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The Effects of Financial Distress, Capital Intensity, and Audit Quality on Tax Avoidance

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ABSTRACT : This study aims to examine the effect of financial distress, capital intensity, and audit quality on tax avoidance, which is proxied by using the cash-effective tax rate (CETR). The population in this study was 47 mining companies listed on the Indonesia Stock Exchange in 2015-2019. The samples used in the study were 8 companies, with 40 observation periods. The data analysis technique used is multiple linear regression. The results show financial distress had a negative effect on tax avoidance, the higher the financial distress experienced by the company, the lower the tendency to do tax avoidance; capital intensity has no effect on tax avoidance; and audit quality has no effect on tax avoidance.
Keywords: Financial Distress, Capital Intensity, Audit Quality, Tax Avoidance

I.   INTRODUCTION

Taxes are one of the largest sources of state revenue, so the government always tries to optimize its tax revenue. The government plans tax revenue in such a way as to match the desired target. However, the tax problem that occurs is that the amount of tax revenue each year does not reach the target set(Wahab et al., 2017). In 2016 there was a decrease in the percentage of tax revenue by 0.36 percent compared to 2015. However, there was an increase in the percentage of tax revenue from 2016 to 2018. In 2019, there was a decrease in tax revenue by 7.8 percent. The realization of tax revenue from 2015 to 2019 has not yet been able to reach the set target, even though there has been an increase in tax revenue. The failure to achieve the tax revenue target raises the question of whether taxpayers take actions that minimize their taxes or whether the tax collection has not been carried out optimally (Wiguna & Jati, 2017). Taxes are an important source of funds used to finance both routine expenditures and development expenditures. In contrast to the state, companies perceive taxes as a burden or expense that can reduce the company's net income(Alsaadi, 2020). Therefore, taxes can influence management to carry out various kinds of tax planning in minimizing the tax burden. One of the ways that companies can do this is by doing tax avoidance(Rani et al., 2018).

Hoque(2017)explains that tax avoidance is a way for management to minimize tax payments made legally by utilizing loopholes that exist in tax provisions. Tax avoidance practice can be said to be a complicated problem because on the one hand tax avoidance does not violate the law(Amidu et al., 2019), but on the other hand, the government does not want taxpayers to take tax avoidance(Bimo et al., 2019). Tax avoidance carried out by companies is of course because there are driving factors for taking these actions, one of which is the decline in the company's financial condition(Salehi et al., 2020). The condition of economic actors will not always be good considering that the world economy always experiences ups and downs. When a company is in an economic condition that causes financial difficulties and has the potential for bankruptcy (financial distress), the company will tend to take tax avoidance measures regardless of the risks the company will experience(Dhamara & Violita, 2017). Saputra et al. (2017) state that financial distress has a positive effect on tax avoidance. In contrast to Cita & Supadmi (2019)which states that financial distress has a negative effect on tax avoidance, while Nugroho & Firmansyah (2017)show that financial distress does not affect tax avoidance.

Capital intensity is a factor that is indicated to influence tax avoidance action. Capital intensity is a description of how a company invests in its fixed assets. Investment in fixed assets provides an opportunity for companies to minimize their tax burden(Sugeng. & Zaman, 2020). This occurs because of the depreciation expense of fixed assets which is a deduction in the tax calculation. The greater the depreciation expense, the smaller the tax burden that must be paid by the company. Companies with a large capital intensity level will show a low effective tax rate, thus indicating tax avoidance actions taken by the company. This is supported by research conducted by Andhari & Sukartha (2017) and Dwiyanti & Jati (2019)showing that capital intensity has a positive effect on tax avoidance. Apsari & Supadmi (2018)found that intensity capital did not affect tax avoidance.

Audit quality is the next factor that is indicated to have an effect on tax avoidance in this study. This is based on the fact that tax avoidance is related to financial statements issued by companies because there is information about corporate taxation. Audit quality is a measure of how the auditor's performance in auditing the company's financial statements by the public accountant's code of ethics and Public Accountant Professional Standards. Companies that have good audit quality will not take any manipulative action to avoid taxes. Lestari & Nedya (2019)show that audit quality has a negative effect on tax avoidance. Unlike Vidiyanti & Shonhadji 92017), audit quality does not affect tax avoidance.

One of the sectors suspected of having the potential for tax avoidance phenomenon is the mining sector. Indonesia is one of the countries with the largest mining producer in the world. In gold mining, Indonesia ranks seventh as the largest gold producer in the world. In addition, Indonesia also ranks fifth as the largest coal producer in the world and is the largest palm oil-producing country. The existence of enormous potential makes the mining sector one of the main foreign exchange earning sectors and has an important role in achieving the development market. However, tax compliance in the mining sector in this sector is still low. This can be seen from the statement of the Minister of Finance of Indonesia, Sri Mulyani Indrawati, who stated that the low tax revenue in the mining sector was due to the low level of taxpayer compliance. Tax amnesty or tax amnesty was given in the first period also does not increase taxpayer compliance. This program was only attended by 967 taxpayers out of a total of 6,001 mineral and coal taxpayers, 68 taxpayers out of a total of 1,114 oil and gas mining taxpayers. The low level of tax compliance indicates tax avoidance measures in the mining sector (Devi & Dewi, 2019)

In 2016, the Indonesian Corruption Eradication Commission also found data that the amount of data on state receivables to the mining sector was IDR 2.5 trillion consisting of taxes, royalties, and reclamation guarantees. In 2019, 56 mining sector companies in North Bengkulu committed tax evasion during 2016-2017 amounting to IDR 1.3 billion per year. These cases are a fraction of the number of tax avoidance cases committed by companies in the mining sector to reduce their tax burdens. This also shows the difference in interests between the government and taxpayers. A government that always tries to maximize its tax revenue, and taxpayers who try to pay a minimum tax burden.
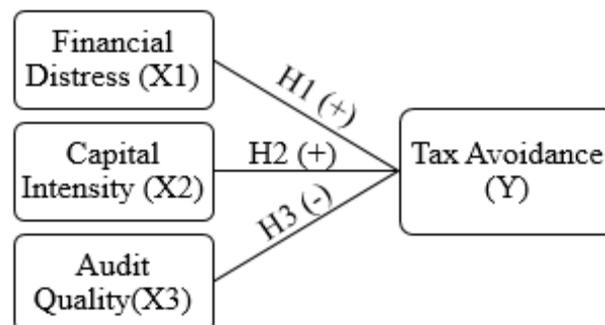

Fig. 1 Conceptual framework

Based on this description, the formulation of the hypothesis used are as follows.
H1: Financial distress has a positive effect on tax avoidance.
H2: Capital intensity has a positive effect on tax avoidance.
H3: Audit quality has a negative effect on tax avoidance.

II.   RESEARCH METHODS
This research is associative quantitative research. Associative research is research conducted to find the influence or relationship between two or more variables. This research examines the relationship between financial distress, capital intensity, and audit quality on tax avoidance. The data collection method used is the non-participant observation method. The population used in this study were all companies that entered the mining sector in 2015-2019, totaling 47 companies. The sample of observations in this research was taken using a purposive sampling method with the following criteria: The company has published the company's financial reports and annual reports for the period 2015-2019; did not experience a loss during 2015-2019 period. This is to prevent a distorted effective tax rate because companies that experience losses do not have the obligation to pay taxes; and Companies with a Cash Effective Tax Rate (CETR) of less than 1, to prevent problems in model estimation. Companies with a CETR value of more than 1 do not reflect tax avoidance because the payment of income tax is greater than the company's profit before tax (Swandewi & Noviari, 2020)

Tax Avoidance

The tax avoidance measurement estimation model used is the Cash Effective Tax Rate (CETR) model. CETR is the ratio of tax payments in cash to profit before corporate income tax. Payment of tax in cash is contained in the cash flow statement for the following year in the income tax payment post in cash flow for operating activities, while profit before income tax is contained in the income statement for the current year. CETR measures directly the cash outflow used for taxation divided by profit before tax (Park, 2018). The CETR proxy is used because this proxy does not affect changes in estimates such as provision for valuation or tax protection (Swandewi & Noviari, 2020). The higher the CETR value, the lower the tax avoidance by the company. The calculations are described as follows.

Cash Effective Tax Rate = (Tax Payment in cash) / (Profit Before Tax)

Financial Distress

Financial distress is indicated as a condition in which a company experiences a decline in its financial condition before liquidation or bankruptcy. In this study, financial distress is measured using the Altman Z-Score formula, which is described as follows.

$Z = 1.2A + 1.4B + 3.3C + 0.6D + 1E$
A = Working capital / Total assets
B = Retained earnings / Total assets
C = Earning before interest and taxes / Total assets
D = Market value of equity to book value / Total debt
E = Sales / Total assets
Z = Overall index

The potential for bankruptcy will be reflected in the Z value on the Altman Z-Score. The company is said to be in a safe zone (not experiencing distress) if the Z value is ≥ 2.99. The company is in a gray zone if the Z value is between $1.81 \leq Z < 2.99$. If the Z value < 1.81, then the company is said to be in a distress zone

Capital Intensity Ratio

The capital intensity ratio shows the amount of capital investment activity of a company in the form of fixed assets. The company will invest in fixed assets to get a tax reduction due to depreciation expenses. This study measures the company's capital intensity ratio with the following formula.
CI = (Total Fixed Assets) / (Total Assets)

Audit quality

Audit quality is defined as the auditor's performance in auditing the company's financial statements by applicable standards based on The Big Four (Price Waterhouse Cooper (PWC), Deloitte Touche Tohmatsu, Ernst & Young, and Klynveld Peat Marwick Goerdeler (KPMG)). Measurement of audit quality uses dummy variables. Number 0 for companies using non-Big Four, and number 1 for companies using Big Four.

III. RESULTS AND DISCUSSION

Multiple linear regression analysis (multiple regression) was conducted to examine the effect of independent variables, namely financial distress (X1), capital intensity (X2), and audit quality (X3) on the dependent variable, namely tax avoidance (Y). The results of multiple linear regression analysis using SPSS 24 can be seen in Table 1

Table 1. Results of Multiple Linear Regression Analysis

		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
	(Constant)	0.580	0.112		5.171	0.000
	Financial Distress	-0.025	0.010	-0.385	-2.597	0.014
	Capital Intensity	-0.113	0.262	-0.078	-0.432	0.668
	Audit quality	-0.087	0.058	-0.273	-1.504	0.141
	Adjusted R Square	: 0.155				
	F : 3.391		Sig. : 0.028			

The Adjusted R Square value is 0.155. This means that 15.5 percent of tax avoidance variance can be explained by financial distress (X1), capital intensity (X2), and audit quality (X3) variables, while the remaining 84.5 percent is explained by other variables not used in Research Model. The calculated F value of 3.391 with a

significance value of F of 0.028. The significance value of F is smaller than α = 0.05, so it can be concluded that the regression model is feasible to use. This result means that the variables financial distress (X1), capital intensity (X2), and audit quality (X3) simultaneously have a significant effect on tax avoidance.

Effect of financial distress (X1) on tax avoidance (Y)

The first hypothesis states that financial distress has a positive effect on tax avoidance. The results of the analysis in Table 1 show that the regression coefficient β1 is -0.025 with a significance value of 0.014 which is smaller than α = 0.05, which means that the Z-Score influences CETR. The regression coefficient β1 of -0.025 indicates that the Z-Score has a negative relationship with CETR. If the company's Z-Score value is higher, the lower the company's CETR value, on the other hand, if the company's Z-Score value is getting lower, the higher the company's CETR value. Z-Score is a proxy used to determine the level of corporate financial distress and CETR is a proxy used to determine the level of corporate tax avoidance. The higher the Z-Score value, the company is said to be free from financial distress. The lower the CETR value will reflect the high level of corporate tax avoidance and vice versa. The test results show that financial distress has a negative effect on tax avoidance, so the **first hypothesis is rejected.**

Hartoto (2018) states that financial distress has a negative effect on tax avoidance. These results confirm the agency theory which explains that the principal assigns the responsibility to manage the company to the management so that the management is obliged to account for it to the principal. Companies that experience financial distress problems are considered too risky to take tax avoidance. This is because the company will be increasingly difficult in its corporate funding activities. This research also confirms the theory of planned behavior which states that individual behavior to respond to something is influenced by the intention that can arise because of the belief about the outcome of the behavior. In this case, the management when the company experiences financial distress believes that tax avoidance will worsen the company's image. Cita and Supadmi (2019) state that companies that take tax avoidance when experiencing financial distress will increase the risk of deteriorating the company's image and give negative signals to investors due to tax avoidance actions that can increase the company's cost of debt

Effect of capital intensity (X2) on tax avoidance (Y)

The second hypothesis states that capital intensity has a positive effect on tax avoidance. The results of the analysis in Table 1 show that the intensity capital variable has a regression coefficient of β2 of -0.113 with a significance value of 0.668 which is greater than α = 0.05. This means that capital intensity does not affect CETR as a proxy for tax avoidance. The test results show that capital intensity has no effect on tax avoidance, so the **second hypothesis is rejected**. Apsari & Supadmi (2018)state that capital intensity does not affect tax avoidance. In contrast to the research conducted, high investment in fixed assets carried out by a company is aimed at its operational interests, so that it will not affect the company's tendency to take tax avoidance measures. High fixed assets of the company will increase the company's operational activities and lead to an increase in net profit compared to an increase in depreciation costs. The high level of fixed assets owned by the company is intended for operational purposes and not for tax evasion. The executive as the policymaker will avoid tax avoidance so that the company's image does not become bad. Companies that use fixed assets for operational purposes and do not take tax avoidance will result in an increased corporate image so that public trust increases and the company benefits.

Effect of audit quality (X3) on tax avoidance (Y)

The third hypothesis states that audit quality has a negative effect on tax avoidance. The results of the analysis in Table 1 show that the audit quality variable has a regression coefficient β3 of -0.087 with a significance value of 0.141 which is greater than α = 0.05. This means that audit quality does not affect CETR. The test results show that audit quality does not affect tax avoidance, so the **third hypothesis is rejected**. Vidiyanti & Shonhadji (2017) state that audit quality does not affect tax avoidance. There are no significant differences in the audits conducted by the big four and non-big four public accounting firms. Every Public Accounting Firm in auditing financial statements is guided by the audit quality control standards that have been established by the Professional Standards Board for Public Accountants of the Indonesian Institute of Certified Public Accountants and the code of ethics for the public accounting profession established by the Indonesian Institute of Certified Public Accountants.

IV.   CONCLUSION

Financial distress has a negative effect on tax avoidance. This result can be interpreted that the higher the financial distress experienced by the company, the lower the tendency to do tax avoidance. Capital intensity does not affect tax avoidance. This result can be interpreted that the investment in fixed assets by the company does not influence the company's tendency to do tax avoidance. Audit quality does not affect tax avoidance. This means that audits conducted by the big four and non-big four public accounting firms do not affect the

tendency of companies to practice tax avoidance. Companies are advised to increase supervision of actions or policies carried out by company management so that they are by applicable taxation provisions and are not classified as tax evasion. The government is advised to supervise companies that do not experience financial distress because the results of this study indicate that companies that do not experience financial distress or the lower the problem of financial distress, the higher the tax avoidance

The results of the coefficient of determination in this study show a low adjusted R Square value of 15.5 percent, which means that the ability of the independent variables used in explaining the dependent variable is limited, so it is hoped that further research will use independent variables that are thought to have an effect on tax avoidance such as corporate social. responsibility, corporate governance, earnings management, and accounting conservatism. Further research is also suggested to use other tax avoidance measurement proxies besides Cash Effective Tax Rates such as Effective Tax Rate, Book Tax Differences, and Current Effective Tax Rate.

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