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What Motivates Companies to Avoid Tax?

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ABSTRACT

This study looks into whether transfer pricing, corporate social responsibility, and leverage are factors that motivate companies to undertake tax-avoidance of non-financial companies on the Indonesia Stock Exchange (IDX). The samples are 86 companies that were randomly selected by simple random sampling from 2017 to 2019. A total of 603 data observations consisting of the annual reports of 52 domestic companies and 34 multinational companies were analysed with multiple linear regression by use of IBM SPSS 21 software. This study implies that the majority of companies consider tax-avoidance practises to be unethical and the tier of tax-avoidance practises in the IDX listed companies are very low. On the other hand, transfer pricing, corporate social responsibility, and leverage do not affect tax-avoidance since those are not factors that cause companies to avoid taxes. Most companies in Indonesia view tax avoidance as unethical even though it is legal. These findings are expected to contribute to regulators in setting tax-avoidance arrangements in Indonesia. Compared to other studies, this study examines tax avoidance practises from an ethical perspective.

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1. INTRODUCTION

Tax-avoidance is a term used to describe a set of tax planning tactics that include: (1) tax-management, (2) tax-planning (3) tax-aggressive, (4) tax-sheltering, and even (5) tax-evasion (Hanlon & Heitzman, 2010). However, the five types of explicit tax-rate reductions have different tendencies, ranging from efforts to avoid taxes that are administered in a legal and safe manner for the taxpayers without conflicting with applicable tax provisions to violating tax provisions or laws.

Agency theory says that tax avoidance is characterised by opportunistic management behaviour such as profit manipulation and can negatively affect capital owners and creditors. "When making this opportunistic decision, management ignores the interests of the owner so that the owner faces several risks related to tax avoidance" (Wardani, 2018). According to Mangunsong (2002), tax-avoidance is accomplished using strategies such as utilising the exceptions and discounts permitted in the provisions and utilising things that are not regulated (loopholes) by the applicable tax laws.

Tax-avoiding schemes reduce the effective tax rate by the exploitation of deficiencies, weaknesses, and ambiguities in tax regulations by mobilising funds, creating fictive businesses, using financial instruments, and treating entities differently in different jurisdictions. (Alm, 2014) and tax-avoidance practises in Indonesia caused the country to lose trillions of rupiah (Nasional.kontan.co.id, 2019).

Companies do tax-avoidance in various ways, one of which is through transfer pricing practises, namely by distorting corporation revenues from high-tax to low-tax countries so that it will generate profits for subsidiaries in low-tariff tax-collecting countries. As for domestic companies, transfer pricing is carried out through the transfer price of goods or services between agencies of a group of companies or between divisions within a company within one territory of state sovereignty (Audric, 2019). The tax savings associated with transfer pricing are greater when the use of tax havens, higher foreign income, and research and development tasks are compiled with a tax minimisation strategy.

However, the company also avoids taxes in terms of funding. Leverage is a form of funding that is intended to minimize taxes. Kim & Im (2017) and Kurniasih et al., (2013) found a significant relation between leverage and tax-avoidance, which means the higher tier of leverage of a company, the tier of the company’s tax-avoidance is high too.

Meanwhile, from another perspective, Companies also avoid taxes through corporate social responsibility (CSR) disclosure. Klassen et al., (2017); Lanis & Richardson (2012) explained that CSR principles could potentially impacted corporate tax-aggressiveness by the board of directors involvement. CSR can affect tax-avoidance in the provision of how the company will be responsible for and manage the company's system.

A company's tax-avoidance relies on the essentials of its CSR activities. As CSR's economic dimension grows, so does tax-avoidance. Higher social dimensions of CSR lead to lower tax avoidance tiers, while (Laguir et al., 2015). Davis et al., (2016); Huseynov & Klamm (2012) found that there is a significant relation between CSR and tax-saving strategy. When a company undertakes tax-avoidance by builiding a tax-saving strategy, the company is also committed to strengthening its social and environmental performance. This is associated with (Lin et al., 2017) research that at a low level of Institutional Environments, companies that disclose CSR do tax-avoidance.

This research was inspired by a report by the International NGO Global Witness which published a report on the results of an investigation into alleged tax evasion by mining companies listed on the IDX. This mining company is suspected of conducting transfer pricing through its subsidiary in Singapore, Coal Trade Services International (Sugianto, 2019). The NGO

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Global Witness report is in line with data from the Ministry of Finance which noted that actual revenue from the mining sector decreased significantly by 27.55% to IDR 16.46 trillion. Deputy Minister of Finance, Suahasil Nazara said that the mining sector has experienced a decline since 2018 (katadata.co.id). This condition is due to the not optimal supervision carried out by tax officers in supervising and examining taxpayers who are indicated to practise tax avoidance (pajak.go.id).

As a key source of government revenue, taxes are very important for governments worldwide. Therefore, To finance various economic and social development activities, the government must ensure that tax compliance is maintained. However, the fact is that tax laws open loopholes for taxpayers to practise tax avoidance and are often carried out by taxpayers. In this case, tax avoidance does not violate the law (the letter of the law), but does not support the purpose of forming the law (the spirit of the law). This tax avoidance is a form of active resistance from taxpayers who avoid tax obligations or reduce their tax obligations (pajak.go.id).

Many studies have examined tax avoidance, (for example, Klassen, Lisowsky & Mescall, 2017; Sentanu & Juliani, 2016; Suprihatin, 2016; Richardson & Taylor, 2015; Mayangsari, 2015) found that Multinational companies have greater opportunity and capacity to reduce corporate taxes than domestic businesses. Then Lopez, Martinez & Garcia, 2019; Goerke, 2019; Mao, 2018; Lin, Cheng & Zhang 2017; Sari & Adiwibowo, 2017 found that The higher a company's CSR disclosure, the lower its tax-avoidance level.

Although there has been a lot of study on tax-avoidance and the factors that influence it, there are still few studies that examine tax-avoidance from an ethical perspective. Tax-avoidance is an unethical act even though it is legal. Singh (2005) argues that the ethical aspects of tax evasion decisions arise because tax compliance decisions require taxpayers to refer to perceived values and ethical codes regarding honesty, fraud, and liability, and judge this behaviour as right or wrong.

This study aims to test whether companies listed on the IDX do tax-avoidance. Even though tax-avoidance is legal, what are the factors that influence it? The results of the study are expected to contribute to regulators in setting tax-avoidance arrangements.

2. METHODS

This study population comprises of 603 non-financial IDX listed companies from the 2017 to 2019 period. While the sample was determined by simple random sampling and obtained 86 companies per year with a total of 603 data observations, consisting of 52 domestic companies and 34 multinational companies as well.

Tax-avoidance is measured using the Effective Tax-rate (ETR) (Hanlon & Heitzman, 2010). Calculation of ETR is dividing income tax expense by profit before tax. According to Lani et al., (2012), Tax-avoidance within the company can be clarified with an ETR. A low ETR value indicates that the income tax burden is lower than the income before taxes. So that it can be interpreted that a company that has a low ETR indicates that the company is indicated to do tax-avoidance. ETR is expected to provide an overall picture of the tax burden which impacts accounting profit. It can be seen in the company's financial statements notes. Companies reduce profits if their ETR is low, as they want small accounting profits to avoid future tax payments so that they can implement policies on accruals contained in deferred tax expense, by reducing the deferred tax expense.

Meanwhile, the measurement of transfer pricing uses the ratio of related transaction receivables, and leverage is measured by the ratio of total debt to total assets.

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CSR uses content analysis or a checklist that pertains to the Global Reporting Initiative (GRI). In total, 91 items are expected from the company. If item i is given a value of 1, and if item i is not given a value of 0 on the checklist. Disclosure of CSR is classified into 3 components: economic, environmental, and social. The social component is classified into several components, namely labor practises & work convenience, human rights, society, and product responsibility. The measurement variable is in Table 1.

Table 1. Variable Measurements

Research Variable	Indicator	Scale	Reference
Tax Avoidance	ETR $=\frac{income\ tax\ expense}{profit\ before\ tax}$	Ratio	Lanis & Richardson, 2012
Transfer Pricing	*Transfer pricing* = $\frac{Related\ Party\ Transaction - Receivable}{total\ accounts\ receivable}$	Ratio	Tiwa et al., 2017
Corporate Social Responsibility (CSR)	CSRIj $=\frac{\sum xij}{NJ}$ If item i is not disclosed then it is given a value of 0 on the checklist but if disclosed then it is given a value of 1 (Initiative, 2013).	Ratio	Initiative, 2013
Leverage	Leverage = $\frac{total\ debt}{total\ assets}$	Ratio	Richardson et al., 2013)

To determine the level of CSR disclosure is carried out through scoring on the items disclosed with the following formula:

$$\textbf{Disclosure index} = \frac{\textbf{The number of disclosure items that are fulfilled}}{\textbf{Maximum number of item scores x 100\%}}$$

The results of scoring CSR index items, then determine the level of CSR disclosure predicate referring to Gustani (2014) with the following categories that shown in Table 2.

Table 2. CSR Disclosure Level Predicate

Predicate	Index Value
Highly Informative	81% - 100%
Informative	66% - 80%
Less Informative	51% - 65%
Uninformative	0% - 50%

This study was tested using the following multiple linear regression:

$$\mathbf{Y = \alpha + \beta 1\ X1 + \beta 2\ X2 + \beta 3\ X3 + e} \text{..........(1)}$$

Description:

Y : Tax-avoidance
A : constant
β1 – β3 : regression coefficient
X1 : Transfer Pricing
X2 : CSR

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X3 : Leverage
E : standard error

Hypothesis:
H1: Tax-avoidance is affected by transfer pricing.
H2: Tax-avoidance is affected by the leverage.
H3: Tax-avoidance is affected by CSR disclosure.

3. RESULTS AND DISCUSSION

Table 3 shows that tax-avoidance measured by the ETR has an average value of 33.30% when compared to the 2017-2019 tax-rate of 25%, so corporate tax payments are higher than the corporate tax-rate applicable in Indonesia. It shows there is no indication of tax-avoidance in companies listed on IDX. Meanwhile, transfer pricing has a low value of 26.55%, and CSR disclosure has a value of 0.47 or 47%. However, leverage has a value of 53.97, which means that 53.97% of the company's financing sources come from debt.

Table 3. Descriptive Statistics

Variable	Minimum	Maximum	Mean	Std. Deviation
Tax Avoidance	.00	226.00	33.30	29.23
Transfer Pricing	.00	100.00	26.55	31.45
CSR	.32	.88	.47	14.27
Leverage	11,00	282.00	53.97	29.93

Furthermore, the results of the analysis of the predicate level of CSR disclosure carried out by non-financial companies registered on the IDX in 2019 were 14% or as many as 12 companies making CSR disclosures. Furthermore, as many as 40% or 34 companies make disclosures in the informative category. Then the less informative category was disclosed by the company by 37% or as many as 32 companies. The remaining 9% or 8 companies disclose CSR in the uninformative category.

In Table 4 transfer pricing has a 0.063 regression coefficient value and 0.287 significant value, it can be concluded that there is no positive influence between transfer pricing and tax-avoidance, so H1 is not proven or rejected.

Tax-avoidance is usually done in multinational companies to transfer part of the profits to subsidiaries operating in countries with lower tax-rates (tax-haven countries) (Zhou, 2011). This test is not consistent with the research of Heckemeyer & Overesch, (2017); Azis A (2019); Darma (2019); and Richardson & Taylor (2015) that transfer pricing motivates companies to avoid taxes.

Although in general, companies do tax-avoidance aiming to cut the amount of tax that should be paid to the government, on the other hand, companies must bear some of the costs due to tax-avoidance. Armstrong et al., (2015) mention that in carrying out tax-avoidance several costs must be borne by the company, namely the time and energy to do tax-avoidance and the risk of tax-avoidance is revealed such as interest and fines even the company can lose its reputation which is bad for the company's long-term business continuity. The fact is that companies are still compelled to avoid taxes through transfer pricing schemes even though there are consequences.

Transfer pricing generally occurs between multinational companies, by taking advantage of the gap in different tax-rates between several or two countries, namely transferring the profits of the subsidiary company to the parent company located in a country with a low tax-rate.

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Because the unit of observation in this study is a company that is under the same tax authority and has the same tax-rate, tax-avoidance is not carried out through transfer pricing.

These results identify that companies do not take advantage of the tax burden efficiency gap by using domestic transfer pricing through affiliated transactions between companies within the country. Referring to the concept of tax avoidance, that tax avoidance is carried out by taking advantage of administrative loopholes. For example, PT. A and PT. B is an affiliated company. Administratively, the two companies are registered at different Tax Service Offices (KPP). The company's management can take advantage of the weakness in supervision carried out by the KPP, through the transfer of its tax administration. Domestic transfer pricing is carried out by exploiting the gap between the final and non-final rates.

The results of this study differ from research conducted by Klassen, Lisowsky & Mescall, 2017; Sentanu & Juliani, 2016; Suprihatin, 2016; Richardson & Taylor, 2015; Mayangsari, 2015, that transfer pricing is the main driver for companies to carry out tax avoidance.

Table 4. Hypothesis Testing Results

	B	t	Sig
(Constant)	32.889	8.220	0.554
Transfer Pricing	.063	1.768	.287
CSR	.085	1.710	.314
Leverage	.066	1.875	.283
F-Test	3.979		
R.Square (R2)	34.4%.		

The test results show that Leverage has a value of 0.066 which means that partial leverage does not affect the company's tax-avoidance, and it was decided that the second hypothesis was rejected.

In the theory related to capital structure, both the proposition developed by Modigliani & Miller (1963) and the trade-off theory by Kraus & Litzenberger (1973), tax is one of the management considerations in deciding the source of company funding. Funding with debt sources has an advantage in terms of the amount of corporate income tax that the company can save due to interest expense which can reduce taxable income. In contrast, funding through equity has consequences for the distribution of retained earnings in the form of dividends to shareholders.

This corporate funding decision can be an illustration of tax-avoidance (Gupta & Newberry, 1997). In general, companies prefer to use external funding rather than internal. External funding such as debt will result in the emergence of interest expenses which can be a deduction from taxable profit.

Leverage is the company's capital support obtained from outside the company. Evidence found that 53.97% of the company's funding came from debt. High leverage does not indicate the company is doing tax-avoidance and is not in line with Firmansyah & Yunidar (2020); Luthfi et al., (2014) where the higher the company's debt level. the more tax-avoidance practises are carried out by the company.

The research results support the results of Prakosa (2014) that leverage does not have a significant effect on tax-avoidance, and Yulyanah & Kusumastuti's study (2019) that leverage does not affect tax evasion. This explains that companies do not depend on debt to finance their operations. Companies use more capital than funds sourced from debt. The results of this study identify that companies that utilise capital in their operations are generally not involved

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in tax avoidance, this indirectly supports good corporate governance in protecting the interests of stakeholders.

Tax-avoidance is not affected by CSR, given that the value of 0.085. Thus, H3 is rejected. CSR activities do not motivate companies to avoid taxes. The form of corporate responsibility to all stakeholders can be seen through CSR. One of the corporate social responsibilities to stakeholders through the government is taxes. Companies involved in tax-avoidance are companies that are not socially responsible (Lanis & Richardson, 2012). The company's decision to reduce its tax-rate or do tax-avoidance is influenced by its attitude towards CSR. A company doesn't only operate for its own sake but should provide benefits to its stakeholders stated by the stakeholder theory. Support from stakeholders is part of the existence of a company. The theory states that stakeholders have the right to know all information, both mandatory and voluntary disclosures as well as financial and non-financial information. When viewed from its tax obligations, although the company is required to be responsible for all its activities to the stakeholders, the company will still do strategies to deal with tax imposition by charging the costs incurred for CSR activities as costs to reduce taxable profit.

These results do not support the research conducted by Davis et al., (2016) who found the proceeds from tax-savings made by the company can be used directly for CSR activities. Research by Laguir et al., (2015); Mao (2019); Muller & Kolk (2015) found that a company's tax-aggressiveness relies on the essentials of its CSR activities. In the regulation of the Indonesian stock exchange. CSR activities are not an option for companies to avoid taxes.

The study of ethical aspects is an important point in this research. Referring to several literature that tax avoidance is an unethical act and this act of non-compliance is contrary to the spirit of contemporary corporate governance which seeks to protect the interests of stakeholders. The economic impact of high tax avoidance is related to the reduced revenue available to the government to finance its various economic development programs. This will also affect the government's efforts to improve services in various important areas such as national security, health, education, and social welfare. Aggressive tax avoidance is contrary to the spirit of corporate governance, but tax avoidance is a legal action from a legal perspective.

The results of this study as a whole support the research results of Abdelmoula, et al., (2022) that companies that focus on ethics and governance are more likely to reduce their tax avoidance activities. these companies aim to maintain their reputation and image. In this case, it can be said that a positive reputation can increase shareholder value. Therefore, companies find a strategy that is strong in their commitment and ethical and responsible behaviour, which enables them to maintain their good image and reputation.

4. CONCLUSION

This study aims to test whether transfer pricing, CSR activities, and leverage are factors that motivate companies to do tax-avoidance from an ethical perspective. Even though tax-avoidance is legal, what are the factors that influence it? The results of the study reveal that In general, there is no indication of tax-avoidance practises in non-financial companies on the IDX. The practise of tax-avoidance in Indonesia is very small, even though legal tax-avoidance is carried out. These results show that most companies in Indonesia view tax-avoidance as unethical even though it is legal. Meanwhile, statistical results show that the tier of leverage and CSR activities are relatively high, this will indicate the practise of tax-avoidance. It can be concluded that transfer pricing, CSR activities, and leverage do not motivate companies to do tax-avoidance, whereas evidence shows that transfer pricing, leverage, and CSR do not affect tax-avoidance. These findings revealed that tax-avoidance practises in Indonesia are not

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associated with transfer pricing, CSR, or leverage, but rather with other factors (e.g. tax rate difference, company size, profitability, etc).

The results of this study are different from previous studies which state that transfer pricing, leverage, and CSR are factors that encourage companies to avoid taxes. This result is associated with the ethical aspect that tax non-compliance in the form of tax avoidance and tax avoidance can increase shareholder wealth such as tax collection, this also has an impact on the distribution of wealth (public benefits financed by tax revenue) and the wider community as other affected stakeholders.

Companies must avoid engaging in non-compliance activities such as engaging in tax avoidance and aggressive tax evasion as part of their social obligations to society, this is in line with the spirit of corporate governance. Companies must focus on corporate governance values and ethical values by maintaining the company's reputation and image. A positive reputation and image can increase shareholder value.

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