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The Effect of Income Smoothing and Dividend Policy on Tax Avoidance in Indonesia

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Abstract

This study aims to examine the effect of earnings smoothing and dividend policy on tax avoidance practices in manufacturing companies listed on the IDX for the 2016-2020 period. This study takes population and samples from financial reports and annual reports of manufacturing companies that contain financial transactions in companies listed on the Indonesia Stock Exchange for the 2016-2020 period. The results of this study indicate that earnings smoothing has a significant effect on tax avoidance in manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the 2016-2020 period. Then, dividend policy has a significant effect on tax avoidance found in manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the 2016-2020 period. Furthermore, profit smoothing and dividend policy together have a significant effect on tax avoidance practices.

Keywords: Income Smoothing, Dividend Policy, Tax Avoidance.

INTRODUCTION

In its development, the government of the Republic of Indonesia requires large funds in carrying out domestic development and improving the national economy. One of the largest sources of state revenue is through the tax sector, so the government makes regulations governing taxation in Indonesia to maximize the potential of taxes that can be received by the state. Taxes are "forcing", where every person or entity as a taxpayer who has a tax burden or debt is obliged to pay off the tax burden or debt and can be subject to sanctions or fines if they do not fulfill their tax obligations, and the person or entity paying the tax also does not benefit directly from the tax they pay. There are two tax functions, namely the budgetair function (source of state finances) and the regularend function (regulator). Taxes have a budgetair function, meaning that taxes are one source of government revenue to finance expenditures, both routine and development while taxes have a regularend function, meaning that taxes are a tool to regulate or implement government policies in the social and economic fields and achieve certain goals outside the financial field.

The tax sector is the largest source of state revenue. Currently, around 80% of the state budget funds come from tax revenues. This is proof that tax revenue has become the backbone of reliable state revenue. Because the role of taxes is very large for the country, the government seeks to increase revenue from the tax sector. Efforts to optimize tax revenue have experienced obstacles, one of which is the existence of tax avoidance activities or so-called tax avoidance (Swingly & Sukartha, 2015) carried out by personal and corporate taxpayers. Unlike the government, on the other hand, the company tries to keep the amount of tax paid to a minimum. The company aims to maximize its profits to increase company value and shareholder wealth. For companies, taxes are a burden that will reduce net income so that companies always want to pay as little tax as possible (Astuti & Aryani, 2017). To obtain the expected profit, one of the company's efforts is to make efforts to reduce the amount of tax paid or become its burden, thus encouraging companies to carry out tax management.

Tax management according to (Pohan, 2018), Tax management is a comprehensive effort made by individual taxpayers or business entities through the process of planning, implementing (implementation), and controlling their tax obligations and rights so that matters relating to taxation from individuals, companies, or organizations can be managed properly, efficiently, and effectively so as to make the maximum contribution to the company in terms of increasing profits or income. The increase in the amount of debt will cause the interest expense that must be paid by the company. The interest expense incurred on the debt will be a deduction from the company's net profit which will reduce tax payments so as to achieve maximum profit. Interest expense that only comes from third party loans or creditors that can be used as a deduction for taxable income that has no relationship with the company as stipulated in Law No. 36 of 2008 article 6 paragraph 1a and article 18 paragraph 3 (Darmawan & Sukartha, 2014: 12). The need for debt is very important for companies to carry out operational activities. Without debt, the company will find it very difficult to achieve its goal, which is to get a large profit. Every debt has a cost, where the cost of each debt is called the cost of debt. The cost of debt is the real cost that the company must incur to obtain debt. Companies must be wise when using debt for operational activities.

The debt obtained by the company will be used as well as possible for operational activities, and if the internal funding sources from the company have run out, the company must find ways to get new sources of debt. Ways to get debt can be in various ways, such as from debt, preferred stock, common stock, retained earnings to fund all company operations. But this method must be supported by good management and teamwork from company stakeholders, namely by creating good corporate governance. There are many companies that do tax avoidance in Indonesia, based on tax data submitted by the Director General of Taxes in 2012 there were 4,000 companies that reported zero tax value, these companies are known to have experienced losses even up to 7 years in a row. The company is generally engaged in the manufacturing sector and raw material management (Directorate General of Taxes, 2017).

The phenomenon that occurs in several Indonesian companies in conducting tax evasion is PT Bentoel Internasional Investama Tbk. The Tax Justice Network on Wednesday, May 8, 2019 reported that the tobacco company owned by British American Tobacco (BAT) carried out tax avoidance practices in Indonesia through PT Bentoel Internasional Investama Tbk, which caused the state to suffer losses of US$14 million per year. Bentoel also made loans originating from Jersey through a company in the Netherlands to avoid withholding tax on interest payments. Indonesia applies a withholding tax of 20%, but due to an agreement with the Netherlands, the tax becomes 0%. From this strategy, Indonesia lost revenue for the country of US$ 11 million per year. The reason is that from a debt of US$ 164 million, Indonesia should be able to tax 20% or US$ 33 million or US$ 11 million per year. Although Indonesia-Dutch later revised the agreement to allow Indonesia to impose a 5% tax, the regulation only took effect in October 2017, which means that Bentoel has completed the debt interest payment transaction (kontan.co.id, 2019). Another manufacturing sector company suspected of tax evasion is PT RNI, a company affiliated with a Singapore company. According to the Directorate General of Taxes (DGT), PT RNI has committed tax evasion. PT RNI as a business entity has been registered as a limited liability company, but in terms of capital relies on affiliated debt, meaning that the Singapore owner provides loans to RNI in Indonesia in several areas such as Jakarta, Solo, Semarang and Surabaya, not investing but paying debts. In the 2014 financial report, PT RNI recorded debt of Rp. 20.4 billion while the company's turnover was only Rp. 2.178 billion, not to mention the losses retained in the annual report of Rp. 26.12 billion. From the report that the company is trying to reduce profits by increasing loans which later interest payments can reduce taxes (Kompas.com, 2016).

The risk of a company is used as a decision to make investments or loans to a company. Creditors expect the return that will be obtained later in accordance with the risks taken. Therefore, creditors also need to analyze the company that will be loaned capital. Creditors must know and consider the size of the risk regarding market conditions that will be taken. The Norton Rose survey entitled Indonesia Inward Investment: An Industry Survey in (Agustami & Cahyani Yunanda, 2014) stated that 57% of respondents from industry players around the world stated that Indonesia is one of the high-risk investment destinations. The factor of weak law enforcement, rampant corruption cases to limited infrastructure is the reason why Indonesia is one of the countries with High Risk Level. In addition, the Jetro Survey also revealed the results of a survey stating that Indonesia is included in a country with a high level of risk compared to other countries. Risks in terms of infrastructure, labor costs, laws in Indonesia that are still very weak, and political risks are the reasons why Indonesia is included in the High Risk Level The percentage of risk is calculated to be high if it exceeds 20%. Indonesia reaches 36% high risk in its infrastructure, 27.2% risk in the legal system and Indonesian laws are still very weak. Not to mention the problem of labor costs which reached 21%, third after China and Thailand. Compared to Malaysia, Indonesia has a much higher risk level. Things like this make Indonesia classified as a High Risk Jurisdiction.

According to financial accounting standards, earnings management is a deliberate process carried out by management to direct the reporting of reported earnings in accordance with investor expectations, but sometimes not in accordance with the facts (Lewar & Fadjarenie, 2022). The theoretical basis and empirical evidence suggest that companies seek to reduce tax expenditures and defer their income taxes. Companies that are larger in size are expected to have a greater tendency to perform earnings smoothing (Suwito & Herawaty, 2005). Based on the political cost hypothesis in positive accounting theory, it is argued that large companies tend to manage earnings, including income decreasing when earning high profits to avoid the emergence of new government regulations, for example increasing corporate income tax. When viewed from profitability, companies that have high profitability (seen from high ROA and Net Profit Margin) will be more free to manage profits, including income decreasing when obtaining high profits to avoid the emergence of new regulations from the government, for example increasing corporate income tax. When viewed from profitability, companies that have high profitability (seen from high ROA and Net Profit Margin) will be more free to do income smoothing because management knows the company's ability to earn profits in the future (Budiasih, 2009). As research conducted by (Sabilla, 2015) which suggests that income smoothing has a positive effect on tax avoidance. Meanwhile, Fadhlania (2019), Satria *et al*., (2021), Deded *et al*., (2021), Octavia & Sari (2022) show that earnings smoothing has no effect on tax avoidance.

In addition to the income smoothing policy, tax avoidance can be done through dividend policy. According to Minanari (2018) dividends are cash flows paid to shareholders, the ratio of cash dividend payments to shareholders is shown through the dividend payout ratio (DPR). The definition of dividend policy according to (van Horne & Wachowicz Jr, 2012) is a policy that is a determination of the percentage of the company's profit to be paid in cash to investors. Payment of dividends will reduce the company's retained earnings so that it will affect the company's overall funding decisions. Dividend distribution is largely influenced by the behavior of investors who prefer high dividends which result in low retained earnings. Investors assume that dividends received today are more valuable than capital gains obtained later (Suyudi *et al*., 2020).

Dividend policy is a decision whether the profit earned by the company at the end of the year will be distributed to shareholders in the form of dividends or will be retained to increase capital for future investment financing (Harjito & Martono, 2012). According to (Ningsih & Indarti, 2012) in (Suroto, 2015), if the company chooses to distribute company profits as dividends, it will reduce retained earnings and further reduce the total source of internal funds (internal financing). Conversely, if the profit earned by the company is used as retained earnings, the company's internal fund formation ability will be greater. There are several previous studies that examined the relationship between earnings smoothing and dividend policy on tax avoidance, including Feryansyah *et al*., (2020), Suyudi *et al*., (2020) showed the results of research that dividend policy affects tax avoidance. Meanwhile, research conducted by Chandra & Trinawati (2019), Fadhlania (2019) shows the results of research that dividend policy has no effect on tax avoidance.

After describing the background above and previous research as well as previous cases, the researcher is interested because there are differences of opinion from previous researchers so that it examines the effect of profit smoothing and dividend policy on tax avoidance practices in manufacturing companies listed on the IDX for the 2016-2020 period.

Literature Review and Hypothesis Development

Agency Theory

According to (Jensen & Meckling, 1976), agency theory or agency theory shows the relationship between the party who gives authority (principal) and the party who is given authority (agent). Agency theory states that shareholders (principals) authorize business decision making to management (agents) who are trusted to fulfill the interests of shareholders. However, in practice, in this relationship there can be a conflict called agency conflict. Agency conflicts occur because management and shareholders want to maximize their respective prosperity (Syaidhatus Zuhriya, 2015).

Bird in the Hand Theory

Bird in the hand theory is one of the theories in dividend policy, this theory was developed by (Gordon & Lintner, 1956) and (Lintner, 1962). Gordon and Lintner state that investors prefer cash dividends rather than being promised a return on investment (capital gains) in the future, because receiving cash dividends is a form of certainty which means reducing risk.

Income Smoothing

Income smoothing is one part of earnings management to avoid fluctuations in company profits. Income smoothing includes the use of certain techniques to minimize or increase the amount of profit for a period equal to the amount of the previous period (Iskandar, 2016).

Dividend Policy

Dividend policy is a policy on dividend distribution by company management regarding the amount of dividends to be paid and the amount of retained earnings for future investment needs (Sutrisno in Iin, 2012). If the company prefers to distribute profits as a larger dividend, then retained earnings will be smaller, thereby reducing the company's internal source of funds.

Tax Avoidance

Tax avoidance can be broadly defined as any activity that reduces or delays tax liability. (Zeng, 2019) points out If tax avoidance represents a continuum of tax planning strategies where something like municipal bond investments are at one end (lower explicit taxes, completely legal), then terms like "non-compliance," "avoidance," "aggressiveness" and "sheltering" would be closer to the other end of the continuum. Tax planning activities or tax strategies can be anywhere along the continuum depending on how aggressive they are in reducing taxes.

Profit Smoothing on Tax Avoidance

The relationship between earnings smoothing and tax avoidance can be linked to agency theory which emphasizes that accounting numbers in financial statements play an important role in emphasizing conflicts between company owners and managers. Agents have more information about the company as a whole including the company's financial performance. When the company's profit increases and decreases drastically in consecutive periods, it causes the tax burden that must be paid by the company to fluctuate. This is a burden for managers in paying taxes, especially when company profits increase sharply, the tax burden will also increase. Therefore, managers do profit smoothing so that the company's profits look stable and the tax burden imposed is not too large. However, this causes information asymmetry and conflicts of interest that make agents present information that is not true to the principal. So the hypothesis in this study is as follows:

H1: Income Smoothing Has a Significant Effect on Tax Avoidance Practices

Dividend Policy on Tax Avoidance

According to Ningsih and Iin (2012) in (Suroto, 2015), if the company chooses to distribute company profits as dividends, it will reduce retained earnings and further reduce the total source of internal funds (internal financing). Conversely, if the profit earned by the company is used as retained earnings, the ability to form internal company funds will be greater. This dividend policy is a decision that must be considered properly by company managers, because low dividends make the share price also low, while little retained earnings cause the company to have little capital used for future investment.

Previously, there was no research that examined dividend policy on tax avoidance. There is research related to dividend policy but on firm value. The research was conducted by (Utami & Darmayanti, 2018), the results of this study are that dividend policy has a positive and significant effect on the value of food and beverage companies. Dividend policy determines how much profit shareholders will get. This will determine the welfare of shareholders which is the main goal of the company. This research states in accordance with the bird in the hand theory that the higher the dividends distributed by the company, the higher the value of a company. Firm value will be maximized by a high dividend payout ratio. (Suroto, 2015) also examines dividend policy on firm value which states that dividend policy has a positive and insignificant effect, where the results of this study contradict the bird in the hand theory. So the hypothesis in this study is as follows:

H2: Dividend Policy Has a Significant Effect on Tax Avoidance Practices

RESEARCH METHODOLOGY

This section describes the type of data collected, the data source, the data period, and the methodology used to test these relationships.

Data, Population and Sample

The population in this study are financial reports and annual reports of manufacturing companies that contain financial transactions in companies listed on the Indonesia Stock Exchange for the 2016-2020 period. The sample in this study was determined using purposive sampling, namely the selection of samples according to certain criteria. The criteria used are as follows:

a. Manufacturing companies listed on the Indonesia Stock Exchange (IDX) and always present financial reports during the observation period.
b. Manufacturing companies that report financials for the 2016-2020 period.
c. Companies that use the Rupiah (Rp) currency.
d. Companies that get profit.

Data Analysis

This study uses multiple linear regression analysis methods using the PLS version 3 computer program (software) and Microsoft Excel.

RESULTS AND DISCUSSION

Measurement Model Evaluation (Outer Model)
Descriptive Statistics Results

Table 1: Descriptive Statistics

No.	*Variabel*	*Missing*	*Mean*	*Median*	*Min*	*Max*	*Standard Deviation*	*Excess Kurtosis*	*Skewness*
1	X1 (income smoothing)	0.000	0.516	1.000	0.000	1.000	0.500	-2.022	-0.065
2	X2 (kebijakan deviden)	0.000	618.065	401.000	2.000	6.376.000	859.910	23.133	4.464
3	Y (penghindaran pajak)	0.000	352.006	247.000	0.000	5.726.000	569.258	62.061	7.408

Source: Organized data, 2023

Convergent Validity

The results of the analysis can be seen in Figure 1.

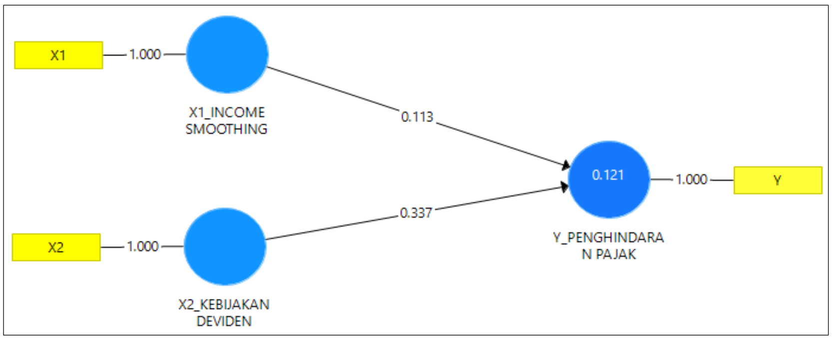

Figure 1: First Outer Loadings

Tabel 2: *Outer Loadings*

	Indicator	Outer Loading	Description
Income Smoothing (X_1)	X1	1.000	Valid
Dividend Policy (X_2)	X2	1.000	Valid
Tax Avoidance (Y)	XY	1.000	Valid

Source: Organized data, 2023

Based on the data presentation in the table above, it is known that each indicator of the research variable has an outer loading value> 0.5. Based on the validity test results, it can be concluded that all variable items consisting of Income Smoothing, Dividend Distribution and Tax Avoidance are valid.

Discriminant Validity

The following is the square root of average extracted (AVE) value of each research variable:

Tabel 3: AVE Reliability Test

Variable	AVE
Income Smoothing (X_1)	1.000
Dividend Policy (X_2)	1.000
Tax Avoidance (Y)	1.000

Source: Organized data, 2023

Based on the data presentation in the table above, it is known that the AVE value of the Income Smoothing, Dividend Distribution and Tax Avoidance variables> 0.5 has an AVE value above 0.5 so that it can be said that the Income Smoothing, Dividend Distribution and Tax Avoidance variables have high discriminant validity.

Composite Reliability

The following is the composite reliability value of each research variable:

Tabel 4: Composite Reliability

Variable	***Composite Realiability***
Income Smoothing (X_1)	1.000
Dividend Policy (X_2)	1.000
Tax Avoidance (Y)	1.000

Source: Organized data, 2023

Based on the data presentation in the table above, it can be seen that the composite reliability value of all research variables is> 0.7. It can be concluded that all variables have a high level of reliability.

Cronbach's Alpha

The reliability test with composite reliability above can be strengthened by using Cronbach's alpha value. The following is the Cronbach's alpha value of each variable:

Tabel 5: Cronbach's Alpha

Variabel	*Cronbachs Alpha*
Income Smoothing (X_1)	1.000
Dividend Policy (X_2)	1.000
Tax Avoidance (Y)	1.000

***Sumber**: Output SmartPLS*

Based on the data presentation in the table above, it can be seen that the Cronbach's alpha value of each research variable is> 0.7. Thus these results can show that each research variable has met the requirements for the Cronbach's alpha value, so it can be concluded that all variables have a high level of reliability.

Evaluation of Structural Model Testing (Inner Model)

Uji Path Coefficient

In this study, the results of the path coefficient test and hypothesis testing will be explained.

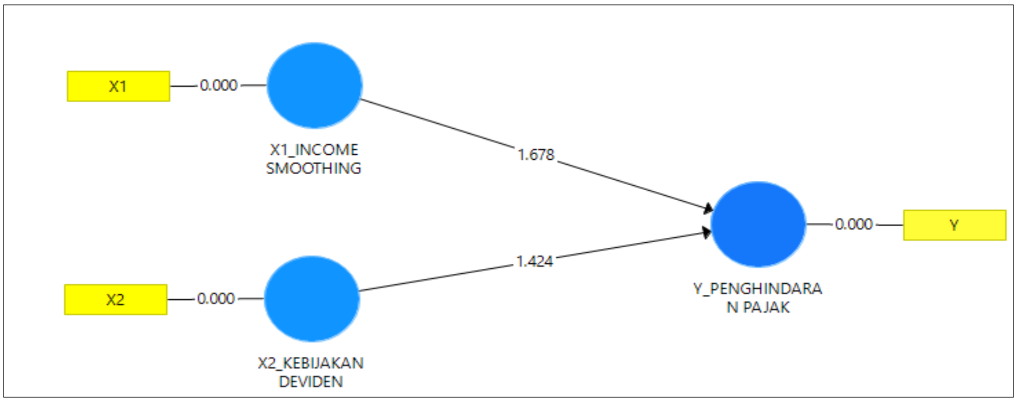

Figure 2: Bootstraping Output

Evaluation of Goodness of Fit of Structural Model (Inner Model)

Tabel 6*: Evaluation of Goodness of Fit of Structural model (Inner Model)*

Variable	R Square	R Square Adjust
Tax Avoidance (Y)	0.121	0.110

***Sumber**: Output SmartPLS*

Based on the data presentation in the table above, it can be seen that the R-Square value for the Tax Avoidance variable (Y) is 0.121 so that it is included in the very low category. The acquisition of this value explains that the percentage of the amount of Tax Avoidance (Y) can be explained by Income Smoothing and Dividend Distribution by 12.10%.

Hypothesis Testing

According to Hartono (2008) in (Abdillah. & Jogiyanto, 2009) explains that the size of the significance of hypothesis support can be used by comparing the T-table and T-statistic values. In this study for a confidence level of 95 percent (alpha 95 percent), the T-table value for a one-way hypothesis (one-tailed). To determine the T-table value, the calculation of df = n-variables (155 samples - X1, X2, Y), df = 152 with a significant level (a) = 5% so that the T-table value is 1.654. Provided that if t count> t table and significant value <0.05 (α: 5%), then the independent variable partially has a significant effect on the dependent variable. The results of the PLS bootstrapping process as in the table below are as follows:

Tabel 7: Results for Inner Weight

Hypotesis	Variable	Parameter Coefficient	T Statistics	P Value	Description
H1	Income Smoothing (X1) => Tax Avoidance (Y)	0.113	1.678	0.04	Significant *
H2	Dividend Policy (X2) => Smoothing (X1) => Tax Avoidance (Y)	0.337	1.424	0.07	Significant n**

***Sumber**: Output SmartPLS*

***Notes**: *Significant 5%. **Significant 10%*

In PLS, statistical testing of each hypothesized relationship is carried out using simulation. In this case, the bootstrap method is carried out on the sample. Bootstrap testing is also intended to minimize the problem of abnormalities in research data. The results of testing with bootstrapping from PLS analysis are as follows:

Hypothesis Testing 1: Income Smoothing (X1) has a Positive and Significant Effect on Tax Avoidance (Y)

The path parameter coefficient obtained from Income Smoothing (X1) on Tax Avoidance (Y) is 0.113 with a t-statistic value of 1.678> 1.654 at a significance level above 5% (significant), this means that Income Smoothing (X1) has a significant positive effect on Tax Avoidance (Y) so that the first hypothesis (H1) is accepted.

This also fulfills agency theory, where this theory states that there are information asymmetries and conflicts of interest that make managers as agents present information that is not true to the principal (company owner). Information asymmetry carried out by managers by smoothing profits so that the company's profits look stable so that the tax burden imposed is not too volatile, in fact companies that do profit smoothing have no effect on the small possibility of tax avoidance practices, because when the company does profit smoothing, the company will still be taxed at the profit earned by the company. Meanwhile, companies that do not do earnings smoothing are most likely because the company maintains the company's credibility. Not only that, but good income smoothing practices will be able to optimize company revenues and costs to achieve tax efficiency. This includes managing assets, debt, and expenses to suit lower tax purposes.

The results of this study are the same as the results of research obtained by (Andani, 2017) and (Framita, 2018) which state that high profits make it easier for management to manage their profits, so companies tend to practice profit smoothing when profitability levels are high. When the company does profit smoothing, it means that the company makes the tax paid not as it should be, so this indicates that the company also practices tax avoidance.

Hypothesis Testing 2: Dividend Distribution (X2) has a Positive and Significant Effect on Tax Avoidance (Y)

The path parameter coefficient obtained from Dividend Distribution (X2) on Tax Avoidance (Y) is 0.213 with a t-statistic value of 1.424> 1.287 at a significance level above 5% (significant) which states that there is no significant effect between Dividend Distribution (X2) but the results of statistical testing with a significance level at the 10% level state that there is a significant positive effect between Dividend Distribution (X2) on Tax Avoidance (Y), so that the second hypothesis (H2) is accepted.

This is in accordance with the bird in the hand theory, the company's profit distributed in the form of dividends makes the company's share price rise because investors view dividends as more certain than capital gains so that this increases the value of the company and indicates that the company is in a good economy, but on the other hand there is a burdensome thing, namely investors must pay high taxes because of the dividends distributed by the company. Then, it is a way for companies to transfer profits from the company's income statement to shareholders. This means that by the company reducing its reported income, it can reduce its tax liability.

Previously, there was no research that examined dividend policy on tax avoidance. There is research related to dividend policy but on firm value. The research was conducted by (Utami & Darmayanti, 2018), the results of this study are that dividend policy has a positive and significant effect on the value of food and beverage companies. Dividend policy determines how much profit shareholders will get. This will determine the welfare of shareholders which is the main goal of the company. This research states in accordance with the bird in the hand theory that the higher the dividends distributed by the company, the higher the value of a company. Firm value will be maximized by a high dividend payout ratio. (Suroto, 2015) also examines dividend policy on firm value which states that dividend policy has a positive and insignificant effect, where the results of this study contradict the bird in the hand theory.

Multiple Regression Analysis

Based on the path parameter coefficients obtained in the table above, the structural equation model formed is as follows:

Tax Avoidance* = 0.113*IncomeSmoothing***(X1) + 0.337*Dividend Policy(X2)**

The regression equation that has been prepared can be interpreted as follows:

1. The regression coefficient value for Income Smoothing has a value of 0.113, meaning that if the other independent variables are constant, then each one-unit increase in Tax Avoidance will be followed by an increase in Tax Avoidance by 0.113 units.
2. The regression coefficient value for Dividend Distribution competence has a value of 0.337, which means that if the other independent variables are constant, then each one-unit increase in Tax Avoidance will be followed by an increase in Tax Avoidance by 0.337 units.

CONCLUSIONS

Based on testing with SmartPLS 3.0, the conclusions of the results find evidence of the effect of income smoothing and dividend policy on tax avoidance in Indonesia (Case study on manufacturing companies listed on the IDX for the 2016-2020 period), namely profit smoothing has a significant positive effect of 0.113 or 11.30% on tax avoidance in manufacturing companies listed on the Indonesia Stock Exchange (BEI) for the 2016-2020 period. Then the dividend policy has a significant positive effect of 0.337 or 33.70% on tax avoidance found in manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the 2016-2020 period.

Furthermore, it is hoped that researchers can provide knowledge related to earnings smoothing and dividend policy on tax avoidance contained in manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the 2016-2020 period. Then it is hoped that students can use other hypotheses apart from the previously existing hypotheses. Furthermore, it is hoped that students can conduct further or more in-depth research in addition to variables such as in this study, namely earnings smoothing, dividend policy and tax avoidance practices because there is not much research related to the effect of earnings smoothing, dividend policy on tax avoidance practices..

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