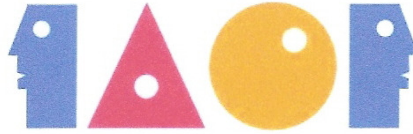

THE EFFECT OF DEFERRED TAX AND TAX PLANNING TOWARD EARNINGS MANAGEMENT PRACTICE: AN EMPIRICAL STUDY ON NON MANUFACTURING COMPANIES LISTED IN INDONESIA STOCK EXCHANGE IN THE PERIOD OF 2008-2012

Luluk Muhimatul Ifada* , Nova Wulandari
Dept. of Accounting, Faculty of Economic
Sultan Agung Islamic University, Indonesia
*Corresponding Author: luluk.ifada@unissula.ac.id

Abstract

This study aims to analyze the relationship among deferred expense and tax planning toward earnings management on the non-manufacturing companies listed in Indonesia Stock Exchange in 2008 to 2012. The samples used in this study are 207 non-manufacturing companies. The analysis method used is multiple regression analysis. Multiple regression analysis is used to determine the effect that occurs between deferred tax expense and tax planning toward earnings management. The deferred tax has an influence on earnings management in the company which is done by minimizing its taxable income. The company size is used because it has a role as a wide stakeholder; the company provides earnings management to give a good impression on the public. In addition, tax planning also has a role in earnings management in term of minimizing tax payments. These results indicate that, (1) The Deferred Tax Variable has significant effect toward the earning management, (2) Company Size Variable has no significant effect toward the increase in earning management practices, (3) Tax Planning Variable has no significant effect on the increase in earning management practices.

Keywords : Deferred Tax Expense, Company Size, Tax Planning, and Earning Management.

للاستشارات المنارة
www.manaraa.com

Introduction

Earnings management is a choice performed by manager to determine accounting policies to achieve some specific purposes (Scott, 2003). Earnings management occurs when managers choose a particular accounting policy with the aim to regulate a reporting related to amount of income to be reported to the stakeholders which can influence the reporting of agreements based on the accounting numbers. One of earnings management concepts that can be used is the agency theory. The agency theory explains that earning management is influenced by conflicts of interest between the parties concerned and the management in charge. This conflict arises when a company wants a certain profit level.

In earnings management, tax is one way to lower the profit of company in accordance with the interests of the company. A company intends to increase the internal and shareholder wealth. The company is also trying to reduce the tax to be paid to the government because the company considers the tax as a burden for companies that should be minimized since the company does not gain benefit from the tax payment (Mangoting, Suratno 1990 and 2008). Nonetheless, the government also wants the company to pay a tax as much as possible by the consideration that tax is other resources of the government's acceptance of oil and non-oil sources. If the tax burden is felt to be too heavy for the company, it can encourage management to cope with a variety of ways, one of them is by manipulating the company's earnings, or often called earnings management (Anggraeni, 2011).

By consideration that the management wants to minimize tax payments, then, under PSAK No. 46 (IAI, 2009), it is described that the value of the recorded deferred tax assets should be reassessed (on the balance sheet date). Based on this PSAK No. 46, the management needs to redefine the balance of deferred tax assets and reserves annually, whereas, to determine the balance of the annual tax reserve management assessment, it is done subjectively. In addition to the deferred tax expense, other efforts are often referred to as tax planning or *tax sheltering* (Suandy, 2008). Tax planning is a method that can be used by taxpayer in the conduct of business or income tax management, but it should be noted that the tax in question is tax planning management without violating the Constitution or Act applicable on taxation. Tax is one of the important sources of state revenues in order to finance the development of the country.

www.manaraa.com

One way for the government to reduce earnings management practice is to revise the regulation on tax. In law No. 36, 2008, there is a change to the rate of tax collection agency which initially adopts a single tax rate of 28% (percent) from January 1, 2009, now becomes 25% (percent) from January, 01, 2010 until today. Therefore, regardless of taxable income, the rate used is 25% (percent). In addition to the companies that *go public,* they get a decrease in the rate of 5% (percent) of the normal fare with the other terms. In 2009, the go public company tax rate is 23% (percent). In 2010, its tax rate is 20% (percent). From the revised legislation on the tax, then the companies do earnings management by minimizing the amount of taxable income in the year prior to the enactment of new tax rates, so that the burden of the company becomes smaller (Wijaya and Martani, 2011).

In addition, the other management's efforts to take advantage of changes in tax rates of other entities are by *tax shifting* as a transfer of profit for the year before changes in corporate tax rates to a year after the change in tax rates. According to accounting field, this effort adheres to the principle of *accrual basis* which is used for the recognition of income (revenue) and load (expense) which occurs regardless of the time or cash outlay of income or load concerned.

In the earnings management practices, in addition to the deferred tax and tax planning, the other factors affecting it is the company size. The company size has a very important role in the practice of earnings management. The smaller size firms are considered to do more earnings management than the larger ones. This is because the larger the size of the companies is, the more the information available to investors in making investment decisions related to the shares of the company will be. Moreover, the large companies are often overlooked by the public. In contrast to the small companies, they tend to do earnings management practices because they want to show that the condition of the company is good, so that, the investors are interested to plant stock in that company.

The changes of PPH rates of 28% to 25% from January 2010 may affect the behavior of the company in managing financial statements. According to Wijaya and Martani (2011), the changes in tax rates could provide incentives for companies to perform earnings management by minimizing the taxable income, so that, the corporate tax burden is getting smaller. The deferred tax is increasing when the company accelerates the recognition of expenses (suspend the revenue) for accounting purposes compared with the company tax purposes. In

www.manaraa.com

addition to the tax burden, Wijaya and Martani (2011) also show that the company size also has no significant effect on earnings management practices. In addition to deferred tax expense and the size of the company, tax planning is also used in the practice of earnings management. In the study by Yana Ulfah (2013), it is said that tax planning has a positive effect on earnings management practice in manufacturing companies, tax planning is done by regulating how earnings are reported to show that earnings management is active. Tax planning is a means to fulfill tax obligations properly but the amount of tax paid can be minimized.

In contrast to previous studies (Wijaya and Martani, 2011) and (Yana ulfah, 2013), in this study, the writer uses non-banking and non-manufacturing companies listed on the Stock Exchange (2008 - 2012) and the latest corporate income tax rates based on the law No. 36 of 2009 amounted to 25% from January 1, 2010 and adds factor of the company size. In the study by Martani and Wijaya (2011) on the company earnings management practices in response to a decrease in the tax rate in accordance with Law No. 36 in 2008, advocated for further research is by using the latest tax rate of 25%, it is used to determine whether the company does earnings management practice after a decrease in the corporate tax rate. This factor is considered to provide the different results of studies on the effect of deferred tax expense and tax planning to earnings management.

Literature Review

Earnings management practices undertaken by management are based on two theories, the *agency* and the *positive theory*.

Agency theory

Hendriksen and Breda (1992) illustrates that the agency relationship is a contract between the *agent* and the *principal. An agent* closes a contract to do a certain thing for the *principal,* as well as a *principal* closes contracts to reward *agents.* If analogized, it is like owner and manager of the company. Jensen and Meckling (1976), in Setiowati (2007), define an agency relationship as a contract in which one or more *principal* (owner) uses other parties or *agent* (manager) to run the company.

In agency theory, the principal or shareholder or owner facilitates and funds the agents for the needs of the company's operations. *Agent* is the management with the obligation to manage the company mandated by *the principal* to him. *Agency theory* assumes that each individual is motivated by the personal welfare and interests. The *principal* is motivated to

المنارة للاستشارات
www.manaraa.com

make a contract for the personal welfare through the distribution of dividends and stock price increases. *Agents* are motivated to improve it with an increase in ompensation. Conflicts of interest increase when the principal does not have enough information about the performance of the agent as principal inability to monitor the activities of agents in the company. However, the agent has more information about the capacity of self, work environment, and the company as a whole. This has resulted in an imbalance of information held by the principal and agent, and known as the asymmetry of information.

Positive Accounting Theory

Earnings management behavior can be explained through *Positive Accounting Theory* (PAT). PAT explains the factors that affect management in selecting the optimal accounting procedures and with a specific purpose. Watts and Zimmerman (1986) explain that a certain economic factor can be attributed to the behavior of the manager or the preparers of financial statements. This is because the positive accounting theory recognizes the existence of three agency relationship, (1) between the management and the owners (the bonus plan hypothesis), (2) between management and creditors (the debt to equity hypothesis), and (3) between the management and the government (the political hypothesis).

Under PSAK No. 46 (IAI, 2009: 8), the definition of deferred tax is the balance in the balance sheet as a tax benefit in which its amount is the estimated amount in need for the upcoming period as a result of temporary differences between the financial accounting standards and tax regulations as a result of balance loss to be utilized in future periods.

The company size can be expressed in total assets, sales and market capitalization. These three measurements are often used to identify a company because the larger the size of the assets owned by the company is, the greater the company doing turnover and market capitalization will be. In addition, the company size can also be explained by a scale which can be clarified by the company size. The company size will affect the manager in making the financial statements.

Tax Planning by Hoffman (1961) is one of a capacity owned by the taxpayer (TP) to prepare financial activities in order to get expenditure (expense) of minimum tax. Tax planning is theoretically known as the effective tax planning that a person must try to get tax savings tax through the procedure of tax

المنارة للاستشارات
www.manaraa.com

avoidance systematically in accordance with the tax laws.

According Sitorus (2006), earnings management is a management action to deal with accounting policies of a particular standard to affect the profit expected through the management of internal factors owned or used by the company.

Theoretical Framework and Development Of Hypotheses

The Effect of Deferred Tax Expense toward Earning Management

In principle, deferred tax is the tax impact of future income due to temporary differences between the tax and accounting treatment of tax losses which can still be compensated in the future. Yulianti (2005) states that the liabilities (assets) of deferred tax increases when companies accelerate revenue recognition or suspend recognition of load (load accelerate or defer income) for accounting purposes compared with the company tax purposes. Based on this pattern, the company will report the accounting profit higher than the profit according to the tax, thereby increasing the net deferred tax liability of the company, and vice versa. Based on the study by Yana Ulfah (2013), it is proven that there is a positive impact of deferred tax expense and tax planning for earnings management practices, which means the increase on the deferred tax expense and the tax planning will increase the profit of company management. From this study, this study hypothesizes:

H1: the greater the deferred tax expense is, the greater the probability of the company to perform earnings management will be.

The Effect of Earnings Management toward Company Size

The company size is the size of the company measured by using total assets or property owned by the company. There are various options that are usually used to represent the size of the company, i.e. the number of employees, number of sales, total assets and market capitalization. The greater the asset is, the greater the invested capital will be; the more the sales are, the more the total turnover will be; and the greater the market capitalization will be, the more well-known the company in the community will be.

The large companies usually have a role as wider stakeholders. This makes the big companies have a large impact on the public interest than the smaller ones. Large companies have more atten-

المنارة للاستشارات
www.manaraa.com

tion by the public so that they are more careful in presenting the financial statements. As a result, they do earnings management to give the best impression on the community. In the study by Wijaya and Martani (2011) proves that large companies are more likely to reduce profits of financial statements in delaying the taxable income as a response to the reduction in corporate tax rates. Based on previous study by Wijaya and Martani (2011), the hypothesis of the size of the company is:

H2: the company size negatively affects earnings management.

The Effect of Tax Planning toward Earning Management

Political cost hypothesis is one of the hypotheses in the positive accounting theory. *Political cost hypothesis* states that companies with large scale tend to lower their profit by reason of the violation of government regulations (Watts and Zimmerman, 1986). In this case, government regulations are related to taxation. If a large company lowers its earnings, the company tax is also small.

Yin and Cheng (2004) in Wijaya and Martani (2011) state that companies that have good tax planning, will benefit from *tax shields* and be able to minimize their tax payments. Income tax is one of the sectors of tax revenues accounted for most major countries. In 2009, there is a change in legislation of income tax law from a single tax of 28% to the tax rate of 25% in 2010. Through this change, many companies want to take advantage of it by minimizing the amount of tax to be paid by way of earnings management. Efforts to minimize the tax burden are commonly referred to as tax planning.

Based on previous studies that discuss the earnings management practices studied by Martani and Wijaya (2011) and Ferry and Anna (2012) which are able to prove that the tax planning measured by using tax retention rate is capable of detecting earnings management practices, and based on these results, the writer formulates the hypothesis as follows:

H3: tax planning positively affects earnings management practices

Methods

Types of Research

This study is an empirical study by analyzing the non-manufacturing companies listed in Indonesia Stock Exchange in 2008 to 2012.

Population and Sample.

www.manaraa.com

In this study population used is non-manufacturing companies listed on the Indonesia Stock Exchange from 2008 until 2012. In Ferry and Anna (2013), it is stated that the non-manufacturing companies are used because they have higher probability in earnings management practices, while banking and other financial companies are not used as sample to avoid industrial or special regulations that may affect the use of *Discretional Accrual (DA).*

The method development samples used in this study is purposive sampling, i.e. the population who does not qualify is not taken. Moreover, sampling is only from the population who meet the following requirements:

1. The company has profit which always rises during the year of observation. This is due to the tendency of companies that report earnings to always rise to attract investors and keep the business competitive.

2. The company's financial statements are presented in the rupiah currency.

3. Non-manufacturing companies except banks that have complete data as needed for the study.

Variables of the Study

The variables used in this study are the dependent and the independent variables.

Dependent Variables

The dependent variable in this study is the earnings management. Earnings management is defined as a choice by management in determining accounting policy to achieve some specific purposes (Scott, 2003). While Healy and Wahlen (1999) define earnings management as financial reporting which is not neutral (unbiased) and managers are also intervened to generate personal finance.

Earnings management is measured by the scale of measurement probability variable of firm *i* to do earnings management in year t. EM (Equity Market Value) is net income divided by the value of the equity markets in the early year to show expectations of the company reported earnings.

$$EM = \frac{\text{Net Profit}}{\text{Early Year Equity}}$$

Independent Variables

In research by Yana Ulfah (2013) explains that the measurement of variables, including:

المنارة للاستشارات
www.manaraa.com

a. Deferred tax expense (H1) should be weighted for every company that has the same deferred tax expense not necessarily have the same weight, because the deferred tax expense is dependent on the total assets.

H1 = DTEit x Total Assets

Based on the study by Yulianti (2005), Wijaya and Martani (2011) and Yana Ulfah (2013), the calculation of deferred tax expense (DTEit) is calculated by dividing the deferred tax expense of firm i in year t (H1) with total assets at the end of the year t-1.

$$DTEit = \frac{\text{Deferred Tax t (H1)}}{\text{Total Assets t} - 1}$$

b. Company size is the size of the company (H2) which is measured by Ln total assets as a control variable in the study.

c. Tax incentives are measured from business tax planning. Tax planning is a step taken by the tax payer to minimize tax payments for the current year or years to come. The variable of tax planning (H3) is measured by using the formula:

$$\text{Tax Plan (In)} = \frac{\sum_{t}^{t-1}(25\%\ PTI - CTE)/5}{TAt}$$

In which;
Tax Plan: Tax Planning
PTI: Pre Tax Income
CTE: Current portion of total tax expense

Tax Intensive is measured from the business tax planning. The Calculation is from 2008 to 2012, the calculation of rates uses appropriate presentation of 25% in line with tax law No. 36 of 2008 which is 25%.

Finding And Discussion

Statistical Description

Based on the statistical data, it can be known that the total of observation which is used in this study contains 95 observations, where DTE variable which is measured by using EM results -0.0081240000 of average value with standard deviation of 0.03188540. The value of DTE variable is between -0.06180 and 0.16511. The TA variable results 28.694473 of average score with standard deviation of 1.32281839. The value of TA variable is between 26.22082 and 32.34387. The IN variable results 6.536234800 of average value with standard deviation of 4.3950840600. The value of variable IN is between -2.32891000000 and 2.58707000000.

المنارة للاستشارات
www.manaraa.com

Hypothesis Test

The test on the hypothesis is conducted through testing regression equation model partially toward each independent variable. The results of the test on regression equation model partially are as follows.

1. The effect of DTE on Equity Market Value

The first hypothesis which measures the effect of DTE on Equity Market Value shows that based on the t test, it results -3.667 of t-count and the significant level is 0.002 (<0.05). This result shows that DTE has significant effect on Equity Market Value, so that the first hypothesis in this study is supported. The coefficient value has negative course which shows that if companies do the DTE so their Equity Market Value will be decreasing.

2. The effect of TA on Equity Market Value

The second hypothesis which measures the effect of TA on Equity Market Value shows that based on the t test, it results – 0.031 of t-count and the significant level is 0.975 (>0.05). This result shows that TA has no significant effect on Equity Market Value, so that the second hypothesis in this study is not supported. The coefficient value has negative course which shows that if companies do the TA so their Equity Market Value will be decreasing.

3. The Effect of IN on Equity Market Value

The third hypothesis which measures the effect of TA on Equity Market Value shows that based on the t test, it results 0.965 of t-count and the significant level is 0.348 (>0.05). This result shows that IN has no significant effect on Equity Market Value, so that the third hypothesis in this study is not supported. The coefficient value has positive course which shows that if companies do the TA so their Equity Market Value will be increasing.

Discussion

The Effect of Deferred Tax Expense toward Earning Management

The result of the test on deferred tax expense and earning management statistically shows that the deferred tax expense has negative significant effect on the earning management, which means if the deferred tax expense is raising so the probability of companies to manage their profit will be decreasing. This means that the deferred tax expense affects earning management. However, the result of this

المنارة للاستشارات
www.manaraa.com

study is not in line with the first hypothesis which states that "the higher the deferred tax expense, the higher the probabilty of companies to manage their profit". This study is also not in line with the study conducted by Yana Ulfah (2013) which points out that deferred tax expense has positive significant effect on earning management.

This is possible because the lose is given by GAAP to the company to choose the method of accounting in arranging the financial report of the commercial. Meanwhile, the fiscal financial report is arranged by the company based on taxation rules that do not make looseness for the management to select the accounting model (only cash-based accounting model) and accounting method. This is why the company needs to do a fiscal correction and also causes differences between fiscal profit and accounting profit. Thus, it causes the increase of postponed obligation tax consistent with the company that owes more revenue.

The Effect of Company Size Toward Earning Management

The result of tests done to the variable size of the company to the earning management is statistically proven that the size of the company has no significant negative effect on earning management. The value of the coefficient has a negative direction, which means that the greater the size of the company is, the earning management done is smaller or down. While the insignificant one proves that the company size has no effect on earning management. Different with the previous study in Wijaya and Martani (2011), who are able to prove the existence of a significant negative effect of company size on the earning management. Thus, the second hypothesis in this study is not supported.

The performance of large company work will be viewed by the public so that the company will report its financial condition more carefully, more informative in the information contained in it and more transparent so that the company will be less in doing earning management (Suryani, 2010).

The Effect of Tax Planning on Earnings Management

The result of tests done to the variable tax planning and earning management statistically shows that tax planning has not significant positive effect on earning management, which means the higher the tax planning is, the greater the company conducts earning management. This means that tax planning does not affect earning management. The result of this study has no same direction with the third hypothesis, which

المنارة للاستشارات
www.manaraa.com

states that "tax planning has significant effect on the increase in earning management practices". The result of this study differs from research conducted by Yana Ulfah (2013) which states that tax planning has positive significant effect on earning management.

Company conduct tax planning as effective as possible, not only to take advantage of the fiscal terms, but in fact the company also gains advantages to obtain additional capital from investors through the sale of shares of the company. In doing tax saving strategies, company must conduct it legally to avoid the sanctions of taxes in the future.

Conclusions, Limitations and Recommendations

Conclusions

Based on the result of the data analysis and discussion that has been described, it is known that from the relevant variables and independent variables used, it can be concluded as follows:

1. The Deferred Tax Variable has significant effect toward the earning management.
2. Company Size Variable has no significant effect toward the increase in earning management practices.
3. Tax Planning Variable has no significant effect on the increase in earning management practices.

Limitations of Study

This study has some limitations that may cause disruption to the result of the study, such as:

1. This study only take a sample of non-manufacturing companies except banks listed in BEI, so that the results would be different or cannot be generalized if it uses of all companies listed in BEI.
2. This study gains the Adjusted R-square value of 53.3%, this result shows the effect that is given to the deferred tax expense, the size of the company and tax planning toward the earning management practices. So, there are other variables that have a considerable effect on the cost of debt.

Recommendations

Concerning the existence of some limitations as it has been delivered, so the further study needs to pay attention to some recommendations as follows:

1. In the next study, it is expected to use a sample of the entire company and use the longer year of observation so that the results can be generalized to the entire capital market companies.

المنارة للاستشارات
www.manaraa.com

2. In the next study, it is suggested to add other variables to affect earning management, the managerial ownership, institutional, sales growth, and so forth.

References

Ardilla. (2011). *Perubahan Tarif Pajak Penghasilan Badan 2008 dan Intensif Pajak Non Pajak Terhadap Manajemen Laba.* Diponegoro University Press. (unpublished)

Anggreani. (2011). *Pengaruh Tarif Pajak Terhadap Manajemen Laba.* Diponegoro University Press. (unpublished).

Ferry dan Anna. (2012). Pengaruh Perencanaan Pajak Terhadap Manajemen Laba Pada Perusahaan Nonmanufaktur Yang Terdaftar di BEI. *Skripsi Program Sarjana Universitas Atma Jaya Jogjakarta*.

Guenther, D. (1994). Earnings Management in Response to Corporate Taxe Rate Changes : Evidence from the 1986 Tax Reform Act. *The Accounting Review*, pp 230 – 243.

Hoffman.(1961). *Tax Planning*. http://www.pajak.go.id/dmdokuments/UU-36-2008.pdf, Access 15 September, 2014.

Ikatan Akuntansi Indonesia.(2009). *Pernyataan Standart Akuntansi Keuangan*, Salemba Empat Jakarta.

Philips, John, Morton Pincus, and Sonja Olhoft Rego. (2003). Earning Manajemen : New Evidence Bused on Deferred Tax Expense. *The Accounting Review*, Vol. 27, pp 491-522.

Restie. (2009). *Analisis Ukuran Perusahaan dan Mekanisme Corporate Goverment terhadap Manajemen Laba.* Diponegoro University Press. (unpublished).

Scoot, William R. (2000). *Financial Accounting Theory Edition. Scarborough Ontario* : Prentice Hall Canada. Inc.

Setyawati. (2001). Perilaku Manajemen Dalam Perubahan Undang – Undang PPH tahun 1994 pada peusahaan manufaktur. *Journal on Accounting*, Indonesia

Suandy, E. (2008). *Perencanaan Pajak.* Jakarta : Salemba Empat, Ed. 4.

المنارة للاستشارات
www.manaraa.com

Suryani, 2010. Earning Manajemen. *Thesis Journal.*

Trisna, D., Kadek, and Sukartha, M. (2012). Pengaruh Perubahan Tarif Pajak Penghasilan Badan Tahun 2010 pada Manajemen Laba. *E-journal on accounting*, Udayana University.

Ulfah, Y. (2013). Pengaruh Beban Pajak Tangguhan dan Perencanaan Pajak Terhadap Manajemen Laba. *4th National Symposium on Tax.*

Watts dan Zimmerman. (1986). *Positif Accounting Theory,* prentice – hall.

Wijaya, and Martani, D. (2011). Praktik Manajemen Laba Perusahaan Dalam Menanggapi Penurunan Tarif Pajak Sesuai UU No. 36 Tahun 2008. *National Symposium On Accounting XIV Aceh 2011*.

Zain, M. (2007). *Manajemen Perpajakan*. Jakarta : Salemba Empat, Edisi Ketiga (dalam Ferry dan Anna).

المنارة للاستشارات
www.manaraa.com

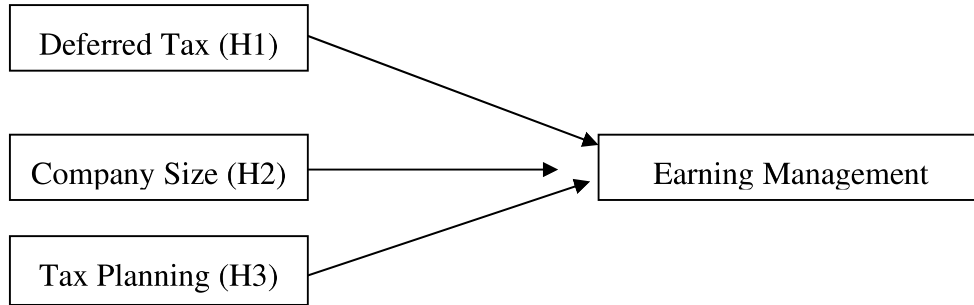

Figure 1. The Research Model

Table 1. Sample selection process:

Information	Total
Non-manufacturing companies listed on the Stock Exchange (except banking)	207
Companies that do not have financial statements for 5 years in a row (data incomplete)	(134)
Companies whose financial statements are not measured by using the rupiah unit (U$ Dollar)	(5)
Companies that have a profit decline	(49)
Sample firms (which always have profit rise)	19

Table 2. Statistical description

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
DTE	95	-.06180	.16511	-8.1240000E-3	.03188540
TA	95	26.22082	32.34387	2.8694473E1	1.32281839
IN	95	-2.32891E11	2.59707E11	6.5362348E9	4.39508406E10
Valid N (listwise)	95				

المنارة للاستشارات
www.manaraa.com

Table 3. The results of multiple regression analysis

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	-4673	12 545		-.373	.714
	DTE	-79 999	21 815	-.635	-3667	.002
	TA	-.014	.458	-.009	-.031	.975
	IN	3.379E-10	.000	.290	.965	.348

a. Dependent Variable: LNEM

المنارة للاستشارات
www.manaraa.com

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

المنارة للاستشارات

www.manaraa.com