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# CAN REDUCING CORPORATE INCOME TAX RATES DECREASE TAX AVOIDANCE?

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**Abstract**
This research aims to examine and analyze the effect of reducing corporate income tax rates on tax avoidance practices carried out by non-cyclical consumer sector companies. This research involves secondary data analysis using the Panel Data Regression approach with 6 research samples taken from the non-cyclical consumer sector on the LQ45 index for the 2018-2022 period. The total sample used in the study amounted to 30 observations based on purposive sampling. The test results show that reducing the corporate income tax rate positively and significantly affects tax avoidance practices in non-cyclical consumer sector companies on the LQ45 index. This research is expected to encourage the government to formulate other tax incentive policies and provide insights into the effectiveness of the implemented tax policies. One of the expected objectives of companies utilizing tax incentives is to accelerate the economic growth of society. Lower tax burdens are hoped to encourage companies to expand their businesses and potentially absorb more labor, triggering multiplier effects in the economic sector to advance public welfare. In terms of literature, this research contributes to enriching the discussion about the effect of reducing corporate tax rates on companies' tax avoidance, and it is expected to contribute to the development of tax accounting literature.
**Keywords**: Effective tax rate, Income tax rate, Tax avoidance

## INTRODUCTION

Taxes are compulsory contributions the government imposes on individuals or companies, regulated by law (Kayshev, 2020). They serve as the government's main source of revenue, funding public expenditures such as healthcare, education, infrastructure, security, and social programs. Therefore, taxes can be defined as a mandatory and coercive levy. Naturally, individuals or society often dislike something mandatory and coercive. Taxpayers, in particular, use various methods, ranging from legal (tax avoidance) to illegal (tax evasion) means, to avoid taxes despite the risk of facing tax consequences in the future. It is further compounded by the lack of direct benefits taxpayers receive for their contributions.

Taxes are crucial for the prosperity of a nation. The state relies on taxes as contributions from its citizens to build a country aimed at ensuring the welfare of all (Ojo, 2020). The significance of taxes is that governments must optimize tax intensification and extensification to meet or exceed the revenue targets set in the State Budget (APBN). Budget deficits can be minimized or even converted into budget surpluses if tax revenues are maximized. Taxes serve as a source of funds (budgetary function) and perform a regulatory, redistribution, and democratic function (Ikatan Akuntan Indonesia, 2012).

Taxes play multiple roles in governance and societal development (Mohammed & Tangl, 2023). Through the revenue function, taxes are crucial in funding various government expenditures outlined in the state budget, which includes predetermined tax targets for each fiscal year. Taxes also have a regulatory function, as seen during the COVID-19 pandemic, when tax incentives were used to accelerate economic recovery, demonstrating their role in mitigating crises. Moreover, the redistribution function of taxes helps distribute wealth equitably, promotes balanced development, and addresses economic, social, and political inequalities in Indonesia. Taxes also support the democratic function, symbolizing a partnership between the government and taxpayers, with taxes acting as a societal contract that fosters collective nation-building.

The corporate income tax rate has undergone significant changes. Under Law Number

7 of 1983, the corporate income tax rate was applied progressively, ranging from 15% to 35% based on taxable income. Later, under Law Number 10 of 1994, the rates were revised to 10%–30%, and this progression continued until Law Number 17 of 2000, which also applied a progressive rate. In 2009, Indonesia shifted to a flat tax rate of 28%, reduced to 25% in 2010, and further reduced to 22% by Law Number 7 of 2021 through the Job Creation Law to support economic recovery after the COVID-19 pandemic.

Naturally, taxpayers attempt to minimize their tax burden, as taxes reduce their ability to expand businesses, pay salaries, and cover rent, transportation, and production costs (Dyreng et al., 2008). Companies legally avoid tax by exploiting loopholes in tax regulations, such as using tax incentives or transferring assets to low-tax jurisdictions. Although legal, tax avoidance reduces potential tax revenue, prompting governments to close loopholes through new regulations (Lietz, 2013). On the other hand, tax evasion, which involves illegal practices like underreporting income, violates tax laws.

Using tax incentives to reduce the corporate income tax rate is a legitimate tax avoidance strategy. Companies can use these incentives to grow, hire more employees, and contribute to economic growth. However, companies may still avoid tax by delaying revenue recognition or accelerating expense recognition to shift profits to periods with lower tax rates (Oktavianie, 2019). With the reduction in corporate income tax rates, it is hoped that companies will refrain from further tax avoidance or tax evasion, considering that taxes play a crucial role in national development. A balance between government needs and company interests must be achieved, making this a topic worthy of further research to enhance tax policy effectiveness. The reduction in the corporate income tax rate from 25% to 22% in 2020 raises concerns about its effect on corporate tax avoidance. While tax avoidance is legal, it can reduce potential tax revenue and harm the state's fiscal position. On the other hand, companies may face increased audit risks, reputational damage, and disruptions to long-term sustainability due to excessive tax avoidance.

Previous research on the effect of tax rate reductions on tax avoidance has produced mixed results. Some studies show a positive relationship between lower tax rates and increased tax avoidance (Rombe et al., 2017; Kiryanto, 2022), while others find no significant effect (Oktavianie, 2019; Handayani & Rachmawati, 2022). Most research has focused on general companies without considering industry-specific characteristics, leaving gaps in the literature.

This study examines the effect of corporate income tax rate reductions on tax avoidance practices in non-cyclical consumer sector companies listed on the LQ45 index. This sector is relatively stable and less affected by economic fluctuations, making it ideal for analyzing consistent tax avoidance behavior. Unlike previous research, this study focuses on the non-cyclical consumer sector, using data from both before and after the tax rate reduction to compare short- and long-term impacts.

This research also contributes to the Directorate General of Taxes (DGT) by evaluating the effectiveness of the tax rate reduction policy and helping formulate policies to prevent harmful tax avoidance practices. Further investigation is necessary to comprehensively understand tax avoidance in the non-cyclical consumer sector and offer insights for improving tax policy.

This study builds upon previous research by Handayani & Rachmawati (2022) but focuses on the non-cyclical consumer sector, which tends to remain stable regardless of economic conditions. It extends the observation period to five years, covering the years before and after the 2020 tax rate reduction. By focusing on stable companies listed in the LQ45 index, this study aims to provide policymakers with valuable insights into creating more effective tax policies for various sectors.

## LITERATURE REVIEW

The concept of agency theory refers to the relationship between the agent's and the principal's interests in achieving optimal company performance (Anthony & Govindarajan, 1995). Berle and Means (1932) further explain that agency theory describes the efforts to understand and address difficulties arising from inadequate knowledge when entering into agreements or contracts. Agency theory remains relevant in taxation, particularly between the government and company managers. In this case, the government acts as the "principal" by setting tax regulations, while the company manager is the "agent" responsible for implementing tax regulations from the company's perspective. Company managers often have a motive to minimize the company's tax burden and increase net profit, with the expectation of receiving a bonus. However, this conflicts with the government's need for tax revenue to fund infrastructure development and public services for the welfare of the people.

In the context of agency theory, tax avoidance practices may arise as a management response to corporate income tax rate reductions. Managers may feel encouraged to engage in tax avoidance to maximize company profits or meet performance targets set by shareholders. Yamashita and Otogawa (2007) demonstrated that companies delayed reporting taxable income to reduce taxable profits, even after lowering the tax rate. Company management may employ various strategies after the issuance of policies to reduce tax rates, thereby minimizing the company's tax payments. Consequently, tax rate reductions may influence management's decision to avoid tax.

The reduction in corporate income tax rates is expected to significantly impact tax avoidance practices in non-cyclical consumer sector companies listed on the LQ45 index. This underscores the need for closer supervision of corporate tax compliance in response to changes in tax regulations. Additionally, effective policies must be developed to prevent the abuse of tax avoidance practices that could harm the broader economy.

According to Law Number 28 of 2007 concerning the Third Amendment to Law Number 6 of 1983 on General Provisions and Procedures for Taxation, taxes are mandatory contributions owed by individuals or entities to the state, imposed by law, without direct reward, and used for state purposes to achieve the greatest welfare for the people.

Corporate income tax for businesses began in 1983 with progressive tax rates based on taxable income, which were replaced in 2009 by a flat rate. As of the time of this research, the applicable corporate income tax rate is 22%, as stipulated by Law Number 7 of 2021 on the Harmonization of Tax Regulations.

Tax avoidance is a legal means of reducing taxes within the boundaries of tax legislation, often achieved through tax planning (Zain, 2007). Suandy (2013) defines tax avoidance as an effort to legally reduce taxes by optimizing available provisions, such as deductions and exceptions, and exploiting weaknesses in existing tax regulations. A strong understanding of tax regulations is necessary for tax avoidance practices, as crossing legal boundaries transforms tax avoidance into tax evasion. Tax avoidance involves identifying loopholes in tax laws that can be exploited to reduce a company's tax liabilities. These loopholes often exist due to ambiguities or gaps in the regulations. In Indonesia, the self-assessment system allows taxpayers to calculate and report their taxes, providing tax avoidance opportunities. Tax avoidance can be categorized into two types: passive resistance, which involves indirect obstacles to tax collection, and active resistance, where taxpayers take direct actions to avoid or reduce their tax liabilities. Tax avoidance is commonly measured using the Effective Tax Rate (ETR).

Non-cyclical consumer industries, such as food and beverages, typically exhibit stability in consumer demand because their products are necessities and are less dependent on economic fluctuations. Many companies in this sector showed consistent growth even during economic downturns like the COVID-19 pandemic. These industry characteristics make it an ideal setting for observing the effects of tax rate reductions on tax avoidance practices, as economic conditions influence companies in the non-cyclical consumer sector. Additionally, companies listed on the LQ45 index tend to be large, stable firms, providing a solid foundation for this study.

Reducing corporate income tax rates can significantly influence business entity behavior and drive complex economic responses. The government's goal in lowering corporate tax rates is to stimulate job creation and attract investment, ultimately fostering economic growth. However, lower tax rates may also encourage companies to engage more actively in tax avoidance to maximize profits. Management might accelerate cost recognition before the tax rate reduction, as seen in 2019 when the rate was 25%, or delay revenue recognition to benefit from the reduced 22% tax rate in 2020.

Agency theory provides a framework for understanding the relationship between principals and agents with divergent interests. The government (as the principal) sets tax regulations in taxation, while company managers (as agents) are responsible for corporate tax compliance. Conflicts of interest arise because managers aim to minimize tax burdens to increase profits and bonuses, while the government seeks tax revenue for public services. Reducing the corporate tax rate may exacerbate this agency conflict, as lower tax rates incentivize managers to engage in tax avoidance, acting in their self-interest when monitoring and controlling costs are low. As a result, tax rate reductions may create opportunities for managers to exploit weaknesses in the tax system and pursue more aggressive tax avoidance strategies.

Previous studies have explored the relationship between tax rate reductions and tax avoidance, with many finding a positive correlation. Yamashita and Otogawa (2007) found that firms in Japan delayed revenue recognition to reduce taxable profits following a tax rate reduction. Dyreng et al. (2008) showed that multinational companies in the United States increased tax avoidance activities after tax reforms that lowered corporate tax rates. Hanlon and Heitzman (2010) found that U.S. firms responded to tax rate reductions by increasing tax avoidance, mainly through transfer pricing manipulation. Rego (2003) demonstrated that lower tax rates in Portugal led to increased tax avoidance by large corporations. Similar results were observed in Indonesia, where Rombe et al. (2017) found that the 2009 corporate tax rate reduction led to increased tax avoidance practices in manufacturing companies. Kiryanto (2022) also found a positive relationship between lower tax rates and tax avoidance in firms listed on the Indonesia Stock Exchange.

Based on agency theory and empirical evidence from previous studies, it can be concluded that reducing corporate tax rates increases incentives for company managers to engage in tax avoidance. Therefore, this study is expected to find a positive relationship between decreased corporate income tax rates and increased tax avoidance practices in non-cyclical consumer sector companies listed on the LQ45 index. Based on this explanation, the hypothesis is formulated as follows:

$H_1$: A decrease in corporate tax rates positively affects tax avoidance.

## METHODS

The method used in this study is a quantitative approach. The data used in this study are secondary data sourced from annual financial reports of non-cyclical sector companies from 2018 to 2022. The data is obtained through the IDX.co.id website. The summary of the sample of this study using purposive sampling is as follows:

Summary of Research Sample

| Criteria | Amount |
|---|---|
| Non-cyclical sector companies listed on the IDX for the period 2018 to 2022 | 6 |
| Number of observation periods for each company | 5 |
| Total Sample | 30 |

Source: processed

The sampling technique uses purposive sampling, based on criteria that meet the requirements according to the research to be sampled. The following criteria are chosen in determining the sample: companies in LQ45 and non-cyclical consumer sector companies. This study's dependent variable is tax avoidance, which includes companies' legal efforts to reduce their tax liabilities. Tax avoidance is proxied by using the negation of the effective tax rates (ETR) ratio as used by Puspitasari et al. (2021) and Yulianty et al. (2021), calculated using the following formula:

$$\text{Effective Tax Rate} = \frac{\text{Tax Expense}}{\text{Earning Before Income Tax}}$$

Tax avoidance is obtained from the ETR value multiplied by -1. This study's independent variable is the Corporate Income Tax Rate. The proxy for the corporate income tax rate follows Shome (2021), using the applicable corporate tax rate. In line with Law Number 7 of 2021 concerning the Harmonization of Tax Regulations, the Indonesian government has changed the corporate income tax rate. Up to 2019, the rate was 25%; from 2020, it was reduced to 22%.

This study also incorporates two control variables: Leverage, measured by the Debt-to-Equity Ratio (DER), and Profitability, measured by Return on Assets (ROA). Leverage represents a company's debt proportion and capacity to meet short-term and long-term obligations. It is calculated by assessing the ratio of total liabilities to total equity. While debt can support a company's operational and investment activities, it also incurs interest costs that increase with higher leverage. Thus, greater leverage leads to increased interest expenses. However, debt can be strategically used to reduce taxable profits, as interest expenses are tax-deductible. This aligns with the findings of Tanjaya & Nazmel (2021), which suggest that companies use debt as a tax avoidance tool, consistent with agency theory.

Profitability, crucial for maximizing profits, requires continuous monitoring of business performance to ensure efficient and effective achievement of objectives. A decrease in a company's ability to generate profit results in a lower profitability ratio. Return on Assets (ROA) is commonly used to measure profitability, as it reflects a company’s capacity to generate profits relative to its total assets over a specific period. Effective asset management is critical in profitability and can impact tax avoidance practices. Companies can secure tax benefits and engage in tax avoidance strategies by efficiently utilizing assets for income deductions. This use of assets for tax planning purposes is supported by the research of Putri & Putra (2017) and Permata et al. (2018), which emphasize the connection between profitability management and tax optimization.

The study utilizes panel data, combining cross-sectional data from six non-cyclical consumer sector companies listed on the LQ45 index with time-series data from 2018-2022. The total number of observations is 30 (6 companies over 5 years). A panel data regression model is employed to test the research hypothesis, with the Effective Tax Rate (ETR) as the dependent variable and the corporate income tax rate as the independent variable. The panel data regression model is as follows:

$$\mathbf{TAXAVOID_{it}} = \beta_0 + \boldsymbol{\beta_1 RATE_{it}} + \boldsymbol{\beta_2 ROA_{it}} + \boldsymbol{\beta_3 DER_{it}} + \boldsymbol{\varepsilon_{it}}$$

## RESULTS AND DISCUSSIONS

Table 1 shows a description of variable study in statistics.

Table 1 Statistics Descriptive

| Variable | Mean | Max. | Min. | Std. Dev. | Obs |
|---|---|---|---|---|---|
| Tax Avoidance | -0.24 | -0.17 | -0.33 | 0.03 | 30 |
| RATE | 0.232 | 0.25 | 0.22 | 0.015 | 30 |
| DER | 0.44 | 1.29 | 0 | 0.45 | 30 |
| ROA | 0.156 | 0.466 | 0.031 | 0.118 | 30 |

Source: processed

The 30 Tax Avoidance variable observations show an average value (mean) of -0.24 with a standard deviation of 0.03. The fact that the standard deviation is larger than the mean indicates that the ETR variable has varied observations. The maximum value for Tax Avoidance is -0.17, while the minimum is -0.33. For the Income Tax Rate variable, the mean is 0.232 with a standard deviation of 0.015, meaning the standard deviation is smaller than the mean, suggesting that the observations for this variable are less varied. The maximum value is 0.25, and the minimum value is 0.22.

The Debt-to-Equity Ratio (DER) shows a mean of 0.44 and a standard deviation of 0.45. The DER exhibits high variability since the standard deviation exceeds the mean. The maximum value is 1.29, and the minimum is 0. For the Return on Assets (ROA), the mean is 0.156, with a standard deviation of 0.118. The ROA demonstrates less variability as the standard deviation is smaller than the mean. The maximum value is 0.466, and the minimum value is 0.031.

Furthermore, in panel data regression analysis, the Chow test is used to determine whether the Common Effect Model (CEM) or the Fixed Effect Model (FEM) is more appropriate for the data. This test assesses the significance of the cross-section term using a p-value. The Common Effect Model is selected if the p-value (F) is greater than 0.05 (not significant). The Fixed Effect Model is preferred if the p-value is less than 0.05 (significant). The Chow test in this study is conducted at a significance level of 5% ($\alpha = 0.05$).

Table 2 Hypothesis Test Result

| Variable | Coefficient | t | P>\|t\| |
|---|---|---|---|
| C | -0.01 | -0.16 | 0.87 |
| RATE | -0.01 | -3.69 | 0.00*** |
| DER | 0.02 | 1.80 | 0.08* |
| ROA | 0.01 | 0.70 | 0.49 |
| Adj.R2 | | 0.57 | |
| F-stat | | 9.58 | |
| Prob (F-stat) | | 0.00 | |

This study suggests that income tax rates have a negative coefficient because well-designed tax incentives can positively influence tax avoidance practices. The greater the tax incentives provided, the more likely companies are to avoid tax (Alm, 2012). Tax incentives may encourage more aggressive tax planning strategies, including repatriating profits previously held abroad. Reducing tax rates can motivate companies to repatriate earnings, aiming to manage these returns at reduced tax expenses (Firmansyah & Kartiko, 2023).

This study's findings indicate that reductions in corporate income tax rates positively affect tax avoidance practices in non-cyclical consumer sector companies listed on the LQ45 index. This outcome aligns with agency theory, which posits that managers tend to act self-interested. When tax rate reductions increase incentives, managers become more aggressive in minimizing the tax burden to benefit the company's financial performance. Thus, reducing tax rates incentivizes managers to engage in more tax avoidance.

This result is also relevant to previous studies, including those by Yamashita & Otogawa (2007), Dyreng et al. (2008), Hanlon & Heitzman (2010), Rego (2003), Rombe et al. (2017), and Kiryanto (2022), which also found a positive relationship between decreased tax rates and increased tax avoidance. This suggests that tax avoidance following tax rate reductions is not unique to Indonesia but is observed in other countries.

The relatively stable financial performance of non-cyclical consumer sector companies may explain why these firms tend to increase tax avoidance when tax rates are reduced. Less affected by economic fluctuations, these companies have more leeway for tax optimization and often possess the resources and expertise to implement complex tax avoidance strategies. Their stability allows them to focus on optimizing tax planning without the pressure of economic volatility that other sectors might experience.

This finding offers empirical evidence that the reduction in corporate income tax rates, initially intended to spur investment and economic growth, may be exploited by companies for tax avoidance purposes. As a result, the government should account for this potential outcome when designing tax policies. More comprehensive policies, including strengthened tax oversight and stricter enforcement, are needed to prevent tax avoidance practices that could harm the state's fiscal health.

The positive relationship between tax rate reductions and tax avoidance among non-cyclical consumer sector companies can be attributed to the stability of this industry. Since it is less susceptible to economic shocks, the sector can take full advantage of tax incentives like reducing corporate income tax rates from 25% to 22%. This tax cut enables companies to avoid tax, freeing up profits for business expansion and other strategic needs. When corporate income tax rates decrease, companies are more motivated to reduce their tax burden. It may prompt them to optimize their tax structures by employing tax avoidance strategies (Desai & Dharmapala, 2009).

Moreover, reducing tax rates increases a company's net profit after tax, providing additional resources for tax avoidance activities, such as exploiting tax loopholes or engaging in complex tax schemes (Alstadsæter & Johannesen, 2022). Practices like asset or debt shifting, creating special-purpose financial entities, and using intricate financial instruments may become more common. Lower tax rates can also encourage aggressive tax strategies, including improper transfer pricing, profit shifting to low-tax jurisdictions, or utilizing sophisticated corporate structures to minimize tax liabilities (Benkraiem et al., 2022).

The results of the panel data regression in this study indicate that the leverage variable (DER) has a coefficient value of 0.0287071 and a significance value ($P>|t|$) of 0.086, which is greater than the $\alpha$ value of 0.05. It suggests that leverage does not significantly affect tax avoidance practices. Companies focus on debt levels from the long-term sustainability perspective rather than tax avoidance (Firmansyah et al., 2023). Excessive debt burdens operational activities, as high interest and principal repayments must be made even though interest expenses reduce the overall tax expenses (Firmansyah et al., 2023).

For the second control variable, profitability (ROA), the regression results show a coefficient value of 0.00076 with a significance value ($P>|t|$) of 0.493, also greater than the $\alpha$ value of 0.05. This indicates that profitability, as measured by ROA, does not significantly affect tax avoidance practices. ROA, which reflects the efficiency with which a company's assets are used to generate profits, is typically viewed as a measure of operational performance. However, the relationship between ROA and tax avoidance is not always direct. For instance, companies might avoid tax by exploiting tax loopholes or taking advantage of government tax incentives that reduce income tax liabilities, which may disconnect asset efficiency performance from tax avoidance practices.

## CONCLUSIONS

This study demonstrates that the reduction in corporate income tax rates significantly influences the increase in tax avoidance practices among non-cyclical consumer sector companies listed on the LQ45 index. The findings align with previous studies that found a positive relationship between lower tax rates and increased tax avoidance. These results highlight the need for comprehensive tax strategies, including strengthening tax monitoring and enforcement, to prevent harmful tax avoidance practices that negatively affect the state.

The study acknowledges several limitations. First, it focuses on non-cyclical consumer companies within the LQ45 index, limiting the generalizability of the findings to other industries or business types that may respond differently to tax rate changes. Second, the research design employs only one independent variable—reduction in corporate income tax rates—restricting the exploration of other potential factors influencing corporate financial performance. Additionally, while the study incorporates Return on Assets (ROA) and Debt-to-Equity Ratio (DER) as control variables, other relevant factors, such as company size, may also affect the observed relationships. These limitations suggest the need for future research to examine a broader range of industries, include additional independent variables, and consider other control variables when analyzing the impact of tax rate changes.

Suggestions for future research include expanding the scope of study to include more companies from various industries to enhance the generalizability of the results. Additional independent variables should be considered to identify other factors influencing tax avoidance practices. Moreover, incorporating control variables, such as company characteristics or macroeconomic factors, or introducing moderating variables would help determine whether the effect of tax rate reductions on tax avoidance varies under specific conditions.

It is important to consider that the effects of lowering tax rates on tax avoidance practices may vary depending on the context and prevailing tax regulations. Additionally, ethical considerations and the broader impact on tax revenue and fairness must be evaluated when assessing the consequences of such policies. Policymakers should conduct in-depth research before making tax policy decisions, as these policies greatly impact state revenues and companies' strategies to avoid taxes. Tax policies should balance promoting sustainable development for the public while ensuring businesses remain competitive without being excessively burdened by tax obligations.

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