

THE EFFECT OF GOOD CORPORATE GOVERNANCE ON TAX AVOIDANCE WITH PROFITABILITY AS A MODERATING VARIABLE: EVIDENCE FROM INDONESIAN MANUFACTURING COMPANIES

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Received: 05/04/2025 | Revised: 13/04/2025 | Accepted: 10/05/2025 | Published: 29/05/2025

Abstract

Purpose – This study investigates whether profitability moderates the association between Good Corporate Governance (GCG) mechanisms and tax avoidance in manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the 2020–2024 period. The key argument is that GCG effectiveness in constraining tax avoidance is conditional upon firm profitability levels, as higher profitability simultaneously increases both tax avoidance incentives and political costs of non-compliance.

Design/Methodology/Approach – This study analyzes 460 firm-year observations from 92 manufacturing companies selected through purposive sampling. The primary analysis employs panel data regression with firm fixed effects and year dummies using Stata 17, complemented by Moderated Regression Analysis (MRA) to test interaction effects. GCG is proxied by independent commissioners, audit committee size, institutional ownership, and external audit quality (Big Four affiliation). Tax avoidance is measured using Cash Effective Tax Rate (CETR), and profitability by Return on Assets (ROA). Robustness checks include pooled OLS, Book-Tax Difference as an alternative proxy, and split-sample analysis by profitability median.

Findings – Independent commissioners ($\beta = 0.148$; $p < 0.01$), institutional ownership ($\beta = 0.178$; $p < 0.01$), and audit quality ($\beta = 0.218$; $p < 0.01$) are significantly positively associated with CETR indicating lower tax avoidance. Audit committee size shows no significant association ($p = 0.132$). Profitability significantly moderates the associations between independent commissioners ($\beta = 0.164$; $p < 0.01$) and institutional ownership ($\beta = 0.142$; $p < 0.01$) with tax avoidance, but does not moderate the audit committee and audit quality paths.

Research Implications – The sample is confined to manufacturing companies, limiting cross-sector generalizability. CETR is influenced by temporary differences between accounting and taxable income. Audit quality is proxied solely by Big Four affiliation, not capturing qualitative dimensions. The observational design precludes definitive causal claims.

Originality/Value – This study provides evidence consistent with profitability functioning as a moderating mechanism that explains when GCG is effective in constraining tax avoidance. The findings reveal that strategic monitoring mechanisms (independent commissioners and institutional investors) are conditionally effective depending on profitability, while procedural compliance mechanisms (audit committees and external auditors) operate more universally. The 2020–2024 period covering pandemic disruption, fiscal incentives, and the implementation of Indonesia's Tax Harmonization Law provides a unique empirical setting.

Keywords: *Good Corporate Governance; Manufacturing Companies; Profitability; Tax Avoidance; Moderating Variable*

INTRODUCTION

Background of the Study

Tax revenue constitutes the primary source of Indonesia's national income, supporting more than 70% of the State Revenue and Expenditure Budget (APBN). However, Indonesia's tax ratio remains comparatively low relative to other ASEAN nations. Data from the Ministry of Finance indicate that the tax ratio stood at approximately 9.1% of GDP in 2022, rising to 10.2% in 2023 before declining to 9.8% in 2024 (Ministry of Finance, 2024). This persistently low tax ratio is partially attributable to tax avoidance practices by corporate taxpayers, particularly manufacturing companies that represent the largest non-oil and gas tax contributors (Directorate General of Taxes, 2023). Tax avoidance refers to legal strategies employed by firms to minimize tax burdens by exploiting provisions

within tax regulations (Hanlon & Heitzman, 2010). Although legal, these practices reduce state revenue that would otherwise be collected. Among manufacturing companies on the IDX, tax avoidance is observable through significant cross-firm variation in Cash Effective Tax Rates (CETR). Data indicate that the average CETR of manufacturing companies during 2020–2024 ranged between 0.18 and 0.28, where CETR values below the effective corporate tax rate of 22% suggest the presence of tax avoidance activities (Mulyani et al., 2022; Pratomo & Rana, 2021).

A particularly interesting phenomenon occurred during the 2020–2024 period, which encompasses the COVID-19 pandemic, fiscal incentive programs, and post-pandemic economic recovery. During the pandemic, the government provided various tax incentives including a reduction in the corporate income tax rate from 25% to 22% through Government Regulation in Lieu of Law (Perppu) No. 1 of 2020 which should theoretically have reduced firms' incentives for tax avoidance (Rahayu & Dewi, 2022). However, empirical evidence suggests that tax avoidance practices actually increased during the incentive period, indicating that internal corporate factors particularly governance structures and profitability play a more dominant role than regulatory factors in determining tax compliance levels (Kovermann & Velte, 2021). Furthermore, the implementation of Indonesia's Tax Harmonization Law (UU HPP) No. 7 of 2021 introduced structural changes to the tax landscape that may have altered the governance–tax avoidance dynamic in ways not captured by pre-pandemic research.

Good Corporate Governance (GCG) is believed to function as a monitoring mechanism that constrains opportunistic managerial behavior, including aggressive tax planning (Desai & Dharmapala, 2006). Based on agency theory (Jensen & Meckling, 1976), the separation of ownership and management creates conflicts of interest wherein management may exploit tax avoidance strategies for personal benefit through rent extraction (Desai & Dharmapala, 2009). GCG mechanisms such as independent commissioners, audit committees, institutional ownership, and audit quality serve as monitoring instruments that align managerial interests with those of shareholders and other stakeholders, including the government as tax recipient (Khatib et al., 2021; Alkurdi & Mardini, 2020).

However, prior research on the GCG–tax avoidance relationship has produced inconsistent findings. Alkurdi and Mardini (2020) and Kovermann and Velte (2021) found that GCG mechanisms significantly constrain tax avoidance. Conversely, Dyreng et al. (2019) and Lanis and Richardson (2015) reported that several GCG mechanisms have no significant effect, and in some cases may even facilitate more aggressive tax planning. In the Indonesian context, Mulyani et al. (2022) and Pratomo and Rana (2021) reported mixed results depending on the GCG proxy employed. This inconsistency suggests the presence of a conditional variable that influences GCG effectiveness in constraining tax avoidance.

Literature Review

The theoretical framework of this study integrates agency theory and political cost theory. Agency theory, as comprehensively reviewed by Panda and Leepsa (2021), explains that conflicts of interest between principals and agents create incentives for management to engage in opportunistic behavior including tax avoidance. GCG functions as a monitoring mechanism that constrains such managerial discretion (Khatib et al., 2021). Political cost theory (Watts & Zimmerman, 1986) complements this framework by explaining that firms with higher profitability face greater political scrutiny and public attention, and therefore tend to avoid excessively aggressive tax strategies to minimize political costs (Wahab et al., 2020).

Empirical evidence on the GCG–tax avoidance relationship has grown substantially in the past decade. Kovermann and Velte (2021) conducted a meta-analysis of 69 international studies and concluded that strong governance is, in aggregate, negatively associated with tax avoidance, although the strength of the relationship varies by institutional context. Alkurdi and Mardini (2020) found that board independence and audit quality significantly constrain tax avoidance in developing countries. In the ASEAN context, Salhi et al. (2020) documented that institutional ownership is negatively associated with tax aggressiveness. In Indonesia, Mulyani et al. (2022) confirmed the effectiveness of independent commissioners, while Pratomo and Rana (2021) found that audit committees alone are insufficient without adequate member expertise in taxation matters.

Profitability is hypothesized as the variable that moderates the GCG–tax avoidance relationship. Firms with higher profitability have larger taxable income, thereby increasing both the incentives and opportunities for tax avoidance (Wahab et al., 2020; Drake et al., 2020). Simultaneously, higher profitability increases firm visibility to tax authorities and the public, which should encourage greater compliance. The interaction between opportunistic pressures (tax avoidance incentives) and political pressures (oversight costs) creates conditions where GCG effectiveness becomes dependent on profitability levels a moderating mechanism that has been scarcely tested empirically, particularly in developing economies (Richardson et al., 2020).

Gap Analysis

The inconsistency in prior findings points to three research gaps. First, an analytical gap: existing studies predominantly examine the direct effect of GCG on tax avoidance without considering conditional factors that influence governance effectiveness. The contradictory results Alkurdi and Mardini (2020) finding significant effects while Dyreng et al. (2019) reporting insignificant results suggest an omitted moderating variable. This study addresses this gap by positioning profitability as a moderator that theoretically explains when GCG is effective and when it is not in constraining tax avoidance.

Second, a temporal gap: the majority of Indonesian studies on GCG and tax avoidance use pre-pandemic data, thus not accounting for the structural shifts in tax dynamics introduced by the COVID-19 pandemic, fiscal incentives, and the Tax Harmonization Law implementation. The 2020–2024 period uniquely encompasses three distinct economic phases pandemic (2020–2021), transition (2022–2023), and recovery (2024) each with different taxation and governance dynamics (Habib et al., 2022).

Third, a methodological gap: Indonesian research commonly employs pooled OLS regression that ignores firm-specific heterogeneity. This study uses panel fixed effects regression with clustered standard errors and Moderated Regression Analysis (MRA), providing more conservative and reliable estimates for panel data (Wooldridge, 2020).

Purpose and Hypotheses

This study aims to examine: (1) whether GCG mechanisms are associated with tax avoidance; and (2) whether profitability moderates these associations. The following hypotheses are formulated:

H¹: Independent commissioners are negatively associated with tax avoidance.

H²: Audit committee size is negatively associated with tax avoidance.

H³: Institutional ownership is negatively associated with tax avoidance.

H⁴: Audit quality is negatively associated with tax avoidance.

H^{5a–5d}: Profitability moderates the association between each GCG mechanism and tax avoidance.

METHOD

Research Design

This study employs a quantitative approach with a causal-explanatory design using secondary panel data from audited financial statements and annual reports of manufacturing companies listed on the IDX for the 2020–2024 period, sourced from www.idx.co.id and IDN Financials. The observational design examines associations within the theoretical framework; causal claims are not made (Wooldridge, 2020).

Population and Sampling

The population consists of all manufacturing companies listed on the IDX during 2020–2024 (208 companies). Purposive sampling criteria include: (1) consistently listed throughout the period; (2) published audited financial statements ending December 31; (3) complete data for all variables; (4) did not incur fiscal losses for more than two consecutive years; (5) financial statements in Rupiah; and (6) no delisting. Continuous variables are winsorized at the 1st and 99th percentiles (Wooldridge, 2020). The sample selection process is presented in Table 1.

Table 1. Sample Selection Process

No	Sample Selection Criteria	Total
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1	Manufacturing companies listed on IDX (2020–2024)	208
2	Not consistently listed during the research period	(30)
3	Incomplete data for research variables	(46)
4	Fiscal losses for more than 2 consecutive years	(24)
5	Financial statements in non-Rupiah currency	(10)
6	Delisted during the research period	(6)
	Total sample companies	92
	Total firm-year observations (92 × 5 years)	460

Source: Processed data, 2025

Instrument: Variable Measurement

Table 2 presents the operational definitions. The dependent variable, tax avoidance, is measured by CETR. Lower CETR indicates higher tax avoidance. The independent variables are four GCG mechanisms. The moderating variable is profitability (ROA). Control variables include firm size, leverage, and capital intensity, consistent with prior tax avoidance studies (Kovermann & Velte, 2021; Richardson et al., 2020).

Table 2. Variable Operationalization

Variable	Proxy	Measurement	Scale
Tax Avoidance (Y)	CETR	Cash taxes paid / Pre-tax income	Ratio
Independent Comm. (X ₁)	INDP	Independent commissioners / Total board	Ratio
Audit Committee (X ₂)	ACSIZE	Number of audit committee members	Ratio
Institutional Own. (X ₃)	INST	Institutional shares / Total shares × 100%	Ratio
Audit Quality (X ₄)	BIG4	Dummy: 1 = Big Four auditor, 0 = Non-Big Four	Nominal
Profitability (Mod.)	ROA	Net income / Total assets	Ratio
Firm Size (Control)	SIZE	Ln (Total Assets)	Ratio
Leverage (Control)	LEV	Total Debt / Total Assets	Ratio
Capital Intensity (Ctrl)	CAPINT	Fixed Assets / Total Assets	Ratio

Source: Compiled from various sources, 2025

Analysis Plan

Data analysis employs panel data regression estimated in Stata 17. The Hausman test selects between fixed effects (FE) and random effects (RE). Year dummies control for time-specific shocks, particularly pandemic effects (2020–2021) and Tax Harmonization Law implementation (2022). Standard errors are clustered at the firm level (Wooldridge, 2020). Two models are estimated:

Model 1 (Direct Effect):

$$CETR_{it} = \alpha + \beta_1 INDP_{it} + \beta_2 ACSIZE_{it} + \beta_3 INST_{it} + \beta_4 BIG4_{it} + \beta_5 SIZE_{it} + \beta_6 LEV_{it} + \beta_7 CAPINT_{it} + \mu_i + \delta_t + \varepsilon_{it}$$

Model 2 (Moderated Regression Analysis):

$$CETR_{it} = \alpha + \beta_1 INDP_{it} + \beta_2 ACSIZE_{it} + \beta_3 INST_{it} + \beta_4 BIG4_{it} + \beta_5 ROA_{it} + \beta_6 (INDP \times ROA)_{it} + \beta_7 (ACSIZE \times ROA)_{it} + \beta_8 (INST \times ROA)_{it} + \beta_9 (BIG4 \times ROA)_{it} + \text{Controls} + \mu_i + \delta_t + \varepsilon_{it}$$

Where μ_i = firm fixed effects and δ_t = year fixed effects. Interpretation note: lower CETR indicates higher tax avoidance. Accordingly, a positive coefficient on a GCG variable indicates that the mechanism increases CETR (reduces tax avoidance), interpreted as a constraining effect on tax avoidance.

Robustness checks include: (1) pooled OLS estimation; (2) Book-Tax Difference (BTD) as an alternative tax avoidance proxy; and (3) split-sample analysis by ROA median to confirm that GCG effects are stronger in the high-profitability subsample.

Scope and Limitations of Methodology

The observational design precludes definitive causal inference. Panel fixed effects control for time-invariant unobserved heterogeneity, but endogeneity from simultaneity remains possible (Wooldridge, 2020). CETR is influenced by temporary differences between accounting and taxable income and may not capture all dimensions of tax aggressiveness. Audit quality proxied solely by Big Four affiliation does not capture qualitative dimensions such as audit team expertise and industry specialization (Bédard & Gendron, 2023).

3. RESULTS AND DISCUSSION

Results

Descriptive Statistics

Table 3 presents descriptive statistics based on 460 firm-year observations after winsorization.

Table 3. Descriptive Statistics

Variable	N	Minimum	Maximum	Mean	Std. Deviation
CETR	460	0.042	0.486	0.2318	0.08412
INDP	460	0.200	0.800	0.4082	0.09218
ACSIZE	460	2.000	5.000	3.1412	0.44216
INST	460	0.112	0.984	0.6614	0.17428
BIG4	460	0.000	1.000	0.3842	0.48682
ROA	460	-0.184	0.382	0.0648	0.08216
SIZE	460	25.418	33.682	28.5216	1.52814
LEV	460	0.048	0.884	0.4128	0.18412
CAPINT	460	0.042	0.718	0.3284	0.16218

Source: Stata 17 output, 2025

The mean CETR of 0.2318 is slightly above the effective corporate tax rate of 22%, but the wide distribution (minimum 0.042; maximum 0.486) indicates significant cross-firm variation in tax avoidance levels. Approximately 38.4% of sample firms are audited by Big Four firms. The mean ROA of 0.0648 reflects moderate profitability with substantial variation, capturing the heterogeneous pandemic and recovery impacts on manufacturing firm performance.

Diagnostic Tests

Table 4 summarizes the specification and diagnostic tests for both panel models.

Table 4. Diagnostic and Specification Tests

Diagnostic Test	Model 1 (Direct)	Model 2 (MRA)
Hausman Test (Chi ² /Sig.)	32.418 / 0.000 → Fixed Effects	38.216 / 0.000 → Fixed Effects
Year Dummies F-test	F = 5.842; p = 0.000 → Significant	F = 4.618; p = 0.001 → Significant
Modified Wald (Heteroscedasticity)	Chi ² = 918.42; p = 0.000 → Clustered SE	Chi ² = 1124.86; p = 0.000 → Clustered SE
Wooldridge Autocorrelation	F = 1.842; p = 0.178 → No autocorrelation	F = 2.118; p = 0.148 → No autocorrelation
Mean VIF	1.48 (< 10) → No multicollinearity	2.84 (< 10) → No multicollinearity

Source: Stata 17 output, 2025

The Hausman test rejects the null for both models ($p < 0.01$), supporting fixed effects estimation. Year dummies are jointly significant, confirming time-specific effects during the pandemic and Tax Harmonization Law

implementation periods. The Modified Wald test detects heteroscedasticity, addressed through firm-clustered standard errors (Wooldridge, 2020). No serial autocorrelation or multicollinearity is detected.

Panel FE Model 1: Direct Effect of GCG on Tax Avoidance

Table 5 presents the fixed effects regression results for Model 1.

Table 5. Panel FE Model 1 (Direct Effect: GCG → Tax Avoidance)

Variable	B	Clustered SE	Beta (β)	t-stat	Sig.	Decision
(Constant)	0.384	0.082		4.682	0.000	
INDP (X ₁)	0.128	0.042	0.148	3.048	0.003	H ₁ Supported
ACSIZE (X ₂)	0.012	0.008	0.064	1.512	0.132	H ₂ Not Supported
INST (X ₃)	0.086	0.024	0.178	3.584	0.000	H ₃ Supported
BIG4 (X ₄)	0.038	0.014	0.218	2.714	0.007	H ₄ Supported
SIZE	-0.008	0.004	-0.142	-2.124	0.034	Significant
LEV	-0.064	0.022	-0.138	-2.908	0.004	Significant
CAPINT	-0.048	0.018	-0.092	-2.668	0.008	Significant
Year Dummies						Included
Firm Fixed Effects						Included

Source: Stata 17 output, 2025

Within $R^2 = 0.284$; $F = 22.416$; $Sig. = 0.000$; $N = 460$; $Firms = 92$. Clustered SE at firm level.

Interpretation note: positive coefficients on GCG variables indicate that the mechanism increases CETR (reduces tax avoidance).

Independent commissioners are significantly positively associated with CETR ($\beta = 0.148$; $p = 0.003$), indicating that a greater proportion of independent commissioners is associated with higher CETR and lower tax avoidance, supporting H₁. Economically, a one-standard-deviation increase in INDP is associated with an approximately 1.4 percentage point increase in CETR a meaningful magnitude given the sample mean CETR of 23.18%. Audit committee size shows a positive but insignificant association ($\beta = 0.064$; $p = 0.132$), failing to support H₂. This finding suggests that committee size alone is an insufficient proxy for tax oversight effectiveness consistent with the argument that member tax expertise is more determinative (Pratomo & Rana, 2021; Bédard & Gendron, 2023).

Institutional ownership demonstrates a strong positive association with CETR ($\beta = 0.178$; $p = 0.000$), supporting H₃. Institutional investors possess superior monitoring capabilities and tend to avoid aggressive tax strategies that may generate reputational risk and litigation exposure (Salhi et al., 2020; Khan et al., 2020). Audit quality shows the largest positive association with CETR ($\beta = 0.218$; $p = 0.007$), supporting H₄ firms audited by Big Four firms tend to have higher CETR, consistent with the argument that high-quality auditors constrain aggressive tax planning (Kovermann & Velte, 2021).

Panel FE Model 2: Moderated Regression Analysis

Table 6 presents the MRA results testing the moderating effect of profitability.

Table 6. Panel FE Model 2 (MRA: GCG $\times$ Profitability $\rightarrow$ Tax Avoidance)

Variable	B	Clust. SE	Beta	t-stat	Sig.	Decision
(Constant)	0.342	0.088		3.886	0.000	
INDP	0.118	0.044	0.136	2.682	0.008	
ACSIZE	0.010	0.008	0.054	1.284	0.200	
INST	0.078	0.026	0.162	3.000	0.003	
BIG4	0.034	0.014	0.196	2.428	0.016	
ROA	0.284	0.068	0.278	4.176	0.000	
INDP $\times$ ROA	0.412	0.148	0.164	2.784	0.006	H _{5a} Supported
ACSIZE $\times$ ROA	0.086	0.062	0.068	1.388	0.166	H _{5b} Not Supported
INST $\times$ ROA	0.348	0.124	0.142	2.806	0.005	H _{5c} Supported
BIG4 $\times$ ROA	0.118	0.084	0.072	1.404	0.162	H _{5d} Not Supported
SIZE	-0.006	0.004	-0.108	-1.684	0.093	
LEV	-0.058	0.022	-0.126	-2.636	0.009	
CAPINT	-0.042	0.018	-0.082	-2.334	0.020	
Year Dummies						Included
Firm FE						Included

Source: Stata 17 output, 2025

Within $R^2 = 0.358$; $F = 18.842$; $Sig. = 0.000$; $N = 460$; $Firms = 92$. Clustered SE at firm level.

The increase in Within R^2 from 0.284 (Model 1) to 0.358 (Model 2) indicates that the addition of interaction terms substantively improves model explanatory power.

The INDP $\times$ ROA interaction is significantly positive ($\beta = 0.164$; $p = 0.006$), supporting H_{5a}. Profitability strengthens the negative association between independent commissioners and tax avoidance in more profitable firms, the monitoring effect of independent commissioners becomes stronger in constraining tax avoidance. The INST $\times$ ROA interaction is also significantly positive ($\beta = 0.142$; $p = 0.005$), supporting H_{5c}. Institutional investors are more effective in constraining tax avoidance in profitable firms, likely due to greater political cost pressures.

Conversely, the ACSIZE $\times$ ROA ($\beta = 0.068$; $p = 0.166$) and BIG4 $\times$ ROA ($\beta = 0.072$; $p = 0.162$) interactions are not significant, thus H_{5b} and H_{5d} are not supported. These findings indicate that audit committee and external audit effectiveness in constraining tax avoidance is not conditional upon profitability likely because both mechanisms operate through structural regulatory compliance channels rather than opportunistic monitoring channels.

Robustness Checks

Three robustness checks are conducted (Table 7). First, pooled OLS estimation yields qualitatively similar results, with systematically larger coefficients consistent with upward bias from uncontrolled firm heterogeneity (Wooldridge, 2020). Second, using Book-Tax Difference (BTD) as an alternative tax avoidance proxy produces consistent coefficient signs and significance. Third, split-sample analysis by ROA median confirms that GCG effects are substantially stronger in the high-profitability subsample, corroborating the moderation findings.

Table 7. Robustness Checks

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Specification	Panel FE (Main)	Pooled OLS	Panel FE-BTD	High ROA Subsample
INDP → CETR	0.148**	0.172***	0.134**	0.218***
INST → CETR	0.178***	0.198***	0.162**	0.242***
BIG4 → CETR	0.218**	0.248***	0.194**	0.268***
INDP×ROA	0.164**	0.188***	0.148*	0.212***
INST×ROA	0.142**	0.168**	0.128*	0.196**
Within/Adj. R ²	0.358	0.412	0.326	0.418
N	460	460	460	230

Source: Stata 17 output, 2025

*** $p < 0.01$; ** $p < 0.05$; * $p < 0.10$.

Summary of Hypothesis Testing

Table 8 presents a comprehensive summary of all hypothesis testing results.

Table 8. Summary of Hypothesis Testing Results

No	Hypothesis	Coeff.	Sig.	Result
H ₁	Independent commissioners are negatively associated with tax avoidance	0.148	0.003	Supported
H ₂	Audit committee size is negatively associated with tax avoidance	0.064	0.132	Not Supported
H ₃	Institutional ownership is negatively associated with tax avoidance	0.178	0.000	Supported
H ₄	Audit quality is negatively associated with tax avoidance	0.218	0.007	Supported
H _{5a}	ROA moderates INDP → tax avoidance	0.164	0.006	Supported
H _{5β}	ROA moderates ACSIZE → tax avoidance	0.068	0.166	Not Supported
H _{5□}	ROA moderates INST → tax avoidance	0.142	0.005	Supported
H _{5^d}	ROA moderates BIG4 → tax avoidance	0.072	0.162	Not Supported

Source: Processed data, 2025

Discussion

The significant positive association between independent commissioners and CETR ($\beta = 0.148$; $p = 0.003$) is consistent with agency theory, confirming that independent commissioners serve as effective monitors constraining opportunistic tax planning behavior (Panda & Leepsa, 2021; Alkurdi & Mardini, 2020). Commissioners without managerial affiliation provide more objective oversight of corporate tax strategies, ensuring that tax planning does not exceed reasonable compliance boundaries. This finding aligns with Mulyani et al. (2022) in the Indonesian context and Kovermann and Velte (2021) in their international meta-analysis.

The insignificant finding for audit committee size ($\beta = 0.064$; $p = 0.132$) should not be interpreted as evidence that audit committees are unimportant in the tax context. Rather, this finding more likely reflects the limitations of size as a proxy. As argued by Pratomo and Rana (2021) and Bédard and Gendron (2023), audit committee effectiveness in constraining tax avoidance depends critically on members' tax expertise, frequency of meetings, and independence from management dimensions not captured by headcount alone. Most sample firms maintain the regulatory minimum of three members with limited variation.

Institutional ownership demonstrates the strongest association with CETR ($\beta = 0.178$; $p = 0.000$), consistent with the monitoring hypothesis. Institutional investors tend to avoid aggressive tax strategies due to reputational risk,

potential sanctions from tax authorities, and the uncertainty generated by uncertain tax positions that may reduce firm valuation (Salhi et al., 2020; Khan et al., 2020). Audit quality shows the largest coefficient ($\beta = 0.218$; $p = 0.007$), confirming that Big Four auditors provide additional oversight of aggressive tax planning (Kovermann & Velte, 2021).

The moderation findings constitute the study's primary contribution. Profitability significantly strengthens the constraining effects of independent commissioners ($\beta = 0.164$; $p = 0.006$) and institutional ownership ($\beta = 0.142$; $p = 0.005$) on tax avoidance. These findings are consistent with political cost theory: firms with higher profitability are more visible to tax authorities and the public, making GCG more effective in constraining tax avoidance as the political costs of non-compliance increase (Wahab et al., 2020; Richardson et al., 2020). In profitable firms, independent commissioners and institutional investors have stronger incentives to ensure tax compliance because reputational risks from aggressive tax strategies are amplified.

Conversely, the insignificant moderation for audit committees and audit quality suggests that these mechanisms operate through structural compliance channels adherence to audit standards and financial reporting procedures that are relatively independent of profitability levels (Bédard & Gendron, 2023). This finding provides an important nuance: strategic monitoring mechanisms (commissioners and institutional investors) are conditionally effective depending on profitability, while procedural compliance mechanisms (audit committees and external auditors) operate more universally regardless of profitability. This distinction enriches the understanding of how and when different governance mechanisms constrain tax avoidance.

Implications

The theoretical implication extends agency theory and political cost theory by demonstrating that the GCG–tax avoidance relationship is conditional upon profitability and varies by governance mechanism type. For corporate management, the findings emphasize the importance of strengthening board independence and institutional investor roles, particularly during periods of high profitability. For the Directorate General of Taxes, the findings suggest that tax enforcement should be prioritized toward profitable firms with weak governance structures. For financial regulators (OJK), the findings support strengthening requirements regarding audit committee members' tax expertise.

Research Contribution

This study makes three contributions. First, it provides evidence from a developing economy that profitability functions as a moderating variable that explains when GCG is effective in constraining tax avoidance distinguishing between conditionally effective strategic monitoring mechanisms and universally effective procedural compliance mechanisms (Richardson et al., 2020). Second, panel fixed effects with clustered standard errors and MRA provide more conservative estimates than the pooled OLS approach prevalent in Indonesian research (Wooldridge, 2020). Third, the 2020–2024 period covering pandemic disruption, fiscal incentives, and Tax Harmonization Law implementation provides a comprehensive temporal perspective on governance–tax avoidance dynamics under varying economic and regulatory conditions.

Limitations

Several limitations should be acknowledged. First, the sample is confined to manufacturing companies; generalization to other sectors requires separate replication. Second, CETR is influenced by temporary differences and may not capture all dimensions of tax aggressiveness (Drake et al., 2020). Third, audit quality is proxied solely by Big Four affiliation without considering industry specialization or audit team experience (Bédard & Gendron, 2023). Fourth, the observational design limits causal inference despite fixed effects controls (Wooldridge, 2020). Fifth, the 2020–2024 period includes structural regulatory changes that may confound the governance–tax avoidance relationship.

Suggestions for Future Research

Future research should: (1) extend the sample to non-manufacturing sectors such as mining and banking; (2) employ multidimensional tax avoidance proxies encompassing BTDR, ETR, and DTAX simultaneously; (3) measure audit committee effectiveness through competence indices and meeting frequency; (4) consider additional moderating variables such as ownership concentration, media pressure, or political connections; (5) employ instrumental variable or GMM estimation to strengthen causal inference; and (6) test whether the Tax Harmonization Law created a structural break in the GCG–tax avoidance relationship.

4. CONCLUSION

This study examined whether profitability moderates the association between GCG and tax avoidance in manufacturing companies listed on the IDX for the 2020–2024 period. The results confirm that independent commissioners, institutional ownership, and audit quality are significantly negatively associated with tax avoidance, while audit committee size shows no significant association. Profitability significantly moderates the associations between independent commissioners and institutional ownership with tax avoidance, but does not moderate the audit committee and audit quality paths. The primary contribution is the demonstration that GCG effectiveness in constraining tax avoidance is conditional strategic monitoring mechanisms (independent commissioners and institutional investors) are more effective in profitable firms due to heightened political costs, while procedural compliance mechanisms (audit committees and external auditors) operate more universally. These findings apply specifically to Indonesian manufacturing companies during 2020–2024 and represent observational panel associations; generalization to other sectors, periods, or country contexts should not be assumed without separate replication.

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