The Impact of Profitability, Firm Size, and Leverage on Tax Avoidance: Moderating Role of Parent Company Location

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Abstract

This study examines the effect of profitability, firm size, and leverage on tax avoidance. Additionally, the study investigates the moderating role of parent company location on the relationship between profitability, firm size, leverage, and tax avoidance. Using a sample of 504 observations from companies listed on the Indonesia Stock Exchange, excluding the financial and real estate sectors, and employing multiple linear regression analysis, this study finds that profitability negatively affects tax avoidance, firm size negatively affects tax avoidance, and leverage positively affects tax avoidance. The study also finds that parent company location strengthens the positive relationship between leverage and tax avoidance. The results of this study imply that leverage is a significant factor influencing corporate tax avoidance practices, and this effect is amplified by the presence of parent company location in the relationship between leverage and tax avoidance.

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1. Introduction

Tax is an obligation to pay the government, collected from individuals or companies according to the law, without direct compensation, and is intended to support the state's functions for the prosperity of its citizens. The role of tax is crucial for Indonesia's economy. In the 2024 State Revenue and Expenditure Budget, tax revenues are targeted at IDR 2,309.9 trillion or 82.42% of the overall state revenue target, including grants amounting to IDR 2,802.3 trillion. The significant contribution of tax benefits both society and the government. For the government, taxes are used to fund government programs, including healthcare, education, social protection, food security, subsidies, infrastructure, and others. For society, these government programs lead to improved welfare.

In the last three years, the Directorate General of Taxes (DGT) has successfully achieved its tax revenue targets. One key to this success is the increase in taxpayer compliance. The establishment of the Tax Compliance Committee and CRM is one of DGT's strategies to enhance taxpayer compliance (Wildan, 2024). With the presence of the Oversight Committee, monitoring, service, and auditing activities become more directed and effective, and taxpayer potential is explored based on risk.

Although tax revenue has been achieved in the last three years, according to research published by the Organisation for Economic Co-operation and Development (OECD) titled Revenue Statistics in Asia and the Pacific 2023, Indonesia's tax-to-GDP ratio was 10.9% in 2021. This figure falls short of the Asia-Pacific average of 19.8%, with a gap of 8.9 percentage points. This ratio is also below the OECD average (34.1%) by 23.2 points. One reason for the low tax ratio is tax avoidance (Hajawiyah et al., 2021). Tax evasion in Indonesia cost the country USD 2,736.5 in 2023, or 0.3% of GDP, according to the State of Tax Justice 2023 report published by the Tax Justice Network.

Tax avoidance in Indonesia has become a serious concern for both the government and the public, one prominent case being PT Adaro Energy Tbk (AE). According to information from Global Witness, AE, one of Indonesia's mining giants, was accused of engaging in transfer pricing practices to avoid taxes. Allegedly, during the period from 2009 to 2017, AE set up a scheme involving its subsidiary in Singapore, Coaltrade Services International, to reduce its tax obligations in Indonesia. Due to this transfer pricing scheme, AE is suspected of causing a state loss of IDR 1.75 trillion. This amount should have been paid into the Indonesian state treasury as tax but was instead funneled to Coaltrade Services International in Singapore (Danang, 2024).

Another notable case involves PT Toyota Motor Manufacturing Indonesia (TMMIN), which also concerns transfer pricing issues. The case emerged from the company's request for a tax refund for the 2005, 2007, and 2008 tax years. Following procedure, DGT conducted a tax audit of TMMIN's tax return for 2005. DGT's audit found irregularities in TMMIN's financial statements, particularly a drastic decrease in gross profit, from IDR 1.5 trillion in 2003 to IDR 950 billion in

2004. This indicates a significant drop in the company's profitability. The decrease in gross profit was accompanied by a decline in gross profit margin. In 2003, TMMIN's gross profit margin was 14.59%, but it sharply dropped to 6.58% in 2004 (Idris, 2024).

In tax avoidance, companies often use profit-shifting techniques, which are closely related to the company's profitability levels. According to research by Taylor et al., (2015), multinational corporations use transfer pricing, thin capitalization, and tax havens to shift profits and minimize tax liabilities. Multinational enterprises (MNEs) systematically engage in complex strategies, moving profits to countries with lower tax rates. This is facilitated by the global nature of their operations and their ability to maneuver intangible assets and cross-border capital structures to exploit different tax regimes. The variations in tax systems across countries influence MNEs' decisions in allocating income and expenses to optimize their tax obligations (Desai and Dharmapala, 2006).

Previous research by Hossain et al. (2024) suggests that several factors influence tax avoidance practices, including profitability, company size, and leverage. High-profit companies tend to engage in tax avoidance. The larger the company, the more resources it has, making it more likely to utilize complex schemes. Meanwhile, companies with high leverage ratios tend to have larger interest payments. Markle and Shackelford (2014) found in their study that the location of MNEs and their subsidiaries significantly affects their global Effective Tax Rate (ETR). This means that the country where MNEs and their subsidiaries are located has a substantial impact on the taxes they pay globally.

In relation to transfer pricing and tax avoidance, the OECD launched the G20 Base Erosion and Profit Shifting Project (BEPS Project) in 2013. This addresses tax planning tactics used by MNEs to exploit gaps and mismatches in tax rules to avoid high taxes. Developing countries, which rely more heavily on corporate income tax, are disproportionately affected by BEPS. BEPS practices cause countries to lose USD 100-240 billion annually. Tambunan (2021) stated that profit allocation is based on value creation, routine functions, and other considerations, prior to assessing business sustainability.

Indonesia has implemented the four minimum standards required by the OECD, namely Action 5 on harmful tax practices, Action 6 on preventing tax treaty abuse, Action 13 on the Country-by-Country Report, and Action 14 on the Mutual Agreement Procedure. One BEPS Action already incorporated into Indonesia's domestic tax regulations is BEPS Action 13 on the Country-by-Country Report, also known as the *Laporan per Negara* (Dan and Tobing, 2014). The Country-by-Country Report must be submitted by domestic taxpayers, who are the main entities of a business group with consolidated gross revenues of at least IDR 11 trillion. The Country-by-Country Report is a document used to assess whether there has been transfer pricing. It contains information on the allocation of income, taxes paid, and business activities of all entities, from the parent company to its subsidiaries. The report is then exchanged under agreements with other jurisdictions through the Competent Authority and used for transfer pricing risk analysis.

Based on research with varying results on the relationship between profitability, company size, and leverage with tax avoidance, and the presence of empirical evidence that demonstrates the moderating role of parent company location in strengthening the positive relationship between profitability, company size, and leverage with tax avoidance, as well as the lack of extensive research measuring the moderating role of company location.

2. Literature Review and Hypothesis Development

2.1   Agency Theory

Agency theory is as an interaction that occurs when at least one principal entrusts another party (agent) to carry out tasks on behalf of the principal's interests (Jensen and Meckling, 1976). In this relationship, decision-making authority is given to the agent. In the context of a company, the principal typically consists of shareholders and creditors. Shareholders are the owners, while creditors are those who lend funds to the company. Agents, on the other hand, are typically the company's management. Management is responsible for managing the company's resources and making decisions to achieve corporate objectives.

The issue that arises is that both the principal and the agent have their own interests in maximizing their own welfare. This agency problem leads to agency costs, including monitoring, bonding, and residual loss due to the asymmetric information that can create uncertainty. Monitoring costs are the expenses incurred by the principal to measure, observe, and control the agent's activities. Meanwhile, bonding costs are the expenses incurred by managers in terms of time and effort to build the principal's trust. The term "bonding" is used because these costs arise to align the agent's interests with those of the principal. The goal is to reduce monitoring costs. Residual loss refers to the wealth reduction that occurs because the agent continues to act in a way that is not aligned with the principal's interests, even after monitoring and bonding costs have been incurred.

High supervision costs can prevent tax avoidance by reducing managerial opportunism, but they may also limit the flexibility needed for strategic tax planning. However, high tax avoidance through profit manipulation and financial reporting can generate agency costs that are detrimental to shareholders, such as high tax compliance costs, tax audit costs, legal costs, and damage to the company's reputation.

Differences in corporate governance affect tax avoidance strategies, as effective governance structures reduce agency costs and limit aggressive tax avoidance practices (Desai and Dharmapala, 2006). Tax savings can be directed towards climate-related initiatives, demonstrating that tax avoidance can support broader strategic goals that may potentially increase shareholder value in the long term. This perspective aligns tax avoidance not only with direct financial gains but also with the company's strategic responsibilities.

2.2 Positive Accounting Theory

This model seeks to explain and predict accounting practices by observing empirical events (Godfrey et al, 2010). Watts and Zimmerman (1986) formulated three hypotheses that describe opportunistic behavior by managers: the bonus plan hypothesis (or management compensation hypothesis), the debt/equity hypothesis (or debt hypothesis), and the political cost hypothesis.

First, the bonus plan hypothesis explains that the presence of bonuses motivates managers to embellish profit reports, as bonuses depend on performance. It assumes that profits will be used to accumulate compensation amounts, leading to profit manipulation. Managers tend to use accounting policies to shift reported profits over time, which can be harmful because they focus only on meeting targets and thus are cautious of the manipulative effects.

Second, the debt hypothesis explains that if a company is at risk of compromising its debt contracts, it is very likely that agents will shift future profits to the present. These contracts often require the borrower to comply with certain ratios in the financial statements, which are affected by profits. If these requirements are violated, creditors may impose penalties, such as restricting dividend payments, denying additional loans, or raising interest rates. Consequently, managerial intervention in reporting profits is done to avoid these violations, leading to profit reports that do not reflect the company's true fundamental performance.

Third, the political cost hypothesis suggests that as spending on political activities increases, it is very likely that agents will use accounting policies to defer current profits to future periods. This approach involves selecting methods that tend to reduce reported profits (Scott, 2015).

2.3 Profitability

Profitability is one of the most crucial financial indicators. It is used to measure a company's efficiency and performance in generating profit. This concept refers to the extent to which a company can generate profit from its operations relative to sales, total assets, or equity. The primary indicators for measuring profitability are NPM, ROA, and ROE.

NPM measures how effectively a company converts sales into net profit, while ROE measures the company's ability to generate profit from investments made by the principal. Meanwhile, ROA assesses the effectiveness of management in utilizing assets to generate net profit. In research conducted by Darsani and Sukartha (2021), it was found that companies with a high capital intensity ratio tend to have a higher ROA, indicating more optimal efficiency in asset utilization.

Wahyuni et al. (2019) revealed that business tactics, including debt management and increasing sales volume, play a significant role in influencing profitability. Companies that adopt aggressive growth strategies with balanced funding tend to experience higher profitability.

Based on research by Hossain et al. (2024); Wulandari and Sudarma, (2022), profitability has a positive effect on tax avoidance. As profits increase, the amount

of tax liabilities also rises, leading to higher tax aggressiveness if the company seeks to minimize its Effective Tax Rate (ETR). Hamilah (2020), found in her research that a company's profitability significantly affects tax avoidance practices. However, studies by Shubita (2024); Noviyani and Mu'id (2019) found the opposite: the higher the profitability, the lower the level of tax avoidance.

2.4   Firm Size

Firm size is as an important indicator that explains the capacity and scale of a company's operations based on the value of its assets. According to Richardson et al. (2016), measuring a company's size through asset value provides insight into the resources that can be mobilized for operational activities, investment, and expansion. A company's assets include not only physical resources such as property, equipment, and inventory, but also non-physical assets like patents, brand ownership, and goodwill. Research has found that companies with greater asset value tend to have better access to capital markets, more opportunities in contract negotiations, and often higher operational efficiency due to economies of scale.

Company size is frequently used as a parameter to control for the effects of economies of scale. As scale increases, the tendency for tax avoidance also tends to rise. This phenomenon occurs because large-scale companies generally have more resources, including access to more complex legal and financial services, allowing them to design more efficient and effective tax management strategies. With such capabilities, large companies can legally optimize their tax burdens through various mechanisms, such as income allocation across countries, exploiting tax rate differences, and maximizing the use of tax incentives. Chen et al. (2010), in their research found that the larger the company, the more it engages in tax avoidance activities.

Research conducted by Siregar (2021) and Sopiyana, (2022) found that company size has a positive influence on tax avoidance. This is because larger companies have greater access to resources, which can assist them in designing and implementing more complex tax avoidance strategies (Shubita, 2024).

2.5   Leverage

This presents an overview of the proportion of debt used by a company to finance its operations, serving as an important indicator in financial analysis. The proportion shows how much of the company's assets are funded through debt compared to equity.

In addition to increasing profit potential, companies also have other reasons for deciding on leverage policies, particularly tax-related reasons. Leverage can influence the level of a company's tax aggressiveness. According to Choi (2003), companies use debt not only to enhance profit potential but also to gain tax benefits. This is because interest expenses on debt are a deductible component from pre-tax profits. In other words, interest expenses reduce taxable income, thereby resulting in lower tax liabilities.

Research by Hossain et al. (2024); Wahyuni et al. (2019) found that leverage has a significantly positive effect on tax avoidance. The higher a company's leverage ratio, the more debt the company holds. Consequently, its interest expenses are also higher. This increase in interest expenses reduces the total tax liability the company owes to the state.

2.6   Tax Avoidance

Frank et al. (2009) state that this is equivalent to tax aggressiveness, which involves manipulating taxable income and can include tax evasion, which violates tax laws. Tax avoidance, on the other hand, refers to exploiting loopholes in tax regulations and legally avoiding breaches of tax provisions. Companies can take advantage of this situation by attempting to reduce their tax burden in order to achieve profit enhancement goals.

To minimize tax burdens, companies can plan using various strategies, such as tax avoidance (Hanlon and Heitzman, 2010). In measuring the level of tax avoidance, the Effective Tax Rate (ETR) is used (Huang et al., 2016). ETR is considered effective in providing a true representation of the tax burden experienced by a company (Hoopes et al., 2012).

2.7   Parent Company Location

Weber and Friedrich (1929) revealed that choosing a location is a prospective activity. This is because location influences the development of commercial activities. A strategic location offers its own advantages in terms of accessibility. The more strategic a location is for business activities, the greater the profit opportunities it creates. This view arises from the fact that a strategic location can reduce production costs and enhance wider recognition.

According to Legwaila (2012), a parent company is situated between the primary shareholders and the operating company, acting simultaneously as both a parent and a subsidiary. These companies are typically established in jurisdictions different from the primary investor's jurisdiction. This strategic arrangement allows investors to optimize the infrastructure of the jurisdiction that best aligns with their investment objectives, considering both tax and non-tax characteristics of potential locations.

Jensen and Meckling (1976) described how ownership and control structures within a parent company influence managerial behavior and agency costs. A parent company plays a crucial role in reducing agency costs through supervision and control over the operational activities of its subsidiaries. As a holding company, the parent holds the authority to oversee and control its branches, which operate as a unified management entity.

The location of the parent company can influence tax avoidance strategies due to differences in tax rates. These tax rate differences can be exploited by multinational companies for profit shifting. Dischinger et al. (2014) emphasized the importance of headquarters location. Profit shifting activities are undertaken in response to tax

rate differences between the parent and subsidiary companies. Profit shifting becomes significant when the parent company is located in a country with relatively lower taxes compared to the subsidiary, resulting in profit transfers from the subsidiary to the parent company.

In Ciganskis (2023), research, the important role of company size and the location of corporate headquarters in shaping tax strategies and interactions with national and international tax laws is highlighted. The location of the parent company significantly influences the strategies used for tax reduction, with multinational companies often choosing jurisdictions with favorable tax laws to base key parts of their operations.

The strategic placement of a parent company in a low-tax jurisdiction can enhance the tax benefits of leverage (Kontogoulidis, 2023). By channeling loans through these entities, multinational companies can exploit differences in tax rates and regulations to minimize their tax liabilities. This not only involves the direct effect of tax reduction from debt financing but also incorporates complex arrangements that exploit regulatory differences across jurisdictions.

Hypothesis

Based on the literature review and theories discussed, since no research has yet used parent company location as a moderating variable, this study proposes a hypothesis, which introduces a novelty to this research:

H_1: Profitability has a positive effect on tax avoidance;

H_2: Firm size has a positive effect on tax avoidance;

H_3: Leverage has a positive effect on tax avoidance;

H_4: The location of the parent company strengthens the positive relationship between profitability and tax avoidance;

H_5: The location of the parent company strengthens the positive relationship between firm size and tax avoidance; and

H_6: The location of the parent company strengthens the positive relationship between leverage and tax avoidance.

3. Research Method

The documentation method is used to collect data. The stages involve gathering, documenting, and analyzing verified financial reports of companies for the 2016–2022 period from several listed companies on the IDX. The type of data used in the testing is panel data, which is a combination of cross-sectional and time-series data, suitable for research in the field of economics and financial statement data (Pesaran, 2015).

In processing the data, this study uses Stata version 17. The analysis method includes descriptive statistical analysis, correlation tests, panel data regression model selection tests to obtain the best fit, classical assumption tests, and hypothesis testing.

Table 1: Selection criteria

Sample Selection Criteria	Number of Firms	Number of Firm-Years
Public companies listed on IDX	932	6.624
Less:		
Listed in financial and real estate sectors	(236)	(1.652)
Companies without parent company location data	(344)	(2.408)
Companies listed on IDX before December 31, 2015	(269)	(1.883)
Companies under suspension	(1)	(7)
Extreme Outlier	(10)	(70)
Total	72	504

The selection of companies is based on the industry sector categories used in S&P Capital IQ. Data sources are obtained from S&P Capital IQ, the IDX website, and the companies' official websites. The industry sectors focused on in this study include various sectors, such as energy, industrials, consumer discretionary, consumer staples, health care, information technology, communication services, and utilities. The financial sector is excluded due to regulatory considerations, and the real estate sector is excluded because it has a different taxation system.

The empirical method applied is multiple regression analysis. Furthermore, the following model is used:

$$ETR_{i,t} = \beta_0 + \beta_1 ROA_{i,t} + \beta_2 SIZE_{i,t} + \beta_3 LEV_{i,t} + \beta_4 LOC_{i,t} + \beta_5 INS\_OWN_{i,t} + \beta_6 MAN\_OWN_{i,t} + \beta_7 POL_{i,t} + \beta_8 AGE_{i,t} + \varepsilon \qquad \text{(Model 1)}$$

$$ETR_{i,t} = \beta_0 + \beta_1 ROA_{i,t} + \beta_2 SIZE_{i,t} + \beta_3 LEV_{i,t} + \beta_4 (ROAxLOC)_{i,t} + \beta_5 (SIZExLOC)_{i,t} + \beta_6 (LEVxLOC)_{i,t} + \beta_7 LOC_{i,t} + \beta_8 INS\_OWN_{i,t} + \beta_9 MAN\_OWN_{i,t} + \beta_{10} POL_{i,t} + \beta_{11} AGE_{i,t} + \varepsilon \qquad \text{(Model 2)}$$

Explanation:
ETR = Tax avoidance
β = Constant
ROA = Profitability
SIZE = Firm size
LEV = Leverage
LOC = Moderating variable of parent company location
INS_OWN = Control variable for institutional ownership
MAN_OWN = Control variable for managerial ownership
POL = Control variable for political connections
AGE = Control variable for firm age
i,t = Indicator for firm i and year t
ε = Error term

Hypotheses 1, 2, and 3 of this study will be tested using Model 1, while hypotheses 4, 5, and 6 will be tested using Model 2.

In this research, the dependent variable of tax avoidance is proxied by the Effective Tax Rate (ETR). ETR is considered capable of providing an accurate representation of the tax burden experienced by a company, using Generally Accepted Accounting Principles (GAAP ETR) (Hoopes et al., 2012). The ETR used here follows the calculation method in Wang et al. (2020), which is:

$$ETR = \frac{Tax\ expense}{Pre - Tax\ Income}$$

Before performing the regression, the ETR value is subtracted from 1. An increase in the ETR value indicates a higher level of tax avoidance practices.

The profitability variable uses ROA as an indicator of a company's profitability. ROA is linked to the company's net income and its liabilities (Dakhli, 2022). ROA is calculated using the following formula:

$$ROA = \frac{Net\ Income}{Total\ Assets}$$

The natural logarithm of total assets is applied as an indicator or measurement of firm size (SIZE), with firm size classification based on total assets Eddy et al., 2020). The formula for calculating SIZE is as follows:

$$SIZE = \ln\ (Total\ Assets)$$

Leverage (LEV) is used to determine whether a company's assets are primarily financed by debt or equity. If leverage is high, it indicates that the assets are largely financed by debt (Sopiyana, 2022). The formula for calculating LEV is as follows:

$$LEV = \frac{Total\ Debt}{Total\ Equity}$$

Multinational enterprises (MNEs) are characterized as companies in Indonesia that have parent companies. In subsidiary companies, direct investors maintain control. MNEs, which are more internationally diversified through the establishment of foreign subsidiaries, generally show a higher tendency for tax avoidance (Park et al., 2016).

The proxy used for this variable is a dummy variable, where a value of 1 is assigned if the parent company is located outside of Indonesia, and a value of 0 is assigned otherwise.

Institutional ownership refers to the ownership of a company's shares by institutional entities, such as pension funds, insurance companies, mutual funds, and

other investment funds. Institutional investors often have a greater influence on corporate decisions and may be more effective in overseeing management. Jenifer and Alfia (2024) define institutional ownership with the following measurement:

$$ISN\_OWN = \frac{\text{Total institutional shares}}{\text{Total share outstanding}}$$

Managerial ownership refers to the proportion of shares or equity ownership in a company held by the company's managers or executives. Jenifer and Alfia (2024) define managerial ownership using the following formula:

$$MAN\_OWN = \frac{\text{Total managerial shares}}{\text{Total shares outstanding}}$$

The control variable of political connections is used to examine the influence of government shareholding, which can affect government policies or decisions that impact a company's operations and profits. Companies with political connections tend to engage in tax aggressiveness. The aim is to minimize the risk of detection, as politicians often protect companies connected to them, thereby reducing the associated risk (Pranyoto et al., 2020). The proxy applied for this variable is a dummy variable, where a value of 1 indicates periods in which shares are held by the government, and a value of 0 indicates otherwise.

Firm age is defined as the period of time from the company's establishment or the start of its operations to a specific point in time. This variable is important because firm age can affect various aspects of company performance, such as profitability, market access, credibility, and experience in dealing with market fluctuations. Firm age is measured using the following formula:

$$AGE = Y0 - Y1$$

Description:
Y0: Year the company was founded
Y1: Year of the data

4. Results and Discussion

Table 2: Statistic descriptive

Variable	Obs	Mean	Std. Dev.	Min	Max
ETR	504	.776	.219	.195	1.387
ROA	504	.038	.122	-.583	.427
SIZE	504	12.593	1.655	6.379	16.193
LEV	504	1.276	1.817	-1.011	9.673
LOC	504	.167	.373	0	1
ROAxLOC	504	.009	.049	-.175	.427
SIZExLOC	504	2.048	4.628	0	14.793
LEVxLOC	504	.209	.873	0	9.673
INS_OWN	504	21.344	30.637	0	92.456
MAN_OWN	504	46.558	35.821	0	99.347
POL	504	.135	.342	0	1
AGE	504	29.583	15.991	6	101

Table 2 presents the descriptive statistics summary for all operational variables in the research over the 2016–2022 period. In this study, two types of variables are utilized: discrete and continuous. The first, also called dummy variables, is used for the variables LOC and POL. Meanwhile, continuous variables are used for ETR, ROA, SIZE, LEV, ROAxLOC, SIZExLOC, LEVxLOC, INS_OWN, MAN_OWN, and AGE.

According to Table 2, the average tax avoidance of companies, measured by ETR, is 0.776. The volatility of the effective tax rate in this sample ranges from 0.195 to 1.387 with a standard deviation of 0.219. It is important to note that the differences in the average of this variable may be due to variations in the research subjects used. The profitability variable, measured by return on assets (ROA), has an average value of 0.038. The volatility of ROA in this study ranges from -5.583 to 0.427, with a standard deviation of 0.122.

The firm size variable, measured by (SIZE), has an average value of 12.593, ranging from 6.379 to 16.193, with a standard deviation of 1.655. The company leverage variable, measured by (LEV), has an average value of 1.276, with values ranging from -1.011 to 9.673, and a standard deviation of 1.817. The parent company location variable (LOC) is a dummy variable, where a value of 1 indicates that the parent company is located outside Indonesia. LOC has an average value of 0.167, meaning 16.7% of the sample has parent companies located outside Indonesia, with a standard deviation of 0.373.

Table 3: Pairwise Correlation

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
(1) ETR	1.000											
(2) ROA	-0.226*	1.000										
	(0.000)											
(3) SIZE	-0.291*	0.373*	1.000									
	(0.000)	(0.000)										
(4) LEV	0.138*	-0.174*	0.079*	1.000								
	(0.002)	(0.000)	(0.076)									
(5) LOC	0.019	0.066	-0.083*	-0.005	1.000							
	(0.673)	(0.138)	(0.063)	(0.904)								
(6) ROAxLOC	-0.048	0.354*	0.068	-0.087*	0.432*	1.000						
	(0.283)	(0.000)	(0.129)	(0.050)	(0.000)							
(7) SIZExLOC	0.007	0.080*	-0.028	-0.020	0.990*	0.465*	1.000					
	(0.869)	(0.072)	(0.525)	(0.661)	(0.000)	(0.000)						
(8) LEVxLOC	0.138*	-0.035	-0.127*	0.339*	0.536*	0.055	0.501*	1.000				
	(0.002)	(0.429)	(0.004)	(0.000)	(0.000)	(0.216)	(0.000)					
(9) INS_OWN	-0.039	0.067	-0.027	-0.028	0.053	0.058	0.057	0.086*	1.000			
	(0.384)	(0.132)	(0.540)	(0.531)	(0.234)	(0.192)	(0.201)	(0.053)				
(10) MAN_OWN	0.129*	0.041	-0.224*	-0.140*	0.153*	0.083*	0.150*	0.051	-0.668*	1.000		
	(0.004)	(0.354)	(0.000)	(0.002)	(0.001)	(0.064)	(0.001)	(0.252)	(0.000)			
(11) POL	-0.208*	-0.012	0.494*	0.074*	-0.114*	-0.061	-0.102*	-0.084*	-0.107*	-0.264*	1.000	
	(0.000)	(0.784)	(0.000)	(0.096)	(0.010)	(0.172)	(0.022)	(0.060)	(0.016)	(0.000)		
(12) AGE	-0.111*	-0.004	0.201*	0.128*	-0.007	-0.010	-0.005	-0.077*	-0.070	-0.303*	0.411*	1.000
	(0.013)	(0.928)	(0.000)	(0.004)	(0.875)	(0.819)	(0.906)	(0.086)	(0.118)	(0.000)	(0.000)	
*** p<0.01, ** p<0.05, * p<0.1												

Based on the results of the Pairwise Correlation as shown in Table 3, all operational variables have absolute correlation coefficients of less than 0.8. Therefore, it is indicated that there is no multicollinearity issue in this study.

4.1   Analysis of Panel Data Regression Model Selection

For panel data model selection, three tests are conducted: the Hausman test, the Chow test, and the Lagrange Multiplier test. The Chow test is performed by running a Fixed Effect regression. If the Prob F value is significant at the 5% significance level, H0 is rejected, and thus H1 is accepted. Based on Table 4, the Prob > F value in model 1 is 0.0000, and the Prob > F value in model 2 is 0.0000, leading to the rejection of H0. Therefore, the Fixed Effect model is chosen over the Pooled OLS model.

Table 4: Chow Test

Dependent Variable	*F test that all u_i=0*	*Prob > F*	Conclusion
Model 1	F(71, 425) = 2.84	0.0000	*Fixed Effect*
Model 2	F(71, 422) = 2.83	0.0000	*Fixed Effect*

The Hausman test is conducted to select between the Random Effect and Fixed Effect models for panel data. If the Prob > chi2 value is significant at the 5% significance level, H0 is rejected. Based on Table 4, the Prob > chi2 values for both model 1 and model 2 are greater than 0.05, or not significant at the 5% significance level. Therefore, H0 is accepted, and the Random Effect model is chosen over the Fixed Effect model.

Table 5: Hausman Test

Dependent Variable	*Chi2*	*Prob > Chi2*	Conclusion
Model 1	1.30	0.9884	*Random Effect*
Model 2	1.49	0.9990	*Random Effect*

Since the results of the Hausman test indicate that the Random Effect model is more appropriate than the Fixed Effect or Pooled OLS, the Lagrange Multiplier test is not necessary.

Hypothesis testing is conducted if the F-test, or simultaneous test, yields statistically significant results. Hypothesis testing involves using the t-test to analyze the direction and significance of the impact of estimator variables on the dependent variable. The t-test is conducted at specified significance levels of 1%, 5%, and 10%.

Hypothesis testing and conclusions are drawn based on the results of the t-test (Ghozali, 2018).

Hypothesis testing is conducted using the t-test to determine the significance, direction, and effect of estimator variables on tax avoidance for each research model. The t-test is performed at specified significance levels of 1%, 5%, and 10%. The t-test results can be found in Table 6 for model 1 and Table 7 for model 2. The default t-test in Stata is a two-tailed test. This study, however, conducts a one-tailed test. Therefore, for hypothesis testing, the p-value is halved first. In each table, the significance levels for the one-tailed test are marked in the final column.

Table 6: T-test - Model 1

ETR	Coef.	St.Err	t-value	p-value	Sig (One-tailed)
ROA	-.204	.105	-1.94	.052	**
SIZE	-.023	.010	-2.23	.026	**
LEV	.019	.006	3.22	.001	***
LOC	-.010	.039	-0.26	.794	
INS_OWN	.000	.000	-0.39	.695	
MAN_OWN	.000	.000	1.35	.176	*
POL	-.068	.046	-1.48	.140	*
AGE	-000	.000	-0.25	.800	
Constant	1.034	.140	7.38	.000	***
Observations	504				
Number of Firms	72				
Random Effects?	*Firm, Year*				
Clustered Standard Errors?	*Firm*				
*** p<.01, ** p<.05, * p<.1					

Table 7: T-test - Model 2

ETR	*Coef.*	*St.Err*	*t-value*	*p-value*	*Sig (One-tailed)*
ROA	-.231	.117	-1.98	.048	**
SIZE	-.024	.011	-2.08	.038	**
LEV	.014	.006	2.16	.031	**
LOC	-.247	.314	-0.79	.431	
ROAxLOC	.167	.263	0.63	.526	
SIZExLOC	.015	.025	0.62	.533	
LEVxLOC	.027	.015	1.75	.081	**
INS_OWN	.000	.000	0.18	.856	
MAN_OWN	.000	.000	1.22	.224	
POL	-.069	.047	-1.47	.143	*
AGE	-.000	.001	-0.13	.898	
Constant	1.05	.155	6.80	.000	***
Observations	504				
Number of Firms	72				
Random Effects?	*Firm, Year*				
Clustered Standard Errors?	*Firm*				
*** p<.01, ** p<.05, * p<.1					

4.2   Profitability and Tax Avoidance

The hypothesis testing did not support the first hypothesis, which predicted that profitability, as measured by ROA, has a significant positive effect on tax avoidance; thus, the first hypothesis is rejected. Based on this empirical evidence, it can be concluded that profitability is not a factor considered by companies in tax avoidance practices. The higher a company's profitability, the lower the level of tax avoidance. Companies with high profitability tend to attract more attention from tax authorities, shareholders, and the public. Additionally, such companies are under greater pressure to comply with tax regulations to maintain their reputation and avoid penalties associated with non-compliance.

This empirical evidence aligns with the findings of Shubita (2024); Capras et al. (2024); Noviyani and Mu'id (2019), who reported a negative relationship between profitability and tax avoidance. Companies with high profitability are less likely to engage in aggressive tax avoidance, as they tend to achieve financial efficiency by adhering to regulations and managing their reputation. However, this result contrasts with the studies by Darsani and Sukartha (2021); Hamilah, (2020); Siregar, (2021); Tanjaya and Nazir, (2021), which found that high profitability is associated

with increased tax avoidance practices. These studies suggest that highly profitable companies have more resources to allocate toward tax planning, including hiring tax consultants, accountants, and legal advisors to implement complex tax avoidance strategies. Meanwhile, studies by Mulyati et al. (2019); Rahayu et al. (2023); Wahyuni et al. (2019) found no significant relationship between profitability and tax avoidance practices.

4.3   Firm Size and Tax Avoidance

The hypothesis testing did not support the second hypothesis, which predicted that firm size, as measured by SIZE, has a significant positive effect on tax avoidance; therefore, the second hypothesis is rejected. The larger the company, the lower the level of tax avoidance practices. Large companies tend to have stronger financial capabilities, allowing them to fulfill their tax obligations. This reduces the likelihood of tax avoidance, as these companies have sufficient resources to pay their taxes in full. Furthermore, large companies are often under public and governmental scrutiny, which encourages them to maintain a good reputation by complying with tax regulations.

This empirical evidence is consistent with the findings of Tanjaya and Nazir (2021), who argued that companies are more cautious when making tax-related policies or decisions, as failure to comply can lead to sanctions and reputational damage, which may harm the company. However, this result contrasts with the studies conducted by Shubita (2024); Mulyati et al. (2019); Siregar (2021); Sopiyana (2022), which found that larger companies may have the resources and complexity to engage in more sophisticated tax planning. Additionally, studies by Hamilah (2020); Noviyani and Mu'id (2019); Rahayu et al. (2023) showed that company size does not influence corporate tax avoidance behavior.

4.4   Leverage and Tax Avoidance

The hypothesis testing supports the third hypothesis, which predicted that corporate leverage, as measured by LEV, has a significant positive effect on tax avoidance; thus, the third hypothesis is accepted. This suggests that companies with higher debt levels tend to be more aggressive in avoiding taxes. One of the primary incentives for companies to incur debt is the ability to reduce taxes through interest deductions. Interest on debt is often deductible from pre-tax income, directly lowering the tax liability. Companies with high leverage incur larger interest expenses, resulting in significant tax reductions.

This empirical evidence aligns with the findings of Hamilah (2020); Mulyati et al. (2019); Noviyani and Mu'id (2019); Rahayu et al. (2023); Siregar (2021); Sopiyana (2022); Wahyuni et al. (2019), who found that increased leverage is associated with higher tax avoidance. Companies with high leverage (a high level of debt) are generally more active in tax avoidance practices compared to companies with lower leverage.

However, this finding contrasts with other studies, such as Tanjaya and Nazir (2021),

who suggested that high leverage can negatively impact a company by encouraging conservative accounting practices and increasing the risk of default, which could ultimately threaten the company's going concern. Shen et al. (2024) further noted that loans from local governments significantly lower a company's effective tax rate.

4.5 The Moderating Role of Parent Company Location on Profitabilty and Tax Avoidance

The hypothesis testing for the fourth hypothesis provides evidence that the location of the parent company does not strengthen the negative effect of profitability on tax avoidance; thus, the fourth hypothesis is rejected. Based on these results, it can be concluded that there is no difference in the impact of profitability on tax avoidance when moderated by the parent company's location. Even when the parent company is located outside Indonesia, multinational corporations can still engage in tax avoidance practices through profit shifting. Multinational companies typically have numerous subsidiaries located in various jurisdictions, enabling them to execute orders from the holding company in managing their business.

This finding aligns with Granda (2021), who identified profit shifting by examining the relationship between corporate profitability and tax incentives. This suggests that companies facing relatively higher tax rates systematically report lower profits than similar companies in lower-tax jurisdictions, thereby supporting profit-shifting behavior regardless of the location of the company.

4.6 The Moderating Role of Parent Company Location on Firm Size and Tax Avoidance

The hypothesis testing for the fifth hypothesis provides evidence that the location of the parent company does not strengthen the negative effect of firm size on tax avoidance; therefore, the fifth hypothesis is rejected. Based on these results, even if the parent company is located in a jurisdiction with different tax regulations, this does not affect the negative relationship between firm size and tax avoidance levels. Although firm size may offer cross-border tax avoidance opportunities, cross-border activities can also reduce the marginal benefits of tax avoidance due to additional exposure to foreign market risks (Chen et al., 2024).

4.7 The Moderating Role of Parent Company Location on Leverage and Tax Avoidance

The hypothesis testing for the sixth hypothesis provides evidence that the location of the parent company strengthens the positive effect of leverage on tax avoidance; therefore, the sixth hypothesis is accepted. Based on these results, it can be concluded that there is a difference in the effect of leverage on tax avoidance when moderated by the parent company's location.

Consistent with the findings of Desai and Dharmapala (2006), companies can aggressively avoid taxes by incorporating subsidiaries in tax havens to shield their foreign income from domestic corporate taxes. Companies often use intra-group

transactions, such as related-party loans from the parent company to subsidiaries, to shift profits. This practice is particularly utilized by companies with high leverage, as interest payments on intra-group loans can be used to reduce taxable income. Consequently, the location of the parent company enhances the positive effect of leverage on tax avoidance, allowing companies to aggressively optimize their global tax liabilities.

Research by Hossain and Mitra (2023), also indicates that the location of the headquarters significantly impacts a company's financial policies. Most strategic decisions are made at the parent company level, and therefore, the location of the parent company can guide the conditions of its subsidiaries. Lin et al. (2014) similarly found that companies with high profitability can directly influence the relationship between tax aggressiveness and debt levels.

5. Conclusion

Based on the tests and discussion in the previous chapter, the study found several key pieces of empirical evidence. First, profitability, as measured by ROA, negatively affects tax avoidance, suggesting that higher ROA, or more efficient profit generation from assets, decreases the likelihood of tax avoidance. Similarly, firm size, measured by SIZE, also has a negative effect on tax avoidance, indicating that larger companies are less likely to engage in tax avoidance practices. Conversely, leverage, as measured by LEV, has a positive effect on tax avoidance, implying that companies with higher leverage are more likely to avoid taxes. Additionally, the location of the parent company does not strengthen the negative effect of profitability or firm size on tax avoidance. This suggests that profitability and firm size independently influence tax avoidance, regardless of whether the parent company is located outside Indonesia. However, the location of the parent company does strengthen the positive effect of leverage on tax avoidance, indicating a difference in leverage's impact when the parent company is located abroad.

Several recommendations for future research improvements are identified. First, future research should consider adding discretionary permanent book-tax difference (DTAX) as a proxy for tax avoidance. Additionally, it is recommended to expand the data on parent company locations to include countries classified as tax havens. Extending the study period to cover more than seven years could also provide a more comprehensive understanding of the trends. Furthermore, adding control variables that influence tax avoidance would enhance the analysis. Finally, future studies could focus on specific sectors, such as manufacturing, mining, or consumer goods, to explore sector-specific tax avoidance behaviors.

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