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The Role of Profitability, Leverage, and Corporate Social Responsibility in Corporate Tax Aggressiveness

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Abstract

This paper investigates the concept of tax aggressiveness and explores its determinants within corporate practices. Tax aggressiveness refers to strategies employed by businesses to reduce their tax liabilities through legal methods (tax avoidance) or illegal methods (tax evasion). While tax planning can reduce financial burdens, excessive tax aggressiveness carries risks such as legal sanctions and reputational damage. The study identifies key determinants influencing tax aggressiveness, including profitability, leverage, company size, and Corporate Social Responsibility (CSR). Profitability allows firms to allocate resources towards tax planning, while leverage enhances opportunities for minimizing tax obligations. The relationship between CSR and tax aggressiveness is crucial, as firms with higher CSR rankings tend to engage in lower tax aggressiveness. This suggests that socially responsible corporations may adopt more ethical tax practices, balancing financial efficiency with public accountability. The findings emphasize the importance of aligning tax strategies with legal and ethical standards to avoid long-term consequences. The paper highlights the significant role of CSR in shaping corporate tax behavior and offers insights into how industries can strategically manage their tax obligations.

Keywords

Tax Aggressiveness, Tax Avoidance, Tax Evasion, Corporate Social Responsibility, Leverage

1. Introduction

Tax is the largest source of state income for a number of sovereign countries including Indonesia. Therefore, the government is making every effort to be able to increase the country's tax revenue. The Minister of Finance of the Republic of Indonesia said that tax revenue in 2022

reached 2,626.4 trillion rupiah or 115.9% of the target stated in PP No. 98 of 2022. Meanwhile, customs and excise revenue reached 317.8 trillion rupiah or 106.3% of the specified target. The increasing performance of the APBN provides a positive signal for economic recovery after being hit by COVID 19. Tax is an obligation of Taxpayers to the state which is enforceable based on legislation without obtaining direct incentives and is used for the needs of the country for the greatest possible public welfare.

Tax Subjects according to the Income Tax Law (UU PPh) in Indonesia consist of individuals, undivided inheritance as a whole replacing the entitled, bodies and permanent business entities. If subjective and objective tax obligations are met, they will become Taxpayers (WP). Corporate taxpayers consist of a group of people and/or assets as a whole, including limited liability companies, limited partnerships, other companies, state-owned enterprises or regional-owned enterprises with any name or form, firms, partnerships, cooperatives, pension funds, associations, associations, foundations, mass institutions, socio-political institutions, or other institutions, institutions and other forms of institutions including collective investment contracts and permanent business entities.

However, the corporate sector often views tax as a significant financial burden, prompting industries to engage in tax planning strategies aimed at reducing their tax liabilities. While tax planning can help reduce the burden, excessive tax planning may lead to tax aggressiveness, which may manifest as either tax avoidance (legal) or tax evasion (illegal). Tax aggressiveness is a common practice across industries, where businesses implement strategies to minimize their tax obligations, often by exploiting loopholes in tax laws or failing to report income.

Corporate taxpayers view taxes as a business burden so that companies try various strategies to minimize their tax burden. The strategy used by the industry to make its taxes efficient is through tax planning. Excessive tax planning can create tax aggressiveness. Tax aggressiveness can be done in 2 ways, namely legally (tax avoidance) or illegally (tax evasion). Reminda (2017) said that tax aggressiveness is an attitude that is planned or manipulated to reduce fiscal benefits through tax design that is categorized (tax avoidance) or not classified (tax evasion). This opinion is in line with the definition of tax aggressiveness as all efforts made by management to reduce tax liabilities that should be paid by the company (Lanis & Richardson, 2012).

The determinants of tax aggressiveness are multifaceted. Previous research has identified various factors that may influence the level of tax aggressiveness in industries, such as profitability, leverage, industry size, and corporate social responsibility (CSR) (Alkadrie & Khairunnisa, 2023). Profitability can influence the willingness of a company to engage in tax minimization strategies, with more profitable companies possibly seeking ways to reduce their tax burden. Similarly, leverage, or the use of debt in the capital structure, could incentivize tax aggressiveness due to its potential to reduce taxable income through interest deductions. The size of the company may also be a factor, as larger companies might have more resources to exploit tax planning opportunities. Additionally, CSR, which encompasses a company's commitment to societal welfare, may negatively affect tax aggressiveness, as socially responsible companies are less likely to engage in aggressive tax strategies. The aim of this conceptual paper is to define and explore tax aggressiveness and its key determinants—profitability, leverage, company size, and corporate social responsibility (CSR)—within the food and beverage sub-sector in Indonesia.

By conceptualizing these factors, the paper seeks to develop a theoretical framework for understanding how they influence tax planning behavior in industries.

2. Results

2.1 Tax Aggressiveness

Tax aggressiveness is nothing new in the industry. Tax aggressiveness is an action where an industry carries out various efforts to be able to reduce the industry's tax payable because taxes are commercially a burden for the industry. The higher the tax payable of an industry, the lower the industry's after-tax income so that the dividends distributed will be smaller. In other words, the higher the tax rate will reduce the welfare of shareholders. Efforts to reduce taxes aggressively are known as tax aggressiveness. Tax aggressiveness can be carried out in 2 ways, namely tax avoidance (legal) and tax evasion (illegal). Tax avoidance is carried out by exploiting loopholes in tax policies and regulations. While tax evasion is carried out by deliberately not reporting the income earned to the tax authorities. Tax aggressiveness is a familiar thing for business people in industries everywhere which is carried out to minimize industrial taxes (Manurung, & Lumbantoruan, 2021).

According to Reminda (2017) stated that tax aggressiveness is an action that is planned or manipulated to reduce fiscal benefits through proper tax design either legal or illegally. This is in line with the definition of Lanis & Richardson (2012) which states that tax aggressiveness is all efforts carried out by management to reduce the tax burden that should be paid by the industry. While in Timothy (2010) tax aggressiveness is divided into 2 parts, namely tax avoidance which utilizes existing laws to see what types of transactions are "profitable", usually carried out by someone who understands and knows the loopholes in tax regulations. While the second way is by tax sheltering where a transaction is designed with the aim of reducing its tax obligations.

Tax aggressiveness has its own advantages and disadvantages for the industry (Rizki & Nugroho, 2024). The advantage is that with tax aggressiveness, the industry can save on its tax debts and increase industry income. This also has a positive impact on managers (agents) where managers usually get bonuses because of their satisfactory work results. While the disadvantage is that if this action is found by the Directorate General of Tax to be inconsistent with applicable tax provisions, the industry will receive sanctions and fines in accordance with applicable laws. There are a number of ways to calculate tax aggressiveness, including using the Effective Tax Rate (ETR), Book Tax Difference (BTD), Residual Tax Difference (RTC), and Cash Effective Tax Rate (CETR). This study calculates tax aggressiveness using ETR for reasons of simplicity in research but can achieve research objectives. Industry size is a scale used to categorize the size of an industry through the size of income (profit), amount of capital, and amount of assets (Basyaib, 2007). In general, industry size is only divided into 3 criteria, namely large industry, medium industry, and small industry (Machfoedz, 1994). This division is based on the number of industrial assets where the greater the number of assets owned by an industry, the higher the industry size will be. Research conducted by Shantikawati (2020) shows that industry size has no effect on tax aggressiveness in the mining industry listed on the IDX for the period 2014-2018. Meanwhile, research conducted by Tristiawan & Yusuf (2022) states that industry size has a significant effect on tax evasion. Corporate Social Responsibility (CSR) is the commitment of

industry or the business world to contribute to sustainable economic growth by paying attention to the social responsibility of the industry and focusing on the balance between attention to economic, social, and environmental factors. Half of the industry considers that communicating CSR activities or programs is as important as the CSR activity itself.

2.2 Profitability

Profitability is the capability of an industry to gain profit from its business activities such as sales, assets and equity. The profitability ratio is used to show the efficiency of the industry. This is in line with the definition put forward by Kasmir (2017) where the profitability ratio is used to calculate the effectiveness of management based on the returns obtained from sales and investments made by the industry. Profitability is able to show how much profit the industry has or the profits owned by the industry (Parang et al., 2022).

The profitability ratio describes the industry's capability to gain profit through all capabilities, as well as existing sources such as sales activities, cash, assets, total staff, total branches, and others (Harahap, 2009). The ratio that describes the industry's capability to gain profit is called the operating ratio. The level of profitability can be a special attraction for investors when they want to invest in an industry because the industry shows good performance in managing industrial operations. The profitability ratio has a number of functions, including:

- a. Profitability ratios calculate the amount of industry profit and assess the industry's capability to pay off debts to creditors based on the level of asset usage and other resources.
- b. Profitability ratios can be used as a comparison of the profit position of changes in the operating year with the previous year

2.3 Leverage

Leverage is an investment strategy using debt to increase the value of the company. The leverage ratio is used to calculate how far the industry's capital is financed using debt, which means the total debt used by the industry to fund its business activities compared to using industry assets (Kasmir, 2017). The industry can use the level of leverage to reduce profits, which ultimately reduces its tax liability (Adisamartha & Noviari, 2015). Regulation of the Minister of Finance Number PMK No. 169 / PMK.010 / 2015 concerning Determination of the Amount of the Ratio between Debt and Company Capital for Income Tax Calculation Purposes further regulates the ratio of debt to capital that can be recognized in calculating interest expenses. The determination of the ratio between debt and capital for income tax calculation purposes is determined at a maximum of four to one (4:1). Furthermore, there are 5 types of leverage ratios according to Hery (2017), namely:

- a. Debt Ratio used to calculate the ratio between the amount of debt and the amount of assets.
- b. Debt to Equity Ratio used to calculate the ratio between the amount of debt and the amount of equity.
- c. Long Term Debt to Equity Ratio used to calculate the ratio between long-term debt and equity.
- d. Times Interest Earned Ratio used to show how far the industry is able to pay off interest.

- e. Operating Income to Liabilities Ratio which shows how far the industry is able to pay off all its obligations.

Leverage is an investment strategy that uses debt as leverage to achieve a certain level of investment. The leverage ratio is used to calculate how much of an industry's capital structure is financed by debt, which means the total debt used by the industry to fund its business activities compared to using industry assets (Kasmir, 2017). The higher the leverage value of an industry, the greater the total debt of the industry (Ilham et al., 2021). A search conducted by Shantikawati (2020) shows that leverage has a significant positive effect on tax aggressiveness in the mining industry listed on the IDX for the period 2014-2018. Another study conducted by Masyitah et al. (2022) stated that leverage has no effect on tax aggressiveness in the plastic and packaging industry listed on the IDX for the period 2016-2020.

2.4 Corporate Social Responsibility

Corporate Social Responsibility (CSR) is a commitment of industry or business world to contribute to sustainable economic growth by paying attention to the social responsibility of the industry and focusing on the balance between attention to economic, social, and environmental factors (Suparjo & Dana, 2024). CSR is a concept or action implemented by industry as a sense of responsibility to the environment where the industry is established. Examples of CSR include maintaining the environment around the business premises, ensuring the prosperity of the surrounding community, and also providing financial support to maintain public facilities and the industrial environment. Guidelines for CSR activities in Indonesia are also stated in Law Number 40 of 2007 concerning Limited Liability Companies Article 74 paragraph 1. The advantages of industry implementing CSR disclosure are:

- a. Industry can grow a positive image and strengthen brand image in the eyes of the public.
- b. Finding new opportunities for cooperation between one industry and another.
- c. Can help grow the welfare of the people who are the target of CSR.
- d. Helping to grow environmental sustainability around the industry.

The influence of CSR on tax aggressiveness can be analyzed through CSR disclosure in financial reports and company annual reports. Industries with low CSR rankings are suspected of being socially irresponsible and more aggressive in avoiding taxes (Puspita & Putra, 2021). Furthermore, other studies state that industries with low social responsibility are industries that are more aggressive in tax planning and do not have a good understanding of tax benefits compared to other industries (Adisamartha & Noviari, 2015). Tax aggressiveness is seen as unethical and irresponsible by the public, therefore tax evasion is inconsistent with CSR (Puspita & Putra, 2021; Nurlis et al. 2021). Thus, CSR has a significant negative influence on tax aggressiveness. Based on the description of the theoretical study above, the relationship between tax aggressiveness and its determinants in the form of profitability, leverage, company size and corporate social responsibility can be described with a framework of thought and hypothesis.

3. Conclusion

This paper has explored the concept of tax aggressiveness and its various determinants, emphasizing the strategic role it plays for industries seeking to reduce their tax liabilities. Tax aggressiveness, which includes both tax avoidance (exploiting legal loopholes) and tax evasion (illegal underreporting of income), is a common practice across industries aiming to maximize profits and enhance shareholder value. However, this behavior also presents significant risks, including legal repercussions and potential damage to a company's reputation.

4 The study identified several key factors influencing tax aggressiveness, including profitability, leverage, company size, and corporate social responsibility (CSR). Profitability, for instance, provides industries with the necessary financial resources to engage in tax planning, while leverage can offer opportunities for reducing tax liabilities. The relationship between CSR and tax aggressiveness is particularly noteworthy, as industries with stronger CSR commitments tend to demonstrate lower levels of tax aggressiveness. This suggests that industries may find it beneficial to align their tax strategies with broader social and environmental goals, enhancing their public image while maintaining compliance with tax regulations.

The broader implications of these findings highlight the need for industries to carefully balance tax planning strategies with ethical considerations. While tax aggressiveness can offer short-term financial benefits, it also comes with long-term risks that could harm a company's reputation and financial stability.

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