THE EFFECT OF TAX PLANNING, DEFERRED TAX BURDEN, AND PROFITABILITY ON EARNINGS MANAGEMENT IN INDUSTRIAL COMPANIES

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ABSTRACT

Earnings management is a company's practice of manipulating financial indicators or accounting data for specific purposes. The aim of this study is to determine the effect of tax planning, deferred tax burden, and profitability on earnings management. This study uses a purposive sampling method and Statistical Package for the Social Sciences Version 27 (SPSS) software for data processing. The sample used in this study were industrial companies listed on the Indonesia Stock Exchange for the period 2019–2022. The results of this study indicate that tax planning affects earnings management, while deferred tax charges and profitability do not.

Keywords - **Tax planning, deferred tax expenses, profitability, earnings management.**

INTRODUCTION

Accounting serves many functions, one of which is to measure company management’s performance. Financial statements are a benchmark provided by the company's managers regarding the company’s profits or income. These statements form the basis for decision-making for internal and external stakeholders. Financial statements are also a communication tool that helps external parties make decisions related to funding and investment activities, which are expected to bring profits to the company.

Profit is the foundation of financial statements, as high profits indicate good overall company performance. Profit is critical information for investors, creditors, and company owners and serves as a measure for investment and credit decisions. In this new era, companies must compete in global markets by constantly demonstrating their strengths (Setyawan, Wulandari, & Widyaningrum, 2021). The intensity of competition in international markets forces organizations to engage in earnings management, a practice of manipulating financial statements to improve operational results (Herdawati, 2015).

This behavior occurs due to differing interests between company owners (principals) and the managers (agents) hired to run operations, leading to what is known as agency conflict. Managers often have more knowledge about the company’s internal operations and future prospects than shareholders, and this can result in self-interested decisions that increase operational costs or mismanage risk.

Earnings management can make financial statements less reliable. This issue isn't restricted to corporate directors but also involves owners, insiders, commissioners, managers (including government and professional bodies), and even volunteers. The problem is not confined to developing nations but also occurs in developed countries. Some companies have engaged in poor earnings management, such as Caterpillar Inc. and AeroGrow International, Inc.

Managers often manipulate profit figures to influence various decisions, including reducing tax liabilities. Tax planning, a legal means of minimizing taxes, often leads to smaller tax payments but can also reduce company profits (Achyani & Lestari, 2019). Even though tax planning is legal, it's still seen as detrimental to government revenues. However, this practice is not fraudulent, so the company can report higher revenues.

Profitability is an indicator of business performance, measured by the company's profits. Low profitability often drives companies to engage in earnings management to attract investors (Lestari & Wulandari, 2019). In practice, investors tend to focus on profit information in financial statements, as it helps predict industry prospects and financial performance (Sari & Muhammad, 2022).

A prominent example of earnings management occurred in 2019 with PT Garuda Indonesia TBK. In 2017, PT Garuda Indonesia reported a loss of $216.58 million, but in its 2018 financial report, the company showed a drastic profit increase of $809,000. The commissioners of PT Garuda Indonesia refused to approve and sign the 2018 financial report due to concerns over a partnership deal with PT Mahata Aero Teknologi, where revenue was recognized despite no payment having been made. This resulted in artificially high profits and taxes, ultimately causing a 4.4% drop in the company's stock value.

Based on the issues mentioned above, the purpose of this research is to examine the positive or negative effects of tax planning, deferred tax burden, and profitability on earnings management. The study focuses on the manufacturing sector, where companies may manipulate financial statements to present better performance than actual. Practices such as revenue recognition or shifting operational costs to future periods can distort financial reports.

Research Questions:

1. Does tax planning affect earnings management in manufacturing companies listed in Indonesia?
2. Does profitability affect earnings management in these companies?
3. Does the deferred tax burden affect earnings management?

Research Objectives:

1. To understand the impact of tax planning on earnings management.
2. To assess the impact of profitability on earnings management.
3. To identify the effect of the deferred tax burden on earnings management

METHODOLOGY

A. Research Design and Approach

The study employs a quantitative approach to examine the influence of tax planning, deferred tax burden, and profitability on earnings management within industrial companies listed on the Indonesia Stock Exchange (IDX) from 2019 to 2022. A purposive sampling method was used to select companies that met specific criteria, ensuring data relevance and quality.

B. Population and Sample

- Population: The population includes all industrial companies listed on the Indonesia Stock Exchange (IDX) during the period 2019-2022.

- Sample:

- The purposive sampling method was employed to narrow the population to companies that met the study's criteria.
- The final sample consists of 14 companies with a total of 56 data points (observations), each

representing a company's financial information across the specified period.
Sample Selection Criteria:

- Companies listed on the IDX under the industrial sector from 2019-2022.
- Companies with complete financial reports in Indonesian Rupiah.
- Exclusion of companies with foreign currency financial reporting and those with losses, as these could bias the analysis of earnings management.
  - TABLE:

SAMPLE SELECTION

No.	Criteria	Number of Companies	Total Sample
1	Industrial companies listed (2019-2022)	66	264
2	Incomplete financial reports	-21	-84
3	Foreign currency reporting	-4	-16
4	Companies with losses	-27	-108
	Final Sample	14	56

C. Variable Measurement

1. Dependent Variable (Y): Earnings Management

Earnings management is measured using Discretionary Accruals (DA) as per the Modified Jones Model. Discretionary Accruals (DA) are used as a proxy for earnings manipulation efforts, calculated by adjusting total accruals for normal accruals, focusing on managerial discretion in financial reporting.

2. Independent Variables

- Tax Planning (X1):

❖ Tax planning is quantified by the Effective Tax Rate (ETR). A lower ETR indicates higher tax planning.

$$\mathbf{ETR = \frac{Tax\ Expense}{Profit\ Before\ Tax}}$$

❖ A negative or extremely low ETR suggests aggressive tax planning efforts, while a higher ETR implies limited tax manipulation.

- Deferred Tax Burden (X2):

- Deferred tax burden is measured by the Deferred Tax Expense Ratio (BPT). It reflects the proportion of deferred tax relative to total assets, used as a proxy for long-term tax planning.
- Profitability (X3):

$$\mathbf{BPT = \frac{Deferred\ Tax\ Expense}{Total\ Assets\ (t\text{-}1)}}$$

- Profitability is represented by the Return on Assets (ROA), a common indicator of financial performance and efficiency.

$$\mathbf{ROA = \frac{Net\ Income\ After\ Tax}{Total\ Assets} \times 100\%}$$

D. Hypotheses

The study is structured around the following hypotheses, aligned with the conceptual framework based on Agency Theory:

H1: Tax planning (ETR) positively impacts earnings management. H2: Profitability (ROA) positively impacts earnings management.
H3: Deferred tax burden (BPT) negatively impacts earnings management.

E. Data Analysis Techniques
1) Descriptive Statistics:
   - Descriptive statistics provide summaries of the sample data, including minimum, maximum, mean, and standard deviation values for each variable (ROA, ETR, and BPT).
2) Classical Assumption Tests:
   - These tests ensure the data meet regression analysis requirements:
     - Normality Test: The Kolmogorov-Smirnov test is used to verify if data distributions are normal (acceptable when Sig. > 0.05).
     - Heteroskedasticity Test: Both Park Test and Scatterplot methods are employed to check for unequal variances across residuals, indicating no heteroskedasticity if there's no discernible pattern and Sig. > 0.05.
     - Multicollinearity Test: Variance Inflation Factor (VIF) and Tolerance values assess multicollinearity among independent variables, with VIF < 10 and Tolerance close to 1 indicating no multicollinearity issues.
     - Autocorrelation Test: Durbin-Watson Test (DW) checks for autocorrelation, with DW values between 1.5 and 2.5 suggesting no autocorrelation in residuals.

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon$$

where Y is earnings management, X_1 is ETR, X_2 is ROA, X_3 is BPT, α is the constant, and ϵ represents the error term.

3) Multiple Linear Regression Analysis:
     - This technique assesses the relationship between independent variables (ETR, ROA, BPT) and the dependent variable (earnings management).
     - The model formula used is :

4) Hypothesis Testing:
     - Coefficient of Determination (R^2): Measures the proportion of variance in earnings management explained by the independent variables.
     - F-Test: Determines if all independent variables together significantly affect earnings management (Sig. < 0.05 indicates a significant relationship).
     - T-Test: Evaluates each independent variable's impact on earnings management individually (Sig. < 0.05 suggests a significant effect for that variable).

RESULTS

A. Descriptive Statistics

Variable	Minimum	Maximum	Mean	Std. Deviation
Profitability (ROA)	0.0269	0.22551	0.0705687	0.04877138
Tax Planning (ETR)	-2.16084	0.81082	0.2317664	0.34263153

Deferred Tax Expense (BPT)	0.003	0.226	0.07057	0.048771

B. Classical Assumption Tests

- Normality Test:
  Kolmogorov-Smirnov: Asymp. Sig. (2-tailed) = 0.008, indicating non-normal distribution (Ajija et al., 2011).
- Heteroskedasticity Test:
  Park and Scatterplot: No heteroskedasticity detected, as significance values are all above 0.05.
- Multicollinearity Test:
  Tolerance and VIF: Tolerance values > 0.1 and VIF < 10 indicate no multicollinearity issues.
- Autocorrelation Test:
  Durbin-Watson Test: DW value of 2.135 indicates no autocorrelation.

C. Regression Analysis

The multiple regression model yields the following results:

1) Constant: -0.018, the baseline for earnings management.
2) Profitability (ROA): Coefficient of -0.119, indicating no significant influence.
3) Tax Planning (ETR): Coefficient of 0.098, showing a significant positive influence on earnings management.
4) Deferred Tax Expense (BPT): Coefficient of 0.004, showing minimal impact.

D. Equations

- R-Squared (R^2):
  Adjusted $R^2 = 0.022$, indicating 2.2% of earnings management variation is explained by the model.
- F-Test:
  Significance = 0.250 (> 0.05), suggesting that the independent variables do not explain the model when tested together.
- T-Test:
  - Profitability (ROA): Sig. 0.725, indicating no significant effect.
  - Tax Planning (ETR): Sig. 0.046, indicating a significant positive impact on earnings management.
  - Deferred Tax Expense (BPT): Sig. 0.971, showing no significant effect.

CONCLUSION

The study analyzes the relationship between tax planning, deferred tax burden, and profitability on earnings management in manufacturing companies listed on the Indonesia Stock Exchange from 2019 to 2022. The results indicate that:

- Tax Planning positively impacts earnings management, suggesting that companies with effective tax planning engage in earnings manipulation.

- Profitability and Deferred Tax Expense do not significantly affect earnings management, indicating these are not primary tools for earnings manipulation

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