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Debt Covenant and Exchange Rate on Tax Avoidance (An Empirical Study of Manufacturing Companies on The Indonesia Stock Exchange in 2012-2017)

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***Abstract*—** The purpose of This Study is to analyze the influence of exchange rate and inflation to tax revenue, both partially and simultaneously. The variables tasted in this study are exchange rate and inflation as the independent variable (X) and tax revenue as dependent variable (Y). population and samples used in this study are the data of exchange rate, inflation, and tax revenue on period 2013 until 2019. The research method used in this study is verification investigation with causality relationship. This study uses the method of multiple linier regression analysis with a significant level is 5%, using E-Views10. The results of this study show that partially exchange rate and inflation have a significant effect on tax revenue. Furthermore, the result of simultaneous testing show that exchange rate and inflation have significant effect on tax revenue.

Keywords-*component; Inflation, Exchange rate, Tax revenue*

I. Introduction

One of the obstacles in the context of optimizing tax revenue is resistance to tax avoidance by companies seeking to reduce business costs, including tax burdens (Faisal Reza, 2012). Pohan (2013: 23) explains tax avoidance as one of the active tax resistance efforts, namely all efforts ant actions that are directly aimed at the tax authorities and aim to avoid taxes. The methods and techniques used are exploiting the weakness (gray area) contained in the tax laws and regulations themselves, to minimize the amount of tax owed.

There are different perspectives on taxes between the government and company management. For the government, taxes paid by companies are one of the main sources of income. Conversely, for companies as corporate taxpayers, taxes are costs that will reduce income. This difference causes the purpose of the company as a taxpayer to conflict with the government's goal of maximizing revenue from the tax sector (Ratmono and Winarti, 2015). Budiman and Setiyono (2012) state that tax avoidance can be said to be a complex and unique problem, because on hand tax avoidance is allowed but on the other had tax avoidance is undesirable.

Globalization has caused economies in various countries to develop rapidly. With this development, national companies are now transforming into multinational companies whose activities are not only centered on one country, but in several countries. International trade transactions involving multinational companies in one group are growing increasingly complex, which involve not only goods, but also capital and immovable assets. In the end, this complexity results in complexity in analyzing and understanding the transaction, including in the interests of taxation.

The 2016 Directorate General of Taxes, Ministry of Finance (DJP Kemenkeu) stated that 2,000 multinational companies operating in Indonesia did not pay Corporate Income Tax Articles 25 and 29 for 10 years for reasons of loss. The multinational company use three main modes in order to avoid the obligation to pay taxes in Indonesia. The three main modes are; first, the company is an affiliated company whose parent company is overseas, so it is very prone to transfer pricing. DGT questioned the royalty payments that subsidiary companies in Indonesia still paid to the parent company; second, thousands of multinational companies suffer losses because many of these companies receive tax incentives, such as tax holidays and tax allowances when applying for permits to the Investment Coordinating Board (BKPM). When filing a complaint, this company often increases its purchases of capital goods; third, the company changed its name frequently. The goal is to get back the tax incentives and eventually the company can lose again (http://www.liputan6.com/).

Multinational companies will seek to maximize income globally and minimize tax burdens, especially corporate income tax. To achieve this goal, the company carries out transfer pricing practices (Suandy, 2016). A company doing multinational business, in this case exports and imports, will face various types of taxes. Differences in tax burdens in multinational businesses are common. So that countries with less developed companies actually imposes high tax rates. With this, advanced companies will think about how to reduce their taxes because taxes are a deduction for profits. If taxes can be reduced, it can reduce company costs.

Debt covenant or long-term debt contract is a contract aimed at borrowers by creditors to limit activities that might damage the loan value and loan recovery (Cochran, 2001). This agreement limits all company activities that can damage the loan value. With these restrictions, it can trigger violations by companies because they are unable to move freely (Nurlita, 2018). In accordance with the debt covenant hypothesis, companies with high debt ratios prefer to implement accounting policies that increases the company's profits. The tendency of companies is to choose accounting procedures with changes in reported earnings from future to present periods to do tax avoidance (Ria et al, 2017).

Another factor that influences companies to do tax avoidance is the exchange rate. Exchange rate has two accounting effects, namely to include foreign currency transactions and disclosure of profits and / or losses that can affect the company's overall profits. As a result, multinational companies may try to reduce their foreign currency exchange rate risk by moving funds into a strong currency through transfer pricing to maximize the company's overall profits.

II. THEORETICAL FRAMEWORK

A. *Positive Accounting Theory*

Watts and Zimmerman (1986) in their journal Positive Accounting Theory states that Positive Accounting Theory can explain why accounting policies are a problem for companies and parties with an interest in financial statements, and to predict which accounting policies the company wants to choose under certain conditions. Positive accounting theory proposes three earning management hypotheses, namely: (1) the bonus plan hypothesis, (2) the debt covenant hypothesis, and (3) the political cost hypothesis. (Watts and Zimmerman, 1986).

B. *Tax Avoidance*

Robert H Anderson in Rahayu (2010 : 147) argues that tax avoidance is a way to reduce taxes that are still within the limits of the tax laws and can be justified, especially through tax planning. Meanwhile, Pohan (2013: 23) states that tax avoidance is a tax avoidance effort that is carried out legally and safely for taxpayers because it does not conflict with taxation provisions, where the methods and techniques used tend to take advantage of the weaknesses (gray area) contained in tax laws and regulations themselves, to minimize the amount of tax owed. From the above meanings it can be conclude that tax avoidance is a legal action taken by taxpayers to reduce the tax burden payable which is still within reasonable limits by utilizing the regulations contained in the law.

Tax avoidance can be measured by several measures. According to Hanlon an Heitzman (2010), there are twelve ways that are generally used in measuring tax avoidance. The estimation model of tax avoidance measurement in this study uses the Effective Tax Rate (ETR) model which is expected to be able to identify the aggressiveness of corporate tax avoidance which is carried out using fixed differences as well as temporary differences (Chen et al. 2010). The greater the ETR indicates the lower the level of corporate tax avoidance (Judi Budiman and Setiyono, 2012).

The formula for calculating ETR is as follows : ETR = Tax Expense/Pre – Tax Income (Rist and Pizzica, 2014:54)

C. *Debt Covenant*

Debt covenant is a contract aimed at borrowers by creditors to limit activities that might damage the loan value and loan recovery (Cochran, 2001). These agreements limit the ability of managers to invest, pay dividends, increase the ability of managers to invest, pay dividends, increase loans and then limit activities that are potentially detrimental to managers. The agreement also limits the distribution of dividends to shareholders, for example it can effectively force influential companies to reinvest their cash flows, and thereby reduce the debt overhang problem associated with managers' unwillingness to undertake positive NPV projects as the ratio of debt to equity growth.

The agreement also limits the sale of assets or mergers and acquisitions that reduce the possibility of asset replacement, while restrictions on leases and sale and leaseback transactions and negative agreements in settlement of claims (Nikolaev, 2010). But agreements can also become binding even for the financial health of the company, thereby restricting the manager's ability to make decisions that increase the value of the firm.

Covenant restrictions can result in either the failure to leave assets unproductive or the inability to invest in good projects. The debt covenant is proxied by the leverage ratio. Leverage is the ratio of total debt to total assets owned by the company. This ratio is used to provide an overview of the capital structure of the company, so that it can be seen the risk level of a debt uncollectible (Sunarto, 2002 in Rosa, et al, 2017). The DER formula is as follows: Debt to Equity Ratio = (Total Debt) / (Total Equity).

D. *Exchange Rate*

The exchange rate according to the FASB is the ratio between a currency unit and a number of other currencies that can be exchanged at a certain time (Sartono, 2001). Multinational corporations' cash flow denominated in several currencies relative to the dollar value will differ over time. For example, most multinational companies require the exchange of one currency for another to make payments, because exchange rates fluctuate constantly, the amount of cash needed to make payments is also uncertain. The consequence is that the number of units of currency of origin required to pay for raw materials from abroad can change even though the supplier does not change the price (Marfuah and Azizah, 2014).

Under such conditions, multinational companies may try to reduce their foreign currency exchange rate risk by shifting their overall profits. This is because the exchange rate has two accounting effects, namely to include foreign overall company profits (Chan et al., 2002).

According to Marfuah et al. (2014) the exchange rate is calculated based on a scale ratio of foreign exchange profit or loss divided by profit or loss before tax, with the formula : Exchange Rate = (Profit and Loss on Foreign Exchange) / (Profit and Loss Before Taxes) x 100%.

III. Research Methods

The objects in this study are debt covenants, exchange rates and tax avoidance in manufacturing companies listed on the Indonesia Stock Exchange for the period 2012-2017. The unit of analysis in this research is manufacturing companies listed on the Indonesia Stock

Exchange (IDX) in the period 2012 to 2017. The unit of analysis in this research is manufacturing companies listed on the Indonesia Stock Exchange in 2012-2017. The sample used in this study is a manufacturing company that meets the sampling criteria.

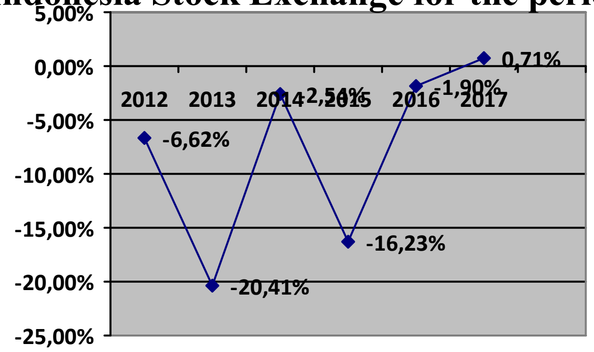
The method used in this research is explanatory. The purpose of this study is to test the hypothesis and explain the relationship of the variables under study. This study uses a quantitative approach. While the characteristics of this research are replication.

IV. RESULT AND DISCUSSION

Debt covenant is a contract aimed at borrowers by creditors to limit activities that may damage the loan value and loan recovery (Cochran, 2001 in Verawaty, 2011). The debt covenant is proxied by leverage ratio. Leverage is the ratio of total debt to total assets owned by the company. This ratio is used to provide and overview of the capital structure of the company, so that it can be seen the risk level of a debt uncollectible (Sunarto, 2002 in Rosa, et al, 2017)

Debt covenant can be calculated using the following formula : Debt to Equity Ratio = (Total Debt) / (Total Equity) The overall development chart of Debt Covenants in Manufacturing companies listed on the Indonesia Stock Exchange for the period 2012-2017 is as follows:

Graph 4.1
The Average Effect of Debt Covenants on Manufacturing Companies Listed on the Indonesia Stock Exchange for the period 2012-2017



Source : www.idx.co.id

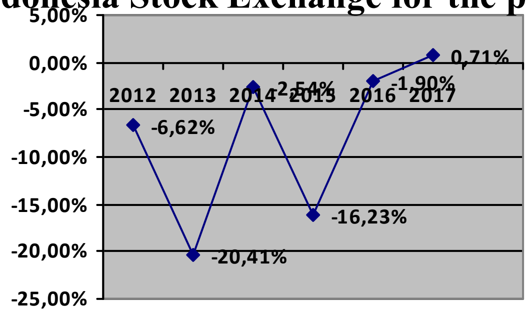
The exchange rate according to the FASB is the ratio between a currency unit and a number of other currencies relative to the dollar value will differ over time.

Most multinational companies require the exchange of one currency for another to make payments, because exchange rates fluctuate constantly, the amount of cash needed to make payments is also uncertain. The consequence is that the number of units of currency of the country of origin required to pay for raw materials from abroad can change even though the supplier does not change the price (Marfuah and Azizah, 2014).

In this study, the exchange rate is measured from the profit or loss of transactions of companies using foreign currency or calculated from the profit or loss on exchange rates divided by the profit or loss on sales with the following formula : Exchange Rate = (Profit and Loss on Foreign Exchange) / (Profit and Loss Before Taxes) x 100% The chart of the overall Exchange Rate Development for Manufacturing Companies listed on the Indonesia Stock Exchange for the period 2012-2017 is as follows :

Graph 4.2

The Average Effect of Debt Covenants on Manufacturing Companies Listed on the Indonesia Stock Exchange for the period 2012-2017



Source : www.idx.co.id

In this study, the authors performed a linear regression analysis of panel data to determine of Debt Covenant and Exchange Rate on Tax Avoidance. The results of the calculation of multiple linear regression are as follows :

Tax Avoidance = 0.248851 – 0.000334 Debt Covenant – 0.067165 Exchange

Rate Simultaneous test is conducted to test whether the independent variables simultaneously or together have a significant effect on the dependent variables simultaneously or together have a significant effect on the dependent variable. Base on data analysis, it was found that the prob. (F-statistic) of 0.000000 <0.05; then H0 is rejected, which means that simultaneously the Debt Covenant and Exchange Rate have an effect on Tax Avoidance.

Partial test is performed to determine the value of the regression coefficient individually on the dependent variable whether it is significant or not. Based on data analysis, it can be concluded that : the t-count value of the Debt Covenant variable is -0.0552280 with a p-value of 0.9583. Due to the prob. (p-value) > 0.05 (5% significance level) or 0.9583> 0.05, then H0 is accepted and it is concluded that Debt Covenant has no significant effect on Tax Avoidance. The t-count value of the Exchange Rate variable is -5.983055 with a p-value of 0.0000. Due to the prob. (p-value) > 0.05 (5% significance level) or 0.0000 < 0.05, then H0 is rejected and it is conclude that the Exchange Rate has a significant effect on Tax Avoidance.

Based on the results of data analysis, it is known that the coefficient of determination R2 is 0.116330 or 11.63%. The coefficient of determination (R2) in essence measures how far the model's ability to explain variations in the independent variable (Ghozali, 2013: 97). This shows that the Debt Covenant and Exchange Rate have an effect on Tax Avoidance with an effect of 11.63 %, while the remaining 88.37% is explained by other variables outside the research.

V. Conclusion

This research was conducted with the aim of obtaining empirical evidence regarding the effect of debt covenants and exchange rates on Tax Avoidance in manufacturing companies listed on the Indonesia Stock Exchange for the period 2012-2017. The sample used was 46 companies which were observed for 6 years. Based on the results of data processing and discussing in the previous chapter, it can be concluded that :

1. Debt Covenant has no effect on the company's decision to practice Tax Avoidance.
2. Exchange Rate affects the company's the decision to practice Tax Avoidance.

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