Governors
Volume: 03 | Number 01 | April 2024 |
E-ISSN: 2962-5505 | DOI: doi.org/10.47709/governors.v3i1.4036

Executive Incentives, Profitability Against Tax Avoidance: A Study Of Banking Companies In Indonesia

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ABSTRACT

Many parties contribute taxes to the State, one of which is companies. In calculating company profits, tax costs are very important because taxes are a cost account that can reduce the amount of profit the company earns during the year. The greater the tax paid to the state treasury, the less profit the company generates. This research aims to examine: executive incentives and profitability on tax avoidance. The population in this research are banking companies listed on the Indonesia Stock Exchange in 2017-2020. Sampling using purposive sampling, obtained 26 samples. This research uses multiple linear regression techniques. The results of this research indicate that executive incentives have no effect on tax avoidance because the compensation system without a share basis that applies to companies in Indonesia is less effective in motivating executives to avoid corporate taxes. In companies that manage corporate governance well, alignment between the interests of shareholders and executives through increasing compensation does not apply, so that increasing executive compensation has no effect on tax payments. Profitability has a significant negative effect on tax avoidance because companies that earn profits are assumed not to practice tax avoidance because they are able to manage their income and tax payments.

Keywords: Executive incentives, Profitability, Tax avoidance

INTRODUCTION

Tax is a mandatory contribution that is required and regulated by law aimed at every citizen, both individual and corporate taxpayers. Its implementation improves community welfare indirectly. Tax payments are used by the government as a national development strategy to improve general welfare in various aspects of community life (Ambarsari et al., 2019).

Companies are one of the many parties that contribute taxes to the country. Tax costs are very important in calculating company profits because taxes are a cost account that can reduce company profits during the year. The more taxes paid to the state treasury, the lower the company's profits for that year. Therefore, many companies use tax avoidance as a way to reduce the amount of tax transferred to the state treasury. Companies do not always like government tax collection because their profits will be reduced due to large tax payments, so companies try to minimize taxes paid legally and illegally. Meanwhile, the government always wants tax revenues to be as high as possible to finance state development programs.

Companies established in Indonesia, whether owned by Indonesian or foreign citizens, are required to contribute to paying taxes. The calculation of the tax amount is the result of multiplying the rate by the profit earned. This will reduce the company's after-tax profit for one period. The greater the multiplication result, the greater the tax paid and the reduced profit the company generates for investment purposes and shareholder welfare. Therefore, it is not surprising that companies respond unfavorably by taking actions that can reduce the amount of tax paid or what is known as tax avoidance (Ariani and Prastiwi, 2020). The tax target set by the Minister of Finance every year never reaches the target due to tax avoidance. The tax sector is the backbone of the country's economy for financing development so targets must be pursued. The realization of tax revenues in Indonesia from 2017 to 2020 is shown in table 1 below:

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Table 1. Tax Revenue in 2017-2020 IDR Trillion

No	Year	Target	Realization	Achievement
1	2017	1,283	1,147	89.4%
2	2018	1,424	1,315	92%
3	2019	1,577	1,332	84.4%
4	2020	1,198	1,069	89.25%

Source: CNBC Indonesia, 2022

Tax revenues are very important to maintain economic stability, so collections must be maximized to avoid tax avoidance strategies carried out by companies. The phenomenon of tax realization not reaching the target from year to year ultimately raises the question of what factors cause this recurring incident to never be resolved. The existence of different conditions means that the factors causing tax avoidance have not yet reached a consensus, so further research on tax avoidance is still very necessary.

According to Lestari and Putri (2017) There are two ways to reduce the tax payments owed: tax evasion and tax evasion. Tax avoidance offers several economic advantages to businesses. To increase company profits, management must try to minimize the tax burden expected by shareholders. However, shareholders also expect appropriate tax avoidance from management because if there is too little, it will result in the risk of fines and reduce the value of the company (Armstrong et al., 2015)

Companies that avoid taxes have a relationship between managers and investors. According to Minnick and Noga (2010) Investors always expect high profits and an increase in company value, so shareholders want the taxes paid to be minimized. On the other hand, managers, who are tasked with tax avoidance, also have an aim towards the wealth owned by their company. There are different interests between taxpayers and the government, which leads to large tax avoidance. This is indicated by the government's tax revenue revenue ratio which has not yet reached the target, which means that Indonesia's state revenue revenue in the tax sector is not yet optimal.

Management The company as executive leader has a role in deciding all company strategies, including planning in the field of taxation. Taxation is a company cost that is very avoidable because of the nature of taxes which do not have direct benefits felt by the company. Therefore, most company leaders choose tax planning with the aim of avoiding large taxes and to obtain increased profits. Although management decisions may not necessarily be in accordance with the wishes of shareholders. Existing companies usually do not have the aim of making profits only to improve the welfare of their shareholders. In practice, companies try to save as much tax as possible in various ways, even though the risks they bear are greater. Prameswari (2017) opinion Companies carry out careful tax planning to avoid various tax sanctions, both administrative and criminal sanctions, which are caused by differences in interpretation between tax authorities and taxpayers due to tax regulations that are too broad and information systems that are less efficient. Companies need aggressive tax planning to reduce taxes. Reducing such taxes is referred to as tax aggressiveness.

Aggressiveness Corporate taxes are likely influenced by several factors, one of which is executive incentives. Executive incentives are given to the company's directors, board of commissioners and core employees to encourage them to achieve company goals. This incentive can be in the form of material or non-material rewards. According to research conducted by Desai and Dharmapala (2006) increases in executive compensation are associated with managers' tax avoidance.

Another factor that is thought to influence corporate taxpayer compliance is profitability. In this research, profitability is measured by return on assets (ROA). The ROA ratio shows how much profit a company achieves based on how effectively the company uses all the assets it owns. The ROA ratio also shows profits beyond capital sources. Research result Dewinta and Setiawan (2016) shows that return on assets (ROA) has an impact on tax avoidance because companies can manage their assets well, one of which is by utilizing depreciation and amortization expenses, as well as research and development expenses, which can be used as a deduction from taxable income. Additionally, companies can profit from tax incentives and weaknesses in tax regulations.

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LITERATURE STUDY

Agency Theory

To explain the relationship between managers and owners, who have different interests, agency theory is a classical theory. This relationship is defined by the creator of this theory, Jensen and Meckling (1976) as a mutually binding cooperation contract but have different views on the resources owned by the company. Managers, as people who have access to company assets, can make decisions aimed at generating more profits for the shareholders who have given the mandate rather than personal profits. However, shareholders had to pay the agency for the lack of information (Putri and Putra, 2017).

The agency theory is very relevant to various cases of taxpayer non-compliance because the tax collection system in Indonesia uses a self-evaluation system, which allows corporate taxpayers to calculate and report their own taxes. Because there are differences in interests between taxpayers and the government, taxpayers can increase after-tax profits in various ways. In this way, the government will reduce the income it receives from taxes (Wulandari et al., 2020).

Tax Compliance

Businesses can reduce taxes owed in two ways: reducing gross income or increasing cost components. There are loopholes in the tax provisions that are binding on every taxpayer that can be used to reduce the tax burden. Because it still complies with regulations made by the government, this step is not prohibited. They may also take unlawful actions, such as falsifying evidence from documents that are not genuine (Mangoting, 1999), because this goes against the laws commonly known as tax aggressiveness and high-risk tax exclusion, this action is illegal. Because actions like this can disrupt economic stability, the country is the one who suffers (Lanis et al., 2017).

Shareholders have the main goal of maximizing profit after tax to generate high dividends by reducing costs incurred. Therefore, tax avoidance is not a priority measure but can be used (Nugroho and Agustia, 2017). According to agency theory, when there is a conflict of interest between the principal and an opportunistic agent, they always try to prioritize their personal interests. Avoiding taxes is an unintentional act, but with the hope of getting results (Nugroho and Agustia, 2017).

Executive Compensation

Executive compensation is an incentive or reward given to the board of directors or managers for achievements that lead to increased company performance. Executive compensation can be considered as a tool to encourage the board of directors or managers to continuously improve their performance and act in the interests of shareholders. Armstrong et al. (2015) states that shareholders will be more likely to compensate managers or boards of directors if their wealth or resources increase.

Profitability

In this research, profitability is proxied by Return On Assets (ROA). The ROA ratio measures the performance of a company to estimate the profits generated, so that if a company's profitability increases, it shows that the company generates profits by utilizing the existence of existing assets in the company after reducing costs such as employee development and management costs in increasing intellectual capacity.

METHOD

Types of research

This type of research is quantitative research. According to Sugiyono (2017) quantitative research methods are defined as research that is used to research a certain population or sample and analyze a set of data in a quantitative or statistical way with the aim of testing and analyzing predetermined hypotheses.

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Type and Source of data

The type and source of data in this research uses secondary data, namely in the form of evidence, notes and historical reports compiled in annual financial reports. The observation period was taken in 2017-2020. Data was obtained via the website www.idx.co.id by downloading audited annual financial reports for the 2017-2020 period and from Osiris sources.

Population and Research Sample

Population is a form of generalization of subjects that have been created to be researched and conclusions drawn that have certain classifications and characteristics (Sugiyono, 2017). The population of this research is all companies that have gone public and are listed on the Indonesian Stock Exchange. According to Sugiyono (2017) A sample is part of a population that has classifications and characteristics. The sampling method uses a purposive sampling method, namely with certain types and criteria required,

Table 2. Sample Selection Criteria

No	Criteria	Total
1	Companies registered on the IDX as of December 31, 2020	780
2	Companies classified as non-banking	(733)
3	Banking companies that report annual financial reports consecutively in the 2017-2020 period	(4)
4	A banking company that does not experience losses	(15)
Number of samples		**26**

Source: Processed data, 2024

The number of samples in this research was 26 banking companies.

Operational Definition and Variable Measurement
Independent Variable
Executive Incentives

Armstrong et al. (2015) shows that the way to calculate executive incentives is to divide the amount of annual compensation—which includes bonuses, incentives, allowances, bonuses, and other payments received by the board of commissioners, directors, and key employees—by the company's total sales for the year.

Profitability

Return on Assets is a comparison between the net profit generated by a company and its total assets. This shows how effectively and efficiently a company manages its assets in its operational activities, which is a measurement of how much profit the company generates. In this research, the value of assets (ROA) is calculated using net profit before tax and then compared with the company's total assets (Nadhifah and Arif, 2020). The basis of using profit before tax is used to calculate ROA because it shows the company's ability to generate profits without being affected by taxation and financing decisions.

Dependent Variable

Tax avoidance allows management policies to control the impact of taxation with the aim of reducing the tax owed to the State by using weaknesses in tax law and not violating tax law. In this study, tax reduction is measured using the effective tax rate, or ETR. ETR is calculated by dividing income tax expense by profit before tax. The purpose of the ETR measurement is to provide a complete picture of the tax burden associated with a company's profits reported in their financial statements (Dyreng et al., 2018). To calculate ETR, the following formula can be used:

$$ETR = \text{Tax Expenses} / \text{Earning Before Tax}$$

Technical Data Analysis

The analysis technique used to test the hypothesis uses multiple linear regression analysis.

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The formula for testing the influence of the independent variable on the dependent variable is:

$$TA = \alpha + \beta 1\ IE + \beta 2\ ROA + \varepsilon$$

Information :
TA = Tax avoidance
α = Constant
IE = Executive Incentives
ROA = Return on Assets
β1 - β2 = Regression coefficient
e = error terms

RESULTS AND DISCUSSION

Results

Descriptive Statistical Analysis

Descriptive statistics provide information regarding the description of the variables used in the research, namely institutional ownership, independent commissioners, executive incentives, profitability, tax avoidance and company value. Descriptive statistics provide information regarding the minimum value, maximum value, average value (mean), and standard deviation value of each research variable. Descriptive statistics in this research can be seen in the following table:

Table 3. Descriptive Analysis

	N	Minimum	Maximum	Mean	Std. Deviation
TA	104	0.0861	0.7133	0.2487	0.0926
IE	104	0.0014	0.0614	0.0133	0.0111
ROA	104	0.0016	0.0446	0.0196	0.0101

Source: Processed data, 2024

From table 2 above, it can be seen that the number of observations studied was 104 observations, based on the last 4 periods of annual financial reports (2017-2020). The lowest Executive Incentive for the research sample of banking companies was 0.0014 and the highest was 0.0614. The executive incentives of the research sample as a whole have an average of 0.0133 with a standard deviation of 0.0111. The profitability of the research sample has the lowest ROA of 0.0016 and the highest ROA of 0.0446. The average ROA of banking companies in the research sample is 0.0196 with a standard deviation of 0.0101.

Normality test

Normality test using the Kolmogorov-Smirnov Z value of 1.137 with a significance level of 0.151 means that it shows that the research variables are normally distributed because the significance level is ≥ 0.05 so that the variables of company value, tax avoidance, institutional ownership, independent commissioners, executive incentives and profitability are distributed. normal.

Hypothesis testing

The results of calculations using the SPSS 26 (Statistical Program for Social Science) program application for hypothesis testing are shown in table 4 below:

Table 4. Multiple Linear Regression Analysis

Variable	Regression coefficient	Sig.	Information
Constant	0.322		
Executive Incentives (IE)	-0.905	0.321	Rejected
Profitability (ROA)	-2,038	0.030	Accepted

Source: Processed data, 2024

Discussion

The Effect of Executive Incentives on Tax Avoidance

Based on the results of the regression analysis, it shows that executive incentives have no effect on tax avoidance with a regression coefficient of -0.905 and a significance value of 0.321. This significance value of 0.321 indicates that H_1 is rejected so that in this study executive incentives have no effect on tax avoidance behavior carried out by company management. Shareholders provide executive compensation given to managers or the board of directors so that they behave in accordance with the wishes of the shareholders.

In this research, the number of incentives including bonuses, incentives, allowances and other payments received by executives does not influence companies to avoid tax. The compensation system without a share basis that applies to companies in Indonesia is less effective in motivating executives to avoid corporate taxes. In companies that manage corporate governance well, alignment between the interests of shareholders and executives through increasing compensation does not apply, so that increasing executive compensation has no effect on tax payments. Thus, providing high compensation to executives is not an effective way to increase tax management efforts by reducing tax payments. This is due to the existence of other mechanisms that are more appropriate to apply to manage corporate tax management. These results strengthen the research (Hendrianto et al., 2022; Tanzil and Arrozi, 2020) which states that executive compensation does not have a significant influence on corporate tax avoidance and this is also caused by the relationship between companies with good corporate governance.

The Effect of Profitability on Tax Avoidance

Based on the results of the regression analysis, it shows that profitability has a significant negative effect on tax avoidance with a regression coefficient of -2.038 and a significance value of 0.030. This significance value of 0.030 indicates that H2 is accepted so that in this study profitability has a significant negative effect on tax avoidance behavior carried out by company management. ROA is an indicator of a company's ability to generate profits, so ROA is an important factor in the imposition of income tax for companies.

In this research, the profitability variable is measured using the ROA proxy, which divides profit before tax by the company's total assets. The test results show that the higher a company's profit, the smaller the effective tax rate. The results of this research support previous research conducted by Ambarsari et al. (2019) stated that Return on Assets (ROA) has a negative effect on tax avoidance because ROA is an indicator that reflects a company's financial performance, the higher the ROA value, the better the company's performance. Companies that earn profits are assumed not to practice tax avoidance because they are able to manage their income and tax payments. Derashid and Zhang in Noviyani and Muid (2019) who found that ROA has a negative influence on the effective tax rate. This indicates that companies that operate efficiently will receive a tax subsidy in the form of a lower effective tax rate compared to companies that operate with low efficiency.

CONCLUSION

The results of this research indicate that executive incentives have no effect on tax avoidance because the compensation system without a share basis that applies to companies in Indonesia is less effective in motivating executives to avoid corporate taxes. In companies that manage corporate governance well, alignment between the interests of shareholders and executives through increasing compensation does not apply, so that increasing executive compensation has no effect on tax payments. Profitability has a significant negative effect on tax avoidance because companies that earn profits are assumed not to practice tax avoidance because they are able to manage their income and tax payments.

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Volume: 03 | Number 01 | April 2024 |
E-ISSN: 2962-5505 | DOI: doi.org/10.47709/governors.v3i1.4036

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