

# Profitability Mediates the Effect of Audit Committee and Firm Size on Tax Avoidance in Property and Real Estate Companies in Indonesia

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## ABSTRACT

**Aims:** This study investigates tax avoidance strategies in Indonesia's property and real estate industry, considering firm size, profitability, and audit committee as variables.

**Study design:** A quantitative study is used to collect data that can be measured in numbers and analysed statistically.

**Place and Duration of Study:** Engaging 15 businesses in the property and real estate industry that has maintained a presence on the Indonesia Stock Exchange for a decade.

**Methodology:** In the study, an empirical analysis was conducted using data contained in the company's financial statements to test tax avoidance in Indonesia. This study used a sample of 150 selected through a purposive sampling approach. The sample was then analysed by testing the direct effects and indirect effects using Path Analysis. In this study, the analysis technique used was SPSS 24 software.

**Results:** The results show a strong relationship between tax evasion, firm size, profitability, and the audit committee. Furthermore, it has been demonstrated that the audit committee, firm size, and tax avoidance can all be mediated by profitability. It is important to remember that when profitability is strong, there is a greater chance of tax avoidance.

**Conclusion:** The test's findings indicate that the degree of tax avoidance has decreased along with the increase in active tax monitoring, where the involvement of the audit committee plays an important role. Other factors considered in tax planning strategies are firm size and profitability. Further, more sophisticated research is needed to understand and prevent this tax avoidance practice. Nonetheless, tax avoidance remains an essential topic as this phenomenon continues. For investors, assessing a company's profitability and compliance with tax regulations is crucial to identify potential investment risks.

## 1. INTRODUCTION

The majority of the money needed by the state to maintain fiscal stability, encourage economic growth, and pay for public services comes from taxes. As per Indonesian law number 28 of 2007, taxation is an obligatory governmental contribution owed by persons or businesses that are legally obligated, without any form of compensation, and utilised for state objectives aimed at maximising the well-being of the populace. Using legal loopholes in a nation's tax laws, tax avoidance is a transaction strategy that can reduce tax liabilities [1]. The property and real estate industry is at high risk of tax avoidance because the majority of its funding comes from bank loans, while its operations are related to fixed assets in the form of land and buildings [2].

In the real estate and property sectors, there are numerous instances of tax avoidance. One such example involves Property Company PT Agung Podomoro Land Tbk, which is implicated in a tax avoidance case involving the leak of 11.5 million documents or the Panama Papers [3]. Alongside 4.8 million emails, this document encompasses 32,000 text

pages, 2.1 million PDF documents, 1.1 million photos, and approximately 2,000 miscellaneous files. Furthermore, in order to avoid paying taxes in Indonesia, PT Ciputra Development engaged in tax fraud by hiding assets valued at USD 1.6 billion, or IDR 21.6 trillion [3].

Audit committees are among the elements that encourage or lead businesses to engage in tax evasion. The audit committee has a vital role in maintaining integrity and transparency in the company's financial statements, and they help ensure that the company follows practices in accordance with applicable standards—the audit committee in charge of overseeing financial statements influences in determining tax management, especially tax avoidance.[4]. Prior studies examining the impact of the audit committee on tax avoidance were carried out by Dewi et al. [4]; Tiala et al. [5]; Ritonga et al. [6]Concluded that the audit committee influences tax avoidance. However, Sherly shows different results[7]; and Eksandy[8]It is concluded that the audit committee does not affect tax avoidance. When evaluating the company's assets, its size is a helpful indicator.[9]. Accurately calculated at the conclusion of each year, the assets in question represent the total assets for a particular year. In order to assess the progress of a business, one can examine its total assets. Indicative of a company's promising long-term prospects is its total assets to a greater extent [10]. The scale of the business impacts the potential tax savings achievable through tax avoidance strategies [11].

The effect of firm scale on tax avoidance has been the subject of some prior researchby Chouaibi et al. [12]; Sulaiman[13]; Roslita et al. [14]; determined that the size of a corporation affects tax avoidance. Prabowo showed different results.[15]; and Tanjung et al. [16]It is concluded that firm size does not affect tax avoidance. According to the findings of prior research concerning the impact of firm size and the composition of the audit committee on tax avoidance, there are still differences in results (research gap), so there is a gap to conduct a re-study by testing the profitability variable as a mediator.

Profitability is an indicator used to evaluate the performance of a company. The organisation's profitability metric signifies its capacity to produce monetary gains within a specified timeframe through the effective utilisation of its share capital, assets, and sales volume [1]. One of the ratios used to measure profitability is ROA (Return On Asset). Suppose a company's profitability increases from the previous time. In that case, it is likely that the company also generates greater net profits, which means that the business entity must pay higher taxes [17]. The findings of studies carried out byTamirsyah et al. [18]; Amidu et al. [19] and Sulaiman [20] It has been determined that profitability does not impact tax avoidance.While the results of Sudibyos research [21] and Sherly [7]It is concluded that profitability has a significant positive effect on tax avoidance.

The audit committee plays an integral part in the company's increased profitability. The audit committee, working closely with the board of commissioners, has the critical role of overseeing the company's operations to improve the effectiveness of implementing good corporate governance [22]. Rini et al. [23] also revealed that the more audit committees there are, the more influential the audit committee's supervision can be in improving company performance and havingan impact on profitability. The findings of studies carried out by Mulyadi [24] and Wanodyatama et al. [25]sum up that the audit committee affects profitability. However, different results were carried out by Ramadhani et al. [26], Ramadhani et al. (2021), and Katutari et al. [27]determined that the profitability of the audit committee is unaffected.

Increased profitability occurs due to firm size. Larger companies have a variety of facilities, greater production capacity, and better and more systemised management strategies. Large companies have easier access to funding sources for business development, which attracts trust from investors and lenders[28]. Effective asset management and robust strategies are needed to optimise opportunities and increase company profits. Small companies need help with resource access, marketing-innovation integration, and funding[29]. Because of this, small firms have to face significant risks that can threaten their business survival[28]. The findings of studies undertaken by Pradnyaswari et al. [30]; Vidyasari et al. [31]Concluded that firm size affects profitability. But in contrast to Sutan's research [32], Muliana et al. [33]Which concluded that firm size does not affect profitability

## **2. MATERIAL AND METHODS .**

### **2.1 THEORITICAL REVIEW**

#### **2.1.1 Compliance Theory**

Studies related to obedience theory were first proposed by Milgram (1963) [34]InWijayanti et al. [35]. This theory examines the factors that influence an individual's decision to comply with a request, even though the individual does not agree or the rule is not profitable for the company. The use of compliance theory as a grand theory in this study is considered because of the existence of binding tax regulations for each taxpayer. Given the high likelihood of taxpayers engaging in tax avoidance, it is essential to strengthen the use of compliance theory in tax avoidance research to assess the extent of taxpayer compliance with tax regulations.

#### **2.1.2 Profitability**

A company's profitability is determined by its ability to generate profits within a specific period based on its sales, assets, and share capital [1]. If profitability increases, the company is likely to make greater profits and pay higher taxes [17]. With high profitability, firms will plan taxes carefully to achieve the ideal tax rate, reducing the tendency to evade taxes [36].

### **2.1.3 Audit Commite**

As per the guidelines established by the Indonesian Audit Committee Association, the audit committee has a vital role in assisting the Board of Commissioners in evaluating the internal control system, ensuring the accuracy of financial statements, and assessing the effectiveness of internal audits. To reduce tax avoidance, the audit committee can monitor the enterprise's operations with its authority, ensuring there are no irregularities, especially in the financial statements [37]. An effective method to evaluate the influence of the audit committee on tax avoidance is to analyze how often the company's financial statements refer to the audit committee [38].

### **2.1.4 Firm Size**

Firm size is used as an indicator to evaluate the risk between large and small companies, as well as a parameter to assess the company's assets [9]. The larger the total assets of the enterprise, the more it indicates that the enterprise has positive potential over a more extended period [10]. The greater the scale of the business, the greater the likelihood of tax avoidance to obtain the best possible tax savings [11]. Companies can manage all their assets with the aim of reducing tax liabilities, which can be done through the use of amortisation and depreciation arising from investments in physical and fixed assets [11].

### **2.1.5 Tax Avoidance**

The company believes that paying taxes is an obligation that must be obeyed in accordance with existing regulations. Therefore, the company designs effective and efficient strategies for managing tax affairs and applies avoidance methods that are in accordance with the law [39]. Tax avoidance is a proactive approach firms employ to minimise their tax liability [4]. Since data access is more straightforward and rarely changes, the effective tax rate (ETR) is typically a tool employed for quantifying tax avoidance. The tax expense is divided by the profit before taxes to get the ETR. The more the ETR ratio is more significant, the company's level of tax avoidance activities decreases [36].

### **2.1.6 Hypotesis Development**

#### ***2.1.6.1 The Effect Of Audit Commite on Tax Avoidance***

Companies that prioritise strong corporate governance typically experience a reduced likelihood of engaging in tax avoidance practices, thanks to the diligent oversight and control measures in place [40]. Considering the topic at hand, studies carried out by Rospitasari et al. [41]; and Oktaviani [41] Revealed that the audit committee affects tax avoidance. The reasoning above leads to the formation of the first hypothesis that the study will examine, which is as follows :

H1: Audit Committee Affects Tax Avoidance

#### ***2.1.6.2 The Effect Of Firm Size on Tax Avoidance***

With the growth of firm size, public demands also increase; it is necessary to evaluate whether firm size encourages an increase in tax compliance in accordance with the principles of compliance theory [42]. The likelihood of tax avoidance increases with the size of the business [43]. Previous research conducted by Chouaibi [12]; Sulaeman [13] And Roslita et al. [14] Which points out how a company's size influences tax avoidance. The reasoning above leads to the formation of the second hypothesis that the study will examine, which is as follows:

H2: Firm Size Affects Tax Avoidance

#### ***2.1.6.3 The Effect Of Audit Commite on Profitability***

Higher profits are a sign of a stable financial situation for the company. The more audit committees, the more effective their oversight, which can improve company performance and affect profitability [23]. Wanodyatama conducted prior studies. [25]; Aryan [44] And Merawati et al. [45] It has been found that the audit committee has a significant impact on profitability. The reasoning above leads to the formation of the third hypothesis that the study will examine, which is as follows :

H3: Audit Committee Affects Profitability

#### ***2.1.6.4 The Effect Of Firm Size on Profitability***

The ability of a business to secure more outside funding to support its operations is impacted by its size [46]. Larger firms have more resources to increase their value, thanks to better access to external funding compared to smaller firms [47]. Therefore, firm size is likely to increase profitability—previous research conducted by Pradnyaswari et al. [30]; Vidyasari et al. [31] And Kartika et al. [48] Concluded that firm size affects profitability. The reasoning above leads to the formation of the fourth hypothesis that the study will examine, which is as follows:

H4: Firm Size Affects Profitability.

#### ***2.1.6.5 The Effect Of Profitability on Tax Avoidance***

With impressive profitability, enterprises will plan taxes carefully to achieve the optimal tax rate, thereby reducing the tendency to engage in tax avoidance [36]. Previous research conducted by Sudiby [21]; and Sherly [7] Concluded that profitability affects tax avoidance. The reasoning above leads to the formation of the fifth hypothesis that the study will examine, which is as follows:

H5: Profitability Affects Tax Avoidance

### 2.1.6.6 Profitability Mediates The Effect Of Audit Commite on Tax Avoidance

Companies that have audit committees are responsible for closely monitoring reporting policy issues, which could discourage the company from engaging in tax avoidance. This is in accordance with research conducted by Hapsari et al. [49]. The reasoning above leads to the formation of the sixth hypothesis that the study will examine, which is as follows :

H6: Profitability Able to Mediate the Relationship Between Audit Committee and Tax Avoidance

### 2.1.6.7 Profitability Mediates The Effect Of Firm Size on Tax Avoidance

The scale of a firm can certainly influence its profitability, although it's not a foolproof guarantee of success[50]. When the company achieves optimal profit from its operations, it can encourage the company to conduct tax avoidance in line with the increase in profitability obtained.

H7: Profitability Able to Mediate the Relationship Between Firm Size and Tax Avoidance

The research conceptual framework adopted is as follows, in light of the description above:

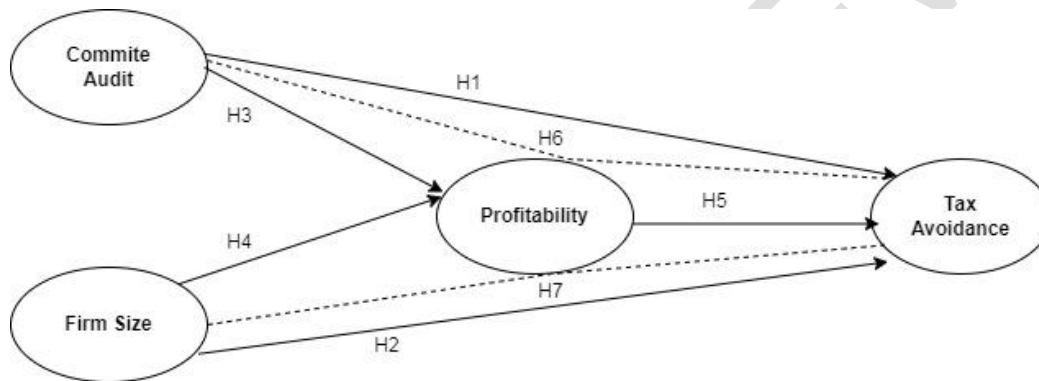


Figure 1 Research conceptual framework

## 2.2 METHODS

### 2.2.1 Data Source

Secondary information from the official website of the Indonesia Stock Exchange of the company sampled in this study were the data sources used in this analysis. Purposive sampling was the approach used to carry out the sampling process in this study, where there were criteria that were used as samples. The object of this study uses 15 samples of property and real estate companies listed on the Indonesia Stock Exchange in the 2013-2023 time span and using the following criteria: (1) Property and *real estate companies* listed on the Indonesia Stock Exchange (IDX) in 2013-2022; (2) Property and *real estate* companies that have complete financial reports; (3) Property and *real estate* companies that have financial reports that have experienced profits during 2013-2022. The observation period is ten years, resulting in a total of 150 observation data.

### 2.2.2 Data Analysis Technique

The data analysis method makes use of path analysis to examine how audit committees, business sizes, and profitability affect tax avoidance and indirect effects using profitability as a mediating variable. Path analysis can be used to assess the impact, both direct and indirect. The form of the path equation in this study is as follows:

$$Y_1 = \alpha + \beta_1 X_1 + \beta_2 X_2 + e$$
$$Y_2 = \alpha + \beta_3 X_1 + \beta_4 X_2 + \beta_5 Y_1 + e$$

Description:

- $X_1$ : Audit Committee
- $X_2$ : Firm Size
- $Y_1$ : Profitability
- $Y_2$ : Tax Avoidance

$\beta$ : Path coefficient between effect and cause variables  
 e: Residual variables

Meanwhile, the mediation test uses the Sobel test to find out whether a variable is able to act as a mediating variable; testing will be carried out. The Sobel test measures how much the independent variable (X) indirectly affects the dependent variable (Y) through the mediating variable (M). Mediation testing with the *Sobel* method can be described as follows:

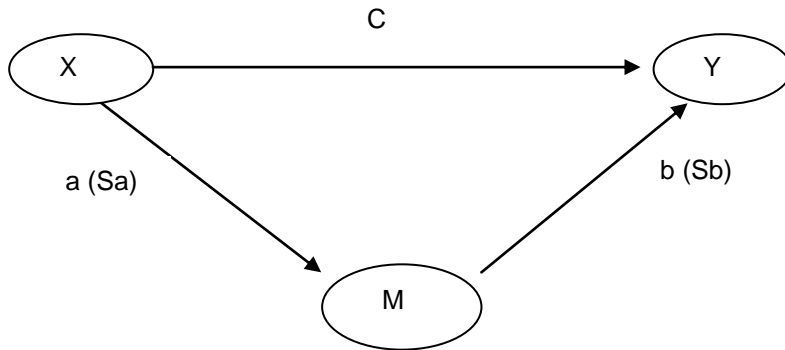


Figure 2 Mediation Model

**2.2.3 Operational Definitions and Research Variables**

The operational definitions or indicators of the variables of profitability, audit committee, firm size and tax avoidance can be explained in table 1 below:

Table 1 Variables and Indicators

Variables	Indicator	Source
Profitability	Net profit after tax Total Assets	Asprilla et al. [39].
Audit Committee	Figuring out how many audit committees the corporation mentioned in the financial statements and the notes to those financial statements	Nawang Kalbuana [10]
Firm Size	Ln (Total Asset)	Marpaung et al. [52]
Tax Avoidance	Tax Expense Profit Before Tax	Permata et al. [53].

**2.2.3.1 Profitability**

The Return On Asset (ROA) ratio is one of the metrics used to assess profitability. ROA is calculated by comparing profit after taxes and functions as an indicator to assess the degree to which the company's assets yield a rate of return.

**2.2.3.2 Audit Commitee**

The process of determining the count of audit committees that are disclosed in the annotations to the financial statements of the organization.

**2.2.3.3 Firm Size**

A statistic used to assess the worth of the firm's assets is its company scale [9]. The assets calculated are total assets for one year, precisely calculated at the end of the year.

**2.2.3.4 Tax Avoidance**

Tax avoidance is done by applying legal efforts, one of which is through ETR (*effective tax rate*) based on applicable financial accounting reporting

**3. RESULTS AND DISCUSSION**

**3.1 RESULT**

Hypothesis testing is carried out by solving the structure of the *Path Analysis* results to test the direct influence between variables described in Table 2 below:

Table 2 Direct Influence Between Variables

Influence between Variables	Path Coefficie	T - Statistics	Sig.	Ket
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	nt			
Audit Committee → Profitability	0.235	2.964	0.004	Sig
Firm Size → Profitability	0.163	2.052	0.042	Sig
Audit Committee → Tax Avoidance	-0.183	-2.302	0.023	Sig
Firm Size → Tax Avoidance	0.188	2.358	0.020	Sig
Profitability → Tax Avoidance	0.256	3.224	0.002	Sig

Source: Secondary Data Processed, 2023

Based on table 2 shows that the direct effect of the audit committee variable, firm size, on profitability, has a significance value smaller than 0.05. The audit committee and the size of the company are found to have an impact on profitability, which is followed by a rise in profitability that is valued at 23.5% and 16.3%, respectively.

The statistical significance of the direct impact of the audit committee variable on tax avoidance is less than 0.05. It is concluded that the audit committee has a negative effect on tax avoidance, followed by a decrease in tax avoidance of -18.3%. Meanwhile, the firm size and profitability variables have a significance value smaller than 0.05. It can be concluded that firm size and profitability affect tax avoidance, and an increase will follow in tax avoidance, which is worth 18.8 and 25.6%, respectively.

The indirect relationship is tested with the Sobel test approach and is explained in table 3 below:

**Table 3. Indirect Influence between Variables**

Influence between Variables				T - Statistics	Sig.	Description	
Audit Committee	->	Profitability	->	tax avoidance	2,182	0,029	Significant
Company size	->	Profitability	->	tax avoidance	2.048	0,040	Significant

Source: Primary Data Processed, 2023

Table 3 above explains the statistical t value of 2.182, which is produced by the audit committee's indirect effect on tax avoidance through profitability with a *significance of* 0.029, so profitability is able to mediate the impact of the audit committee on *tax avoidance*. The indirect effect of firm size on *tax avoidance* through profitability produces a statistical t-value of 2.048 with a *significance of* 0.040, which means that profitability is able to mediate the effect of firm size on *tax avoidance*.

### 3.2 DISCUSSION

Tax avoidance is influenced directly by audit committee size and firm size. The audit committee's duties include keeping an eye on the company's compliance with standards and reducing tax avoidance in order to protect the company's reputation, which is crucial for maintaining the instances of trust of both internal and external parties. Tax avoidance can damage a company's reputation, and the presence of an influential audit committee is expected to reduce this practice. The results of this study support previous research by Tiala et al. [5]; and Dewi et al. [4]. The company size variable is often the focus of taxation authorities and the public, which allows it to rely on tax teams and financial consultants in designing complex tax strategies. However, small and medium-sized businesses typically adhere to tax laws with general awareness, which influences their tax avoidance strategies. This outcome is consistent with studies by Chouaibi [12]; and Roslita et al. [14].

Profitability has a direct effect on tax avoidance; this reinforces the phenomenon that there is a correlation between company profits and the amount of taxes to be paid. Under these conditions, companies usually take various tax strategies to reduce their tax obligations. Therefore, the company's profitability affects the internal party's decision to use tax avoidance practices to maximise profits. These findings are correlated with studies by Sherly [8] and Sudibyo [22], which demonstrate how profitability influences tax avoidance.

Profitability can be influenced by company size and audit committee performance. The audit committee has a vital role in ensuring transparency, accuracy and compliance with applicable accounting standards and regulations. This study is consistent with studies by Mulyadi [24]; Wanodyatama et al. [25] Who found that the more influential the supervision, the higher the profitability. Firm Size affects company profitability where large companies have the best access to resources and technology, increasing efficiency and productivity, which helps management get better prices for raw materials or increase product selling prices, which contributes to overall profitability. This is in line with the result by Pradnyaswari et al. [30]; Vidyasari et al. [31] Which reveals that company size affects profitability.

Profitability mediates the effect of the audit committee on tax avoidance. This result can be explained by the fact that the audit committee has a vital role in ensuring transparency, accuracy, and compliance with applicable accounting standards and regulations, which have an impact on investor confidence in the company. The existence of high trust causes

investors to be interested in buying the company's shares, which results in high profitability. Minimizing tax avoidance by the company is impacted by achieving high profitability. This study develops research conducted by Rini et al. [23]; Wanodyatama[25]; Aryan [44] Which concluded that the audit committee has an impact on profitability and that the findings of this study are consistent with those of Sudibyo [21]; and Sherly [7] It is concluded that profitability has a significantly positive effect on tax avoidance.

Profitability mediates the effect of firm size on tax avoidance. This result can be explained by the fact that large companies have the best access to resources and technology, increasing efficiency and productivity, which helps management get better prices for raw materials or increase product selling prices, which contributes to increased profitability. A high increase in profitability has an impact on the level of compliance with tax regulations to maintain reputation, thereby reducing tax avoidance practices. This study develops research conducted by Pradnyaswari et al. [30]; Vidyasari[31] Whichconcluded that firmsize affects profitability. The findings of this research are connected with studies carried by Sudibyo [21]; and Sherly [7]It is concluded that profitability has a significant positive effect on tax avoidance.

#### **4. CONCLUSION**

Audit committees, firm size, and profitability have a crucial role in tax avoidance. Profitability serves as a significant mediator in connecting audit committees and firm size with tax avoidance practices. Tax avoidance remains an essential topic as this phenomenon continues to take place. For investors, an assessment of a company's profitability and compliance with tax regulations is necessary to identify potential investment risks. With the active involvement of the audit committee, focus on firm size, and profitability in tax planning strategies, it is expected that tax avoidance can be reduced. In addition, further research development is needed to understand and prevent tax avoidance practices

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