Tax Avoidance Determinants of Earning Management

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Abstract

This research seeks to empirically explore the impact of Other Comprehensive Income, Financial Distress, Tax Avoidance, and Free Cash Flow on Earnings Management among Real Estate and Property firms listed on the Indonesia Stock Exchange during the period spanning 2019 to 2021. Employing a approach quantitative, the research utilizes multiple linear regression analysis conducted through SPSS 26 as the analytical tool. Through purposive sampling from a total population of 60 companies, 43 entities meeting the specified criteria were chosen as the sample. The findings reveal that while Other Comprehensive Income, Financial Distress, and Free Cash Flow do not exert a significant influence on earnings management, tax avoidance emerges as a notable factor impacting earnings management.

Keywords: *OCI, Financial Distress, Tax Avoidance, FCF, Earnings Management.*

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A. INTRODUCTION

Financial reporting serves as a vehicle utilized by both internal and external stakeholders to inform economic decision-making processes. Managers depend on financial statements as a key tool to demonstrate the efficiency of goal attainment while fulfilling their accountability responsibilities to the company. In the face of increasing business competition, many companies are making an effort to showcase their company's performance with good performance. To demonstrate the company's performance in generating profits, management tends to manage profits efficiently and opportunistically. The meaning of efficiently managed profits is that profits can be maximized to provide informative information, whereas profit as opportunistic is a measure of managing profits so that profit can increase as desired for the interests of the relevant parties (Widyaningsih, 2017).

Earning is accounting information used as a basis for decision-making. Earning management is an attempt by a manager to use the selection of accounting methods to show better financial performance than the company's economic performance. Profits management is different from fraud, which is an accounting fraud intentionally carried out to mislead users of financial reports (Siska et al., 2021).

Comprehensive Income from Other Sources, Economic Turmoil in Finances, Strategic Tax Planning and Unrestricted Cash Reserves are factors that have led to the development of earning management.

Several previous researches have demonstrated that earning management yields different results. Basyirun (2018), and Bima & Afri (2017) showed that OCI disclosure has a negative relationship with earning management, while Syuhada &

Nofrianty (2019) stated that the disclosures of OCI have no impact on earning management. Natalia & Triyanto (2018) stated that FCF does not influence earning management, whereas financial distress influences earning management. Further Anisah & Fitri (2017) gave FCF results influential on earning management, and Nurdiansyah (2015) stated financial distress has no impact on earning management. Lastly, Maysani & Suaryana (2019) stated that tax avoidance has a positive impact on earning management.

The phenomenon on real estate and property companies in 2020. The real estate and property subsector that experienced a decline in revenue at the start of the pandemic until the middle of 2020 is hospitality. Of the 219 hotels in Jabodetabek, 73 hotels are not operational due to the occupancy rates that occurred in the middle of this year at an average of 15% making it in the lowest position, while in some major cities in Indonesia such as in Bali the Occupancy Rates are ranging from 9% to 22% making it at the lowest figure. Apart from hospitality, some apartments tend to decline during the pandemic. Demand for apartments dropped by about 46% by the year 2020. Data from the Bank of Indonesia show that residential property sales in the third quarter of 2020 are still declining. Meanwhile, there is a recovery in the property sector after the third quarter of 2020. With the introduction of the new normal, housing sales have increased considerably, especially in some large companies that have adapted their sales so that they can have a positive impact on real estate and property companies to strengthen the recovery of the housing subsector by 2021 (Pakasi, 2020).

Interested in re-examining these variables because there is still inconsistency in the results of the research. Besides, due to the right timing, this research was conducted on real estate companies and property industries that experienced fluctuating financial performance during the pandemic period.

B. METHOD

The study employs a quantitative approach, focusing on secondary data extracted from annual reports. The study population comprises manufacturing companies listed on the Indonesian Stock Exchange from 2019 to 2021, totalling 60 companies. Through purposive sampling methods with companies that do not use rupee currency and incomplete data, 43 companies were selected as the sample for this research, resulting in a total dataset of (43 x3) 129 entries.

This study employs a descriptive quantitative analysis as the chosen method for data analysis that analyzes the data obtained using double-linear regression analysis. The tests carried out are statistical tests, normality tests, classical assumptions tests, double regression analyses and hypothesis tests. The analysis of data will be conducted through the utilization of a computer application program SPSS 26 Double Linear Regression Analysis.

Double Regression Analysis

The hypothesis in this study was examined through the application of a replicated regression model, employing the following regression model:

$$Y= \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

Description:

Y	: Earning management
a	: constant
β1 X1	: Comprehensive Income from Other Sources
β2 X2	: Economic Turmoil in Finances
β3 X3	: Strategic Tax Planning
β4X4	: Unrestricted Cash Reserves
ε	: standard error

Partial test (t Test)

According to Ghozali (2013:98), the partial regression test (t) serves to find out whether a partially independent the regression model variables significantly impact the dependent variable. The partial regression test (t) is observed in the "Coefficient" table with a significance level of 5%.

Coefficient of determination (R^2)

The coefficient of determination (R^2) fundamentally gauges the extent to which the model can account for variations in the independent variables. R^2 values range from zero (0) to one (1). A low R^2 value suggests that the independent variables have limited capacity to elucidate variations in the dependent variable. Conversely, a value close to one (1) indicates that the independent variables furnish nearly all the requisite information to forecast variations in the dependent variable (Ghozali, 2013:97).

C. RESULTS AND DISCUSSION

Employing purposive sampling techniques, 43 companies were chosen as samples, encompassing a three-year observation period, resulting in a total of 129 observation data points. However, out of 129 of the data is not distributed normally due to extreme data, and it is necessary to reduce data containing outliers for the data to meet normality assumptions. In this study, the authors extracted 57 data outliers, so only 72 data could be used for research. Table 2 displays the outcomes of the descriptive statistical tests.

Table 1. Results of the Descriptive Statistical Test.

	Mean	Std. Deviation	N
OCI	3319.4444	12550.54725	72
FD	445930.5556	330733.85438	72
TA	9638.8889	26036.43469	72
FCF	1001259251641541.0000	42516783787590568.00000	72
ML	58472.2222	28294.21492	72

Source: Data processed by SPSS vers 26, 2022

Normality Test Results

A test for normality is performed to determine if the distribution of residual values follows a normal pattern. The results of this normality test are illustrated in Table 2:

Table 2 Results of the Normality Test

The One-Sample Kolmogorov-Smirnov Test is applied		
		Unstandardized Residual
N		172
Normal Parameters[a,b]	Mean	0.000
	Std. Deviation	27856,00416
Greatest Discrepancies	Absolute	0,040
	Positive	0,040
	Negative	-0,035
Test Statistic		0,040
Asymp. Sig. (2-tailed)		0,200[c,d]

Referring to Table 2, the Asymp. Sig. (2-tailed) value of 0.20 surpasses the significance threshold of 0.05, suggesting normal distribution of the data. Hence, it can be deduced that the regression model fulfills the assumption of normality.

Classical Assumption Test Results

Heteroskedasticity test

To ascertain whether there is heteroskedasticity, indicating unequal residual variances across different studies in the regression model, a heteroskedasticity test is conducted. The outcomes of the heteroskedasticity test for the hypotheses in this study are presented in Figure 2.

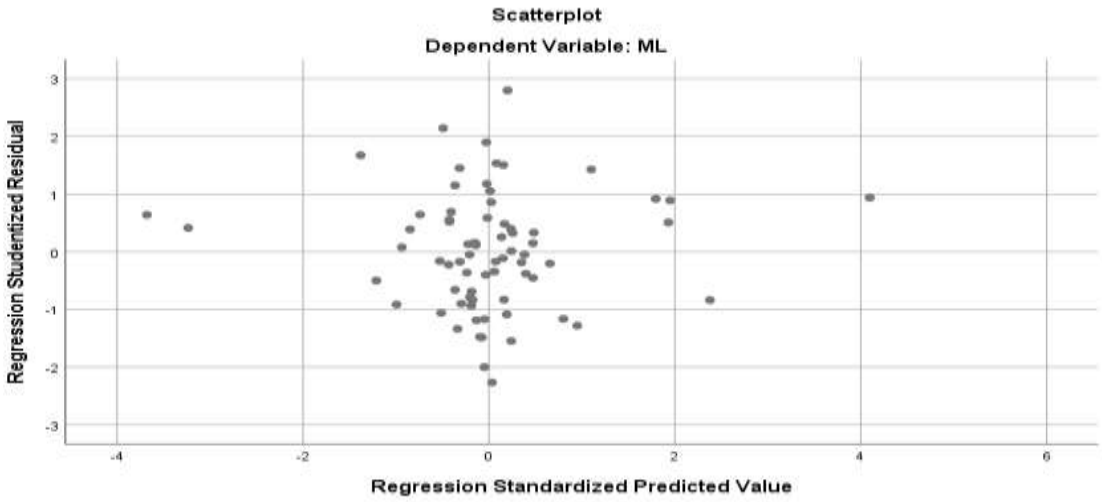

Figure 1. Results of the Heteroskedasticity Test

Analyzing the scatterplot illustrated in Figure 1, it can be deduced that there is no apparent discernible pattern, as the points seem to be randomly distributed, scattered both above and below zero on the Y-axis. Hence, there are no signs of heteroscedasticity in the regression model.

Multicollinearity Test

The multicollinearity test is performed to evaluate whether there is a correlation among independent variables, indicating the presence or absence of a multicollinearity issue.

Table 3. Results of the Multicollinearity Test

Coefficients

Model		Statistics on Collinearity		Information
		Tolerance	VIF	
1	(Constant)			
	OCI	.903	1.107	There's no multi-colonialism
	FD	.985	1.015	There's no multi-colonialism
	TA	.887	1.127	There's no multi-colonialism
	FCF	.966	1.035	There's no multi-colonialism

a. Variable Dependent: Y

The outcomes of the multicollinearity test presented in Table 3 indicate that the independent variables in this study exhibit Tolerance Values (VIF) ≥ 0.10 and VIF ≤ 10, meaning that the used independent variable has no correlation or relationship with each other. So, the results of this study are stated to have no symptoms of multicollinearity disorder.

Autocorrelation Test

In autocorrelation testing can be conducted using the Durbin-Watson method, which examines whether the model is free from errors or interference in period t with errors in period t-1. The outcomes of the autocorrelation test are presented in Table 4:

Table 4. Results of the Autocorrelation Test

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.175[a]	.031	-.027	28675.47302	1.981

a. Predictors: (Constant), OCI, FD, TA, FCF

b. Dependent Variable: ML

The outcomes of the autocorrelation test, as presented in Table 4, indicate that the calculated Durbin-Watson value (d) is 1.981. According to the results described above, the DW value in the regression model can be said to have no auto-correlation, because the value -2 < 1.981 < +2 and can be stated that the regressive model is worthy of use.

Results of Regression Analysis and Hypothesis Test

This study, employing multiple linear regression analysis, seeks to investigate the influence of Other Comprehensive Income, Financial Distress, Tax Avoidance, and Free Cash Flow on Earnings Management among Real Estate and Property firms listed on the Indonesian Stock Exchange between 2019 and 2021. The outcomes of this examination are elaborated in Table 5:

Table 5. Results of the Double Linear Regression Test

Coefficients						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-6.245	8.212		-.761	.476
	OCI	-.225	.179	-.433	-1.258	.255
	FD	.831	.518	.711	1.604	.160
	TA	.774	.275	1.083	2.813	.031
	FCF	.026	.023	.333	1.124	.304

a. Dependent Variable: ML

Referring to Table 5, the regression model can be examined in the following manner: $Y = -6{,}245 - 0{,}225\ X_1 + 0{,}831\ X_2 - 0{,}774\ X_3 + 0{,}026\ X_4 + \varepsilon$

Description:

Y : Earning management
a : constant
$\beta_1 X_1$: *Comprehensive Income from Other Sources*
$\beta_2 X_2$: *Economic Turmoil in Finances*
$\beta_3 X_3$: *Strategic Tax Planning*
$\beta_4 X4$: *Unrestricted Cash Reserves*
ε : standard *error*

Hypothesis Testing

Partial Regression Coefficient Test (t Test)

The outcomes of the hypothesis test for the partial regression coefficients aim to quantify the impact of the independent variables, namely Other Comprehensive Income from Other Sources, Economic Turmoil in Finances, Strategic Tax Planning and Unrestricted Cash Reserves, in relation to the dependent variable, earnings management. These results are presented in Table 6.

Determination Coefficient Test (R^2)

The value of the determination coefficient can inform related variation presentations of dependent variables that explain the result of the resulting regression equation.

Table 6. Results of the Determination Coefficient Test (R^2)

Model Summary					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.175[a]	.031	-.027	28675.47302	1.981

a. Predictors: (Constant), OCI, FD, TA, FCF
b. Dependent Variable: ML

The determination coefficient (R^2) test results, as shown in Table 6, indicate a value of 0.031, equivalent to 3.1%. This implies that the variations in earning management can be accounted for by the independent variables considered in this study: Comprehensive Income from Other Sources, Economic Turmoil in Finances,

Strategic Tax Planning, and Unrestricted Cash Reserves collectively account for 3.1% of the variation, the remaining 96.9% is ascribed to factors and variables outside the scope of this study.

First, the analysis of the first hypothesis, focusing on the influence of Other Comprehensive Income (OCI) on Earnings Management, is detailed in Table 6. The empirical results reveal that OCI does not have a substantial impact on earnings management, as indicated by the significance value of 0.255, surpassing the 0.05 threshold. Therefore, H1 is rejected, signifying that OCI does not exert an influence on earnings management. This outcome contrasts with Basyirun's (2018) study, which asserted a negative impact of OCI on earnings management. However, the results of the study are consistent with the result of Syuhada & Novrianti's (2019) study which showed that the OCI does not influence profits management. OCIs emerged from more transactions related to the valuation of fair value such as fixed asset revaluation (PSAK16), translation of financial statements (SAK10), actuarial modification of fixed-work amounts (PASAK24), fluctuations in the fair value of investments held for sale (SPAK55) as well as a change in the real value of security activities (SASAK55). (A. Halik:2015). During the Covid 19 pandemic, especially in 2020 and 2019, Indonesian economic growth was very weak. In 2019, the economic growth of 5.02% but since the pandemic appeared in Indonesia in 2020 has fallen to 2.97%. The assessment of fair value is strongly influenced by macroeconomic factors such as interest rates, inflation, stock price indices, and other relevant elements. As a result, it can be concluded that Other Comprehensive Income (OCI) does not exert a significant impact on earnings management.

Second, the examination of the second hypothesis, which investigates the influence of Financial Distress on Earnings Management, is explained in Table 6. The empirical findings indicate a lack of substantial impact of Financial Distress on earnings management, as indicated by the significance value of 0.160, which exceeds the 0.05 threshold. Consequently, H2 is rejected, implying that the discernible impact of Financial Distress on earnings management is absent, indicating that Financial Distress does not exert any influence on earnings management. The results of this investigation are congruent with the conclusions drawn by Nurdiansyah & Ferdianshah (2021), affirming the absence of a substantial impact of financial distress on earnings management. Conversely, these findings diverge from the outcomes of Nazalia and Dedik's study (2018) which stated financial distress influences earning management. At the time of the pandemic, almost all companies suffered from financial distress, a condition of financial difficulties that resulted in difficulty in paying their liabilities. The theory that says that companies in financial difficulty will do earning management and those who do not experience financial hardship will not do earning management during the epidemic time has become null and void, because all companies, especially property companies, experience financial distress.

Third, in examining the third hypothesis concerning The Influence of Tax Avoidance on Earnings Management, results depicted in Table 6 offer empirical evidence supporting the notion that Tax Avoidance indeed influences earning

management. The p-value for the tax avoidance variable is 0.03, indicating statistical significance at a level below the 0.05 threshold. Consequently, H3 is accepted, indicating that Tax Avoidance significantly influences earning management. These results align with a research study carried out by Maysani & Suaryana (2019), which demonstrated a effect positive of avoidance tax on earning management. Furthermore, the results of this research find reinforcement in Finance Minister's Regulation No. 9/PMK.03/2021, in which the government provides 6 forms of tax relief for entrepreneurs, including the incentive PPh Final Construction Services. The existence of this tax gap allows companies to exploit the gaps in government regulations to manage profits. The financial resources preserved through tax avoidance strategies have the potential to be directed toward beneficial corporate initiatives, such as investing in projects with positive net present values, distributing dividends, or reducing high-interest debt. This, in turn, has the potential to enhance overall firm value. A deeper exploration could focus on whether companies employing tax avoidance strategies redirect the surplus funds into more productive ventures, including heightened research and development activities (Wang et al., 2020). The findings are also in line with a study by Marwat, et al. (2021) that identifies managers manipulating profits through tax evasion.

Fourth, The Impact of Free Cash Flow on the Management of Earnings, the test results of the fourth hypothesis seen in the empirical evidence presented in Table 6 indicates that there is no discernible influence of Free Cash Flow on management earnings. The significance value for the variable free cash flow is 0.304, surpassing the 0.05 threshold. Consequently, H4 is rejected, indicating that the impact of free cash flow on earnings management is not statistically significant.

The findings of this research align with the outcomes reported in the study conducted by Nazalia & Dedik (2018) which stated that FCF does not influence earning management. Instead, these results contradicted the results of Kodriyah & Anisah's study (2018) that stated FCF influences earning management. FCFs are defined as free cash flows that are available to shareholders or owners after a company invests in fixed assets and working capital necessary for the business to survive. At the time of the COVID-19 pandemic, almost all companies, especially property companies, experienced financial distress that resulted in very low or even none of FCF values. The absence or low value of the corporate FCF is the reason that earning management is not possible.

D. CONCLUSIONS

Research findings suggest that the Other Comprehensive Income (OCI) factor does not play a role in influencing earning management. The effect of OCI on earning management might not be immediately apparent in the financial statement reflecting losses. This can make management more focused on the management of net profits contained in loss reports that are more visible to stakeholders. Financial Distress does not influence earning management. In such situations, management may direct their resources and attention to addressing the underlying financial problems, rather than

engaging in risky earning management practices. Free Cash Flow does not impact Earnings Management. Unrestricted Cash Reserves represents the remaining cash after meeting all expenses and investments. A high unrestricted cash reserves suggests that the company has surplus funds available for investment or other operational activities. Under such circumstances, management may feel no need to manipulate profits because they have the financial capacity to implement long-term strategies. Through effective tax avoidance practices, companies can improve their financial performance and report higher profits. Higher profits can have a good impact on stakeholders and can contribute to a rise in the company's share price. Therefore, management may be motivated to conduct more aggressive earning management to maintain or improve the financial performance that seems good as a result of tax evasion.

This study implies that it is expected to provide important insights to governments that in tightening up-regulation, especially about tax policy, they should pay attention and close the gaps in earning management. When tax regulation and supervision are inadequate, companies can exploit these gaps to carry out tax avoidance practices that affect earning management. Lack of effective supervision or sanctions can encourage management to take risks in conducting more aggressive tax evasion practices.

A potential limitation that may compromise the robustness of the study's findings is the utilization of only four independent variables, including OCI, financial distress, tax avoidance and free cash flow, where only 3.1% of the R Square value, so many other variables that can affect earning management are not included in the study. Moreover, the three-year observation period in 2019-2021 aligned with the occurrence of the Covid-19 pandemic, thus, the research findings could not be generalized under stable economic conditions.

The researchers suggested that future researchers should conduct their research during stable economic periods and then use more independent variables from both the financial and non-financial sides, for instance, factors like Social Responsibility of Corporations (CSR), and Efficient Implementation of Good Corporate Governance (GCG).

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