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Tax Motivation in Earnings Management

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Abtract: Earnings management is a manager's behavior in managing reported earnings by using methods/techniques to achieve personal and corporate interests. Where earnings management can be viewed based on two perspectives, namely the opportunistic perspective and Messod (2001). According to Watts and Zimmerman (1986), one of the hypotheses of managers in earnings management is related to the political cost hypothesis. One of the methods that can be used by management is tax avoidance in the practice of earnings management.

Research evidence shows that first, there is no difference in the pattern of tax avoidance before and during the Covid-19 pandemic, tax avoidance methods are still used as a tool to manage corporate earnings; second, the corporate governance mechanism through majority share ownership by the government is better able to suppress tax avoidance in earnings management; third, to encourage more transparent and ethical business management in companies especially in government-owned companies, voluntary disclosure (CSR) can reduce tax avoidance and reduce earnings management; fourth, the existence of political connections that the company has provides an opportunity for managers to take advantage of information about taxation and use it in earnings management behavior.

Keywords : Earnings Management, Tax Avoidance, Tax Motivation, Tax Regulation

INTRODUCTION

Earnings management is the process of taking steps taken within the constraints of applicable accounting principles to produce the desired level of reported earnings [1]. Earnings management is then explained as the impact of different interests between agents and principles in accordance with agency theory known by [2], the selection of various accounting methods with the aim of managing earnings reported in financial statements in accordance with positive accounting theory introduced by [3].

[4] analyze the development of earnings management using 653 articles over a ten-year period (2000-2009) and state that various studies in earnings management have not been able to determine the main moti-vation of accrual management whether opportunistic behavior or efficiency. It is con-tinued that the results of this study can be related to various hypotheses submitted by [3], namely one related to the political cost hypothesis showing the results of earnings management companies in order to avoid public pressure through regulatory avoidance such as taxes and capital market reg-ulations.

The practice of tax avoidance by the company is a form of motivation in earnings manage-ment, which is related to the political cost hypothesis which explains that companies tend to choose accounting policies that are able to produce or decrease earnings reporting, this is related to the company's desire to avoid gov-ernment regulations. 1986). In addition, [5] mentions three factors in earnings management motivation, namely taxation motivation, CEO turnover and the Debt to Equity Hypothesis at the time of the IPO.

In Indonesia, the research of [6] proved that there was an increase in tax avoidance practices (tax avoidance) during the Covid-19 pandemic carried out by 39 manufacturing companies listed on the IDX for the 2019-2020 period, but the research of [7] did not found differences in tax avoidance patterns between before and during the Covid-19 period in terms of the use of leverage and the intensity of fixed assets by 54 manufacturing companies on the IDX for the period 2018 to 2020.

The purpose of this study is to examine the development of research related to one of the earnings management motivations, which is related to taxation motivation through the use of tax avoidance methods. Some of the articles used are not only from Indonesia, but also from other countries to develop our thinking regarding the practice of earnings management using tax avoidance methods.

A. Agency Theory

Agency theory shows that there are differences in the interests of agents and principals due to differ-ences in information (information asymmetry) between them due to the separation of ownership. Conflicts of interest arise between management and owners due to the separation of ownership and control of the company. This theory was introduced by [2], stating that individuals in management have different preferences so that they have the desire to block all things, their interests are tied to conflict with the principal [8]. The agency problem cannot be completely eliminated, namely the opportunistic behavior of managers in managing companies with more information than the owners and shareholders.

B. Earnings Management

According to [9] earnings management is a financial reporting phenomenon that provides an alternative way to manage earnings, and is not a deviation from rational investment behavior. There are two perspectives on earnings management, namely the opportunistic perspective which states that managers try to mislead investors and the information perspective and the information perspective is a managerial policy made by managers to reveal to investors the manager's personal expectations about the company's future cash flows [10].

C. Motivation in Earnings Management

[3] mention that there are three motivations in earnings management, namely: 1) Bonus plan hypothe-sis or bonus motivation that encourages management to provide the best performance for the company, in-cluding encouraging management's desire to prosper itself through the bonuses it achieves. 2) Debt (equity) hypothesis is a motivation that arises when a company experiences financial difficulties due to its debt ratio being higher than the capital ratio, which results in the company's decision in choosing accounting policies that provide increased performance through profits so that companies can break their promises in paying off debts owed. have in the next period. 3) The Political Cost Hypothesis explains that companies tend to choose accounting policies that are able to produce increased or decreased earnings reports, related to the company's desire to avoid government regulation. One of them is related to the regulation of tax payments that must be paid by the company.

D. Tax Avoidance

Tax avoidance is an effort that is carried out legally and safely for taxpayers, because it does not con-flict with tax provisions. Where the methods and techniques used tend to take advantage of the weaknesses contained in the tax laws and regulations themselves, by reducing the amount of tax payable [11]. According to [7] tax avoidance can be used by corporate taxpayers as an effort to minimize the payment of the tax burden to be paid to the state treasury, this tax practice diverts cash outflows that should be paid to the government into returns for shareholders.

E. The Relationship between Tax Avoidance and Earnings Management

The achievement of the company's goals through the company's profit report is directly proportional to the amount of tax that must be paid by the company. Management then takes certain ways to reduce the income tax payable in order to realize the expected profit target of the company. According to [12] earnings man-agement can be detected by an empirical model based on deferred income tax expense, based on the results of research conducted by [13] and [14] providing a reference for detecting earnings management behavior related to income tax. Accounting manipulation in a certain period can be done by utilizing discretionary accruals which produce the difference between cash flow and profit. When the tax burden has been calculated and must be paid causing cash outflows for the company, this is a consideration for managers in making decisions.

According to [8] managers manage earnings to report lower profits in order to pay less tax, for example in assessing the degree to which special payment account policies encourage private companies in Portugal to engage in earnings management. The desire to minimize taxes encourages managers to manipulate income.

METHOD

A. Desain Ideas

This study is considered as explorative study since it discusses about some of research which explore tax motivation in earnings management practice.

B. Previous Research

Research that tries to analyze the trend of tax avoidance in manufacturing companies in Indonesia during the Covid-19 pandemic is a study conducted by [7]. This study tries to look at the impact of the unexpected event, namely Covid-19 on taxation in Indonesia by using data from 54 companies in the industrial sector on the IDX and comparing from 2018, 2019 and 2020. Based on the findings there is no difference in tax avoidance patterns between before Covid-19 and during Covid-19 in terms of leverage and fixed assets. This shows that the tax avoidance policy is applied as a short-term fiscal strategy to ensure the existence of the company. Similar research results have been found by [15] using an aggressive tax model in five sectors which are the pillars of national economic growth, namely food and beverage, textile and clothing, chemical, automotive and electronics industries, the researchers observed 89 companies during the observation period. 2014-2019. The results of this study indicate that management uses differences in company characteristics to take advantage of components in aggressive taxation actions. The increase in company profits will encourage management to evade taxes to avoid increasing the size of the tax burden and assist companies in going through the impact of the Covid-19 pandemic that can disrupt company performance.

[12] used data on non-financial companies listed on the China Stock Exchange during the period 2004-2006 to test the following three things, namely 1) whether tax avoidance is one of the motivations for earnings management?, 2) Does good operating performance weaken tax avoidance

motivation? and 3) is there a relationship between firm size as measured by government and non-government ownership shares in weakening the relationship between earnings management and tax avoidance?. The results of this study found that: 1) there is a significant positive relationship between tax avoidance on motivation to perform earnings management, 2) the company's long-term performance weakens the relationship between earnings management and tax avoidance positively where there is a negative effect between tax avoidance motivation in earnings management and 3) majority share ownership by the government shows a positive relationship between tax avoidance and earnings management, while for companies without government share ownership, tax avoidance behavior decreases as the company's performance increases. Earnings management motivation through tax avoidance is still found, especially in conditions of declining company performance and in companies owned by the government.

Research conducted by [16] with the aim of testing whether tax avoidance can be used as a company instrument to conduct earnings management and whether the role of governance mechanisms affects the relationship between tax avoidance and earnings management. This study uses data on manufacturing companies listed on the Indonesia Stock Exchange during the period 2009 to 2012, where tax avoidance is measured using the Effective Tax Rate (ETR), earnings management variables are measured using the Jones model, namely accruing discretionary accruals and governance variables are measured using the board. commissioners, independent commissioners and institutional ownership. The results of this study conclude the following: 1) tax avoidance has a positive effect on earnings management, 2) the board of commissioners does not moderate the relationship between tax avoidance and earnings management, 3) independent commissioners do not moderate the relationship between tax avoidance and earnings management and 4) ownership institutions have a weak influence in moderating the relationship between tax avoidance and earnings management. It can be concluded that tax evasion is an instrument used by companies in earnings management, this is a form of management's opportunistic behavior in maximizing their interests in accordance with the assumptions in agency theory. On the other hand, the corporate governance mechanism which is expected to reduce this opportunistic behavior through the role of controlling interests between management and owners is not able to suppress tax avoidance behavior and earnings management in the company. In addition, in Indonesia, the law related to tax avoidance has not been implemented, thus providing more opportunities for management to use it in earnings management practices.

In addition to linking company size and governance to suppress earnings management behavior in the company as well as an agent's control mechanism over the principal, the use of the Corporate Social Responsibility (CSR) variable is also studied in more depth in the research of [17]. This study investigates whether the implementation of CSR imposed by the Chinese government encourages companies to behave responsibly by limiting earnings management and tax avoidance. The results of this study found that government regulations regarding CSR can effectively reduce corporate earnings management and profit avoidance, although the effect is still limited to government companies. This result is associated with previous research by [12], that tax avoidance can be suppressed in companies whose shares are controlled by the government. Although CSR is a voluntary disclosure that companies can make, the laws and regulations related to CSR are implemented by the Chinese government to encourage companies to be more transparent in reporting financial statements and fulfilling their tax obligations. Government-owned companies are under more pressure than non-government companies to comply with the guidelines and apply CSR principles in their business practices. Great control from the government to government-owned companies in supporting the implementation of the CSR law, is able to suppress earnings management and tax avoidance.

The role of the owner of the company, especially the ownership of the company by the government is able to have a major impact on changes in tax avoidance behavior and earnings management in the company. The high importance of legitimacy triggers companies to cover up opportunistic actions by disclosing CSR, corporate ethics can not only be assessed by the level of CSR disclosure. [18] then use the role of political connections as a moderating variable between CSR in tax avoidance and earnings management. Politically active companies engage in tax avoidance practices because they have a lower detection risk, have better information about changes in tax regulations in the future, have lower political costs and are closer to policy makers. This study found that CSR has a positive effect on tax avoidance, real earnings management and aggregate earnings management. Meanwhile, political connections are not proven to have a role in moderating the effect of CSR on tax avoidance and earnings management practices. These results prove that the lack of transparency regarding the history or positions of members of the board of commissioners and directors makes it difficult to detect any political connections within the company.

[8] examine tax avoidance and earnings management in companies in Ghana using an agency theory perspective. This study also evaluates how the company's financial policies are related to tax avoidance and earnings management. The data used in this study are 119 companies in developing countries during the period 2010 to 2013. The results of this study conclude that the company's financing structure has only a small role in the avoidance and/or management of corporate earnings activities, the behavior of transferring managerial supervision with external mechanisms provided by shareholders. debt does not suppress earnings management behavior through tax avoidance activities.

[8] conducted a study to examine the relationship between transfer pricing, earnings management and tax avoidance in 40 non-financial and financial multinational companies listed on the Ghana Stock Exchange and multinational companies that are not listed. The results show that MNCs in Ghana use transfer pricing and income manipulative activities aggressively to reduce corporate tax liability, whereas financial MNCs are more involved in transfer price manipulation and more aggressively in earnings manipulation than non-financial MNCs. In addition, this study also concludes that corporate tax avoidance is negatively related to profitability, tangible assets and liquidity.

RESULTS AND DISCUSSION

Based on the discussion above, several important things can be drawn; first, there is no difference in the pattern of tax avoidance before and during the Covid-19 pandemic, the tax avoidance method is still used as a tool to manage corporate earnings; second, the corporate governance mechanism through majority share ownership by the government is better able to suppress tax avoidance in earnings management, because tax is a government regulation that must be complied with by companies (including government-owned companies); third, to encourage more transparent and ethical business management in companies, voluntary disclosure (CSR) can reduce tax avoidance and reduce earnings management, especially in government-owned companies as a form of compliance and role model for other companies; Fourth, the existence of political connections that the company has provides an opportunity for managers to take advantage of information about taxation and use it in earnings management behavior

CONCLUSION

Recommendations that can be suggested based on the results of this study are to reveal the motivation for tax avoidance in earnings management practices using a positive accounting approach, because all studies studied use agency theory to explain this phenomenon. In addition, other research can be studied more deeply by using political connections and business ethics, tax evasion is indeed legal based on laws and regulations but unethical because the purpose of reporting to reveal the true state of business entities is not being fulfilled.

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