

The Effect of Leverage, Profitability, Company Size, and Political Connection on Tax Avoidance

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Abstract

Tax Avoidance is a form of tax resistance actively practised by taxpayers to legally reduce the tax burden without violating the law by using accounting methods and techniques that take advantage of weaknesses (grey areas) in tax laws and regulations. Tax avoidance can occur because of the weakness of the tax collection system carried out by self-assessment. This research aims to analyze and examine the effect of Leverage, Profitability, Company Size, and Political Connection on Tax Avoidance at consumer goods sector companies listed on the Indonesia Stock Exchange (IDX) for 2016-2020. The population in this study are consumer goods sector companies listed on the Indonesia Stock Exchange (IDX) for the 2016-2020 period. The sampling technique used was purposive sampling and obtained 21 companies in the consumer goods sector with an observation period of five years, so 105 samples were obtained in this study. The data analysis method in this study is panel data analysis with Eviews 12. The results of this study indicate that Leverage, Profitability, Company Size, and Political Connection simultaneously affect Tax Avoidance. Leverage, Company Size, and Political Connection affect Tax Avoidance, and Profitability partially does not affect Tax Avoidance.

Keywords

Leverage, Profitability, Company Suze, Political Connection, Tax Avoidance

1. Introduction

Based on Law Number 16 of 2019 concerning General Provisions and Tax Procedures (KUP). Tax is a mandatory contribution to the state-owned by an individual or entity. It is coercive based on the law without receiving direct compensation and used by the state for the most significant benefit of the people. Based on this statement, every citizen must set aside a portion of their income for development contributions because taxes increase national development. Mardiasmo (2019), the basis of justice with tax collection lies in the relationship between the people and the state. As a citizen, you must be aware of your obligation to pay taxes because taxes are the primary source of state revenue used to finance state expenditures. State development requires no small amount of funds and is trim through tax revenues; therefore, taxes are significant in national development, and as citizens of Indonesia, we must carry out our obligations by paying taxes.

Axes as the primary source of state revenue were seen from the State Revenue and Expenditure Budget (APBN) originating from the Ministry of Finance, which is more than 70% of state revenues and financing from the tax sector. Taxes become the focus of government because they are the backbone of a country.

The tax collection system in Indonesia applies a system called a self-assessment system. According to Mardiasmo (2019), the self-assessment system is a tax collection system that authorizes taxpayers to determine the amount of tax payable with the characteristics of (1) having the authority to determine the amount of tax owed to taxpayers and (2)

taxpayers taking part in calculate, deposit and report the tax payable, (3) the tax authorities do not interfere and only tasked with supervising. The success of this system is primarily determined by the voluntary compliance of taxpayers and optimum supervision by the tax authorities. The tax paid by the taxpayer could be considered correct until the government can prove it wrong, unlike countries that consider taxes as the primary source of state revenue. Companies consider taxes to be an additional burden that can reduce revenue for companies, so companies will try to pay taxes to a minimum and take advantage of the weaknesses of legislation which can be called tax avoidance.

According to Mardiasmo (2019), tax avoidance is an effort to relieve tax payments by not violating the law. In Law Number 36 of 2008, the proper payment of income tax is at a percentage of 25%, meaning that if a company pays income tax below a percentage of 25%, the company can be said to have taken tax avoidance actions. Tax avoidance can be proxied by the Effective Tax Rate (ETR), which measures tax avoidance activities. Tax avoidance can be said to be low if the ETR value is high, and vice versa; if the ETR value is low, the tax avoidance activity is high.

The first variable that considered to influence tax avoidance is leverage. Leverage is recognized as a factor that affects tax avoidance because it can measure how much debt is obtained by the company to get its benefits from the profit-sharing on creditor loans. The amount of debt that causes the tax burden to decrease according to the interest expense borne by the company is rare tax avoidance. One of the leverage proxies is the Debt to Asset Ratio (DAR), which measures how much the company's assets financed by debt.

Another variable that is thought to influence tax avoidance is Profitability. Measuring the effectiveness of management is to calculate a relative to the level of profit earned in sales and investment—the better the company's profitability ratio, the better the company's ability to earn profits. One of the proxies of Profitability is Return On Assets (ROA) measured by net income from sales. Net profit on sales obtained after deducting expenses.

The third variable considerably influences tax avoidance is company size. According to Mahdiana and Amin (2020), the size of the company can show the stability and ability to carry out its economic activities. The larger the company's size, the more it becomes the centre of attention of the government. It will cause company managers to be obedient (compliances) or aggressive (tax avoidance) in taxation. In this study, the measuring instrument used to determine the company size uses the company's total assets because companies with significant total assets tend to be more stable and can maximize company performance to generate greater profits (Siagian and Yudowati 2020).

The last variable that is thought to influence tax avoidance is political connection. Hidayat and Pratomo (2020), the political connection is measured by a dummy variable using the criteria of one of the directors or commissioners who is also a member of the government, a member of a political party, and the military. Companies with a political connection will have easy access to capital loans, protection from the government, and a low risk of tax audits, causing companies to be more aggressive towards taxes.

This study aims to determine how much influence leverage, Profitability, company size, and political connection have on tax avoidance in consumer goods sector companies listed on the Indonesia Stock Exchange (IDX) for 2016-2020. This study was expected to provide empirical evidence regarding the effect of leverage, Profitability, company size, and political connection toward tax avoidance. It is expected to provide additional insights, information and references for the academic environment, managers and regulators in decision-making.

1.1 Objectives

Indonesia Stock Exchange (IDX) provides facilities and infrastructure for implementing all transaction activities in the capital market. Until 2021, 750 money companies have listed their shares on the Indonesia Stock Exchange and were divided into 11 (idx.co.id 2021). Each sector has different issuers in the year 2016-2020.

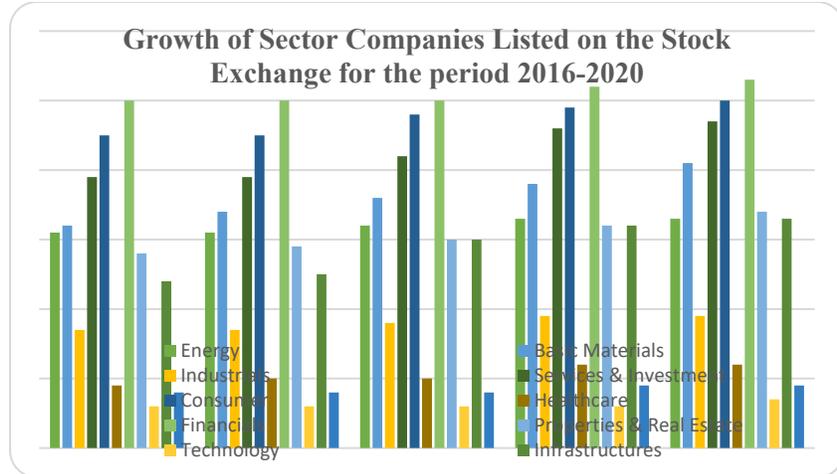


Figure 1. Growth of Sector Companies Listed on The Stock Exchange for the period 2016-2020

Figure 1 shows the development of the number of companies in each sector listed on the Indonesia Stock Exchange. The number of companies in the consumer goods sector continues to grow every year and has the second largest number of companies after the financial sector. The consumer goods industry sector is listed on the Indonesia Stock Exchange (IDX) because the consumer goods sector has a tremendous potential for economic growth. After all, it was influenced by the number of people who continue to grow every year. This growth is caused by the increasing consumption needs and Indonesia's abundant natural resources. Also, high domestic Indonesian economic demand. The consumer goods industry sector is an industry that provides or produces daily necessities for the community, which divided into several sub-sectors, namely the food and beverage, pharmaceutical, cosmetic, household needs, cigarettes, and household appliances sub-sectors. The consumer goods sector is a sector that provides and produces people's daily needs so that the demand for goods in the consumer goods sector is relatively stable and always increases with the increase in population.

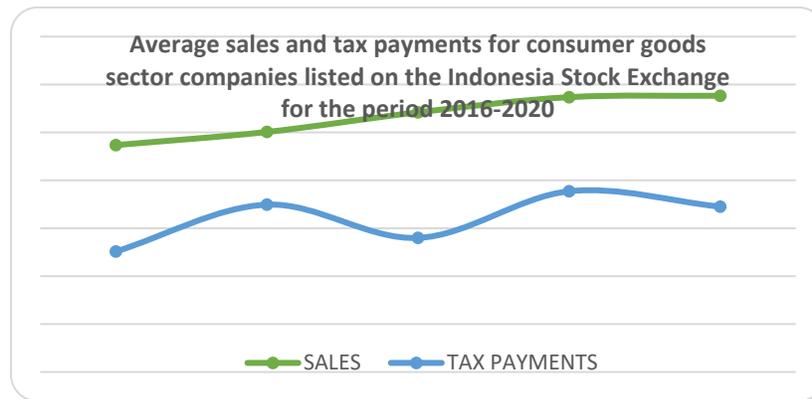


Figure 2. Average sales and tax payments for consumer goods sector companies listed on the Indonesia Stock Exchange for the period 2016-2020

Figure 2 that the average consumer goods sector sales have increased yearly. The increased consumer goods sector sales indicate that the consumer goods sector will tend to develop continuously.

Then, when viewed from the average level of sales of the consumer goods sector listed on the IDX in 2016-2020, an increase in sales that have occurred continuously in the last few years will also impact increasing profits from year to year. The increase in profits will make the tax burden that has to be paid increase, and this is what causes the company to be suspected of taking tax avoidance actions. This happened in 2020, where sales of the consumer goods sector increased, which means that profits also increased, but there was a decrease in tax payments.

2. Literatur review

Tax avoidance is a form of active resistance by taking action to ease the tax burden by not violating the law (Mardiasmo 2019). The government implements a self-assessment tax collection system to provide convenience to taxpayers in paying taxes. This system allows taxpayers to exploit weaknesses (grey areas) in the tax collection system, namely by paying the expected burden by the engineered profit to be lower to the tax authorities to reduce the tax burden. In Law Number 36 of 2008, the correct payment of income tax is at a percentage of 25%, meaning that if a company pays income tax below a percentage of 25%, the company can be said to have taken tax avoidance actions.

According to Hery (2018), the leverage ratio was used to measure the extent to which the company's asset debt can be interpreted as being used to measure how much debt the company has to bear in fulfilling its assets. Leverage is used as a factor that affects tax avoidance. Leverage ratio can measure how much debt the company gets as a separate profit effort from the results of creditor loans and the amount of debt. That causes the tax burden to decrease according to the costs borne by the company was considered by the tax authorities as a tax avoidance measure. One leverage proxies is the Debt to Asset Ratio (DAR), which measures how much the company's assets were financed by debt. DAR is used as a proxy because it does not have anti-avoidance. The higher the DAR, the higher the company's suspicion of tax evasion.

H1 : Leverage has a positive effect on Tax Avoidance

The profitability ratio explains the company's ability to generate profits in all capabilities and resources owned and obtained from sales activities, use of assets and use of capital (Hery 2018). When measuring the effectiveness of management, indicating a measure relative to the level of profit earned in sales and investment. The better the company's profitability ratio, the better the company's ability to earn profits. One of the proxies of Profitability is Return On Assets (ROA) which was measured by net income from sales. Net profit on sales was obtained after deducting expenses. The effect of Profitability on tax avoidance is that if the profit received by the company is large, the tax burden is also significant. Therefore, the company seeks to do tax avoidance so that the tax burden must is not significant.

H2 : Profitability has a positive effect on Tax Avoidance

According to Mahdiana and Amin (2020), company size can show the company's stability and ability to carry out its economic activities. The larger the company's size, the more it becomes the centre of attention of the government. It will cause company managers to be obedient (compliances) or aggressive (tax avoidance) in taxation. In this study, the measuring instrument used to determine the company's size uses the company's total assets because companies with significant total assets tend to be more stable and can maximize company performance to generate greater profits (Siagian and Yudowati 2020). The larger the company's size, the greater the value of the resulting ETR.

H3: Company Size has a positive effect on Tax Avoidance

According to Pratomo et al. (2021), the political connection was measured by a dummy variable using the criteria of one of the directors or commissioners whom members of the government mandate, members of political parties, and the military. Companies with a political connection will have easy access to capital loans, protection from the government, and a low risk of tax audits, causing companies to be more aggressive towards taxes.

H4 : Political Connection has a positive effect on Tax Avoidance

3. Methods

The approach used in this study is quantitative. This research was carried out on the consumer goods companies listed on the Indonesia Stock Exchange (IDX) for 2016-2020. The sampled companies have published their financial statements consistently during the observation period through the website www.idx.co.id. The data taken from the company's annual report is quantitative.

Purposive sampling method was used, where specific criteria compile sample selection. Of the 50 consumer goods companies listed on the Indonesia Stock Exchange (IDX) between 2016 and 2020, only 21 companies met the criteria, so the samples taken were as many as 105.

4. Data Collection

Table 1. Descriptive Statistic

Date: 06/24/22 Time: 14:20
Sample: 2016 2020

	TAX_AVOID...	LEVERAGE_X1	PROFITABIL...	COMPANY_...	POLITICAL...
Mean	0.254765	0.377701	0.117088	16.70882	0.476190
Median	0.250034	0.357222	0.087274	16.75501	0.000000
Maximum	0.745442	0.760285	0.526704	24.11765	1.000000
Minimum	0.024345	0.017691	0.001020	7.603437	0.000000
Std. Dev.	0.116925	0.192280	0.111592	2.200460	0.501828
Skewness	1.366689	0.304502	1.784272	0.170993	0.095346
Kurtosis	7.899872	1.993427	5.714511	5.908822	1.009091
Jarque-Bera Probability	137.7255 0.000000	6.055328 0.048429	87.95099 0.000000	37.52963 0.000000	17.50036 0.000158
Sum	26.75027	39.65857	12.29427	1754.426	50.00000
Sum Sq. Dev.	1.421836	3.845029	1.295091	503.5706	26.19048
Observations	105	105	105	105	105

5. Results and Discussion

5.1 Numerical Results

5.1.1 Results

The average value of the Tax Avoidance dependent variable during the observation period of 0.254765; this illustrates the Effective Tax Rate (ETR) that exceeds the effective taxpayer tax rate that applies by the law of 25%. The result indicates that during the observation period, the company was obedient to the applicable tax regulations so it did not seem to have engaged in tax avoidance. However, with a minimum value of 0.024345, companies still engage in tax avoidance. There were 56 samples during the observation period with ETR below 25%. As such, it was proven that there were still companies engaged in tax avoidance.

The average ratio has an average value of 0.377701 and a standard deviation of 0.192280. The distribution of leverage data using the average value and standard deviation obtained 60 samples that lie between the interval $0.185421 (\mu - 1 \text{ Standard deviation})$ to $0.569981 (\mu + 1 \text{ Standard deviation})$, while 45 samples are outside the interval. This result shows that the leverage data for 2016-2020 was between these values.

The average value of Return On Assets (ROA) during the observation period was 0.117088 with standard deviation of 0.111592. The distribution of leverage data using the average value and standard deviation obtained 91 samples that lie between the interval $0.005496 (\mu - 1 \text{ Standard deviation})$ to $0.22868 (\mu + 1 \text{ Standard deviation})$. In comparison, 14 samples are outside the interval. The result shows that the profitability data for the 2016-2020 period lay between these values.

For company size, the average value of the company is 16.070882 and the standard deviation is 2.200460. the distribution of company size data using the average value and standard deviation obtained 83 samples that lie between the interval $14.50836 (\mu - 1 \text{ Standard deviation})$ to $18.90928 (\mu + 1 \text{ Standard deviation})$. In comparison, 22 samples are outside the interval. The result shows that the company size data for 2016-2020 lay between these values.

The political connection variable is measured using a dummy variable. Given value 1, if the company in the consumer goods sector has a political connection, and 0, if the company in the consumer goods sector does not have a political connection. There are 49 samples of companies with political connections that have political connections. Meanwhile, 56 samples do not have a political connection.

The multicollinearity test shows a VIF value > 0.1 or < 10 , meaning there are no symptoms of multicollinearity. The heteroscedasticity test results show that every variable has a probability value of more than 0,05. So it can be concluded that this study does not have symptoms of heteroscedasticity.

Table 2. Determination Results, F test results, Partial tests (t-test) results

Dependent Variable: TAX_AVOIDANCE_Y
Method: Panel Least Squares
Date: 05/25/22 Time: 15:15
Sample: 2016 2020
Periods included: 5
Cross-sections included: 21
Total panel (balanced) observations: 105

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.080869	0.114344	-0.707243	0.4815
LEVERAGE_X1	0.446804	0.126451	3.533418	0.0007
PROFITABILITY_X2	-0.215596	0.161785	-1.332607	0.1864
COMPANY_SIZE_X3	0.105644	0.025136	4.202889	0.0001
POLITICAL_CONNECTION_X4	-0.112327	0.030411	-3.693618	0.0004

Effects Specification

Cross-section fixed (dummy variables)				
R-squared	0.547679	Mean dependent var	0.490409	
Adjusted R-squared	0.411982	S.D. dependent var	0.120004	
S.E. of regression	0.092022	Akaike info criterion	-1.729328	
Sum squared resid	0.677440	Schwarz criterion	-1.097432	
Log likelihood	115.7897	Hannan-Quinn criter.	-1.473271	
F-statistic	4.036056	Durbin-Watson stat	2.234688	
Prob(F-statistic)	0.000001			

$$Y = -0,080869 + 0,446804X_1 - 0,215596X_2 + 0,105644X_3 - 0,112327X_4 + e$$

Table 2 shows a probability of 0.00001, which means that leverage, Profitability, firm size, and political connection simultaneously affect tax avoidance. The adjusted R-squared value of 0.411982 indicates that the independent variables of leverage, Profitability, company size, and political connection can explain tax avoidance as the dependent variable by 41.19%, and other variables outside the study explain the remaining 58.81%.

5.1.2 Discussion

Effect of Leverage on Tax Avoidance

The significance value of the leverage variable of 0.007, which is smaller than 0.05, indicates that the leverage variable measured using DAR influences tax avoidance as measured by ETR. So it can be decided that H_{01} was rejected so that leverage positively affects tax avoidance.

Effect of Profitability on Tax Avoidance

The significance value of the profitability variable is 0.1864 which is more significant than 0.05, indicating that the profitability variable measured by ROA does not affect tax avoidance as measured by ETR. So it can be decided that H_{02} is accepted so that Profitability has no effect on tax avoidance.

Effect of Company Size on Tax Avoidance

The significance value of the company size variable is 0.0001, which is smaller than 0.05, indicating that the firm size variable measured using the natural logarithm of total assets influences tax avoidance as measured by ETR. So it can be decided that H_{03} rejected, so that company size positively affects tax avoidance.

Effect of Political Connection on Tax Avoidance

The significance value of the political connection variable is 0.0004, which is smaller than 0.05, indicating that the political connection variable measured using the dummy variable influences tax avoidance as measured by the ETR. Then it was decided that H_{04} rejected so that the size of the company positively affected tax avoidance.

5.2 Graphical Results

Based on the results of the normality test output in Figure 3, shows that the probability value of 0.258477 or more than 0.050 means that the data in this study were distributed normally.

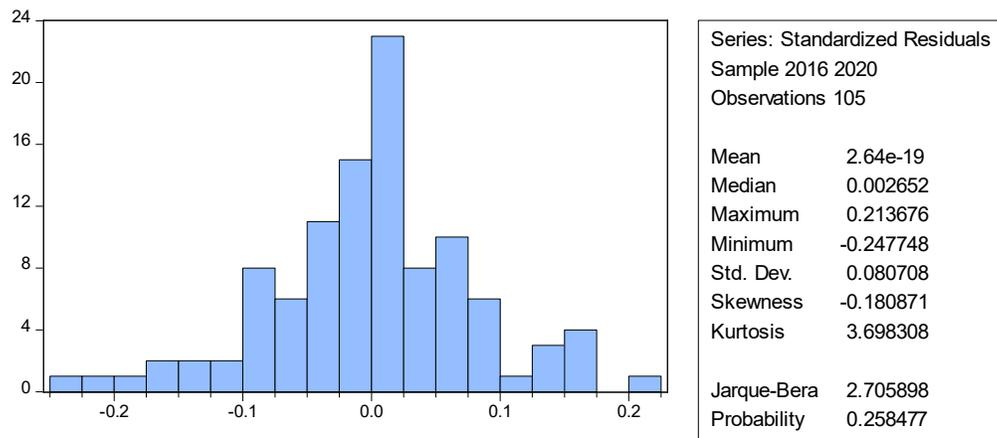


Figure 3. Normality Results

5.3 Proposed Improvements

Results based on research and discussion, the authors provide some suggestions as follows:

1. Directorate General of Taxes (DJP)

The Directorate General of Taxes advised increasing supervision and tightening laws and regulations related to tax avoidance actions taken by companies to minimize tax avoidance actions. The Directorate General of Taxes advised to evaluate companies in the consumer goods sector related to the company's financial activities, especially in taxation.

2. Company

Management of consumer goods sector companies listed on the Indonesia Stock Exchange (IDX) is advised to be more cooperative in managing company finances so as not to harm other parties, such as evaluating the company's actions against government regulations related to taxation.

3. Investors

Investors and potential investors in consumer goods sector companies listed on the Indonesia Stock Exchange (IDX) advised to be more selective in taking action to invest. Investors and potential investors advised considering all the risks that will be faced when investing in the company.

5.4 Validation

Effect of Leverage on Tax Avoidance

Leverage has a probability value of 0.0007, where the value is smaller than the significance level of 0.05, so the H_{01} rejected, and H_{a1} is accepted, which means that partially leverage affects tax avoidance in consumption sector companies for the period 2016-2020. The results are by the hypothesis that has been built previously by the researcher, which states that the effect affects tax avoidance.

Effect of Profitability on Tax Avoidance

Profitability has a probability value of 0.1864, where the value is greater than the significance level of 0.05, so it concluded that H_{a2} is accepted and H_{02} rejected, which means that partially Profitability affects tax avoidance in the consumer goods sector companies for the period 2016-2020. The results are not by the hypothesis that has been built previously by the researcher, which states that Profitability does not affect tax avoidance.

Effect of Company Size on Tax Avoidance

Company size has a value of 0.0001, where the value is smaller than the significance level of 0.05, so the decision was taken that H_{a3} is accepted and H_{03} rejected, which means that partially company size has a negative effect on tax avoidance in the consumer goods sector companies for the period 2016-2020. The results are by the hypothesis that has been built previously by the researcher, which states that company size has a positive effect on tax avoidance.

Effect of Political Connection on Tax Avoidance

The political connection has a probability value of 0.0004, smaller than the significance level of 0.05, so it can be concluded that H_{a4} is accepted and H_{04} is rejected, which means that partially the probability of influencing tax avoidance in consumer goods sector companies for the period 2016-2020. The results are by the hypothesis that has been built previously by the researcher, which states that political connection affects tax avoidance.

6. Conclusion

Based on the results of research that has been carried out and supported by theory and previous research, the conclusion is that during the period of observation of tax avoidance, proxied by ETR; the value is still high. Leverage and company size have a positive effect on tax avoidance. In contrast, Profitability and political connections have a negative effect on tax avoidance.

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Biographies

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