Examining the Factors Affecting Corporate Tax Avoidance in Indonesia

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ABSTRACT

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| **Background:** Tax is paramount for a country since it constitutes the state revenue. Societies do not directly benefit from taxes because the taxes are used for public and collective interests rather than individual ones. The government utilises taxes to improve people’s material and spiritual welfare, thus, domestic income must be promoted.  **Aims:** This study aims to examine the effect of company size, audit quality, and political connections on tax avoidance practices in consumer goods manufacturing companies listed on the Indonesia Stock Exchange (IDX) during the period 2018–2022.  **Methodology:** This study uses a quantitative approach using Agency Theory and Stakeholder Theory as theoretical frameworks.This study was conducted using secondary data from consumer goods manufacturing companies listed on the Indonesia Stock Exchange (IDX) covering the years 2018 to 2022.A total of 155 company-year observations were selected through purposive sampling. Multiple linear regression analysis was used to analyse the data. Tax avoidance is measured using the Cash Effective Tax Rate (CETR). Company size is measured using the natural logarithm of total assets, while audit quality and political connections are measured using dummy variables.  **Results:** The results show that company size has a positive and significant effect on tax avoidance, indicating that larger companies are more able to use tax strategies due to greater resources. However, audit quality and political connections do not have a significant effect on tax avoidance. Interestingly, companies with political connections generally pay lower tax rates. Furthermore, companies with the majority of share ownership by the government face lower taxpayer risks as stipulated in the Regulation of the Minister of Finance Number 71/PMK.03/2010 because the government believes that such companies are less likely to engage in tax avoidance.  **Conclusion:** This study concludes that among the variables studied, only company size significantly affects tax avoidance practices. These findings contribute to a broader understanding of how internal and external factors of an organisation affect corporate tax behaviour, especially in the context of an emerging market such as Indonesia. |

*Keywords: Tax Avoidance, Company Size, Audit Quality, Political Connections, CETR, Indonesia Stock Exchange*

1. INTRODUCTION

Tax is government revenue collected from individuals’ income and business profits, which are mandatory. Tax is paramount for a country since it constitutes the state revenue. Societies do not directly benefit from taxes because the taxes are used for public and collective interests rather than individual ones (Stawati, 2020). The government utilises taxes to improve people’s material and spiritual welfare, thus, domestic income must be promoted (Gazali et al., 2020). Today, the role of government is increasing, in which more taxes are being imposed to finance its activities (Jayalath & Wijebandara, 2023). Along with the increasing economic growth, the government must make efforts to finance all state expenditures from its own revenue. Tax serves as one of the main income sources for the government of Indonesia (Finosari et al., 2020).

However, there is a conflict of interest between the government and business. Companies sometimes use tax evasion as a strategy to reduce their tax by concealing their real revenue. Although citizens generally comply with tax laws, this dependency on tax revenue has not been adequately supported. Companies often try to reduce their tax obligations because they see them as a burden (Indarti & Widiatmoko, 2023). This is done since tax may significantly bring up the negative effect on their profits. Hence, they will take any measures to reduce their payable tax. Tax avoidance does not violate tax regulations because it refers to a reduction of tax payable through safe and legal ways, such as by utilising the ambiguity of tax regulations. The issue of tax avoidance is complex and unique. On the one hand, it is permissible, but on the other hand, tax avoidance is undesirable. From a traditional perspective, tax avoidance mechanisms must increase shareholder value, and from an agency perspective, say that tax avoidance provides different predictions (Alfandia & Putri, 2023; Anggreini & Kusuma, 2024).

Tax avoidance by companies is even driven by their political connections with the government. Corporations frequently use political connections to gain business profits (Ngabdilah et al., 2022). Asadanie and Venusita (2020) also state that there is a unique relationship between the government and business owners. The impact of political connections on tax avoidance in Indonesia has raised significant concerns among policymakers, regulators, investors, and stakeholders. Political connections can be through direct relationships where a member of the company's board has political influence, or indirectly, where there are family ties to government officials (Dewi & Pramanaswari, 2024).

Damayanty and Putri (2021) mentioned in their research that company size is determined by the amount of total assets owned by the company. A big company has more than adequate resources to reach its goals since the more assets it has, the more stable its capability to generate revenues. According to the Agency Theory, a big company must invest in remunerative agents to reduce the tax burden and optimise operations. The number of assets affects all productivity and profits of a company, and the profit will later determine the amount of tax that should be paid by the company (Oktavia et al., 2021).

Audit quality is expected to play an important role in preventing tax avoidance. Setyawan (2020) argues that there is a significant and positive correlation between tax avoidance and company size. A large business with a significant number of assets can easily use the assets to complete tasks or pursue a specific interest. Similarly, big businesses can use their expertise to manipulate their tax amount in order that they pay less by manipulating the taxation regulations.

Some research has already been conducted to investigate the effects of company size, political connections, and audit quality on tax avoidance. Asadanie and Venusita (2020) indicated that political connections affected tax avoidance. In addition, Stawati (2020) proves that company size influences tax avoidance. Another study conducted by Shintawati and Pandoyo (2022) signifies that audit quality negatively and significantly influences tax avoidance by 39.5%.

This study aims to find empirical evidence of the influences of political connections, company size, and audit quality on tax avoidance conducted by the manufacturing companies in the consumption goods sector listed in the Indonesia Stock Exchange between 2018 and 2021.

2. LitErature Review

**2.1 Agency Theory**

Davis et al. (2018) mention that the core of Agency Theory is when a principal gives a mandate to an agent to act on his behalf. Consequently, the agent can opportunistically chase his own interests and profits by using the principal’s profits (assets). Agency Theory proposes intermediary delegation before controlling to prevent delegation abuse.

**2.2 Stakeholder Theory**

This theory emphasises the importance of a manager's accountability to their stakeholders and states that a manager has a moral obligation to consider all the involved stakeholders’ interests. A stakeholder is an individual or a group of people who benefit or suffer a loss from a company’s decision or action. In addition, other larger constituents consisting of stakeholders must also be taken into consideration, including the government, politicians, employees, customers, and professional associations (Chouaibi et al., 2022).

**2.3 Tax Avoidance**

According to Damayanty and Putri (2021), taxpayers can apply tax avoidance to reduce the amount of tax payable. This method takes advantage of tax regulation loopholes, but it is lawful. Companies can use the ambiguity in the tax regulations to legally reduce their taxes. However, it can disrupt the state budget, which will hinder the state's development. Tax evasion can reduce the tax revenue available to governments to manage the economy, while on the other hand, taxpayers who evade taxes feel they can use the evade taxes to improve their own financial stability (Ozili, 2020).

**2.4 Company Size**

An organisation’s total asset shows its maturity. The more the total assets, the better the company’s long-term prospects (Mulyati et al., 2019). A larger number of assets will increase revenues, which later will affect the tax liabilities. Larger business typically uses advantageous accounting methods, such as depreciation costs due to asset acquisition costs that have more room for strategic tax planning. The goal is to reduce the effective tax rate for businesses. Large corporations are more reliable than small ones when it comes to earning profits and paying taxes. According to Damayanty and Putri (2021), a company's total assets must be at an ideal size. If the asset value is high and the cash flow is strong, the company may be in the maturity stage and have a good and stable future.

**2.5 Audit Quality**

Audit quality is an additional component that affects tax avoidance. A study by Putri and Alfandia (2023) found that audit quality was an important element because it improved the ability of auditors to carry out professional duties based on competence, independence, and professional ethics. In addition, better audit quality increases the likelihood that auditors will find incomplete financial statements or substantial weaknesses. According to Amalia and Ferdiansyah (2019), any situation that may occur when an auditor finds a violation in the client's financial statements and notifies the audited party of the violation will be included in the audit quality. Companies in the financial sector will entrust audit procedures to high-quality auditors.

**2.6 Political Connections**

A company has political connections if its management or shareholders are legislative members (Prapita & Safrida, 2019). Rustriarini and Sudiartana (2021) mention that the steering boards of companies with political ties are usually more involved in tax avoidance because they are not subject to strict regulations and have a greater chance of avoiding tax. Putra and Suhardianto (2020) state in their research that the political intelligence of management can affect business strategy. Business managers may see political experience as an influence on conducting tax avoidance because they can make decisions based on political experience that can affect their loyalty to the government. A less aggressive and tax-efficient business strategy will be influenced by management's loyalty to the government.

**2.7 Hypothesis Development**

2.7.1 Effect of company size on tax avoidance

Based on the total assets, companies are classified into large and small companies under the variable of company size. The number of assets of a company indicates the extent and complexity of its transactions, which increases with its size. This allows the business to take advantage of the opportunity to avoid paying tax on each transaction. Due to the possibility of transferring their profits to companies in countries with lower tax rates, companies operating abroad are usually larger than domestic companies. In addition, these companies also tend to practice tax avoidance at a higher level. Large companies take the opportunity to avoid taxes. The larger the amount of a company's net profit, the higher the tax rate will certainly be, so it will encourage the company to practice tax avoidance.  
H1: Company size has a positive and significant effect on tax avoidance.

2.7.2 Effect of audit quality on tax avoidance

Audit quality is the key factor in choosing auditor services that will provide higher-quality results. The business world needs auditors to ensure that the data related to tax laws are accurate. High-quality auditors normally maintain or even improve their performance, integrity, and transparency to keep their reputation as auditors (Aysha & Sari, 2022). This shows that tax avoidance is negatively correlated with audit quality. According to the research conducted by Suciana and Setiawan (2018), asset value (ROA) can be used to measure audit quality. Good audit quality is indicated by the ROA, which is between the threshold, while poor audit quality is shown by the ROA outside the threshold.  
H2: Audit quality has a negative and significant effect on tax avoidance.

2.7.3 Effect of political connections on tax avoidance

Political connections are determined by the presence of BOD and BOC members who happen to be members of political parties. A company is considered to have political connections if it has a relationship with the government that encourages tax avoidance. The relationship with the government is shown by the tolerance between both parties. One of the advantages of this relationship is lax tax checks, which makes it possible for companies to avoid taxes because they feel protected by the political connections. According to research conducted by Lin et al. (2018), the best way for companies to avoid taxes is by transferring profits.

H3: Political connections have a positive and significant effect on tax avoidance.

3. methodology

3.1 Population and sample

The population in this study are manufacturing companies in the consumer goods sector listed in the IDX between 2018-2022. The sampling method used is purposive sampling. Secondary research using data collection techniques by documentation sessions and gathering several documents and data related to the annual reports was also employed in the analysis. The annual reports of the consumer goods manufacturing sector companies in 2018-2021 listed in the IDX are the data selected for this study.

3.2 Variable Definitions and Measurement

3.2.1 Tax avoidance

As stated by Prasetyo and Abdillah (2021), tax avoidance is not a violation of state budget-related laws. Tax avoidance is a way of managing events to minimise or eliminate the tax burden by considering whether or not there is a tax impact on the event. This is done because the laws prohibit reducing, evading, limiting, or lowering tax rates. Tax avoidance is a dependent variable in this study. CETR was used to calculate tax avoidance. CETR is a calculation that can differentiate between real tax paid and commercial profit before tax.

The formulation to calculate CETR is as follows.

CETR = (revenue tax burden)/(revenue before tax)

(Fitri, 2024)

3.2.2 Company size

According to research conducted by Erna et al. (2020), small, medium, and large enterprises are the categories used to determine the size of companies. The number of assets of a company prescribes how big or small the company is. A higher total balance indicates a better long-term outlook. A business with large assets is more profitable and stable than the one with smaller total assets.

The following formula is used to calculate the size of the company.

Company size = Ln (total assets)

(Mahpudin & Aulia, 2020)

3.2.3 Audit quality

Santoso and Doho (2020) argue that a high-quality audit is a way to monitor managers' behaviour in business management and to find and stop accounting fraud. In evaluating a business’s financial statements, external auditors are expected to determine whether or not the business is aggressively applying taxation, a situation that tax authorities consider unclear. The earnings surprise benchmark is used as an indicator of audit quality (Suciana & Setiawan, 2018) to identify and indicate whether management is doing profit management to avoid loss reports. The ROA formula is used to measure audit quality. If the ROA is by the benchmark (< μ-σ < ROA < μ-σ), then the audit quality is good, but if the ROA is outside the benchmark (ROA> μ-σ) or (ROA< μ-σ), then the audit quality is poor. μ is the average ROA of the sample company, and σ is the standard deviation. A higher quality audit from Public Accounting Firms (PAFs) will increase client confidence in the services provided. Good audit quality will be given a grade of 1, while poor audit quality will be given a grade of 0. This variable is represented by KA (Suciana & Setiawan, 2018).

3.2.4 Political connections

Due to government protection, easy access to loans for stock purchases, and other privileges, companies have adopted more proactive tax policies. If an organisation has a strong political connection, the likelihood of tax avoidance increases (Sofie & Sembiring, 2022). A company is considered to have political ties if at least 10% of its shares are owned by its major shareholders who are affiliated with political figures or parties. In addition, if a company's leader is affiliated with a political figure, becoming a minister or a member of the House of Representatives, the company is also considered to have political ties (Sulisyowati & Prabowo, 2020). A dummy variable was used to measure political connections, where companies connected to politics were given a score of 1, and those that did not have political connections got a score of 0.

3.3 Data analysis method

3.3.1 Descriptive statistics

According to Ghozali (2018), the descriptions of maximum, minimum, standard deviation, and average values are presented in the descriptive statistics. To easily understand some of the variables in this study, 35 tests were performed to present numerical measures that are important for the samples of this study.

3.3.2 Hypothesis Testing

3.3.2.1 Multiple linear regression analysis

The purpose of this analysis is to investigate the influence of independent variables on the dependent variable, as well as whether each independent variable has a positive or negative relationship with the dependent variable. It is also used to estimate whether the values of the independent variables increase or decrease based on the dependent variable.

The following is the model for multiple linear regression analysis.

Y = α + β1X1 + β2X2 + β3X3 + e

Where:

Y = Tax avoidance

α = Constant

β1, β2, β3 = Regression coefficients

X1 = Company size

X2 = Audit quality

X3 = Political connections

E = Error

F-test

The goal is to show whether the regression model is feasible or not. This test was carried out using a significance level of 0.05 (α = 5%), showing that the regression data were processed by referring to the output values in the ANOVA table. If the probability value exceeds the significance level (α), the model is not feasible. Conversely, if the probability value is less than α, the regression model is considered feasible or usable.

3.3.2.2 T-test

The extent to which the influence of one independent variable individually explains the variations of the dependent variable is shown using a T-test. Ghozali (2018) also mentions that the individual effect of the independent variables on the dependent variable is indicated by its significance.

4. results and discussion

**Table 1. Selection Result of Purposive Sampling**

|  |  |
| --- | --- |
| Descriptions | Total |
| Manufacturing companies in the consumer goods sector listed in the IDX between 2018-2022. | 113 |
| Manufacturing companies in the consumer goods sector that have conducted IPO since 2018 | (47) |
| Manufacturing companies in the consumer goods sector that did not report their complete financial statements consecutively between 2018-2022. | (2) |
| Companies that experienced consecutive losses between 2018-2022. | (33) |
| Companies that did not use Rupiah as the currency of calculation in their financial statements, to uniform the measurement. | (1) |
| Total of eligible companies | (31) |
| Number of observation years | (5) |
| Total research samples | 155 |

**Results of Descriptive Statistics**

The results of descriptive statistics of each variable are presented in Table 2.

**Table 2. Descriptive Statistics Results**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Variable | N | Minimum | Maximum | Mean | Std. Deviation |
| Company size | 1551 | 27.34 | 32.83 | 29.5140 | 1.51750 |
| Tax avoidance | 155 | .04 | .33 | .2318 | .04589 |

Since audit quality and political connections used dummy variables, their descriptive analyses were separately performed. The results can be seen in Table 3.

**Table 3. Dummy Variable Descriptive Statistics Results**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Variable | Criteria | Code | Total | Percentage |
| Political connections | Companies that had political connections | 1 | 50 | 32% |
|  | Companies that did not have political connections | 0 | 105 | 68% |
| Audit quality | Companies with good audit quality | 1 | 124 | 80% |
|  | Companies without good audit quality | 0 | 31 | 20% |

**Classical Assumption Test Results**

Based on the results of the Kolmogorov-Smirnov test, the variables used in this study are known to have a normal distribution, as seen from the significance value of 0.200>0.05. The multicollinearity test confirmed that all independent variables had a tolerance value of >0.01 and a VIF value of <10. This result indicates that no multicollinearity exists. The heteroscedasticity test also showed that all independent variables had a significance value of >0.05, which means there is no heteroscedasticity. The autocorrelation test using Durbin-Watson showed a value of (dU < dW< 4-dU), which was (17659<1916<2.2341), so there was no autocorrelation.

**Hypothesis Test**

**Multiple Linear Regression Analysis**

Table 4 presents the results of the multiple linear regression analysis.

**Table 4. Results of Multiple Linear Regression Analysis**

|  |  |  |  |
| --- | --- | --- | --- |
|  | Unstandardized Coefficients |  |  |
|  | B | T | Sig. |
| Constant | .110 | 2.151 | .033 |
| Company size | .004 | 2.225 | .028 |
| Audit quality | .006 | .865 | .389 |
| Political connections | .008 | 1.348 | .180 |

Based on the results presented in Table 4, the regression model obtained is as follows.

Y = 0.110+ 0.004H1 + 0.006H2+ 0.008H3

**F-test**

Table 5 presents the results of the F-test.

**Table 5. Results of F-test**

|  |  |  |
| --- | --- | --- |
|  | F | Sig. |
| Regression Residual Total | 2,288 | 0,024 |

The results showed the significance value of the regression model amounting to 0.024. Compared to the alpha value of 0.05, the significance value of F(0.024) is less than 0.05 (alpha = 5%). This means that the regression model is feasible for this study.

**Discussion**

**Company Size and Tax Avoidance**

Company size has a positive effect on tax avoidance. This shows that businesses have a greater ability to avoid taxes as they can hire tax specialists or tax consultants to improve the tax avoidance they practice. Companies with large and stable profits are more likely to encourage their employees to engage in tax avoidance, as higher profits lead to a greater tax burden. Large businesses have more liabilities because they have a lot of assets. This is in line with research conducted by Sulaeman (2021), which found that larger companies tended to engage in more tax avoidance. However, the research findings of Sidaruk and Fadilah (2020) show the opposite, that company size does not have a significant influence on tax avoidance because company size does not affect management's decision to circumvent tax avoidance.

**Audit Quality and Tax Avoidance**

The second hypothesis, which states that audit quality affects tax avoidance, is not supported by the research findings. Although not statistically significant, the results suggest that audit quality has a positive influence. One of the cornerstones of good management is transparency in corporate governance. This can be done by having a high-quality, independent, and experienced auditor submit audited financial statements. The auditor is expected to help the company's management calculate taxes more accurately, but the auditor may not find anything because tax avoidance is not a violation. This can explain why audit quality has no impact on tax avoidance. Instead, they may focus on finding legal loopholes in tax regulations that enable the company to avoid violating the law. Additionally, some companies may pay higher fees to the Public Accounting Firms (PAFs) conducting their audits which potentially compromises the firms' independence in reviewing the companies' financial statements. The findings are in line with the research of Sidaruk and Fadilah (2020), which proves that audit quality does not affect tax avoidance. However, the findings contradict the research of Tahilia et al. (2022), which reveals that audit results have a significantly negative impact on tax avoidance.

This shows that auditors and business management have become more cautious in meeting audit quality requirements, subject to IAPI indicators. The value of audit quality indicators will indicate that the tax avoidance practices of a company will decrease along with the increase in the value of audit quality indicators. In addition, the result shows that consumer goods companies with high audit standards will seek to avoid tax evasion in order to remain operating and maintain public trust.

**Political Connection and Tax Avoidance**

The findings do not support the third hypothesis, which suggests that political connections influence tax avoidance. Although not significant, the results also indicate that there is a positive relationship between political connections and tax avoidance. Companies with political connections generally pay lower tax rates. Furthermore, companies with the majority of share ownership by the government face lower taxpayer risks as stipulated in the Regulation of the Minister of Finance Number 71/PMK.03/2010 because the government believes that such companies are less likely to engage in tax avoidance. Tax avoidance is not influenced by political connections, since if a company has political connections, its tax rates tend to be lower. This corroborates the research conducted by Prapita and Safrida (2019). However, Asadanie and Venusita (2020) argue otherwise, that political ties support tax avoidance because companies with political connections can have greater access to loans and reduce the risk of tax audits. In addition, political parties can be used by diverting the loans to reduce the taxable income.

5. Conclusion

Based on the study results, it can be concluded that company size has a positive and significant effect on tax avoidance, while audit quality and political connections show no influence on tax avoidance.

Future researchers are expected to expand the research subject beyond manufacturing companies in the consumer goods sector listed on IDX to allow more comprehensive analysis. In addition, including more independent variables can also provide deeper insights into the factors contributing to tax avoidance. Moreover, other indicators than CETR can be employed to estimate tax avoidance, such as Book Tax Gap (BTG) or Book Tax Difference (BTD), to be more varied.

This study aims to provide companies with a better understanding, detailed insights, and valuable contributions to optimise their tax payments.

For the government, especially the Directorate General of Taxation, it is suggested to continuously monitor tax avoidance acts that might be conducted by big companies to secure and maximise state revenues. To increase the state revenues and realise the welfare of the Indonesian people, the government must minimise the loopholes in tax regulations by, for example, strengthening the existing regulations and mandating companies to publish their tax payment reports.

For investors interested in a company, it is important to give greater consideration to the factors influencing tax avoidance, such as company size. Since businesses must raise capital to generate more profits, investors should be aware of activities that may lead to tax avoidance. They should also be able to assess whether the tax rates disclosed in the company’s financial statements are within a reasonable range.

For the authors, this research aims to contribute to the current understanding of tax avoidance and to lay the groundwork for future studies on topics such as company size, audit quality, and political connections.

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