

# **The Influence of Profitability, Leverage, and Institutional Ownership on Tax Avoidance (Study on Manufacturing Companies Listed on the Indonesia Stock Exchange (IDX in 2017-2020)**

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## **Abstract**

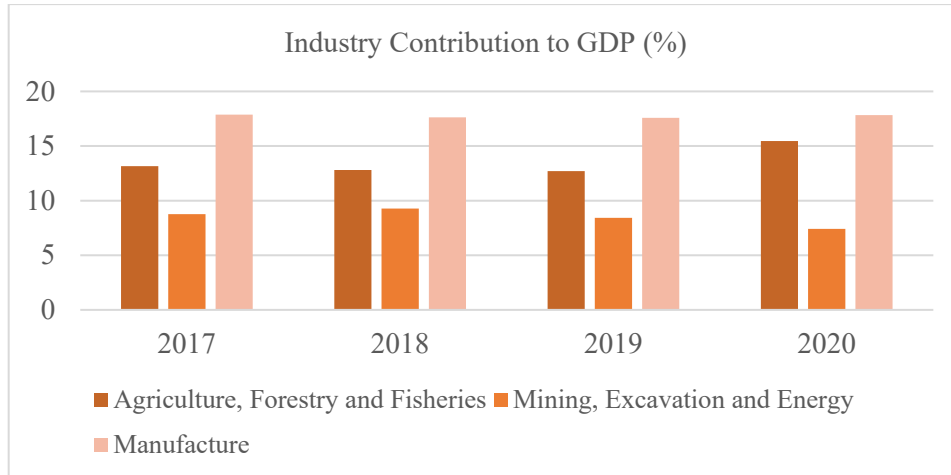
Tax is an important instrument for state to fund the development and were a great source of state than non-tax revenues and grants with a total contribution up to 80%. However, it never changed for 2017-2020 even the tax revenues are more like decreased. The decreased of tax revenues indicated by tax avoidance that entities conducting and at last result in losses as much as 67,7 trillion rupiah. The purpose of this paper was to investigate the influence of profitability, leverage, and institutional ownership on tax avoidance practices by manufacturing companies during 2017-2020. Manufacture companies be the object of this research because of their functional as backbone, give multiplier effect, and has large proportionated companies listed in Indonesia Stock Exchange. The study conducted samples were selecting using purposive sampling. Study samples that met acceptance criteria consisted of 39 firms. The unit of analysis in this study was 156, which was based on the 39 firms that met acceptance criteria multiplied by the the observation period of four years. The investigated technique by applying panel data regression analysis. The results of this research were determined in random effect model. The result from this study demonstrated that profitability, leverage, and institutional ownership on tax avoidance have a significant simultaneous effect. Partial testing shows there is a negative impact of profitability on tax avoidance whereas leverage and institutional ownership had no significant effect on the manufacturing companies.

## **Keywords**

*Backbone, Profitability, Leverage, Institutional Ownership, Tax Avoidance*

## **1. Introduction**

The manufacturing industry is a sector that contributes greatly to the Indonesia economy in terms of Gross Domestic Product. This means, it can be assumed that the manufacturing sector is considered as one of the sectors that contributes to taxation. The Minister of Industry also referred to the manufacturing industry as the backbone industry for other sectors (Kontan, 2020). Aside being the backbone of the economy, the manufacturing industry also has a multiplier effect (Kontan, 2018). The infrastructure and property sector requires the role of the basic industry and chemical sub-sector in the manufacturing industry and human activities require the chemical and consumer goods sub-sector in the manufacturing industry. If these primary needs are met, the economy will develop. The economy of a country grows if there is an increase in the activity of producing goods and services so that it can increase people's income. The manufacturing industry is a sector that has a major contribution to the Indonesia economy as measured by GDP. The following is the contribution of each industry to GDP:

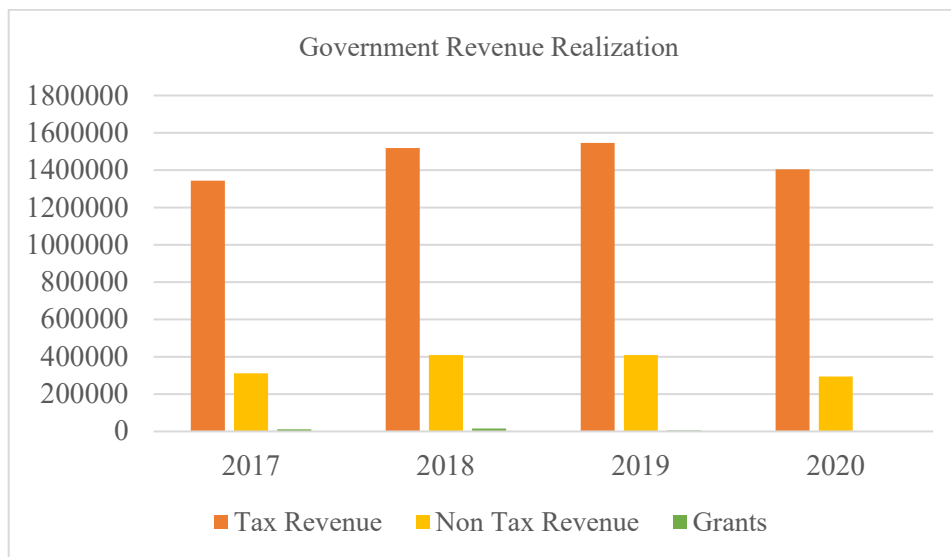


*Source: Indonesia Central Statistics Agency, (data processed by the author)*

Figure 1. Contribution of Each Industry to GDP

Based on Figure 1, the manufacturing industry provides the largest contribution to GDP when compared to the other two sectors. It can be assumed that the tax expense of companies will be greater due to greater the contribution to GDP. Greater expense will trigger the company to minimize the expense, which will result in risk of tax avoidance by looking for loopholes in tax regulations.

Tax is a mandatory contribution of a person or business entity to the government which are coercive. Tax is an instrument used by the state to finance the nation’s development and is the largest source of state revenue when compared to non-tax revenues and grants. The portion of state revenue originating from taxes and non-taxes can be seen as follows:

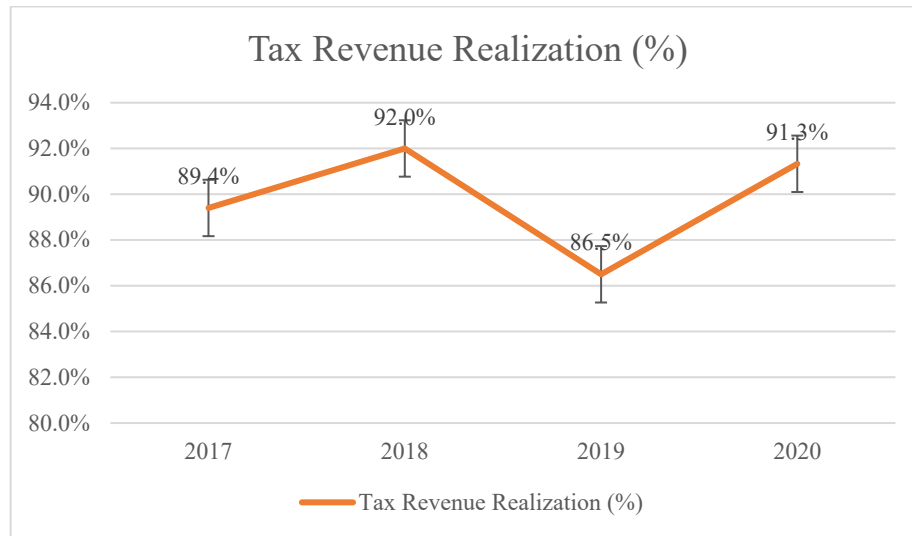


*Source: Indonesia Central Statistics Agency, (data processed by the author)*

Figure 2. Government Revenue Realization

Based on Figure 2 above, the largest portion of government revenue comes from taxes compared to non-tax revenues and grants. The amount of tax revenue grew from 2017-2019 and then decreased in 2020. This illustrates that tax revenue is the most important source of financing for the country because of its large amount.

However, tax performance in Indonesia has never been assessed optimally. As stated by Permata et al. (2018), Indonesia tax ratio is in the range of 11% (tax revenue compared to GDP) thus placing Indonesia in the ranks of ratios that have low tax revenue realization performance. This ratio is still far from the realization of tax revenue, which is obtained by the developed country group in the range of 24-26%. Even the collectability was never up to the mark. Until 2020, the realization of tax revenue in Indonesia is still around 80-90%.



*Source: Ministry of Finance, (data processed by the author)*

Figure 3. Tax Revenue Realization

The failure to achieve the realization of tax revenue from the target based on Figure 3 indicates a difference in interests between taxpayers as tax objects and the government or tax avoidance. Tax avoidance is all forms of activities carried out by tax objects to reduce taxes in a legal way (not violating the law) by taking advantage of weaknesses (grey areas) contained in tax regulations (Alkurdi and Mardini 2020). According to the Tax Justice Network report, it is stated that business entities are the largest contributor to tax loss cases with a total of 67.6 trillion in comparison to private taxpayers who contributed 1.1 trillion losses (Fatimah 2020). One of the industries indicated as the largest contributor to tax avoidance cases is manufacturing, with several major cases being carried out by Astra International carrying out transfer pricing of 2 trillion. Another case is the case of tax avoidance committed by PT. Bentoel Internasional Investama, Tbk which carried out thin capitalization by taking loans from affiliated companies to refinance bank loans, purchase machinery, and work equipment. The loan facility provided to RMBA by overseas affiliated companies is Rp 5.3 trillion. The loan made the company report an increase in net loss of 27.3% (Kontan.co.id, 2019). The existence of the interest expense on the loan reduces the taxable income received by the RMBA.

There are three variables related to tax avoidance, namely profitability, leverage, and institutional ownership. Every year the company has a projected profit that can be generated by referring to historical data and business collaborations that have been carried out with various buyers. This profit will affect the tax expense that must be paid to the government. The greater the profit earned by the company, the potential tax expense to be paid also increases, while the company wants its profits to increase. Therefore, the company will try to minimize its expense including the tax expense by looking for loopholes in tax regulations so that it may result in the potential to cause tax avoidance. Leverage has the nature of a trigger where companies can generate profits without having to wait for their own capital but can take loans. Leverage can be used as a strategy to reduce tax payments. With loans, companies have additional expense in the form of loan principal and loan interest. The principal and interest on the loan can then be deducted from taxable income. Business entities generally have relatively stronger funds than retail so that they can guarantee companies to comply with tax regulations.

## **1.1 Objectives**

The goal of this research is to find out the influence of Profitability proxied by Return on Asset (ROA), Leverage proxied by Debt to Assets Ratio (DAR), and Institutional Ownership on Tax Avoidance proxied by Cash Effective Tax Rate (CETR) in manufacturing companies recorded on the Indonesia Stock Exchange (IDX) in 2017-2020.

## **2. Literature Review**

### **2.1 Agency Theory**

Agency theory is a conflict of interest between the principal-agent or company owner and the manager (Surnawijaya, 2017). In addition, agency theory can also occur between the government as the principal and the company as the agent. In the context of this study, agency conflicts have the potential to occur between the government and the company. The government considers taxes as one of the state's revenues, while companies consider taxes as an expense. As a source of revenue, the government wants large and increasing tax revenues, while companies as tax objects try to suppress their tax payments to reduce the company's expense, one of which is by taking advantage of loopholes or weaknesses or unclear regulations in tax regulations so that it is categorized as tax avoidance. The difference in interests will lead to an agency conflict.

### **2.2 Tax Avoidance**

According to Pohan (2018), tax avoidance is an effort that is carried out legally and safely for taxpayers without conflicting with applicable tax provisions where the methods and techniques used are by exploiting weaknesses or gray areas of the law by reducing the amount of the tax expense. Tax avoidance can be interpreted as an act of reducing taxes but looking for weaknesses in the tax regulations (Dewi and Noviyari 2017). In addition, according to Dewanti and Sujana (2019), tax avoidance is an effort to reduce the tax payable that is legal and safe for taxpayers. Based on these three definitions, it can be concluded that tax avoidance is an effort to reduce the tax payable, but still within the rules or not violating the applicable laws and regulations.

### **2.3 Profitability**

Profitability is a picture used to measure the effectiveness of management in general which can be seen from the large or small level of profits obtained in relation to sales and investment (Ariska et al. 2020). Based on the definition above, it can be concluded that profitability is the level of the company's ability to generate profits. Profitability in addition to having a purpose to determine the company's ability to generate profits during a certain period, is also used to measure how effective the company's management is in managing operations. Profitability is a ratio that describes the level of the company's ability to generate profits based on all available resources. Measurement of profitability can be done by comparing the various elements contained in the income statement or balance sheet. This analysis of profitability allows management to be more effective in implementing improvement and efficiency measures, as well as comparing with predetermined targets or can be compared with industry level averages.

### **2.4 Leverage**

Leverage according to Kasmir (2016) is the ratio used to measure the extent to which the company is financed by debt. According to Sugiono and Untung (2016) leverage is the company's ability to pay interest and other fixed expenses. Leverage shows how assets as the use of company capital are financed by debt (Dewinta and Setiawan 2016). A different perspective is shown by Dewanti and Sujana (2019) which states that leverage is the composition of the company's debt. This means that the composition of the debt can be compared with various other factors, not only assets or the use of the company's overall capital but can also be compared with the company's personal capital or with others. Based on the four definitions above, it can be concluded that leverage can be understood as the composition of debt in a company.

### **2.4 Institutional Ownership**

Institutional ownership is one of the factors that can monitor management behavior, and this provide good benefits for the company. In terms of tax avoidance, institutional ownership has control over the taxes paid. Institutional ownership translates their existence by making companies focus on company policies. According to Alkurdi and Mardini (2020), institutional ownership is the portion of share ownership owned by a business entity. Mayara and

Yendrawati (2016) stated that share ownership by the government, financial institutions, legal entities, foreign institutions, and other trust funds. Institutional ownership is share ownership owned by various institutions such as insurance, investment companies, banks, and other institutions (Sandy and Lukviarman 2015).

### 3. Methods

This study uses quantitative methods. The analytical method used is panel data regression analysis. The hypothesis in this study was tested using EViews software. The population in this study are manufacturing companies listed on the Indonesia Stock Exchange (IDX) from 2017 to 2020. This study uses purposive sampling, which is a sampling method with considered criteria. This study uses several criteria, namely:

- (1) Manufacturing companies listed on the IDX until 2020.
- (2) Manufacturing companies that are consistently listed on the IDX from 2017-2020.
- (3) Manufacturing companies present financial statements using Rupiah currency.
- (4) Manufacturing companies with complete financial statements from 2017-2020.
- (5) Manufacturing companies that did not experience losses in the 2017-2020 accounting period.
- (6) Manufacturing companies that have a CETR value less than 1.
- (7) Manufacturing companies that present all the necessary data.

Based on the sample criteria, the number of samples used in this study were 39 manufacturing companies listed on the Indonesia Stock Exchange with a period of 4 years. Based on the research objectives mentioned in the previous section, to complete the analysis, regression data panels were used. Based on panel data analysis using EViews software, the hypotheses to be used are as follows:

- H1 : Profitability, leverage, and institutional ownership simultaneously have a significant effect on tax avoidance in manufacturing companies listed on the IDX for the 2017-2020 period.
- H2 : Profitability has a significant and positive effect on tax avoidance in manufacturing companies listed on the IDX for the 2017-2020 period.
- H3 : Leverage has a significant and positive effect on tax avoidance in manufacturing companies listed on the IDX for the 2017-2020 period.
- H4 : Institutional Ownership has a significant and negative effect on tax avoidance in manufacturing companies listed on the IDX for the 2017-2020 period.

#### 3.1 Variable Measurement

To test the hypothesis above, this research needs a measurement for each variable. Table 1 shows the measurement variables that used in this research with ratio scale.

Table 1. Research Variable

Variable	Information	Measurement
<b>Dependent Variable</b>		
Tax Avoidance	Efforts are made legally and safely for taxpayers without conflicting with the tax provisions used by exploiting weaknesses or gray areas of the law by reducing the amount of tax owed (Pohan 2018). The Cash ETR is computed using cash taxes paid in the numerator and is affected by tax deferral strategies but is not affected by changes in the tax accounting accruals. (Hanlon and Heitzman 2010)	$CETR = \frac{\text{Cash taxes paid}}{\text{Earnings Before Tax}}$
<b>Independent Variable</b>		
Profitaability	The picture used to measure the effectiveness of management in general can be seen from the large or small level of profits obtained in relation to sales and investment (Ariska et al. 2020).	$ROA = \frac{EAT}{\text{Total Asset}}$

Leverage	The ratio used to measure the extent to which the company is financed by debt (Kasmir 2016).	$DAR = \frac{Total\ Debt}{Total\ Asset}$
Institutional Ownership	In terms of tax avoidance, institutional ownership has control over the taxes paid. Institutional ownership translates their existence by making companies focus on company policies. Portion of share ownership owned by business entities (Alkurdi and Mardini 2020)	$IO = \frac{Institutsional\ Ownership}{\sum Shares\ outstanding}$

#### 4. Data Collection

The type of data used in this study is secondary data. All of data is collected from financial statements and company's annual reports accessed on the Indonesia Stock Exchange (IDX) website or company's website, statistical data collected from the Central of Statistics Agency Indonesia.

#### 5. Results and Discussion

##### 5.1 Numerical Results

Table 2. Descriptive Statistical Analysis

Information	Tax Avoidance	Profitability	Leverage	Ownership Institutional
Mean	25.8247	10.5184	38.8630	74.933321
Maksimum	87.48	52.67	83.18	99.71000
Minimum	3.35	0.29	8.31	21.40000
Std. Dev	11.20777	9.69697	18.179698	16.8657881
Observation	156	156	156	156

Table 2 shows descriptive statistic analysis to describe the tax paid by manufacturing companies listed on the IDX from the period 2017-2020 is 25.82%. The company indicated did not engage in tax avoidance was Mulia Industrindo in 2019 at 87.48%. The company indicated for tax avoidance was Indocement Tunggal Prakarsa in 2019 at 3.35%. Tax avoidance is the act of reducing the amount of tax payments by exploiting the weaknesses of tax regulations. The average ROA value of manufacturing companies listed on the IDX for the 2017-2020 period is 10.52% per year. The company that earned the largest profit in the manufacturing sector was Multi Bintang Indonesia in 2017 with 52.7% of ROA, while the company that earned the smallest profit was Indal Aluminum Industry 2019 with 2.9% of ROA. The total portion of debt in the assets of manufacturing companies listed on the IDX in the 2017-2020 period is 38.86%. The company that has the largest debt level is Merck Sharp Dohme Prima in 2017 with a portion of 83.18%, while the company that has the smallest debt level is the Sido Muncul Herbal and Pharmaceutical Industry in 2017 with a portion of 8.31%. The average institutional ownership in manufacturing companies in the 2017-2020 period is 74.93%. The largest institutional ownership is in the Fajar Surya Wisesa company with a portion of 99.71%. In addition, the company that has the smallest institutional ownership is Ultrajaya Milk Industry & Trading Company with 21.4%. Based on the mean and standard deviation of all variables, it can be concluded that all of data is less varied, because the standard deviation is smaller than the mean.

Analysis of the panel data regression model was used to identify the best panel data regression model. The options for these are common effect model (CEM), random effect model (REM), or fixed effect model (FEM).

Table 3. Chow Test on a Panel Data Regression Model

Redundant Fixed Effects Tests  
Equation: Untitled  
Test cross-section fixed effects

Effects Test	Statistic	d.f.	Prob.
Cross-section F	2.577183	(38,114)	0.0001
Cross-section Chi-square	96.731169	38	0.0000

Based on the Table 3 above, the cross-sectional chi-square value is 0.000 less than 0.05, which means that the fixed effect model is better used for the research model than the common effect model. Due to the value less than 0.05, this model is continued using the Hausman test because it is used to determine the best model between fixed effects or random effects.

Table 4. Hausman Test on a Panel Data Regression Model

Correlated Random Effects - Hausman Test  
Equation: Untitled  
Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	5.486862	3	0.1394

Based on the Table 4 above, the value of the random cross section is  $0.139 > 0.05$ . This means the random effect mode is the best model to use in this research and continue with the Lagrange multiplier test to choose the common effect model or random effect model.

Table 5. Lagrange Multiplier Test on a Panel Data Regression Model

Lagrange multiplier (LM) test for panel data

Null (no rand. effect) Alternative	Cross-section One-sided	Period One-sided	Both
Breusch-Pagan	14.23159 (0.0002)	0.466305 (0.4947)	14.69790 (0.0001)
Honda	3.772478 (0.0001)	-0.682865 (0.7527)	2.184686 (0.0145)
King-Wu	3.772478 (0.0001)	-0.682865 (0.7527)	0.363051 (0.3583)
GHM	-- --	-- --	14.23159 (0.0003)

Based on Table 5 above the one-sided cross section value is indicated by several 0.000 where the value is less than 0.05. So, the Lagrange Multiplier Test shows that the best estimation method is Random Effect Model.

Table 6. Regression Data Panel Result

Cross-section random effects test equation:  
 Dependent Variable: TAX\_AVOIDANCE  
 Method: Panel Least Squares

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.202640	0.186717	1.085276	0.2801
PROFITABILITAS	-0.422671	0.161385	-2.619015	0.0100
LEVERAGE	-0.018067	0.138675	-0.130283	0.8966
KEPEMILIKAN_INSTITUSIONAL	0.001429	0.002201	0.649569	0.5173

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Effects Specification

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Cross-section fixed (dummy variables)

R-squared	0.492327	Mean dependent var	0.258247
Adjusted R-squared	0.309742	S.D. dependent var	0.112078
S.E. of regression	0.093116	Akaike info criterion	-1.685135
Sum squared resid	0.988450	Schwarz criterion	-0.864020
Log likelihood	173.4405	Hannan-Quinn criter.	-1.351633
F-statistic	2.696435	Durbin-Watson stat	3.107810
Prob(F-statistic)	0.000019		

Based on the Table 6 above, profitability (ROA), leverage (DAR) and institutional ownership have an effect of 49.23% on tax avoidance (CETR), while the remaining 50.77% is influenced by other variables not included in this study. This study's panel data regression equation is as follows:

$$\text{CETR} = 0,203 - 0,423(\text{XI}) - 0,018(\text{X2}) + 0,0014(\text{X3}) + \varepsilon$$

## 5.2 Validation

### The Effect of Profitability, Leverage, and Institutional Ownership on Tax Avoidance

Based on the results of tests that have been completed, it shows probability F Statistics value (Prob F statistics) using a random effect model is 0.000000, is less than 0.05 (significant value). This result in H0 being rejected, and H1 is accepted. The result demonstrated that simultaneously, profitability, leverage, and institutional ownership have a significant effect on tax avoidance. This means that these three components can be used together in the context of tax avoidance. The significant results in this study illustrate the indications that tax avoidance in manufacturing companies can be influenced by the company's management activities in profitability, the proportion of debt, and the portion of institutional ownership.

### The Effect of Profitability on Tax Avoidance

Based on Table 6 profitability has a coefficient value of -0.422 and a probability value of 0.01 less than 0.05 (significant value). This result in H0 being rejected, and H2 is accepted, which means that profitability has a significant and negative effect on CETR. If CETR decrease, then tax avoidance will increase, which means profitability has a positive effect on tax avoidance on Manufacturing Companies listed in Indonesia Stock Exchange 2017-2020. These results are supported by research conducted by Dewinta and Setiawan (2016) which states that profitability has a significant effect on tax avoidance, and in correlation this study agrees with the results contained in Dewinta and Setiawan (2016) research, which is negative. That is, the higher the profit that will be obtained by the company, the higher the tendency to do tax avoidance. These results are consistent with descriptive data on tax rates. If the tax rate uses the number 22%, then the level of tendency for manufacturing companies to pay a minimum tax of 22% is 63% and decreases to 47% if the rate is 25%.



### **The Effect of Leverage on Tax Avoidance**

Based on Table 6 if leverage has a coefficient value of -0.018 and a probability value of 0.897 greater than 0.05 (significant value). This result in H0 being accepted, and H3 is rejected, this means that leverage has no significant and negative effect on tax avoidance in manufacturing companies listed on the Indonesia Stock Exchange in 2017-2020. The act of involving debt on the company's capital can reduce tax payments because the company has an additional expense of paying debts. The involvement of debt in the source of capital is legal and it is difficult to detect whether it is the company's needs or intentional tax avoidance. However, with regression testing in this study, the amount of debt has a relationship with tax avoidance by manufacturing companies. The results in this study refute the research conducted by Triyanti et al. (2020) which states that leverage has a significant effect on tax avoidance where the presence of a tax expense can reduce taxable income. This study is in line with research by Assalam and Pratomo (2020) which states that leverage has no significant effect on tax avoidance. In terms of correlation, this study has different results with the research of Triyanti, et al. (2020) which states the results are positive. This result is evidenced by a descriptive analysis where the average debt level of companies indicated by tax avoidance less than 22% has a debt portion of 12.99%, then if the rate increases to more than 25%, the proportion of debt manufacturing companies becomes 19,14%,

### **The Effect of Institutional Ownership on Tax Avoidance**

Based on Table 6, institutional ownership has a coefficient value of 0.0014 with a probability value of 0.517 more than 0.05 (significant value). This result in H0 being accepted, and H4 is rejected, which means that institutional ownership has no significant and positive effect on tax avoidance. Research conducted by Praditasari & Setiawan (2017) is refuted by this study which shows results where institutional ownership has no significant and positive effect on tax avoidance. Business entities or institutions generally have stronger finances than individuals. With stronger resources, the ability to control the activities of the company's management will also be better, including in asking management to report financial statements correctly so that they can give control to the company to comply with tax regulations and prevent company management from avoiding tax. This result is evidenced by a descriptive analysis where the average company with no indication of tax avoidance (> 22%) has an institutional ownership of 96.78%, while the average company with an indication of tax avoidance (< 22%) has an institutional ownership of 55, 03%. Because institutional ownership does not have a significant effect (although it has a role) it can be seen if the corporate income tax rate increases to 25%, where companies that are indicated to be tax compliant have institutional ownership of 73.75%, but institutional ownership in companies that do not comply (< 25%) of 78.06%.

## **6. Conclusion**

This study analyzes the effect of profitability, leverage, and institutional ownership on tax avoidance of manufacturing companies recorded on the Indonesia Stock Exchange (IDX) in 2017-2020. The results found in this study are that profitability, leverage and institutional ownership simultaneously have an impact on the tax avoidance of manufacturing companies recorded on the Indonesia Stock Exchange (IDX) in 2017-2020, while partially leverage and institutional ownership have no effect on tax avoidance, but profitability has a negative impact on tax avoidance. This research is anticipated to add to the existing literature. The authors suggest for further researchers who will use the dependent variable of tax avoidance, it is recommended to use other independent variables such as earnings management, managerial ownership, fixed asset intensity, sales growth, and others. Further researchers can increase the research period and use other industrial sectors. Through this research, it can be a reference for the Directorate General of Taxes where companies with higher profitability will have higher indications of tax avoidance. For the company, it is better not to take advantage of high profitability to avoid tax because it has the potential to get sanctions in the future which will cost the company. For investors, it is better to consider companies with large profits because companies with large profits will tend to avoid tax which can affect the potential sanctions that will be received by the company. In addition, it can be combined with considering companies with high institutional ownership because it can help monitor management performance.

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## **Biography**

**Ardan Gani Asalam** is graduated from Telkom University with a Bachelor of Accounting degree in 2014 and received a master's in accounting from Padjajaran University in 2017. He currently serves as Secretary of the Master of Management Study Program as well as a lecturer in Accounting Study Program at Telkom University Bandung, Indonesia. His expertise is in the field of Taxation. He already has certification as a Tax Consultant.

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