The ES Economy and Entrepreneurship
Vol. 01, No. 03, April, pp. 125~131

Financial Performance's Impact on Tax Avoidance

Muhammad Rinaldi[1], Melda Aulia Ramadhani[2], Sitti Rahma Sudirman[3], Muhammad Harits Zidni K. R.[4]
[1234] Universitas Mulawarman, Indonesia

Article Info

Article history:

Received Apr, 2023
Revised Apr, 2023
Accepted Apr, 2023

Keywords:

Debt to Equity
Effective Tax Rates
Leverage
Profitability
Return On Asset
Tax Avoidance

ABSTRACT

The issue in this study is Indonesia's inability to realize its full potential in terms of tax income, which is declining every year. This study investigates how tax avoidance is impacted by profitability and Leverage. For the Indonesia Stock Exchange (IDX) population in 2017–2019, 73 manufacturing firms in the Basic and Chemical Industry category were selected. So that 28 businesses satisfied the requirements, the sample was chosen using purposive sampling. The study concludes that profitability discourages tax evasion. Therefore, the corporation is more likely to engage in tax evasion the lower its profitability value. Leverage has no bearing on tax evasion. Hence businesses with high or low debt ratios can engage in it. Another result that can be justified is that.

Corresponding Author:

Name: Muhammad Rinaldi
Institution Address: Universitas Mulawarman
Email: muhammadrinaldi@feb.unmul.ac.id

1. INTRODUCTION

According to Article 37A of the Tax Law concerning the KUP, tax participation is required to be in the state due by persons or institutions that are essential based on Kemenkeu by not directly seeking reciprocity and exploitation for the state for the complete development of the community. It is clear from the statute's text that taxes are a state revenue source [1].

When experiencing fluctuations in economic activity, companies often do not understand the focus because they want to get progressive and fixed tax revenues from the guide. Changes in tax policy will certainly affect the company, in terms of its financial statements and tax reporting. *Tax avoidance* is a legal way to avoid taxes.

The Ministry of Finance noted that tax revenue in 2019 collected Rp.1,332.1 trillion, or 84.4% of the target in the 2019 State Budget of Rp.1,577.6 trillion. The Ministry of Finance explained that the failure to calculate revenue according to the target set was due to pressure from global economic constraints that affected tax revenue [2].

The problem reported by the *Tax Justice Network* agency on May 8, 2019, that the tobacco industry owned by *British American Tabacco* (BAT) had implemented *tax avoidance* in Indonesia through PT Bentoel Internasional Investama Tbk caused an impact on the country by suffering losses of US $ 14 million per year. The information proves that BAT has diverted some of its revenue from Indonesia through intra-industry loans and payments back to the UK for royalties, fees, and services.

Tax avoidance is a procedure for reducing taxes that are in tax provisions and can be justified through tax planning [2]. *Tax* *avoidance*, which is also referred to as tax planning, is a way of regulating actions to be free from the impact of unwanted tax imposition [2]. This *tax avoidance* uses ETR measurement. *Effective Tax Rate* (ETR) is a tool to measure how much the company implements *tax avoidance* [2]–[4].

2. LITERATURE REVIEW

2.1 *Agency Theory*

The concept of agency theory can be broadly said to be a contractual bond between principals and agents. This bond is being evaluated for a service in which the principal permits the agent to ignore what would benefit the principal in favor of increasing industrial profits and reducing costs, including taxes, through tax evasion.

For agency theory, the industry can be defined as an agreement or contract between shareholders and managers to create shareholder wealth. The manager, as an agent, performs certain duties for shareholders as principals, while principals distribute rewards to agents in the form of bonuses [5]. It can be concluded that agency theory is a contract between the principal and agent to align interests if a conflict of interest is established.

2.2 *Tax Avoidance*

Tax avoidance is an action to minimize the payment of tax burdens by using the shortcomings of tax regulations with reasonable limits so that it can be said to be valid because it does not violate the law. Still, the government does not correct this action because it can potentially reduce state income in the tax zone. Tax avoidance is a way to reduce the amount of tax owed by exploiting loopholes in regulations. Tax avoidance is a strategy to legally minimize the tax owed by various tax avoidance strategies [1], [6]. According to the above understanding, tax avoidance is a legal activity that takes advantage of tax regulations' weaknesses to reduce the amount of tax owed [7].

2.3 *Financial Performance*

Financial performance is defined as a company's success in managing its finances. It can be seen or formed from financial ratios. Financial performance can also be interpreted as the company's financial performance, which can be seen in how the company survives and the company's ability to generate profits. This performance can be measured using ratios such as Profitability and Leverage [8].

2.4 *Profitability*

Profitability is one measurement of the ability of a company. An industry's profitability proves a company's ability to create profits over a certain period at a certain level of sales, assets, and share capital. Profitability is the ability of a company to generate earnings through its investments by company management with certain policies. One profitability measurement uses the Return On Assets (ROA) ratio [8], [9]. ROA is a measurement used to find out how well the company's assets are used to generate profits. In other words, ROA is here to see whether the assets owned by the company are used as well as possible to generate profits.

2.5 *Leverage*

This bond is put to the test for a service in which the principal authorizes the agent to make decisions that are opposed to what would be advantageous for the principal to prioritize increasing industrial profits and minimizing expenditures, including taxes, by utilizing tax evasion [10]–[12].

2.6 *The Effect of Profitability on Tax Avoidance*

Low-profit margins at the business lead to low profitability. Companies are motivated to engage in tax evasion because of the minimal gain. The business presumes that yields are typical and that low taxes are appropriate. Therefore, it may be argued that significant tax evasion can enhance poor profitability.

Previous research that has been tested proves that profitability negatively affects tax avoidance [4], [13]. This means that the lower the profitability value, the more the tax avoidance value will increase. Other studies show different results where profitability positively affects tax avoidance [14]. This means that the higher the profitability value, the lower the tax avoidance value, so it can be said to be in the opposite direction. Other studies show different results where profitability does not affect tax avoidance that the high lace value of profitability can increase or even decrease the value of tax avoidance.

H1: Profitability Affects Tax Avoidance

2.7 The Effect of Leverage on Tax Avoidance

A large amount of funding from debt by third parties causes High Leverage. The emergence of the debt interest burden accompanies a large amount of money. Companies can use this burden to reduce their tax burden. High-interest rates will reduce company profits, meaning that low companies produce low tax burdens, but high Leverage can increase tax avoidance.

Previous research that has been tested has proven the results that Leverage has a positive effect on tax avoidance [3]. This means the higher the leverage value, the higher the tax avoidance value. This means the higher the leverage value, the higher the tax avoidance value. Other studies show different results where Leverage does not affect tax avoidance [4]. This means that the high lace of the leverage value can increase or even decrease the value of tax avoidance.

H2: Leverage has a positive effect on Tax Avoidance

So, based on the formulation of the hypothesis that has been put forward, a research model can be made to make it easier for the readers of this research.

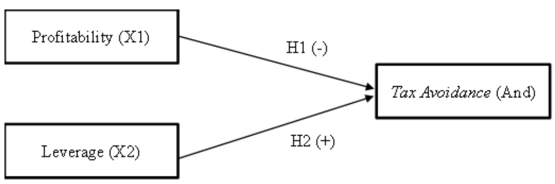

Figure 1. Research Model
Source: Processed Data, 2023

3. METHODS

3.1. Popultation and sample

The technique to determine the sample in this study is to use purposive sampling.

Table 1. Population Elimination

Information	Total	Unit
Population	73	Company
Incomplete annual report (201 7 -2019)	(6)	Company
Loss-making companies	(15)	Company
In addition to using rupiah currency	(23)	Company
Sample	(28)	Company
Years of research	3	Year
Research data	84	Data

Source: Processed Data, 2023

3.2. Variable Operational Definition

Profitability

This study uses ROA proxies according to the formula used to calculate ROA:

$$ROA = \frac{\textit{Earning After Tax}}{\textit{Total Assets}} \quad 100\%$$

Leverage

Leverage in this study is measured using DER, according to the formula used to calculate the ratio:

$$DER = \frac{\textit{Total Liabilities}}{\textit{Total Assets}} \quad 100\%$$

Tax Avoidance

This study used ETR to measure *tax avoidance.*

$$ETR = \frac{\textit{Total Income Tax Expenses}}{\textit{EBT}} \quad 100\%$$

3.3. *Data Analysis Method*

A model equation in this study

$$Y = \alpha - \beta_1 X1it + \beta_2 X2it + e$$

Y : ETR
α : Constant
b1,b2 : Reggresion Coefficient
X1 : ROA
X2 : DER
E : *Error*

4. RESULTS AND DISCUSSION

4.1. *Result*

Analysis Results

Normality Test

The normality test is performed with *the One-Sample Kolmogorov Test.* At this stage, using the initial data produces data that is not normally distributed. So that the data is transformed into SQRT on variables X1 and Y, in addition to converting, disposal of outlier data is also carried out, which results in only 61 sample data remaining. The results of variables that have been changed and discarded outlier data can be seen in the following table:

Table 2. Normality Test

Test To	Significance	Information
1	0,006	Initial Data
2	0,018	SQRT transformation
3	0,218	Buang Data Outlier

Source: Processed Data, 2023

The results of the third test with transformed data and discarded outlier data showed the sig value. 0.218, which means that the data can be said to be normally distributed.

Multicollinearity Test

Table 3. Multicollinearity Test

Variable	*Tolerance*	BRIGHT
Profitability	0,786	1,272
Leverage	0,786	1,272

Source: Data Processed,2023

Descriptive Statistical Analysis

In this analysis, all indeisdent and dependent variables that have passed the classical assumption test are used.

Table 4. Descriptive Statistics

Variable	N	Minimum	*Maximum*	*Mean*
Profitability	61	0,32	1,84	0,8775
Leverage	61	0,00	0,10	0,0400
Tax Avoidance	61	0,26	1,24	0,5300

Source: Data Processed,2023

Multiple Linear Regression Test

Coefficient of Determination Test (R Test)

Table 5. Model Summary

R	*R Square*	*Adjusted R Square*
0,437	0,191	0,163

Source: Data Processed,2023

The R number with several 0.437 or 43.7% is a relationship coefficient proving the degree of a bond between independent and bound variables. The R number is claimed with a strong relationship number sourced from the R number interpretation chart.

The R Square number proves that 0.191 means that the independent variable's relationship level to the finite elastic is 19.1%.

The Adjusted R Square number proves it is 0.163, meaning that the selected independent variable can affect the limited variable by 16.3%. The rest, 83.7%, is an independent variable not used in this study.

Model Test (F Test)

Table 6. ANOVA

Information	*Value*
F_{count}	6,861
F_{sig}	0,002

Source: Processed Data, 2023

Hypothesis Test (Test t)

Table 7. Coefficients

Variable	Coefficient	T_{count}	*Itself.*
Profitability	-2,959	-3,689	0
Leverage	-0,083	-1,411	0,163

Source: Processed Data, 2023

The results of the t-test between Profitability in Tax Avoidance where the regression coefficient is -2.959, the calculated number is -3.689, and the significance level is 0.000. That proves that profitability has a negative effect on Tax Avoidance. As a result, the first hypothesis (H1) is accepted. The regression coefficient has a minus number (-) which proves the consequences are contrary, where every decrease in profitability will increase the Tax Avoidance rate.

The result of the t-test between Leverage to Tax Avoidance, where the regression coefficient is -0.083, the calculated number is -1.411, and the significance level is 0.163. That proves that Leverage does not affect Tax Avoidance. As a result, the second hypothesis (H2) is rejected.

4.2. *Discussion*

The Effect of Profitability on Tax Avoidance

According to the partial test findings in this study, the significant ROA value for profitability is 0.000, less than 0.050, and has a negative directional regression coefficient of -2.959 until H1 is attained. As a result, it can be said that profitability negatively affects tax avoidance. The results of this study prove that the smaller the profit obtained by the industry, there is tendency to carry out tax avoidance practices. This research supports some research that reports that profitability negatively affects tax avoidance [4], [13].

The results showed a negative relationship between profitability and tax avoidance. Companies with a fairly low profit are suspected of tax avoidance. Because of this low profit, it creates motivation for companies to do tax avoidance. The company assumes that yields are common and should not pay high taxes. Because the goal of the company has always been to make a profit, and a good profit is a big profit. So it can be concluded that low p profitability can increase high tax avoidance

The Effect of Leverage on Tax Avoidance

Based on the test results in a partial way in this research, it can be known that the number significance of Leverage measured by DER is 0.163, greater than 0.05, until H2 is rejected. As a result, it can be said that Leverage does not affect Tax Avoidance. This result proves that industries with a large level of loan comparison and a large amount of interest expense are not certain to implement tax avoidance practices. The results of this research support the previous study that tried there was no effect between Leverage and tax avoidance [4].

The results of this study show that there is no influence between Leverage and tax avoidance. Companies that have large debt ratios do not produce high-interest expenses. Companies will always look for loans of funds or capital but always with a little interest, which is why the interest expense generated is small and will not be able to reduce the high corporate tax burden. The results of this study also explain that companies can do tax avoidance with high or low debt ratios because taxes are always considered a responsibility that can reduce the company's net income.

5. CONCLUSION

Based on studies on the impact of profitability and leverage variables on tax evasion in manufacturing firms in the basic industrial and chemical sub-sectors for 2017–2019. This empirical study has shown that profitability has a detrimental impact on tax avoidance. Leverage has little effect on tax evasion. This study backs up the agency's idea that the principal and agent have a contract to align interests in the event of a disagreement. Another conclusion that can be drawn is that corporations of any financial capability (Financial Performance) can engage in tax evasion since companies always perceive taxes as a burden that affects the company's net profit.

The advice that can be given to the next researcher is to use a sample of data from the annual report with a more recent year that is expected to find different results from this research. Next, researchers can obtain different results from other dependent variable measurements such as Cash Effective Tax Rate (CETR) or Book Tax Difference (BTD).

ACKNOWLEDGEMENTS

Thank you very much for saying to our parents, family and all parties who have helped that the author cannot mention their names one by one.

REFERENCES

[1] F. Oktafiani, R. P. A. Hasibuan, R. D. Safira, M. Rinaldi, and J. V. B. Ginting, "Effect Of Profitability, Leverage, And Company Size On Tax Avoidance In Plantation Sector Companies," *JIRK J. Innov. Res. Knowl.*, vol. 2, no. 9, pp. 3583–3588, 2023.

[2] M. Rinaldi, N. W. Respati, and F. Fatimah, "Pengaruh Corporate Social Responsibility, Political Connection, Capital Intensity Dan Inventory Intensity Terhadap Tax Aggressiveness," *Simak*, vol. 18, no. 02, pp. 149–171, 2020, doi: 10.35129/simak.v18i02.118.

[3] P. N. H. Ardianti, "Profitabilitas, Leverage, dan Komite Audit Pada Tax Avoidance," *ISSN 2302-8556 E-Jurnal Akunt. Univ. Udayana DOI https//doi.org/10.24843/EJA.2019.v26.i03.p13 Profitab. , Leverage , dan Kom. Audit Pada Tax Avoid. Fak. Ekon. Univ. Mahasaraswati Denpasar , (Unmas Denpasar) Bali , Ind*, vol. 26, no. 2019, pp. 2020–2040, 2020.

[4] M. Ariani and M. Hasyim, "Pengaruh Profitabilitas, Likuiditas, Leverage, Size, Dan Capital Intensity Ratio Terhadap Effective Tax Rate (Etr)," *Balanc. J. Akunt. dan Bisnis*, vol. 11, no. 1, p. 463, 2018.

[5] M. C. Jensen and W. H. Meckling, "Theory Of The Firm: Managerial Behavior Agency Costs And Ownership Structure," *Financ. Econ.*, vol. 3, pp. 305–360, 1976, doi: 10.1177/0018726718812602.

[6] E. C. Sandag, C. N. M. Rotinsulu, V. Tandiawan, and M. Rinaldi, "Profitability and Company Size Have a Strong Influence on Tax Avoidance," *Al-Kharaj J. Islam. Econ. Bus.*, vol. 4, no. 2, pp. 103–114, 2022, doi: 10.24256/kharaj.v4i2.3602.

[7] M. Hanlon and S. Heitzman, "A Review of Tax Research," *SSRN Electron. J.*, 2011, doi: 10.2139/ssrn.1476561.

[8] M. R. Hutauruk, M. Mansyur, M. Rinaldi, and Y. R. Situru, "Financial Distress Pada Perusahaan Yang Terdaftar Di Bursa Efek Indonesia," *JPS (Jurnal Perbank. Syariah)*, vol. 2, no. 2, pp. 237–246, 2021, doi: 10.46367/jps.v2i2.381.

[9] A. T. Hidayat and E. F. Fitria, "Pengaruh Capital Intensity, Inventory Intensity, Profitabilitas dan Leverage Terhadap Agresivitas Pajak," *E-Jurnal Akunt. STIE Dewantara*, vol. 13, no. 2, pp. 113–127, 2018.

[10] W. M. Sagala and D. Ratmono, "Analisis Pengaruh Pengungkapan Corporate Social Responsibility Terhadap Agresivitas Pajak," *Anal. Pengaruh Pengungkapan Corp. Soc. Responsib. Terhadap Agresivitas Pajak*, vol. 4, no. 3, pp. 668–676, 2015.

[11] M. Fadila, "Pengaruh Return On Asset, Leverage, Ukuran Perusahaan, Kompensasi Rugi Fiskal, Kepemilikan Institusional dan Koneksi Politik terhadap Penghindaran Pajak (Studi Empiros pada Perusahaan Manufaktur yang Terdaftar di BEI tahun 2011-2015)," vol. 4, no. 1, 2017.

[12] M. H. Z. K. Ramadhani, Y. Ulfah, and M. Rinaldi, "The Impact of Bitcoin Halving Day on Stock Market in Indonesia," *J. Int. Conf. Proc.*, vol. 5, no. 3, pp. 127–137, 2022, doi: 10.32535/jicp.v5i3.1800.

[13] T. S. Rozak, A. T. Hardiyanto, and H. Fadilah, "Pengaruh Profitabilitas, Likuiditas, dan Leverage Terhadap Tax Avoidance," *Progr. Stud. Akunt. Fak. Ekon. Univ. Pakuan*, 2017.

[14] D. R. Prihaningtyas, A. Soelistyo, and M. F. Abdullah, "Pengaruh profit, total aset, dan total hutang terhadap effective tax rate pada perusahaan infrastruktur di indonesia," *J. lmu Ekon. Vol 2 Jilid 1/Tahun 2018 Hal.145 - 155*, vol. 2, no. 36, pp. 145–155, 2018.

BIOGRAPHIES OF AUTHORS

	**Muhammad Rinaldi** A Lecture at Accounting Departement in Universitas Mulawarman. Then I finished my master's at Universitas Lambung Mangkurat Banjarmasin. My interest in research dan expertise is in Taxation and Sustainability Accounting. There is my identity as researcher Orcid, Google Scholar. My Email: muhammadrinaldi@feb.unmul.ac.id
	**Melda Aulia Ramadhani** A Lecture at Management Departement in Universitas Mulawarman. Then I finished my bachelor's and master's at Universitas Mulawarman. I am studying a doctoral degree at Universitas Mulawarman in management science, and my study concentration is Human Resource Management. My Email: meldaaulia.ramadhani@feb.unmul.ac.id
	**Sitti Rahma Sudirman** a Lecture at Accounting Departement in Universitas Mulawarman. Then I finished my bachelor's and master's at Universitas Muslim Indonesia Makassar, and taxation accounting is my expertise. There is my identity as a researcher Orchid, Google Scholar. My Email: sittirahma@feb.unmul.ac.id
	**Muhammad Harits Zidni Khatib Ramadhani** A Lecture at Accounting Department in Universitas Mulawarman. Then I finished my bachelor's and masters at Sekolah Tinggi Ilmu Ekonomi Yayasan Keluarga Pahlawan Negara Yogyakarta. My expertise is in Government Accounting, and my interest is blockchain and market capital accounting research. There is my identity as a researcher Orcid, Google Scholar. My Email: muhammadharits@feb.unmul.ac.id