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LEVERAGE, INSTITUTIONAL OWNERSHIP, AND FIRM SIZE ON TAX AVOIDANCE: PROFITABILITY AS A MEDIATING VARIABLE

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Abstract
This study aims to examine the effect of leverage, institutional ownership, and company size on tax avoidance with profitability as an intervening variable in energy sector manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the period 2019-2023. The population of this study includes all manufacturing companies in the energy sector, with a sample of 70 companies selected using purposive sampling techniques. This research method uses a quantitative approach with panel data regression analysis based on Eviews 12 Student Version software. The F test shows that leverage, institutional ownership, company size, and profitability simultaneously have a significant effect on tax avoidance, with an F-count value of 1.862133 and a probability value of 0.044307 ($p < 0.05$). T-test shows that leverage (t-count = 0.132247; p = 0.2688), institutional ownership (t-count = -0.639379; p = 0.5254), and firm size (t-count = 1.362275; p = 0.1790) do not have a significant effect on tax avoidance. In contrast, profitability (t-count = -3.083855; p = 0.0033) has a significant negative effect on tax avoidance. Testing with the Sobel test shows that profitability cannot mediate the effect of leverage and institutional ownership on tax avoidance. However, profitability can mediate the negative effect of firm size on tax avoidance. This finding supports the Agency Theory, which states that profitability can influence management decision making in managing tax burdens.

Keywords: Leverage, Institutional Ownership, Firm Size, Profitability, Tax Avoidance

1. Introduction

Taxation serves as a fundamental component of state revenue, playing a crucial role in financing national development, infrastructure projects, and government operations. Despite its importance, tax avoidance remains a significant challenge in Indonesia, particularly within strategic sectors such as energy. Large corporations often exploit regulatory weaknesses through mechanisms like transfer pricing and the establishment of shell corporations in low-tax jurisdictions to minimize their tax liabilities (Hariana, 2022).

A prominent case involves PT Adaro Energy Tbk, one of Indonesia's largest energy companies listed on the Indonesia Stock Exchange (IDX). According to reports from the Directorate General of Taxes (DGT), PT Adaro Energy utilized transfer pricing methods from 2009 to 2017 to shift substantial profits to tax-haven countries, resulting in an estimated tax reduction of Rp1.75 trillion (approximately $125 million) that should have been paid to the Indonesian government. This case exemplifies how capital-intensive industries, despite their significant contribution to state revenue, remain vulnerable to sophisticated tax avoidance practices.

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The urgency of this research is underscored by inconsistent findings in previous studies regarding the determinants of tax avoidance. Triana Frisila and Jaeni (2022) found that profitability negatively affects tax avoidance, while financial leverage demonstrates a positive influence. Conversely, Trias Arimurti, Devi Astriani, and Sabaruddin (2022) reported that leverage does not significantly impact tax avoidance, whereas Return on Assets (ROA) shows a positive effect. Retno Dwi Rahayu, Sri Mulyani, and Nasrullah (2024) identified positive effects of both leverage and profitability on tax avoidance, with company size exhibiting a negative influence. Meanwhile, Mohklas and Nurul Latifah Pancawardani found that institutional ownership and company size affect profitability but not necessarily tax avoidance directly. Adding to the complexity, Achmad Tjahjono, Yohanes Ambar Setyawan, and Agung Slamet Prasetyo (2022) demonstrated that while company size, institutional ownership, and profitability positively affect tax avoidance, profitability does not significantly mediate the relationship between company size/institutional ownership and tax avoidance.

These contradictory findings highlight a substantial research gap and theoretical ambiguity in understanding the mechanisms driving tax avoidance practices in Indonesia's capital-intensive sectors. Therefore, this study aims to comprehensively examine the factors influencing tax avoidance, focusing on profitability, leverage, company size, and institutional ownership within Indonesian energy companies. The research seeks to provide clarity to the existing contradictory evidence and contribute to the development of more effective tax regulatory frameworks. The findings are expected to offer valuable insights for policymakers, tax authorities, and corporate governance practitioners in addressing tax avoidance challenges.

2. Theoretical Background

2.1 Agency Theory

Agency theory explains the relationship between principals (shareholders) and agents (management) in corporate governance. According to this theory, agents are entrusted with managing company operations and making managerial decisions that should serve the principals' interests. However, in practice, agents often prioritize their personal interests, creating a conflict of interest known as moral hazard (Haryani et al., 2011). This conflict arises because management possesses superior information and may take risks that benefit themselves at the expense of shareholders. The operational implications include monitoring costs, bridging costs, and residual costs resulting from divergent decisions between principals and agents, potentially diminishing the principal's wealth (Ardiansyah, 2014). In the context of tax avoidance, agency theory suggests that management may engage in tax avoidance practices to increase reported profits and enhance their compensation, even when such practices may not align with long-term shareholder interests.

2.2 Tax Avoidance

Tax avoidance refers to legitimate efforts to reduce tax obligations by exploiting loopholes within existing tax regulations without violating the law (Puspita and Febrianti, 2017). It represents a form of tax operation management aimed at minimizing corporate tax burden through legal means (Moeljono, 2020). According to the theory of burden sharing, taxes should be proportionate to an individual's or entity's income and wealth (Hidayat and Purwana, 2017). However, disparities in tax burden distribution remain a

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significant concern for governments, particularly when corporations utilize sophisticated avoidance strategies that, while legal, may contradict the spirit of tax equity.

2.3 Hypothesis Development

2.3.1 The Effect of Leverage on Tax Avoidance

Financial leverage, measured by the ratio of company debt to capital, indicates the extent to which a company relies on external financing. Previous research demonstrates mixed findings regarding leverage's impact on tax avoidance. Studies by Putri and Rahman (2022) found that highly leveraged companies tend to engage more aggressively in tax avoidance, primarily because interest expenses from debt are tax-deductible, providing an incentive to utilize debt financing as a tax reduction strategy. This suggests that companies with substantial debt may actively pursue tax avoidance to optimize their financial structure. Therefore, the first hypothesis is proposed: *H1: Leverage has a positive effect on tax avoidance.*

2.3.2 The Effect of Institutional Ownership on Tax Avoidance

Institutional ownership represents shareholding by large institutional investors who can significantly influence management decisions. Research by Rahmawati and Fadillah (2020) indicates that institutional ownership negatively affects tax avoidance, as institutional investors typically prioritize long-term sustainability and regulatory compliance over short-term tax savings. Their substantial control over management decisions often leads to more conservative tax strategies that align with corporate governance best practices. Based on this theoretical foundation, the second hypothesis is formulated: *H2: Institutional ownership has a negative effect on tax avoidance.*

2.3.3 The Effect of Company Size on Tax Avoidance

Company size, typically measured by total assets, sales value, or market capitalization, influences a firm's approach to tax planning. Larger companies generally possess more resources and sophistication to implement comprehensive tax planning strategies (Handayani and Wulandari, 2014). However, research findings remain inconsistent. Some studies suggest that larger companies engage more actively in tax avoidance due to their greater capacity for tax planning, while others indicate that they may exhibit higher tax compliance to protect their reputation and avoid regulatory scrutiny. Thus, the third hypothesis is proposed: *H3: Company size has a significant effect on tax avoidance.*

2.3.4 The Effect of Profitability on Tax Avoidance

Profitability reflects a company's ability to generate profits from its resource management. Studies present conflicting evidence regarding profitability's relationship with tax avoidance. Research by Putri and Rahman (2020) suggests that highly profitable companies are more likely to engage in tax avoidance to maximize net profits. Conversely, Sari and Kurniawan (2020) found that profitable companies may demonstrate greater tax compliance to maintain their corporate reputation and avoid legal risks. Given these contradictory findings, the fourth hypothesis is formulated: *H4: Profitability has a significant effect on tax avoidance.*

3. Methods

3.1 Research Design

This study employs a quantitative approach with multiple regression analysis to examine the effects of leverage, institutional ownership, and company size on tax

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avoidance, with profitability as an intervening variable. The research design follows a causal-explanatory approach to establish relationships between variables and test the proposed hypotheses.

3.2 Population and Sample

The population of this study comprises all energy sector companies listed on the Indonesia Stock Exchange (IDX) during the 2019-2023 observation period. The sampling technique used was purposive sampling with the following criteria:

1) Energy sector companies consistently listed on the IDX from 2019 to 2023
2) Companies that published complete annual financial reports during the research period
3) Companies with complete data required for all variable measurements Based on these criteria, a final sample of 70 company-year observations was obtained for data analysis.

3.3 Data Collection Technique

Data were collected through documentation technique by gathering:

1) Annual financial reports from the Indonesia Stock Exchange website (www.idx.co.id)
2) Corporate governance reports and ownership structures from company annual reports
3) Tax expense and profit before tax data from financial statement notes

All collected data were verified for completeness and consistency before analysis.

3.4 Operational Definitions and Variable Measurement

The research variables are operationally defined and measured as follows:

Table 1. Variable Operationalization

Variable	Operational Definition	Indicator	Scale
Leverage	A ratio measuring the extent to which company assets are financed by debt	Debt to Equity Ratio (DER) = Total Debt / Total Equity	Ratio
Institutional Ownership	Percentage of shares owned by institutions relative to total outstanding shares	Institutional Ownership = (Number of Institutional Shares / Total Outstanding Shares) × 100%	Ratio
Company Size	A scale indicating company size	Company Size = Ln(Total Assets)	Ratio
Tax Avoidance	Taxpayers' efforts to minimize tax burden legally	Cash Effective Tax Rate (CETR) = Tax Expense / Profit Before Tax	Ratio
Profitability	Company's ability to generate profits	Return on Assets (ROA) = Net Profit / Total Assets	Ratio

3.5 Data Analysis Technique

The data analysis technique uses multiple regression analysis with path analysis to test both direct and indirect effects. The analysis models are specified as Model 1 (Intervening Variable):

$$Profitability = \alpha + \beta_1 Leverage + \beta_2 Institutional\_Ownership + \beta_3 Company\_Size + \varepsilon$$

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Model 2 (Direct and Indirect Effects):

$$Tax\_Avoidance = \alpha + \beta_1 Leverage + \beta_2 Institutional\_Ownership + \beta_3 Company\_Size + \beta_4 Profitability + \varepsilon$$

Data processing was performed using statistical software with a significance level of 5% (α = 0.05). Classical assumption tests including normality, multicollinearity, heteroscedasticity, and autocorrelation were conducted to ensure the validity of regression results.

4. Results and Discussion

4.1 Panel Data Regression Model Selection

To determine the appropriate estimation model for panel data regression, two statistical tests were conducted. Table 2 presents the results of the model selection tests.

Table 2. Panel Data Regression Model Selection Results

Test	Probability Value	Critical Value	Selected Model
Chow Test	0.0458	0.05	Fixed Effect Model
Hausman Test	0.0083	0.05	Fixed Effect Model

Source: Processed research data, 2024

The Chow test yielded a probability value of 0.0458, which is lower than the 0.05 significance level, indicating that the Fixed Effect Model (FEM) is more appropriate than the Common Effect Model (CEM). Similarly, the Hausman test produced a probability value of 0.0083, confirming the superiority of the Fixed Effect Model over the Random Effect Model. Consequently, the Fixed Effect Model was selected for all subsequent analyses.

4.2 Panel Data Regression Analysis

The multiple linear regression analysis using the Fixed Effect Model produced the following equation:

$$CETR = -2.928 + 0.0077*DER - 0.0039*KI + 0.1908*SIZE - 0.0095*ROA + \varepsilon$$

Where:

CETR = Cash Effective Tax Rate (Tax Avoidance)
DER = Debt to Equity Ratio (Leverage)
KI = Institutional Ownership
SIZE = Company Size (Ln Total Assets)
ROA = Return on Assets (Profitability)
ε = Error term

4.3 Hypothesis Testing (T-Test)

Table 3 presents the results of the partial hypothesis testing (T-test) for each independent variable.

Table 3. T-Test Results for Hypothesis Testing

Hypothesis	Variable	Coefficient	t-statistic	p-value	Result
H1	Leverage	0.0077	0.132	0.269	Not Supported
H2	Institutional Ownership	-0.0039	-0.639	0.525	Not Supported
H3	Company Size	0.1908	1.362	0.179	Not Supported
H4	Profitability	-0.0095	-3.084	0.003	Supported

Source: Processed research data, 2024

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4.3.1 The Effect of Profitability on Tax Avoidance (H4)

The results indicate that profitability (ROA) has a significant negative effect on tax avoidance (β = -0.0095, t = -3.084, p = 0.003). This finding supports agency theory, suggesting that highly profitable companies tend to avoid aggressive tax avoidance strategies to maintain their reputation and avoid legal sanctions. This finding aligns with Rahmawati and Fadillah (2020) but contradicts Prasetyo and Sari (2020), potentially due to differences in sample characteristics and regulatory environments.

4.3.2 The Effect of Leverage on Tax Avoidance (H1)

Leverage demonstrates an insignificant positive relationship with tax avoidance (β = 0.0077, t = 0.132, p = 0.269). This contradicts Putri and Rahman (2022) but supports Sari and Kurniawan (2022), indicating that companies in the sample may not utilize debt-related tax shields aggressively for tax avoidance purposes.

4.3.3 The Effect of Institutional Ownership on Tax Avoidance (H2)

Institutional ownership shows an insignificant negative relationship with tax avoidance (β = -0.0039, t = -0.639, p = 0.525). This finding differs from Rahmawati and Fadillah (2020), suggesting that institutional investors in the sample may prioritize other corporate objectives over tax optimization.

4.3.4 The Effect of Company Size on Tax Avoidance (H3)

Company size exhibits an insignificant positive relationship with tax avoidance (β = 0.1908, t = 1.362, p = 0.179). This contradicts Hidayat and Wahyuni (2021), possibly because larger companies in the sample face greater regulatory scrutiny, limiting their tax avoidance activities.

4.4 F-Test and Coefficient of Determination

The F-test results (F-statistic = 1.862, p = 0.044) indicate that the independent variables jointly significantly affect tax avoidance. The Adjusted R-squared value of 0.175 suggests that 17.5% of the variation in tax avoidance is explained by the model, while the remaining 82.5% is attributable to other factors not included in the model.

4.5 Sobel Test for Mediation Analysis

Table 4 presents the results of the Sobel test for mediation effects through profitability.

Table 4. Sobel Test Results for Mediation Analysis

Mediation Path	Sobel Statistic	p-value	Result
Leverage → Profitability → Tax Avoidance	-0.522	0.601	No Mediation
Institutional Ownership → Profitability → Tax Avoidance	1.032	0.302	No Mediation
Company Size → Profitability → Tax Avoidance	-2.611	0.009	Full Mediation

Source: Processed research data, 2024

The Sobel test reveals that profitability fully mediates the relationship between company size and tax avoidance (z = -2.611, p = 0.009). This indicates that larger companies' tax avoidance behavior is channeled through their profitability levels. However, profitability does not mediate the relationships between leverage or institutional ownership and tax avoidance.

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4.6 Discussion

4.6.1 Theoretical Implications and Empirical Findings

The empirical results of this study reveal several theoretically significant patterns in tax avoidance behavior. The most prominent finding concerns the significant negative relationship between profitability and tax avoidance (β = -0.009504, p = 0.0033), which provides strong support for agency theory. This finding suggests that highly profitable companies, contrary to conventional wisdom, tend to be more tax-compliant. This phenomenon can be explained through the reputational capital perspective - profitable companies have more to lose from engaging in aggressive tax planning that might attract regulatory scrutiny and damage stakeholder trust (Desai & Dharmapala, 2006). The substantial profits already generated reduce the marginal benefit of tax avoidance while increasing potential reputational costs.

The non-significant relationship between leverage and tax avoidance (β = 0.007655, p = 0.2688) presents a theoretical puzzle. While traditional tax shield theory suggests that debt-heavy companies should aggressively pursue tax avoidance to maximize interest deductions, our findings align with more recent research indicating that highly leveraged firms may actually avoid aggressive tax positions due to increased monitoring from creditors and credit rating agencies (Graham et al., 2014). This heightened scrutiny creates a disciplinary mechanism that discourages tax avoidance behavior despite the apparent tax shield benefits.

4.6.2 The Institutional Ownership Paradox

The lack of significant effect of institutional ownership on tax avoidance (β = -0.003896, p = 0.5254) contradicts conventional agency theory predictions. This "institutional ownership paradox" can be explained through the heterogeneous preferences of institutional investors. While some institutions may pressure management for tax efficiency, others - particularly long-term oriented investors - may prioritize regulatory compliance and reputational stability over short-term tax savings (Chen et al., 2019). The net effect appears to be neutral, suggesting that institutional ownership's impact on tax avoidance is more complex than previously theorized.

4.6.3 The Mediating Role of Profitability

The Sobel test results reveal a crucial mediating mechanism: profitability fully mediates the relationship between company size and tax avoidance (p = 0.00903). This finding suggests that larger companies do not directly influence tax avoidance behavior; rather, their impact is channeled through profitability. This mediation effect supports the resource-based view of the firm, where larger companies' superior resources and capabilities generate higher profitability, which in turn influences tax strategy decisions (Armstrong et al., 2015). The full mediation indicates that company size alone is insufficient to predict tax avoidance without considering profitability levels.

4.6.4 Contextualizing Within Emerging Markets

The pattern of results must be interpreted within the context of emerging markets, where institutional environments differ significantly from developed economies. The combination of weak legal enforcement and strong political connections in many emerging markets creates a unique institutional logic that shapes corporate tax behavior (Atwood et al., 2012). Our findings suggest that in such environments, profitable firms

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may choose tax compliance as a legitimacy-seeking strategy to offset institutional voids and build political capital.

4.6.5 Reconciling Contradictory Findings

The contradictory results compared to previous studies can be reconciled through several theoretical lenses. First, the evolving global tax governance landscape, particularly the Base Erosion and Profit Shifting (BEPS) initiatives, has fundamentally altered the cost-benefit calculus of tax avoidance (OECD, 2015). Second, sample period differences matter - post-2020 studies likely capture firms' responses to increased tax transparency demands and stakeholder activism. Third, sectoral characteristics of the sampled companies may explain variations, as service and financial sectors face different regulatory pressures compared to manufacturing or extractive industries.

4.6.6 Practical Implications for Corporate Governance

The findings suggest that corporate boards should view tax strategy through a broader governance lens rather than purely as a financial optimization problem. The negative profitability-tax avoidance relationship indicates that tax compliance can be a value-enhancing strategy when balanced against reputational risks and stakeholder expectations. This aligns with emerging concepts of "tax citizenship" where corporations acknowledge their role in supporting public finances (Dowling, 2014).

The study's limitations provide directions for future research, including the need to examine nonlinear relationships, consider country-level institutional differences, and explore the role of corporate culture and ethical leadership in tax decision-making.

5. Conclusion

This study yields several key findings regarding the determinants of tax avoidance in the sampled companies:

1) Leverage demonstrates no significant effect on tax avoidance ($\beta = 0.007655$, $p = 0.2688$). This indicates that variations in corporate debt levels do not systematically influence tax avoidance strategies, suggesting that companies do not primarily utilize leverage as a mechanism for tax planning.
2) Institutional ownership shows no significant impact on tax avoidance ($\beta = -0.003896$, $p = 0.5254$). This finding implies that the presence of institutional investors does not necessarily lead to more aggressive or conservative tax positions, challenging conventional assumptions about institutional monitoring effects.
3) Company size exhibits no direct significant effect on tax avoidance ($\beta = 0.190803$, $p = 0.1790$). However, the mediation analysis reveals a more nuanced relationship, indicating that size influences tax avoidance indirectly through profitability.
4) Profitability demonstrates a significant negative effect on tax avoidance ($\beta = -0.009504$, $p = 0.0033$). This robust finding supports agency theory predictions that highly profitable companies tend to avoid aggressive tax planning to protect reputational capital and minimize regulatory risks.

The mediation analysis provides crucial insights into the complex relationships between corporate characteristics and tax avoidance:

1) The Sobel test confirms that profitability fully mediates the relationship between company size and tax avoidance ($p = 0.00903$). This indicates that larger companies' tax behavior is primarily channeled through their profitability levels, with more profitable large firms exhibiting greater tax compliance.

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2) Conversely, profitability does not mediate the relationships between leverage and tax avoidance ($p = 0.60132$) or institutional ownership and tax avoidance ($p = 0.30203$), suggesting these variables operate through different mechanisms or lack substantial influence on tax avoidance decisions.

The simultaneous significance test (F-test: $p = 0.044307$) confirms that the combined effect of all independent variables significantly influences tax avoidance, though the modest coefficient of determination (Adjusted $R^2 = 0.175196$) indicates that substantial variance remains unexplained by the current model.

From a theoretical perspective, these findings contribute to the evolving understanding of tax avoidance determinants in emerging markets, particularly highlighting the primacy of profitability over traditional factors like leverage and ownership structure. The results suggest that corporate tax behavior is influenced more by reputational considerations and risk management than by straightforward financial optimization.

For practitioners and policymakers, the findings indicate that regulatory focus might be most effective when directed toward understanding how profitability levels interact with corporate tax strategies, rather than assuming that larger or more leveraged firms necessarily engage in more aggressive tax planning.

This study's limitations, including the 17.52% explanatory power and specific sample characteristics, suggest opportunities for future research. Subsequent studies could incorporate additional variables such as corporate governance mechanisms, managerial incentives, and country-level institutional factors to enhance explanatory power. Longitudinal designs examining how these relationships evolve over time would also provide valuable insights into the dynamic nature of corporate tax avoidance behavior.

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