

The Effect of Profitability, Firm Size, and Leverage on Tax Avoidance with Institutional Ownership as Moderating Variable

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Abstract: This study aims to analyze the effect of profitability, firm size, and leverage on tax avoidance with institutional ownership as moderation. This type of research uses quantitative methods. The population in this study are manufacturing companies in the goods and consumption sectors listed on the Indonesia Stock Exchange in 2018-2021. The data analysis technique used in this study was multiple linear regression analysis and moderated regression analysis with the help of SPSS version 26. Samples were taken of 29 companies with a total of 109 data for four years of observation using purposive sampling method. The results of the study show that profitability and leverage have an effect on tax avoidance, while firm size has no effect. Institutional ownership is able to moderate profitability and firm size, but not leverage.

Keywords: Profitability, firm size, leverage, institutional ownership, tax avoidance.

1. Introduction

The state obtains revenue from various sources, one of which is tax revenue. Taxes are needed for the smooth running of economic activities in Indonesia, this is because taxes are the largest source of state revenue. Taxes can be used to finance state expenditure, namely as a driving force for government and supporting economic activities. According to Law Number 28 of 2007 Article 1 Paragraph 1 it is explained that taxes are mandatory contributions to the state owed by individuals or entities that are coercive based on law, with no direct compensation and are used for the needs of the state for the greatest prosperity people.

Based on the tax definition that has been explained in the law, it further strengthens the importance of tax revenue. Tax itself is not something that is voluntary, but coercive in nature so that any negligence in carrying out the obligation to pay taxes can be detrimental to the taxpayer concerned. The government's goal to maximize tax revenue is in sharp contrast to companies trying to minimize spending in paying taxes. Taxes on the company are considered as a burden that will reduce the entity's net profit. In general an entity minimizes the tax burden to optimize corporate profits.

According to (Silvera et al., 2022) Indonesia is currently facing several financial problems, one of which is the loss of state finances. This statement is reinforced by the discovery of 14,965 problems in public finances by the Supreme Audit Agency (BPK) with losses that could reach IDR 10.35 trillion. This can be seen in the exams held during the first semester of 2019 (BPK RI, 2019). The performance of the tax sector in Indonesia can be said to be not optimal because in line with its growth, tax revenues have increased negatively by 3.27% (Ministry of Finance RI, 2019). Improvements in the performance of the tax sector can be made by implementing tax avoidance activities carried out by taxpayers in Indonesia.

Tax avoidance is an action taken in an effort to minimize the amount of tax that must be issued legally and does not violate tax regulations. Tax avoidance is something that is a dilemma for the government, on the one hand it is permissible as long as it is still within the framework of taxation and on the one hand this practice is something that can reduce state revenues (Lutfitriyah & Anwar, 2021). One of the tax avoidance cases committed by PT CCI was suspected of committing tax evasion resulting in an underpayment of IDR 49.24 billion in taxes. DGT found a significant increase in costs from 2002-2006. Large expenses cause taxable income to decrease so that tax payments are also reduced. For DGT, these expenditures are suspicious and lead to transfer pricing practices to minimize taxes. DGT calculated the CCI income taxes shortfall of IDR 49.24 billion. This data shows that tax avoidance has an impact on state revenues (Muhammad et. al, 2022).

Tax avoidance activities carried out by companies are inseparable from various influencing factors. In previous research, several factors that have been examined are institutional ownership, profitability, firm size, and character executive (Oktaviani, 2019), firm size, financial distress, transfer pricing (Lutfitriyah & Anwar, 2021), profitability and institutional ownership (Muhammad et. al, 2022). This research is a development of research (Oktaviani, 2019). The difference between this study and previous studies is that this study added leverage as an independent variable. The reason leverage is added as a variable is because tax payments can also be affected by the level of debt, the higher the level of debt, the higher the tax avoidance.

With so many factors influencing tax avoidance, in this study the authors aim to provide empirical evidence regarding factors such as profitability, firm size, and leverage on their effect on tax avoidance with institutional ownership as a moderating variable.

2. Theoretical Basis

Agency Theory

Agency theory refers to a cooperative relationship in a contract between the owner (principal) and management (agent) in which the principal delegates authority to the agent to manage the company and make decisions. Conflicts of interest between principals and agents result in agency costs such as monitoring, bonding, and residual losses. Separation of powers and conflicts of interest between principals and agents can result in conflicts of interest resulting in information imbalances known as information asymmetry. Agency conflict can have a negative impact on the survival of the company. The conflict of interest is related to the management's decision regarding the company's tax payment policy (Silvera et al., 2022).

Agency theory also states that the owners and managers of firms will try to maximize their personal benefits. The owner will improve the company's performance which is reflected in the profit earned by the company, while the manager tries to increase the compensation that will be obtained. Both will always try to maximize their own interests so they don't hesitate in making decisions even though the risks are high (Oktaviani, 2019).

Contingency Theory

The contingency theory is a situation that is not fixed with a mutually agreed plan and there is no certainty in it. The results of previous studies indicate that there are inconsistent results between one study and another, what happens may be that there are other variables that affect the relationship of one variable to another. There is no unified research results due to certain factors (Ghozali, 2006).

According to Asri (2016), contingency theory is a tool used to interpret empirical results. This is due to limitations in previous research if the results are not satisfactory because there are differences and must be resolved more broadly. Therefore, the addition of moderating variables is used to combine between variables, with a theoretical approach it is expected to provide opportunities for other variables to be used as moderating variables.

Hypothesis Development

1. The effect of profitability on tax avoidance

Profitability is the ratio used to measure a company's performance in generating profits. In this study, return on assets (ROA) is used to measure profitability. The higher the ROA of a company, the company is considered to have good performance in managing its assets to earn profits. Company profits will affect the tax burden that must be paid by the company, so companies with high ROA will tend to practice tax avoidance. This shows that the higher the profitability of a company, the higher the tax avoidance activity (Wirawan & Yuniarwati, 2022).

The research result of Oktaviani, (2019) show that profitability has effect on tax avoidance. The same opinion was also expressed by Wirawan & Yuniarwati, (2022) which states that profitability affects tax avoidance. Based on this explanation, the hypothesis proposed is:

H₁: Profitability affects tax avoidance

2. The effect of firm size on tax avoidance

Based on agency theory, the resources owned by companies can be used by agents to maximize agent performance compensation, namely by reducing the company's tax burden to maximize company performance. The larger the size of the company, the better the company will be in tax planning (Oktaviani, 2019)

The size of the company has a great opportunity to plan taxes and obtain the accuracy of accounting methods in order to reduce the company's effective tax rate. This statement is in line with research by Puspita & Febrianti (2018), shows that company size has a positive impact on tax avoidance, by proving that companies with higher asset values are usually more stable in creating profits. Such a situation can create an increase in the tax burden and tends to lead companies to carry out tax avoidance (Haya & Mayangsari, 2022).

The result of research by Oktaviani, (2019) show that firm size has effect on tax avoidance. Haya & Mayangsari, (2022) also show that firm size has effect on tax avoidance. Based on this explanation, the hypothesis proposed is:

H₂: Firm size affect tax avoidance

3. The effect of leverage on tax avoidance

Leverage is a financial ratio that describes the relationship between a company's debt to capital and company assets. Agency theory explains that policies made by company management have a crucial role in tax avoidance, for example regarding the determination of company financing through debt. If the leverage owned by the company is high, then the company will increasingly depend on debt so that its assets can be funded. Debt certainly raises interest costs which are a burden that can minimize the tax burden. The level of tax avoidance is influenced by the policy in determining company financing through debt by managers (Khoirunnisa & Ratnawati, 2021).

The result of research conducted by (Khoirunnisa & Ratnawati, 2021) show that leverage has effect on tax avoidance. Based on this explanation, the hypothesis proposed is:

H₃: Leverage affect tax avoidance

4. The effect of profitability on tax avoidance moderated by institutional ownership

The greater the profit earned by the company, the greater the amount of income tax payable. The agency theory states that agents will try to manage their tax burden so as not to reduce the agent's performance compensation as a result of the eroding of corporate profits by the tax burden. This means that agents will tend to carry out aggressive tax avoidance activities. Companies with large institutional ownership indicate their ability to supervise management. The existence of institutional ownership as an element of corporate governance can prevent agents from making aggressive efforts in managing the company's tax burden (Olivia et al., 2019)

The research conducted by Putranti & Setiawanta (2015) and Olivia et al., (2019) shows the influence of institutional ownership in moderating the effect of profitability on tax avoidance. Based on this explanation, the hypothesis proposed is:

H₄: Institutional ownership moderates the effect of profitability on tax avoidance

5. The effect of firm size on tax avoidance moderated by institutional ownership

Large company size is often used as an indicator to measure the amount of tax that must be paid by the company even though there are other indicators that make the company do tax avoidance. Large institutional ownership cannot always lead to greater oversight of investors to monitor management but companies with small institutional ownership if properly supervised investors can monitor management performance in minimizing the potential for tax avoidance within the company (Sinurat et al., 2022)

The research results conducted by Darmayanti & Susanto (2015) and Sinurat et al., (2022) shows the influence of institutional ownership in moderating firm size on tax avoidance. Based on this explanation, the hypothesis proposed is:

H₅: Institutional ownership moderates the effect of firm size on tax avoidance

6. The effect of leverage on tax avoidance moderated by institutional ownership

The more loans a company has, the more funding it will receive from third parties, which will increase the interest costs that must be borne by the company and reduce the company's profits. In this case, it will be a conflict with institutional ownership as investors who want the maximum rate of return on the investment they provide in the form of dividends (Aprianto & Dwimulyani, 2019). The more companies get loans from third parties, the higher the interest costs caused by the debts that must be paid by the company and the profits that have been generated by the company will decrease because the profits that should be given to investors in the form of dividends will be allocated to pay debt interest. As a result, there will be resistance from institutional ownership as investors in companies that want dividends on the investment they have invested (Prasatya et al., 2020).

The research conducted by Aprianto & Dwimulyani, (2019) and Prasatya et al., (2020) shows the influence of institutional ownership in moderating leverage on tax avoidance. Based on this explanation, the hypothesis proposed is:

H₆: Institutional ownership moderates the effect of leverage on tax avoidance

3. Methodology

This research is a quantitative research. The data used is secondary data in the form of financial reports obtained from manufacturing companies in the goods and consumption sector of the Indonesia Stock Exchange for 2018-2021. The data analysis technique used in this study is multiple linear regression analysis. Sampling in this study used a purposive sampling method with certain criteria. The population of this study were 29 companies and based on these criteria, 109 samples of company data were obtained.

Table 1: Research Sample Selection Process

The research population is manufacturing companies in the goods and consumption sectors listed on the IDX for the 2018-2021 period		62
No	Sample Criteria	
1	Companies manufacturing goods and consumption sectors that are not routinely listed on the IDX for the 2018-2021 period	(10)
2	Companies that do not issue annual financial reports and have been audited in the 2018-2021 period	(12)
3	Companies that suffered losses during the study period	(11)
4	The number of samples that meet the criteria	29
5	Number of samples during the year of study (29 x 4)	116
6	Data outliers	(7)
7	The number of samples used in the study	109

Source: Processed Data, 2023

In this study the independent variables used were profitability, firm size, and leverage while the dependent variable used was tax evasion and the moderating variable used was institutional ownership. Based on the description above, the research framework can be arranged as presented in the figure 1.1.

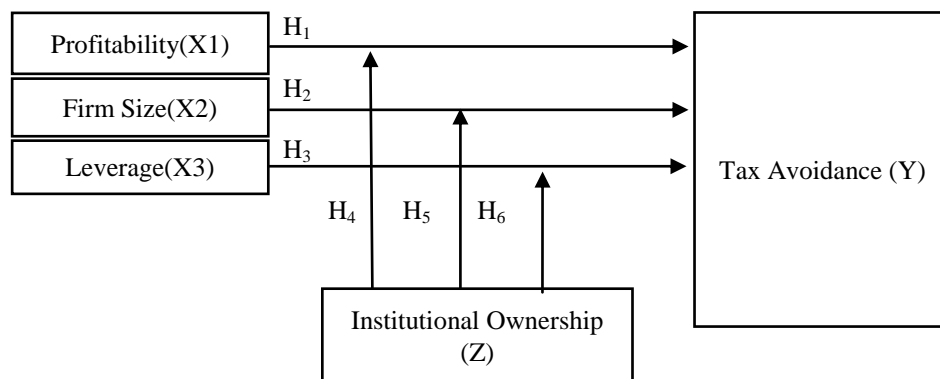


Figure 1.1 Thinking framework

Variable Operation Definition

Table 2: Operational Variable Measurement

Variable	Indicator	Source
Profitability	$ROA = \frac{\text{Profit after Tax}}{\text{Total Asset}}$	(Oktaviani, 2019)
Firm Size	Size = LN (Total Asset)	(Oktaviani, 2019)
Leverage	$DER = \frac{\text{Total Liability}}{\text{Total Equity}}$	(Prasatya et al., 2020)
Institutional Ownership	$KI = \frac{\text{Shares owned by the institution}}{\text{Number of shares outstanding}}$	(Oktaviani, 2019)
Tax Avoidance	$ETR = \frac{\text{Income tax expenses}}{\text{Profit before tax}}$	(Oktaviani, 2019)

Data Analysis Technique

This study uses data analysis techniques which include descriptive statistics, classical assumption tests and hypothesis testing. This study uses multiple regression analysis and moderation regression analysis. The test model used in this study is stated in the following equation:

Equation 1:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + e \dots \dots (1)$$

Equation 2:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_1 X_4 + \beta_6 X_2 X_4 + \beta_7 X_3 X_4 + e \dots \dots (2)$$

Information:

- Y = Tax Avoidance
- a = Constanta
- X1 = Profitability
- X2 = Firm size
- X3 = Leverage
- X4 = Institutional Ownership
- X1X4 = Interaction between profitability and institutional ownership
- X2X4 = Interaction between firm size and institutional ownership
- X3X4 = Interaction between leverage and institutional ownership
- e = Error

4. Results and Discussion

Descriptive Statistics

Table 3: Descriptive Analysis Result

	N	Minimum	Maximum	Mean	Std. Deviation
Profitability	109	0,01	0,47	0,1082	0,09047
Firm Size	109	25,95	32,82	29,2963	1,55404
Leverage	109	0,12	3,82	0,8133	0,71213
Valid N (listwise)	109				

Source: Processed Data, 2023

From the table above it can be seen that the amount of data used in this study was 109 companies. From the results of the data above, it can be seen that company size has the highest standard deviation, namely 1.55404, meaning that company size has the highest data diversity, while profitability has the smallest standard deviation, which is equal to 0.09047, meaning profitability has low data diversity.

Classic Assumption Test

Normality Test

Table 4: Normality Result Test

Asymp. Sig. (2-tailed)	Information
0,175	Normally Distributed

Source: Processed Data, 2023

Based on the results of the normality test using the One-Sample Kolmogorov Smirnov Test shows Asymp. Sig. of 0.200 which means the significance value is more than 0.05 so that the results can be said to be normally distributed data.

Multicollinearity Test

Table 5: Multicollinearity Test Results

	Tolerance Value	VIF	Information
Profitability	0,968	1,033	There is no multicollinearity
Firm Size	0,932	1,072	There is no multicollinearity
Leverage	0,941	1,063	There is no multicollinearity

Source: Processed Data, 2023

Based on the result of the multicollinearity test in the table above, it is known that the tolerance value is more than 0,10 and the VIF value is less than 10 for all independent variables. So it can be concluded that the data doesn't occur multicollinearity.

Heteroscedasticity Test

Table 6: Heteroscedasticity Test Results

	Signification	Information
Profitability	0,866	There is no heteroscedasticity
Firm Size	0,737	There is no heteroscedasticity
Leverage	0,703	There is no heteroscedasticity

Source: Processed Data, 2023

Based on the results of heteroscedasticity in the table above, it shows that a significance value of more than 0.05 is found in all independent variables. Thus the regression equation is free from heteroscedasticity symptoms.

Autocorrelation Test

Table 7: Autocorrelation Test Results

Durbin Watson	Information
1,707	There is no autocorellation

Source: Processed Data, 2023

Based on the result in the table above, it can be seen that the Durbin Watson value is 1,707. These results indicate that the DW value is between -2 and +2 ($-2 < 1,707 < +2$). So it can be concluded that in the regression model there are no autocorrelation symptoms.

Hypothesis Test

Table 8: Multiple Linear Regression Test Results

Variable	Coefficient	t	Sig.	Hypothesis
Constanta	0,294	4,338	0,000	
Profitability	-0,079	-1,997	0,048	H ₁ accepted
Firm Size	-0,002	-0,679	0,499	H ₂ rejected
Leverage	0,011	2,247	0,027	H ₃ accepted
F count			2,845	
R ²			0,075	
Adjusted R ²			0,049	
Signification F			0,041	

Source: Processed Data, 2023

Based on the results of the F test, it is known that the calculated F value is 2.845 with a significance value of $0.041 < 0.05$, so it can be said that the regression model used is feasible.

Based on the results of testing the determinant coefficient (Adjusted R²) the value of Adjusted R² is 0.049 which means that the independent variables (profitability, firm size, and leverage) are able to explain the dependent variable of 4.9% while the remaining 95.1% is influenced by other variables in outside research.

Table 9: Moderated Regression Analysis

	Coefficient	t	Sig	Hypothesis
Constanta	-0,428	-1,463	0,146	
Profitability	-1,293	-4,025	0,000	
Firm Size	0,028	2,566	0,012	
Leverage	-0,044	-1,560	0,122	
Institutional Ownership	1,013	2,484	0,015	
Institusional Ownership x Profitability	1,491	3,824	0,000	H ₄ accepted
Institutional Ownership x Firm Size	-0,041	-2,705	0,008	H ₅ accepted
Institutional Ownership x Leverage	0,068	1,840	0,069	H ₆ rejected

Source: Processed Data, 2023

Based on the test result, the following results were obtained:

1. Profitability (H1)

Based on the results on table 8 of the significance test the t test states that the significance value is 0.048 which means it is smaller than 0.05. So it can be concluded that profitability affects tax avoidance, so that H1 is accepted. High profitability indicates that companies that have the ability to manage good profits can be said to have the adequacy of paying taxes. The level of corporate income tends to be directly proportional to the level of taxes paid by the company. This is due to the amount of tax expense that must be paid is calculated based on the income earned by the company. So companies that have high income will pay high taxes as well.

The results of the research are in line with the research conducted by Anggraeni & Febrianti (2019), Muhammad et. al, (2022), and Ayu & Widya, (2021) which states that profitability affects tax avoidance.

2. Firm Size (H2)

Based on the results on table 8 of the significance test the t test states that the significance value is 0.499 which means it is greater than 0.05. So it can be concluded that firm size has no effect on tax avoidance, so H2 is rejected. The size of a company as measured by the total assets owned does not affect the company's decision to take tax avoidance measures. Even medium and small scale companies will continue to avoid taxes even though the amount does not significantly impact state revenues. Tax payments are an obligation for all citizens or companies, that management wants to be assessed for its good performance by shareholders so that the size of a small or large company does not influence management to commit tax avoidance.

The results of the research are in line with the research conducted by Rahmawati & Nani, (2021) and Tebiono et al., (2019) which states that firm size has no effect on tax avoidance.

3. Leverage (H3)

Based on the results on table 8 of the significance test the t test states that the significance value is 0.048 which means it is smaller than 0.05. So it can be concluded that leverage has an effect on tax avoidance, so that H3 is accepted. The greater the debt owned by the company, the higher the tax avoidance by the company. A high leverage value indicates that the company has a higher level of debt than its own capital. A very high level of interest expense in a company can reduce the company's tax burden. So companies that have a high tax burden will prefer debt to other parties rather than increasing their own capital in order to minimize the tax burden.

The results of the research are in line with the research conducted by Prasatya et al., (2020), Anggraeni & Febrianti, (2019), and Sinurat et al., (2022) which states that leverage affects tax avoidance.

4. Institutional Ownership moderates profitability against tax avoidance (H4)

Based on the results on table 9 of the significance test the t test states that the significance value is 0.000 which means it is smaller than 0.05. So it can be concluded that institutional ownership is able to moderate the effect of profitability on tax avoidance, so that H4 is accepted. In agency theory, institutional ownership has an important role in overcoming agency problems between principals and agents. This study shows that institutional ownership is able to moderate profitability on tax avoidance. When the company experiences increased profitability, the opportunity for tax avoidance will be even greater. The involvement of institutional ownership in this case is related to the amount of dividends that will be given from the profits that the company gets. The greater the tax avoidance action, the greater the amount of dividends that will be given to institutional shareholders.

The results of the research are in line with the research conducted by Olivia et al., (2019) and Prasatya et al., (2020) which states that institutional ownership is able to moderate profitability on tax avoidance.

5. Institutional Ownership moderates firm size against tax avoidance (H5)

Based on the results on table 9 of the significance test the t test states that the significance value is 0.008 which means it is smaller than 0.05. So it can be concluded that institutional ownership is able to moderate the size of the company on tax avoidance, so that H5 is accepted. Companies with large or small total assets will continue to take tax avoidance measures. However, the greater the total assets owned by the company, the more it will be able to generate profits and pay taxes compared to smaller total assets. High institutional ownership in the company will influence the policies taken by management. So management will operate the company more carefully to maintain the company's reputation. Tax avoidance by company management is a strategy so as not to reduce company profits, so as to increase the welfare of shareholders.

The results of the research are in line with the research conducted by Oktaviani (2019) and Sinurat et al., (2022) which states that institutional ownership is able to moderate firm size on tax avoidance.

6. Institutional ownership moderates leverage against tax avoidance (H6)

Based on the results on table 9 of the significance test the t test states that the significance value is 0.069 which means it is greater than 0.05. So it can be concluded that institutional ownership is not able to moderate leverage on tax avoidance, so H6 is rejected. Companies that have high leverage indicate that the company has a high level of debt than its own capital. The high debt in a company will cause a fixed burden for a company. This is inconsistent with institutions as shareholders who have invested their capital in the company. Shareholders want a large amount of dividends to return the capital they have invested.

The results of the research are in line with the research conducted by Prasatya et al., (2020) and Aprianto & Dwimulyani, (2019) which states that institutional ownership is not able to moderate leverage on tax avoidance.

5. Conclusion

The conclusions of this study are as follows:

1. Profitability affects tax avoidance in goods and consumption sector manufacturing companies listed on the Indonesian Stock Exchange (IDX) for the 2018-2021 period.
2. Firm size has no effect on tax avoidance in goods and consumption sector manufacturing companies listed on the Indonesian Stock Exchange (IDX) for the 2018-2021 period.
3. Leverage affects tax avoidance in goods and consumption sector manufacturing companies listed on the Indonesian Stock Exchange (IDX) for the 2018-2021 period.
4. Institutional ownership is able to moderate profitability on tax avoidance in goods and consumption sector manufacturing companies listed on the Indonesian Stock Exchange (IDX) for the 2018-2021 period
5. Institutional ownership is able to moderate firm size on tax avoidance in goods and consumption sector manufacturing companies listed on the Indonesian Stock Exchange (IDX) for the 2018-2021 period.
6. Institutional ownership is unable to moderate leverage on tax avoidance in goods and consumption sector manufacturing companies listed on the Indonesian Stock Exchange (IDX) for the 2018-2021 period.

6. Suggestion

Suggestions for further research are as follows:

1. Future researchers are expected to be able to expand and increase the research sample so that the research can be generalized to all corporate sectors.
2. Future researchers are expected to be able to add more variables used in order to get better results.

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