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THE EFFECT OF THIN CAPITALIZATION AND ASSETS MIX AGAINST TAX AVOIDANCE IN COMPANIES REGISTERED JAKARTA ISLAMIC INDEX (JII) 70

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ABSTRACT

The purpose of this research is to examine and analyze the effect of capitalization and assets mix on tax avoidance. This study uses secondary data in the form of annual reports of companies listed on the Jakarta Islamic Index (JII) for the period 2020 to 2022. A purposive sampling technique is used as a sampling technique with a total of 126 sample data. The analytical method used is multiple linear regression analysis using Eviews 12 Student Version software. This study obtains the following results: (a) thin capitalization does not affect tax avoidance; (b) capital intensity has a positive effect on tax avoidance; (c) inventory intensity does not affect tax avoidance.

Keywords: *thin capitalization*, *assets mix*, *capital intensity*, *inventory*

BACKGROUND

The economic development of a country is largely determined by the state revenue earned, namely one of the sources of income comes from taxes. Every taxpayer, both individual and corporate, must pay taxes by the applicable tax regulations. However, not all taxpayers are willing to participate in paying this tax with different perceptions (Rantung and Adi, 2009). In general, taxes are defined as coercive obligations with periodic payments based on applicable laws and regulations, without any direct reward (Diana Sari, 2016). However, in practice, there is still a difference of interest between taxpayers and the government. One of the phenomena of loss in tax revenue in Indonesia is tax reduction through thin capitalization practices. According to Taylor & Richardson (2012), thin capitalization is one of the variables that encourage international tax avoidance practices. Thin capitalization refers to the company's policy of using a high level of debt compared to ordinary equity. Companies may choose to borrow funds through external debt rather than using their capital to obtain greater tax benefits. Each company has its differentiation in the use of debt, even companies belonging to the same

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sector can have different debt treatment (Brigham & Houston, 2006). In Indonesia, the rules regarding thin capitalization have been regulated in the law regarding the ratio of debt to equity. The debt and capital ratio approach is regulated in Article 18 paragraph (1) of the 1983 Income Tax Law which authorizes the Minister of Finance to determine the limits on debt and capital ratios that can be used in calculating taxes (Salwah & Herianti, 2019). The government officially stipulates PMK No.169/PMK.010/2015 concerning determining the ratio between company debt and capital to calculate Income Tax (PPh) with a maximum limit of 4:1 (Setiawan & Sulistyono, 2016). The Jakarta Islamic Index (JII) is a stock index consisting of companies that meet the Sharia criteria set by the Indonesian Financial Services Authority (OJK). These sharia criteria include the prohibition of usury (interest), gambling, liquor, and other activities that are deemed not by sharia principles. In Indonesia, adopting rules regarding capital structure restrictions on sharia category companies, including the JII and ISSI sharia stock indices. These rules are contained in the Decree of the Chairman of Bapepam and LK Number: KEP-208/BL/2012 regarding the criteria and issuance of the List of Sharia Securities (DES). One of the requirements in the regulation is a limit on total interest-based debt which may not exceed 45% of the company's total assets. In addition, limits are also imposed on total interest income or other non-halal income, which may not exceed 10% of total business income. Companies can also take advantage of tax incentives that come from non-debt. When a company incorporated in the limited Sharia index uses debt benefits for tax incentives, the company will use tax avoidance from non-debt benefits, namely the asset mix (Hanlon & Heitzman, 2010). The composition of company assets, including taxable assets and non-taxable assets, is related to the assets mix.

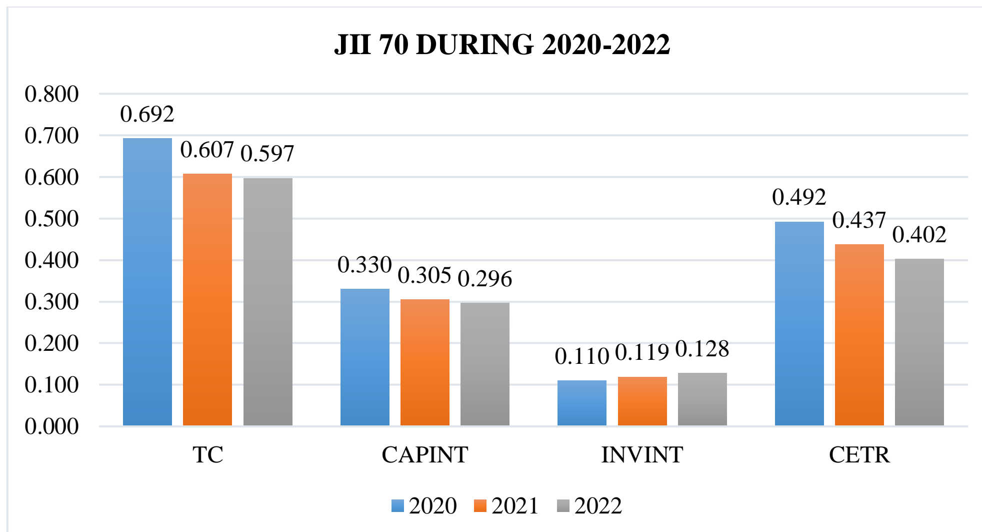

Figure 1. Average TC, CAPINT, INVINT and CETR in companies listed on the Jakarta Islamic Index (JII) 70 during 2020 – 2022
Source: Data processed by researchers (2023)

Based on Figure 1, the average thin capitalization overall in 2020 – 2022 has decreased, which means that companies do not use debt as capital. Likewise, the average capital intensity in 2020-2022 has decreased, while the average inventory intensity in 2020-2022 has increased every year. Overall, the average value of tax avoidance proxied by CETR during the period 2020 – 2022 has decreased every year.

THEORETICAL FRAMEWORK

Tax Avoidance

Tax avoidance is an advanced stage of tax planning and is a form of active resistance by taxpayers used to reduce the amount of tax to be paid. Each researcher has his definition regarding whether tax avoidance is considered a permissible action (Khomsatun & Martani, 2015). In general, tax avoidance is a practice carried out by companies to reduce the tax burden that must be paid by taking advantage of existing legal loopholes. This definition is in line with the research by Dyreng et al. (2008) which states that tax avoidance occurs when companies use unclear regulations or the existence of legal loopholes (loopholes) to maximize the tax benefits obtained.

Assets Mix

The proportion of asset components influences tax avoidance because different investment policies will get different tax treatment. The basic concept of the assets mix can be applied in the context of taxation and tax avoidance to assist companies in optimizing tax benefits and managing their tax obligations. Gupta & Newberry (1997) stated that there is an effect of tax avoidance on investment decisions of a company with a mix of assets. In this study, the composition of the assets mix uses a proxy approach to the levels of capital intensity and inventory intensity.
The following is a theoretical framework:

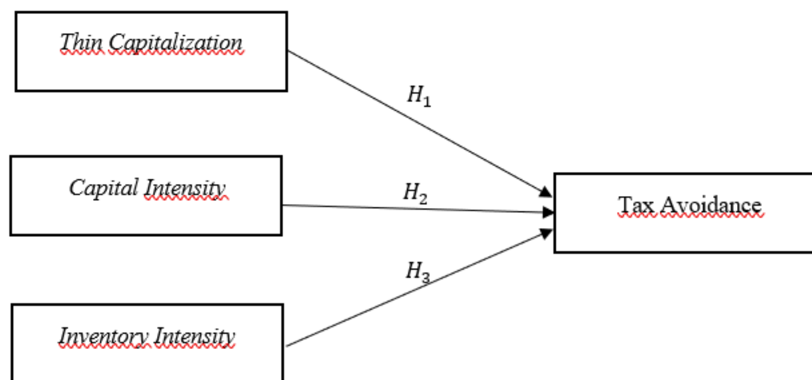

Figure 2. Theoretical framework of the influence thin capitalization, capital intensity and inventory intensity on tax avoidance
Source: Data processed by researchers (2023)

METHOD

This research uses quantitative methods and logistic regression analysis techniques using the Eviews 12 Student Version software. This research uses secondary data with documentation and literature study techniques. This documentation technique is carried out by collecting data obtained from companies that have previously been processed in the form of annual reports on the Jakarta Islamic Index (JII) 70 during 2020 - 2022. Data can be found by visiting the website www.idx.co.id.

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RESULT

Based on the test results of descriptive statistical analysis. The average, maximum, minimum, and standard deviation values of fixed asset revaluation variables were obtained from 117 sample companies. Based on the descriptive statistical test, the average value of tax avoidance was 0.27, which indicated that of the 141 sample companies, 27% committed tax avoidance. based on the results of multiple linear regression tests it was also found that capital intensity has a significant influence on the practice of tax avoidance in companies registered with the Jakarta Islamic Index (JII) 70 during the 2020-2022. But apart from that, Thin Capitalization and Inventory Intensity have been shown to not affect tax avoidance practices in companies registered with the Jakarta Islamic Index (JII) 70 during 2020-2022.

DISCUSSION

The effect of thin capitalization on tax avoidance

Based on the results of statistical testing with the t-test, show that the thin capitalization variable has a significance level of 0.0555 which is above the desired significance level of 0.05 (0.0555 > 0.05). This value indicates that thin capitalization has no effect on tax avoidance in companies listed on JII 70. Companies with high debt levels can have more significant growth opportunities than companies with low debt levels (Haufler and Runkel, 2012). The practice of thin capitalization is one of the reasons for choosing debt as a source of funding. However, companies can also choose debt as funding because the company's equity is not divided into share capital, so there are no other options that can be used besides debt. Thus, it can be concluded that the company's thin capitalization scheme is not solely for tax avoidance practices. Thus the results of this study reject the first hypothesis (H1).

Effect of capital intensity on tax avoidance

The results of the t-test show that the capital intensity variable shows a significance value of 0.0138 < 0.05 so capital intensity affects tax avoidance. This value indicates that capital intensity has an effect on tax avoidance in companies listed on JII 70. When a company has high asset intensity, the resulting depreciation expense on fixed assets is also high so that the existing profits are reduced and the tax payable on these profits is also reduced. Based on fiscal provisions, depreciation expense is one of the costs allowed as a deduction from gross income. When a company has a significant capital intensity, the company's operational activities will increase and generate profits for the company. Large profits can fulfill the interests of the government as a tax collector so that the realization of tax revenue becomes more optimal. Thus the results of this study accept the second hypothesis (H2).

Effect of inventory intensity on tax avoidance

The results of the t-test show that the inventory intensity variable shows a significance value of 0.1740 > 0.05, this indicates that inventory intensity does not affect tax avoidance. The average level of inventory for JII 70 companies is low compared to total assets, which indicates that there is not much inventory in the company. This shows that more or less inventory intensity does not fully describe the company taking tax avoidance actions. This happens because usually, the tax law does not provide tax incentives for companies that have a large amount of inventory. The amount of intensity of inventories owned by the company is not a factor in determining the size of the amount of tax paid by the company. Inventory intensity cannot have a good impact on company tax planning. Thus the results of this study reject the third hypothesis (H3).

CONCLUSION

This study aims to find out whether thin capitalization, capital intensity, and inventory intensity have an effect on tax avoidance in companies registered with the Jakarta Islamic Index (JII) 70 in 2020 – 2022. Based on the results of the data analysis that was carried out in the previous chapter, the conclusions that can be drawn from this research are as follows:

1. Thin capitalization has no effect on tax avoidance in companies in the Jakarta Islamic Index (JII) 70 category in 2020 – 2022. This means that the size of the company's debt level has no effect because debt is used to fund the company's operational business. Therefore the use of debt in corporate financing is not intended to practice tax avoidance.
2. Capital intensity has a positive effect on tax avoidance for companies in the Jakarta Islamic Index (JII) 70 category in 2020 – 2022. This means that when a company has a high fixed asset intensity, the depreciation expense generated on these fixed assets is also high so that the existing profit decreases and the tax payable on those profits also decreases.
3. Inventory intensity has no effect on tax avoidance for companies in the Jakarta Islamic Index (JII) 70 category in 2020 – 2022. This means that both low and high levels of inventory intensity do not affect tax avoidance practices. This happens because usually, the tax law does not provide tax incentives for companies that have a large amount of inventory.

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