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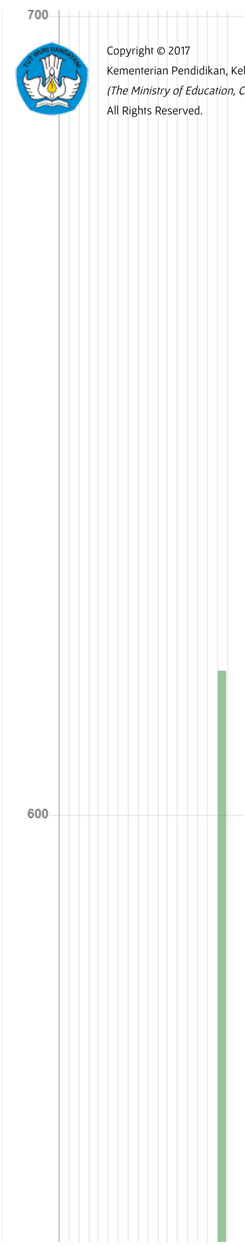
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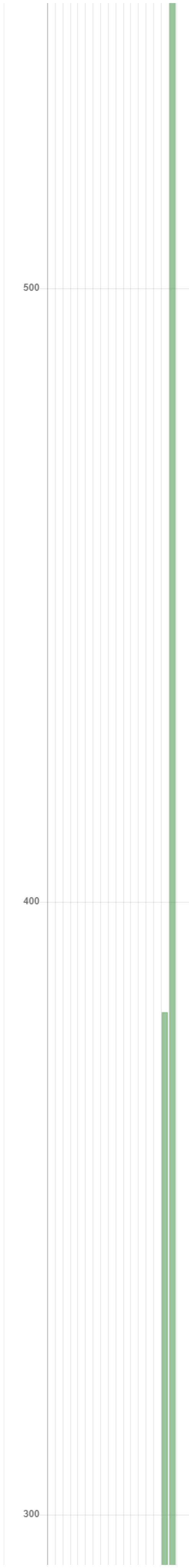
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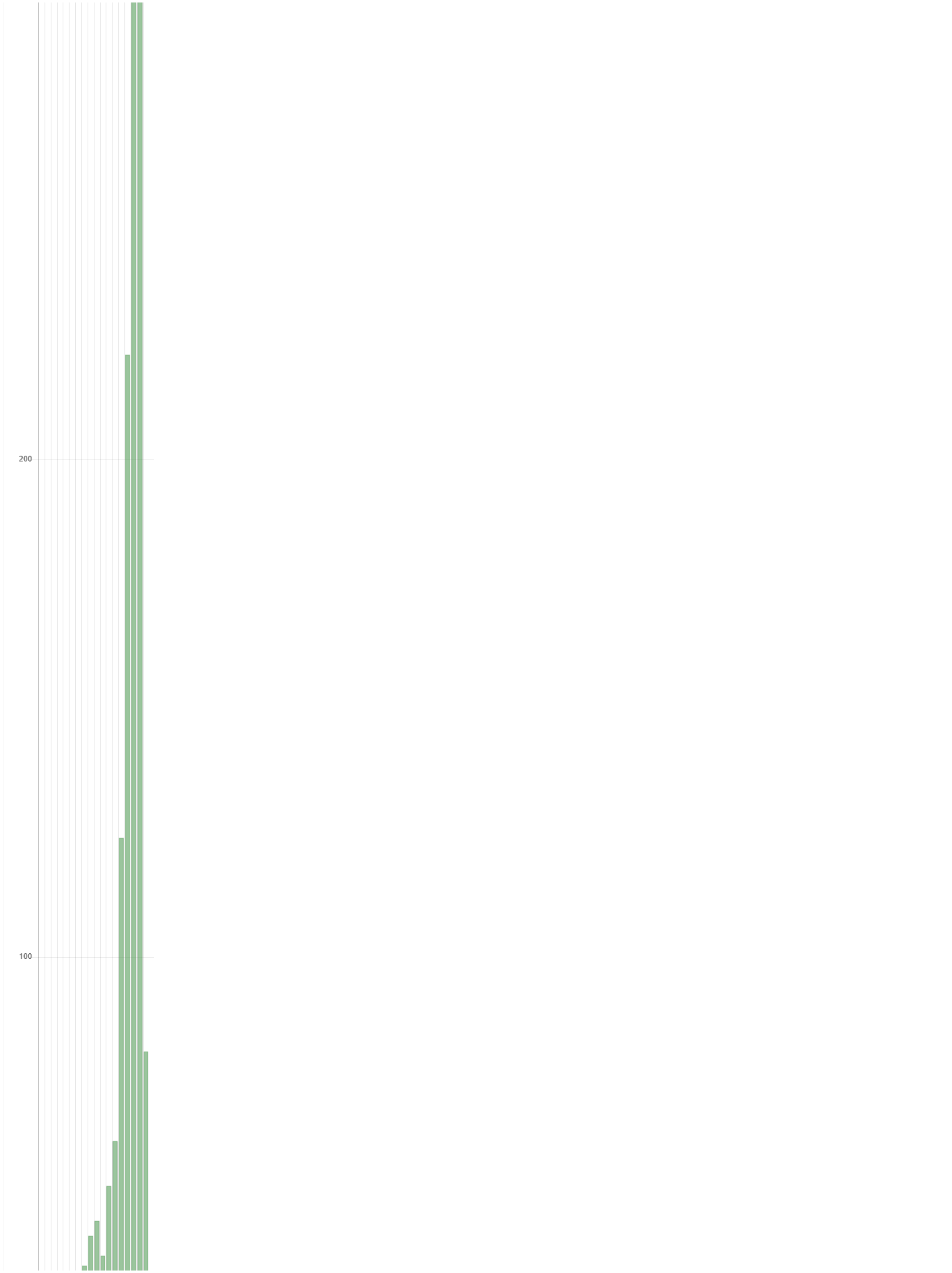
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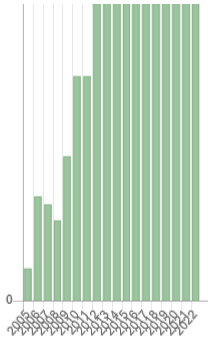

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# Tax Avoidance, Tax Reporting Aggresiveness, Tax Risk, & Corporate Risk

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**Keywords:**
tax avoidance, tax aggressiveness, tax risk, corporate risk

**ABSTRACT**
This study aims to examine whether tax avoidance, tax reporting aggressiveness and tax risk have an effect on corporate risk. This study describes the different terms of tax avoidance and tax aggressiveness. Tax avoidance measurement is measured using the cash effective tax rate formula, while tax aggressiveness is measured using permanent different. Tax risk is measured using the standard deviation formula from the cash effective tax rate, while corporate risk is measured using the volatility of the stock returns. The sample of this research is manufacturing companies listed on the Indonesia Stock Exchange, with a research period of 2016-2019. The results of this study indicate that tax avoidance, tax reporting aggressiveness and tax risk have an effect on corporate risk.

## INTRODUCTION

The manufacturing industry sector is the mainstay sector that drives the Indonesian economy. Besides the positive growth every year, the manufacturing industry sector also provides a large investment boost (kemenperin.go.id). Even during the current Covid-19 pandemic, the government continues to be committed to maintaining the manufacturing industry in the context of national economic recovery. This industry is considered capable of rising faster than other sectors and again becoming a mainstay sector that drives the economy for Indonesia (Timotius, 2020; republika.go.id).

The strength of the manufacturing industry also makes this sector the largest contributor to tax revenue. Despite experiencing a decline during this pandemic, the manufacturing industry remains a support for tax revenue in Indonesia (Reily, 2017; national.kontan.co.id). Being a support for Indonesia's tax performance does not mean that tax revenue from this sector has been optimal, this is due to tax avoidance practices that are still being carried out by companies (Wiyarti, 2015). Tax avoidance is a term that is often known as an act of evading tax. Dyreng et al. (2008) define tax avoidance as a form of activity that will result in reduced corporate taxes through a decrease in income before tax. Tax avoidance is mostly done by companies because tax avoidance is considered as an act that does not violate the law. However, Dyreng et al. (2019) stated that tax avoidance activities that are too aggressive can cause large tax uncertainty in the future. This raises the term tax aggressiveness. The company seeks to minimize its tax burden in a way that does not violate the law. Taxable income will be kept as low as possible compared to pretax financial income. The higher the difference between those two items, the more items on the commercial financial report are different from the fiscal report. This is what is then called the tax reporting aggressiveness.

This study aims to distinguish the term tax avoidance from tax reporting aggressiveness and tax risk, and then to test whether those three items have an influence on company risk. Initially, the tax avoidance activities carried out by the company will look good, because the purpose of this activity is to reduce the tax burden that must be borne by the company. The minimum corporate tax burden will maximize shareholder or investor profits. However, tax avoidance activities will in fact create uncertainty in the future so as to mislead investors. Utilization of statutory loopholes is highly dependent on the subjectivity of each individual. This can lead to tax liabilities in the future, so that the tax payments will be higher.

The uncertainty that the company will face in the future indicates that financial information is not transparent for investors and this can reduce the value of the company (Desai & Dharmapala, 2006; Desai & Dharmapala, 2009). The tax uncertainty in the future and poor company transparency will increase the risk of the company. In line with Kim et al (2011), who stated that aggressive tax avoidance activities have an effect on the risk of destroying stock prices. Thus, researchers are interested in examining the effect of tax avoidance, tax reporting aggressiveness, and tax risk on the risks at manufacturing companies in Indonesia. Researchers hope the results of this study can provide an understanding for each taxpayer about the consequences of tax avoidance, tax aggressiveness and tax risk management that can affect company risk.

### Literature Review and Hypothesis Development

Self Assessment System which is implemented in Indonesia, gives authority to each taxpayer to calculate and report their own taxes. With a set of existing tax laws, taxpayers are required to understand them in order to carry out their tax obligations properly. Taxation laws are made separate from accounting regulations for the purpose of reporting tax to be accountable to the Government. Pretax financial income must be adjusted to the tax rules so as to produce taxable income. The various existing rules certainly have loopholes that can be used for the benefit of taxpayers, moreover, each rule can be interpreted by different individuals. This causes taxpayers to have the opportunity to do good tax planning in order to minimize the taxes they have to pay (Suandy, 2016).

Tax avoidance activities in Indonesia are often known as tax avoidance. Tax avoidance is an effort made in the context of tax savings by utilizing taxation provisions that are carried out legally (Mardiasmo, 2016; Lim, 2011). But over time, the term tax aggressiveness appears.

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Balakrishnan et al. (2019) stated that the more aggressive companies are in carrying out tax planning, the companies are actually doing tax avoidance. This study tries to describe the differences between the two terms. Dyreng et al. (2008) define tax avoidance as a form of activity that will result in explicitly reducing corporate taxes (usually associated with a decrease in profit before tax). Guenther et al. (2013) define tax avoidance by providing concrete examples to clarify activities including tax avoidance. Tax avoidance is an activity that of course aims to reduce the amount of tax payments, for example opening a subsidiary in a country with low tax rates or benefiting from accelerated depreciation.

The term tax aggressiveness is then defined by Gunther et al. (2013) as tax avoidance activities through interpretation of tax laws. Tax aggressiveness can increase a company's risk due to the uncertainty of the amount of tax payments in the future. Hanlon & Slemrod (2009) stated something similar by adding that the uncertainty was not only related to the amount of tax payments but also the sanctions and fines. Furthermore, tax aggressiveness is a behavior in manipulating taxable income which can lead to tax evasion (Frank et al., 2009; Tooma, 2006).

Thus it can be concluded that tax avoidance is an activity or action in order to reduce the amount of tax payments. Tax avoidance will not cause uncertainty in the future, because the tax avoidance actions taken are not the result of interpretation of the law. Tax avoidance is an activity that is in line with the law so that there is nothing more that can be debated between the taxpayer and the tax authorities, for example, there are rules that allow taxpayers to make accelerated depreciation. Of course this will lead to companies to pay less tax. However, it is different from tax aggressiveness, where tax aggressiveness is a behavior in tax avoidance. Tax aggressiveness will depend on the individual who does tax avoidance, how that individual interprets the tax law, so that the tax aggressiveness will create uncertainty about tax payments in the future. The difference between the taxpayer's interpretation and the tax authorities, if a tax audit is carried out, can make the taxpayer pay taxes in a larger amount than what was originally planned. For example, shifting expenses to deductible expenses can reduce taxable income. The difference in interpretation between the taxpayer and the tax authorities can cause uncertainty in the future.

Although tax avoidance is said to not cause uncertainty in the future that can cause company risk, tax avoidance is still considered to be harmful for the company. As stated by Balakrishnan et al. (2019) that companies that actively practice tax avoidance will make complex reporting. The increase of the complex reporting tends to hide bad information and cover it from investors so that it is not transparent (Desai & Dharmapala, 2006). The results of research by Guenther et al. (2013) stated that tax avoidance has no effect on company risk, however, research by Kim et al. (2011) gave the opposite result that companies that are not transparent about their tax avoidance actions will be dangerous for the company's survival. This action is usually done by managers who are opportunistic and tend to manipulate earnings. In a certain period of time, this is what drives the stock price of a company to be destroyed or the risk of company bankruptcy increases. Thus, the first hypothesis in this study is:

**Ha1:** tax avoidance has an effect on company risk.

Tax aggressiveness is clearly stated to cause uncertainty in the future. For example, the large difference between (commercial) pretax financial income and taxable income. This is due to the many fiscal corrections made in order to obtain the possible minimum taxable income. As a result, the quality of earnings displayed to the investors is less and less reflective of the true quality. Ayers et al. (2010) found that the greater the difference between pretax financial income and taxable income, the lower the quality of the company's earnings. Even though the income shown to investors looks large (a result of aggressive tax avoidance), the earnings quality is not as good as the earnings value shown. Coupled with the uncertainty in the future that can make the company pay higher taxes than originally planned, these conditions make the company's value very bad in the eyes of investors. Thus, the second hypothesis in this study is:

**Ha2:** tax aggressiveness has an effect on company risk.

Neuman et al. (2013) stated that tax risk is an activity or action that has the potential to result in different tax expenditures than originally expected. This is related to the company's cash flow. Uncertainty in the future (Dyreng et al., 2019; Guenther et al., 2017) due to tax aggressiveness involves differences in perceptions between taxpayers and tax authorities regarding the gray area as previously explained. Each item that the company recognizes as a deduction may not necessarily be approved by the tax authorities so this will result in larger corporate tax payments. The more aggressive the company is in implementing tax avoidance, the greater the uncertainty that the company will face in the future regarding its tax payments, in other words, the company's cash flow will also experience uncertainty regarding its tax payments. This uncertainty makes the chances of a company bankruptcy even greater. Thus, the third hypothesis in this study is:

**Ha3:** tax risk has an effect on company risk.

## RESEARCH METHODS

This study used secondary data in the form of financial reports downloaded from www.idx.co.id. The data that has been collected will be tested for classical assumptions consisting of normality test (using one sample Kolmogorov Smirnov), multicollinearity test (using VIF and Tolerance), heteroscedasticity test (using the Glejser test), and autocorrelation test (using the run test) (Ghozali, 2013).

The sample will be taken from a population of all manufacturing companies listed on the Indonesia Stock Exchange (IDX) based on a nonprobability sampling approach using a purposive sampling method. Purposive sampling is a sampling technique with considerations set by the researcher (Sugiyono, 2016; Hartono, 2010). Thus the considerations used by researchers in this sampling are as follows:

1. A business entity in the form of a manufacturing company listed on the IDX and publishing consistent and complete audited financial reports for the period of 2016-2019
2. Providing a complete annual report and sustainability report for the period of 2016-2019
3. The business entity was not in a suspended or delisted condition during 2016-2019
4. The business entity has complete data regarding tax payments, profit before tax, and stock returns
5. The business entities have a Cash Effective Tax Rate ≤ 1
6. The business entities use the Rupiah currency in presenting its financial statements.

Operational definitions of research variables:

1. Tax avoidance, defined by Hanlon and Heitzman (2010) as a tax planning activity with the aim of explicitly reducing the tax burden. Tax avoidance uses the proxy Cash Effective Tax Rate (CETR) which is formulated by comparing cash spent to pay taxes with income before tax (Dyreng et al., 2008; Hanlon and Slemrod, 2009; Hanlon and Heitzman, 2010). According to Dyreng et al. (2008), CETR is the best proxy for measuring short-term tax avoidance. The greater the CETR value indicates that the company is less aggressive about tax avoidance. The CETR formula is stated as follows:

$$CETR = \frac{Tax\ payment}{Income\ before\ tax}$$

2. Tax aggressiveness, as stated by Guenther et al. (2013) stated that the more activities the company undertakes in order to reduce the amount of taxes owed, it can be concluded that the more aggressive the company is in implementing tax avoidance. The proxy used to measure tax aggressiveness is to see the permanent difference. The permanent difference indicates that the pretax financial income and taxable income will be different continuously. The bigger the permanent difference is, the more aggressive the company is in reducing taxes. Unlike the time difference, the permanent difference will not change the amount of tax payments.
3. Tax risk, measured by the volatility of future tax rates stated by Guenther et al. (2017) as uncertainty regarding the tax that the company must pay in the future. The higher the volatility of future tax rates, the greater the uncertainty a company will face over its tax payments. Future tax rate volatility is obtained from calculating the standard deviation of the annual CETR.
4. The dependent variable in this study is company risk. According to Guenther et al. (2017), company risk is a reflection of the future uncertainty faced by the company. This uncertainty concerns all matters that can result in the company or the company being in an unfavorable condition. The risk of the company uses the volatility proxy of the stock's return. The volatility of stock returns is obtained from

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calculating the standard deviation of the stock returns for 12 months per period.

The data analysis used in this study is multiple linear regression analysis with the help of SPSS software. The regression equation formed is:

$$CR_{it} = a + b1.TA_{it} + b2.TRA_{it} + b3.TR_{it} + b4.ROA_{it} + b5.LEV_{it} + e$$

where:

$CR_{it}$ : corporate risk (standard deviation of 12 months in year *t* stock returns)
$TA_{it}$ : tax avoidance (tax payment in year *t* divided by income before tax in year *t*)
$TRA_{it}$ : tax reporting aggressiveness (permanent differences in year *t*)
$TR_{it}$ : tax risk (standard deviation of tax payments in year *t* divided by profit before tax in year *t*)
$ROA_{it}$ : return on assets (income after tax in year *t* divided by total assets in year *t*)
$LEV_{it}$ : leverage (total debt in year *t* divided by total equity in year *t*)

## RESULTS AND DISCUSSION

The data in this study have fulfilled all the classical assumption tests which consist of normality test, multicollinearity test, heteroscedasticity test, and autocorrelation test. The classical assumption tests results are presented in the table below.

**Table 1. Classical Assumption Tests Result**

| Test | Result | |
|---|---|---|
| Normality Test (One-Sample Kolmogorov-Smirnov Test) | Asymp. Sig. (2-tailed) is 0.000 | |
| Multicolinearity Test: | Tolerance | VIF |
| -Tax avoidance | 0.997 | 1.003 |
| -Tax reporting aggressiveness | 0.972 | 1.029 |
| -Tax risk | 0.960 | 1.042 |
| -Return on assets | 0.900 | 1.111 |
| -Leverage | 0.949 | 1.053 |
| Heteroscedasticity Test | Sig. | |
| -Tax avoidance | 0.532 | |
| -Tax reporting aggressiveness | 0.097 | |
| -Tax risk | 0.953 | |
| -Return on assets | 0.176 | |
| -Leverage | 0.626 | |
| Autocorrelation Test | Asymp. Sig. (2-tailed) is 0.271 | |

Source: Data processed

The model test results are presented in the table below.

**Table 2. Regression Model Testing Results**

| Model | | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | 2.160 | 5 | .432 | 58.672 | .000[a] |
| | Residual | 1.517 | 206 | .007 | | |
| | Total | 3.677 | 211 | | | |

a. Predictors: (Constant), lev, tav, tr, tag, roa
b. Dependent Variable: cr

Sig value. of 0.000 indicates that the regression model in this study is correct and that each independent variable in this study can predict the dependent variable. While the results of hypothesis testing are shown in the table below.

**Table 3. Hypothesis Testing Results**

| Model | | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | .036 | .016 | | 2.316 | .022 |
| | tav | .087 | .043 | .090 | 2.018 | .045 |
| | tag | 1.043E-12 | .000 | .104 | 2.297 | .023 |
| | tr | .721 | .046 | .722 | 15.807 | .000 |
| | roa | -.138 | .064 | -.102 | -2.158 | .032 |
| | lev | -.014 | .021 | -.030 | -.663 | .508 |

a. Dependent Variable: cr

The results of this study indicate that tax avoidance has an effect on corporate risk. The results of this study are in line with the research of Kim et al. (2011) who stated that a company's tax avoidance activities tend not to be transparent. This at the same time hides bad information from investors which in turn leads to the collapse of the company's stock price. Companies that do a lot of tax avoidance will provide complex reports, the more complex the reports are made, the less transparent the reports are. Although tax avoidance will minimize a company's tax liability and maximize shareholder value, the lack of transparency in the information provided to investors can create company risks.

The results of this study also show that tax aggressiveness and tax risk have an effect on corporate risk. Aggressive behavior in order to reduce the amount of tax owed will create great uncertainty. This uncertainty concerns about the difference in perceptions between tax authorities and taxpayers. The more aggressive the company is to reduce the tax payable (tax reporting aggressiveness), the more items in the tax report can be debated. This has led to uncertainty about the amount of tax payments in the future. The more aggressive a company is, the more permanent differences will be shown in its financial statements. This permanent difference will increase the difference between pretax financial income and taxable income. Dhaliwal et al. (2017) stated that taxable income is proven to be able to predict performance uncertainty in the future. This is reinforced by Lev & Nissim (2004) who prove that taxable income (fiscal profit) can reflect stock returns in the future.

Uncertainty arising from a company's tax aggressiveness will worsen the company's value in the eyes of investors. Desai & Dharmapala (2009) stated that the uncertainty arising from tax aggressiveness is related to the lack of transparency in a company, so that it has an impact on the decline in company value in the eyes of investors. In line with what Balakrishnan et al. (2019) that companies that carry out tax aggressiveness also tend to cover bad information and provide inaccurate earnings information so that it will pose a risk to the company. This is supported by the results of research by Ginting & Martani (2017) which states that tax aggressiveness has a strong positive relationship with financial reporting aggressiveness. The more aggressive the company is in tax avoidance, the more aggressive the company will be in presenting financial statements in the sense that the financial statements are less transparent.

Likewise with tax risk, the uncertainty of future cash flows will certainly make the company value worse in the eyes of investors. This is in line with what Guenther et al. (2013) stated that tax risk is closely related to future stock price volatility, thereby increasing corporate risk. A good current profit does not necessarily indicate a good company performance either. A good current profit conditions must be supported by good cash flow as well. Paying larger taxes in the future will worsen the company's cash flow and of course this is very risky for the company.

## CONCLUSION

After knowing the results of this study, namely that tax avoidance, tax reporting aggressiveness and tax risk have an effect on corporate risk, the implications of the first research results for companies are expected not only to see short-term results but should pay attention to the long-term effects of each action or activity. Tax avoidance should be still carried out in the corridor of a good and transparent tax planning, instead of producing tax reporting aggressiveness which can pose a risk to the company. Good tax planning will reduce the company's tax risk so that the company can be better in managing its cash flow as well. Second, investors should pay attention to the cash effective tax rate and the permanent difference of a company before starting investing. Third, for the government, in order to reduce the existing gap in the tax law so that the difference in perceptions of tax authorities and taxpayers are getting smaller. This can prevent companies from making tax reporting aggressiveness.

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