared by looking at how large the total assets the company owns. Many other factors can be used as a reference when measuring the firm size. However, researchers chose assets as a reference because assets are considered more stable when measuring the firm size.

Companies with large total assets are considered to have economic stability, and usually, the more assets they have, the higher the risk of the company carrying out tax avoidance practices. One fraudulent way to reduce the tax value is to look at the depreciation value of fixed assets such as equipment and vehicles. The depreciation value will reduce the company's net income, so the tax paid will also be reduced.

The results of previous research (Anjarwi Astri Warih, 2019; Solihin et al., 2020a) state that firm size influences tax avoidance, and (Isik et al., 2017; Lamuda, 2017; Laurencia & Mulyana, 2022) also state that firm size influences profitability. Based on this description, the following hypothesis can be made:

H1: Firm size has a significant effect on tax avoidance practices
H2: Firm size influences profitability

Family Ownership, Profitability, and Tax Avoidance

Family firms are considered the most efficient organization with low agency costs (Hiranrithikorn & Joemsittiprasert, 2019). Family ownership is also considered an alternative governance device (Almuzaiqer et al., 2022; Ferramosca & Allegrini, 2018; et al., 2015). This argument suggests that family ownership can reduce potential problems of managerial opportunism and lead to less aggressive tax positions. Additionally, families worry about reputational costs and fines.

Family owners are less likely to take aggressive tax positions because they care about their family's reputation. Family owners recognize their company as a legacy that must be passed on to their successors. They then focus more on the long-term value of their business rather than short-term net income (Gaaya et al., 2017; Maron, 2016).

Family ownership has less incentive to generate additional cash flows to build up potential sanctions and reputational costs if tax authorities detect aggressive tax positions (Almuzaiqer et al., 2022; Gaaya et al., 2017; Park, 2018; Setiawan & Pereira, 2021). In line with this argument, family owners are expected to be less likely to engage in aggressive tax practices.

H3: Family ownership influences tax avoidance practices
H4 Family ownership influences profitability practices

The Effects of Profitability on Tax Avoidance

Profitability is one of the benchmarks companies use to see the company's ability to generate net income while running a business. Because the company's primary goal is to obtain maximum net income, profitability is used as a benchmark.

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On the income and loss statement, the tax will be charged after deducting total income from total costs, and then the earnings before tax account will appear, after which earnings before tax and total tax will be reduced again to produce an income value afterward tax or net income. In this case, companies that practice tax avoidance can get around this by making it appear that the net income earned is low so that the company will pay its tax obligations at a low nominal rate.

Profitability is an indicator that reflects a company's financial performance related to the company's net income and taxable income for taxpayers. The higher the profitability, the higher the net income obtained by the company, and the better the management of a company's assets. When a company experiences income growth, the income tax will also increase. Then, companies tend to avoid taxes. The results of previous research state that profitability positively affects tax avoidance practices (Marsahala et al., 2020; Pangaribuan et al., 2021; Widiatmoko & Mulya, 2021). Based on this, the following hypothesis is made:
H5: Profitability has a significant effect on tax avoidance practices

Conceptual Framework

In this research, researchers will analyze the influence of profitability, firm size, and family ownership on tax avoidance practices.

Endogenous variables are tax avoidance and profitability. Exogenous variables are family ownership and firm size. The conceptual framework in this research can be described in figure 1.

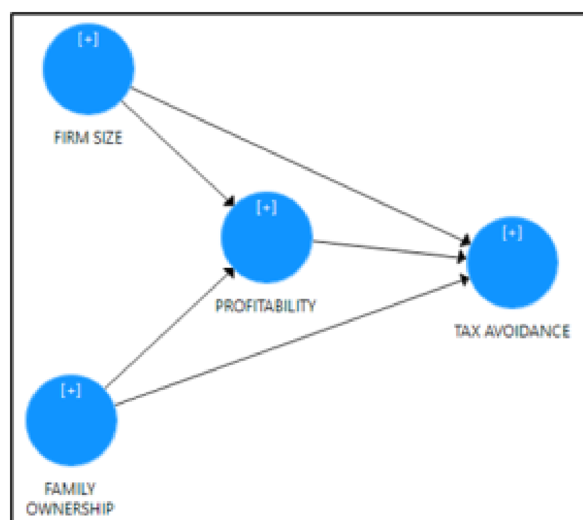

Figure 1. Research Framework

MATERIAL AND METHODS

Population and Sample

This research was conducted using quantitative descriptive research methods, which included collecting information and data through interviews, observation, and documentation. Then, the information and data obtained will be managed using quantitative methods, namely mathematical calculations, to obtain the desired results.

This research was carried out by accessing the Indonesian Stock Exchange (IDX) website and several sample company websites related to the research. This research was conducted concerning manufacturing companies in Indonesia listed on the Indonesia Stock Exchange in the period chosen by the researcher, namely from 2017 to 2023.

The population of this research data is all service companies in the manufacturing sector. Sample selection uses purposive sampling with the following conditions:

a. Manufacturing sector companies
b. The company is registered on the IDX until 2023
c. Financial statements for 2017 to 2023, available on the company website or IDX, present the data researchers need in full.

Variables

This research consists of two variables: the dependent variable and the independent variable. Based on the problem formulation and research hypothesis, these variables can be explained as follows:

Endogenous Variables. Endogenous variables are variables that are influenced by exogenous variables. In this research, the dependent variables are tax avoidance and profitability.

Tax avoidance. Tax avoidance is measured by the Company's Effective Tax Rate (ETR), which refers to total tax costs divided by earnings before tax. This measure is widely used in recent literature (Gaaya et al., 2017). ETR is an appropriate measure of corporate tax avoidance to assess corporate tax avoidance behavior for several reasons. ETR can capture all tax deductions through tax shelters and existing loopholes in tax laws. ETR is the inverse function of tax avoidance because a lower value of the effective tax rate means greater involvement in corporate tax avoidance (Gaaya et al., 2017). ETR has the following formula:

$$ETR = \frac{Total\ Tax\ Expense}{Net\ Income\ Before\ Tax}$$

Profitability (Z). Profitability is one of the benchmarks companies use to see the company's ability to generate net income while running a business. In profitability ratios, there are several ratio components, and in this research, the Net Income Margin (NPM) ratio is used as a measuring tool. Net Income Margin is a ratio that measures a company's ability to generate net income from sales made by the company (Yusuf & Isa, 2022). The higher the ratio value, the better the company's performance in obtaining net income on sales and vice versa. The Net Income Margin Ratio can be obtained using the formula:

$$NPM = \frac{Earning\ after\ Taxes}{Sales}$$

The exogenous variables in this research are firm size and family ownership. Firm size (X1). Firm size is the size or scale of a company, which can be measured by looking at how a company carries out its activities, whether stable or unstable. Firm size can be calculated using the following formula:

$$FIRM\ SIZE = Ln\ ASSET$$

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Family Ownership (X2). Family ownership in this study is measured by the percentage of shares owned by shareholders who belong to the same family (Brune et al., 2019). Family companies defined as a company where the founder or his family members continue to occupy positions in top management, board committees, or block holders of the company.

$$FO = \%\ shares\ that\ the\ family\ owns$$

Hypothesis Testing

This research uses a structural equation model with partial least squares regression tests to determine the relationship between many exogen and endogen variables. The model used in this research consists of the following:

Model I is an equation of the relationship between firm size and family ownership on profitability.

$$Z = \alpha + \beta_1 x1 + \beta_2 2 + e \quad (1)$$

Model II, the equation for the relationship between firm size, family ownership, and profitability on tax avoidance.

$$Y = \alpha + \beta_1 x1 + \beta_2 x2 + \beta_5 z1 + e \quad (2)$$

With:
XI = Firm size
X2 = Family Ownership
Z1 = profitability
Y = Tax Avoidance

RESULTS AND DISCUSSION

This study measures the relationship between profitability, firm size, and family ownership on tax avoidance. The research sample is made up of manufacturing sector companies listed on the Indonesia Stock Exchange. The research period is 2017 to 2023.

This research uses secondary data taken from the official website of the Indonesian Stock Exchange and the official websites of each company. The sampling technique used in this research was purposive sampling. Fifty-six companies were sampled in this research during the 2017-2023 period.

Descriptive Statistics

Descriptive statistics can provide an overview of each variable studied, seen from the minimum, maximum, average (mean), and standard deviation during the research period.

The results of this descriptive analysis test can be seen in Table 1, which presents the dependent variable used in this research, namely tax avoidance, and the independent variables are profitability and firm size in the companies designated as research samples. The following table explains the descriptive analysis for all variables from 2017-2023.

Table 1. Descriptive Statistics

	Min	Max	Std. Dev
Tax Avoidance	0.09	0.26	0.03
Profitability	0.01	0.38	0.09
Firm Size	20.93	33.26	2.78
Family Ownership	0	1	0.1

Table 1 shows overall descriptive statistics for all variables with a research sample of 56 companies from 2017 to 2023. This research uses the Current Effective Tax Rate (CETR) to measure tax avoidance. The minimum value of the overall tax avoidance variable is 0.09. A relatively low tax payment value means the ratio of taxes paid. It shows that there are companies that practice tax avoidance. The mean value is 0.22, and the standard deviation is 0.03, indicating that the data distribution is quite good.

Profitability has a minimum value of 0.01 and a maximum value of 0.38. The mean value is 0.10, and the standard deviation is 0.09. The mean value is greater than the standard deviation, which means the data distribution is quite good.

The minimum value of the overall firm size variable is 20.93, and the maximum value is 33.260. The mean value is 28.85, and the standard deviation is 2.78. The mean value is greater than the standard deviation, which means the data distribution is quite good.

The minimum value for the overall family company variable is 0, and the maximum is 1.00. The mean value is 0.22, and the standard deviation is 0.1. A mean value close to 0.00 indicates that most of the sample is not a family company.

Results

Table 2 shows the results of statistical testing of the direct relationship between each variable.

Table 2. Path Coefficients

	Original Sample	P-Values
FIRMSIZE → PROFIT	-0.05	0.58
FIRMSIZE → TAXAVOID	0.39	0.00
FAMOWN → PROFIT	0.26	0.00
FAMOWN → TAXAVOID	0.15	0.13
PROFIT → TAXAVOID	0.17	0.04

The first hypothesis states that firm size influences profitability. The results of statistical testing support this hypothesis. Based on Table 2, it is known that the calculated t-value is 0.05 with a significance value of 0.58. The significance level is more than 0.05, so it can be concluded that firm size does not affect profitability, so the first hypothesis is rejected. The higher the firm size does not prove the greater the profitability.

Profitability ratios aim to assess the company's ability to earn net income. Profitability can be used as a measure of the success of a company. If the company's profitability is high, it can succeed in achieving its desired goals. By seeing the company's high profitability, stakeholders will be interested in investing their shares. Companies with large assets can use

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existing resources optimally and efficiently to gain net income. In the research, the larger the firm size does not affect on profitability. The findings does not parallel with the previous findings (Isik et al., 2017; Lamuda, 2017; Laurencia & Mulyana, 2022).

The firm size hypothesis was carried out to test the effect of firm size on tax avoidance. Based on Table 2, it is known that the calculated t-value is 0.39 with a significance value of 0.00. The significance level is less than 0.05, so it can be concluded that firm size affect tax avoidance, so the second hypothesis is supported. Large companies with higher operational activity tend to have more flexible gaps to use in tax avoidance policies.

Firm size is directly proportional to the availability of resources owned by a company, so it strives to maximize the company's net income. Company performance will be maximized to accumulate maximum net income by implementing tax avoidance practices. Apart from that, firm size also symbolizes the size of the assets owned by a company. Therefore, large companies tend to accumulate by working systemically and designing more precise tax planning to achieve maximum tax savings, including legal tax avoidance. In the end, the company will get maximum net income, too. Large and stable net income will encourage companies to carry out tax avoidance practices.

The larger the firm size, the greater the practice of tax avoidance. It is in line with the theory proposed regarding the relationship between firm size and tax avoidance, which states that firm size confirms the company's readiness to accumulate net income, including by preparing expert resources (Anjarwi Astri Warih, 2019; Solihin et al., 2020b). One way to manage the tax burden is by avoiding taxes. In practice, the company's size will be in line with and directly proportional to the company's transactions. Behind corporate transactions, it allows the industry to legally take advantage of tax avoidance opportunities in every business transaction. Not only that, large companies that work transnationally in all countries have greater tax avoidance goals than those that work domestically.

The third hypothesis states that family ownership influences profitability. The test results show that family ownership is proven to increase profitability (0,26; p=0.00). Family ownership is considered an effective organizational structure compared to other shareholders. Family firms have higher ownership concentration, lower diversification policies, long-term goals, and outstanding reputational interests.

The family, as shareholders, is involved in management, which can influence company decisions (Almuzaiqer et al., 2022; Gaaya et al., 2017; Setiawan & Pereira, 2021). Along with these characteristics, there are two competing views regarding the influence of family ownership on corporate tax avoidance. From agency theory, the family has a high concentration of ownership, thereby reducing agency costs between management and). It shows that families are less opportunistic and tend to avoid risky activities, including tax avoidance practices (Gaaya et al., 2017; Park, 2018). Family owners control the company's management and board of directors. Substantial involvement in the company leads to the alignment of management and control interests (Gaaya et al., 2017).

Hypothesis four states that family ownership influences tax avoidance practices. The test results show that there is no significant effect (0.15; p = 0.13). Family ownership does not show a tendency to influence management to avoid tax. Compared with non-family firms, family firms are considered the most efficient organizational form with low agency costs.

Family ownership is also considered an alternative governance device. This argument suggests that family ownership can reduce potential problems of managerial opportunism and lead to less aggressive tax positions. Additionally, families worry about reputational costs and fines. In particular, family owners are less likely to take aggressive tax positions because they care about their family's reputation. Family owners recognize their company as a legacy that must be passed on to their successors (Gaaya et al., 2017). They then focus more on the long-term value of their business rather than short-term net income. There will be other costs of tax aggressiveness, namely the potential price discounts imposed by external shareholders when they view tax avoidance as rent extraction by insiders.

Family companies are less tax-aggressive than non-family companies. Family owners have less incentive to generate additional cash flows to build up potential sanctions and reputational costs if tax authorities detect aggressive tax positions. In line with this argument, family owners are expected to be less likely to engage in aggressive tax practices.

The fifth hypothesis was carried out to test the effect of profitability on tax avoidance. Based on Table 2, it is known that the calculated t-value is 2.03, with a significance value of 0.004. The significance level is smaller than 0.05, so it can be concluded that profitability significantly affects tax avoidance, so the first hypothesis is accepted.

If a company has high profitability, then it has good prospects. Profitability allows companies to increase the company's operating capacity due to increased income growth. The higher the sales growth, the higher the tax avoidance activity of a company because companies with relatively large sales levels will provide opportunities to gain large net income and minimize the tax burden paid by the company (Pangaribuan et al., 2021; Widiatmoko & Mulya, 2021).

Companies tend to avoid taxes to maximize their net income. Even though the company is highly profitable, it still tries to maximize net income by implementing tax avoidance measures. The amount of income reflects the tax the company must pay; this is in line with the increase in the company's net income. Companies tend to avoid taxes because company net income can erode their income.

Profitability can influence company tax planning. Where the company wants to obtain the maximum income, the company plans tax avoidance practices. So, the greater the profitability

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will be directly proportional to the practice of tax avoidance. Companies that have high profitability tend to increase their tax avoidance.

Indirect Effects

Table 3 show results of testing the indirect relationship for each antecedent variable. It proves that firm size directly influences tax avoidance and is not proven to have an indirect relationship through profitability (p=0.57).

The same is indicated by family ownership. FAMOWN was not proven to have an indirect relationship with tax avoidance (p=0.098). It also proves that profitability is not an intervening variable in the relationship between family ownership and tax avoidance. Family ownership is not a determinant of tax avoidance practices.

Table 3. Specific Indirect Effects

	Original Sample	P-Values
FIRMSIZE → PROFIT → TAXAVOID	-0.01	0.57
FAMOWN → PROFIT → TAXAVOID	0.04	0.10

Conclusion

This research was conducted to find out the results of testing the influence caused by firm size, family ownership, and profitability in manufacturing sector companies listed on the Indonesia Stock Exchange from 2017 to 2023. Sampling used a simple random sampling method with a sample size of 56 manufacturing companies. Profitability influences tax avoidance. It happens because if a company's profitability increases, the tax burden will be higher, thus encouraging companies to avoid taxes. Firm size influences tax avoidance. These results indicate that the size of a manufacturing company directly influences its actions in carrying out tax avoidance. Family ownership is proven to have no direct or indirect relationship to tax avoidance. Family ownership is not a factor that needs to be considered as a motivation for tax avoidance.

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