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The Effect of Leverage, Earning Management, Capital Intensity, and Inventory Intensity on Tax Aggressiveness of Manufacturing Companies in Indonesia

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Abstract

The largest source of revenue in Indonesia comes from the taxation sector. Taxes increase the state revenue, which the government utilizes for building public facilities and infrastructures, providing subsidies to the public, financing public interests, and so on. In addition to producing revenue, taxes may be used to promote economic stability. Thus, this study aims to examine and analyze the financial aspects of tax aggressiveness. The financial aspects include leverage, capital intensity, inventory intensity, and earning management. The population used in this study was manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the 2016–2019 period. Data analysis was carried out based on Eviews, with a selected sample of 32 companies of four observation years. Therefore, the number of samples was 128. The results of this study revealed that the best estimation model to use is the Fixed Effect Model (FEM). This study proved that leverage and earning management had a positive and significant effect on tax aggressiveness. In contrast, capital intensity and inventory intensity did not affect tax aggressiveness. In addition, the result of this study is still far from perfect. It is, therefore, hoped that further research can add other variables to find better results.

Keywords: Leverage, Capital Intensity, Inventory Intensity, Earning Management, Tax Aggressiveness

JEL Classification Code: G32, H26, H83

1. Introduction

The source of revenue in Indonesia comes from taxation, non-taxation, and grants. The largest revenue sector is the taxation sector. Taxes aim to increase state revenue, which the government will utilize for the benefit of the state, such as building public facilities and infrastructures, providing subsidies to the public, financing public interests, and so on. Taxes also serve as the economic stability of the country. However, one factor in the decline in tax revenue from the manufacturing, mining, and other sectors is tax avoidance practices. Tax avoidance refers to the use of legal means to avoid paying tax. In such a case, taxpayers take unfair advantage of the shortcomings in the tax rules which allows them to find new ways to avoid the payment of taxes that are within the limits of the law. Taxes are considered to reduce the company's income and profit. The higher the amount of tax paid, the smaller the amount of profit the company gets (Putri & Lautania, 2016).

Companies adopt various methods to reduce the taxes that must be paid, or they try to minimize the tax burden or even avoid the tax burden, causing the company to resort to tax aggressiveness (Chen et al., 2010). Corporate tax aggressiveness is an attempt by the company to reduce the income tax payments to the state, designed through tax planning measures to minimize tax burdens, either using legal means by implementing tax avoidance or illegal

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means by taking tax evasion actions (Chen et al., 2010; Crocker & Slemrod, 2005). In this case, many studies have been conducted on corporate tax aggressiveness. Tax aggressiveness can be seen from two aspects: financial and non-financial aspects of company performance (Richardson & Lanis, 2007). Some of the aspects are leverage, capital intensity, inventory intensity, and earning management.

A leverage/debt ratio is any one of several financial measurements that look at how much capital comes in the form of debt (loans) or assesses the ability of a company to meet its financial obligations (Jihadi et al., 2021). This ratio is also beneficial for long-term creditors and shareholders who want to know the prospects for dividends and interest payments in the future. If the use of leverage in company operations is significant, the interest expense that the company must pay will increase (Kurniawati, 2019), which will reduce the company's tax burden. Previous research on the effect of leverage on tax aggressiveness was carried out by Suyanto and Supramono (2012), who found a significant positive effect of leverage on tax aggressiveness. This result is in line with the results of the research by Kurniawati (2019) and Yartono and Yuliza (2020). The higher the leverage level, the higher the tax aggressiveness level (Yartono & Yuliza, 2020). Tax aggressiveness is where the company takes advantage of the interest arising from the debt to reduce the amount of taxes that must be paid.

Capital intensity is how much the company invests in its fixed assets. These fixed assets can show the amount of the company's wealth because the more the company invests in fixed assets, the greater the company will bear the burden of depreciation. Cahyadi et al. (2020) and Putri and Lautania (2016) showed that the effect of capital intensity on tax aggressiveness is positive and significant.

Furthermore, the company has current assets in the form of inventory used for company operations in producing products. Inventory intensity reflects how much the company invests in the inventory in the company (Fahrani et al., 2017). A study conducted by Kurniawati (2019) regarding the effect of inventory intensity on tax aggressiveness has found that inventory intensity did not affect tax aggressiveness.

According to Angelo et al. (2009), Scott (2000), and Tiaras and Wijaya (2017), earning management is a practice followed by the management of a company to influence the earnings reported in financial statements. It is executed to match a set target and is different from managing the underlying business of the company. An earnings management strategy uses accounting methods to present an excessively positive view of a company's financial positions, inflating earnings. One motivation for management to do earnings management is to avoid corporate tax. Suyanto and Supramono (2012) revealed a significant positive effect of earnings management on tax aggressiveness. Therefore, this study aims to test and analyze the financial performance of the company. The test aims to prove if leverage, capital intensity, inventory intensity, and earning management, whether partially or jointly, influence tax aggressiveness.

2. Literature Review

2.1. Tax Aggressiveness

Tax aggressiveness is an action taken by a company in minimizing its tax burden with tax planning, both legal (tax avoidance) and illegal (tax evasion). This action is carried out to minimize or reduce the tax costs (Sunarto, Widjaja, & Oktaviani, 2021). Tax aggressiveness often refers to tax avoidance and it is part of tax planning. Tax aggressiveness is viewed as an activity of value maximization that shifts the wealth from the state to the company shareholders (Chen et al., 2010).

2.2. Leverage

Leverage or debt ratio is the ratio used to measure the extent to which the company's assets are financed using debt by comparing the company's debt burden with the assets owned by the company. The debt ratio measures a company's total liabilities against its total assets and is expressed as a percentage. It implies the company's ability to satisfy its liabilities with its assets, or how many assets the company must sell to pay all its liabilities. It shows the company's overall debt burden. Leverage occurs when a company finances the assets with borrowed funds. The leverage level can describe the company's financial risk (Nilmawati, Untoro, Hadinugroho, & Atmaji, 2021; Tahir, Masri, & Rahman, 2020; Vijayakumaran & Vijayakumaran, 2019). Companies financing their assets using debt will incur interest to be paid as a result of borrowing funds from third parties or creditors (Yartono & Yuliza, 2020). In running its business, the company has two sources of capital: debt and equity. Debt given incurs interest expense, where the treatment of interest in taxation is different from the treatment of dividends. Interest expense is permitted as a deduction from income. This creates loopholes and opportunities for companies to avoid taxes using interest.

2.3. The Capital Intensity Ratio

The capital intensity ratio is the amount of capital invested in the company's fixed assets, which is usually measured using the ratio of fixed assets divided by sales. Capital intensity can reflect how much capital is needed to generate income. Capital intensity is closely related to company investment (Richardson & Lanis, 2007). The company's investment is realized in fixed assets. Fixed asset capitalization is carried out through depreciation expense for fixed assets.

2.4. Inventory Intensity

Inventory intensity is a reflection of how much the company invests in the company's inventory. The greater the inventory owned by the company, the greater the maintenance and storage burden of the company's inventory. These expenses will later reduce the company's net profit and the amount of taxes paid by the company. Managers will try to minimize the additional tax burden by having a large inventory so that the company's profits are reduced (Putri & Lautania, 2016; Richardson & Lanis, 2007).

2.5. Earnings Management

Earnings management is an attempt by managers to manipulate financial statements to increase and decrease the profit for the current period of a company without causing an increase or decrease in the economic profit of the company in the long run (Angelo et al., 2009; Scott, 2000). Earnings management is the act of intentionally influencing the process of financial reporting to obtain some private gain. Different types of earnings management include moving earnings from one reporting period to another to paint a better picture or manipulating the balance sheet to hide liabilities and inflate earnings. Earnings management involves the alteration of financial reports to mislead stakeholders about the organization's underlying performance. Managers have the option to manipulate the earnings signal through tax avoidance.

3. Hypothesis Development

3.1. The Effect of Leverage on Tax Aggressiveness

According to Munawir (2010), leverage or debt ratio is used to analyze and interpret short-term financial positions. This ratio is beneficial for long-term creditors and shareholders who want to know the prospects of future dividends and interest payments. The leverage hypothesis with agency theory explains that a company with a high debt ratio has a high level of tax aggressiveness. It happens because the company's debts increase the interest expenses which in turn reduce company profits. With a decrease in the company's profit, the corporate tax that the company must pay will also decrease. In contrast, companies with low leverage will also have a low level of tax aggressiveness.

The research results of Kurniawati (2019), Suyanto and Supramono (2012), and Yartono and Yuliza (2020) found a significant positive relationship between leverage and corporate tax aggressiveness. The higher the company's leverage level, the higher the level of corporate tax aggressiveness. Thus, the hypothesis is as follows:

H1: *Leverage has a positive effect on tax aggressiveness.*

3.2. The Effect of Capital Intensity on Tax Aggressiveness

Capital intensity is how much the company invests its fixed assets. Fixed assets show the wealth owned by the company because the more the company invests its fixed assets, the more the company bears depreciation expenses. From this depreciation expense, the company's profit can decrease, thereby reducing the company's total tax obligations. The findings of Cahyadi et al. (2015) stated that capital intensity positively affected corporate tax aggressiveness. Thus, the hypothesis is as follows:

H2: *Capital intensity has a positive effect on tax aggressiveness.*

3.3. The Effect of Inventory Intensity on Tax Aggressiveness

Fahrani et al. (2017) stated that inventory intensity reflects how much the company invests in the inventory of the company. Companies that invest in inventory will incur costs of maintaining and storing inventory. It causes the company expenses to increase which can reduce company profits. Companies with a high level of inventory intensity will be more aggressive towards the level of the tax burden.

In agency theory, management has the responsibility of optimizing the profits of the company's owner. With a high inventory owned by the company, the expenses incurred to manage the inventory are also high. This expense causes inventory maintenance costs to increase, as such, the company's profits decrease. The decrease in profit decreases the tax burden to be borne by the company. With high inventory intensity, companies will be more aggressive towards taxes. Putri and Lautania (2016) showed that inventory intensity had a negative effect on corporate tax aggressiveness. Thus, the hypothesis is as follows:

H3: *Inventory intensity has a negative effect on tax aggressiveness.*

3.4. The Effect of Earnings Management on Tax Aggressiveness

The motivation of a manager to do earnings management is tax avoidance. The company performs earnings management to reduce the tax burden (Scott, 2000). Earnings management is management's intervention in the external financial reporting process for personal gain. Earnings management refers to a company's deliberate use

of accounting techniques to make its financial reports look better. Earnings management can occur when a company feels pressured to manipulate earnings to match a pre-determined target. Earning management also has a significant positive effect on tax aggressiveness (Suyanto & Supramono, 2012; Tiaras & Wijaya, 2017). Thus, the hypothesis is as follows:

H4: *Profit management has a positive effect on tax aggressiveness.*

4. Research Methods

In this study, the population was all manufacturing companies listed on the Indonesia Stock Exchange for the 2016–2019 period. The sample used has been through selection with the following criteria: 1) manufacturing companies consistently listed on the Indonesia Stock Exchange from 2016–2019 2) companies that had profits consecutively during the 2016–2019 period, and 3) companies with a CETR value of more than 0 and less than 1.

Tax aggressiveness is an action taken by companies to reduce taxable income through tax planning, both legally (tax avoidance) and illegally (tax evasion) (Frank et al., 2009). In this research, tax aggressiveness was measured using the Cash Effective Tax Rate (CETR). This measurement reflects both permanent and temporary differences in taxes within the company. The CETR is formulated as follows (Pinto et al., 2015).

$$\text{CETR}_{it} = \frac{\text{Payment of taxes}_{it}}{\text{Income before tax}_{it}}$$

CETR_{it}: Cash Effective Tax Rate of company *i* in period *t*
Payment of taxes_{it}: The amount of tax paid by company *i* in period *t*
Income before tax_{it}: Income before tax paid by company *i* in period *t*

Leverage or debt ratio is the ratio used to measure the extent to which the company's assets are financed using debt by comparing the company's debt burden with the assets owned by the company. The leverage ratio measures a company's total liabilities against its total assets and is expressed as a percentage. It shows the company's overall debt burden (Kasmir, 2014). In this study, leverage is calculated using the DAR (Debt to Asset Ratio) formula. DAR can describe the funding decisions made by the company.

Capital intensity is the amount of capital invested in the company's fixed assets (Richardson & Lanis, 2007). Capital intensity is calculated by comparing fixed assets to total assets.

Inventory intensity indicates how much the company invests in the inventory of the company. Inventory intensity in this research was measured by comparing the total inventory to total assets (Fahrani et al., 2017; Richardson & Lanis, 2007).

Earnings management is the use of accounting techniques to produce financial statements that present an overly positive view of a company's business activities and financial position. Earnings management is one factor that can reduce the credibility of financial reports (Angelo et al., 2009). In this study, earnings management was measured using the Discretionary Accrual (DA) value. DA was calculated by using the modified Jones model. This model was chosen because it is the best model for detecting earnings management compared to other models used for identifying earnings management.

1. Calculating Total Accrual:
$$\text{Total Accrual } (\text{TA}_{CC}) = \text{NI}_{it} - \text{CFO}_{it}$$
2. Estimating Total Accrual (TAC) with Ordinary Least Square (OLS) to get the regression coefficient:
$$\text{TCA}_{it}\ \text{A}_{it} - 1 = \beta_1(1\text{A}_{it} - 1) + \beta_2(\Delta\text{REV}_{it} - \Delta\text{RE C}_{it}$$
$$\text{T A}_{it} - 1) + \beta_3(\text{PPE}_{it}\ \text{A}_{it} - 1) + e_{it}$$
3. Calculating Non-Discretionary Accruals (NDA):
$$\text{NDAC}_i = \beta_1(1\text{A}_{it} - 1/) + \beta_2(\Delta\text{REV}_{it} - \Delta\text{REC}_{it}\text{TA}_{it} - 1) + \beta_3(\text{PPE}_{it}\text{A}_{it} - 1/)$$
4. Calculating Discretionary Accruals (DA):
$$\text{DAC}_{it} = [t - 1/] - \text{NDAC}_{i,t}$$

Description:

NI_{it} : Operating profit for company *i* in year *t*
CFO_{it} : Cash Flow Operating of company *i* in year *t*
TAC_{it} : The Total Accruals of company *i* in year *t*
DAC_{it} : Discretionary Accruals company *i* in year *t*
NDAC_i : Non-Discretionary Accruals company *i* in period *t*
$\text{A}_{it}-1$: Total assets of company *i* at *t*–1
ΔREV_{it} : Change in company *i* revenue in year *t*
ΔREC_{it} : Change in receivables of company *i* in year *t*
PPE_{it} : Property, Plant, Equipment company *i* in year *t*
$\beta_1\ \beta_2\ \beta_3$: Regression coefficient

Data analysis was performed using Eviews based on panel data. In selecting the panel data regression model, there are two comparison tests. The first test is the Chow test

that was conducted to choose between the common effect model and the random effect model. The second test is the Hausman test that was conducted to choose between the fixed effect model and the random effect model.

5. Results

5.1. Step 1: The Selection of the Estimation Model Using the Chow Test Method

The Chow test was conducted to compare the fixed effect model and the common effect model and select the best model to be used in this study. The hypothesis proposed in the Chow Test is as follows:

If the profitability value is >5%, then the common effect model is used.
If the profitability value is <5%, then the fixed effect model is used.

Based on Table 1, it could be concluded that the fixed effect model can be employed in this study. This is indicated by the sig value of 0.0255 in the χ^2 cross-section, which is smaller than 0.05.

5.2. Step 2: The Selection of the Estimation Model Using the Hausman Test Method

The Hausman test was conducted to compare the fixed effect model and the random effect model and select the best model to be used in this study. The hypothesis proposed in the Hausman Test is as follows:

If the *p*-value is >5%, then the random effect model is used.
If the *p*-value is <5%, then the fixed effect model is used.

Table 2 signifies that the fixed effect model can be employed in this study. This is indicated by the sig value of 0.0312 in the cross-section, which is smaller than 0.05.

Table 1: Chow Test Results

Effects Test	Statistic	d.f.	Prob.
Cross-section *F*	1.354832	(31,92)	0.1351
Cross-section χ^2	48.134364	31	0.0255

Table 2: Hausman Test Results

Test Summary	χ^2 Statistic	χ^2 d.f.	Prob.
Cross-section random	7.090174	4	0.0312

5.3. Coefficient of Determination (R^2)

The coefficient of determination measured the model's ability to explain the variation in the dependent variable.

Based on Table 3, it can be seen that the Adjusted *R*-squared value is 0.367123, and the Prob *F*-statistic value is 0.000008. The adjusted *R*-squared of 0.367123 means that 36.7% of the change in CETR could be explained by changes in leverage, capital intensity, inventory intensity, and earnings management. Meanwhile, the remaining 63.3% changes in CETR were explained by other variables outside this research model.

5.4. Hypothesis Test (*T*-Test)

Based on Table 4, leverage had a positive and significant relationship with tax aggressiveness, with a probability value of 0.0094, which is below 0.005, hence, hypothesis 1 iss accepted. Capital intensity showed a probability value of 0.5332. This value is greater than 0.005, hence, hypothesis 2 is rejected. Inventory intensity had a probability value of 0.5046. This value is greater than 0.005, hence, hypothesis 3 is rejected. Earnings management showed a probability value of 0.0000, which is below 0.005, hence hypothesis 4 is accepted.

6. Discussion

6.1. The Effect of Leverage on Tax Aggressiveness

The statistical calculation results showed that leverage had a probability value of 0.0094, indicating that the probability value was less than 0.05 or 5%. This result indicates that leverage had a significant positive effect on tax aggressiveness. Leverage or debt ratio is the company's ability to meet financial obligations in the long and short term. Leverage arises when a company finances the assets using borrowed funds. These funds will later generate interest that the company must pay to third parties or creditors.

The sample company, PT Unilever Tbk, in 2019, had debts in the form of capital loans from third parties. This debt can generate interest that the company must pay. However, interest expense is also is an allowable tax deduction. By taking advantage of this, the amount of tax that must be paid can be reduced. The interest expense arising from debt can be used as a deduction in the tax calculation so that the tax paid is smaller. The greater the leverage level of a company, the greater the level of corporate tax aggressiveness is.

This result align with the studies of Cahyadi et al. (2020), Fitria (2018), and Kurniawati (2019). However, this result is not in line with Dewinta and Setiawan (2016), who revealed that leverage had a negative effect on corporate tax

Table 3: Panel Data Determination Coefficient Test Results

R-squared	0.541538	Mean dependent var	0.077031
Adjusted *R*-squared	0.367123	S.D. dependent var	0.048947
S.E. of regression	0.038939	Akaike info criterion	–3.421365
Sum squared resid	0.139497	Schwarz criterion	–2.619231
Log likelihood	254.9673	Hannan-Quinn criter.	–3.095454
F-statistic	3.104884	Durbin-Watson stat	1.745647
Prob (*F*-statistic)	0.000008		

Table 4: Panel Data Regression Output of FEM Approach

Variable	Coefficient	Std. Error	*t*-statistic	Prob.
C	–0.056751	0.026383	–2.151061	0.0341
Leverage	0.155498	0.058599	2.653608	0.0094
Capital Intensity	0.029953	0.047883	0.625551	0.5332
Inventory Intensity	–0.045177	0.067442	–0.669857	0.5046
Earning Management	1.929595	0.400054	4.823339	0.0000

aggressiveness. This result is also not in line with Fahrani et al. (2017) and Tiaras & Wijaya (2017) who proved that leverage did not affect corporate tax aggressiveness.

6.2. The Effect of Capital Intensity on Tax Aggressiveness

The statistical calculation results showed that capital intensity had a probability value of 0.5332, indicating that the probability value was higher than 0.05 or 5%. This indicates that capital intensity did not affect tax aggressiveness.

Capital intensity is the amount of capital a company has for investment purposes in the form of fixed assets, which is calculated using the fixed asset ratio. The sample company, PT Semen Baturaja Tbk, invested a lot in the form of fixed assets. Although the sample company has high fixed assets, it could not take advantage of the depreciation expense which is an allowable tax deduction. Depreciation reduces the amount of taxes a company pays through tax deductions. The sample company's fixed assets are used for operational purposes, thus, increasing income which is greater than the depreciation expense. The use of fixed assets in this way could increase taxable income, as such, the taxes paid are higher. Therefore, high fixed assets do not affect the level of tax aggressiveness.

This result is consistent with the research of Cahyadi et al. (2020) and Fahrani et al. (2017), who found that capital intensity did not affect corporate tax aggressiveness. Nevertheless, it does not support the study by Fitria (2018), who showed that capital intensity had a positive and significant effect on corporate tax aggressiveness.

6.3. The Effect of Inventory Intensity on Tax Aggressiveness

The statistical calculation results showed that inventory intensity had a probability value of 0.5046, indicating that the probability value was higher than 0.05 or 5%. This proves that inventory intensity did not affect tax aggressiveness. Inventory intensity is the investment made by a company in its inventory.

The sample company, PT Gudang Garam Tbk, had a high amount of inventory. A company with a high inventory ratio cannot use inventory as a deduction for tax. This research result stated that inventory intensity did not affect tax aggressiveness because inventory is shown in the balance sheet (financial statements) and not in the profit and loss statement of the company. The components affecting corporate taxes are shown in the profit and loss statement. Hence, investments in the form of inventory (of the sample company) did not impact the company's tax aggressiveness.

This result supports the study of Fitria (2018) who revealed that inventory intensity did not affect tax aggressiveness. On the contrary, this result is not consistent with Fahrani et al. (2017) and Putri and Lautania (2016), who showed that inventory intensity affected tax aggressiveness.

6.4. The Effect of Earnings Management on Tax Aggressiveness

The statistical calculation results showed that earning management had a probability value of 0.00, indicating that the probability value was lesser than 0.05 or 5%. This result indicated that earnings management had a significant positive effect on tax aggressiveness.

To reduce the amount of taxable income, the management resorted to income decreasing techniques in the current period of the company. To pay lower taxes, companies have the incentive to engage in income-decreasing earnings management Thus, companies tend to keep their profits low by carrying out earnings management. This result aligns with previous studies by Angelo et al. (2009), Sunto and Supramono (2012), and Tiaras and Wijaya (2017) found that earning management had a positive and significant effect on corporate tax aggressiveness.

7. Conclusion

The results of this study conclude that (1) leverage had a positive and significant effect on tax aggressiveness; (2) capital intensity and inventory intensity did not significantly affect tax aggressiveness; and (3) earning management had a positive and significant effect on tax aggressiveness. Based on the results, only leverage and earning management were accepted in this study with a positive and significant effect on tax aggressiveness. This study is still far from perfect. It is, therefore, hoped that further research can add some other variables to find better results.

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