



### THE EFFECT OF PROFITABILITY AND COMPANY SIZE ON TAX AVOIDANCE

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#### ABSTRACT

This study discusses the effect of profitability and company size on tax avoidance through a literature review. Tax is a mandatory contribution that functions for the development of the country, but there are differences in interests between the government and taxpayers. Companies often engage in legal tax avoidance through strategies that are in accordance with tax regulations. There are several factors that influence tax avoidance, including profitability and company size. The results of this study indicate that profitability has a positive effect on tax avoidance, where companies with high profits tend to practice tax avoidance to reduce the tax burden. In addition, company size has no significant effect on tax avoidance practices. This suggests that both large and small companies tend to comply with their tax obligations, regardless of the scale of operations and level of profitability.

#### INTRODUCTION

According to the Law on General Provisions and Tax Procedures (KUP Law) No. 28 of 2007 Article 1 paragraph 1 explains that taxes are mandatory contributions to the State that are owed and are compelling based on the law, by not getting a direct reward and are used for State purposes for the greatest prosperity of the people. Taxes are also one of the means in equalizing income, a source of State development funds, or citizens' income. If no citizen pays taxes, the development of the State or infrastructure will be hampered, and by paying taxes the community will also benefit from taxes such as the construction of public facilities, bridges, toll roads or highways and others.

There are different taxation interests between the government and taxpayers. Through tax contributions, the government can implement programs, such as increasing economic growth by developing infrastructure, public assets, and other facilities. This shows that tax revenue has an important role in ensuring the sustainability of State financing and development (Sunarsih et al., 2019). However, in tax collection for taxpayers, especially corporate taxpayers, tax payments themselves are considered to reduce income or corporate income so as to reduce the benefits obtained by the company. The company considers that if the amount of tax paid is too large it is detrimental to the company, because the more taxes paid the more the company's expenses, this difference in interests causes the company to reduce taxes legally or illegally (Susanti, 2018).

Most companies reduce taxes in a legal way, namely by doing tax avoidance because the tax reduction carried out still complies with the provisions of tax regulations such as utilizing exceptions and deductions that are allowed or delaying tax payments that have not been regulated in the applicable tax regulations. Tax avoidance has a slightly complicated but unique problem, because on the one hand tax avoidance is allowed by law but on the other hand tax avoidance is still undesirable for the government because it reduces State revenue.

Various regulations and policies have been implemented to address tax evasion, but the effectiveness and fairness of these measures still need to be tested. The tax ratio in Indonesia reached 10.4% in 2022, showing a downward trend that has been ongoing since 1980. However, in 2023, this ratio declined again to 10.21%. In 2021, it was noted that Indonesia's tax ratio was

below the standard achieved by Asia-Pacific countries, which had a tax ratio of 20%, and China with a record of 21%. This puts Indonesia's tax ratio far below the average tax ratio of ASEAN countries at 18%. Meanwhile, Japan and OECD countries recorded tax ratios of 33% and 34% respectively. (<https://lnq.com/cnbcindonesia> )

There are several cases of tax avoidance cases that have occurred in Indonesia, such as the case in 2020 by PT Toyota Motor Manufacturing Indonesia (TMMIN) which allegedly committed tax avoidance through a transfer pricing scheme. In this case TMMIN is suspected of transferring profits to a country with a lower tax rate through transactions with affiliated companies abroad. Then the case in 2022 by PT Asian Agri Group, which is one of the plantation companies in Indonesia. PT Asian Agri Group was involved in a tax evasion case through manipulation of financial statements and the use of leverage to reduce tax liabilities. In the previous year, this company was also given a large fine after being proven to have committed tax evasion worth more than 1 trillion rupiah.

This tax avoidance activity has many factors that can affect it such as profitability, leverage, transfer pricing, company size, sales growth, and many others. In this study, researchers only focused on 2 factors, namely the profitability factor and the company size factor.

Profitability is a description of the company's financial performance in its efforts to generate profits. Profitability consists of several ratios and one of them is Return On Assets (ROA), which describes the company's financial performance with an indicator of the company's profit compared to the total assets owned by the company. Company profits are closely related to taxation, where companies that have high profits will affect the amount of tax burden that must be paid by the company. Based on research (Mahdiana, M. Q., & Amin, M. N. 2020), (Arinda, G. A. M et. al. 2022) Profitability has a significant positive effect on tax avoidance. Then, according to (Stawati, V. 2020) and (Sarimin, M. D & Oktari, Y. 2023) Profitability has no influence on tax avoidance. Meanwhile, according to (Maynardarto, E. C. 2022) Profitability has a negative effect on tax avoidance.

Furthermore, Company Size (Firm Size). Company size according to (Bridgham & Houston, 2011) is how big or small a company is, which can be measured in various ways, such as revenue, total assets, and total equity owned by the company. Company size can also be seen from the total assets owned, which includes the incorporation and management of various resources to produce goods or services produced or sold. Company size can describe the company's operational activities and the revenue earned. Research conducted by (Sulaeman, R. 2021) and (Arinda, G. A. M et. al. 2022) states that company size has a positive influence on tax avoidance. Meanwhile, according to (Sawitri, A. P et. al. 2020) Company size has no influence on tax avoidance.

A literature review on tax avoidance aims to establish a comprehensive understanding of previous research, delve into relevant concepts and theories, and identify gaps in the existing literature that have not yet been explored. Through this review, researchers can identify trends, influencing factors, and methodologies that have been employed in the analysis of tax avoidance. Additionally, the literature review serves as a foundation for developing more focused hypotheses, allowing subsequent research to contribute more effectively to the advancement of knowledge and practice in the field of taxation.

## **THEORETICAL REVIEW**

Jensen and Meckling (1976) state that agency theory is an understanding related to the bond between the principal and an agent in the contract. In this theory, the agent is delegated authority by the principal in achieving his goals, so that the agent has authority over management activities, and the decisions made. However, it is not uncommon for there to be a conflict of interest between the principal and the agent. The existence of differences in functions and interests has a direct effect on the quality of financial information, including tax avoidance activities, which occur because the principal cannot always supervise the agent so that it can provide opportunities for agents to commit fraud or irregularities.

### **Tax Avoidance**

Tax avoidance is a practice or effort made by a company or organization to minimize the tax burden incurred. This tax avoidance is considered legal and can be done because it is

still in accordance with tax regulations, but the government objects because it can harm and reduce State revenues. According to research conducted (Mahdiana & Amin, 2020) this tax avoidance is an obstacle for the government in tax collection, causing a decrease in state cash revenue.

#### Profitability

Profitability is the company's ability to generate profit or profit from its resources (Kasmir, 2017). Many ways can be done to measure profitability such as Return on Asset (ROA), Net Profit Margin (NPM), Gross Profit Margin (GPM), and Return on Equity (ROE). This profitability is directly proportional to the tax burden that the company will pay, because the higher the profit generated by the company, the higher the tax burden that will be paid. Vice versa, the lower the level of profitability, the lower the tax burden that will be issued. As stated in the study (Mahdiana, M. Q., & Amin, M. N. 2020) Profitability has a significant positive effect on tax avoidance.

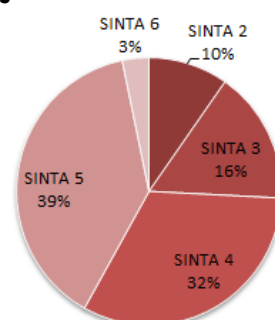
#### Firm Size

Company size is an important factor that can affect tax avoidance and the way companies fulfill their tax obligations. According to Brigham & Houston (2011: 4), company size can be measured through revenue, total assets, and total equity. The larger the size of the company, the greater the attention given by the government, which encourages managers to comply with tax regulations (Kurniasih & Sari, 2013). In addition, with a larger size, the tax burden to be paid also increases, so the company or organization tries to reduce the tax burden. Research conducted by (Sawitri, A. P et. al. 2020) Company size has no influence on tax avoidance.

### RESEARCH METHODS

This study used a qualitative research method with a literature review approach. Qualitative research analysis is carried out using information delivery techniques, to determine the causal factors interpreted in sentences (Santoso & Masitoh, 2022). This literature review approach is carried out by analyzing several relevant and recent articles, which are sourced from SINTA indexed journals, and have a focus related to the effect of profitability and company size on tax avoidance. Articles that discuss the effect of profitability and leverage on tax avoidance are obtained from SINTA indexed journals with SINTA (2), SINTA (3), SINTA (4), SINTA (5) categories with a total of 30 articles. This method was chosen by the author with the aim of obtaining new literature that can be used as a reference for further research.

**Figure 1**  
**Percentage of Sinta Indexed Articles**



The percentage of SINTA indexed articles used in this literature review-based research is SINTA 2 indexed articles of 10% as many as 3 articles, SINTA 3 of 16% as many as 5 articles, SINTA 4 of 32% as many as 10 articles, SINTA 5 of 39% as many as 13 articles, SINTA 6 of 3% as many as 1 article.

## DISCUSSION

### The Effect of Profitability on Tax Avoidance

Corporate profitability is one of the key factors that influence tax avoidance decisions. Various studies show a complex relationship between profitability and tax avoidance, with varying results. In the literature review on the effect of profitability on tax avoidance, there are various findings that show mixed results. Some studies, such as those conducted by Mahdiana & Amin (2020) and Rachmat Sulaeman (2021), state that profitability has a significant positive effect on tax avoidance. This finding indicates that companies with high levels of profitability tend to be more active in conducting tax planning to reduce their tax burden. This is due to the company's efforts to maximize net income that can be enjoyed by shareholders. In addition, research by Sakti Hermawan (2021) also supports this view, where high profitability encourages companies to undertake greater tax avoidance.

However, not all studies agree on this relationship. Some studies, such as those conducted by Vani Mailia Apollo (2020) and Maria Denastri Sarimin & Yunia Oktari (2023), found that profitability has no significant effect on tax avoidance. This research shows that even though companies have high profits, it does not always encourage them to do aggressive tax avoidance. Instead, companies with high profitability may prefer to comply with their tax obligations in order to maintain their reputation and avoid risks that may arise from tax avoidance practices.

Overall, out of the 30 articles reviewed, around 15 articles stated that profitability has a positive effect on tax avoidance, while the other 10 articles found no significant effect. The rest show varying results depending on the context and research methods used. This variability in results indicates the need for further research to understand the factors that influence tax avoidance decisions among firms, including the role of tax regulations, firm size, and management structure.

### The Effect of Firm Size on Tax Avoidance

The majority of the research results listed in Table 2 state that the results are still very varied. Some of the articles found a significant negative or significant positive effect, but the number of articles that did not find a significant effect was very large. There are 5 articles that find that company size has a significant positive effect, which indicates that the larger the size of the company, the greater the possibility of tax avoidance. A total of 6 articles show a significant negative effect, which indicates that in some cases, a larger company size actually reduces the likelihood of tax avoidance. There are 11 articles that state that company size has no significant effect and 3 that state no effect at all, which indicates that in the majority of studies 14 out of 30 articles, company size is not a factor that plays an important role in tax avoidance. So it can be concluded that company size has no influence on tax avoidance.

## CONCLUSION

Based on the literature review conducted, it can be concluded that profitability has a positive effect on tax avoidance, indicating that more profitable companies tend to engage in strategies to minimize their tax liabilities. In contrast, company size appears to have no significant effect on tax avoidance, suggesting that larger firms may not necessarily adopt more aggressive tax planning practices than their smaller counterparts.

However, this study highlights the need for further research that comprehensively examines additional variables that may influence tax avoidance beyond profitability and company size. Several other factors warrant investigation, including capital intensity, leverage, the presence of independent commissioners, institutional ownership, sales growth, political connections, audit quality, managerial ownership, firm value, thin capitalization, conservatism, solvency, and Islamic corporate social responsibility. By exploring these variables, future research can provide a more nuanced understanding of the dynamics surrounding tax avoidance and its determinants in various corporate contexts.

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