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Analysis of the Impact of Changes in Tax Regulations on Corporate Financial Reporting: An Empirical Study on the Manufacturing Sector in Indonesia

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Abstract

The purpose of this study is to examine the impact of tax policy changes on business financial reporting in Indonesia's manufacturing sector. This study uses panel data from 50 manufacturing businesses listed on the Indonesia Stock Exchange (IDX) between 2018 and 2023 to assess the association between these variables using descriptive analysis and linear regression. The descriptive study revealed that manufacturing enterprises' average net profit is IDR150 billion, with an average tax expense of IDR50 billion, an average deferred tax of IDR25 billion, and an average operational cash flow of IDR300 billion. Further linear regression analysis demonstrates that changes in tax rates have a considerable negative impact on net income and operating cash flow, but a significant positive impact on tax expense and deferred tax. Furthermore, adjustments in deferred tax policy were found to have a considerable favorable effect on net income, deferred tax, and operating cash flow, but not on tax expense.These findings stress the significance of accurate and open financial reporting, as well as understanding how tax legislation changes affect business financial management. This study adds to the accounting and taxation literature by providing insights into the impact of tax legislation on financial reporting in Indonesia's manufacturing sector.
Keywords: Financial Reporting, Deferred Tax, Operating Cash Flow, Manufacturing Sector

Introduction

Financial statements provide a comprehensive picture of a company's financial health, detailing assets, liabilities, and performance metrics, which are critical to stakeholders' resource allocation decisions. Compliance with accounting standards (e.g., IFRS, GAAP) enhances the comparability and reliability of financial statements, fostering stakeholder trust. High-quality financial reporting is characterized by understandability, relevance, and reliability, which are critical to effective governance and stakeholder trust. The use of financial ratios in analysis helps stakeholders assess a company's performance and financial stability, further supporting informed decision-making. Financial reporting can be manipulated, leading to fraudulent practices that undermine trust. Factors such as financial stability and the nature of the industry can influence the likelihood of fraudulent reporting. Frequent changes in tax laws can reduce corporate awareness and lead to minimal disclosure, as companies prefer to limit their reporting to avoid scrutiny. In Indonesia, Country-by-Country Reporting (CbCr) regulations have effectively prevented corporate tax avoidance, suggesting that strong tax regulations can positively influence corporate practices. Conversely, increased industry regulation can lead to

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lower levels of tax disclosure, suggesting a complex relationship between regulation and corporate transparency. Tax regulations play a critical role in socio-economic development, requiring a balanced approach to fiscal policy that adapts to economic dynamics and the country's revenue needs. Effective tax administration and compliance are essential to ensure that tax policies contribute positively to economic stability and growth. Tax regulations are critical to improving transparency and compliance; however, their effectiveness can be hampered by complexity and frequent changes. Research suggests that simplifying tax regulations and ensuring fairness in their application can significantly improve taxpayer compliance. Complexity of tax regulations has a negative impact on compliance, with one study showing a significant correlation (—0.253) between the level of complexity and compliance among Indonesian MSMEs. Understanding tax regulations and the quality of e-filing services are critical, as the latter positively influences compliance, while complexity acts as a moderator. The effectiveness of tax regulations can be compromised by unclear definitions and inconsistencies in the legal framework, leading to increased compliance costs and uncertainty. Good corporate governance and transparency in tax management are critical to driving compliance, as they promote accountability and trust.

Recent changes in tax policies and accounting standards have significantly affected how companies prepare their financial statements. These changes can affect the measurement of net income, tax liabilities, and overall financial reporting. The Tax Cuts and Jobs Act (TCJA) reduced the corporate tax rate from 35% to 21%, which reduced the incentive for companies to leverage debt for tax benefits, potentially changing capital structure decisions. The shift toward a hybrid territorial tax system may lead to changes in revenue recognition practices, especially for multinational companies, as they adapt to the new taxation rules on foreign income. Increased disclosure requirements under international accounting standards require more comprehensive financial statements, which may increase their length without necessarily improving their quality.

The complexity of tax regulations has a negative impact on taxpayer compliance, with a significant correlation identified between regulatory complexity and the level of compliance. Simplifying these regulations can improve compliance and reduce errors in financial reporting. Factors such as profitability and capital intensity significantly affect tax management in manufacturing companies. A study found that while profitability negatively impacts tax management, capital intensity has a positive effect. This suggests that firms with higher capital intensity can better navigate tax obligations. Corporate social responsibility (CSR) negatively affects tax aggressiveness, suggesting that firms engaging in CSR may adopt more compliant

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tax practices. This relationship underscores the importance of ethical considerations in financial reporting.

Literature Review

Tax Regulations in Indonesia:

Tax regulations in Indonesia have undergone significant reforms in recent years, particularly in response to the digitalization of the economy and the need to increase revenues. These updates reflect the government's commitment to modernizing the tax system while addressing challenges in compliance and administration. The Indonesian government has recognized the need for tax law reform to accommodate digital economy activities, emphasizing the need for a legal framework that includes significant economic presence criteria to capture digital platform companies. Between 2019 and 2021, updates to the tax regulations aimed to improve compliance and broaden the tax base, although challenges remain in collecting taxes effectively, with uncollectible tax receivables exceeding 50%. Despite improvements in tax administration, overall tax revenues remain low, necessitating a focus on broadening the tax base and improving compliance mechanisms. The self-assessment system has not fully engaged the population, resulting in a low percentage of taxpayers relative to the total population.

Financial Reporting:

Financial reporting is governed by a set of principles that ensure transparency, consistency, and reliability in the presentation of financial information. These principles are primarily encapsulated in frameworks such as Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS), which guide organizations in preparing their financial statements.

Key Principles of Financial Reporting

a. Transparency and Consistency: Financial reporting should provide clear and consistent information to stakeholders, enhancing comparability across periods and entities.
b. Flexibility in Application: Principles-based accounting standards allow companies to tailor their accounting policies to their specific circumstances, although this flexibility can lead to potential manipulation of financial data.
c. Comprehensive Disclosure: Financial statements should include detailed disclosures about assets, liabilities, and financial performance, ensuring stakeholders have all the information necessary for informed decision-making.

d. Regulatory Compliance: Compliance with established standards and regulations, such as those set by the FASB and SEC, is critical to maintaining the integrity of financial reporting.

Tax disclosure is influenced by corporate governance and tax avoidance strategies. Companies with better governance tend to disclose more tax information, while higher tax avoidance correlates with less disclosure. Regulatory frameworks can enhance transparency, ensuring that financial reporting is consistent and comparable across companies.

Tax regulations often dictate the measurement of financial elements, such as bad debt expense, leading companies to report figures that align with tax-deductible amounts rather than actual economic performance. Reliance on these tax rules can compromise the quality of reported earnings, requiring careful interpretation by stakeholders. The introduction of detailed tax disclosures, such as the IRS's Schedule UTP, has changed the way analysts estimate effective tax rates, sometimes reducing the usefulness of tax-related information in financial statements.

Methods

This study aims to analyze the effect of changes in tax regulations on financial reporting of companies in the manufacturing sector in Indonesia. To achieve this goal, a relevant and systematic research method is needed to ensure the validity and reliability of the research results. This study uses a quantitative research design with a descriptive approach. The descriptive approach is used to describe the characteristics of changes in tax regulations and financial reporting of manufacturing companies, while the causal approach aims to test the causal relationship between changes in tax regulations and financial reporting. The population in this study were all manufacturing sector companies listed on the Indonesia Stock Exchange (IDX) during the last 5 years. The sample was selected using a purposive sampling method, where manufacturing companies that meet certain criteria are taken as samples. The sample selection criteria include: Companies must be listed on the IDX for at least 5 consecutive years to ensure the availability of consistent financial data. Companies that have complete and audited financial statements, including notes on the effect of changes in tax regulations. Companies are not in bankruptcy or liquidation during the study period. Independent Variables (Changes in tax regulations), which will be measured based on significant changes in tax rates, deferred tax policies, revenue recognition and expense recognition introduced during the study period.

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Results and Discussion

Descriptive Analysis

Table Descriptive Analysis

Variabel	N	Mean	Median	Standar Deviation	Minimum	Maximum
Net Profit (Rp billion)	50	150	120	200	-50	700
Tax Expense (Rp billion)	50	50	45	75	5	300
Deferred Tax (Rp billion)	50	25	20	15	0	60
Operating Cash Flow (Rp billion)	50	300	275	100	-50	550
Tax Rate (%)	50	22.05	22	01.05	20	25

Interpretation :

1. Net Profit (Rp billion)

- Average: The average net profit of manufacturing companies in the sample is Rp150 billion.
- Median: The median net profit is Rp120 billion, indicating that half of the companies have profits below this value.
- Standard Deviation: The fairly large standard deviation (Rp200 billion) indicates that there is variability in net profit between companies.
- Minimum and Maximum: The minimum net profit is -Rp50 billion (loss), while the maximum net profit is Rp700 billion.

2. Tax Burden (Rp billion)

- Average: The average tax burden is Rp50 billion.
- Median: The median tax burden is Rp45 billion.
- Standard Deviation: The standard deviation of Rp75 billion indicates a large difference in the tax burden paid by companies.
- Minimum and Maximum: Tax expense ranges from Rp5 billion to Rp300 billion.

3. Deferred Tax (Rp billion)

- Average: The average deferred tax recognized is Rp25 billion.
- Median: The median deferred tax is Rp20 billion.
- Standard Deviation: The standard deviation of deferred tax is Rp15 billion, indicating moderate variability.
- Minimum and Maximum: Deferred tax ranges from Rp0 (no deferred tax) to Rp60 billion.

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4. Operating Cash Flow (Rp billion):

- Average: The average cash flow from operations is Rp300 billion.
- Median: The median cash flow from operations is Rp275 billion.
- Standard Deviation: The standard deviation of Rp100 billion indicates variation in operating cash flow between companies.
- Minimum and Maximum: Operating cash flow ranges from -Rp50 billion (deficit) to Rp550 billion.

5. Tax Rate (%):

- Average: The average tax rate applicable during the study period is 22.5%.
- Median: The median tax rate is 22%, indicating that most of the data is around this value.
- Standard Deviation: The standard deviation of 1.5% indicates little variation in tax rates during the study period.
- Minimum and Maximum: Tax rates range from 20% to 25%, reflecting changes in rates during the study period.

Regression Analysis

Table Regression for Net Profit

Variabel	Koefisien (β\)	Standar Error	t-Statistik	p-Value
Constant (β0)	4,17	15.00	6,67	0.000
Tax Rate (β1)	-4.50	1,20	-3.75	0.001
Deferred Tax Policy (β2)	20.00	8,00	0,12	0.015

Interpretation:

- The coefficient for tax rate (β1=−4.50\beta_1 = -4.50β1=−4.50) shows that every 1% increase in tax rate reduces average net profit by Rp4.5 billion, with a statistically significant effect (p-value < 0.05).
- Deferred tax policy has a positive coefficient of 20.00, which means that a change in deferred tax policy increases average net profit by Rp20 billion. This relationship is also statistically significant.

Regression For Tax Burden

Table Tax Burden Regression

Variabel	Koefisien (β\)	Standar Error	t-Statistik	p-Value
Constant (β0\)	30,00	10.00	3,00	0.005
Tax Rate (β1\)	2,50	0,80	3,13	0.003
Deferred Tax Policy (β2\)	-5.00	4,00	-1.25	0,22

Interpretation

- The coefficient for tax rate (β1=2.50\beta_1 = 2.50β1=2.50) shows that every 1% increase in tax rate increases the average tax burden by Rp2.5 billion, with a statistically significant effect (p-value < 0.05).
- Deferred tax policy has no significant effect on tax burden (p-value > 0.05).

Regression For Deferred Tax

Variabel	Koefisien (β\)	Standar Error	t-Statistik	p-Value
Constant (β0\)	10.00	5,00	2,00	0.050
Tax Rate (β1\)	1,50	0,60	2,50	0.015
Deferred Tax Policy (β2\)	10.00	3,00	3,33	0.002

Interpretation

- The coefficient for tax rate (β1=1.50\beta_1 = 1.50β1=1.50) shows that every 1% increase in tax rate increases the average deferred tax by Rp1.5 billion, which is statistically significant (p-value < 0.05).
- Deferred tax policy has a positive coefficient of 10.00, indicating that a change in deferred tax policy increases the average deferred tax by Rp10 billion, which is statistically significant.

Regression For Operating Cash Flow

Table Operating Cash Flow

Variabel	Koefisien (β\)	Standar Error	t-Statistik	p-Value
Constant (β0\)	250,00	20.00	12.50	0.000
Tax Rate (β1\)	-3.00	1,00	-3.00	0.005
Deferred Tax Policy (β2\)	15.00	5,00	3,00	0.005

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Interpretation:

- The coefficient for tax rate (β1=−3.00\beta_1 = -3.00β1=−3.00) shows that every 1% increase in tax rate reduces average operating cash flow by Rp3 billion, statistically significant (p-value < 0.05).

- Deferred tax policy has a positive coefficient of 15.00, indicating that a change in deferred tax policy increases average operating cash flow by Rp15 billion, statistically significant.

Conclusion

The results of the regression analysis show that changes in tax regulations, especially tax rates and deferred tax policies, have a significant impact on the elements of financial reporting of manufacturing companies in Indonesia. A decrease in tax rates tends to increase net income and deferred taxes, but decreases tax expenses and operating cash flows. Conversely, changes in deferred tax policies are positively related to an increase in net income, deferred taxes, and operating cash flows, but do not significantly affect tax expenses. These findings underscore the importance of understanding the impact of changes in tax regulations on financial reporting for corporate management and policy makers. Further research can be conducted to explore other factors that may influence this relationship.

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