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Factors Affecting Book-Tax Differences in Indonesian Manufacturing Industries

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Abstract

The motivation behind this investigation was to determine the effect of earnings management and tax management on book-tax differences (BTD) and audit fees. The research uses secondary data from the annual financial reports of manufacturing entities from 2015 to 2019 which are recorded on the Indonesia Stock Exchange. The study used a purposive sampling selection method to select 112 samples over a five-year period (2015–2019). Data processing was performed using path analysis techniques at a significance level of 0.05. The uniqueness of this study comes from the use of audit fees as a moderating variable, with the consideration that audit fees have an impact on the preparation of financial reporting. The research results explain that tax management has an effect on BTD. Tax management provides an opportunity for companies to carry out tax planning based on tax law in order to embezzle tax sanctions and make tax payments efficient. However, audit fees do not significantly strengthen the relationship between earnings management or tax management on BTD.

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1. Introduction

In relation to Indonesian tax revenue, income tax is divided into two, namely individual income tax and corporate income tax. If broken down by state revenue, the income tax of corporate taxpayers has a very large contribution to the total state tax revenue compared to the income tax of individual taxpayers.

The below table contains the total incomes from tax revenue, non-tax state revenue (PNBP) and grants for 2017, 2018 and 2019 in billions of rupiah.

Table 1. Indonesian tax income.

Year	Tax income	Non-tax income	Grant	Total tax income
2017	1,343,529.80	311,216.30	11,629.80	1,666,375.90
2018	1,518,789.80	409,320.20	15,564.90	1,928,110.00
2019	1,643,083.90	386,333.90	1,340.00	2,030,757.80

Source: Indonesian Central Statistics Agency.

The figures in Table 1 show that the state revenue from the tax sector is the largest share compared to the non-tax sector; therefore, taxes are the main source of state revenue in Indonesia.

Tax revenue in Indonesia decreased throughout 2019. The manufacturing and mining sectors experienced the largest decline in tax payments to the state treasury. The Minister of Finance, Sri Mulyani Indrawati, said that the realization of tax revenue, which amounted to Rp1,332.1 trillion last year, only grew by 1.4% on an annual basis. Tax payments for the manufacturing and mining sectors recorded negative growth because they were directly related to commodity prices and international trade. Tax revenue from the mining sector experienced the biggest contraction. This sector recorded a negative growth of 19%. In fact, in 2018, the mining sector recorded growth of up to 50.7%. The sector that suffered the most was the mining sector, which contracted by 19% last year. This is one of the causes of pressure on tax revenues (source https://news.ddtc.co.id).

The most recent issue in charge research is book charge contrasts. Book charge contrasts are characterized as the distinction between bookkeeping benefits and available pay. This distinction is brought about by the principle of making financial reports dependent on Financial Accounting Standards (FAS) with charge fiscal summaries dependent on material duty guidelines. The issue of book-tax differences increases the chances of making a profit and boosting income quality (Scholes, Wolfson, Erickson, Maydew, & Shevlin, 2005). The results of this examination express that the measure of expense reviews significantly affects the honesty of fiscal reports. This research aims to determine the effect of earnings management and tax management on book-tax differences and determine if audit fees can weaken or strengthen the effect of earnings management and tax management on commercial profit and tax profit.

2. Literature Review

Entities that are listed on the Indonesia Stock Exchange have complex problems and require investors to finance them through their investments. Managers have a fiduciary responsibility to investors with a focus on maximizing their value. The separation of proprietorship and control prompts a possible irreconcilable circumstance between agents and investors. A contention happens when the interests of the executives are not in accordance with those of the financial backers. The board's aim is to serve their own interests to the detriment of financial backers, for example, the receipt of significant compensation and high rewards. However, investors' main aim is to maximize the value of their investment. This has become associated with agency theory.

2.1. Agency Theory

Jensen and Meckling (1976) express that the office relationship is an assortment of agreements between the proprietor of monetary assets (head) and the chief (specialist) who deals with the utilization and control of these assets. In suppressing the risk of agency theory associated with the agency burden that occurs, agency expense is defined as the cost borne by investors to encourage managers to maximize investor wealth. Jensen and Meckling (1976) state that there are three types of agency costs, namely monitoring expenses, bonding expenses, and residual losses. Information asymmetry comprises two types: Moral risk, which occurs because management does not do what has been agreed, and adverse selection, which occurs because the principal does not know whether the decision made by the agent is true information. This can be related to earnings management practices in a company. This current study tested and analyzed earnings quality by linking it to book-tax differences, so it can be concluded that book-tax difference (BTD) can explain profit quality, and profit quality is related to earnings management practices.

Agency theory is relevant to this research because it can explain that management as an agent practices earnings management. Earnings management behavior by agents affects the difference contrast between bookkeeping benefits and taxable profit in a company's financial statements. Thus, if earnings management behavior is high, it will indicate book-tax differences. However, the opposite applies if the earnings management activity is small.

2.2. Book-Tax Differences (BTD)

Tang and Firth (2011) explained that accounting profit and tax profit is the difference between profit before tax reported in commercial financial statements and taxable profit reported to the Tax Office. This study suspects that the size of discretionary accruals affects the size of the book-tax differences. Book-tax differences are transitory contrasts that emerge because income and cost are not the equivalent in each rule; however, over the long term, the recognized amounts will be the equivalent. Perpetual contrasts are not perceived by the tax rules but are perceived in the bookkeeping results (Ferreira, 2012).

2.3. Earnings Management

Tang and Firth (2012) investigated the existence of earnings management in companies in China. Scott (2009) stated that the time spent planning monetary reports for external parties is so that companies can incrementally reduce income revealing, and the executives can utilize the slack in the utilization of bookkeeping strategies and make arrangements (discretionary) that can quicken or postpone expenses and incomes so the organization's benefits are more modest or more prominent and true to form.

2.4. Audit Fee

In principle, review charges are controlled by exertion (Choi, 2010). It has been demonstrated that examiners include board honesty in their judgment to evaluate the innate dangers and control related to reviews (Ayers, 1998). The size of the audit fee that has been agreed by the auditor with his client will affect the quality of the audit.

2.5. Tax Management

Tax management is a strategic planning process with the aim of increasing profit performance measurement. Tax management has costs that include opportunity cost and political cost (Scholes et al., 2005; Slemrod, 1992). The practice of tax management is very influential on the BTD (Dridi, 2015).

3. Hypothesis Formulation

According to research by Anastasia (2013), high discretionary accruals will affect larger BTD, and high tax avoidance treatment is associated with higher earnings achievement from earnings management. It is found that BTD is useful for accrual accounts to determine the occurrence of profit management.

Tang and Firth (2011) stated that book-tax differences are a way to manipulate accounting profit and tax profit caused by entity motivation, and the higher the level of management incentives to carry out earnings management practices, the greater the difference in earnings (Ahnan & Murwaningsari, 2019). Companies that have a high BTD level are more likely to meet profit management estimates. In accordance with the arguments of Phillips, Pincus, and Rego (2003), if a large BTD is associated with a large probability of meeting management's desired earnings, it is useful in earnings management practices. Therefore, the hypothesis becomes:

H1: Earnings management has a significant effect on BTD.

BTD will have a different meaning when the value is absolute, that is, the company seems to have a higher accounting profit than its fiscal profit. In other words, the company is indicated to have taken tax management action because its BTD value is high. For this study, the true (not absolute) BTD value was used. Several studies state that BTD contains information on tax avoidance using tax management (Plesko, 2004). According to Anggreni (2017), tax plan behavior is manifested by large book-tax differences. From this argument the hypothesis is:

H2: Tax management has a negative effect on BTD.

Hanlon, Krishnan, and Mills (2012) concluded their research with evidence that BTD is associated with high audit fees. This signals that these tax accounting differences represent proxies that can be analyzed for the quality of earnings that affect the auditor's decision to examine a company's financial reports. Therefore, the following can be hypothesized:

H3: Audit fee strengthens the influence of earnings management on BTD.

Large audit costs will cause auditors not to be neutral in carrying out their functions, and accountants' opinions weaken the practices of auditors. Asthana & Boone (2012) and Eshleman & Guo (2013) found similar evidence regarding the economic dependence of auditors on clients. They found that clients who incur a high audit fee have large accrual accounts, mainly to meet analysts' projections, especially in terms of tax costs. Hanlon et al. (2012) explained that there is a significant effect of audit fee on BTD. This gives rise to the following hypothesis:

H4: Audit fee strengthens the relationship between tax management and BTD.

4. Methodology, Sample Size and Variables

Figure 1 explains the relationship between the variables used as the research objects. Independent variables, earnings management and tax management all have an influence on the dependent variable of book-tax differences, while the moderating variable in this figure is the audit fee, which functions to strengthen the relationship between the dependent variable and the independent variables. The control variables in this study are size, leverage, and profitability.

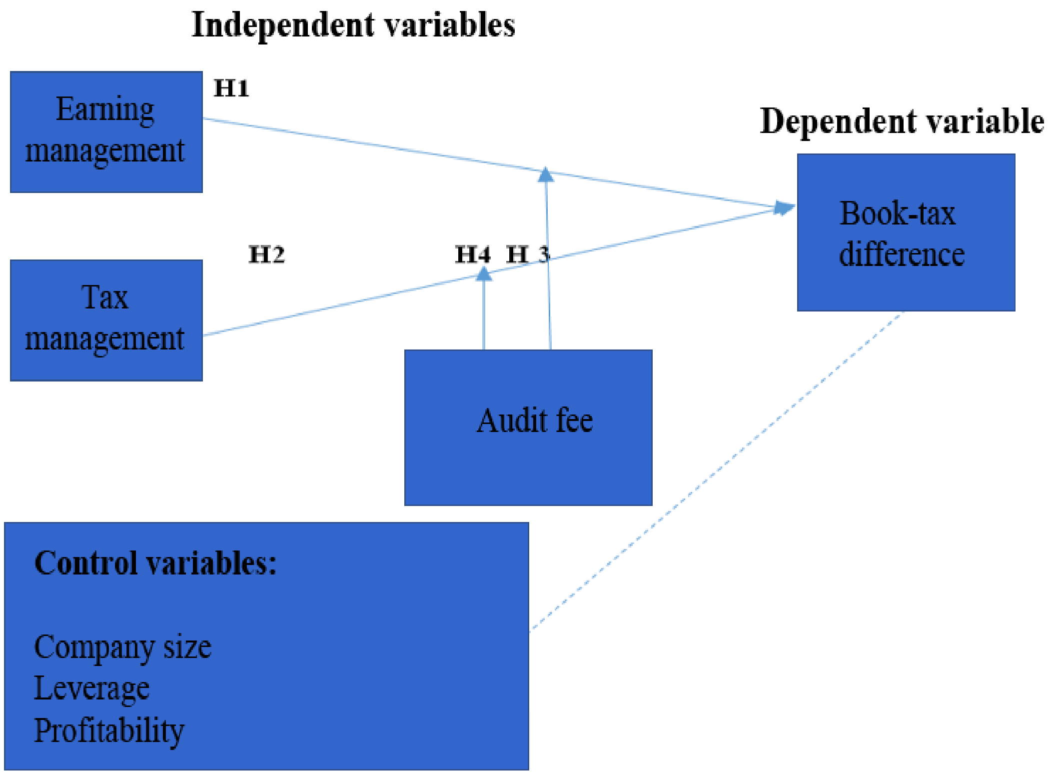

Figure 1. Framework.

Models:
Hypotheses 1 and 2:
BTD = β0 + β1 Ern_Mgt + β2 Tax_Mgt + β3 Size + β4 Lev + β5 Pro + ε

Hypotheses 3 and 4:
BTD = β0 + β1 Ern_Mgt + β2 Tax_Mgt + β3 Ern_Mgt*Aud_Fee + β4 TM*Aud_Fee + β5 Size + β6 Lev + β7 Pro + ε

This investigation utilizes secondary data from the yearly fiscal summaries of manufacturing organizations between 2015 and 2019 that are listed on the Indonesia Stock Exchange. The research sample selection method uses purposive sampling with the following criteria: the entity uses the Indonesian rupiah (IDR) currency, the entity has the necessary variable components, the company has not experienced a loss during the five years recorded on the Indonesia Stock Trade, the company publishes audited financial reports on December 31 consistently, and the company has complete data for the full five-year period (2015–2019). The number of samples used was 112 in five years. Data processing was performed using path analysis techniques at a significance level of 5%, or 0.05.

5. Measurement

5.1. Book-Tax Difference (BTD)

The dependent variable used in this research is BTD, which is the differences in earnings based on book value and tax value, referring to research by Tang & Firth (2012). BTD is calculated using the following formula:

$$BTD = \frac{\text{Accounting Profit} - \text{Tax Profit}}{\text{Total Assets}}$$

5.2. Earnings Management

This research uses an accrual earnings management measure using discretionary income (Stubben, 2010).

This is measured as follows:

1) Revenue Model: $\Delta\ AR_{it} = \alpha + \beta 1 \Delta R1\_3_{it} + \beta 2 \Delta R4_{it} + e$
2) Conditional Revenue Model: $\Delta ARit = \alpha + \beta 1 \Delta Rit + \beta 2 \Delta Rit \times SIZEit + \beta 3 \Delta Rit \times AGEit + \beta 4 \Delta Rit \times AGE\_SQit + \beta 5 \Delta Rit \times GRMit + \beta 6 \Delta Rit \times GRM\_SQit + e$

Note:
AR = year-end receivables, R1_3 = revenue in the first three quarters, R4 = revenue in the fourth quarter, SIZE = natural log of total assets at the end of the year, AGE = age of the company (years), GRM = gross margin, SQ = square of the variable, e = error.

5.3. Tax Management

The measure of tax management is the effective tax rate. Reasonable tax rates are used to strategize corporate tax savings systems because they provide information on the effects of tax incentives and the development of income tax rates (Gupta and Newberry, 1997).

5.4. Audit Fee as a Moderating Variable

The audit fee is determined by the auditor and his client. It is likely that the audit fee will affect the quality of the audit produced. High audit fees will increase the accuracy of auditors in the process of checking financial statements and expand the audit procedures used when auditing financial statements (Nuraeni & Mulyati, 2018).

Research conducted by El-Gammal (2012) proves that large audit fees paid to independent auditors will affect the quality of the audits they produce. Research conducted by Nuraeni & Mulyati (2018) states that audit fees are closely related to earnings persistence. Audit costs in this study use measurements adopted from research by Martinez & da Jesus Moraes (2014) and Evlin and Sistya (2018):

Audit Fee = Natural Log of Audit Fee.

6. Discussion and Results

Table 2. Descriptive statistics.

	N	Min.	Max.	Mean	Std. deviation
Ern_Mgn	112	-1.9778	0.21503	0.3103027	0.850017
Tax_Mgn	102	0.00482	0.54839	0.3390788	0.54808576
Aud_Fee	112	20.06934	33.32018	27.4443702	2.85628077
Lev	112	0.10923	2.65455	0.7457072	0.48351997
Siz	112	0.11620	0.59764	0.0782831	0.10743786
Pro	112	20.34752	33.32018	28.2787078	1.95339401
BTD	112	0.92937	0.63182	0.0155578	0.18435841
Valid N (Listwise)	102				

Note: Ern_Mgt = Earnings management, Tax_Mgt = Tax management, Aud_Fee = Audit fee, Lev = Leverage, Siz = Size, Pro = Profitability, BTD = Book-Tax difference.

Based on Table 2, the minimum earnings management value is -1.9778, the mean value is 0.3103017 and the standard deviation value is 0.850017. This indicates that the standard deviation is greater than the average, which means that the variation of earnings management is heterogeneous, i.e., the average cannot be used to describe the overall data. For leverage, the minimum value is 0.00482, the mean value is 0.7457072 and the standard deviation value is 0.54808576. This shows that the standard deviation is smaller than the average, so the homogeneous leverage variation can be used to explain the data as a whole.

Table 3. Regression results.

Dependent variable	Independent variable	Prog. sign	Coeff.	T-stat	Sig.	Information
BTD	Cons		-0.088	0.297	0.383	-
	Ern_Mgt	+	-2.854	-0.013	0.495	H1 rejected
	Tax_Mgt	-	-0.02	0.566	-0.013*	H2 accepted
	Ern_Mgt*AF	+	0.942	0.058	0.477	H3 rejected
	Tax_Mgt*AF	+	-0.001	-0.496	0.310	H4 rejected
	Lev	+	0.079	1.912	0.019 *	H5 accepted
	Siz	+	0.191	0.453	0.018*	H6 accepted
	Pro	+	0.001	0.595	0.027*	H7 accepted
	F-statistic	0.03*	-	-	-	-
	Adj R-squared	0.307				
	Standard error	0.5123				
	N	112	-	-	-	-

Note: $BT = \beta 0 + \beta 1 Ern\_M + \beta 2 Tax\_Mgt + \beta 3 Ern\_M{*}AF + \beta 4 Tax\_Mgt{*}AF + \beta 5\ Siz + \beta 6\ Lev + \beta 7 Pro + \varepsilon$.
Ern_Mgt = Earnings management, Tax_Mgt = Tax management, Aud_Fee = Audit fee, Lev = Leverage, Siz = Size, Pro = Profitability, BTD = Book-tax difference.

Based on the results in Table 3, the F-statistic is 0.03, which is smaller than 0.05, meaning that the significance level is 0.03 < 0.05. Because the level of significance is < 0.05, the result implies that the independent variable impacts the dependent variable.

The adjusted R-squared is 0.307, which implies that 30.7% of the BTD factors can be clarified by the tax management and earnings management variables. The remainder (69.3%) can be explained by different factors not included in the study. As indicated by Chin (1998), the R-squared qualities are 0.6 (strong), 0.3 (moderate) and 0.19 (weak).

Tax management has a large negative effect (-1.3%) on the BTD variable, which means that each increase in tax management decreases BTD by 1.3%. If leverage increases by 1.9%, an increase of 1.9% in book-tax difference will follow. If the control variable of Size increases by 1.8%, it will be followed by an increase in book-tax difference of 1.8%. If profitability increases by 2.7%, then an increase in BTD of 2.7% will follow.

6.1. The Effect of Earnings Management on Book-Tax Differences

A regression analysis was carried out on the effect of earnings management on BTD. The regression result is 0.495, which is greater than 0.05, so it can be interpreted that the independent variable of earnings management has no significant effect on BTD. It can therefore be concluded that the difference in accounting gain and taxable gain in the financial report is not due to profit management practices. The results of this analysis are in contrast to those of Sari and Purwaningsih (2014). From the perspective of the main goal of earnings management, performance can be improved by choosing accounting methods and manipulating discretionary accruals to generate the desired profit for the benefit of managers (bonuses and performance appraisals). If viewed from the perspective of the main objective of earnings management, it makes sense that tax management has no significant effect on BTD.

6.2. The Effect of Tax Management on Book-Tax Differences

The regression analysis shows that tax management has a significance value of -0.013, which is less than 0.05, thus explaining that tax management has a significant influence on BTD and the practices used by the company are effective.

Tax management helps companies to carry out tax planning in accordance with tax regulations in order to avoid sanctions and make tax payments efficient by using tax avoidance so that tax planning can lead to lowering the company's tax burden without violating applicable tax regulations. The after-effects of this examination support the study carried out by Mangunsong (2002). The better the tax planning, the less BTD will occur in an entity.

6.3. The Audit Fee Strengthens the Influence of Earnings Management on Book-Tax Differences

The regression results for the moderating effect of audit fee on the connection between profit management and BTD show a value of 0.477, which is more than 0.05, so it can be interpreted that the audit fee does not strengthen the relationship between earnings management and BTD**.** This is different from the results of the research conducted by Hanlon (2002), which explains that higher audit costs lead to higher BTD, so audit fees can moderate the relationship between earnings management and BTD. High audit costs do not have a major effect on earnings management practices, and large audit fees do not have an impact on BTD.

Usually, effective audit fees are used to measure audit quality. The results of previous research explain that audit fees have a major effect on the quality of audit reports (Wiguna, Yasa, & Suardani, 2019). Also, previous studies state that high audit fees affect audit reporting decisions (Trainor, 2009).

6.4. Audit Fee Strengthens the Influence of Tax Management on Book-Tax Differences

The results of the regression analysis state that audit costs result in a moderating effect between tax management and BTD. The value is 0.310, which exceeds 0.05, and means that the audit fee cannot strengthen the relationship between earnings management and BTD. The results of this study seem to be inversely related to the results of research conducted by Martinez and da Jesus Moraes (2014) and Maharani (2014), who explain the influence between tax avoidance and audit costs. Currently, external auditors can carry out a higher complexity audit, which is believed to help companies in their tax planning. The results of Martinez and Maharani's research make sense because a high audit fee will ensure capable auditors with a high level of financial and tax knowledge who will conduct an extensive audit.

7. Conclusion

The findings in the research confirm that tax management has a positive effect on book-tax differences because tax management encourages companies to carry out tax planning in accordance with regulations to avoid sanctions. It was also found that leverage, company size, and profitability affect book-tax differences.

This research is expected to be useful for tax accountants as an evaluation tool to determine the condition of a client as best as possible; a good client assessment will make it easier for tax accountants to prepare financial reports for taxation to minimize the risk of penalties.

The limitation of this study relates to the sample as it only uses public companies in the manufacturing sector, so this will have an impact on the generalizability of the research results.

Further research is recommended because Indonesia is a developing country, so researchers can carry out further studies on other industries besides manufacturing.

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