Journal of Economics, Finance and Management Studies

ISSN (print): 2644-0490, ISSN (online): 2644-0504

Volume 06 Issue 11 November 2023

Article DOI: 10.47191/jefms/v6-i11-43, Impact Factor: 7.144

Page No: 5640-5644

Financial Statement Ratios, Audit Quality and Long-Term Tax Avoidance

Shinta Budi Astuti[1], Tryas Chasbiandani[2], Khalida Utami[3], Zhuhai Fahru Muharomi[4]

[1,2,3,4] Faculty of Economics and Business, Universitas Pancasila, Indonesia

ABSTRACT: Taxes are a burden for companies, reducing their profits, so they engage in tax planning to minimize the amount of tax they must pay. Tax avoidance is a way for companies to reduce or minimize tax payment obligations, but it does not violate the provisions or government policies in taxation. The purpose of this study is to assess and analyze the effect of financial statement ratios and audit quality on Tax Avoidance both short-term and long-term. The study introduces a method of measuring corporate tax avoidance, namely long-term cash ETR. This study finds that there is various effect in Indonesia, Thailand, and Malaysia on corporate tax avoidance.

KEYWORDS: tax avoidance, ETR, ratios, audit quality

INTRODUCTION

Economic growth is important for developing countries so the source of state revenue becomes a matter of concern in determining the economic policies taken. In Indonesia, taxes are a source of state revenue and have a role as a source of funds for state financing from the non-oil and gas sector, so the role of taxes should be optimally increased in order to accelerate the pace of growth in Indonesia. The obligation to pay taxes in Indonesia is subject to two things, namely individual tax subjects and corporate tax subjects. In the case of corporate taxpayers (companies), taxes become a burden that reduces company profits, so companies do tax planning in an effort to reduce the amount of tax the company must pay.

Tax avoidance is an effort by taxpayers not to perform actions that are subject to tax or efforts that are still within the framework of the provisions of tax legislation to minimize the amount of tax payable. Tax avoidance is a way for companies to reduce or minimize tax payment obligations, but does not violate the provisions or government policies in taxation. The purpose of tax planning actions is that the company manipulates taxation so that the tax debt paid to the state can be reduced as low as possible or so that the tax payment obligations look small. The tax avoidance that has been carried out by these companies is inseparable from the involvement of executives or company leaders.

Tax avoidance is an interesting thing to research because there is no universal definition of tax avoidance. The lack of research on corporate tax avoidance, especially corporate tax avoidance in the long term, motivates researchers to conduct research with the theme of long-term tax avoidance which is also associated with financial statement ratios in this case the liquidity ratio and solvency ratio, as well as audit quality. This study introduces a method of measuring corporate tax avoidance, namely long-term cash ETR. Researchers grouped samples based on the amount of long-term cash ETR. Based on this, this research takes the title "The Effect of Liquidity, Solvency and Audit Quality on Long-Term Tax Avoidance".

The contribution of this research is to add to the literature related to tax avoidance in Indonesia in the long term, so that it can be an evaluation of tax planning activities carried out by public companies in Indonesia. In addition, it is also an addition to the literature on factors that affect long-term tax avoidance and its effect on firm value. Using a sample of companies in Southeast Asia. In this study, analyze how the character of financial statement ratios and audit quality on the application of Tax Avoidance policies. Based on the formulation of the problem, the purpose of this study is to assess and analyze the effect of financial statement ratios and audit quality on Tax Avoidance both short term and long term.

LITERATURE REVIEW

Agency Theory

According to Fligstein and Freeland (1995), agency theory can regulate the relationship between principal and agent. In this agency theory, it is explained that there is a relationship between shareholders and management. Scott (2015) argues that agency theory is the relationship between the principal and the agent. In agency theory, the principal is the party who employs or contracts the agent, while the agent is the party who carries out the principal's interests. This gives rise to a contract of interest between the two parties. The emergence of interest contracts and different goals between the two parties, so one way that can unite the goals of the principal and agent is through financial statements or reporting (Luayyi, 2010). The differences in objectives that arise result in tax avoidance, where there is a conflict of interest between the government and the company. The government wants the company to pay taxes in accordance with what must be paid in tax legislation and wants to obtain large state revenues while the company optimizes company profits and wants to pay taxes as low as possible than it should. The occurrence of agency problems is due to a conflict of interest between the agent and the principal. In theory, managers or agents should agree with the company's goals with the aim of increasing company value and making profits for shareholders or principals increase. But in practice this is not the case, managers certainly work to make themselves personally profitable with an increase in salary or benefits, this will certainly lead to several policies that will be contrary to the wishes of shareholders (Anwar, 2019: 9).

Tax Avoidance

Tax avoidance is a tax saving action that is still in the corridor of legislation (lawful fashion). In traditional theory tax avoidance is considered as an activity to transfer welfare from the state to shareholders (Kim, Li and Zhang; 2011), therefore the separation of ownership and control is important. This separation of ownership and control indicates that tax avoidance is an important activity, so owners need to design the right incentives for management so that managers make effective and efficient tax decisions, namely when the costs to be incurred are still smaller than the benefits to be received.

In the agency literature, tax avoidance can facilitate managerial opportunities for earnings manipulation or inappropriate resource placement. Hanlon (2010) defines tax avoidance as explicit tax reduction. Tax avoidance represents a continuation of the company's tax planning strategy. Tax avoidance activities create opportunities for management to carry out activities designed to cover up bad news or mislead investors (Desai and Dharmapala, 2006). Research related to factors affecting tax avoidance has been widely conducted, especially in the U.S., but the results are still diverse. This diversity of results is one of the interesting things to be reexamined, using different tax avoidance measurements. Dyreng, et.al (2008) conducted research on tax avoidance but with long-term measurements.

The use of this long period of time is considered to be able to describe the overall corporate tax planning activity, which shows all elements of tax avoidance and is able to show extreme cases that may occur, for example in the case of Enron. Enron had a very low long run ETR because it did not pay taxes for 4 periods (1996 - 1999). The use of a long period of time can also be used to test whether companies are able to conduct tax avoidance over a long period of time continuously, as well as the relationship between annual tax avoidance and long-term tax avoidance. Companies can do tax avoidance in accordance with their tax strategy.

Financial Statement Ratios

Liquidity is the company's ability to meet the company's short-term obligations. Definition of Liquidity according to experts: 1) According to (Harahap, 2011) "The liquidity ratio shows the extent of current assets in paying current liabilities. So that the higher the value of current assets compared to current debt, the higher the company's ability to pay its short-term obligations " 2) According to (Prihadi, 2020) "liquidity is the company's ability to pay short-term obligations or current debt of the company". Liquidity in this study is proxied by Current Ratio and Quick Ratio.

H1 : Quick Ratio affects Long-term Tax Avoidance

H2 : Current Ratio affects Long-term Tax Avoidance

Leverage is a ratio used to measure the extent to which the company's activities are financed by debt, it can be said how much debt burden the company will bear compared to its assets, this ratio measures the company's ability to pay all short-term or long-term liabilities with its total assets (Kasmir, 2014 in Hidayat, 2018). Trade off theory states that the leverage policy used by managers to obtain funds from external / debt for the continuity of the company will generate interest incentives and can reduce the tax burden where it can be used to avoid taxes because the interest expense will be a deduction from taxable income. The results of Oktamawati's research (2017) state that the greater the value of corporate debt, the lower the tax avoidance practices carried out by the company, companies whose funding composition uses debt will cause interest expenses to be paid, a high leverage ratio will show that the company uses funding from third party debt which will cause the high interest that the company will receive. In this study, Leverage is proxied by Debt to equity ratio. So, the hypotheses in this study are:

H3: Debt to Equity Ratio affects long-term tax avoidance

Companies audited by The Big Four Public Accounting Firm (KAP) usually produce better audit quality, and it will be more difficult to carry out tax avoidance policies. Thus, if the higher the audit quality of a company, the company is less likely to manipulate profits for tax purposes (Chai and Liu 2009). The results of previous research on the effect of audit quality on tax avoidance conducted by Annisa (2012) show that audit quality has a significant effect on tax avoidance. Based on theory and previous research, it is suspected that there is a relationship between audit quality and tax avoidance so that the following hypothesis can be proposed:

H4: Audit quality affects long-term tax avoidance.

Based on the research objectives above, the framework of thought presented is as follows:

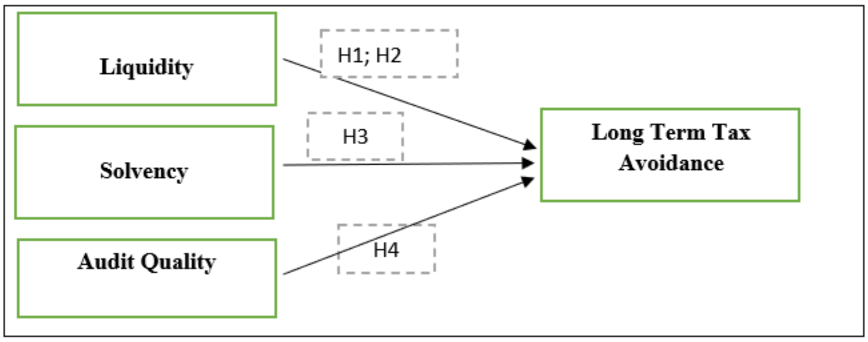

Figure 1. Framework

METHODS

This research is a quantitative study that aims to assess and analyze the effect of Financial Statement Ratios and Audit Quality on long-term Tax Avoidance. The type of data used is quantitative data using secondary data. The population of this study are all manufacturing companies listed on the stock exchanges in several ASEAN countries except for the banking and finance sector. While the samples used in this study are manufacturing companies listed on the Indonesia, Malaysia and Thailand stock exchanges. data collection techniques in this study are using documentation and literature study methods. The data collected are data related to tax avoidance, financial statement ratios and audit quality contained in annual reports published on their respective websites. The analytical method used to answer the research questions uses multiple regression analysis by testing 3 regression equation models. After obtaining the results of testing the effect of financial ratios and audit quality on Tax Avoidance in three ASEAN countries consisting of Indonesia, Malaysia and Thailand, then a comparative analysis of the effect of long-term Tax Avoidance for 2022 in the three ASEAN countries is carried out. So that by doing this analysis, it can answer the problems in this study.

RESULTS

Hypothesis testing in this study is to examine the effect of financial ratios and audit quality on tax avoidance. Based on the results of multiple regression analysis displayed in table 1 shows the results for the three regression models of the influence of Corporate Governance proxied by audit quality and the influence of financial ratios proxied by Quick Ratio, Current Ratio, and Debt to Equity Ratio on Tax Avoidance in three ASEAN countries namely Indonesia, Malaysia and Thailand. The test results can be seen in the following table:

Table 1. Hypothesis Testing Results

	INA		MALAY		THAI	
	Koef B	***P-value***	**Koef B**	***P-value***	**Koef B**	***P-value***
Const	38,90	0,23	-27,46	0,06	9,195	0,00
KA	-25,38	0,51	44,61	0,01	0,073	0,93
QR	-61,28	0,02	61,67	0,00	-2,116	0,01
CR	33,67	0,05	-27,19	0,00	0,851	0,13
DER	0,51	0,00	0,18	0,23	0,018	0,02
N	715		895		771	
F (Sig)	(0,008)		(0,000)		(0,001)	
Adj R^2	0,014		0,059		0,019	

Financial Statement Ratios, Audit Quality and Long-Term Tax Avoidance

Effect of Liquidity on Long-Term Tax Avoidance

In this study, the liquidity ratios used are Quick Ratio and Current Ratio. Based on the results of hypothesis testing, it shows that the Quick Ratio in Indonesia and Thailand has a negative effect on long-term tax avoidance, while in Malaysia it has a positive effect. Current Ratio in the sample of companies in Indonesia has a positive influence on long-term Tax Avoidance. The sample in Malaysia shows a negative effect on long-term Tax Avoidance, this result is in accordance with the research of Khatami, et all; 2021. This shows that the smaller the Current Ratio, the company will tend to choose to pay its corporate debt rather than having to pay large taxes so that companies tend to do Tax Avoidance to reduce their tax burden. The greater the Current Ratio, the greater the company's assets so that the company is not afraid to make tax payments and not do Tax Avoidance.

In the sample in Thailand Current Ratio has no effect on Tax Avoidance. Current Ratio has no effect because such a large Current Ratio illustrates the amount of cash that is idle so that it is thought to be less productive. If the Current Ratio is very small, it will reduce the level of creditor confidence in the company which has an impact on reducing capital loans from creditors. Therefore, there is a possibility for companies to jointly maintain the level of Current Ratio (Nyman, et all; 2022).

Effect of Solvency on Long-Term Tax Avoidance

Solvency measured by Debt to Equity Ratio, has a positive influence on long-term tax avoidance in Indonesia. This is also in line with Thailand where Debt to equity ratio has a positive effect on long-term tax avoidance. Solvency measures how much the company is financed with debt. The higher the solvency, the higher the level of corporate debt. The company's ability to meet its short-term obligations is one of the factors that can encourage companies to avoid taxes. This is because the higher the level of short-term debt owned by the company makes the company try to avoid taxes in order to be able to obtain high profits to immediately pay off the debt. These results are in line with research conducted by Aulia and Mahpudin (2020) which states that solvency affects tax avoidance while in Malaysia, DER has no effect on long-term tax avoidance, this is in line with research conducted by Handayani (2018) which states that solvency has no significant effect on tax avoidance.

Effect of Audit Quality on Long-Term Tax Avoidance

Audit quality has a significant effect with a positive direction on tax avoidance in Malaysia. The audit committee can help overcome agency problems by ensuring that the accounting information presented is accurate and free from bias. The information is provided in a timely manner to shareholders and other interested parties. The formation of the structure and selection of audit committee personnel is the responsibility of the board of commissioners, the board of commissioners abuses its authority, so the minimum composition or the increasing number of audit committee personnel will further exacerbate tax avoidance. This is because the audit committee is one of the supports that can directly provide supervision and bridge the manager's reporting to the owner (Mulyani, Wijayanti & Masitoh, 2018). The results of this study are in line with agency theory which explains that the more maximal the "audit committee in supervising the process of making financial statements, the management as an agent can maximize tax avoidance. So, many or few audit committees provide assurance that they can play a role in determining the effective tax rate policy in a company (Susanti & Fidiana, 2019).

Audit quality has a significant positive effect on long-term tax avoidance in Malaysia, so it can be concluded that the audit committee in a company will take tax avoidance actions. The results of this study are consistent with research conducted by Mulyani, Wijayanti & Masitoh (2018), Silvia (2018), Hardi et al. (2020) which shows that the audit committee has a positive effect on tax avoidance. However, for Indonesia or Thailand, audit quality has no effect on long-term Tax Avoidance. This is in line with research conducted by Susanti & Fidiana (2019), Purbowati (2021) and Sunarsih & Oktavia (2016) which shows that the audit committee has no effect on tax avoidance.

CONCLUSIONS

Based on the results of the analysis and discussion that has been described, the following conclusions can be drawn: (1) There is a negative effect of Quick Ratio on Tax Avoidance in companies in Indonesia and Thailand, but a positive effect on companies in Malaysia. (2) There is a positive effect of Current Ratio on Tax Avoidance in the Indonesian sample and a negative effect in Malaysia. The sample in Thailand shows that there is no influence between Current Ratio on Tax Avoidance. (3) There is a positive effect of Debt to Equity Ratio on Tax Avoidance in sample companies in Indonesia and Thailand. The sample in Malaysia shows that there is no influence between Debt to Equity Ratio on Tax Avoidance. (4) Audit quality has a significant positive effect on long-term Tax Avoidance in Malaysia.

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