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The Influence of Tax Compliance and Earnings Quality on Financial Performance (Evidence from Indonesia and Thailand)

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Abstract

This study aims to analyse the effect of tax compliance and earnings quality on financial performance. Information on financial performance is needed by management for evaluating and determining targets, while external parties use it for various purposes. Several studies have found the effect of tax and earnings quality on corporate financial performance, with different results. Using 332 Indonesian and Thai manufacturing companies from 2014 to 2017 as a sample, this study did not find the effect of earnings quality on financial performance. In addition, a significant effect of tax compliance was found on financial performance. This result explains that tax has an important role in the sustainability business, therefore that management attention is needed in tax policy making so that it does not have a negative impact on the company. With the finding that tax compliance has a negative effect on financial performance, it is clear that there are still many taxpayers who have not utilized the taxation facilities from the government that should support the company's financial performance.

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Tax compliance
Earnings quality
Financial performance.

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1. Introduction

Financial performance is one of the measures used in assessing whether or not management is good at running its business so that it encourages management to continue to improve that performance. Many factors are thought to have an impact on improving financial performance, such as capital expenditure (Majanga, 2018) age of the company, and the attendance of board in meetings (Bhatt & Bhattacharya, 2015) cash conversion cycle and liquidity (Afrifa & Padachi, 2016).

Tax is a corporate obligation in helping the country carry out development that is useful for the sustainability of the company's business. Several studies have found the negative effect of tax on financial performance because the tax burden can reduce the net profit of the business and this is what drives companies to not comply (De Schoenmaker, Van Cauwenberge, & Vander Bauwhede, 2014; Thanjunpong & Awirothananon, 2019). Other studies have found otherwise, company compliance with applicable provisions can improve company performance (Tariq & Abbas, 2013). Companies that comply with taxation provisions have a small risk of compliance costs such as tax penalties so that financial performance is higher than companies that are not compliant (Chude & Chude, 2015; Matarirano, Chiloane-Tsoka, & Makina, 2019).

Generally, tax compliance research is done by analysing primary data obtained by questionnaire or interview (Aktaş, Özer, & Özcan, 2019; Sadress, Bananuka, Orobia, & Opiso, 2019) very little tax compliance research uses secondary data. By developing the old measurement of the effective tax rate, this study uses secondary data in measuring corporate tax compliance.

Management has access to company information directly compared to other stakeholders, such as investors, governments, customers, vendors. Though the information is used by stakeholders with their respective goals. Then the quality of financial information can improve the company's image so that it helps in business activities that can improve the company's financial performance. Some previous studies found a positive effect on earnings quality on financial performance (Machdar & Murwaningsari, 2017; Utami, Nuzula, & Damayanti, 2019) but the opposite was found in other studies where earnings quality had a negative influence on financial performance (Ma & Ma, 2017; Sanjaya & Deviesa, 2017).

The study of financial performance is important to help management to analysing the factors that have an impact on business continuity. Therefore, this study was conducted to analysing the effect of tax compliance and earnings quality on financial performance.

2. Literature Review

Compliance theory explains that a person takes an action that is obedient or does not comply with the provisions due to two things, namely the individual approach and the economic approach (Devos, 2012). The company complies with the tax provisions because in addition to being aware that taxes are an obligation of all citizens also to avoid the cost of tax penalties that reduce the level of profitability of the company. Whereas in stakeholder theory it is explained that the actions taken by management are carried out well because it impacts stakeholders including investors, governments, customers, vendors.

Financial performance is the ability of companies to manage their resources (Kartikahadi, Sinaga, Syamsul, Siregar, & Wahyuni, 2016). Financial performance is usually used as a measurement of management in managing a company. Several financial ratios are used in measuring financial performance, such as profitability ratios, solvency ratios, and activity ratios.

2.1. Tax Compliance on Financial Performance

Tax is the highest state revenue in developing countries, such as Indonesia and Thailand, on the one hand, tax is the obligation of companies to support the government to build and develop facilities that support the company's business activities. Various tax facilities are provided by the government in supporting taxpayers to carry out their taxation rights and obligations, such as electronic services. In addition, there are other facilities that help smooth the business of the company (Chude & Chude, 2015; Matarirano et al., 2019), such as restitution facilities and goods import facilities provided by the Indonesian government for compliant taxpayers to help improve financial performance. Even so, several other studies found a negative effect of tax on financial performance (De Schoenmaker et al., 2014; Thanjunpong & Awirothananon, 2019). Therefore, taxes are part of the company's profit and loss which has an impact on financial performance.

H1. Tax compliance has an influence on financial performance.

2.2. Earnings Quality on Financial Performance

Corporate financial information, especially profit information, is used by various parties for a specific purpose. The company carries out earnings management so that financial performance looks good, in contrast to quality earnings information that results in poor financial performance (Ma & Ma, 2017; Sanjaya & Deviesa, 2017). Other research found the opposite results, the quality of corporate profits improve the good image of the company to stakeholders so that smooth business transactions and improve financial performance (Machdar & Murwaningsari, 2017; Utami et al., 2019).

H2. Earnings quality has an influence on financial performance.

3. Method

3.1. Design

This research is a quantitative study with pooled least square test to test hypotheses. The research data was taken from the annual reports of manufacturing companies listed on the Indonesia Stock Exchange and the Thailand Stock Exchange from 2014 to 2017. From the existing 284 population, 83 companies were sampled. 332-panel data were analysed from 83 sample companies for 4 years of observation.

3.2. Variables

3.2.1. Dependent Variables

The dependent variable of this research is financial performance (FP), which is how much the company uses its resources to obtain operating profit. Return on capital employed is used in measuring financial performance in this study.

3.2.2. Independent Variables

There are two independent research variables in this study. The first is tax compliance (TC), a tax-compliant company that records tax burdens in accordance with applicable regulations. Developing an effective tax rate that is commonly used to measure tax planning, this study measures tax compliance with a tax compliance ratio that is by dividing current tax with fiscal earnings that have been multiplied by the tax rate. The second independent variable is earnings quality (EQ), financial information that has high earnings quality is information that is near-real and far from earnings manipulation. Earnings quality in this study was measured using performance adjusted discretional accruals, namely by conducting a regression between assets, depreciation, and ROA of total accruals where the error value of the regression results was then multiplied by minus 1 to be used as a value of earnings quality (Chen, Cheng, & Wang, 2015; Yasser, Mamun, & Ahmed, 2016).

3.2.3. Control Variables

We use five control variables to strengthen the research model namely capital expenditure (CAP) which is measured by dividing the cost of managing assets with total assets (Majanga, 2018) company age (FAGE) is how long corporate was established (Bhatt & Bhattacharya, 2015) cash conversion cycle (CCC) & Liquidity (LIQ) (Afrifa & Padachi, 2016) attendance of board (BOARD) is frequency of board meeting in the year (Fauzyyah & Rachmawati, 2018).

3.3. Research Model

The regression estimates for hypothesis test as follow:

$$FP = \beta_0 + \beta_1 TC + \beta_2 EQ + \beta_3 CAP + \beta_4 FAGE + \beta_5 CCC + \beta_6 LIQ + \beta_7 BOARD + \varepsilon$$

Using STATA 16, we started the analysis of the data by conducting assumption tests of normality, variant inflation factor test, Cook-Weisberg test, and autocorrelation tests whose results were good. In the model suitability test that is by the chow test, LM test, and the thirst test found a suitable model is pooled least square.

4. Result

4.1. Descriptive Statistics

Table-1. Descriptive Statistics

Variable	Mean	Std. Dev.	Min	Max
FP	0.1641	0.2174	- 0.7874	2.0700
TC	1.8475	13.4778	- 87.4167	201.3542
EQ	0.0742	2.5468	- 2.1229	29.8884
CAP	0.0732	0.0558	- 0.0039	0.2814
FAGE	37.2349	15.7871	5.0000	100.0000
CCC	201.3526	93.1079	66.0509	1,222.0043
LIQ	2.7380	2.3301	0.3453	15.1646
BOARD	12.0994	8.2253	3.0000	48.0000

Note: FP = Financial Performance, TC = Tax Compliance, EQ = Earnings Quality, CAP = Capital Expenditure, FAGE = Firm Age, CCC = Cash Conversion Cycle, LIQ = Liquidity, BOARD = Attendance of Board in meeting.

Table 1 shows the statistical values of each study variable. The mean value of 0.1641 explains that the unit of analysis provides a value of operating profit of 16.41% of the resources owned.

Table-2. Regression result.

Independent	Coefficient	Prob.
TC	-0.00151	0.073*
EQ	0.00045	0.919
CAP	-0.66742	0.001***
FAGE	0.00565	0.000***
CCC	-0.00032	0.010**
LIQ	-0.00498	0.307
BOARD	-0.00113	0.428
N	332	
Adj. R	0.1522	
Prob. F-Stat	0.0000	

Note: FP = Financial Performance, TC = Tax Compliance, EQ = Earnings Quality, CAP = Capital Expenditure, FAGE = Firm Age, CCC = Cash Conversion Cycle, LIQ = Liquidity, BOARD = Attendance of Board in meeting
* for significant 10%, ** for significant 5%, *** for significant 1%.

4.2. Regression Result

Table 2 shows the results of the regression test for each of the independent and control variables. It is known that earnings quality does not have a significant effect on financial performance, while tax compliance has a significant effect.

Based on these results, hypothesis 1 is accepted, meaning that tax compliance has an influence on the company's financial performance. With a negative coefficient, this study shows that tax compliance decreases the company's financial performance, this result is in accordance with previous research (De Schoenmaker et al., 2014; Thanjunpong & Awirothananon, 2019). These results indicate that some companies do not utilize industrial facilities provided by the government to compliant taxpayers, such as restitution and import facilities. In fact, by utilizing this facility, the company's business activities and company finances can increase business effectiveness so as to improve performance.

Based on the regression results in Table 2 also shows that earnings quality has no significant effect on financial performance. Therefore, hypothesis 2 is rejected. Quality financial information from companies does not have an impact on financial performance. This finding is important information for companies to encourage in making quality financial reports. This result is not in line with several previous studies that found the effect of earnings quality on financial performance (Machdar & Murwaningsari, 2017; Utami et al., 2019).

Some control variables are known to have a significant influence on financial performance. Capital expenditure and the cash conversion cycle were found to have a negative effect on financial performance, while firm age had a positive effect on financial performance.

5. Conclusion

5.1. Conclusion and Implication

The results of this study found that tax compliance has a negative impact on financial performance. This result reflects that there are still compliant companies that have not utilized industrial facilities from the state such as restitution and import facilities so that there is no help in increasing work effectiveness and financial performance.

The results of this study have implications for company management to utilize industrial facilities provided by the government to compliant taxpayers so that they can help the company's business activities and improve financial performance.

5.2. Limitation and Recommendation

There are still many companies that do not have complete research data, so they are eliminated from this research analysis unit. The results of this study explain Indonesian and Thai manufacturing companies, different results may be obtained with other units of analysis, such as companies in other sectors or other countries.

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