The Effect of Earnings Management, Financial Performance and Thin Capitalization on Tax Aggressivity

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ABSTRACT

This study aims to discover and test the effects of earning management, financial performance (profitability), and thin capitalization on tax aggressiveness. This research employs an associative quantitative approach with secondary data. This study's population consists of all 8 companies listed on the Indonesia Stock Exchange (IDX) in the category of manufacturing companies in the food and beverage sector from 2017 to 2021. Purposive sampling was used in this study, multiple linear regression methods were used for data analysis, and the data was processed using Eviews version 9. According to the findings of this study, earnings management has an impact on tax aggressiveness, financial performance has no impact on tax aggressiveness, and thin capitalization has no impact on tax aggressiveness. Earning management, financial performance, and thin capitalization simultaneously impact tax aggressiveness.

Keywords: *Earning Management, Financial Performance, Profitability, Thin Capitalization and Tax Aggressiveness.*

1. INTRODUCTION

Corporate tax aggressiveness refers to a company's desire to reduce the amount of tax that must be paid, either legally (Tax Avoidance) or illegally (Tax Evasion), by exploiting tax regulations loopholes (Mustika, 2017). Tax evasion cases, which frequently take the form of tax evasion, are discovered by competent authorities in various business and economic sub-sectors. McDonald's, for example, is one of the sub-sectors that have the potential to carry out tax evasion actions.

French McDonald's and related companies agreed to pay the French government more than 1.2 billion euros to settle a case where the fast-food giant was accused of tax evasion for years. The settlement was approved by a Paris court on Thursday (16/6), according to the national financial prosecutor's office. McDonald's stated that the agreement was reached after "productive discussions" with tax authorities.

According to London Economics, the decision means that a tax fraud investigation launched in 2016 in response to union complaints will be closed. Meanwhile, the Luxembourg prosecutor's office announced that McDonald's France, McDonald's System of France, MCD Luxembourg Real Estate, and other related companies had agreed to pay 1.24 billion euros in fines, penalties, and taxes to settle cases after years of negotiations. From 2009 to 2020, the company was accused of hiding French profits in Luxembourg with lower taxes and reporting artificially low profits in France.

Case According to the statement, tax evasion can be harmful to the state of Indonesia because government revenues are generated through the tax sector. Tax evasion, on the other hand, is good news for businesses because it allows them to earn more profits by avoiding

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their tax obligations. The preceding case demonstrates that many companies are still attempting to carry out tax aggressiveness to manipulate fiscal profits through proper tax planning, classified or not classified as tax evasion. Knowledge of tax regulations is essential in fostering tax compliance behavior because taxpayers can only comply if they are aware of tax regulations (Putri & Hunein, 2021).

Each company uses a different method, which determines the activities performed by the company. Every method the company uses will be profitable because tax-aggressive activities will provide what each company desires. Earnings management, financial performance, and thin capitalization are all factors that influence corporate tax aggressiveness. Several factors can influence the level of tax aggressiveness. The first factor is earnings management; earnings management performed by the company is one of the factors that can influence the level of tax aggressiveness.

Earnings management is defined as an effort by an entity's or company's management to manipulate financial reports to the extent permitted by the General Guided Accounting Guidelines (PABU) for the benefit of management. According to Feryansyah & Lilik Handjani (2020), there is a relationship and influence caused by the implementation of earnings management on tax aggressiveness (Suyanto & Supramono, 2012). Based on a management policy that views taxes as a burden on the company, profits earned will be regulated in such a way with specific accounting methods or policies to reduce profits to reduce taxable income.

Meanwhile, IAI (2012) defines financial performance as a company's ability to manage and control its resources (Putri Maidina et al., 2020). Profit, the basis for imposing income tax, is also associated with financial performance (Pratiwi, 2018). Financial performance will influence tax aggressiveness when the annual tax payment rises, decreasing company profitability. Because profitability reflects the company's financial performance benchmarks over a year. When profits are stable and sound, the government hopes businesses will fulfill their obligations as taxpayers by paying off their tax debt and vice versa (Suyanto & Supramono, 2012).

Thin capitalization refers to a company's investment decisions regarding funding its activities and operations by prioritizing debt sources over capital structure (Andawiyah, A., Subeki, A., & Hakiki, 2018) (Ciptaningrum, 2020). This scheme arises due to differences in taxation provisions, where debt funding generates interest expenses that can be financed or deducted from taxable income recognized fiscally. In contrast, capital structure funding generates dividends that are not expenses that can be deducted from taxable income taxes (Dharmawan, P. E., Djaddang, S., & Darmansyah, 2017). It is something to consider if the company wants to increase its revenue by exploiting tax loopholes.

2. LITERATURE REVIEW

Agency theory is a business management theory that explains the relationship between principals and their agents. According to Jensen and Macking (1976), agency theory describes a relationship that arises from a contract between the principal and another party known as the agent, in which the principal delegates a job to the agent. The owner's interests are assumed to align with the company's interests in agency theory, where the owner wants large company profits, and the manager wants compensation and bonuses for his performance. In this case, the manager has the opportunity to influence the company's financial statements so that its performance appears to be good. Desai and Dharmapala (2009) support this statement by stating that agency theory has two views for tax avoidance: traditional and contemporary. Conflicts will arise if there is asymmetric information in the relationship between the agent and principal. As a result, agents are more likely to engage in inappropriate behavior (dysfunctional behavior). One of the dysfunctional behaviors agents perform manipulating financial statement data to match the principal's expectations, even though the

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report does not describe the company's actual condition. It is done to ensure that agents receive fees and trust from the principal. Earnings management practices can include data manipulation in these financial reports. Agents can also use manipulation to reduce the tax burden by taking advantage of their interest expense. Managers can fund their businesses with debt to reduce their tax burden. Thin capitalization refers to corporate funding from debt sources. This manager's tax planning activity allows management to achieve its goals of increasing company profits. According to stakeholder theory, a company is not only an entity that operates for its own sake, but it must also be able to benefit its stakeholders. (Shareholders, creditors, consumers, suppliers, government, community, analysts, and other parties). This stakeholder group is the primary factor that companies consider when disclosing and not disclosing information in financial reports (Septiani E. et al., 2019; Ruhiyat, E., 2020). Its theory considers the interests, needs, and influence of parties involved in company policies and operations, particularly when making business decisions. As a regulator, the government is one of the company's stakeholders. According to this theory, companies try to provide stakeholder satisfaction in various ways because, with stakeholder satisfaction, the company will receive good support, such as from shareholders and other investors, which will undoubtedly benefit the company. So, the company will do various things to improve its net profit with reproaches like tax aggressiveness by using earnings management to get much support from its stakeholders.

3. RESEARCH METHOD

The type of research used in this research is quantitative research. The quantitative research method is a type of research that is explicitly systematic, planned, and structured clearly from the start to the creation of the research design. The data used in this research is secondary data. This study uses secondary data. Secondary data is obtained from studies, literature, or similar studies related to this research problem.

3.1. Data Collection Techniques

The data collection technique used in this research is a documentation study, namely a data collection model that is carried out by collecting all secondary data and all information used to solve problems in research. Secondary data in this study are companies whose financial reports are on the Indonesian Stock Exchange website (www.idx.co.id). Secondary sources do not directly provide data for data collection, for example, through other people or documents (Sugiyono, 2017).

3.2. Sample Collection Techniques

This study's population comprises all food and beverage sub-sector manufacturing firms listed on the Indonesia Stock Exchange (IDX) from 2017 to 2021. Purposive sampling was used in this research, with specific considerations (Valentika & Nursyirwan, 2020). Over five years, it acquired as many as 8 companies.

3.3. Data Analysis Techniques

The data for this study will be processed using the Eviews application version 9. Data analysis techniques were used in this study to test hypotheses. The Eviews program version 9 was used for the tests. Eviews version 9 is a Windows-based statistical analysis program that also serves as a communication tool for time series and time series electronics.

These multiple regression analysis methods were carried out on the model proposed by research using EViews Software version 10 to predict the relationship between the independent and dependent variables. The multiple regression analysis equations are:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + e$$

Where:

Y	= Tax Aggressivity
α	= Constant
β_1	= Coefficients
X_1	= Earnings Management
X_2	= Financial Performance
X_3	= Thin Capitalization
e	= error

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4. RESULTS AND DISCUSSIONS

4.1. Results

Table 1: Statistic Descriptive

Variables	Mean	Standard Deviation	Min	Median	Max
Tax Aggressivity	0.240313	0.018966	0.195170	0.244230	0.272810
Earnings Management	-0.051731	0.043489	-0.175910	-0.048180	0.011000
Financial Performance	0.069750	0.034825	0.020000	0.060000	0.140000
Thin Capitalization	0.640488	0.289246	0.196910	0.601490	1.070320

Source: Proceed by E-views, 2022

Table 2: Regression test

Variables	Coefficient	Sig.
Earnings Management	0.280496	0.0000
Financial Performance	0.112418	0.0912
Thin Capitalization	0.009350	0.3131
R-square	0.931475	
Prob(F-statistic)	0.000000	
Observations	*40*	

Source: Proceed by E-views, 2022

4.2. Discussion

The results of research conducted by researchers show that partially variable earnings management influences tax aggressiveness. It can be seen from the probability value of 0.0000, which is less than 0.05 (0.0000<0.05), so earnings management partially affects tax aggressiveness. This research is supported by Shelly Novitasari's (2017) entitled The Influence of earnings management, corporate governance, and capital intensity on corporate tax Aggression. It is found that earnings management affects tax aggressiveness. One of the characteristics of earnings management is to minimize profits (income minimization) by reducing profits to produce a minimum reported profit so that companies can minimize the tax that must be paid to the government. The company's earnings management size will affect the increase or decrease in tax evasion, as seen from the positive coefficient value. Tax evasion will increase if earnings management increases, and vice versa.

The research results show that the variable financial performance (profitability) partially does not affect tax aggressiveness. It can be seen from the probability value of 0.0912, which is greater than 0.05 (0.0912 > 0.05). So financial performance (Profitability) has no partial effect on tax aggressiveness. The results

of this study are in line with research by Rohmansyah & Fitriana (2020), Azzam & Subekti (2019), and Nugraha (2015), which shows that profitability has no significant effect on tax aggressiveness. It shows that profitability is optional for companies in carrying out tax aggressiveness. High profitability indicates that the company's high profit is accompanied by the complexity of the company's operational activities to increase awareness of compliance with tax obligations following applicable laws.

However, the results of this study do not support the results of research conducted by Rahmawati (2018), Dewa Luh (2019), January (2017), and Widyatiningsih (2020), who found that profitability has a significant effect on the level of corporate tax aggressiveness. Companies with high profitability levels will always comply with tax payments. Thus, a high value of ROA will be carried out by a mature tax plan to generate optimal taxes, and tend to become tax-aggressive activities will be reduced. It illustrates that companies with high profitability levels will always comply with paying taxes. In contrast, companies with low profitability will avoid paying taxes to protect people's assets. So, a higher ROA will not affect tax vigilance (Azzam, 2019).

The research results show that the thin capitalization variable partially does not affect

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tax aggressiveness. It can be seen from the probability value of 0.3131, which is more significant than 0.05 (0.3131 > 0.05). So thin capitalization does not partially affect tax aggressiveness. This study's results align with the research of Sianipar et al. (2020) and Dharmawan et al. (2017), which state that thin capitalization does not affect tax evasion. Furthermore, it is contrary to the research conducted by Roza (2020) and Olivia & Dwimulyani (2019), which states that thin capitalization affects tax evasion. From the results of this study, many companies in Indonesia still rely more on equity for corporate funding than the debt sector. In addition, many Indonesian companies use debt. The goal is not to avoid taxes but for other purposes, such as expansion and company operations. It can be seen from the company's debt, which is dominated by short-term debt that does not contain interest.

However, agents can also use manipulation by taking advantage of their interest expense to minimize the tax burden that must be paid. Managers can fund companies from debt sources to reduce their tax burden. Corporate funding from debt sources is often referred to as thin capitalization. The tax planning activity carried out by this manager creates an opportunity for management to achieve its goals in terms of increasing company profits.

5. CONCLUSIONS

Based on research and data analysis regarding earnings management, financial performance (profitability), and thin capitalization on tax aggressiveness in food and beverage manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the 2017-2021 period. Earnings management influences tax aggressiveness. Financial performance (profitability) does not affect tax aggressiveness. Thin capitalization does not affect tax aggressiveness.

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