Tax Avoidance and the Readability of Financial Statements: Empirical Evidence from Indonesia

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Abstract

This study aims to obtain empirical evidence regarding the link between tax avoidance (TA) and the readability of financial statements. This is a quantitative research using Ordinary Least Squares regression analysis which is then processed using STATA 14.0. A total of 278 companies listed on the Indonesia Stock Exchange during the period 2017–2019 is the data of this study. In detecting TA in a company, this study uses the ETR and CashETR and for the measurement of financial statement readability, this study uses gunning fog index and length of the document. The findings of this study suggest that tax avoidance and clear financial statements are mutually exclusive in the sense that when tax avoidance is practiced, companies will tend to conceal the information conveyed by financial statements. In other words, it is concluded that the more a company engages in tax avoidance, the lower the readability of the company’s financial statements. This study provides in-depth evidence that tax avoidance is indirectly related to the disclosure of information by the company. Users of financial statements will realize that the company seeks to make disclosures that are in their best interests to avoid their tax avoidance strategy being detected.

Keywords: Effective Tax Rate, Financial Statement Readability, Gunning Fog Index, Length of Document, Tax Avoidance

JEL Classification Code: H25, H26, M41

1. Introduction

Tax Avoidance (TA) is described as a tax planning activity designed to bring about a reduction of explicit taxes (Hanlon & Heitzman, 2010). When TA is carried out by a company, it will have an impact on that company’s business (Lazăr & Istrate, 2018). If TA is being implemented, the
taxpaying company takes advantage of loopholes in tax regulations to avoid obligations that could burden it, which means the amount of tax owed is lower and the profits for shareholders are increased. Although TA is permissible in the eyes of the law, it is nevertheless detrimental to the state, because it causes a decrease in the revenue that it derives from the taxation (Choi, 2021).

In a study carried out by Chen et al. (2014), they stated that engaging in TA requires the company to make a sacrifice in terms of increasing agency costs and a decrease in the value of the company, which is also considered as a common view of the TA itself (Choi, 2021). The contention that TA activities cause an increase in agency costs is corroborated by the research of Desai and Dharmapala (2005) who demonstrated that planning to engage in TA is a replication of the practice of agency theory, where shareholders demand that management guarantee bonuses for legally avoiding their company’s tax liabilities.

Essentially, the practice of TA in Indonesia involves exploiting legal loopholes that exist in the tax law, Law Number 16 of 2009 pertaining to the fourth amendment
to Law Number 6 of 1983 which, in turn, pertains to the General Provisions and Tax Procedures in Article 4 paragraph (4), stipulates the Annual Income Tax Return of Taxpayers and requires them to maintain accounts which must be accompanied by financial statements (FS) in the form of balance sheets and income statements as well as other information needed to calculate the amount of taxable income. In other words, a company’s responsibility—with regard to including FS in its reporting of income for tax purposes—indirectly makes it possible for the tax authorities to detect TA activities (Prananjaya & Naras, 2019). Therefore, the strategy of the management of a company seeking to engage in TA is to deliberately obfuscate the information in the FS by making them less easy to read. This aims to reduce the risk posed by tax audits where the company may be assessed as non-compliant with regard to the taxes it pays (Nguyen, 2020).

An important qualitative aspect of a financial report is conceptualized in SFAC No. 2 pertaining to qualitative characteristics of accounting information which emphasizes the primary qualities of a financial report in terms of the information’s relevance, reliability, understandability, and comparability (Inger et al., 2018). The element of understandability itself in a financial report plays a major role in making FS useful for its users. The level of understandability of an FS has an impact on the understanding of those using it to determine the value and business of the company. According to El-Sayed et al. (2021), a simple disclosure (meaning one that is easy to read) will improve non-professional investors’ perceptions of a company’s future performance. An understandable FS is synonymous with an easy-to-read FS. This statement is in line with research by Baskerville and Rhys (2014) who stated that the understandability of a financial report is linked very closely to its readability. The definition of readability is the ease with which readers can process and understand the information presented in writing (et al., 2017). Therefore, readability can be identified as a prerequisite for the understandability of a financial report.

The readability of financial statements (FSR) has an important role as a reflection of a company’s management performance in aligning its financial disclosures while bearing in mind the company’s future as outlined using a narrative approach (Loughran & Mcdonald, 2014). On the other hand, FSR makes it possible for management to shape investors’ assessment of the company’s value by performing thematic manipulation as well as structural and visual manipulation of the narrative underpinning the disclosures (El-Sayed et al., 2021; Fuadah & Kalsum, 2021) because companies seek to send positive signals while preventing the publication of news that tends to be bad (Seifzadeh et al., 2021).

FSR is linked to the persistence of corporate earnings (Li, 2008). A financial report with a high level of complexity will have a low level of readability, which means it will provide information that users of the FS will find difficult to understand, which will have an impact on the actions those users take when responding to the information the company has provided (Beuselinck et al., 2018). Factors that affect readability variations in the narrative disclosure of a financial report include company performance, earnings manipulation, financial reporting policies, strict stock market disclosures, and managerial optimism.

Obfuscating the understandability of FS can make it difficult for outsiders to detect corporate tax planning (Beuselinck et al., 2018). In the research by Balakrishnan et al. (2019), they stated that companies that engage in TA have lower transparency. In other words, the readability of reporting is replicated as a tool used by the company to successfully implement TA measures in the context of corporate tax planning.

Research by Nguyen (2020) focused on companies with TA above the research median and showed a negative causality relationship between TA and FSR, where management of companies engaging in TA tends to reduce the readability with the aim of reducing the risk that the TA strategy will be detected. Studies suggest the tax authority acquires information in tax disclosures, creating a trade-off for managers on whether to provide decision-useful information for stakeholders or conceal information from the tax authority. Meanwhile, Inger et al. (2018) investigated this trade-off by examining the readability of tax footnotes. They found a positive association between tax avoidance and tax footnote readability for firms with tax avoidance below the industry-year median, consistent with managers highlighting good performance in the form of tax savings with straightforward disclosures. In contrast, they found a negative association between tax avoidance and tax footnote readability for firms with levels of tax avoidance above the industry-year median, consistent with managers concealing tax avoidance.

The tax footnotes are a part of financial statements that are studied closely because they are considered the best general source of information about corporate activities related to taxation (Inger et al., 2018). Balakrishnan et al. (2019) stated that companies face a trade-off between tax benefits and financial transparency when they decide on how aggressive to be with their tax planning. In the same study, Balakrishnan et al. (2019) used data in the analysis and discussion section of a company’s FS, because this section is thought to contain complex disclosures related to corporate taxation. In contrast to the research results that have been described above, the research of Beuselinck et al. (2018) found a negative link between FSR and tax aggressiveness. They argue that management prefers to use financial reporting complexity to disguise the information being reported only when the benefits of aggressive tax policies outweigh the required expenses.
The existence of conceptual differences and differing research results—as well as the limitations faced by the research presented in several previous studies—indicated to the author that there were gaps in the research that could be used as background issues for this study. In addition, the limited empirical research (related to the impact of TA on FSR) that had been conducted on companies in Indonesia provided a gap that is used to provide more empirical evidence to explore the research questions. Based on the description and research gaps that have been described previously, the authors are interested in raising the related phenomena as the research topic.

This study aims to obtain empirical evidence about the relationship between TA and FSR in companies listed on the Indonesian Stock Exchange (IDX). This is correlational research using a quantitative approach. The data analysis method used is multiple linear regression testing using a statistical application called STATA 14.0. Furthermore, through the analysis and procedures applied in this study, the results show a negative relationship between the two main variables, namely tax avoidance (TA) and readability of financial statements (FSR). As for the results of this study, the authors expect that they will be able to contribute by providing insight for people using this research to understand the concepts underpinning the link between TA and FSR.

2. Literature Review and Hypotheses Development

2.1. Agency Theory

This theory is conceptualized as being a contractual binding of an agent to a principal with the objective of facilitating the will of the principal in the delegation of some decision-making authority to the agent (Jensen & Meckling, 1976). According to Lee et al. (2015) agency theory is the theoretical basis that explains how the agent and principal in a company are involved in cooperation with one another to reduce the company’s tax liability.

As a theory whose rationale assumes that the principal and agent have differing interests, it is likely that the agent does not always act to prioritize the principal’s benefits in every situation. The existence of a gap with regard to the benefits derived from agency theory causes agents to tend towards engaging in self-interested behavior by creating information asymmetry (Bendickson et al., 2016). This information asymmetry can manifest itself in the possibility of data manipulation by company management with the aim of benefiting the management itself (Laiho, 2011). Information asymmetry can occur at the point where the principal, as the owner, does not know what actions the agent is taking in carrying out the principal’s instructions (Shapiro, 2005). Therefore, the creation of information asymmetry can be used by agents and principals when engaging in TA. The information gap between management and stakeholders provides an opportunity for information asymmetry to be used as a way to manage the company’s TA.

The agency theory perspective means that corporate income tax is depicted as being a significant burden, especially for shareholders, which indicates that the use of corporate TA is obviously useful (Saka et al., 2017). The principals actually want lower tax burdens on their income to provide themselves with a higher total income. Meanwhile, the company management is motivated to cooperate in implementing corporate TA because there are incentives that have been promised by the principal.

2.2. Tax Avoidance

TA occurs when the taxpayer organizes all matters related to taxation in a certain way and with the aim of taking advantage of the weakness or ambiguity of the tax law (United Nations, 2011). Thus, TA is not an activity that violates legal norms but instead carries negative connotations in the eyes of the taxation authority, because it has the effect of decreasing state revenues derived from taxation. Therefore, TA relates to both the pros and cons of the relationship between the taxpayer and the government.

The TA schemes vary; some of them involve creating fictitious transactions, the enlarging of loans, utilizing fixed asset depreciation procedures, abusing tax facilities, and carrying out transfer pricing. All of these schemes involve the use of legal loopholes that exist. For example, the use of the MSME final tax rate of 0.5% which should only be for taxpayers who meet the requirements set by Government Regulation No.23 of 2018, can be used by taxpayers who actually do not meet the requirements in several ways, one of which is to reduce income to below the market price with the aim of keeping the gross turnover below IDR 4.8 billion in one tax year, making the taxpayer entitled to this tax facility.

In its development, TA can be measured mathematically, using GAAP Effective Tax Rates (ETR), Cash Effective Tax Rates (CashETR), and book-tax difference (BTD). These are among the most common measurements used to analyze the level of TA. These measures of TA have been used extensively in the previous literature (Dyreng et al., 2008; Nguyen, 2020). The ETR is also widely used to calculate companies’ tax burden and aggressive tax planning (Jaffar et al., 2021).

2.3. Financial Statement Readability (FSR)

According to Luo et al. (2018), readability is the main attribute of textual information which has been observed
inclusively in various fields. Readability has also been demonstrated as making it easier for readers to understand writing in the context of communication, psychology, and education (Du Toit, 2017). Therefore, readability is a crucial aspect to which writers pay attention when conveying information in a textual form. The most important textual information in expressing the firm’s financial disclosures is its FS, and its readability (FSR) is measured as a measure of management’s success in communicating company accounting information (Malcolm & Richard, 1992).

FSR can be measured using several approaches that provide different points of view regarding the text being analyzed. The measurements used to measure FSR include the Gunning Fog Index (FOG) and Length Of Document (LENGTH). FOG is defined as a linear combination of the average length of a sentence and the proportion of complex words (i.e. words with three or more syllables), where the results of the measurement will show a scale that explains the approximate reading level of the user (Loughran & Mcdonald, 2014). Meanwhile, LENGTH is calculated from the logarithm of the total number of words in a “10-K document” (a comprehensive report filed annually by a publicly-traded company about its financial performance) (Nguyen, 2020).

In this study, the approach used to measure FSR uses the two readability measurements that have been described previously, namely FOG and LENGTH. The selection of these approaches bears in mind the measurements used in previous empirical research and is supported by the relevance and adequacy of the data that it is expected to produce. FOG is the first measurement used in this study because according to Inger et al. (2018), it makes it easy to calculate obfuscation in any form of text, and this measurement is not biased by the length of a text. The other index used is LENGTH because, according to Li (2008), longer documents appear to impede understanding because they are difficult to read, making what they are reporting less transparent, implying that information can be hidden from outside parties. Furthermore, the variation provided by these readability measurements intends to provide this study with robust research results.

2.4. Hypothesis Development

The explanation of the theoretical basis that relies on agency theory explicitly provides evidence that TA is one of the real forms of an agency theory concept. Agency theory reveals the perspective of management to choose to engage in TA by making complex FS and having a low level of readability, as long as there are advantages to doing so (Beuselinck et al., 2018; Inger et al., 2018; Nguyen, 2020; Sukotjo & Soenarno, 2018). Indirectly agency theory has a vital role in linking TA with FSR. Therefore, agency theory is seen as a grand theory and it is one of the foundations for the formation of hypotheses in this research.

In his research, Nguyen (2020) examined the effect of TA on FSR. With his orientation towards companies with relatively high levels of TA (i.e. above the research median), he demonstrated that such companies with high levels of TA, strategically speaking, tend to produce FS that are more difficult to read. The FS is made more difficult to read with the aim of reducing the risk of the company’s TA strategy being exposed. In other words, the phenomenon justifies the initial argument of the study, which asserts that there is a negative relationship between TA and FSR.

Beuselinck et al. (2018) examined the relationship between FSR and tax aggressiveness. This study demonstrated that companies engaging in aggressiveness in their tax planning have FS that is less understandable. A company’s management uses complex language to disguise tax aggressiveness strategies. Another finding in this study shows that the negative relationship between tax aggressiveness planning and FSR is significantly weakened in companies that are required to include IRS Schedule M-3 with corporate income tax payments. IRS Schedule M-3 requires a detailed reconciliation of tax filing differences with respect to foreign operations significantly reducing the opportunity for companies to engage in tax evasion and/or aggressiveness.

In their research, Inger et al. (2018) examined the impact of TA on the readability of tax footnotes. Based on this concept, a hypothesis is developed which stated that when tax planning activities become more complex, the disclosures about tax will become more difficult to describe, and hence the readability decreases. TA is demonstrated as having a positive effect on the readability of tax footnotes in companies with TA levels below the median. However, in companies with TA levels above the median, it has been found that TA has a negative effect on the readability of tax footnotes, where management obfuscates the tax disclosures they make to the tax authorities.

Mindful of the theoretical basis, as well as the exposure to the results of previous empirical research, this study has developed a hypothesis that provides a provisional description of the relationship between TA and FSR. A company’s income tax is a significant burden for its shareholders (Khan et al., 2017). TA is engaged by companies with the aim of deriving economic benefit from the revenue that companies do not pay to the government in taxes (Utomo et al., 2012). Meanwhile, the tax authorities view the practice of TA as being detrimental to the state’s revenues. Therefore, tax audits are often carried out to prevent TA. Thus, in dealing with the risk of tax audits, management effectively takes the decision to disclose financial information in a way that is not easy to read so that the information provided to users of FS...
(including the tax authorities) appears vague (Nguyen, 2020). Based on the considerations laid out above, the author proposes the following hypothesis:

**H1:** The more a company engages in tax avoidance, the lower the readability of the company’s financial statements.

3. Research Methodology

3.1. The Measurement of Variables

TA in this study acts as an independent variable. In detecting TA in a company, this study uses the ETR and CashETR indexes which are oriented towards measuring the percentage of company income before taxes in terms of the corporate income taxes paid in the year concerned. A number of previous studies that measured TA have made use of related indices, including those by Nguyen (2020), Balakrishnan et al. (2019), Khan et al. (2017), and Beuselinck et al. (2018). ETR is formulated as follows:

\[
ETR = \frac{\text{Income Tax Expense}}{\text{Earning Before Income Tax}}
\]

Meanwhile, CashETR is formulated in this way:

\[
\text{Cash ETR} = \frac{\text{Corporate Income Tax Paid} (t+1)}{\text{Earning Before Income Tax} (t)}
\]

The dependent variable in this study is financial statement readability (FSR). In its original context, FSR aims to make the disclosure of financial information act as effective communication of information that contains relevant information value (Loughran & McDonald, 2014). In this study, a company’s FS is analyzed and measured using two related indices that have been implemented in previous studies. These indexes are FOG and LENGTH.

The previously mentioned indices have been implemented in the research by Nguyen (2020) and Beuselinck et al. (2018) who provides empirical research results. The formulation of the two indices previously mentioned is as follows:

\[
\text{FOG} = 0.4 \times \left( \frac{\bar{x} \text{ number of words}}{\text{number of sentence}} + \text{percent of complex words} \right)
\]

\[
\text{LENGTH} = \log (NWords)
\]

The formulations of FOG and LENGTH adhere to the development of the formulas described in the research by Li (2008) Furthermore, in calculating the level of FOG and LENGTH in each research sample, the author uses an online-based “Gunning Fog Index” application with the aim of obtaining accurate results.

This study uses several control variables (Table 1). Referring to previous research (Beuselinck et al., 2018; Inger et al., 2018; Nguyen, 2020; Sunarto et al., 2021), the control variables used in this study include company profitability, company age, company debt, company size, and company value.

3.2. Data Sources and the Research Sample

The secondary data collected come from the audited annual FS of companies listed on the IDX during the period 2017–2019, with the exception of those operating in the financial, insurance, and real estate sectors. The reason these sectors are excluded is due to the character of the companies and their reporting structure. In comparison to non-financial industries, the financial industry interprets leverage differently; excessive leverage for financial companies is a normal occurrence and does not signify financial distress. (Fama & French, 1992).

The author took into account the amendments to Indonesian Accounting Standards (PSAK 1) relevant to the

<table>
<thead>
<tr>
<th>No</th>
<th>Control Variables</th>
<th>Measurement</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Profitability (PRO)</td>
<td>Earning after taxes/Total assets</td>
<td>Jewell and Mankin (2011)</td>
</tr>
<tr>
<td>2</td>
<td>Age of company (AGE)</td>
<td>ln(Company’s first year in its IPO – Current year)</td>
<td>Inger et al. (2018)</td>
</tr>
<tr>
<td>3</td>
<td>Company debt (LEV)</td>
<td>Total debt/Total assets</td>
<td>Mowen et al. (2011)</td>
</tr>
<tr>
<td>4</td>
<td>Company size (SIZ)</td>
<td>ln(Total assets)</td>
<td>Beuselinck et al. (2018)</td>
</tr>
<tr>
<td>5</td>
<td>Company value (VAL)</td>
<td>Market value of equity + Total debt/Total assets</td>
<td>Desai and Dharmapala (2005)</td>
</tr>
</tbody>
</table>
presentation of financial statements (FS) in 2015, which were effectively implemented in 2017, when selecting the study criteria. Several aspects in the amendments to PSAK 1 of 2015’s materiality and amalgamation section could have had an impact on FSR. The emphasis is placed on the obligation of each entity to provide information about all the facts that have been summarised in the form of FS and its associated notes in the section on materiality and amalgamation in the amendments to PSAK 1 of 2015. In addition, entities are prohibited from providing an unclear understanding of the information in the FS. This blurring of understanding can take the form of providing irrelevant information with the aim of covering up the relevant information that exists or by merging relevant items that have different properties and/or functions into one (Indonesian Accountants Association, 2015). The sample comprises data from 278 companies as shown in Table 2.

3.3. Analysis Techniques

In accommodating the required data analysis, STATA 14.0 software has been used. Furthermore, the analytical technique used is descriptive statistical analysis. For hypothesis testing, the research uses multiple linear regression testing accompanied by robustness testing using the Huber-White standard error method. The reason for using the Huber-White standard error method is to avoid the negative effects of heteroscedasticity (Long et al., 2010). Thus, this study will include four test models in the regression analysis. The test model applied in this study is formulated using the following equation:

$$TA = \alpha + \beta_1 FSR + \beta_2 PRO + \beta_3 AGE + \beta_4 LEV + \beta_5 SIZ + \beta_6 VAL + \varepsilon$$

TA : Tax evasion (measured using two proxies)
\(\alpha\) : Constant
\(\beta_1\) to \(\beta_6\) : Independent variable regression coefficient

FSR : Readability of financial statements (measured using two proxies)
PRO : Company profitability
AGE : Age of company
LEV : Company debt
SIZ : Company size
VAL : Company value

4. Results and Discussion

4.1. Research Results

Table 3 below showed the descriptive statistics of this study and then followed by the regression results in Table 4. The linear regression applied in this study was accompanied by the estimated coefficients generated using the robustness method. They show that the research hypothesis is supported because the four models indicate a significant negative relationship between TA and FSR. The ETR variable in model (1) shows a significant negative relationship with FOG, with a coefficient value of \(-2.534\) (\(t = -2.42; p < 0.05\)). In model (2), the CashETR index shows a significant negative relationship with the FOG index with a coefficient value of \(-1.443\) (\(t = -2.29; p < 0.05\)). In model (3), ETR shows a significant negative relationship with LENGTH, with a coefficient of \(-0.225\) (\(t = -1.82; p < 0.1\)). In model (4), the CashETR index indicates a significant negative relationship with a coefficient value of \(-0.139\) (\(t = -1.68; p < 0.1\)).

In this study, the robustness method chosen to maintain the validity of this research is the Huber-White standard error method. This method provides consistency in the regression coefficient-covariance matrix that estimates the presence of heteroscedasticity issues in an unknown form (Long et al., 2010). Heteroscedasticity can take various forms and yield various results in different processes (Hayes & Cai, 2007). Issues related to heteroscedasticity have a material impact because the assumption of heteroscedasticity implies that the error variance is related to the predictor or a linear combination of predictor variables (Hayes & Cai, 2007).

Table 2: Criteria for Sample Selection

<table>
<thead>
<tr>
<th>Criteria</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Companies listed on the IDX</td>
<td>439</td>
<td>439</td>
<td>439</td>
<td>1,317</td>
</tr>
<tr>
<td>Companies that do not meet the requirements for calculating the index for the TA variable</td>
<td>(169)</td>
<td>(138)</td>
<td>(193)</td>
<td>(500)</td>
</tr>
<tr>
<td>Companies that do not meet the requirements for calculating the index for the FSR variable</td>
<td>(156)</td>
<td>(181)</td>
<td>(169)</td>
<td>(506)</td>
</tr>
<tr>
<td>Company with age (x &lt; 1) year(s)</td>
<td>(13)</td>
<td>(17)</td>
<td>–</td>
<td>(30)</td>
</tr>
<tr>
<td>Others (companies that do not explicitly indicate the number of outstanding shares)</td>
<td>(1)</td>
<td>(1)</td>
<td>(1)</td>
<td>(3)</td>
</tr>
<tr>
<td>Total sample</td>
<td>100</td>
<td>102</td>
<td>76</td>
<td>278</td>
</tr>
</tbody>
</table>
4.2. Discussion

According to Drake et al. (2020), the decline in the effective tax rate indicates an increase in the practice of corporate TA. Furthermore, referring to the results of the regression analysis, when the effective tax rate is low, the FSR index shows the opposite value. By contrast, the higher the FOG value, the less easy the textual information in the FS will be to understand. (Loughran & Mcdonald, 2014). Furthermore, according to Li (2008), longer documents will be more difficult and require higher costs in terms of processing information. So, when FOG and LENGTH indicate high values, it means that FS tends to be difficult to read. When conceptualized into H1, the results of linear regression show the alignment of concepts, where the more TA practices are carried out by the company, the lower the company’s FSR. Thus, the proposed H1 is accepted, where TA is demonstrated to be negatively related to FSR. Indirectly, these results can be interpreted as showing that agency theory underlies the series of measures taken by companies when engaging in TA. When management publishes FS with low readability, it is done in the hope of avoiding the detection of TA practices by the tax authorities. Strategically, schemes of TA practices are a choice that is purely determined by a company’s management (Kovermann & Velte, 2019). On the other hand, FSR plays a significant role in the transparency of the information disclosed by a company in terms of the level of information asymmetry faced by external stakeholders in evaluating that company’s performance and value more accurately (Luo et al., 2018).

Table 3: Descriptive Statistics

<table>
<thead>
<tr>
<th></th>
<th>N</th>
<th>Mean</th>
<th>Median</th>
<th>Std</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>FOG</td>
<td>278</td>
<td>17.659</td>
<td>17.215</td>
<td>1.799</td>
<td>14.400</td>
<td>22.010</td>
</tr>
<tr>
<td>LENGTH</td>
<td>278</td>
<td>4.668</td>
<td>4.670</td>
<td>0.162</td>
<td>4.077</td>
<td>5.173</td>
</tr>
<tr>
<td>ETR</td>
<td>278</td>
<td>0.255</td>
<td>0.251</td>
<td>0.101</td>
<td>0.000</td>
<td>0.971</td>
</tr>
<tr>
<td>CashETR</td>
<td>278</td>
<td>0.274</td>
<td>0.259</td>
<td>0.146</td>
<td>0.000</td>
<td>0.929</td>
</tr>
<tr>
<td>PRO</td>
<td>278</td>
<td>0.125</td>
<td>0.066</td>
<td>0.400</td>
<td>0.000</td>
<td>5.317</td>
</tr>
<tr>
<td>AGE</td>
<td>278</td>
<td>2.284</td>
<td>2.565</td>
<td>1.047</td>
<td>0.000</td>
<td>3.611</td>
</tr>
<tr>
<td>SiZ</td>
<td>278</td>
<td>28.568</td>
<td>28.682</td>
<td>2.346</td>
<td>0.240</td>
<td>32.043</td>
</tr>
<tr>
<td>LEV</td>
<td>278</td>
<td>0.513</td>
<td>0.377</td>
<td>1.782</td>
<td>0.000</td>
<td>29.889</td>
</tr>
<tr>
<td>VAL</td>
<td>278</td>
<td>2.050</td>
<td>1.276</td>
<td>2.509</td>
<td>0.193</td>
<td>23.286</td>
</tr>
</tbody>
</table>

Table 4: Multiple Linear Regression Results

<table>
<thead>
<tr>
<th></th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FOG</td>
<td>–2.534** (–2.42)</td>
<td>–0.225* (–1.82)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ETR</td>
<td>0.787*** (5.72)</td>
<td>0.802*** (5.50)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>PRO</td>
<td>0.057 (0.57)</td>
<td>0.039 (0.39)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>AGE</td>
<td>0.095 (1.57)</td>
<td>0.097 (1.64)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SiZ</td>
<td>0.103* (1.74)</td>
<td>0.100* (1.70)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>LEV</td>
<td>0.105*** (3.44)</td>
<td>0.105*** (3.45)</td>
<td></td>
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</tr>
<tr>
<td>VAL</td>
<td>CashETR</td>
<td>–1.443** (–2.29)</td>
<td>–0.139* (–1.68)</td>
<td></td>
</tr>
<tr>
<td>_cons</td>
<td>15.093*** (8.36)</td>
<td>14.814*** (8.44)</td>
<td></td>
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<tr>
<td>R²</td>
<td>0.100</td>
<td>0.094</td>
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<tr>
<td>R²_a</td>
<td>0.081</td>
<td>0.074</td>
<td></td>
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<tr>
<td>N</td>
<td>278</td>
<td>278</td>
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</table>

t statistics in parentheses. *p < 0.1, **p < 0.05, ***p < 0.01.
It can be stated that, by lowering the level of FSR, companies facilitate their TA practices. Thus, companies that practice TA tend to publish financial reports deliberately that lack credibility in terms of their readability. A decrease in tax obligations is expected to increase the company’s profitability in any given year. Companies with high levels of profitability tend to make poor quality disclosures in their FS. This statement is demonstrated by the results of the regression analysis conducted on the company’s profitability control variables, whereby the profitability relationship is positive in all the regression models that are applied. Therefore, it can be concluded that companies with a low level of FSR tend to have high profitability. This statement is in line with the objectives of TA which aims to minimize tax obligations downstream which, in turn, leads to the company obtaining increased profits. Indirectly, lowering the level of FSR is one of the company’s ways to increase its profitability. Meanwhile, according to Nguyen (2020), when investing in companies that engage in a high degree of TA, there will be an inherent trade-off between high earnings as a result of more aggressive TA and the higher cost of information risk associated with more difficult-to-read financial reporting. Moreover, according to Salehi et al. (2020) and Xu et al. (2020), FSR has a positive relationship with audit fees. Therefore, the trade-off issue will be a serious matter for every potential investor to consider.

Conceptually, TA activities are not actions that violate the law. Therefore, many companies exploit loopholes to avoid their tax obligations. As for these loopholes are concerned, according to the regression results of this study, the size of a company tends to be used by its stakeholders in terms of engaging TA. This statement is an interpretation developed from observations which show that the firm size variable has a positive relationship with the dependent variable in the second major model of linear regression, \( \gamma = \text{LENGTH} \). Therefore, it can be stated that companies that are large will tend to obfuscate the information published in their FS. The size of a company is based on the accumulated monetary value of all the assets it owns. Thus, a large company is one that has a lot of assets, both in terms of types and amounts. Furthermore, the complexity and large quantities of assets owned by a company have an impact on the disclosures in the FS, with the level of FSR correlating with the disclosure in the company’s FS. Therefore, it is possible for large companies to provide an interpretation of their assets by deliberately issuing FS that is less readable. Meanwhile, Rego (2003) argued that large companies generally engage in more business activities and financial transactions than small companies, thus providing more opportunities for them to evade taxes on their income. So, it can be deduced that large companies tend to take advantage of tax loopholes pertaining to their many assets by issuing FS with low levels of readability to avoid taxes.

TA and FSR exhibit a negative relationship. Companies will strategically lower the level FSR when they practice TA. Overall, no significant outcome was found. Thus, generally speaking, the findings regarding the results presented confirm the consistency of the findings of Beuselinck et al. (2018), Inger et al. (2018), and Nguyen (2020).

5. Conclusion

Profit is the point at which any business entity achieves success. The higher the magnitude of this point, the more the effort must be committed to attaining it. Tax avoidance is described as an important influence on companies’ efforts to increase profits. The increase in profit, in this case, is a result of the company’s efforts to avoid tax obligations.

Manipulation of the readability of a company’s financial statements has been recognized as one of the strategies a company might use to lessen the chance of its tax evasion activities being discovered. Thus, reducing the readability of the financial statements is a way for companies to handle their tax avoidance practices. Evidence supporting this claim is provided by the main findings in this study which show a negative relationship between tax avoidance and the readability of financial statements. Thus, when companies engage in tax avoidance, it has been demonstrated empirically that companies tend to reduce the credibility of their financial statements in terms of their readability.

The main limitation of this study is the approach used to calculate the readability of financial statements. This limitation specifically refers to the use of a database for research in Indonesia. This is because the financial statements used as research data are delivered in two languages, namely, Indonesian and English. Due to the presence of Indonesian language content in financial statements, not all methodologies to calculating financial statement readability are compatible or applicable.

The author hopes that, in the future, the understanding provided by well-developed research related to the readability of textual information in Indonesia can be maximized. Furthermore, the author suggests that policymakers, namely tax authorities, should be expected to pay closer attention to the calculation of a company’s financial statement readability to detect tax avoidance practices by the companies. On the other hand, academically speaking, the author hopes that this research will be further developed in the future. This could be in the form of adding vulnerable periods to the population criteria used, performing different measurement variations in examining the main variables, and modifying variables by adding moderating ones.
References


