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COOPERATIVE TAX AVOIDANCE: EVIDENCE OF IMPLEMENTATION OF AGENCY THEORY

Sugiyanto Sugiyanto\*, Sugiyanto Ikhsan, Anggi Andriani Rahayu, M. Arsyad Arradya

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## **ACCEPTANCE LETTER**

February 26, 2024

Dear author(s),  
Sugiyanto\*, Sugiyanto Ikhsan, Anggi Andriani Rahayu, M. Arsyad Arradya  
Universitas Koperasi Indonesia  
Email: [giyant2000@ikopin.ac.id](mailto:giyant2000@ikopin.ac.id)

It's my pleasure to inform you that, after the peer review, your paper "COOPERATIVE TAX AVOIDANCE : EVIDENCE OF IMPLEMENTATION OF AGENCY THEORY" has been ACCEPTED to publish in Tec Empresarial journal (P-ISSN: 1659-2395, E-ISSN: 1659-3359) in the Volume 19 Number 1 of 2024.

I believe that our collaboration will help to accelerate the global knowledge creation and sharing one step further. Please do not hesitate to contact me if you have any further questions.

Regards,



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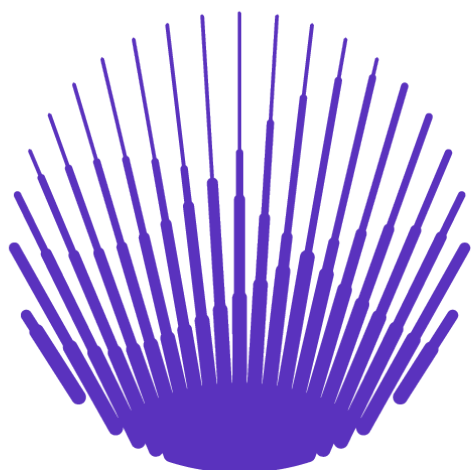
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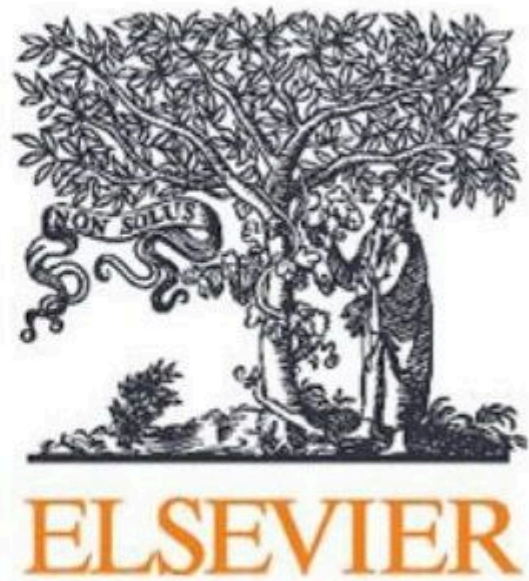
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## COOPERATIVE TAX AVOIDANCE: EVIDENCE OF IMPLEMENTATION OF AGENCY THEORY

**Sugiyanto Sugiyanto\*, Sugiyanto Ikhsan, Anggi Andriani Rahayu, M. Arsyad Arradya**

<sup>1,2,3,4</sup> Universitas Koperasi Indonesia

### **Abstract**

This research aims to analyze the application of Agency Theory in cooperative business organizations, specifically focusing on the relationship between owners (members) and management, as well as the relationship between management and the tax authorities. The management is obligated to enhance the well-being of members by raising the residual business outcomes, namely profitability. Internally, this may be achieved via enhancing cost efficiency, optimizing capital use, and leveraging debt. Externally, management might use legal strategies to minimize tax obligations. The research was structured using a quantitative methodology, specifically utilizing panel data. The study was conducted from 2015 to 2019, utilizing purposive selection to choose a sample of 100 enterprises located in the eastern region of western Java. Path analysis was used as the research methodology. The findings of this research suggest that cooperative management aims to enhance profitability and achieve tax savings in a lawful manner, in order to fulfill the members' expectations of improving their well-being. Additionally, the management remains committed to fulfilling its tax payment commitments.

**Keywords:** Operating Efficiency; Capital Intensity; Leverage; Profitability; Tax Avoidance.

### **1. Introduction**

Taxation is the primary and crucial means of generating money for the government, and hence it must be consistently examined and enhanced to bolster national progress. Taxes are a way for people to help pay for things like infrastructure, hospitals, schools, and police forces, among other public goods that people use on a daily basis. Various methods outlined in legislation, administrative regulations, and programs like Tax Amnesty are part of the government's ongoing effort to increase tax collection. The Central Government Financial Report (2020) states that in 2015, tax revenue reached 83.29% of the target. The proportion increased at a consistent rate for the next three years. In 2016, it was 83.48%, in 2017 it was 91.23%, and this year it was 93.86%. The goal of the 2019 State Budget is to collect IDR 1,786.4 Trillion in taxes.

Indonesia's tax performance is now inferior to that of other nations. In the ASEAN area, Indonesia's tax percentage surpasses only that of Myanmar. According to the Ministry of Finance's statistics, the goal tax ratio to be attained in 2019 is 12.2% as set by the state budget. The actual tax ratios for previous years were 13.7% in 2014, 11.6% in 2015, 10.8% in 2016, 10.7% in 2017, and 11.6% in 2018.

With a tax ratio of 17.7 percent on average, Indonesia is considered a lower-middle income nation<sup>1</sup>. But the author claims that poor tax compliance is to blame for Indonesia's low tax percentage. The high costs of tax compliance, the lack of clarity on the law, and

the pressure from other countries over Indonesia's uncompetitive tax rates are all contributing causes. In order to tackle the problem of low taxpayer compliance, tax authorities have the task of enhancing the effectiveness of communication with

segmented taxpayers. Every community, whether it be a business or a person, has a responsibility to contribute to the advancement of the country by fulfilling their tax obligations, including cooperatives. In accordance with the Income Taxes Law, cooperatives, which are considered to be business enterprises, are required to pay taxes, as described in article 2, paragraph 1 (b). Cooperatives are one of the taxpayers that are required to fulfill their tax duties, which may include the collection of individual taxes or the reduction of those taxes.

According to the Ministry of Cooperatives and SMEs, Indonesia has 123,048 operational cooperatives with 22,463,738 members in 2019. The cooperative provided IDR 5.7 Trillion in tax contributions to state revenue in 2018, up from IDR 4.4 Trillion in 2017 and IDR 3.4 Trillion in 2016. Cooperatives still contribute little. Cooperative management tax compliance, particularly corporation tax, worsens this scenario.

Many cooperative practitioners state that cooperatives do not need to pay corporate tax because of their business orientation as a service to members and not profit-oriented<sup>2</sup>. The surplus obtained by the cooperative which is referred to as the residual operating results, as the efficiency of operational costs, this is in accordance with the statement that cooperative operated at cost<sup>3</sup>.

For businesses, the tax of earning before tax diminishes the net profit the owner and cooperative are entitled to and the residual outcomes of the firm. In the face of competing interests, cooperative management must demonstrate their successes to boost member welfare with the remaining business result. However, management must also confront the government, which mandates businesses to pay taxes. These contrasts in interests drive cooperative management to use tax planning, such as lawful tax evasion, to control their taxes.

<sup>1</sup> H S Prayoga, "Tax Ratio Indonesia Rendah, Ini Yang Harus Dilakukan Otoritas Pajak," *Kontan. Co. Id*, 2019.

<sup>2</sup> Anggi Sugiyanto, Andriani Rahayu, "The Implementation of Risk Management and Its Effect on Good Cooperative Governance and Success," *Journal of Indonesian Economy and Business* 33, no. 3 (2018): 243–56.

<sup>3</sup> Roy, *Cooperative, Development, Principle and Management (4th Ed.)*. (The Interstate Printers & Publisher Inc., 1981).

Tax avoidance as a way to save tax legally by using regulatory loopholes or because there is no regulation yet<sup>4</sup>. The Minister of Finance stated that the delay in the collection of tax funds is due to the large number of taxpayers who practice tax avoidance and tax evasion<sup>5</sup>. Tax avoidance in its application of agency theory where there is a conflict of interest between managers, tax executors and investors<sup>6</sup>.

As an agent, cooperative management must prioritize the welfare of the owner. However, the manager is also obligated to pay corporation tax, which results in lower earnings for the members. Management must exhibit its performance to stakeholders while also effectively managing tax obligations via lawful tax avoidance strategies. Profitability is an indicator of the effectiveness of management. Profitability distribution as a dividend leads to a decline in the agency conflict<sup>7</sup>. Dividend payout also resolves the agency conflict between the inside and outside shareholders<sup>8,9</sup>. The level of cooperative tax payments is directly proportional to the magnitude of residual earnings before to taxation, as well as the extent of tax avoidance measures used to augment the residual earnings post-taxation, hence benefiting the owner's entitlements. The government's primary objective is to

increase tax revenue to achieve the goal of national income, while managers want to reduce tax payments in order to maximize profitability<sup>10</sup>. Past studies have focused on investigating Cooperative Tax Avoidance via the use of Agency Theory. The study variables will be examined in the context of their impact on profitability and tax evasion. Specifically, the link between operational efficiency, capital intensity, leverage, and these two outcomes will be investigated.

## 2. Literature Review

### Theoretical Framework and Hypothesis Development

<sup>4</sup> Ni Koming Ayu Praditasari and Putu Ery Setiawan, "Pengaruh Good Corporate Governance, Ukuran Perusahaan, Leverage Dan Profitabilitas Pada Tax Avoidance," *E-Jurnal Akuntansi Universitas Udayana* 19, no. 2 (2017): 1229–58.

<sup>5</sup> Ria Triananda Putri, Ihyaul Ulum, and Adi Prasetyo, "Company Risk, Size, Fiscal Loss Compensation, and Tax Avoidance: Evidence from Indonesian Islamic Companies," *Journal of Innovation in Business and Economics* 2, no. 02 (2018): 87–94.

<sup>6</sup> Nan Zhang et al., "Structures of K<sub>0.05</sub>Na<sub>0.95</sub>NbO<sub>3</sub> (50–300 K) and K<sub>0.30</sub>Na<sub>0.70</sub>NbO<sub>3</sub> (100–200 K)," *Acta Crystallographica Section B: Structural Science* 65, no. 3 (2009): 291–99.

<sup>7</sup> James J Park, "Shareholder Compensation as Dividend," *Michigan Law Review*, 2009, 323–71.

<sup>8</sup> Michael C Jensen, "Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers," *The American Economic Review* 76, no. 2 (1986): 323–29.

<sup>9</sup> Stewart C Myers, "Outside Equity," *The Journal of Finance* 55, no. 3 (2000): 1005–37.

<sup>10</sup> Abim Wafirli, "The Influence of Profitability, Leverage, Firm Size and Capital Intensity towards Tax Avoidance" (Universitas Jenderal Soedirman, 2017).

Previous research that focused on tax avoidance as the dependent variable was conducted by<sup>11,12</sup>. Tax evasion, leverage, operational efficiency, and capital intensity affect profitability, according to this study. It also examines how Operating Efficiency, Capital Intensity, and Leverage on Tax Avoidance affect profitability directly and indirectly.

### **The Effect of Operating Efficiency, Capital Intensity and Leverage on Profitability**

The presence of an agency connection between members and management is shown, aiming to reduce agency conflict and enhance profitability by improving operational efficiency, maximizing asset utilization, and leveraging. According to<sup>13</sup>, profitability measured by "return on equity (ROE) is influenced by operating efficiency, asset use efficiency and financial leverage". The value of the cost-efficiency ratio affects the change in the value of the net profit margin<sup>14</sup>. Profitability can be increased by the effective use of assets, measured by asset turnover or capital intensity ratio that impacts profitability<sup>15,16</sup>. Leverage, as measured by the debt to equity ratio, has a positive effect on return on equity<sup>17,18</sup>. The results of research conducted<sup>19</sup> also concluded that there is a significant effect of leverage on firm value as measured by Tobin's Q.

### **Direct and Indirect Effect of Operating Efficiency, Capital Intensity, Leverage on Tax Avoidance Through Profitability**

In order to keep the cooperative owner and the tax authorities on good terms, management employs tax avoidance strategies. In order to keep owner profitability high and reduce tax

<sup>11</sup> Jennifer L Brown and Katharine D Drake, "Network Ties among Low-Tax Firms," *The Accounting Review* 89, no. 2 (2014): 483–510.

<sup>12</sup> Sunday Oseiweh Ogbeide, "Firm Characteristics and Tax Aggressiveness of Listed Firms in Nigeria: Empirical Evidence," *International Journal of Academic Research in Public Policy and Governance* 4, no. 1 (2017): 556–69.

<sup>13</sup> Stephen A Ross, Randolph W Westerfield, and Bradford D Jordan, "Fundamentals of Corporate Finance" (McGraw-Hill, 2022).

<sup>14</sup> Basyirun Iqbal, "Analisis Pengaruh Operational Efficiency Dan Cost Efficiency Ratio Terhadap Net Profit Margin" (Skripsi Program Studi Manajemen Fakultas Ekonomi Universitas Hasanuddin, 2011).

<sup>15</sup> Ross, Westerfield, and Jordan, "Fundamentals of Corporate Finance."

<sup>16</sup> John Nofsinger, Troy Adair, and Marcia Cornett, "Finance: Applications and Theory" (McGraw-Hill/Irwin Series in Finance, Insurance and Real Estate). New York ..., 2012).

<sup>17</sup> Jihan Salim, "Pengaruh Leverage (DAR, DER, Dan TIER) Terhadap ROE Perusahaan Properti Dan Real Estate Yang Terdaftar Di Bursa Efek Indonesia Tahun 2010–2014," *Perbanas Review* 1, no. 01 (2015).

<sup>18</sup> Raluca-Georgiana Moscu, "The Relationship between the Capital and Ownership Structures of Companies Listed on the Bucharest Stock Exchange," *International Journal of Academic Research in Business and Social Sciences* 4, no. 2 (2014): 255.

<sup>19</sup> Inggi Rovita Dewi, Siti Ragil Handayani, and Nila Firdausi Nuzula, "Pengaruh Struktur Modal Terhadap Nilai Perusahaan," *Jurnal Administrasi Bisnis (JAB)* 17, no. 1 (2014).

payments via tax evasion, management aims to maximize operational efficiency while lowering capital intensity and leverage. Operating efficiency is used to enhance cost effectiveness, particularly in relation to operational expenses. Capital intensity refers to the strategic utilization of cooperative-owned resources to enhance business operations. As a result, there is a corresponding increase in the requirement for fixed assets, leading to higher depreciation expenses. These expenses are considered non-cash costs and are utilized to reduce cooperative income. Leverage refers to the strategic action taken by management to raise the amount of money needed from creditors, resulting in an increase in the interest cost that must be paid. Depreciation and interest expenditure may be used to optimize tax payments. Several studies have been conducted to examine the factors that influence tax avoidance, among others, capital intensity, leverage, and profitability<sup>20</sup>. Another study from the perspective of financial management is related to tax planning which is influenced by aspects of operating efficiency, capital intensity, leverage, and profitability<sup>21</sup>. Other research also states that tax avoidance is influenced by capital intensity, leverage, and profitability.

This study explores how operational efficiency, capital intensity leverage, and profitability affect tax evasion. Additionally, it investigates the indirect impact of these factors on tax avoidance via their influence on profitability. The management aims to enhance the owner's desired level of profitability. However, it is important to note that the cooperative's tax obligations are also determined by its profitability. As profitability increases, so does the corresponding tax liability. Earning management can manipulate profitability using specific tools to do tax avoidance<sup>2223</sup>. The action of earnings management can moderate the effect of operating efficiency, capital intensity and leverage on tax avoidance<sup>24</sup>. A higher leverage ratio indicates the dependence of funding from creditors, which results in an increasingly large interest expense<sup>25</sup>, and will reduce profits and taxes that must be paid. Leverage is a significant and positive relationship with tax aggressiveness that measured by the effective tax rate<sup>26</sup>.

<sup>20</sup> Jeong Ho Kim and Chae Chang Im, "The Study on the Effect and Determinants of Small-and Medium-Sized Entities Conducting Tax Avoidance," *Journal of Applied Business Research (JABR)* 33, no. 2 (2017): 375–90.

<sup>21</sup> Merle M Erickson, Shane M Heitzman, and X Frank Zhang, "Tax-Motivated Loss Shifting," *The Accounting Review* 88, no. 5 (2013): 1657–82.

<sup>22</sup> Brad A Badertscher et al., "Earnings Management Strategies and the Trade-off between Tax Benefits and Detection Risk: To Conform or Not to Conform?," *The Accounting Review* 84, no. 1 (2009): 63–97.

<sup>23</sup> William Robert Scott, *Financial Accounting Theory* (prentice hall, 1997).

<sup>24</sup> Sasiska Rani, Didik Susetyo, and Luk Luk Fuadah, "The Effects of the Corporate's Characteristics on Tax Avoidance Moderated by Earnings Management (Indonesian Evidence)," 2018.

<sup>25</sup> Ayu Yuni Astuti, Elva Nuraina, and Anggita Langgeng Wijaya, "Pengaruh Ukuran Perusahaan Dan Leverage Terhadap Manajemen Laba," in *FIPA: Forum Ilmiah Pendidikan Akuntansi*, vol. 5, 2017.

<sup>26</sup> Ogbeide, "Firm Characteristics and Tax Aggressiveness of Listed Firms in Nigeria: Empirical Evidence."

Further agency issues arise between tax authorities and management. Management aims to boost cooperative profits. Still, management avoids taxes when profitability rises and taxes rise<sup>27</sup>. Businesses must pay taxes in proportion to their profits since profitability affects the effective tax rate. Some evidence suggests that income is related to tax avoidance practices<sup>28</sup>. Other researchers also explain that there is a relationship between the amounts of income earned by the amount of tax paid<sup>29</sup>. High tax payments offset high profitability<sup>30</sup>. The research is in line with the research conducted<sup>31</sup>, which states that profitability has a positive effect on the effective tax rate. Hence, it can be elucidated that as the business revenue increases, so does the inclination to engage in tax evasion.

### 3. Theoretical Analysis and Research Hypotheses

This statistically-based quantitative research seeks to prove agency theory in cooperatives by examining the dynamics between members, management, and tax authorities. This study looks at cooperative samples in "Jawa Barat Bagian Timur" to see how operational efficiency, capital

intensity, leverage, profitability, and tax evasion are portrayed. Cooperative financial accounts from 2015 to 2019 are being sought after for secondary data analysis. Using route analysis, we determined the correlations between the research variables, and we used a purposeful sample technique using 100 cooperatives. Cooperation in action necessitates the following: annual member meetings, financial reporting, a turnover of more than IDR 4.8 billion, and the payment of corporation tax on any residual profits. The proposed hypothesis set is as follows:

<sup>27</sup> Muhammad Sadiq, Shafi Mohamad, and Garrett Kwong Wing Chong, "Political Influences and Effective Tax Rates: Evidence from Pakistan," *Dilemas Contemporáneos: Educación, Política y Valore* 6, no. Special (2019).

<sup>28</sup> Andrew Johns and Joel Slemrod, "The Distribution of Income Tax Noncompliance," *National Tax Journal* 63, no. 3 (2010): 397–418.

<sup>29</sup> Razieh Tabandeh et al., "Estimating Factors Affecting Tax Evasion in Malaysia: A Neural Network Method Analysis," *Prosiding Persidangan Kebangsaan Ekonomi Malaysia Ke VII* 1525 (2012).

<sup>30</sup> Citra Lestari Putri and Maya Febrianti Lautania, "Pengaruh Capital Intensity Ratio, Inventory Intensity Ratio, Ownership Strucutre Dan Profitability Terhadap Effective Tax Rate (ETR)(Studi Pada Perusahaan Manufaktur Yang Terdaftar Di Bursa Efek Indonesia Tahun 2011-2014)," *Jurnal Ilmiah Mahasiswa Ekonomi Akuntansi* 1, no. 1 (2016): 101–19.

<sup>31</sup> Charoline Cheisvianny, "Rinaldi.(2015). Pengaruh Profitabilitas, Ukuran Perusahaan Dan Kompensasi Rugi Fiskal Terhadap Tax Avoidance (Studi Empiris Pada Perusahaan Manufaktur Yang Terdaftar Di BEI Tahun 2010-2013)," in *Seminar Nasional Ekonomi Manajemen Dan Akuntansi (Snema) Fakultas Ekonomi Universitas Negeri Padang*, n.d.

Hypothesis 1: The profitability is influenced by the operational efficiency, capital intensity, and leverage.

Hypothesis 2: The factors of operational efficiency, capital intensity, leverage, and profitability have a direct impact on tax evasion.

Hypothesis 3 posits that operational efficiency, capital intensity, and leverage factors have indirect impacts on tax evasion via influencing profitability.

#### 4. Research Design

The study's variables, together with their definitions and measurements:

##### 1) Tax Avoidance

The Effective Tax Rate (ETR) compares a company's actual taxes paid to its pre-tax profits to quantify tax evasion. ETR measures tax paid as a percentage of income (Ardyansah, 2014). According to (Noor et al., 2010), ETR is a measure of the corporate tax burden because it reveals the level of tax paid on profit. ETR calculation is formulated:

$$\text{Effective Tax Ratio} = \frac{\text{Tax Payment} \dots\dots\dots}{\text{Earning Before Tax}} \times 100\%$$

1)

A higher Effective Tax Rate (ETR) indicates more taxpayer compliance and less tax evasion. Conversely, a lower ETR suggests lower compliance in tax payment and increased tax avoidance by the taxpayer.

##### 2) Profitability Ratio

A profitability ratio is the ability to obtain a return on the owner's capital<sup>32 33</sup>. This study uses ROE to measure the level of profitability, showing effectiveness in generating profitability for owners (Hanafi, 2005). ROE is formulated as follows:

$$\text{Return on Equity} = \frac{\text{Earning After Tax} \dots\dots\dots}{\text{Equity}} \times 100\%$$

2)

A higher return on equity (ROE) indicates a greater capacity of the management to fulfill the owner's desires in enhancing their wellbeing. The higher the value of

<sup>32</sup> Ross, Westerfield, and Jordan, "Fundamentals of Corporate Finance."

<sup>33</sup> Nofsinger, Adair, and Cornett, "Finance: Applications and Theory."

ROE, the higher the return to which the owner is entitled so that the better and more effective business management (Harahap, 2009).

### 3) Operating Efficiency Ratio

Operating efficiency ratio demonstrate the ability to use efficiently the costs and expenses that must be borne to generate sales<sup>34 35</sup>, while according to (Pancheva, 2013) states that Operating efficiency is measured by comparing total costs with sales. Operating efficiency ratio is formulated:

$$\text{Operating Efficiency} = \frac{1 - \text{EBT}}{\text{Sales}} \times 100\% \quad 3)$$

A lower ratio indicates that management is more adept at cost utilization, resulting in a higher capacity for profit generation. This ratio serves as an indicator of management's efficiency in running the firm.

### 4) Capital Intensity Ratio

The capital intensity ratio is calculated by dividing total assets by turnover over the same time. Another metric for the capital intensity ratio is the percentage of fixed assets to total assets held<sup>36</sup>. This ratio is the opposite of total asset turnover, which is to measure the effectiveness of sales with a certain number of assets<sup>37 38</sup>.

$$\text{Return on Equity} = \frac{\text{Total Assets}}{\text{Sales}} \times 100\% \dots\dots\dots 4)$$

A lower ratio indicates a higher level of efficiency in using assets to generate sales. A larger ratio leads to increased depreciation, which is recorded as an expenditure but does not involve actual cash flow. This ultimately reduces the residual income of the cooperative and resulting in a lesser amount of corporation tax.

<sup>34</sup> Ross, Westerfield, and Jordan, "Fundamentals of Corporate Finance."

<sup>35</sup> Nofsinger, Adair, and Cornett, "Finance: Applications and Theory."

<sup>36</sup> Putri and Lautania, "Pengaruh Capital Intensity Ratio, Inventory Intensity Ratio, Ownership Strucutre Dan Profitability Terhadap Effective Tax Rate (ETR)(Studi Pada Perusahaan Manufaktur Yang Terdaftar Di Bursa Efek Indonesia Tahun 2011-2014)."

<sup>37</sup> Ross, Westerfield, and Jordan, "Fundamentals of Corporate Finance."

<sup>38</sup> Nofsinger, Adair, and Cornett, "Finance: Applications and Theory."

### 5) Leverage

The leverage ratio measures how debt finances assets. The debt can measure leverage to assets ratio, which compares the total debt with equity (Ardyansah, 2014) and (Ross et al., 2012).

$$\text{Debt to Asset Ratio} = \frac{\text{Total Debt}}{\text{Total Assets}} \times 100\% \dots\dots\dots 5)$$

The greater this ratio shows, the more significant the source of funds originating from debt as a result of the interest expense to be paid is greater, and the residual income is smaller and results in smaller corporate tax that must be paid, the tax has an effect on the active interest of the loan<sup>39</sup>.

## 3 Empirical Results and Analysis

Although the number of cooperating samples meets the sample size, most fail the requirement. The 54 cooperatives with turnover under IDR 4.8 billion pay 0.5% in taxes. 46 cooperatives with sales above IDR 4.8 billion and corporation tax must submit accounting-standard financial reports. These cooperatives have yearly member meetings and report just their surviving activities.

### 1) Variable Description

The study findings include the average, minimum, maximum, and standard deviation values for each variable, as shown in Table 1.

**Table 1. Variable Description**

No	Description	Unit	Average	Min	Max	Deviation Standard
1	Tax Avoidance	%	21.34	0.62	42.83	9.72
2	Return on Equity	%	11.56	0.28	98.71	16.66
3	Operating Efficiency	%	91.89	57.59	99.83	8.92
4	Capital Intensity	%	265.16	16.21	959.2	238.1
5	Debt to Equity Ration	%	259.01	9.85	1143.11	248.7

### 2) Path Analysis Test Results

<sup>39</sup> Franco Modigliani and Merton H Miller, "The Cost of Capital, Corporation Finance and the Theory of Investment," *The American Economic Review* 48, no. 3 (1958): 261–97.

## 5. Model 1 Track Structure:

**Table 2. Line Structure Coefficient Model 1: Effect of Operating Efficiency, Capital Intensity and Leverage on Profitability**

Model	R	R Square	Adjusted R Square	Std. Error of Estimate
1	.517 <sup>a</sup>	.267	.256	18.02531

a. Predictors: (Constant), Leverage, Capital Intensity, Operating Efficiency

Model	Unstandardized Coefficients		Standardized Coefficient	t	sig
	B	Std Error			
(Constant)	91.776	13,383		6,858	,000
Operating Efficiency	-,981	,142	-,464	-6,899	,000
Capital Intensity	-,029	,007	-,278	-4,202	,000
Leverage	,285	,053	,346	5,369	,000

a. Dependent Variable: Profitability

The examination of the route structure of model 1, as shown in Table 2, reveals the extent to which the variables of operational efficiency, capital intensity, and leverage impact profitability. Profitability is significantly affected by the values of the three independent variables' path coefficients, as can be seen in the Coefficients table. The p-value for each variable is less than 0.05, with a total of 0.000. The determinant coefficient is 0.267 and the correlation coefficient is 0.517, according to the Model Summary table. With a combined coefficient of 26.7%, operational efficiency, capital intensity, and leverage are the three independent factors that have the most impact on profitability. Unknown factors impact the remaining 73.4%.

Hypothesis 1 proposed that the analytical findings validate a substantial influence of the variables of operational efficiency, capital intensity, and leverage on profitability. More precisely, the study revealed that the variables of operational efficiency and capital intensity had a detrimental impact, but the variable of leverage had a beneficial impact on profitability.

## 6. Model 2 Track Structure:

**Table 3. Line Coefficient Model 2: The effect of operating efficiency, capital intensity leverage, and profitability variables on tax avoidance**

Model	R	R Square	Adjusted R Square	Std. Error of Estimate
1	.563 <sup>a</sup>	.317	.302	8.28169

a. Predictors: (Constant), Profitability, Capital Intensity, Leverage, Operating Efficiency

Model	Unstandardized Coefficients		Standardized Coefficient	t	sig
	B	Std. Error			
(Constant)	-18,361	6,886		-2,666	,008
Operating Efficiency	,397	,073	,396	5,415	,000
Capital Intensity	,001	,003	-,011	-,165	,869
Leverage	,285	,053	,346	5,369	,002
Profitability	-,107	,034	-,225	-3,156	,002

a. Dependent Variable: Tax Avoidance

The research investigated the model route structure 2 based on the results. The Coefficients table, namely Table 3, clearly shows that three of the four operational efficiency factors - capital intensity, leverage, and profitability - have a significant influence on tax evasion. More precisely, the variables of operational efficiency, leverage, and profitability have significance values less than 0.05, with corresponding values of 0.000, 0.002, and 0.002, respectively. Nevertheless, the p-value ( $0.869 > 0.05$ ) indicates that the degree of capital investment does not have a substantial effect on tax evasion. The Summary table route coefficient is 0.563, however the R Square is 0.317. The coefficient shows that operational efficiency, capital intensity, leverage, and profitability affect tax evasion by 31.7%. Unknown factors affect 68.3%. The results of the investigation do not fully support the second hypothesis. A company's capacity to avoid paying taxes is greatly affected by its operational efficiency, leverage, and profitability. To add insult to injury, tax avoidance is severely affected by profitability. Efforts to lower tax burden are independent of the level of capital investment.

Testing Hypothesis 3 using model 2 route structure analysis data. Operational efficiency, capital intensity, and leverage indirectly affect tax avoidance via profitability by multiplying their direct influence on profitability by the beta coefficient of profitability on tax avoidance. The indirect impact of operational efficiency factors on tax avoidance via profitability is calculated as -0.089, which is the result of multiplying 0.396 by -0.225. The overall impact of operational efficiency factors on tax evasion, mediated by profitability factors, is the combined result of a direct effect of 0.396 and an indirect effect of -0.089. The value is 0.307. The calculated indirect and total impacts are shown in Table 4.

**7. Table 4. Path coefficient calculation which includes Direct Effect, Indirect Effect and Total**

		Effects		
No	Description	Direct Effect	Indirect Effect	Total
1	The effect of Profitability on Tax Avoidance	-0.225		
2	The effect of Operating Efficiency on Tax Avoidance through Profitability	0.396	0.104	0.500
3	The effect of capital intensity against tax avoidance through profitability	0.011	0.063	0.074
4	The effect of leverage on tax avoidance through profitability	0.216	-0.078	0.138

Operational efficiency indirectly affects tax evasion by 0.104 via profitability. Operating efficiency characteristics affect tax avoidance via profitability by 0.500, whereas capital intensity has an indirect impact of 0.063 and a total effect of 0.074. The indirect impact of leverage is -0.078 and the overall effect is 0.138. According to Hypothesis 3, operational efficiency, capital intensity, and leverage indirectly affect tax evasion via profitability.

## 8. Discussion

This study examined the agency connection between members, management, and a tax authority in a cooperative corporate organization. Management strives to increase profitability to meet member expectations and improve their well-being. The negative effect of operating efficiency on profitability shows that enhancing operational cost efficiency may boost cooperative profitability. Formula for operational efficiency:  $1 - (\text{EBT} / \text{Sales})$ . Consequently, a lower value of this ratio indicates a higher level of operational cost efficiency, leading to increased profitability. Hence, the endeavors of management to enhance efficiency might lead to a rise in profitability, as assessed by return on equity. This endeavor was undertaken to fulfill

the owner's wishes in order to mitigate agency concerns via the enhancement of operational efficiency. The results of this study are in accordance with the opinions<sup>40 41 42</sup>, dividend distribution will reduce agency problems. Operating efficiency reduces agency problems<sup>43 44</sup>.

The capital intensity ratio, in contrast to asset turnover, indicates a more efficient use of cooperative assets when it is lower. The findings of this study suggest that capital intensity has a notable adverse impact on profitability. This implies that effective asset management by the management has been instrumental in enhancing profitability, thereby aligning with the objectives of the stakeholders. The results of this study are in accordance with the opinions<sup>45 46</sup> that internally profitability can be improved by streamlining asset utilization. The debt ratio, or leverage, measures cooperative funding received via debt. The evidence shows that leverage boosts profitability. Interest on cooperative debt lowers profits before tax, lowering corporate tax burden. Corporation tax decreases cooperatives' interest payments, improving member profitability. Debt may also boost owner returns. The research found that growing debt disciplines management<sup>47 48</sup>.

Agency conflict inside the cooperative arises from divergent interests between the management, who are entrusted with the authority by the cooperative members as owners. However, this conflict may be mitigated. Conflicts may be minimized by implementing efficient cost management strategies, optimizing asset utilization, and fostering collaborative debt management. These measures aim to accomplish the intended profitability goals of the stakeholders. The research findings suggest that cooperative management endeavors might effectively mitigate conflicts of interest between taxpayers and the tax authorities in relation to tax payments. Cooperative management must engage in tax planning, including the practice of tax avoidance. Efforts are exerted to strategically manage aspects that may be used to lawfully minimize tax payments. Efficiently managing operations, leverage, and profitability is crucial

<sup>40</sup> Park, "Shareholder Compensation as Dividend."

<sup>41</sup> Jensen, "Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers."

<sup>42</sup> Myers, "Outside Equity."

<sup>43</sup> Phillip J McKnight and Charlie Weir, "Agency Costs, Corporate Governance Mechanisms and Ownership Structure in Large UK Publicly Quoted Companies: A Panel Data Analysis," *The Quarterly Review of Economics and Finance* 49, no. 2 (2009): 139–58.

<sup>44</sup> Nirosha Hewa Wellalage and Stuart Locke, "Agency Costs, Ownership Structure and Corporate Governance Mechanisms," *Journal of Law and Governance* 6, no. 3 (2011): 53–70.

<sup>45</sup> Afzalur Rashid, "CEO Duality and Agency Cost: Evidence from Bangladesh," *Journal of Management & Governance* 17 (2013): 989–1008.

<sup>46</sup> Chrisostomos Florackis and Aydin Ozkan, "The Impact of Managerial Entrenchment on Agency Costs: An Empirical Investigation Using UK Panel Data," *European Financial Management* 15, no. 3 (2009): 497–528.

<sup>47</sup> Modigliani and Miller, "The Cost of Capital, Corporation Finance and the Theory of Investment."

<sup>48</sup> Modigliani and Miller.

since these factors have a substantial impact on tax evasion. Operational efficiency and financial leverage directly contribute to the reduction of tax liabilities. The enhanced operational efficiency implemented by management influences tax compliance and reduces attempts to evade tax payments. In other words, improved company management results in higher tax payments.

The presence of cooperative profitability has a detrimental and noteworthy impact, indicating that when profitability increases, management endeavors to decrease tax payment compliance or intensify tax evasion measures. This management action aims to enhance the evaluation of management's accomplishments by members, since it involves a deliberate attempt to minimize taxes in order to increase profitability. The management continues to endeavor to minimize tax payments in a manner that adheres to the regulations, so fulfilling the tax authority's objective of increasing revenue. The mitigation of party conflicts may be achieved. The results of the study are in accordance with opinions<sup>49</sup> that tax avoidance is influenced by capital intensity, leverage, and profitability. Leverage is a significant and positive relationship with tax aggressiveness that measured by the effective tax rate<sup>50</sup>.

A noteworthy discovery is that profitability serves as an intermediary factor, linking operational efficiency, capital intensity, and leverage to tax evasion. Cooperative management tries to strike a balance between the concerns of its members and the need to fulfill tax obligations. Members are motivated by the desire to attain the remaining business outcomes in order to enhance their well-being. The tax authority is interested in the cooperative's tax obligations, while management is focused on the accomplishments achieved, including the pay they will receive. The management aims to enhance operational efficiency, optimize asset utilization, and maximize the debt capacity to amplify the residual business outcomes that members are entitled to. These efforts are also aimed at achieving tax deductions.

Based on the current circumstances, it is evident that the majority of members are quite optimistic about the allocation of the remaining profits produced by cooperatives. Further investigation of the dividend distribution practices of members' financial behavior is intriguing. Conversely, cooperative management as an entity is associated with the responsibility of paying taxes. This is achieved by minimizing operational expenses and taking on more debt, both to enhance profitability and to reduce tax payments.

## 9. Conclusions

Examining the correlation between tax evasion and operational efficiency, capital intensity, and leverage, as well as their direct and indirect impacts, Agency theory is more effective in cooperative firms that adhere to unique values and ideals, as shown by their profitability. Members and tax authorities have competing interests, which management works to address. To increase the cooperative's profit, management is working to reduce operating

<sup>49</sup> Erickson, Heitzman, and Zhang, "Tax-Motivated Loss Shifting."

<sup>50</sup> Ogbeide, "Firm Characteristics and Tax Aggressiveness of Listed Firms in Nigeria: Empirical Evidence."

expenses, make better use of assets, and manage debt more effectively. Increasing cooperative profitability utilizing debt. Management may be able to decrease cooperative taxes and increase member profitability via tax avoidance, all while remaining in compliance with tax regulations.

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# COOPERATIVE TAX AVOIDANCE: EVIDENCE OF IMPLEMENTATION OF AGENCY THEORY

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## COOPERATIVE TAX AVOIDANCE: EVIDENCE OF IMPLEMENTATION OF AGENCY THEORY

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### Abstract

This research aims to analyze the application of Agency Theory in cooperative business organizations, specifically focusing on the relationship between owners (members) and management, as well as the relationship between management and the tax authorities. The management is obligated to enhance the well-being of members by raising the residual business outcomes, namely profitability. Internally, this may be achieved via enhancing cost efficiency, optimizing capital use, and leveraging debt. Externally, management might use legal strategies to minimize tax obligations. The research was structured using a quantitative methodology, specifically utilizing panel data. The study was conducted from 2015 to 2019, utilizing purposive selection to choose a sample of 100 enterprises located in the eastern region of western Java. Path analysis was used as the research methodology. The findings of this research suggest that cooperative management aims to enhance profitability and achieve tax savings in a lawful manner, in order to fulfill the members' expectations of improving their well-being. Additionally, the management remains committed to fulfilling its tax payment commitments.

**Keywords:** Operating Efficiency; Capital Intensity; Leverage; Profitability; Tax Avoidance.

### 1. Introduction

Taxation is the primary and crucial means of generating money for the government, and hence it must be consistently examined and enhanced to bolster national progress. Taxes are a way for people to help pay for things like infrastructure, hospitals, schools, and police forces, among other public goods that people use on a daily basis. Various methods outlined in legislation, administrative regulations, and programs like Tax Amnesty are part of the government's ongoing effort to increase tax collection. The Central Government Financial Report (2020) states that in 2015, tax revenue reached 83.29% of the target. The proportion increased at a consistent rate for the next three years. In 2016, it was 83.48%, in 2017 it was 91.23%, and this year it was 93.86%. The goal of the 2019 State Budget is to collect IDR 1,786.4 Trillion in taxes.

Indonesia's tax performance is now inferior to that of other nations. In the ASEAN area, Indonesia's tax percentage surpasses only that of Myanmar. According to the Ministry of Finance's statistics, the goal tax ratio to be attained in 2019 is 12.2% as set by the state budget. The actual tax ratios for previous years were 13.7% in 2014, 11.6% in 2015, 10.8% in 2016, 10.7% in 2017, and 11.6% in 2018.

With a tax ratio of 17.7 percent on average, Indonesia is considered a lower-middle income nation<sup>1</sup>. But the author claims that poor tax compliance is to blame for Indonesia's low tax percentage. The high costs of tax compliance, the lack of clarity on the law, and

the pressure from other countries over Indonesia's uncompetitive tax rates are all contributing causes. In order to tackle the problem of low taxpayer compliance, tax authorities have the task of enhancing the effectiveness of communication with

segmented taxpayers. Every community, whether it be a business or a person, has a responsibility to contribute to the advancement of the country by fulfilling their tax obligations, including cooperatives. In accordance with the Income Taxes Law, cooperatives, which are considered to be business enterprises, are required to pay taxes, as described in article 2, paragraph 1 (b). Cooperatives are one of the taxpayers that are required to fulfill their tax duties, which may include the collection of individual taxes or the reduction of those taxes.

According to the Ministry of Cooperatives and SMEs, Indonesia has 123,048 operational cooperatives with 22,463,738 members in 2019. The cooperative provided IDR 5.7 Trillion in tax contributions to state revenue in 2018, up from IDR 4.4 Trillion in 2017 and IDR 3.4 Trillion in 2016. Cooperatives still contribute little. Cooperative management tax compliance, particularly corporation tax, worsens this scenario.

Many cooperative practitioners state that cooperatives do not need to pay corporate tax because of their business orientation as a service to members and not profit-oriented<sup>2</sup>. The surplus obtained by the cooperative which is referred to as the residual operating results, as the efficiency of operational costs, this is in accordance with the statement that cooperative operated at cost<sup>3</sup>.

For businesses, the tax of earning before tax diminishes the net profit the owner and cooperative are entitled to and the residual outcomes of the firm. In the face of competing interests, cooperative management must demonstrate their successes to boost member welfare with the remaining business result. However, management must also confront the government, which mandates businesses to pay taxes. These contrasts in interests drive cooperative management to use tax planning, such as lawful tax evasion, to control their taxes.

<sup>1</sup> H S Prayoga, "Tax Ratio Indonesia Rendah, Ini Yang Harus Dilakukan Otoritas Pajak," *Kontan. Co. Id*, 2019.

<sup>2</sup> Anggi Sugiyanto, Andriani Rahayu, "The Implementation of Risk Management and Its Effect on Good Cooperative Governance and Success," *Journal of Indonesian Economy and Business* 33, no. 3 (2018): 243–56.

<sup>3</sup> Roy, *Cooperative, Development, Principle and Management (4th Ed.)*. (The Interstate Printers & Publisher Inc., 1981).

Tax avoidance as a way to save tax legally by using regulatory loopholes or because there is no regulation yet<sup>4</sup>. The Minister of Finance stated that the delay in the collection of tax funds is due to the large number of taxpayers who practice tax avoidance and tax evasion<sup>5</sup>. Tax avoidance in its application of agency theory where there is a conflict of interest between managers, tax executors and investors<sup>6</sup>.

As an agent, cooperative management must prioritize the welfare of the owner. However, the manager is also obligated to pay corporation tax, which results in lower earnings for the members. Management must exhibit its performance to stakeholders while also effectively managing tax obligations via lawful tax avoidance strategies. Profitability is an indicator of the effectiveness of management. Profitability distribution as a dividend leads to a decline in the agency conflict<sup>7</sup>. Dividend payout also resolves the agency conflict between the inside and outside shareholders<sup>8</sup>. The level of cooperative tax payments is directly proportional to the magnitude of residual earnings before to taxation, as well as the extent of tax avoidance measures used to augment the residual earnings post-taxation, hence benefiting the owner's entitlements. The government's primary objective is to

increase tax revenue to achieve the goal of national income, while managers want to reduce tax payments in order to maximize profitability<sup>10</sup>. Past studies have focused on investigating Cooperative Tax Avoidance via the use of Agency Theory. The study variables will be examined in the context of their impact on profitability and tax evasion. Specifically, the link between operational efficiency, capital intensity, leverage, and these two outcomes will be investigated.

## 2. Literature Review

### Theoretical Framework and Hypothesis Development

<sup>9</sup> Ni Koming Ayu Praditasari and Putu Ery Setiawan, "Pengaruh Good Corporate Governance, Ukuran Perusahaan, Leverage Dan Profitabilitas Pada Tax Avoidance," *E-Jurnal Akuntansi Universitas Udayana* 19, no. 2 (2017): 1229–58.

<sup>5</sup> Ria Triananda Putri, Ihyaul Ulum, and Adi Prasetyo, "Company Risk, Size, Fiscal Loss Compensation, and Tax Avoidance: Evidence from Indonesian Islamic Companies," *Journal of Innovation in Business and Economics* 2, no. 02 (2018): 87–94.

<sup>12</sup> Nan Zhang et al., "Structures of K<sub>0.05</sub>Na<sub>0.95</sub>NbO<sub>3</sub> (50–300 K) and K<sub>0.30</sub>Na<sub>0.70</sub>NbO<sub>3</sub> (100–200 K)," *Acta Crystallographica Section B: Structural Science* 65, no. 3 (2009): 291–99.

<sup>7</sup> James J Park, "Shareholder Compensation as Dividend," *Michigan Law Review*, 2009, 323–71.

<sup>8</sup> Michael C Jensen, "Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers," *The American Economic Review* 76, no. 2 (1986): 323–29.

<sup>15</sup> Stewart C Myers, "Outside Equity," *The Journal of Finance* 55, no. 3 (2000): 1005–37.

<sup>10</sup> Abim Wafirli, "The Influence of Profitability, Leverage, Firm Size and Capital Intensity towards Tax Avoidance" (Universitas Jenderal Soedirman, 2017).

Previous research that focused on tax avoidance as the dependent variable was conducted by<sup>1112</sup>. Tax evasion, leverage, operational efficiency, and capital intensity affect profitability, according to this study. It also examines how Operating Efficiency, Capital Intensity, and Leverage on Tax Avoidance affect profitability directly and indirectly.

### **The Effect of Operating Efficiency, Capital Intensity and Leverage on Profitability**

The presence of an agency connection between members and management is shown, aiming to reduce agency conflict and enhance profitability by improving operational efficiency, maximizing asset utilization, and leveraging. According to<sup>13</sup>, profitability measured by "return on equity (ROE) is influenced by operating efficiency, asset use efficiency and financial leverage". The value of the cost-efficiency ratio affects the change in the value of the net profit margin<sup>14</sup>. Profitability can be increased by the effective use of assets, measured by asset turnover or capital intensity ratio that impacts profitability<sup>1516</sup>. Leverage, as measured by the debt to equity ratio, has a positive effect on return on equity<sup>1718</sup>. The results of research conducted<sup>19</sup> also concluded that there is a significant effect of leverage on firm value as measured by Tobin's Q.

### **Direct and Indirect Effect of Operating Efficiency, Capital Intensity, Leverage on Tax Avoidance Through Profitability**

In order to keep the cooperative owner and the tax authorities on good terms, management employs tax avoidance strategies. In order to keep owner profitability high and reduce tax

- <sup>22</sup> Jennifer L Brown and Katharine D Drake, "Network Ties among Low-Tax Firms," *The Accounting Review* 89, no. 2 (2014): 483–510.
- <sup>12</sup> Sunday Oseiweh Ogbeide, "Firm Characteristics and Tax Aggressiveness of Listed Firms in Nigeria: Empirical Evidence," *International Journal of Academic Research in Public Policy and Governance* 4, no. 1 (2017): 556–69.
- <sup>10</sup> Stephen A Ross, Randolph W Westerfield, and Bradford D Jordan, "Fundamentals of Corporate Finance" (McGraw-Hill, 2022).
- <sup>17</sup> Basyirun Iqbal, "Analisis Pengaruh Operational Efficiency Dan Cost Efficiency Ratio Terhadap Net Profit Margin" (Skripsi Program Studi Manajemen Fakultas Ekonomi Universitas Hasanuddin, 2011).
- <sup>15</sup> Ross, Westerfield, and Jordan, "Fundamentals of Corporate Finance."
- <sup>14</sup> John Nofsinger, Troy Adair, and Marcia Cornett, "Finance: Applications and Theory" (McGraw-Hill/Irwin Series in Finance, Insurance and Real Estate). New York ..., 2012).
- <sup>17</sup> Jihan Salim, "Pengaruh Leverage (DAR, DER, Dan TIER) Terhadap ROE Perusahaan Properti Dan Real Estate Yang Terdaftar Di Bursa Efek Indonesia Tahun 2010–2014," *Perbanas Review* 1, no. 01 (2015).
- <sup>18</sup> Raluca-Georgiana Moscu, "The Relationship between the Capital and Ownership Structures of Companies Listed on the Bucharest Stock Exchange," *International Journal of Academic Research in Business and Social Sciences* 4, no. 2 (2014): 255.
- <sup>11</sup> Inggi Rovita Dewi, Siti Ragil Handayani, and Nila Firdausi Nuzula, "Pengaruh Struktur Modal Terhadap Nilai Perusahaan," *Jurnal Administrasi Bisnis (JAB)* 17, no. 1 (2014).

payments via tax evasion, management aims to maximize operational efficiency while lowering capital intensity and leverage. Operating efficiency is used to enhance cost effectiveness, particularly in relation to operational expenses. Capital intensity refers to the strategic utilization of cooperative-owned resources to enhance business operations. As a result, there is a corresponding increase in the requirement for fixed assets, leading to higher depreciation expenses. These expenses are considered non-cash costs and are utilized to reduce cooperative income. Leverage refers to the strategic action taken by management to raise the amount of money needed from creditors, resulting in an increase in the interest cost that must be paid. Depreciation and interest expenditure may be used to optimize tax payments. Several studies have been conducted to examine the factors that influence tax avoidance, among others, capital intensity, leverage, and profitability<sup>20</sup>. Another study from the perspective of financial management is related to tax planning which is influenced by aspects of operating efficiency, capital intensity, leverage, and profitability<sup>21</sup>. Other research also states that tax avoidance is influenced by capital intensity, leverage, and profitability.

This study explores how operational efficiency, capital intensity leverage, and profitability affect tax evasion. Additionally, it investigates the indirect impact of these factors on tax avoidance via their influence on profitability. The management aims to enhance the owner's desired level of profitability. However, it is important to note that the cooperative's tax obligations are also determined by its profitability. As profitability increases, so does the corresponding tax liability. Earning management can manipulate profitability using specific tools to do tax avoidance<sup>22,23</sup>. The action of earnings management can moderate the effect of operating efficiency, capital intensity and leverage on tax avoidance<sup>24</sup>. A higher leverage ratio indicates the dependence of funding from creditors, which results in an increasingly large interest expense<sup>25</sup>, and will reduce profits and taxes that must be paid. Leverage is a significant and positive relationship with tax aggressiveness that measured by the effective tax rate<sup>26</sup>.

<sup>20</sup> Jeong Ho Kim and Chae Chang Im, "The Study on the Effect and Determinants of Small-and Medium-Sized Entities Conducting Tax Avoidance," *Journal of Applied Business Research (JABR)* 33, no. 2 (2017): 375–90.

<sup>21</sup> Merle M Erickson, Shane M Heitzman, and X Frank Zhang, "Tax-Motivated Loss Shifting," *The Accounting Review* 88, no. 5 (2013): 1657–82.

<sup>22</sup> Brad A Badertscher et al., "Earnings Management Strategies and the Trade-off between Tax Benefits and Detection Risk: To Conform or Not to Conform?," *The Accounting Review* 84, no. 1 (2009): 63–97.

<sup>23</sup> William Robert Scott, *Financial Accounting Theory* (prentice hall, 1997).

<sup>24</sup> Sasiska Rani, Didik Susetyo, and Luk Luk Fuadah, "The Effects of the Corporate's Characteristics on Tax Avoidance Moderated by Earnings Management (Indonesian Evidence)," 2018.

<sup>25</sup> Ayu Yuni Astuti, Elva Nuraina, and Anggita Langgeng Wijaya, "Pengaruh Ukuran Perusahaan Dan Leverage Terhadap Manajemen Laba," in *FIPA: Forum Ilmiah Pendidikan Akuntansi*, vol. 5, 2017.

<sup>26</sup> Ogbeide, "Firm Characteristics and Tax Aggressiveness of Listed Firms in Nigeria: Empirical Evidence."

Further agency issues arise between tax authorities and management. Management aims to boost cooperative profits. Still, management avoids taxes when profitability rises and taxes rise<sup>27</sup>. Businesses must pay taxes in proportion to their profits since profitability affects the effective tax rate. Some evidence suggests that income is related to tax avoidance practices<sup>28</sup>. Other researchers also explain that there is a relationship between the amounts of income earned by the amount of tax paid<sup>29</sup>. High tax payments offset high profitability<sup>30</sup>. The research is in line with the research conducted<sup>31</sup>, which states that profitability has a positive effect on the effective tax rate. Hence, it can be elucidated that as the business revenue increases, so does the inclination to engage in tax evasion.

### 3. Theoretical Analysis and Research Hypotheses

This statistically-based quantitative research seeks to prove agency theory in cooperatives by examining the dynamics between members, management, and tax authorities. This study looks at cooperative samples in "Jawa Barat Bagian Timur" to see how operational efficiency, capital

intensity, leverage, profitability, and tax evasion are portrayed. Cooperative financial accounts from 2015 to 2019 are being sought after for secondary data analysis. Using route analysis, we determined the correlations between the research variables, and we used a purposeful sample technique using 100 cooperatives. Cooperation in action necessitates the following: annual member meetings, financial reporting, a turnover of more than IDR 4.8 billion, and the payment of corporation tax on any residual profits. The proposed hypothesis set is as follows:

- <sup>23</sup> Muhammad Sadiq, Shafi Mohamad, and Garrett Kwong Wing Chong, "Political Influences and Effective Tax Rates: Evidence from Pakistan," *Dilemas Contemporáneos: Educación, Política y Valores* 6, no. Special (2019).
- <sup>28</sup> Andrew Johns and Joel Slemrod, "The Distribution of Income Tax Noncompliance," *National Tax Journal* 63, no. 3 (2010): 397–418.
- <sup>29</sup> Razieh Tabandeh et al., "Estimating Factors Affecting Tax Evasion in Malaysia: A Neural Network Method Analysis," *Prosiding Persidangan Kebangsaan Ekonomi Malaysia Ke VII* 1525 (2012).
- <sup>30</sup> Citra Lestari Putri and Maya Febrianti Lautania, "Pengaruh Capital Intensity Ratio, Inventory Intensity Ratio, Ownership Strucutre Dan Profitability Terhadap Effective Tax Rate (ETR)(Studi Pada Perusahaan Manufaktur Yang Terdaftar Di Bursa Efek Indonesia Tahun 2011-2014)," *Jurnal Ilmiah Mahasiswa Ekonomi Akuntansi* 1, no. 1 (2016): 101–19.
- <sup>31</sup> Charoline Cheisviyanny, "Rinaldi.(2015). Pengaruh Profitabilitas, Ukuran Perusahaan Dan Kompensasi Rugi Fiskal Terhadap Tax Avoidance (Studi Empiris Pada Perusahaan Manufaktur Yang Terdaftar Di BEI Tahun 2010-2013)," in *Seminar Nasional Ekonomi Manajemen Dan Akuntansi (Snema) Fakultas Ekonomi Universitas Negeri Padang*, n.d.

Hypothesis 1: The profitability is influenced by the operational efficiency, capital intensity, and leverage.

Hypothesis 2: The factors of operational efficiency, capital intensity, leverage, and profitability have a direct impact on tax evasion.

Hypothesis 3 posits that operational efficiency, capital intensity, and leverage factors have indirect impacts on tax evasion via influencing profitability.

#### 4. Research Design

The study's variables, together with their definitions and measurements:

##### 1) Tax Avoidance

The Effective Tax Rate (ETR) compares a company's actual taxes paid to its pre-tax profits to quantify tax evasion. ETR measures tax paid as a percentage of income (Ardyansah, 2014). According to (Noor et al., 2010), ETR is a measure of the corporate tax burden because it reveals the level of tax paid on profit. ETR calculation is formulated:

$$\text{Effective Tax Ratio} = \frac{\text{Tax Payment} \dots \dots \dots}{\text{Earning Before Tax}} \times 100\%$$

A higher Effective Tax Rate (ETR) indicates more taxpayer compliance and less tax evasion. Conversely, a lower ETR suggests lower compliance in tax payment and increased tax avoidance by the taxpayer.

##### 2) Profitability Ratio

A profitability ratio is the ability to obtain a return on the owner's capital<sup>32 33</sup>. This study uses ROE to measure the level of profitability, showing effectiveness in generating profitability for owners (Hanafi, 2005). ROE is formulated as follows:

$$\text{Return on Equity} = \frac{\text{Earning After Tax} \dots \dots \dots}{\text{Equity}} \times 100\%$$

A higher return on equity (ROE) indicates a greater capacity of the management to fulfill the owner's desires in enhancing their wellbeing. The higher the value of

<sup>32</sup> Ross, Westerfield, and Jordan, "Fundamentals of Corporate Finance."

<sup>33</sup> Nofsinger, Adair, and Cornett, "Finance: Applications and Theory."

ROE, the higher the return to which the owner is entitled so that the better and more effective business management (Harahap, 2009).

### 3) Operating Efficiency Ratio

Operating efficiency ratio demonstrate the ability to use efficiently the costs and expenses that must be borne to generate sales<sup>34 35</sup>, while according to (Pancheva, 2013) states that Operating efficiency is measured by comparing total costs with sales. Operating efficiency ratio is formulated:

$$\text{Operating Efficiency} = \frac{1 - \text{EBT}}{\text{Sales}} \times 100\% \quad 3)$$

A lower ratio indicates that management is more adept at cost utilization, resulting in a higher capacity for profit generation. This ratio serves as an indicator of management's efficiency in running the firm.

### 4) Capital Intensity Ratio

The capital intensity ratio is calculated by dividing total assets by turnover over the same time. Another metric for the capital intensity ratio is the percentage of fixed assets to total assets held<sup>36</sup>. This ratio is the opposite of total asset turnover, which is to measure the effectiveness of sales with a certain number of assets<sup>37 38</sup>.

$$\text{Return on Equity} = \frac{\text{Total Assets}}{\text{Sales}} \times 100\% \dots\dots\dots 4)$$

A lower ratio indicates a higher level of efficiency in using assets to generate sales. A larger ratio leads to increased depreciation, which is recorded as an expenditure but does not involve actual cash flow. This ultimately reduces the residual income of the cooperative and resulting in a lesser amount of corporation tax.

<sup>34</sup> Ross, Westerfield, and Jordan, "Fundamentals of Corporate Finance."

<sup>35</sup> Nofsinger, Adair, and Cornett, "Finance: Applications and Theory."

<sup>36</sup> Putri and Lautania, "Pengaruh Capital Intensity Ratio, Inventory Intensity Ratio, Ownership Strucutre Dan Profitability Terhadap Effective Tax Rate (ETR)(Studi Pada Perusahaan Manufaktur Yang Terdaftar Di Bursa Efek Indonesia Tahun 2011-2014)."

<sup>37</sup> Ross, Westerfield, and Jordan, "Fundamentals of Corporate Finance."

<sup>38</sup> Nofsinger, Adair, and Cornett, "Finance: Applications and Theory."

### 5) Leverage

The leverage ratio measures how debt finances assets. The debt can measure leverage to assets ratio, which compares the total debt with equity (Ardyansah, 2014) and (Ross et al., 2012).

$$\text{Debt to Asset Ratio} = \frac{\text{Total Debt}}{\text{Total Assets}} \times 100\% \dots\dots\dots 5)$$

The greater this ratio shows, the more significant the source of funds originating from debt as a result of the interest expense to be paid is greater, and the residual income is smaller and results in smaller corporate tax that must be paid, the tax has an effect on the active interest of the loan<sup>39</sup>.

## 3 Empirical Results and Analysis

Although the number of cooperating samples meets the sample size, most fail the requirement. The 54 cooperatives with turnover under IDR 4.8 billion pay 0.5% in taxes. 46 cooperatives with sales above IDR 4.8 billion and corporation tax must submit accounting-standard financial reports. These cooperatives have yearly member meetings and report just their surviving activities.

### 1) Variable Description

The study findings include the average, minimum, maximum, and standard deviation values for each variable, as shown in Table 1.

**Table 1. Variable Description**

No	Description	Unit	Average	Min	Max	Deviation Standard
1	Tax Avoidance	%	21.34	0.62	42.83	9.72
2	Return on Equity	%	11.56	0.28	98.71	16.66
3	Operating Efficiency	%	91.89	57.59	99.83	8.92
4	Capital Intensity	%	265.16	16.21	959.2	238.1
5	Debt to Equity Ration	%	259.01	9.85	1143.11	248.7

### 2) Path Analysis Test Results

<sup>39</sup> Franco Modigliani and Merton H Miller, <sup>5</sup>“The Cost of Capital, Corporation Finance and the Theory of Investment,” *The American Economic Review* 48, no. 3 (1958): 261–97.

### 5. Model 1 Track Structure:

**Table 2. Line Structure Coefficient Model 1: Effect of Operating Efficiency, Capital Intensity and Leverage on Profitability**

Model	R	R Square	Adjusted R Square	Std. Error of Estimate
1	.517 <sup>a</sup>	.267	.256	18.02531

a. Predictors: (Constant), Leverage, Capital Intensity, Operating Efficiency

Model	Unstandardized Coefficients		Standardized Coefficient	t	sig
	B	Std. Error			
(Constant)	91.776	13,383		6,858	,000
Operating Efficiency	-,981	,142	-,464	-6,899	,000
Capital Intensity	-,029	,007	-,278	-4,202	,000
Leverage	,285	,053	,346	5,369	,000

a. Dependent Variable: Profitability

The examination of the route structure of model 1, as shown in Table 2, reveals the extent to which the variables of operational efficiency, capital intensity, and leverage impact profitability. Profitability is significantly affected by the values of the three independent variables' path coefficients, as can be seen in the Coefficients table. The p-value for each variable is less than 0.05, with a total of 0.000. The determinant coefficient is 0.267 and the correlation coefficient is 0.517, according to the Model Summary table. With a combined coefficient of 26.7%, operational efficiency, capital intensity, and leverage are the three independent factors that have the most impact on profitability. Unknown factors impact the remaining 73.4%.

Hypothesis 1 proposed that the analytical findings validate a substantial influence of the variables of operational efficiency, capital intensity, and leverage on profitability. More precisely, the study revealed that the variables of operational efficiency and capital intensity had a detrimental impact, but the variable of leverage had a beneficial impact on profitability.

### 6. Model 2 Track Structure:

**Table 3. Line Coefficient Model 2: <sup>20</sup> The effect of operating efficiency, capital intensity leverage, and profitability variables on tax avoidance**

<sup>8</sup> Model	R	R Square	Adjusted R Square	Std. Error of Estimate
1	.563 <sup>a</sup>	.317	.302	8.28169

Model	Unstandardized Coefficients		Standardized Coefficient	t	sig
	B	Std. Error			
(Constant)	-18,361	6,886		-2,666	,008
Operating Efficiency	,397	,073	,396	5,415	,000
Capital Intensity	,001	,003	-,011	-,165	,869
Leverage	,285	,053	,346	5,369	,002
Profitability	-,107	,034	-,225	-3,156	,002

a. Dependent Variable: Tax Avoidance

The research investigated the model route structure 2 based on the results. The Coefficients table, namely Table 3, clearly shows that three of the four operational efficiency factors - capital intensity, leverage, and profitability - have a significant influence on tax evasion. More precisely, the variables of operational efficiency, leverage, and profitability have significance values less than 0.05, with corresponding values of 0.000, 0.002, and 0.002, respectively. Nevertheless, the p-value ( $0.869 > 0.05$ ) indicates that the degree of capital investment does not have a substantial effect on tax evasion. The Summary table route coefficient is 0.563, however the R Square is 0.317. The coefficient shows that operational efficiency, capital intensity, leverage, and profitability affect tax evasion by 31.7%. Unknown factors affect 68.3%. The results of the investigation do not fully support the second hypothesis. A company's capacity to avoid paying taxes is greatly affected by its operational efficiency, leverage, and profitability. To add insult to injury, tax avoidance is severely affected by profitability. Efforts to lower tax burden are independent of the level of capital investment.

Testing Hypothesis 3 using model 2 route structure analysis data. Operational efficiency, capital intensity, and leverage indirectly affect tax avoidance via profitability by multiplying their direct influence on profitability by the beta coefficient of profitability on tax avoidance. The indirect impact of operational efficiency factors on tax avoidance via profitability is calculated as -0.089, which is the result of multiplying 0.396 by -0.225. The overall impact of operational efficiency factors on tax evasion, mediated by profitability factors, is the combined result of a direct effect of 0.396 and an indirect effect of -0.089. The value is 0.307. The calculated indirect and total impacts are shown in Table 4.

7. **Table 4. Path coefficient calculation which includes Direct Effect, Indirect Effect and Total**

		Effects		
No	Description	Direct Effect	Indirect Effect	Total
1	<sup>36</sup> The effect of Profitability on Tax Avoidance	-0.225		
2	The effect of Operating Efficiency on Tax Avoidance through Profitability	0.396	0.104	0.500
3	The effect of capital intensity against tax avoidance through profitability	0.011	0.063	0.074
4	The effect of leverage on tax avoidance through profitability	0.216	-0.078	0.138

Operational efficiency indirectly affects tax evasion by 0.104 via profitability. Operating efficiency characteristics affect tax avoidance via profitability by 0.500, whereas capital intensity has an indirect impact of 0.063 and a total effect of 0.074. The indirect impact of leverage is -0.078 and the overall effect is 0.138. According to Hypothesis 3, operational efficiency, capital intensity, and leverage indirectly affect tax evasion via profitability.

## 8. Discussion

This study examined the agency connection between members, management, and a tax authority in a cooperative corporate organization. Management strives to increase profitability to meet member expectations and improve their well-being. The negative effect of operating efficiency on profitability shows that enhancing operational cost efficiency may boost cooperative profitability. Formula for operational efficiency:  $1 - (EBT / \text{Sales})$ . Consequently, a lower value of this ratio indicates a higher level of operational cost efficiency, leading to increased profitability. Hence, the endeavors of management to enhance efficiency might lead to a rise in profitability, as assessed by return on equity. This endeavor was undertaken to fulfill

the owner's wishes in order to mitigate agency concerns via the enhancement of operational efficiency. The results of this study are in accordance with the opinions<sup>40 41 42</sup>, dividend distribution will reduce agency problems. Operating efficiency reduces agency problems<sup>43 44</sup>.

The capital intensity ratio, in contrast to asset turnover, indicates a more efficient use of cooperative assets when it is lower. The findings of this study suggest that capital intensity has a notable adverse impact on profitability. This implies that effective asset management by the management has been instrumental in enhancing profitability, thereby aligning with the objectives of the stakeholders. The results of this study are in accordance with the opinions<sup>45 46</sup> that internally profitability can be improved by streamlining asset utilization. The debt ratio, or leverage, measures cooperative funding received via debt. The evidence shows that leverage boosts profitability. Interest on cooperative debt lowers profits before tax, lowering corporate tax burden. Corporation tax decreases cooperatives' interest payments, improving member profitability. Debt may also boost owner returns. The research found that growing debt disciplines management<sup>47 48</sup>.

Agency conflict inside the cooperative arises from divergent interests between the management, who are entrusted with the authority by the cooperative members as owners. However, this conflict may be mitigated. Conflicts may be minimized by implementing efficient cost management strategies, optimizing asset utilization, and fostering collaborative debt management. These measures aim to accomplish the intended profitability goals of the stakeholders. The research findings suggest that cooperative management endeavors might effectively mitigate conflicts of interest between taxpayers and the tax authorities in relation to tax payments. Cooperative management must engage in tax planning, including the practice of tax avoidance. Efforts are exerted to strategically manage aspects that may be used to lawfully minimize tax payments. Efficiently managing operations, leverage, and profitability is crucial

<sup>40</sup> Park, "Shareholder Compensation as Dividend."

<sup>41</sup> Jensen, "Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers."

<sup>42</sup> Myers, "Outside Equity."

<sup>43</sup> Phillip J McKnight and Charlie Weir, "Agency Costs, Corporate Governance Mechanisms and Ownership Structure in Large UK Publicly Quoted Companies: A Panel Data Analysis," *The Quarterly Review of Economics and Finance* 49, no. 2 (2009): 139–58.

<sup>44</sup> Nirosha Hewa Wellalage and Stuart Locke, "Agency Costs, Ownership Structure and Corporate Governance Mechanisms," *Journal of Law and Governance* 6, no. 3 (2011): 53–70.

<sup>45</sup> Afzalur Rashid, "CEO Duality and Agency Cost: Evidence from Bangladesh," *Journal of Management & Governance* 17 (2013): 989–1008.

<sup>46</sup> Chrisostomos Florackis and Aydin Ozkan, "The Impact of Managerial Entrenchment on Agency Costs: An Empirical Investigation Using UK Panel Data," *European Financial Management* 15, no. 3 (2009): 497–528.

<sup>47</sup> Modigliani and Miller, "The Cost of Capital, Corporation Finance and the Theory of Investment."

<sup>48</sup> Modigliani and Miller.

since these factors have a substantial impact on tax evasion. Operational efficiency and financial leverage directly contribute to the reduction of tax liabilities. The enhanced operational efficiency implemented by management influences tax compliance and reduces attempts to evade tax payments. In other words, improved company management results in higher tax payments.

The presence of cooperative profitability has a detrimental and noteworthy impact, indicating that when profitability increases, management endeavors to decrease tax payment compliance or intensify tax evasion measures. This management action aims to enhance the evaluation of management's accomplishments by members, since it involves a deliberate attempt to minimize taxes in order to increase profitability. The management continues to endeavor to minimize tax payments in a manner that adheres to the regulations, so fulfilling the tax authority's objective of increasing revenue. The mitigation of party conflicts may be achieved. The results of the study are in accordance with opinions<sup>49</sup> that tax avoidance is influenced by capital intensity, leverage, and profitability. Leverage is a significant and positive relationship with tax aggressiveness that measured by the effective tax rate<sup>50</sup>.

A noteworthy discovery is that profitability serves as an intermediary factor, linking operational efficiency, capital intensity, and leverage to tax evasion. Cooperative management tries to strike a balance between the concerns of its members and the need to fulfill tax obligations. Members are motivated by the desire to attain the remaining business outcomes in order to enhance their well-being. The tax authority is interested in the cooperative's tax obligations, while management is focused on the accomplishments achieved, including the pay they will receive. The management aims to enhance operational efficiency, optimize asset utilization, and maximize the debt capacity to amplify the residual business outcomes that members are entitled to. These efforts are also aimed at achieving tax deductions.

Based on the current circumstances, it is evident that the majority of members are quite optimistic about the allocation of the remaining profits produced by cooperatives. Further investigation of the dividend distribution practices of members' financial behavior is intriguing. Conversely, cooperative management as an entity is associated with the responsibility of paying taxes. This is achieved by minimizing operational expenses and taking on more debt, both to enhance profitability and to reduce tax payments.

## 9. Conclusions

Examining the correlation between tax evasion and operational efficiency, capital intensity, and leverage, as well as their direct and indirect impacts, Agency theory is more effective in cooperative firms that adhere to unique values and ideals, as shown by their profitability. Members and tax authorities have competing interests, which management works to address. To increase the cooperative's profit, management is working to reduce operating

<sup>49</sup> Erickson, Heitzman, and Zhang, "Tax-Motivated Loss Shifting."

<sup>50</sup> Ogbeide, "Firm Characteristics and Tax Aggressiveness of Listed Firms in Nigeria: Empirical Evidence."

expenses, make better use of assets, and manage debt more effectively. Increasing cooperative profitability utilizing debt. Management may be able to decrease cooperative taxes and increase member profitability via tax avoidance, all while remaining in compliance with tax regulations.

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- <sup>26</sup> Johns, Andrew, and Joel Slemrod. "The Distribution of Income Tax Noncompliance." *National Tax Journal* 63, no. 3 (2010): 397–418.
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