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# **Moderated by Political Connection: Profitability and Leverage on Tax Avoidance**

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**Abstract---***Along with the rampant cases of tax avoidance in the health sector and the telecommunications sector, this study examines whether the profitability and leverage of companies in these two sectors affect tax avoidance behavior. This study also examines how political connection moderates the relationship between these two variables on tax avoidance. Data was collected from companies listed on the Indonesia Stock Exchange from 2020 to 2023 using a purposive sampling technique. The analysis found a positive relationship between company profitability and tax avoidance behavior. The same relationship was found between leverage and tax avoidance behavior. Furthermore, using the Moderated Regression Analysis (MRA) technique, this study confirms the moderating role of political connection in influencing corporate tax avoidance behavior.*

**Keywords---***Leverage, Political Connection, Profitability, Tax Avoidance.*

#### **Introduction**

Tax avoidance is a legal and safe effort for taxpayers because it does not conflict with tax provisions, where the methods and techniques used tend to take advantage of the weaknesses (gray areas) contained in tax laws and regulations, to reduce the amount of tax payable (Murkana & Putra, 2020). Tax avoidance is done by not violating applicable law. The achievement of tax revenue in Indonesia in 2019 amounted to 84.44 percent. This achievement is indeed lower than last year, which reached 92.41 percent, but it is still better than the achievements in 2015 and 2016, which amounted to 83.3 percent and 83.5 percent of the target, respectively. In 2016, there was an increase in tax revenue realization from the previous year, but it did not meet the target. The target should have been realized with the Tax Amnesty policy, but was not achieved, This indicates that there are still tax avoidance actions. Furthermore, from 2020 to 2022, which indicates a positive trend. Meanwhile, the realization of tax revenue in 2022 has grown by 114 percent from the realization in 2021. The realization of tax revenue is supported by tax, customs, and excise revenues. The positive trend from 2020 to 2022, when the COVID-19 pandemic hit Indonesia, made tax revenue realized or achieved. This is inversely proportional to normal conditions (before the COVID-19 pandemic), which have not met the target or have not been realized (Hanlon & Heitzman, 2010).

Profitability is a ratio to assess the company's ability to generate profits. This ratio also provides a measure of the effectiveness of the company's management. This is indicated by the profit generated from sales and investment income (Ari et al., 2021). Profitability consists of several ratios, one of which is Return on Assets (ROA). ROA

serves to measure the company's effectiveness in using its resources (Kurniasih & Sari, 2013). ROA can also calculate profitability, an indicator to assess the company's financial performance during the COVID-19 pandemic, because the higher the ROA value, the better the company's financial performance (Niu & Wokas, 2021). When the company's profit grows, the amount of income tax will increase following the increase in corporate profits, so the tendency to do tax avoidance by the company will also increase (Apriatna & Oktris, 2022; Dewinta & Setiawan, 2016).

Several studies have proven that profitability has a significant effect on tax avoidance, including Djolafo (2022), Kudil et al. (2022), Laeladevi et al. (2021), Murkana & Putra (2020) Rahmadani et al. (2020), Sari et al. (2021), and Sriyono & Andesto (2022). Different results were found from several other studies, which stated that profitability has no significant effect on tax avoidance, including Fatimah et al. (2021), Fauzan et al. (2019), Handayani & Mildawati (2018), Mulyati et al. (2019), and Subagiastra et al. (2016). Several studies also prove that profitability has a significant effect on tax avoidance, moderated by political connections, including Kudil et al. (2022), Laeladevi et al. (2021), and Rahmadani et al. (2020).

Another factor that can affect tax avoidance is leverage. In general, leverage arises because companies finance assets with borrowed funds that carry interest. In other words, through leverage, it can be seen whether the assets owned by a company come from debt or its capital. If the company has a high level of leverage, the assets owned by the company come from loans or debt (Rifai & Atiningsih, 2019). Therefore, if the company has a low level of leverage, the assets owned by the company come from its capital (Sopiyana, 2022). Later, the size of the leverage owned by the company can affect the amount of tax that must be paid by the company. This is because the interest costs derived from the debt can be deducted in the tax calculation, making the company's tax burden smaller (Hidayat, 2018).

Several researchers have proven that leverage has a significant effect on tax avoidance, including Djolafo (2022), Irawati et al. (2020), Mulyati et al. (2019), Nathania et al. (2021), Rahmadani et al. (2020), Sari et al. (2021), and Stawati (2020). In contrast to several other studies, which prove that leverage does not have a significant effect on tax avoidance, including Anggriantari & Purwantini (2020), Handayani & Mildawati (2018), and Jamaludin (2020).

Referring to the different results of previous research, a contingency approach is needed in this study. This contingency theory reveals that a control system or management accounting system will depend on the situation and conditions experienced by the company; the more appropriate the system is applied, the better it will be. In this theory, it is stated that there will be no best system design that can be applied universally and effectively to all types of situations and conditions. This contingency theory is an approach to understanding organizational behavior, where understanding is used as a contingent factor that affects the functioning of the organization (Sulastri & Rifa'i, 2019). Therefore, a contingency approach is needed because there are inconsistencies in the results of previous studies, so there is uncertainty about the factors that can influence the relationship between profitability and leverage on tax avoidance that need to be evaluated. This contingency approach provides the possibility of other variables that can act as moderating variables that can influence the relationship between profitability and leverage on tax avoidance. The contingency factor chosen in this study is the political connection variable because it refers to the research of Rahmadani et al. (2020). It is known that political connection can moderate the effect of leverage significantly on tax avoidance.

Political connection is a political relationship in the executive and legislative branches that does not violate the rule of law, but it is difficult to separate personal or group interests from ethical state interests (Indarto & Widarjo, 2021). Too aggressive tax planning can be associated with the risk of falling stock prices (Kim & Zhang, 2016). Consequently, for a sample of international firms, political connections are positively associated with corporate risk-taking, as political connections serve as an insurance mechanism against extreme events (Masripah et al., 2017). In other words, connected international firms may be more involved in tax planning due to higher risk-taking tendencies, which are caused by political connections (Ajili & Khlif, 2020).

This is in line with research from Thalita et al. (2022), which proves that tax avoidance is moderated by political connection. Meanwhile, several other studies also prove that political connection is influenced by tax avoidance, such as Ferdiawan & Firmansyah (2017), Firmansyah et al. (2022), Hanny & Niandari (2018), Sudibyo & Jianfu (2016), and Ying et al. (2017). This is inversely proportional to several other studies, where the effect of political connection has no significant effect on tax avoidance, including Kim & Zhang (2016), Masripah et al. (2017) and Pranoto & Widagdo (2016).

### *Literature Review and Hypothesis Development*

Tax avoidance is an attempt to reduce the tax burden by not violating existing laws. Tax avoidance is also considered as a transaction scheme aimed at minimizing the tax burden by exploiting the weaknesses (loopholes) of a country's

tax provisions, so that tax experts declare it legal because it does not violate tax regulations. These companies often have more resources to use tax avoidance strategies, such as complex tax planning or income shifting to lower tax jurisdictions. In addition, high profitability encourages companies to minimize tax liabilities to increase net profits. However, aggressive tax avoidance can also pose reputational and legal risks for companies, which must be considered in their strategy (Handayani & Mildawati, 2018). The effect of profitability on tax avoidance in Indonesia, developed from previous research by Djolafo (2022), Kudil et al. (2022), Laeladevi et al. (2021), Murkana & Putra (2020), Rahmadani et al. (2020), Sari et al. (2021), and Sriyono & Andesto (2022), which proves that profitability has a significant effect on tax avoidance.

H1: Profitability has a positive effect on tax avoidance in health sector companies and the telecommunications sector listed on the Indonesia Stock Exchange (IDX).

The amount of DER, then, shows that the composition of total debt (short-term and long-term) is higher than the total equity capital, so that it will have an impact on the company's greater costs to outsiders. The increasing burden on creditors shows that the company's capital sources are highly dependent on outsiders, so that it can reduce the amount of profit received by the company (Rifai & Atiningsih, 2019). Companies that have high leverage tend to utilize debt interest as a tax deduction, because interest payments are often tax-deductible. By increasing debt, companies can effectively increase tax avoidance, thereby improving cash flow and increasing profitability. However, excessive use of leverage also brings financial risks, which may affect their future tax avoidance decisions. The effect of leverage on tax avoidance in Indonesia, developed from previous research by Djolafo (2022), Irawati et al. (2020), Mulyati et al. (2019), Nathania et al. (2021), Rahmadani et al. (2020), Sari et al. (2021), and Stawati (2020), proves that leverage has a significant effect on tax avoidance.

H2: Leverage has a positive effect on tax avoidance in health sector companies and the telecommunications sector listed on the Indonesia Stock Exchange (IDX).

Political connection is the way companies that have access to the government like the risk of low tax audits. Agency theory explains the relationship, managers who have an incentive to maximize profit after tax may be encouraged to engage in tax avoidance, especially if the company shows a high level of profitability, which means there is a large tax liability to be reduced. However, this tax avoidance can be affected by political connection, which acts as a moderating factor (Kovermann & Velte, 2019). If a company has strong political connections, managers may feel safer in engaging in tax avoidance, as these connections may protect against the risk of tax audits or legal sanctions. Conversely, without political connections, managers may be more cautious in avoiding taxes due to concerns about repressive actions from tax authorities. In this case, political connections can strengthen the relationship between profitability and tax avoidance, where more profitable firms tend to be more aggressive in tax avoidance, and this relationship is stronger when there is political support that moderates potential risks. The effect of profitability on tax avoidance in Indonesia, moderated by political connections, is developed from previous research (Kudil et al., 2022; Laeladevi et al., 2021; Rahmadani et al., 2020), which proves that profitability has a significant effect on tax avoidance moderated by political connections. Thus, the third hypothesis in this study is

H3: Profitability affects tax avoidance, moderated by political connections in health sector companies and the telecommunications sector listed on the Indonesia Stock Exchange (IDX).

Political connection is the path of a company that has access to the government, like a low risk of tax audits. Relationships that can facilitate (smooth) all affairs or activities regarding state administration or statehood. In the context of agency theory, the relationship between leverage, tax avoidance, and political connections can be explained through the differences in objectives between managers (agents) and owners (principals) of the company, as well as how external factors such as political connections affect managers' decisions. Leverage, or the use of debt, can motivate managers to reduce tax liabilities because debt interest paid is usually tax-deductible, which provides an incentive for managers to take on more debt, especially if the company has a high level of profitability. However, in agency theory, conflicts of interest between agents and principals arise because managers may focus more on short-term tax deductions, while owners prioritize long-term financial sustainability and risk. Political connection acts as a moderating factor in this relationship because companies with strong political connections can more freely utilize debt without worrying about sanctions or strict supervision from tax authorities. Such political connections can reduce the risk faced by managers in tax avoidance, giving them a sense of security to be more aggressive in using leverage. Conversely, without political connections, the risks associated with tax avoidance can be greater, so managers may be more cautious. The effect of leverage on tax avoidance in Indonesia, moderated by political connection, was developed from the research of Rahmadani et al. (Rahmadani et al., 2020), which proves that

leverage has a significant effect on tax avoidance, moderated by political connections. Thus, the fourth hypothesis in this study is.

H4: Leverage affects tax avoidance in Indonesia which is moderated by political connections in health sector companies and the telecommunications sector listed on the Indonesia Stock Exchange (IDX).

## Methods

The research design that is the object of this study, namely the dependent variable, is Tax Avoidance (Y), then the independent variable is Profitability (X1), and Leverage (X2), and the moderator variable is Political Connection (Z). The subjects of this research are companies listed on the IDX in the health sector and the telecommunications sector listed on the Indonesia Stock Exchange (IDX) for the period 2020-2023.

This study took a population of 34 companies in the health sector and 11 companies in the telecommunications sector through the IDX website that went public from 2020 to 2023. The year 2020 is the beginning, because the measurement of tax avoidance using the Cash Effective Tax Rate (CETR), requires company financial report data at the beginning of the COVID-19 pandemic that occurred in Indonesia, as well as a decrease in the income tax rate for corporate taxpayers to 22 percent which took effect in the 2020 tax year, following the mandate of Government Regulation Number 30 of 2020. Meanwhile, 2023 is the end of the COVID-19 pandemic period (post-COVID-19 pandemic), which is real-time data to assist the author in monitoring the measurement of tax avoidance in Indonesia both during the COVID-19 pandemic and post-COVID-19 pandemic. The sampling method in this study uses non-probability sampling with a purposive sampling technique, which is a sampling technique with certain considerations that do not provide equal opportunities for each member of the population to be selected as a sample (Sugiyono, 2013). The criteria used to determine the sample include:

- 1) Companies in the health sector and telecommunications sector that go public in publishing complete financial reports in the period from 2020 to 2023.
- 2) Companies in the health sector and telecommunications sector that were listed from the period before 2020 and are still listed in the 2020-2023 period on the Indonesia Stock Exchange stock list.
- 3) Companies in the health sector and the telecommunications sector that go public in presenting financial statements use the rupiah currency, the reason is that the financial statements are an accumulation of transactions throughout the year, so it becomes less valid if each value is converted using the exchange rate on one specific date.
- 4) Companies in the health sector and telecommunications sector that go public with gross turnover of more than 50 billion rupiah, because they do not obtain a tariff reduction facility in accordance with Article 31E of the Income Tax Law.

This research uses data processing tools, namely the STATA software tool. The advantage of STATA software compared to other tools is that STATA uses syntax-type commands whose commands are not limited to the menu. In addition, the resulting output is also divided into each test, making it easier to interpret the results in the STATA software. This study uses a multiple linear regression analysis model.

## Result and Discussion

### *Multiple Linear Regression Analysis*

This multiple linear regression analysis is used to analyze the effect of Return on Asset (ROA) (X1), Debt to Asset Ratio (DAR) (X2) and Political connection (Z) on tax avoidance (Y). The results of the panel data regression test processed with the help of STATA software obtained results that can be seen in Table 1 below.

Table 1  
Summary of Multiple Linear Regression Analysis Results

Dependent Variable: Y_CETR				
Variable	Coefficient	Std. Error	t-Statistic	P Value
Return on Asset (ROA) (X <sub>1</sub> )	0,2617	0,0447	5,85	0,000
Debt to Asset Ratio (DAR) (X <sub>2</sub> )	0,1179	0,0082	14,31	0,000
Political connection (Z)	0,6400	0,3795	1,69	0,095
C	-0,9633	0,1394	-6,91	0,000

R-squared	0,7680
Adjusted R-squared	0,7600
F-statistic	97,08
Prob(F-statistic)	0.0000

Secondary Data, 2024

From the results of multiple linear regression analysis in Table 5.9, the following equation can be made:

$$Y = -0.9633 + 0.2617 X_1 + 0.1179 X_2 + 0.6400 Z$$

Based on the above equation, the following can be explained.

The constant value is -0.9633 if the value of Return on Asset (ROA) (X1), Debt to Asset Ratio (DAR) (X2), and Political connection (Z) is equal to zero, then the value of tax avoidance (CETR) (Y) is equal to -0.9633 percent.

$\beta_1 = 0.2617$ , if the value of Return on Asset (ROA) (X1) increases by 1 unit, the value of tax avoidance (Y) will increase by 0.2617 percent, assuming other independent variables are constant.

$\beta_2 = 0.1179$  If the Debt to Asset Ratio (DAR) (X2) value increases by 1 unit, the value of tax avoidance (Y) will increase by 0.1179 percent, assuming other independent variables are constant.

$\beta_3 = 0.6400$ , if the value of Political connection (Z) increases by 1 unit, the value of tax avoidance (Y) will increase by 0.6400 percent, assuming other independent variables are constant.

#### *Hypothesis Test*

##### *Simultaneous Test Results (F Test)*

The F-statistical test in this study was carried out by looking at the significance value in the ANOVA table, with the aim of knowing the simultaneous influence of the variables Return on Asset (ROA), Debt to Asset Ratio (DAR), political connection, and leverage on tax avoidance. The results of the F test can be seen in Table 2.

Table 2  
Simultaneous Test

<i>F-statistic</i>	174,06
<i>Prob(F-statistic)</i>	0,0000

Secondary Data, 2024

The results of the F test (F test) show that the calculated F value is 174.06 with a significance value of 0.000, which is smaller than  $\alpha = 0.05$ ; this means that the model used in this study is feasible. These results mean that the five independent variables can predict or explain the phenomenon of tax avoidance, especially in health sector companies and the telecommunications sector, which are listed on the Indonesia Stock Exchange from 2020-2023. This means that simultaneously Return on Asset (ROA) (X1), Debt to Asset Ratio (DAR) (X2), Political connection (Z), and the interaction variable X1.Z and the interaction variable X2.Z have a significant positive effect on tax avoidance in the health sector and the telecommunications sector.

#### *Partial Test (t-test)*

##### *Return on Asset (ROA) on tax avoidance*

The results of the t-test calculation can be seen in Table 2. From the table, it is known that the regression coefficient value of X1 or Return on Asset (ROA) is 0.4852108 with a significance level of 0.000 smaller than the real level  $\alpha = 0.05$ . This shows that Return on Asset (ROA) has a positive and significant effect on tax avoidance in health sector companies and the telecommunications sector. So, the hypothesis, which states that Return on Asset (ROA) has a positive effect on tax avoidance, can be accepted.

*Debt to Asset Ratio (DAR) on tax avoidance*

The results of the t-test calculation can be seen in Table 2. From the table, it is known that the regression coefficient value of X2 or Debt to Asset Ratio (DAR) is 0.1072801 with a significance level of 0.000 smaller than the real level  $\alpha = 0.05$ . This shows that the Debt to Asset Ratio (DAR) has a positive and significant effect on tax avoidance in the health sector and the telecommunications sector. So, the hypothesis that states that Debt to Asset Ratio (DAR) has a positive effect on tax avoidance can be accepted.

*Test Coefficient of Determination (R<sup>2</sup>)*

The coefficient of determination (R<sup>2</sup>) is used to determine and measure the model's ability to explain variations in the independent variable. Researchers use the adjusted R2 value when evaluating which is the best regression model, because, unlike R2, the adjusted R2 value can increase or decrease if one independent variable is added to the model. The results of the coefficient of determination test in this study can be seen in Table 3 below:

Table 3  
Test Results of the Coefficient of Determination

<i>R-squared Overall</i>	0,8681
Secondary Data, 2024	

The test results in Table 5.11 provide results where the R-squared value is 0.8681. This means that variations in tax avoidance in health sector and telecommunications sector companies, which are listed on the Indonesia Stock Exchange in 2020-2023, can be significantly influenced by variations in the Return on Asset (ROA) variable (X1), Debt to Asset Ratio (DAR) (X2), Political connection (Z), and the X1.Z interaction variable and the X2.Z interaction variable by 86.81 percent, while the remaining 13.19 percent is explained by other factors not explained in the research model.

*Moderation Regression Analysis*

This moderation regression analysis is used to analyze the effect of Return on Asset (ROA) (X1), Debt to Asset Ratio (DAR) (X2) with a moderation variable, Political connection (Z), on tax avoidance (Y). The results of the moderation regression test processed with the help of STATA software are obtained results that can be seen in Table 4 below.

Table 4  
Moderation Regression Analysis

Dependent Variable: Y_CETR				
Variable	Coefficient	Std. Error	t-Statistic	P Value
<i>Return on Asset (ROA) (X<sub>1</sub>)</i>	0,4852	0,0719	6,75	0,000
<i>Debt to Asset Ratio (DAR) (X<sub>2</sub>)</i>	0,1072	0,0080	13,28	0,000
<i>Political connection (Z)</i>	-0,0721	0,7492	-0,10	0,924
Variabel Interaksi X1.Z	0,8300	0,1413	5,87	0,000
Variabel Interaksi X2.Z	0,2170	0,0198	10,93	0,000
C	-0,7074	0,1692	-4,18	0,000
R-squared	0,8681			
F-statistic	174,06			
Prob(F-statistic)	0,0000			
Secondary Data, 2024				

From the results of multiple linear regression analysis in Table 5.12, the following equation can be made:

$$Y = -0.7074 + 0.4852 \text{ ROA} + 0.1072 \text{ DAR} - 0.072158 \text{ PC} + 0.8300 \text{ ROA.PC} + 0.2170 \text{ DAR.PC}$$

Based on the above equation, the following can be explained.

The constant value is -0.7074643 if the value of Return on Asset (ROA) (X1), Debt to Asset Ratio (DAR) (X2), and Political connection (Z) is equal to zero, then the value of tax avoidance (CETR) (Y) is equal to -0.7074643 percent.

$\beta_1 = 0.4852108$ , if the value of Return on Asset (ROA) (X1) increases by 1 unit, the value of tax avoidance (Y) will increase by 0.4852108 percent, assuming other independent variables are constant.

$\beta_2 = 0.1072801$  if the Debt to Asset Ratio (DAR) (X2) value increases by 1 unit, the value of tax avoidance (Y) will increase by 0.1072801 percent, assuming other independent variables are constant.

$\beta_3 = -0.072158$ , if the value of Political connection (Z) increases by 1 unit, the value of tax avoidance (Y) will decrease by -0.072158 percent, assuming other independent variables are constant.

$\beta_4 = 0.830033$ , if the interaction value of Return on Asset (ROA) with Political connection (X1Z) increases by 1 unit, the value of tax avoidance (Y) will increase by 0.830033 percent assuming other independent variables are constant.

$\beta_5 = 0.2170987$  if the interaction value of Debt to Asset Ratio (DAR) with Political connection (X2Z) increases by 1 unit, the value of tax avoidance (Y) will increase by 0.2170987 percent assuming other independent variables are constant.

Based on the results of the Moderation Regression Analysis Test, it can be concluded as follows:

The role of Political connection in moderating the effect of Profitability on Tax avoidance

The significance value of the moderation variable ( $\beta_3$ ) Political connection is 0.924 (non-significant) and the significant value of the Interaction variable between Profitability and Political connection ( $\beta_4$ ) is significant at 0.000, this indicates that the moderation variable is a pure moderation type. The results of the moderation regression analysis show that the value of the profitability variable is significantly positive and the interaction variable of profitability with political connection is significantly positive, indicating a unidirectional relationship, so it is concluded that the political connection variable is a moderating variable that strengthens the positive effect of profitability on tax avoidance.

#### *Political connection in moderating the effect of leverage on tax avoidance*

The significance value of the moderating variable ( $\beta_3$ ) Political connection is 0.924 (non-significant) and the significant value of the interaction variable between leverage and Political connection ( $\beta_5$ ) is significant at 0.000, this indicates that the moderating variable is a pure moderation type. The results of the moderation regression analysis show that the value of the leverage variable is significantly positive and the interaction variable of leverage and political connection is significantly positive, indicating a unidirectional relationship, so it is concluded that the political connection variable is a moderating variable that strengthens the positive effect of leverage on tax avoidance.

### **Conclusion**

- 1) Profitability (ROA) statistically has a positive effect on corporate tax avoidance in the health sector and telecommunications sector for the period 2020-2023. This means that the higher the Return on Asset (ROA), the more tax avoidance will increase.
- 2) Leverage (DAR) statistically has a positive effect on tax avoidance in the health sector and the telecommunications sector for the period 2020-2023. This means that the higher the Debt to Asset Ratio (DAR), the more tax avoidance will increase.
- 3) Political connection is a moderating variable that strengthens the positive effect of the effect of profitability on tax avoidance. This means that the higher the Return on Asset (ROA), reinforced by the higher Political Connection, the higher the tax avoidance will be.
- 4) Political connection is a moderating variable that strengthens the positive effect of leverage on tax avoidance. This means that the higher the Debt to Asset Ratio (DAR), strengthened by the existence of a higher Political Connection, tax avoidance will increase.

#### *Managerial Implication*

This research highlights that corporate profitability and leverage have a significant effect on tax avoidance, while political connections can strengthen or weaken the effect depending on how the relationship is utilized. Companies,

especially in the healthcare and telecommunications sectors, need to improve tax transparency and compliance to avoid reputational risks and legal implications. Stricter regulation and supervision of politically connected companies are also important to curb tax avoidance practices that harm the state. These findings enrich the Political Connection theory and open up further research opportunities on the influence of political connections on corporate financial decisions across industry sectors.

### Research Limitation

This study has several limitations, including only focusing on health and telecommunications sector companies listed on the IDX during 2020-2023, so the results cannot be generalized to other sectors or companies. The use of secondary data from financial statements also limits the completeness of information, especially regarding subjective variables such as political connections and tax avoidance. In addition, this study only examines three main variables-profitability, leverage, and political connections-without considering other factors such as corporate governance, ownership structure, or management integrity that also have the potential to influence corporate taxation decisions.

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