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# THE EFFECT OF TAX AVOIDANCE ON COMPANY VALUE WITH PROFIT QUALITY AS AN INTERVENING VARIABLE

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## ABSTRACT

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***This study aims to examine the relationship of tax avoidance to firm value with earnings quality as an intervening variable in companies engaged in manufacturing in Indonesia. The sample in this study are manufacturing companies listed on the Indonesia Stock Exchange in 2017 - 2022. This type of research is quantitative research. The research sample used as many as 134 manufacturing companies listed on the Indonesia Stock Exchange in 2017 - 2022. The data used are financial reports and annual reports issued by the company each year. The sampling technique uses purposive sampling method. The results of this study indicate that tax avoidance has no effect on earnings quality, earnings quality has a positive effect on firm value and tax avoidance has a negative effect on firm value. In addition, this study also shows that earnings quality cannot be an intervening variable in the relationship of tax avoidance and firm value.***

**KEYWORDS:** ***tax avoidance, firm value, and earnings quality.***

## INTRODUCTION

Tax is the largest source of state revenue in Indonesia, so the government is always trying to increase state revenue through the taxation sector by updating existing tax regulations to increase the level of compliance of individual taxpayers and corporate taxpayers in paying their tax obligations. Companies as corporate taxpayers have different interests with the government as tax collectors. For companies, a large number of tax obligations will reduce the net profit obtained, so the company wants to pay as little tax liability as possible to get a high net profit. Therefore. The company does one of the strategies to reduce its tax liability. One such strategy is by way of tax avoidance.

Zain (2007) states that tax avoidance is usually carried out by reducing the company's tax obligations which are still within the limits of tax laws and regulations and do not violate the provisions of applicable tax laws. Then according to research conducted by Harventy (2016) tax avoidance by companies can increase firm value because the profits the company gets will be even greater, but according to Chen et al. (2013) tax avoidance hurts firm value. This is because the act of tax avoidance results in the profit presented not being the actual profit so that it can lower the quality of earnings and can lead to errors in decision-making for users of the company's financial statements and this will lower the company's value.

According to Sutopo (2009), the quality of company earnings is profit that correctly and accurately describes the company's operational profitability. The company's profit is considered good if the profit in the financial statements reflects the company's actual performance. If the profit presented in the financial statements cannot reflect the company's actual performance, it will make investors make the wrong decision in investing their capital and this can make investors undervalue the company. In other words, the existence of tax avoidance actions aimed at reducing company tax obligations by reducing company profits will make the quality of the resulting profits low and low quality earnings will reduce the value of the company in the eyes of investors because investors feel cheated by the profits presented by company.

Based on the description above, this study aims to see whether the practice of tax avoidance has a negative effect on earnings quality and firm value, whether earnings quality can have a positive effect on firm value, and whether earnings quality can be an intervening variable in the relationship between tax avoidance and firm value. The companies studied in this study are companies in the manufacturing sector that are listed on the Indonesia Stock Exchange (IDX) in 2017 - 2022.

## LITERATURE REVIEW

### Positive Accounting Theory

Positive accounting theory is based on the assumption that the company given freedom in determining policies to maximize the value of the company and this makes management have freedomto choose the accounting method to be used in management will tend to take opportunistic actions to maximize their personal gain first (Chariri & Ghozali, 2007). Opportunistic actions taken by management will result the company's earnings quality is low and the earnings quality is low make users of financial statements make internal mistakes decision making (Paul, 2012).

### Tax Definition

According to Article 1 paragraph 1 of Law No. 28 of 2007 concerning General Provisions and Procedures for Taxation states that taxes are mandatory contributions to the state owed by individuals or entities that are coercive based on the law by not getting compensation directly and used for the needs of the state for the greatest prosperity of the people. Waluyo (2013) explains that the tax rate is a certain percentage that has been determined in laws and regulations in determining the amount of tax payable to be imposed on individual taxpayers or corporate taxpayers.

### Tax evasion

Companies as corporate taxpayers always want the lowest possible payment of tax obligations, this makes companies take tax avoidance actions to get tax obligations that are smaller than the amount they should be (Zain, 2007). According to Harventy (2016), tax avoidance is an effort to avoid tax imposition through transactions that are not tax objects.

### Profit Quality

The company's profit is considered to have high quality if it can provide information about company performance that is relevant to certain decision making (Dechow, 2010). No profit show actual information about the company's performance can mislead users of financial statements in making various important decision. According to Dechow (2010), high and low earnings quality can be measured using earnings management proxies. If in the presentation earnings there are high earnings management practices, it can be ascertained that the quality of the company's earnings will be low because of low profits presented does not show the actual facts about the condition company.

### The value of the company

Firm value is a condition that has been achieved by a company, company as public trust in the company after the company has gone through a process of activities for several years since the company was founded (Noerirawan, 2012). For companies that sell their shares to the public (go public), the price of shares traded on the Stock Exchange is an indicator of company value so that if the company's stock price is high, the company's value is also high and if the company's stock price decreases, the company's value will also decrease (Fuad & Christin, 2006). According to Harventy (2016), increasing corporate value is the main goal of the company because high corporate value can provide prosperity for shareholders.

## HYPOTHESIS

### H1: Tax avoidance has a negative effect on earnings quality company

According to Hoque et al. (2011), the act of tax avoidance is usually carried out by management by using existing loopholes to minimize company profits so that tax obligations are low, and this can make the quality of profits generated by the company low because they are considered unable to be used for decision making that the company will make. In a study by Frank et al. (2008) explained that companies that carry out tax reporting aggressiveness by means of tax avoidance tend to be aggressive in carrying out earnings management practices. So it can be concluded that the high level of tax avoidance in the company will make earnings management practices high so that the quality of the profits generated by the company is low. Larastomo et al. (2016) stated that tax avoidance has a positive effect on earnings management, or in other words tax avoidance has a negative effect on earnings quality because the greater the earnings management practice, the lower the earnings quality in a company.

### H2: The quality of company earnings has a positive effect on value company.

According to Meindarto & Lukiastuti (2016), the quality of company earnings is High earnings can make the company's value high because high earnings

quality means that the profits presented are actual company information, so that investors do not make mistakes in making decisions and this can make investors rate the company high, while low company earnings quality will make investors make mistakes in making decisions because the information presented is not actual information so that the value of the company will be reduced in the eyes of investors.
Investors consider financial reports to have information that it is important to analyze the company's stock so that if the profit in the financial statements does not show actual information, it can make investors make mistakes in making a decision (Susanti, 2010). In the study of Siallagan & Machfoedz (2006) it is proven that earnings quality has a positive influence on firm value, or in other words the higher the quality of company earnings, the greater the firm value because high earnings quality can show actual company information.

**H3: Tax avoidance has a negative effect on firm value.**
Tax avoidance by companies aims to reduce the company's tax obligations that must be paid by reducing company profits, and these activities will have a negative impact on company value in the eyes of investors (Anggoro & Septiani, 2015). According to Wang (2010), company officials usually do not always want tax avoidance in the company because tax avoidance is considered to provide incorrect information to investors, thus allowing investors to withdraw all funds invested in company shares, and it can make the value of the company to be low. Tax avoidance actions can also pose major risks that companies will face, such as detection and imposition of fines that will be carried out by the tax authorities for tax evasion by companies, and this will result in a decrease in company value (Anggoro & Septiani, 2015). In a study by Jiang et al. (2010) found that tax avoidance can lead to loss of firm value. Then in the research conducted by Harventy (2016) it is proven that tax avoidance has a negative effect on firm value, which means that the higher the tax avoidance in a company, the lower the firm value.

## RESEARCH METHODS
### Population and Research Sample
The population in this study are all manufacturing companies registered on the Indonesia Stock Exchange (IDX) in the period 2017 – 2022. The sampling method used is a non-probability sampling technique, namely purposive sampling because the sample selection is based on certain criteria.

### Data collection technique
Documentation, namely the collection of available data on the object of research, in this case in the form of financial statement documents of manufacturing companies listed on the Indonesia Stock Exchange for the 2017 – 2022 period which are downloaded from the http://www.idx.co.id/ website and related company websites .

### Research Variable
### Firm Value
The dependent variable in this study is firm value. Mark The company will be measured using the Tobin's Q formula developed by James Tobin, using the formula as following:

$$Tobin's\ Q = \frac{\mathrm{MVE + D}}{\mathrm{BVE + D}}$$

- MVE = Market Value of Equity, namelymultiplying the share price at the end of the period by the number of shares outstanding at the end of the period.
- BVE = Book Value of Equity, is the difference between the company's total assets with total liabilities.
- D = Total debt of the company at the end of the period.

### Tax Evasion
The independent variable in this study is tax avoidance. Tax avoidance will be measured using ETR (Effective Tax Rates) by using the following formula:

$$ETR = \frac{Income\ Tax\ Expenses}{Pretax\ Accounting\ Income}$$

### Earnings Quality
The intervening variable in this study is earnings quality proxied by earnings management practices and will be measured using Jones' modified model, namely discretionary accruals with the following formula following:

$$\frac{\mathrm{TA_{it}}}{\mathrm{A_{it-1}}} = \beta_1\left(\frac{1}{\mathrm{A_{it-1}}}\right) + \beta_2\left(\frac{\Delta\mathrm{REV_{it}}}{\mathrm{A_{it-1}}}\right) + \beta_3\left(\frac{\mathrm{PPE_{it}}}{\mathrm{A_{it-1}}}\right) + \varepsilon$$

- TAit = Total company accruals in the year period t. Obtained by subtracting the company's net income by cash flow from operating activities in the period of year t.
- Ait-1 = Total assets of the company in the year period t-1.
- $\Delta REVit$ = Company revenue in the year period t is reduced by the company's revenue

in the period of year t-1.

- PPEit = Total Property, Plant, Equipments in the year period t

**Control Variable**
**ROA (Return On Assets)**
ROA is a ratio that describes the extent of assets The company has the ability to generate profits.

$$ROA = \frac{\text{Net Income}}{\text{Total Asset}}$$

**Leverage**
Leverage is the calculation ratio used for find out the value of assets funded by corporate debt.

$$Lev = \frac{\text{Total Liabilities}}{\text{Total Asset}}$$

**Size**
Company size is a benchmark that describes the size of a company

$$Size = LN \text{ (Total asset)}$$

**Hypothesis testing**
This study uses a path analysis model (path analysis) to find out how much direct influence the independent variables have on the dependent variable and the indirect effect between the independent variables on the dependent variable through the intervening variables and to test whether the intervening variables in the study can mediate between the independent variables. to the dependent variable. In the path analysis in this study the hypothesis will be tested with two equation models as follows:

$$\mathbf{DACC = \beta_1\, ETR + \beta_2\, ROA + \beta_3\, Lev + \beta_4\, Size + \varepsilon 1}$$

$$\mathbf{Tobin's\ Q = \beta_1\, DACC + \beta_2\, ETR + \beta_3\, ROA + \beta_4\, Lev + \beta_5\, Size + \varepsilon 2}$$

## DISCUSSION

**H1 : Tax avoidance has a negative effect on the company's profit quality**
Hypothesis 1 in this study states that tax avoidance has a negative effect on the company's profit quality. It can be seen that the tax avoidance variable proxied by ETR has a std value. coefficient of 0.0580034 with a probability value of 0.530. The probability value of 0.530 means that the tax avoidance variable has no significant effect on the earnings quality variable which is proxied by the value of discretionary accruals. Based on the results obtained by the researcher, hypothesis 1 in this study was rejected. In other words, the higher or lower the company's ETR value has no relationship to the high or low earnings management practices within the company, so it has no effect on the quality of earnings in the company's financial statements. This is because the sample companies in this study have different objectives in practicing earnings management and tax avoidance (Aditama & Purwaningsih, 2014). These results are consistent with research by Husain (2017) which states that tax avoidance has no significant effect on earnings management practices.

**H2 : The Quality of Company Profits Has a Positive Influence on Company Value**
Hypothesis 2 in this study states that earnings quality has a positive effect on firm value. It is known that the earnings quality variable which is proxied by the value of discretionary accruals has a std value. coefficient of -0.1516649 with a probability value of 0.020. The probability value of 0.020 means that the earnings quality variable has a significant effect on the value variables of 13 companies. std value. the coefficient which is negative indicates that hypothesis 2 in this study is accepted. This is because the lower the value of discretionary accruals, the lower the practice of earnings management so that the company's earnings quality will be higher. Therefore, if the value of discretionary accruals indicating earnings management practices has a negative effect on firm value, then the quality of firm earnings has a positive effect on firm value. This is because the higher the quality of company profits can show actual company information thereby minimizing errors for the users in making decisions and this will make the company value high because the company is considered to have presented correct and accurate information (Meindarto & Lukiastuti, 2016 ). These results are consistent with previous research conducted by Siallagan & Machfoedz (2006) which states that earnings quality has a positive effect on firm value.

**H3: Tax Avoidance Has a Negative Effect on Company Value**
Hypothesis 3 in this study states that tax avoidance has a negative effect on firm value. It can be seen that the tax avoidance variable proxied by ETR has a std value. coefficient of 0.1477821 with a probability value of 0.035. The probability value of 0.035 means that the tax avoidance variable has a significant effect on the firm value variable. std value. the coefficient which is positive indicates that hypothesis 3 in this study is accepted. This is because the lower the ETR value, the higher the tax avoidance actions taken by the company so that it will make the company's value lower. Therefore, if the ETR value has a positive effect on firm value, then tax avoidance has a negative effect on firm value. This is because the existence of tax avoidance in a company makes the company provide inaccurate information to investors so that it will affect investors' decisions in providing company value (Anggoro & Septiani, 2015). These results are

consistent with Harventy's research (2016) which states that tax avoidance has a negative effect on firm value.

**H4: Profit Quality as an Intervening Variable Between Tax Avoidance on Firm Value**

It can be seen that the indirect effect of the tax avoidance variable on the firm value variable through the earnings quality variable has a std value. coefficient of -0.0087971 which is obtained by multiplying the value of std. the coefficient between the tax avoidance variable on earnings quality is 0.0580034 and the earnings quality variable on firm value is -0.1516649. The results of the indirect effect between the tax avoidance variable on the firm value variable through the earnings quality variable have a probability value of 0.544. Thus the earnings quality variable cannot be an intervening variable in the relationship between the variable tax avoidance and firm value. The results of this study prove that the tax avoidance variable has a negative effect on the firm value variable directly so there is no need to go through the earnings quality variable. This is because the earnings quality variable cannot be an intervening variable in manufacturing companies listed on the Indonesia Stock Exchange (IDX) in 2017 – 2022.

## CONCLUSION

Based on the results of the data analysis that has been carried out in this study, it can be concluded that tax avoidance measures proxied using ETR have no effect on earnings quality proxied using discretionary accruals. This means that high or low tax avoidance in a company will not be followed by an increase or decrease in the quality of the profits generated in the company's financial statements. Earnings quality is proxied using discretionary accruals which indicates that earnings management practices have a negative effect on firm value. This shows that the lower the earnings management practices, the higher the quality of the company's earnings so that it will make the company's value even higher. Therefore it can be interpreted that the quality of company earnings has a positive effect on firm value. Then the act of tax avoidance which is proxied using the ETR value has a positive effect on firm value. This shows that the lower the ETR value, the higher the tax avoidance actions taken by the company so that it will make the company value even lower. Therefore it can be interpreted that tax avoidance has a negative effect on firm value. Earnings quality in this study, which is proxied using discretionary accruals, cannot be an intervening variable in the relationship between tax avoidance and firm value, this is because the probability value in the indirect effect between avoidance and firm value through earnings quality shows insignificant results. . The limitation in this research is that the research was only conducted on manufacturing companies. Based on the limitations of the research above, suggestions for further research are expected to use a longer research sample period and include other sectors so that it is not only the manufacturing sector.

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