ANALYSIS OF CORPORATE INCOME TAX REDUCTION A STUDY CASE ON MANUFACTURING COMPANIES IN INDONESIA IN THE YEAR 2008-2014

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Abstract

This research aimed to determine the effect of ABTD (Abnormal Book-Tax Differences) before and after tax rate reduction. This research also examined the effect of taxation facility, foreign operation, pretax cash flow from operation, and size of the company towards ABTD. Samples in this research are manufacturing company that listed in Indonesia Stock Exchange 2008-2014 by using method of purposive sampling so there are 357 companies. This research used multiple regression analysis. The result of this research indicates that the foreign operation variable and pretax cash flow from operation variable have positive effect on ABTD. While the size of the company variable has negative effect on ABTD. The conclusions of this research are that tax management depends on foreign operation, and earnings management depends on pretax cash flow from operation and size of the company.

Keywords: Earnings Management; Tax Management; Tax Reform

INTRODUCTION

Since the start of *Orde Baru*, the state income from tax remains becoming revenues particularly revenues from income tax. Improvements to increase income tax revenues are always done by the government one of which is with tax reform. Tax reform is a fundamental change in all aspects of taxation in order to improve national development. Tax reform in Indonesia began in 1983, namely with the introduction to the principle of self-assessment in calculating income tax. The last change in 1997 occurred including Law No. 36 Year 2008 regarding Fourth Amendment of Law No. 7 Year 1983 on Income Tax (Bawazier, 2011). This fourth change lead change in tax rates for corporate income tax from previous ones is progressive with a tax rate of 10% to 30% to proportional rate as big as 28% in 2009, and re-revised in 2010 become 25%, which is still valid today. This tax rate reduction is advantageous for the company because it can reduce the amount of tax paid by the company. A decrease in tax rates create incentives of companies to perform negative earnings (income decreasing) by deferring revenue and recognizing expenses in the year before tax rate reduction is done (Guenther, 1994).

The amount of tax paid by the company will reduce the income received by the company. The company's goal is to obtain high profits for the welfare of their shareholders and to keep in order to their profits remains high companies tend to do earnings management. However, the contribution of high profit for the welfare of its shareholders are faced with tax that is a burden as a deduction of income, so it is not infrequently the company make tax management to minimize their tax liabilities. Scott (2009) defines

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earnings management as an accounting policy choice-making by managers in achieving their goals. Earnings management will display financial information that does not reflect the actual situation to safeguard the company's reputation in the eyes of stakeholders. Long-term strategy that is done by the company to maintain its reputation is tax management. Mangoting (1999) states that tax management is a means to meet tax liability correctly but the amount of tax paid can be pushed as low as possible to obtain profit and liquidity that is expected by management. Tax management is done by utilizing cracks found on tax regulation applicable so that tax management is not contrary to the law.

Corporate income tax rate reduction from the previous one is progressive becoming a proportional rate of 25% applicable to currently utilized by the company to increase earnings management and tax management. Based on Article 17, paragraph 2b of Law No. 36 Year 2008 the government also provides a reduction in the tax rate of 5% for companies that own 40% or more of the total shares that are deposited and traded on the Indonesia Stock Exchange are owned by the public. This tax facility will lead to differences in taxes paid by the company. Tax law with accounting standard has differences so that it occurs temporary differences or permanent differences which implies on differences of tax book, or better known Book Tax Differences (BTD). At BTD concept consists of Normal Book-Tax Differences (NBTD) and Abnormal Book-Tax Differences (ABTD). NBTD is an accounting and fiscal profit differences that were reasonable and subject to the accounting standards and tax laws. Whereas differences caused by earnings management or tax management and these differences reflect unnatural differences called ABTD Septiani and Martani (2013).

Discussion about the effect of tax rate reduction in relation to earnings management and tax management becomes an interesting thing to discuss. In 2013, research on this subject has been done by Septiani. The study discusses about the relationship between corporate governance and tax reform to ABTD (Abnormal Book-Tax Differences). On this occasion, the writer would like to discuss about the relationship between tax reform on earnings management and tax management with emphasis on ABTD as a proxy of earnings management and tax management. The difference of this study with previous research is with the addition of foreign operation and pretax cash flow from operation variables as well as eliminating corporate governance variable. Based on the explanation above, it is obtained the purpose of this study is to know the effect of corporate income tax rate reduction before and after tax rate reduction, tax facilities, foreign operation, pretax cash flow from operations, and company size to earnings management and tax management.

Agency theory explains that each party both agent and principal will only do what will benefit them respectively. Different interests between the agent and the principal or the equivalent of the company and its stakeholders will rise to a condition in which each party is trying to maximize their respective interests. Problems will occur if there is information asymmetry between agents and principals. Managers as company superintendent are more aware of company's internal information and company's prospects in the future than capital owners or shareholders. As a manager, the manager should provide information about the actual condition of the company to the owner.

METHODS

This study was conducted by using data from manufacturing companies listed in Indonesia Stock Exchange from year 2008-2014 so that it was obtained a population of 111 companies. Sampling was done by purposive sampling with criteria, a company belonging to manufacturing industry, had a fiscal year-end December 31, presented financial statements data and fixed assets as well as intangible assets completely from 2008-2014, and did bookkeeping in the rupiah currency. Based on defined criteria, then it was obtained number of sample as many as 357 observations with 7 years of research.

The research model used in this study was as follows:

$$ABTD_{it} = \alpha_0 + \alpha_1 YEAR_{it} + \alpha_2 FAC_{it} + \alpha_3 FOR\_D_{it} + \alpha_4 PTCFO_{it} + \alpha_5 SIZE_{it}\, \varepsilon_{it}$$

In which :

α_1, α_2, α_3, α_4, and α_5 were intercepts

ABTD = abnormal book tax differences which was regression residual of book tax differences from estimation model of Manzon and Plesko (2002)

YEAR = dummy variable year before tax changes, 1 for 2008 and 2009, 0 for 2010, 2011, and 2012.

FAC = dummy variable equal to 1 if the company got tax facilities of corporate income tax rates, 0 if di not.

FOR = dummy variable of foreign operation company i in year t, 1 if the company had foreign operation and 0 if it did not.

PTCFO = change ratio in cash flows before tax to total assets of the company i in year t

SIZE = natural logarithm of the total assets of the company i in year t

ε = error

Dependent variables in this research were earnings management and tax management. Proxy used to measure earnings management and tax management was Abnormal Book Different Tax (ABTD). ABTD measured by residuals estimation of the BTD regression model. This BTD model is a model of Manzon and Plesko (2002) who state BTD.

The models among others:

$$BTD_{it} = \beta_0 + \beta_1 \Delta INV_{it} + \beta_2 \Delta REV_{it} + \beta_3 NOL_{it} + \beta_4 TLU_{it} + \beta_5 \Delta EB_{it} + \varepsilon_{it}$$

In which:

BTD = book-tax differences for company i in year t

ΔINV_{it} = investment changes in both fixed asset and intangible assets in the company from year t-1 to year t

ΔREV_{it} = changes in company's revenue from year t-1 to year t

NOL_{it} = value of net operating losses in accounting

TLU_{it} = value of tax losses utilized in the company i in year t

ΔEB_{it} = changes of company's employee benefit from year t-1 to year t

Independent variable was free variable that influenced dependent variable. The independent variables in this study were as follows: Year of Tax Rate Reduction (YEAR). Tax rate reduction in Indonesia during 2008-2011 has been done 2 times, namely in 2009 from a progressive rate to a flat rate as big as 28% and in 2010 to 25%. Variable of tax rate reduction would be measured by using dummy variables. Where for years 2008 and 2009 as a year before tax rate reduction would be given a value of 1 and 0 for years 2010, 2011, and 2012 as a year after the enactment of tax rate reduction; Tax Facilities (FAC). Measurement for this variable was in the form of dummy. For companies that got a facility of tariff reduction as big as 5% with a minimum requirement 40% of shares deposited owned by the public given value of 1 while 0 for otherwise. So that companies that got this facility would be charged 23% in 2009 and 20% in 2010. In contrast, companies that did not get this facility would be charged normal tariff; Foreign Operation (FOR). Foreign operation through branch had several distinct advantages in taxation. Tax benefits from foreign operation, namely a branch had revenues that are generally sheltered from taxation in the origin country until dividend sent. The differences of regulations and tax rates of each country allow companies to conduct tax management. So that the measurement for variable of foreign operation using dummy. It was given 1 if the company had foreign operation and 0 if it did not; Pretax Cash Flow From Operation (PTCFA). Low profitability level tended to perform tax management and earnings management. The public would have more confidence to the company if the company had high level of profitability. Measurements for variable of Pretax Cash Flow From Operation is from the quotient between the change in cash flow before taxes to total assets; Company Size (SIZE). Company size in this study was the natural logarithm of the total assets of the company which was symbolized by SIZE. Suwito and Herawaty (2008, 138) defined company size as a scale that could classify company in various ways namely total assets, total sales, number of employees, and others.

Variables of tax facilities and foreign operation were factors of tax management detection. It was classified such because these variables can be an incentive to do tax management. The variables of pretax cash flow from operations and company size are all factors detecting earnings management. This was due to these variables can be an incentive to do the earnings management.

RESULTS AND DISCUSSION

Descriptive statistics of 357 observations on companies that were become the research sample from year 2008-2014 could be seen in table 2

Table 1. Descriptive Statistics
Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
ABTD	357	-29,90000	37,80000	-,0022492	12,54158553
YEAR	357	,00	1,00	,2857	,45239
FAC	357	,00	1,00	,3922	,48892

	357	,00	1,00	,3137	,46466
FOR	357	,00	1,00	,3137	,46466
PTCFA	357	-14,90	17,20	1,1045	4,83376
SIZE	357	11,30	18,30	14,3031	1,51384
Valid N (listwise)	357				

Source : Secondary data processed with SPSS21

The results of descriptive statistical analysis in table 2 indicated that the unit of analysis (N) was 357. ABTD as dependent variable was the regression residuals of BTD regression model. ABTD was a proxy for detecting earnings management and tax management practices. According to table 2 above, average ABTD was 0,0022492 with standard deviation of 12,54158, which showed that the range of ABTD values studied was quite large. The maximum and minimum value of ABTD was 37.80 (-29.90). YEAR variable was a variable of tax rate reduction in Indonesia where 1 for years 2008 and 2009, and 0 for years 2010, 2011, 2012, 2013, and 2014. The maximum value (minimum) of YEAR variable was 1 and 0.1 with the mean of 0.2857 or 28.57%. Whereas standard deviation for YEAR variable was 0.4524 which meant that the range of YEAR variable value was equal to 0.4524. FAC as a variable of tax facility showed maximum and minimum values 1 and 0.1 indicated a perfect score. 0 indicated that there were still companies that have not yet gotten a tax facility by 5% with a minimum requirement of 40% of shares deposited owned by the public. The average variable of FAC as big as 39.22% meant there were 39.22% of listed companies received tax facilities. Whereas standard deviation of FAC variable was 0.48892 meant the range of FAC variable value was 0.48892 or 48.92%.

FOR as variable of foreign operation showed a maximum value (minimum) of 1 and 0.1 with an average value of 31.37%. Score 0 indicated that there were still companies that did not have foreign operation in the amount of 31.37%. Meanwhile, variable of PTCFA showed a maximum value (minimum) of 17.20 (-14.90) with an average value of PTCFA variable as big as 1.1045. Standard deviation in the amount of 4.83376 indicated that the range of PTCFA variable value which examined was quite large. SIZE or also called company size showed a maximum value (minimum) was 11.30 (18.30) with average value of 14.3031 which meant that the average amount of assets owned by the company amounted to 14.3031. Standard deviation for the variable of size was 1.51384 which indicated that the range of values of SIZE variable was large enough.

The result of linear regression in this study could be seen in table 2 below:

Table 2. The Result of Regression

Coefficients[a]

Model		Un-standardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
	(Constant)	20,291	6,396		3,172	,002
1	YEAR	-,796	1,439	-,029	-,553	,581
	FAC	,276	1,342	,011	,205	,837

FOR	5,651	1,456	,209	3,881	,000
PTCFA	,354	,134	,136	2,651	,008
SIZE	-1,562	,451	-,189	-3,462	,001

a. Dependent Variable: ABTD

Source : Secondary data processed with SPSS21

Based on the result of linear regression, it was obtained a result that year of tax rate reduction had a negative and insignificant effect on earnings management and tax management. This result did not correspond to the first hypothesis (H1) that earnings management and tax management in the year before tax rate reduction occurred was higher than after tax rate reduction.

This result was not consistent with research conducted by Septiani and Martani (2011) which stated that reduction in corporate income tax rates in 2008 and 2009 became an incentive of the company to conduct earning management and tax management. This was allegedly due to the implementation of earnings management and tax management done by manufacturing companies could not be done at any time. Companies did not directly respond to a change of tax rate in conducting earning management and tax management even though the tax rate changed several times. Descriptive statistical data showed that average years of tax rate reduction was as big as 4.52%, this meant that around 4.52% of manufacturing companies did earnings management and tax management at the time tax rate reduction. Another reason year before tax rate reduction did not have effect on earnings management and tax management was a manufacturing company that suffered losses did not do earnings management and tax management. Companies that suffered losses did not need to do earnings management to minimize the payment of income tax for companies that suffered losses were freed from paying taxes. In tax regulations, company that suffered losses may compensate for the losses maximum within five years. This study took the data at manufacturing companies did not look in terms of the company suffered consecutive profit or losses in a row but in any event the company entered into study sample. Years before tax rate reduction did not have effect on earnings management and tax management according to research conducted by Hardini (2013) with entitled Earnings Management as a Response on Changes of Corporate Income Tax Rate in Indonesia (Empirical Study on Manufacturing Companies listed on the Indonesia Stock Exchange). The result of this study indicated that the implementation of earnings management before tax rate reduction could not influence manufacturing companies to implement earnings management.

Variable of tax facility was calculated by using dummy variables. Companies that got tax facilities in the form of tariff reductions would be rated 1 and companies that did not get tax facilities in the form of tariff reductions rated 0. Based on the result of linear regression, it was obtained the result that tax facilities had a positive and insignificant effect on earnings management and tax management. This result was not in line with Hypothesis 2 that tax facilities had a positive effect on earnings management and tax management. The result of this study was not consistent with the research conducted by Septiani and Martani (2011) which stated that facility of corporate income tax rate reduction as big as 5% that caused by its shares owned by the public resulting effect on earnings management and tax management. Worsening of tax management was not only influenced by tax facilities. Indicators of worsening tax management of a

company not with tax facilities given, but the company would undertake tax management if tax rate set by the government increased. This was in accordance with the research conducted by Alm (1991) in Hutagaol et.al (2007) which stated that tax facilities had positive effect on the company's effective tax rate.

Based on SFAS (PSAK) No. 10 Acurate Accounting, foreign operation was a subsidiary, acquisition company, joint venture or branch of the reporting company,that the activities carried out in a country outside the country of the reporting company. Differences in tax and accounting regulations that were utilized by the company to conduct earnings management and tax management. Foreign operation variables in this study used a dummy variable, in which the company had foreign operations rated 1 and companies that did not have foreign operation rated 0. Based on the result of the linear regression it was obtained that the variable of foreign operation had significant positive effect on earnings management and tax management. This result was in accordance with Hypothesis 3 that foreign operation had a positive effect on earnings management and tax management. This result was consistent with research conducted by Kamila (2013) who examined the relationship analysis between financial reporting aggressiveness and tax aggressiveness at the time of the tax rates reduction. Companies that had foreign operation were believed to have incentive to conduct tax management.

The differences of tax regulations between states made companies did tax management. The company would conduct earnings management from countries with high tax rates to countries with low tax rates. This result was consistent with research of Indraswari (2010) which examined the influence of international status, diversified operations and legal origin to earnings management. Companies with multi operational had a greater opportunity to take advantage of tax through the use of tax planning by presenting a lower tax burden. Similarly, the performance reporting to investors, the management of the company with diverse business segments convicted did earnings management with direction to increase profits.

Pre-tax cash flow from operation described the level of company's profitability was assumed that the higher the level of company's profitability, then the motivation to reduce profits in the financial statements in order to the cost of tax decreased was bigger. Based on the result of linear regression, it was obtained result that Pre-tax cash flow from operation had influence and significant on earnings management and tax management. This result was in accordance with Hypothesis 4 that Pre-tax cash flow from operation had a positive effect on earnings management and tax management. This result was consistent with previous research that was conducted by Indraswari (2010) where the greater level of company's profitability it would be getting worse management of company's taxes. Tax management level would worsen due to the increase of the company's effective tax rate. The result of this study was in accordance with research conducted by Richardson and Lanis (2007) which stated that profitability would be a positive influence on the company's effective tax rate.

Company size was a value that indicated large or small of a company that could be seen from the total assets owned by the company. Based on the result of linear regression, it was obtained a result that company size had a negative and significant effect on earnings management and tax management. This result was in accordance with Hypothesis 5 that company size negatively influenced earnings management and tax

management. This result was consistent with research conducted by Septiani (2011) which stated that company size had effect on earnings management and tax management. The regression results indicated that large companies do earnings management and tax management was greater than the smaller companies it was suspected because large companies usually had their own tax department to be able to reduce its taxable income in order to streamline its tax burden. Company size was a value that indicated large or small of the company that was measured from the natural logarithm of total assets of the company.

Research conducted by Halim, et al (2005) stated that company size had positive effect on earnings management so that the research was in contrast to research conducted by Halim, et al. But the results of this study conducted by research of Nuryaman (2008) and (Guenther, 1994) Restuwulan (2009) which stated that company size negatively affected earnings management.

CONCLUSIONS

Based on the results of data testing, it is found that reduction in corporate income tax rates in 2008 and 2009 is not empirically proven to be an incentive for companies to conduct earnings management and tax management. Factor of tax management that proved empirically affects ABTD is foreign operation. While the facility of corporate income tax rate reduction as big as 5% which is caused its shares owned by the public has not been proven empirically affects earnings management and tax management (ABTD). Factors of earnings management namely pre tax cash flow from assets and firm size proved empirically influence earnings management and tax management (ABTD). The factors that influence the practices of earnings management and tax management in this study is an adaptation of research conducted by Septiani and Martani, 2013 in which the measurement of the variables of Year of Tax Rate Reduction (YEAR) and Tax Facility (FAC) in this study uses dummy variables. Further research can use other measurements.

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