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Original Research Article

The Effect of Profitability, Leverage and Company Size on Tax Avoidance through Earnings Management Practices in Go Public Manufacturing Companies in Indonesia

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Abstract: This research aims to analyze the effect of profitability, leverage and size of the company on tax avoidance through earnings management practices in manufacturing companies going public in Indonesia. Profitability indicators are measured by comparing operating income with total company assets. Leverage is measured by comparing total debt with total assets. Company size is measured using the natural logarithm of total assets. Tax avoidance is measured using the Cash Effective Tax Rate. Earnings management practices are measured using the discretionary accruals. The population is all manufacturing companies that went public in Indonesia. Samples were selected using the purposive sampling method. Path analysis is used to test the hypothesis of the direct effect of profitability, leverage and firm size on earnings management practices and tax avoidance. As well as examining the indirect effect of profitability, leverage and company size on tax avoidance through earnings management practices. Research has found evidence of profitability, leverage and firm size directly have a significant effect on management practices and tax avoidance. Earnings management practices have a significant effect on tax avoidance. Profitability Leverage and company size significantly influence tax avoidance through earnings management practice.

Keywords: Profitability, leverage, company size, earning management practices, tax avoidance.

INTRODUCTION

Tax is a mandatory contribution for citizens, both as individuals and as business entities, to the state based on the law, which is coercive, does not receive direct compensation and is fully utilized to finance the interests of the nation. In the Republic of Indonesia, tax revenue is the main source of state revenue. In 2017 around 85% of total state revenue came from revenues in the tax sector (DGT.2017).The Government of the Republic of Indonesia through the Directorate General of Taxes continues to make improvements and renewals tax regulations in order to increase state revenue from tax sources. On the other hand, the entity considers tax as a deduction component of income that is distributed to owners or reinvested. Kurniasih (2013) argues that business entities seek to reduce tax payments by avoiding tax. The reduction in tax payments has an impact on not achieving the tax revenue target as stipulated in the APBN.

The existence of loopholes in tax regulations is one of the reasons the entity takes legal action to reduce the tax burden owed. Tax avoidance provides an opportunity for management to design activities to keep bad news and mislead investors (Desai & Dharmapala, 2006). The management manages income to reduce tax obligations without the knowledge of investors, also manipulates income and keeps negative company information by using tax planning strategies.

Differences in interests to minimize the amount of tax paid on the one hand and the interests of presenting high-performance financial statements for the users (shareholders, creditors and investors) on the other hand, create conflicts for management when making financial statements. In general, management has an interest in reporting increased profits to investors and other external parties (Burgstahler & Dichev, 1997). The scheme of earnings management practices is carried out for tax purposes, where management reflects between the benefits of saving taxes and the risk of

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detecting earnings management practices (Badertscher *et al.*, 2009).

Earnings management practices are considered by management to choose certain accounting methods, in order to achieve the desired goal by increasing or decreasing reported earnings. Scott (2015) states that earnings management practice activities are carried out for several reasons: to increase bonuses, debt agreements, tax motivation, transition of directors, initial public offerings, and issuance of financial statements to users, especially shareholders. According to Scott (2015), the practice of earnings management is carried out by the management using the gaps from accounting standards. Earnings management practices have an impact on the discrepancy of the numbers in the financial statements with the actual situation. Matterthis already of course it will harm the interested parties. Subramanyam (2008) states that the practice of earnings management (earnings management) to polish the earnings presented is not in harmony with the actual conditions.

Profitability, leverage and firm size can be suspected as the cause of the management to practice earnings management and tax avoidance simultaneously. Profitability provides information about the company's ability to earn profits in its operational activities. Management performance in general can be seen from the level of profitability generated. If the level of profitability produced by the company is high, then the management is considered to have high performance, otherwise if the level of profitability is low, then the management is considered to have low performance. To save the performance of the management in the eyes of the owner, companies with low levels of profitability tend to manage profits in the desired direction through earnings management practices.

Profitability shows the amount of profit generated by the entity from the total assets owned. Profit is used as the basis for calculating tax payable. Logically, the higher the profit, the higher the tax to be paid. Derazhid and Zhang, (2003) found evidence that the higher the profitability, the more efficient the entity in using assets. This means that the more efficient the company, the lighter the tax owed by the company, because the effective tax rate is lower. Low tax burdens tend to be owned by entities with high income and high efficiency levels. Low tax burden because entities can take advantage of tax incentives and other tax deductions.

Leverage describes the entity's ability to paydebt used in carrying out operational activities. Leverage is used by investors to see the ability and risk of the entity. Investors tend to face high risk when the leverage of an entity is higher. To overcome this and so that the company is not liquidated, investors ask for a high level of profit. Actions that can be taken by the management in the immediate future are to manage earnings through earnings management practices. Mamedova (2008), Oktovianti (2012), and Agustia (2013) found evidence that leverage has an impact on earnings management practices. Leverage reflects the entity's loan amount used in carrying out its operating activities. The increase in the amount of the loan will of course lead to an interest expense that must be paid on the loan.Koh & Lee (2015) find that leverage affects financial reporting decisions and corporate tax reporting non-monotously depending on the level of debt ratios. If the company's debt ratio is relatively low, it is likely that the company will be aggressive in financial reporting. On the other hand, when a company's debt financing is above a certain level, the company tends to be more aggressive in reporting taxes because the debt ratio increases.

Company size reveals the size of the organization or entity. Various parameters can be used to determine the size of an entity including: the number of employees of the company, the total assets owned, the amount of sales obtained in one period, as well as the total shares outstanding. Defond &Jiambalvo(1994) found a large positive impact of small entities on earnings management practices. Entities with large categories are required to be able to respond to the expectations of capital owners or other shareholders. For this reason, large entities have a tendency to manipulate earnings through earnings management practices. Jao and Pagalung (2011), obtained evidence that the size of the company has a negative impact on earnings management practices. Large-scale companies are less motivated to practice earnings management, this happens because external parties and shareholders of large companies are considered more responsive than external parties and shareholders of small companies. Big companies often to the government's attention, this condition creates a tendency for the company's management to act aggressively or obediently (Kurniasih, 2013). The larger the size of the company, the more it will consider the risks of managing taxes. Although in principle large companies have greater resources to manage taxes compared to small scale companies.

The management practices earnings management for tax reasons. Management considers tax as a burden on the company for it needs to be managed. The management carries out tax management with the aim of avoiding high taxes or reducing the tax burden in a safe and legal way through tax planning. Prakosa (2014) implies that tax evasion is legal because it does not violate applicable rules or standards. On the other hand, tax avoidance is said to be an unjustified action, because it reduces state revenues. In actual business practice, the management is faced with a difficult situation where the management cannot be aggressive in financial reporting and tax reporting

simultaneously.Hunt *et al*., (1996) Jenkins *et al*., (1998); Johnson (1988); David A. Guenther (1997). Rationally, the management will compromise one strategy with another based on the differential weighting of financial reporting and tax costs. Frank *et al*., (2009) found evidence that tax reporting aggressiveness and aggressive financial reporting are positively related. Other researchers related to earnings management practices with tax motivation found income decreasing earnings management in the period before the reduction of income tax rates, in response to the 1986 corporate income tax rate transition in the United States. Guenther (1994) found a signal of income decreasing earnings management through negative current accrual indicators.

Motivated by the findings of Koh & Lee, (2015) which states that Companies with long-term debt financing are more likely to be aggressive in financial reporting, while companies with higher financing deficits or better access to capital markets tend to be aggressive in tax reporting and other findings from previous researchers. The following research aims to empirically examine the direct and indirect effects of the ability to generate profits (profitability), leverage and firm size on earnings management practices and tax avoidance, with the object of manufacturing companies going public in Indonesia for the period 2013 to 2017. Koh & Lee (2015), this study does not examine how the strategies made by the company in dealing with conflicting circumstances for the purpose of fulfilling financial reporting on the one hand and reporting for taxes on the other.

Rahardja (2014) using earnings management as a mediation found no evidence that earnings management mediates the effect of firm size on financial performance. Agustina *et al*., (2015) found evidence that earnings management can mediate the effect of leverage on stock returns.Achyani *et al*., (2015), found evidence of earnings management mediating the effect of corporate governance practices on firm value. Prima & Pratiwi (2017), find evidence earnings management practices mediating the effect of Good Corporate Governance on tax aggressiveness. Taufiq *et al*., (2014), found no evidence of earnings management practices mediating the effect of the implementation of good corporate governance on financial performance.

The following research was conducted with a view to, firstly obtaining empirical evidence of the effect of profitability, leverage and firm size on earnings management practices. Second, obtaining the effect of profitability, leverage and firm size on tax avoidance. Third, get empirical evidence of the effect of earnings management practices on tax avoidance. And finally get an empirical effect of profitability, leverage and company size on tax avoidance through earnings management practices

LITERATURE REVIEW

Agency theory explains the relationship between shareholders as principals and management as agents. The management as the chosen person is obliged to manage the resources owned by the company and be responsible for the tasks assigned to the person who chose him. Meanwhile, shareholders hope that management can take policies and act in the interests of shareholders. Conflict will occur if the agent does not carry out the principal's orders. Regarding taxation, conflicts can occur between the government as the principal and the management as the agent. The government as the principal asks the company to pay taxes in accordance with the tax laws. Meanwhile, as an agent, the management prioritizes its interests in optimizing the company's profits by minimizing the tax burden, through tax avoidance. The management of the company as an agent who has an interest, has the right to make decisions to maximize profits with the policies issued. The character of the company manager certainly influences the manager's decision to decide on his policy to minimize the burden including the tax burden without violating the applicable provisions by avoiding tax.

According to Brown (2012) tax avoidance is the adjustment of transactions to obtain profits, benefits or tax reductions in ways that are not desired by law. Zain (2003), states tax avoidance as a control measure to avoid the imposition of unwanted taxes. According to Wang (2010), tax avoidance is a specific tax deduction per dollar from pre-tax profit. Dyreng *et al*., (2008) argue that it is necessary to emphasize that companies that do tax avoidance do not always involve in something that is not true. Tax avoidance is associated with tax planning, both of which use legal means to reduce or eliminate tax obligations. Tax planning is not disputed as long as no provisions are violated. Meanwhile, tax avoidance is generally considered an unacceptable act. However, as long as no laws or regulations are violated, tax avoidance is allowed

Existence loopholes in tax provisions can be exploited by taxpayers to pay the minimum tax payable as a whole. In this case, it means that the entity pays the tax that should be paid, or pays the tax with the minimum amount, managed in an elegant way and does not violate the applicable provisions. However, the omission of tax evasion can result in injustice in tax collection. Complicated and unique tax avoidance can only be done through a unique, complex and systematic transaction scheme that can only be carried out by entities with large size categories and have the ability to manage taxes. This condition creates the impression of injustice in tax collection, where large companies seem to pay lower taxes, compared to small companies.

Legally avoidance Tax is an act in a certain way in order to avoid the imposition of taxes that should not be. The void or ambiguity of the law is used

by taxpayers to avoid tax. Tax avoidance provides an opportunity for management to manipulate profits or place resources that are not in accordance with actual conditions. Tax avoidance as a tax deduction clearly illustrates the continuation of the tax planning strategy (Dyreng *et al*., 2010). Pevasion Taxes provide flexibility for management to carry out activities designed to hide bad news and mislead investors (Dharmapala, 2009). Due to the complexity of the transaction and the management's ignorance of the applicable tax provisions, it can justify tax avoidance. This reason is important to reduce the discovery of tax evasion by tax auditors.

The agent's dysfunctional behavior provides an opportunity to manipulate the data in the financial statements to match expectations principal, although the report does not describe the conditions which are actually. The manipulation of financial report data is in the form of: earnings management practices within the limits of general accepted accounting *principles*, that intentionally leads to a desired level of profit reported (Assih, 2000). Earnings management can occur when management uses more judgment in preparing financial statements and in selecting transactions that can change financial statements (Healy & Wahlen, 1998).

Earnings management practices (*Eearnings management)* is a change in the company's economic performance that is reported by the company's internal parties to mislead interested parties or to influence contractual performance (Healy and Wahlen, 1999). Earnings management practices occur when managers use *judgment* to manage transactions in making financial reports, which mislead stakeholders. The practice of earnings management is a form of manager intervention in the preparation of the company's financial statements with the aim of benefiting the management. Earnings management practices are one of the factors that reduce integrity, because the resulting financial information is biased. This of course will deceive the users of financial information who believe in the profits that have been engineered as profits that are certain to be true.

Scott (2003: 369) argues that earnings management practices are a strategy for managers to choose accounting methods to achieve the desired goals. Objectively, earnings management practices occur because of information asymmetry between owners and managers. According to Scott (2015) there are two aspects that must be considered in understanding earnings management practices. First Earnings management practice is understood as the opportunistic attitude of the management to maximize the benefits of compensation contracts, debt contracts, and political costs (opportunistic Earnings Management). Second, the practice of earnings management is understood as an efficient contracting perspective (efficient Earning Management), where management has elasticity to protect themselves and the company against unexpected circumstances that benefit other parties. With earnings management practices, management can influence the market value of the company's stock, for example making income smoothing or profit growth over time. Earnings management practices are carried out by management to maximize profits orminimize profit.

Various forms of earnings management practices are carried out: 1) Taking a bath, also called the big bath, occurs during periods of organizational stress or reorganization, for example the replacement of directors. This technique is used when expenses in future periods are recognized in the current period. Done when the company's conditions are unfavorable and unavoidable. The impact is that the profit for the next period will be high even though the company's condition is not profitable. 2) Income minimization. The pattern of minimizing profits due to political motives or motives to minimize taxes. Income minimization is done when the company gets high profitability. The goal is that the company does not get political attention or is not subject to high taxes. In this pattern, the policy is carried out by writing off capital goods and intangible assets, charging advertising, research and development as expenses. 3) Income maximization, a pattern of earnings management practices carried out with the aim of obtaining larger bonuses or avoiding violations of long-term debt contracts (debt covenants). 4) Income smoothing, this pattern is generally carried out when the company chooses to inform a stable trend of earnings development, rather than revealing an extreme increase or decrease in profit. 5) Timing Revenue and Expenses Recognition, the pattern of earnings management practices is carried out by making certain policies related to the timing of a transaction, for example recognizing revenue early. Some of the reasons for the management to practice earnings management; bonus plan (bonus scheme); long-term debt contracts (Debt Covenant); political reasons (political); taxation (taxation); change of directors; and an initial public offering.

Healy (1985) in Dechow *et al*., (1995), detect earnings management practices by comparing the average total accruals (divided by total assets of the previous period). De Angelo (1986) examines earnings management practices by calculating the initial difference in total accruals, assuming that the first difference is expected to be zero. This means that earnings management practices are not detected. Non-discretionary accruals in this model are measured using the total accruals of the last period

$$NDAt = TAt\text{-}1$$

Where

NDAt = estimation of non-discretionary accruals

TAt-1 = total accruals divided by total assets 1 year before year t

Jones (1991) in Dechow *et al*., (1995) provides a model to help identify earnings management practices by separating discretionary accruals and non-discretionary accruals. This model controls the effect of changes in the company's economic condition using the following non-discretionary accruals.

NDAt = 1 1/ TAt-1 + 2 REVt / TAt-1 + 3 PPEt / TAt-1

Where

REVt = revenue in year t minus revenue in year t-1 divided by total assets in year t-1.

PPEt = *gross property plan and equipment* in year t divided by total assets in year t-1

At-1 = total assets in year t-1

1, 2, 3 = *Firm-specific parameters*

Industry Adjusted Model (Dechow and Sloan, 1991) assumes that the variation in the determinant of non-discretionary accruals is the same in the same type of industry. In this model non-discretionary accruals are obtained by:

NDA_t = 1 + 1 median1 (TAτ)

Beaver and Engel (1996) proposed a special accrual model

NDAit = 0 + 1 COit + 3 NPAit + 4 NPAit+1 + e

Where

COit: *loan charge-off* (loans written off)

LOAN: *loans outstanding* (outstanding loan)

NPAit: non-performing assets (productive assets with problems) consist of productive assets based on the level of collectibility, namely a) in special attention (DPK), b) substandard (KL). C) doubtful (D) and d) stuck (M)

NPAit+1: difference *non-performing assets* t+1 with nonperforming assets t

All variables are deflated by book value of equity plus loan loss allowance. So that the calculation of accruals under management are:

DAit = TAit - NDAit

Information:

DAit: managed accruals

TAit: total accruals (for the special accrual model, total accruals are calculated based on total balance of allowance for earning assets write-off (PPAP))

NDAit: non-managed accruals

The company's financial condition is often associated with company performance, which is defined as the results the company has achieved in a certain period and reflects the extent to which the company's health level (Sukhemi, 2007:23). The results achieved in the company's activities can be seen from the operational, financial, marketing, technology, and human resources aspects. The company's achievements in operational aspects reflect the company's capabilities in managing and allocating the company's resources. Achievement in the financial aspect provides information about the company's financial condition in a certain period as measured by profitability indicators.

Profitability provides information about the company's ability to earn profits in its operational activities. Management achievement in general can be seen from the level of profitability generated by the company. If the profitability generated by the company is high, then the management is considered to have high performance, otherwise if the profitability is low, then the management is considered to have low performance as well. The main objective of the company is to earn a good profit as much as possible, Profitability can be used to see how much the effectiveness of a company in achieving its achievements.

The net result of a series of policies and decisions (Brigham and Houston, 2001:89, profitability is used by internal and external parties, investors or creditors in making decisions related to the company's operational activities. For internal and external parties, profitability is used to assess the profit development of the company. From time to time; assessing the amount of net profit after tax with own capital and measuring the productivity of all company funds that are used properly loan capital and own capital. For investors, profitability is used as a starting point measure to assess the success of the company. For creditors, profitability is measurement of operating cash flows that can be used as a source interest and principal payments. Profitability which is calculated by comparing operating profit with assets shows the level of effectiveness of a company in managing its assets; both from own capital and capital from loans. Investors will see how effective the company is in managing assets through the level of profitability, the higher the level of profitability generated by a company will have an impact on the value of a company's shares. The higher the level of ability to generate profits, the higher taxes and the rate of return on investment (dividends) that the company must pay

Leverage is a financial ratio that indicates the interaction between debt and assets owned by the company, Harahap (2013). This ratio shows how much the company's operational activities are financed by debt or external parties. Fahmi (2012) argues that leverage is a benchmark used to analyze financial statements in order to determine the amount of guarantees available to creditors. *Leverage* measured by comparing the total debt to the company's capital known as the Debt to Equity Ratio. Leveragereflects the company's ability to repay debt using existing capital. The higher the Debt to Equity, the greater the company's debt structure compared to the total equity, which means that the greater the company's burden. The

increasing burden on creditors indicates that the company's capital structure depends on outside parties. The amount of debt burden borne by the company will of course result in a reduced amount of profit received by the company. In the practice of a business entity with a high leverage ratio, it will also pose a high financial risk. Conversely, if the entity's leverage ratio is low, the risk of loss will also be low, especially when the economy is down.

In general, company size is a comparison of the size of an entity. Small scale companies can be classified according to various ways such as the number of assets, the number of sales, the number of employees and others. Brigham & Houston (2010:4), stated that the size of the company is the size of the company which is reflected in total assets, total sales, total profits, tax expenses and others. The size of a company affects the structure of the funds needed, meaning that the larger the company, the greater the funds needed to support its operational activities.

The grouping of company size on the basis of the large or small operational scale of the company by investors is used as one of the determining variables for investment decisions. Large companies generally have large total assets so that they can attract investors to invest in the company. In principle, the size of the company is divided into 3 categories, namely large companies (large firms), medium-size companies (medium-size) and small companies (small firms). Large companies with large total assets reflect that the company has reached a maturity stage where at this stage the company's cash flow is positive and is considered to have good prospects in a relatively long period of time.

The size of the company reflects the stability and ability of the company to carry out economic activities. Large companies have a big enough incentive to practice earnings management compared to small companies, this happens because large companies are required to be able to meet the expectations of investors or shareholders. Defond (1993) states that firm size is positively correlated with earnings management practices. Jao and Pagalung (2011), find evidence that firm size has a negative effect on earnings management practices. This means that large companies lack the incentive to practice earnings management. This happens because shareholders and outsiders in large companies are considered more critical than small companies. Company size reflects the company's ability related to the return of its tax decisions. The size of the company that classifies companies into large or small categories based on total assets is one of the determinants of tax avoidance decisions. The larger the assets, the larger the size of the company, the more complex the transactions that occur. The complexity of transactions allows companies to take advantage of loopholes in tax regulations to evade tax.

Large-scale companies tend to have greater resources, when compared to small-scale companies. With the available resources, it is possible for large companies to carry out tax management, in order to reduce the tax burden payable to the maximum through earnings management practices. Regarding the profit earned, pBig companies will get more attention from the government. The bigger the company, the higher the government's spotlight on the company, especially the tax authorities who have an interest in imposing taxes in accordance with the applicable tax rules. Such conditions create a tendency for management to comply with applicable regulations. This means that the larger the size of the company, the more careful the management in managing the tax burden.

HYPOTHESIS

Hypothesis 1a : Profitability has a negative effect on avoidance

Hypothesis 1b : *Leverage* positive effect on tax avoidance.

Hypothesis 1c : The size of the company has a negative effect on tax avoidance.

Hypothesis 2a : Profitability has a positive effect on earnings management practices

Hypothesis 2b : *Leverage* positive effect on earnings management practices

Hypothesis 2c : Ucompany size has a negative effect on earnings management practices

Hypothesis 3 : Earnings management practices affect tax avoidance

Hypothesis 4a : Earnings management practices positively mediate the profitability drivers of tax avoidance

Hypothesis 4b : Earnings management practices positively mediate the effect of Leverage on tax avoidance

Hypothesis 4c : Earnings management practices positively mediate the effect of firm size on tax avoidance.

RESEARCH METHODS

The research was designed to examine the effect of the independent variable on the dependent variable. The first examines the effect of the independent variables including profitability, leverage and firm size on the dependent variable of tax avoidance. The second examines the effect of the independent variables on profitability, leverage and firm size on the dependent variable of earnings management practices. Third, examine the effect of the independent variable of earnings management practice on the variable of tax avoidance practice. Fourth, examine the effect of profitability, leverage and firm size on tax avoidance through earnings management practices. The population in this research are all manufacturing companies that went public in Indonesia

until 2017 as many as 154 companies. The sample used is determined by purposive sampling method. As much as 66 manufacturing companies over a five-year period were sampled in this research. The research was conducted on publicly listed manufacturing companies in Indonesia. Observation period of 5 (five) years, from 2013 to 2017. The data needed in this research is in the form of secondary data sourced from the company's financial statements, collected using the documentation method. The data analysis technique used descriptive analysis and linear regression analysis. Descriptive analysis is used to make it easier to understand the variables used in the study. Repeated linear regression analysis was used to test the hypothesis of the direct effect of profitability, leverage and firm size on earnings management practices and tax avoidance. PThe procedure for testing the role of mediator proposed by Baron and Kenny (1986) is used to test the hypothesis of the mediating role of earnings management practices.

According to Brigham and Houston (2001:89) profitability is the net result of a series of policies and decisions, which indicate the company's success in generating profits. Operationally Profitability is a ratio that measures how efficiently a company manages company assets to generate profits over a period measured by the proxy of operating profit divided by the total assets of the company. According to Cashmere (2011:113) *Leverage* is a measure of the extent to which the company's operational activities are financed by loans. This means how much debt the company uses to finance business activities compared to its own capital. Leverage is the ratio of total debt (both short term and long term) with the total assets owned by the company at the end of the year, in this receipt it is proxied by total debt divided by total assets. Company size is the size of a company that can be seen from the number of assets, total sales, total profit, tax expense and others (Brigham & Houston, 2001:4). The size of the company in this research is proxied by using the natural logarithm of total assets.

According to Healy and Wahlen (1999) the practice of earnings management (earnings management) is a change in the company's economic performance carried out by the company's internal parties to mislead interested parties or influence contractual results. Earnings management practices are proxied by *discretionary accruals Modified Jones Model.* Zain (2003), states that tax avoidance is a process of controlling actions in order to avoid the consequences of imposing unwanted taxes. Tax avoidance in this receipt is proxied by the Cash Effective Tax Rate (CETR)

RESEARCH RESULTS AND DISCUSSION

Research result

Measurement of Earnings Management Practices

Discretionary accruals (DA) Modified Jones model is used to measure earnings management practices. *Discretionary accruals (DA)* obtained by subtracting the estimated accrual (TA) value with non-discretionary accrual (NDA), which is calculated using a linear regression model. The following table 5 describes the regression parameters for each proxy.

Table 1: Regression parameters for each earnings management practice proxy

	Coefficients	***Standard Error***	***P-value***
2017			
Constanta	0.245806	0.391452	0.532353
1/TAi,t-1	-20970.69	119090.6	0.860797
Salesi,t/TAi,t-1	-0.183981	1.248919	0.883364
PPEi,t/TAi,t	-0.080199	0.501926	0.873571
2016			
Constanta	1.429273	3.64123	0.696017
1/TAi,t-1	-451120.59	1129836.53	0.691059
Salesi,t/TAi,t-1	-12,164365	13.391521	0.367204
PPEi,t/TAi,t	2.622160	4.642600	0.574245
2015			
Constanta	0.4646228	5,6792813	0.9350612
1/TAi,t-1	-70236.13	1739950,58	0.9679305
Salesi,t/TAi,t-1	12.183181	18,518344	0.5130391
PPEi,t/TAi,t	2.8402778	7.153697	0.6927041
2014			
Constanta	3.171875	3.554823	0.375696
1/TAi,t-1	-30475,90	774380.96	0.968734
Salesi,t/TAi,t-1	-2.101518	5,703849	0.713801
PPEi,t/TAi,t	-2.110502	4.462855	0.637942
2013			
Constanta	0.076947	0.031671	0.018026
1/TAi,t-1	4022.44	5801.71	0.490698
Salesi,t/TAi,t-1	0.019004	0.041476	0.648421
PPEi,t/TAi,t	-0.092566	0.033001	0.006713

Descriptive Analysis

Descriptive analysis explains the variables of profitability, leverage, firm size, earnings management practices and tax avoidance

Table 2: Descriptive Statistics of Variables

Variable	Minimum	Maximum	mean	Std. Deviation
Profitability	0.0025	0.8557	0.1275	0.1132225
Leverage	0.0011	0.7678	0.4326	0.1787985
Company Size	11.4798	19.5047	14.6793	1.6501106
Discretionary accruals (DA)	-1.0459	1.6132	0.9255	0.2051663
Cash Effective Tax Rate (CETR)	0.0033	0.4990	0.2487	0.0926063

Source: Processed data

Manufacturing companies that went public in Indonesia for the period 2013 to 2017 which were sampled in this study had the ability to generate an average profit (profitability) of 12.75%. The ability to generate the highest profit 85.57%. The ability to generate the lowest profit at 0.25%. The average leverage level is 43.26%. The highest debt level is 76.78%. The lowest debt level is owned by the smallest 0.11%. The average size of the company (in total assets) is 14.67. The largest company size is 19.50 and the smallest company size is 11.47. This means that the publicly listed manufacturing companies in Indonesia for the period from 2013 to 2017 which were sampled in this study had an average company size with total assets of 10,303,936 (in millions of rupiah). The largest company size with total assets of 295,646,000. (in million rupiah). The smallest company size with total assets of 96,745. (in millions of rupiah). The average discretionary accruals (DA) of 0.09256 indicates that publicly listed manufacturing companies in Indonesia for the period 2013 to 2017 which are sampled in this study carry out earnings management practices by increasing profits. Earnings management practice by increasing the highest profit (DA = 1.6132). While the practice of earnings management by lowering the highest profit (DA = -1.0459). The average Cash Effective Tax Rate (CETR) of 0.24 indicates that the manufacturing companies that went public in Indonesia from 2013 to 2017 which were the samples of this study indicated tax evasion. The smallest Cash Effective Tax Rate is 0.0033. The biggest Cash Effective Tax Rate is 0.4969. The smallest company size with total assets of 96,745 (in millions of rupiah). The average discretionary accruals (DA) of 0.09256 indicates that publicly listed manufacturing companies in Indonesia for the period 2013 to 2017 which are sampled in this study carry out earnings management practices by increasing profits. Earnings management practice by increasing the highest profit (DA = 1.6132). While the practice of earnings management by lowering the highest profit (DA = -1.0459). The average Cash Effective Tax Rate (CETR) of 0.24 indicates that the manufacturing companies that went public in Indonesia from 2013 to 2017 which were the samples of this study indicated tax evasion. The smallest Cash Effective Tax Rate is 0.0033. The biggest Cash Effective Tax Rate is 0.4969. The smallest company size with total assets of 96,745. (in millions of rupiah). The average discretionary accruals (DA) of 0.09256 indicates that publicly listed manufacturing companies in Indonesia for the period 2013 to 2017 which are sampled in this study carry out earnings management practices by increasing profits. Earnings management practice by increasing the highest profit (DA = 1.6132). While the practice of earnings management by lowering the highest profit (DA = -1.0459). The average Cash Effective Tax Rate (CETR) of 0.24 indicates that the manufacturing companies that went public in Indonesia from 2013 to 2017 which were the samples of this study indicated tax evasion. The smallest Cash Effective Tax Rate is 0.0033. The biggest Cash Effective Tax Rate is 0.4969. The average discretionary accruals (DA) of 0.09256 indicates that publicly listed manufacturing companies in Indonesia for the period 2013 to 2017 which are sampled in this study carry out earnings management practices by increasing profits. Earnings management practice by increasing the highest profit (DA = 1.6132). While the practice of earnings management by lowering the highest profit (DA = -1.0459). The average Cash Effective Tax Rate (CETR) of 0.24 indicates that the manufacturing companies that went public in Indonesia from 2013 to 2017 which were the samples of this study indicated tax evasion. The smallest Cash Effective Tax Rate is 0.0033. The biggest Cash Effective Tax Rate is 0.4969. The average discretionary accruals (DA) of 0.09256 indicates that publicly listed manufacturing companies in Indonesia for the period from 2013 to 2017 that were sampled in this study carried out earnings management practices by increasing profits. Earnings management practice by increasing the highest profit (DA = 1.6132). While the practice of earnings management by lowering the highest profit (DA = -1.0459). The average Cash Effective Tax Rate (CETR) of 0.24 indicates that the manufacturing companies that went public in Indonesia from 2013 to 2017 which were the samples of this study indicated tax evasion. The smallest Cash Effective Tax Rate is 0.0033. The biggest Cash Effective Tax Rate is 0.4969. 09256 shows that publicly listed manufacturing companies in Indonesia for the period 2013 to 2017 which are the sample in this study carry out earnings management practices by increasing profits. Earnings management practice by increasing the highest profit (DA = 1.6132). While the practice of earnings

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Regression Analysis Results

The classical test shows the VIF value of the independent variable below 5, meaning that all variables are free from the influence of multicollinearity. The data are normally distributed, because spread around dan close to the line diagonal. The DW value is between-1 < DW < 2, which means that there is no autocorrelation in the regression model used. The data are scattered irregularly without a certain pattern, so it is stated that the regression model is free from heteroscedasticity.

Table 3: Linear Regression Test Results 1

Model	Standardized coefficient	t	p value	R	*Adjusted* R2
Profitability	-0.156	-3.736	0.000	0.345	0.119
Leverage	-0.123	-4,672	0.000		
Company size	-0.006	-2,178	0.055		

Source: processed data, 2019

Based on table 3, It is known that profitability directly affects tax avoidance with a path coefficient of -0.156, a significance level of 0.000 <0.05. Leverage directly affects tax avoidance with a path coefficient of -0.123, a significance level of 0.000 <0.05. Firm size directly affects tax avoidance with a path coefficient of -0.005, a significance level of 0.055 > 0.05, with the equation value Y2 = -0.156 X1 + (-0.123) X2 + (-0.006) X3 + e2

Table 4: Results of 2 Linear Regression Test

Model	Standardized coefficient	t	p value	R	*Adjusted* R2
Profitability	0.302	3.034	0.003	0.247	0.061
Leverage	-0.222	-3,530	0.000		
Company size	-0.015	-2,136	0.033		

Source: Processed data

Based on Table 4 it is known that; Profitability directly affects earnings management practices with a path coefficient of 0.302, a probability value of 0.003 less than 0.05. Leverage directly affects earnings management practices with a path coefficient of -0.222, a probability value of 0.000 less than 0.05. Firm size has an effect on earnings management with a path coefficient of -0.015, a probability value of 0.033 which is smaller than 0.05. These findings show evidence of a hypothesis which states that profitability, leverage and firm size affect earnings management practices, which is acceptable, with the equation value Y1 = 0.302 X1 + (-0.222) X2 + (-0.015) X3 + e1

Table 5: 3 linear regression test results

Model	Standardized coefficient	t	p value	R	*Adjusted* R2
Profit management	0.101	4,348	0.000	0.233	0.054

Source: processed data

Table 5 shows that earnings management practices affect tax avoidance with a path coefficient of 0.101, a probability value of 0.000 less than 0.05. with the equation value Y2 = 0.101 Y1 + e3

Table 6: Linear Regression Test Results 4

Model	Standardized coefficient	t	p value	R	*Adjusted* R2
Profitability	-0.185	-4,504	0.000	0.396	0.157
Leverage	-0.101	-3.878	0.000		
Company Size	-0.004	-1.453	0.147		
DA	0.098	4,333	0.000		

Source; processed data

Based on Table 3,4,5,6 it is known that: the path coefficient of profitability on earnings management practices is 0.303 with a significant level of 0.003 <0.05. The path coefficient of earnings management practices on tax avoidance is -0.098 with a significant level of 0.000 < 0.005. The profitability path coefficient on tax avoidance is -0.185, the significance level is 0.000 <0.05. The coefficient of the leverage path on earnings management practices is - 0.222 with a significant level of 0.000 < 0.05. The coefficient of earnings management practice on tax avoidance is -0.098 with a significant level of 0.000 < 0.005. The coefficient of leverage on tax avoidance is -0.101 with a significance level of 0.000 <0.05. The path coefficient of firm size on earnings management practices is -0.015 with a significant level of 0.033 <0.05. The coefficient of earnings management practice on tax avoidance is -0.098 with a significance level of 0.000 < 0.005. Firm size has an effect on tax avoidance through earnings management practices with a coefficient of -0.004 with a significance level of 0.147 > 0.05. With the regression equation: CETR = 0.367 + (-0.185) Profit. + (-0.101) Lev. + (-0.004) size + 0.098 DA + e1

Overall linear regression analysis is as follows.

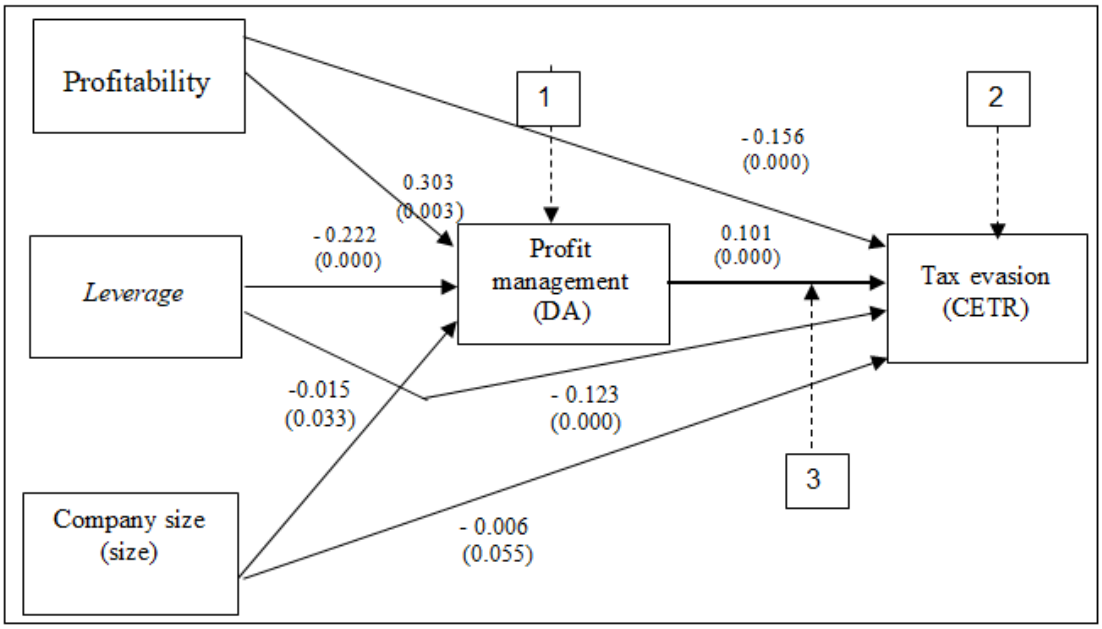

Figure 1: Path Diagram of the Effect of Profitability, Leverage and Firm Size against Tax Avoidance through Earnings Management Practices

DISCUSSION

Descriptive Statistics

Descriptive statistics show that publicly listed manufacturing companies in Indonesia, which are the sample in this study, have a fairly good average level of ability to generate profits or profitability. The average debt level is below equity, meaning that most of the operating costs of manufacturing companies in Indonesia use their own capital. The logarithm of the total asset norm shows that the average firm size varies, even though the firm considered to have good prospects in carrying out activities for a relatively long period of time.

Average value *discretionary accruals* shows that the manufacturing companies that are the sample are indicated to practice earnings management by increasing profits. With the discretionary accrual numbers that are negative and positive, it indicates that there is an effort from the management to increase or decrease the profit figure by utilizing accruals. There is an indication of tax avoidance in publicly listed manufacturing companies in Indonesia that are the sample. This is indicated by an average of *Cash Effective Tax Rate (CETR)* which is below the tax rate for corporate taxpayers.

The direct effect of profitability, leverage and firm size on tax avoidance

Profitability has a significant negative effect on tax avoidance. The research findings do not support the research results of Cahyono *et al*., (2016) which provides evidence that profitability has no effect on tax avoidance. The findings are consistent with the findings of Kuniasih (2013), Maharani (2014) and Saputra et.al (2015) who found evidence that profitability negatively affects tax avoidance. This means that the higher the profitability, the more efficient the company, the more effective the corporate tax rate. Thus the level of profitability is the reason for the management to do tax avoidance.

Leverage has a significant negative effect on tax avoidance. The research findings are in line with the results of Swingly's (2015) research which found evidence of leverage having a negative effect on tax avoidance. The findings are consistent with the findings of Ozkan (2001) which provides evidence that companies with high tax obligations choose to borrow in order to reduce taxes. This shows that in order to reduce the tax burden paid, the company deliberately makes loans. Koh & Lee (2015) found that debt ratios influence financial reporting decisions and corporate tax reporting non-monotously depending on the level of debt ratios. If the company's debt ratio is relatively low, it is likely that the company will be aggressive in financial reporting. On the other hand, when a company's debt financing is above a certain level, companies tend to be more aggressive in reporting taxes because the debt ratio increases. In other words, it can be stated that companies with high tax burdens do tax avoidance by way of debt. This is done because an increase in the amount of debt will cause an interest component, which can reduce the company's pre-tax profit, resulting in a reduced tax burden to be paid by the company.

Firm size has a negative effect on tax avoidance. The research findings are in line with the findings of Kurniasih (2013) who found evidence that firm size had a negative effect on tax avoidance. This finding succeeded in obtaining evidence that the smaller the company, the higher the tax avoidance. On the other hand, the larger the size of the company, the smaller the level of tax avoidance. This happens because the larger the size of the company, the greater the government's spotlight on the company, the more careful the management will be in considering the risks to manage the tax burden that must be paid. The findings of this research are not in line with the findings of Swingly (2015), Putri (2017) and also Silviani (2017) who get evidence that company size has a significant positive effect on tax avoidance. This means that the larger the size of the company, the higher the level of tax avoidance. Based on this description, it can be stated that profitability, leverage and firm size have a negative effect on tax avoidance. The findings also provide evidence that profitability has the greatest effect on tax avoidance. This means that the higher the level of profitability, the higher the earnings management practices carried out by manufacturing companies. Leverage and firm size have a negative effect on tax avoidance. The findings also provide evidence that profitability has the greatest effect on tax avoidance. This means that the higher the level of profitability, the higher the earnings management practices carried out by manufacturing companies. Leverage and firm size have a negative effect on tax avoidance. The findings also provide evidence that profitability has the greatest effect on tax avoidance. This means that the higher the level of profitability, the higher the earnings management practices carried out by manufacturing companies.

The direct effect of profitability, leverage and firm size on earnings management practices.

Profitability has an effect on earnings management practices. The findings are consistent with the findings of Widyastuti (2009) and Amertha (2013) who found evidence that profitability positively affects earnings management practices. The findings show evidence that profitability or financial performance is a driving force for opportunistic management to practice earnings management by increasing profits or decreasing profits according to the company's performance conditions. If the company performs well, the management tends to take earnings management actions by lowering profits. Conversely, if the company's performance is bad, the management tends to take earnings management actions by increasing profits. The findings do not support the findings of Dewi & Prasetiono (2012) and Gunawan *et al*., (2015) who found evidence that profitability had no effect on earnings management practices. This means that the level of company profitability is not a reason that must be considered by management in making decisions to practice earnings management.

Leverage has an effect on earnings management practices. The findings are consistent with the findings of Mamedova (2008), Oktovianti (2012) and Agustia (2013) found evidence that corporate leverage has an effect on earnings management practices. This implies that the size of the debt owned by the company is one of the reasons for the company to practice earnings management. Companies with high leverage show that proportional credit is higher than those that are proportionally active and will have a tendency to manipulate in the form of earnings management. This means that companies with high leverage have a trend to adjust reported earnings by increasing or decreasing earnings in future periods to the current period. The findings do not support the findings of Fitri (2012) who found evidence that leverage has no significant effect on earnings management practices. This means that the amount of

debt owned by the company is not one of the reasons for the company to carry out earnings management.

Firm size has a negative effect on earnings management practices. This finding is not in line with the results of research by Defond (1994) and Ali (2015) which reveal that there is a positive relationship between firm size and earnings management. In this case, the larger the size of the company, the greater the demand for the company to be able to meet the expectations of investors or shareholders and financial analysts to show a positive increase in earnings. This condition encourages the company management to practice earnings management. Larger companies also have more negotiating power with auditors, more transaction bids and management power; which makes it easier to manipulate earnings. The findings are consistent with the findings of Jao & Pagalung (2011) and Sufitrayati (2015) who found firm size had a negative effect on earnings management practices. This means that the smaller the size of the company, the higher the level of earnings management practice. Meanwhile, large companies are less motivated to practice earnings management, because shareholders and outsiders in large companies are considered more critical than small companies. Based on this description, it can be stated that profitability, leverage and firm size have a significant effect on management practices. The research findings provide evidence that profitability has the greatest influence on earnings management practices. This means that the higher the level of profitability of the manufacturing company, the higher the earnings management practices carried out.

5.1.1. The effect of earnings management practices on tax avoidance

Earnings management practices have a significant effect on tax avoidance. The findings are consistent with the findings of Wang & Chen (2012) who get evidence that there is a relationship between earnings management practices and tax avoidance by adding business performance variables. The findings are also in line with the findings of Arief *et al*., (2016) who found evidence that earnings management practices significantly affect tax aggressiveness as a form of tax avoidance. And Selvia's research (2017) which found evidence of earnings management practices having an effect on tax avoidance. This finding indicates that the more aggressive the company is to practice earnings management, the more aggressive the company will be to do tax avoidance. This means that the more management practices earnings management, the more motivated the company to do tax avoidance. This finding provides evidence that one of the reasons for the management to practice earnings management is to avoid high taxes.

Frank *et al*., (2009) found that there is a positive relationship between tax reporting aggressiveness and aggressive financial reporting. So if a business entity practices tax report manipulation aggressively, then aggressive manipulation activities are also carried out on financial statements. Earnings management practices for tax purposes are usually carried out by reducing reported tax income earnings, which automatically reduces book income/earnings so that the tax-book income difference remains normal. Scoot, (2000) states that tax motivation is one of the reasons for the management to carry out earnings management. Companies by doing income decreasing to reduce the tax burden.

The effect of profitability, leverage and firm size on tax avoidance through earnings management practices

The profitability path coefficient on tax avoidance with earnings management practices as mediation is larger and significant (two tails) than the profitability path coefficient for tax avoidance without mediation. This shows evidence that earnings management practices can partially mediate the effect of profitability on tax avoidance. The leverage path coefficient has an effect on tax avoidance with earnings management practices as mediation, which is larger and significant (two tails) than the leverage path coefficient on tax avoidance without mediation. This shows evidence that earnings management practices partially mediate the effect of leverage on tax avoidance.

The path coefficient of firm size on tax avoidance without the mediation of earnings management practices is smaller and insignificant (two tails) than the path coefficient of size on tax avoidance with earnings management practices as mediation. This shows evidence that earnings management practices perfectly mediate the effect of firm size on tax avoidance. Based on this description, it can be concluded that earnings management practices partially mediate the effect of profitability, leverage and firm size on tax avoidance in publicly listed manufacturing companies in Indonesia for the period 2013 to 2017.

CONCLUSIONS AND SUGGESTIONS

The publicly listed manufacturing companies in Indonesia that are the sample in this study, have an average level of ability to generate profits or profitability that is quite good. The average debt level is below equity, meaning that most of the operating costs of manufacturing companies in Indonesia use their own capital. The logarithm of the total asset norm shows that the average size of the company varies, however, the company is considered to have good prospects in carrying out activities for a relatively long period of time.

There are indications of earnings management practices in the manufacturing companies that are sampled, marked by the value of discretionary accruals which are negative and positive which indicate an effort from management to increase or decrease profits by

utilizing accruals. Indications of tax avoidance can be seen in the sample companies, indicated by the average Cash Effective Tax Rate (CETR) which is below the tax rate for corporate taxpayers.

Profitability has a negative effect on tax avoidance, consistent with the findings of Kurniasih (2013), Maharani (2015) and Saputra *et al*., (2015). Leverage has a negative effect on tax avoidance, consistent with the findings of Ozkan (2001) and Koh & Lee (2015). Firm size has a negative effect on tax avoidance, consistent with the results of Kurniasih's (2013) research. Profitability has a positive effect on earnings management practices. This finding is consistent with the findings of Widyastuti (2009) and Amertha (2013) who found evidence that profitability has a positive effect on earnings management practices. Leverage has a negative effect on earnings management practices. This finding is consistent with the findings of Mamedova (2008), Oktovianti (2012) and Agustina (2013). Firm size has a negative effect on earnings management practices.

Earnings management practices affect tax avoidance. This finding is consistent with the results of research by Wang & Chen (2012) and Arief *et al*., (2016) who found evidence that earnings management practices have a significant effect on tax avoidance. This means that the higher the practice of earnings management, the higher the tax avoidance by the company. This is in line with what has been stated by Scott (2015) that one of the motivations of the management to practice management is for the purpose of reducing taxes.

Earnings management practices can partially mediate the effect of profitability on tax avoidance. The effect of profitability on tax avoidance without earnings management practices as mediation is smaller (significant) the effect of profitability on tax avoidance with earnings management practices as mediation. Earnings management practices partially mediate the effect of leverage on tax avoidance. The effect of leverage on tax avoidance without earnings management practices as mediation is smaller (significant) than the effect of leverage on tax avoidance with earnings management practices as mediation. Earnings management practices perfectly mediate the effect of firm size on tax avoidance. The effect of firm size on tax avoidance without earnings management practices as mediation is smaller (not significant) than the effect of size on tax avoidance with earnings management practices as mediation. Earnings management practices partially mediate the effect of profitability, leverage and firm size on tax avoidance in publicly listed manufacturing companies in Indonesia for the period 2013 to 2017.

Managementcompanies need to be more careful in carrying out earnings management practices and tax avoidance. Tax avoidance should not be carried out because it results in not achieving the tax revenue target as stipulated in the State revenue and expenditure budget. Investors and potential corporate investors should be more careful and thorough in analyzing the level of profitability, leverage and company size related to earnings management practices and tax avoidance. A deeper study is needed regarding the practice of earnings management and tax avoidance by taxpayers of business entities that go public in Indonesia, not only focusing on manufacturing companies. Further researchers who wish to conduct research on tax avoidance should pay more attention to the consistency of research results from period to period. Research related to earnings management practices and tax avoidance on the Stock Exchange should use a different business sector or type of industry such as the financial services industry and banking or others.

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