

# Do Investors Care About Tax Avoidance? Evidence from Indonesia

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**A** The purpose of this study is to investigate the response of investors to instances of corporate tax  
**B** avoidance in Indonesia, which is typified by corporate risk and firm value. This research employs  
**S** data from all companies listed on the Indonesian Stock Exchange, with the exception of financial  
**T** sector companies, for the four -year period between 2020 and 2023. The research method is panel  
**R** data regression, with the Common Effect Model identified as the optimal regression model. The  
**A** findings indicate that tax avoidance is associated with an increase in corporate risk, yet in the  
**C** short term, it is linked to an increase in firm value. This research concludes that investors perceive  
**T** tax avoidance behavior in a negative light.

**T** **Keywords:** Tax Avoidance, Corporate Risk, Firm Value.

## 1. Introduction

It is evident that tax avoidance practices remain a prevalent phenomenon in Indonesia. This is due to the fact that a considerable number of taxpayers perceive tax avoidance as a legitimate means of action (Hidranto, 2023). The consequence of persistent tax avoidance by corporations is the suboptimal generation of state cash revenues. The Indonesian government continues to pursue the prevention of all forms of tax avoidance through the issuance of regulations. One of the most recent regulations pertaining to the prevention of tax avoidance practices is Peraturan Pemerintah No. 55 Tahun 2022 concerning adjustments to income tax rules, which is a derivative of Undang - Undang No. 7 Tahun 2021 concerning Tax Harmonization (UU HPP). The issuance of new regulations and improvements to existing legislation by the government indicates that this practice remains prevalent. It is commonly assumed by taxpayers that the tax avoidance actions taken by companies will result in a reduction of their tax payment obligations, thereby maximizing the value received by shareholders. Dyreng et al., (2019) asserted that tax avoidance is not merely an attempt to reduce taxes, but rather encompasses a spectrum of tax reduction activities, ranging from innocuous strategies that minimize taxes to aggressive tactics that would otherwise be impermissible. In the event of litigation, the outcome could be favorable for the plaintiff. Consequently, the practice of tax avoidance introduces an element of uncertainty for companies, particularly with regard to their future tax obligations. This uncertainty increases the risk of declining stock prices (Kim et al., 2011; Su & Deng, 2024). Investors are averse to tax avoidance practices that are associated with a decline in firm value (Chen et al., 2014; Desai & Dharmapala, 2006, 2009), as well as an elevated risk of declining stock prices (Kim et al., 2011). The practice of tax avoidance is correlated with the prevalence of aggressive financial reporting, which in turn increases uncertainty regarding the value of company shares (Ginting & Martani, 2017; Guenther et al., 2017).

The objective of this research is to ascertain empirical evidence regarding the impact of tax avoidance on corporate risk and value. It is anticipated that the findings of this study will raise awareness among companies as taxpayers that tax avoidance is not a legally permissible action and can have a detrimental effect on the company due to the negative consequences of such actions. Furthermore, it is expected that the results will demonstrate that such actions are not favorably viewed by investors. This research on tax avoidance will be conducted over the period 2020-2023, with a particular focus on investor reactions to tax avoidance in Indonesia over the past four years, during which time numerous new regulations have been introduced. This research also builds upon the work of Dyreng et al. (2008), who tested the years 1995-2004, and Blouin (2014), who tested the period 2005-2013. It is hoped that the results of this research will provide the latest contribution regarding tax avoidance.

## 2. Theoretical Background

Table 1. Operational Definition of Variables

The agency theory, as proposed by Jensen & Meckling (1976) and Eisenhardt (1989), is a significant contribution to the field of organizational studies. The agency theory posits that in a company, there exists a principal, who is the owner (investor), and an agent, who is the party authorized (manager) by the principal to oversee the operations of the company. While both investors and managers share the objective of maximizing company value, their approaches to achieving this goal frequently diverge. Managers will employ a variety of strategies to maximize corporate profits, as these actions can offer substantial incentives, despite the inherent risks associated with such methods. One method employed to maximize profits is the avoidance of taxes, which are viewed as a reduction in company profits. Consequently, asymmetric information is frequently unavoidable, whereby company managers do not disclose the actual financial condition of the company in financial reports, but rather information that is advantageous for themselves. This discrepancy in information arises when both parties prioritize profits above all else. Company owners are primarily concerned with achieving positive financial outcomes, yet they may lack clarity regarding the specific means through which these profits are generated. Conversely, company managers will endeavor to present elevated profits in financial reports pertaining to their remuneration. Company managers endeavor to present the most favorable financial results to investors.

As posited by Hanlon & Heitzman (2010), tax avoidance can be defined as a series of activities undertaken with the explicit intention of reducing the amount of tax payable. It can be inferred that the greater the number of activities a company engages in with the objective of reducing its tax liability, the more aggressive its tax strategy is likely to be. Balakrishnan et al. (2019) posited that a company's proclivity towards tax avoidance is inversely correlated with the transparency of information it provides to investors. Ginting Martani (2017) demonstrates a significant correlation between aggressive tax avoidance and aggressive financial reporting. In such cases, companies will present complex reporting that is not transparent in nature (Desai & Dharmapala, 2006). The uncertainty of future taxes and the lack of transparency in corporate reporting increase the risk of financial collapse for companies (Kim et al., 2011). Furthermore, tax avoidance by companies may result in future tax payments related to tax audits. Bauckloh et al. (2021) present empirical evidence indicating that US investors exhibit a negative reaction when presented with information regarding the potential financial implications of tax avoidance on companies, which subsequently results in a decline in stock prices. Accordingly, the initial hypothesis of this research is that tax avoidance affects corporate risk.

Tax avoidance is regarded as a managerial strategy employed to disguise unfavorable information that could mislead investors and, consequently, diminish the firm's value (Desai & Dharmapala, 2009; Hanlon & Slemrod, 2009; Wang, 2011). Guedrib & Marouani (2023) assert that investors view tax avoidance negatively, characterizing it as a risky action that reduces firm value. Accordingly, the second hypothesis of this research is that tax avoidance affects firm value.

## 3. Methods

The present study employs a comprehensive sample comprising all companies listed on the Indonesian Stock Exchange, with the exception of those operating within the financial sector. The samples were selected based on the criteria outlined in the following section, which employs the method of purposive sampling.

The company is not involved in the financial sector.

The company was not included in any listings or delisting during the specified research period, which spanned from 2020 to 2023.

The company has complete data according to the indicators used.

Companies that use the rupiah as their reporting currency. The data collection technique employed is the retrieval of secondary data from a database. The data set employed in this research is panel data, which will be subjected to panel data regression analysis. The following table presents the operational definitions of the variables employed in the research:

Variable	Indicator
Effective Tax Rate (ETR)	Tax Avoidance: A comparison of the income tax expense with the profit before tax (Dyreng et al., (2008). A higher ETR is indicative of a reduced degree of aggressive tax avoidance practices.
Firm Value: Tobin's Q (TQ)	A comparison is made between the sum of the book value of debt and the market value of ordinary shares, with the book value of assets (Kim et al., 2011; Yee et al., 2018).
Corporate Risk: Corporate Risk (CR)	Volatility of stock returns (Guenther et al., 2017).
Control Variables-Company Characteristics:	
Size	Natural logarithm of total assets (Desai & Dharmapala, 2009; Yee et al., 2018).
DER	The ratio of long-term debt to total assets (Desai & Dharmapala, 2009; Yee et al., 2018).
ROA	Comparison of net profit with total assets (Desai & Dharmapala, 2009; Yee et al., 2018).
Control Variable-Fixed Effect:	
Industry	Industry types based on the Global Industry Classification Standard

The process of hypothesis testing is conducted through panel data regression, which encompasses the following steps:

In order to identify the most optimal regression model, three tests will be applied: Chow Test, Hausman Test and Lagrange Multiplier Test.

Classical assumptions test is conducted to guarantee that the data obtained through research are not affected by any issues related to classical assumptions.

The Goodness of Fit Model Test is conducted to ascertain the accuracy of the regression model and to confirm that the independent variables are indeed capable of accurately predicting the dependent variable.

A panel data regression test was conducted. The regression equations utilized in this research are as follows:

$$CR = \beta_0 + \beta_1ETR + \beta_2SIZE_{it} + \beta_3DER_{it} + \beta_4ROA_{1it} + \beta_5INDUSTRY_{it} + \varepsilon \quad (1)$$

$$FV = \beta_0 + \beta_1ETR + \beta_2SIZE_{it} + \beta_3DER_{it} + \beta_4ROA_{1it} + \beta_5INDUSTRY_{it} + \varepsilon \quad (2)$$

Dimana:

CR : Corporate Risk

FV : Firm Value

ETR : Tax Avoidance as measured by ETR

SIZE : Size of the company as control variable

DER : Debt to Equity Ratio as control variable

ROA : Return on Asset Ratio as control variable

INDUSTRY : Type of industry as control variable

$\varepsilon$  : Residual value

e) Robustness test is conducted to prevent endogeneity issues.

#### 4. Results and Discussion

The research utilized all companies listed on the Indonesia Stock Exchange, with the exception of those operating within the financial sector and those not included in sectors based on the Global Industry Classification Standard. This resulted in a total of 637 companies being included in

the study. Of the 637 companies, 352 were identified as eligible for inclusion based on the completeness of the data required by the researchers.

The research data has been subjected to a series of classical assumption tests and has been found to meet all of the requisite criteria. The results of the Chow Test, Hausman Test, and Lagrange Multiplier Test indicated that the optimal model for this research was the Common Effect Model (CEM). The following section presents an overview of ETR in Indonesia over the past four years.

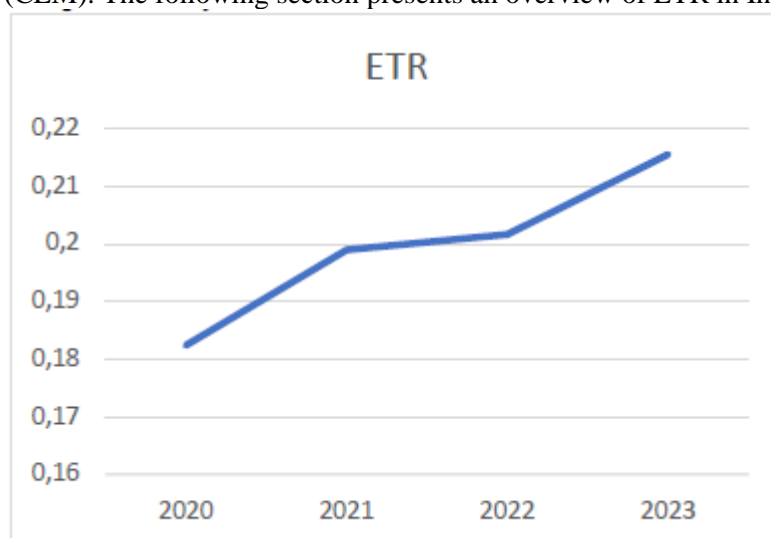


Figure 1. ETR

As illustrated in the above image, the ETR value has been observed to increase on an annual basis. An elevated ETR is indicative of a diminished prevalence of tax avoidance. This indicates a reduction in the level of tax avoidance, or a shift towards less aggressive tax planning by companies. This is related to the introduction of new regulations by the government in the context of tax avoidance, as well as the implementation of numerous amendments to existing legislation. The hypothesis test that follows will examine investor reactions to tax avoidance by companies.

### Hypotheses Test

The following section presents the results of the Common Effect Model testing.

Table 2. Tax Avoidance and Corporate Risk

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	4.936541	1.179149	4.186527	0.0000
TA	-0.281337	0.325474	-0.864391	0.0375
SIZE	-0.165834	0.041927	-3.955248	0.0001
ROA	1.581648	0.585895	2.699543	0.0070
DER	1.811088	0.503066	3.600101	0.0003
INDUSTRI	0.323857	0.132424	2.445613	0.0146
Root MSE	2.449911	R-squared	0.020032	
Mean dependent var	0.588879	Adjusted R-squared	0.016537	
Hannan-Quinn criter.	4.646864	F-statistic	5.731652	
Durbin-Watson stat	1.354139	Prob(F-statistic)	0.000030	

As evidenced by the data presented in the table above, the probability value associated with the F-statistic is less than 0.05, which provides sufficient evidence to conclude that the regression model is an accurate representation of the data. The probability value of 0.0375 for tax avoidance, as measured by the Effective Tax Rate (ETR), is below the value of 0.05, indicating that there is a negative relationship between ETR and corporate risk. The ETR indicator is employed in the context of tax avoidance, whereby a higher ETR value is indicative of a company that is not engaging in aggressive tax avoidance. Therefore, it can be concluded that there is a negative correlation between ETR and

corporate risk. In other words, as ETR increases, corporate risk decreases. The findings of this study indicate that a reduction in a company's tax avoidance practices is associated with a corresponding decline in its risk profile.

The practice of tax avoidance is indicative of a lack of transparency towards investors and a reduction in the comparability of accounting practices (Baker et al., 2023; Balakrishnan et al., 2019). This can result in elevated share price volatility (Su & Deng, 2024), which will in turn precipitate a decline in stock market performance due to investor distrust. Furthermore, tax avoidance results in inefficiency in investment (Benkraiem et al., 2024), a reduction in credit ratings, and an increase in corporate risk (Ariff et al., 2023; Dhawan et al., 2020; Edwards et al., 2016; Richardson et al., 2015).

Table 3. Tax Avoidance and Firm Value

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.392481	0.070828	19.66008	0.0000
TA	-0.056973	0.019567	-2.911711	0.0037
SIZE	-0.022853	0.002519	-9.073833	0.0000
ROA	0.091678	0.035189	2.605329	0.0093
DER	0.154153	0.030233	5.098883	0.0000
INDUSTRI	0.032134	0.007963	4.035271	0.0001
Root MSE	0.147131	R-squared		0.069879
Mean dependent var	0.763028	Adjusted R-squared		0.066554
Hannan-Quinn criter.	-0.978067	F-statistic		21.02096
Durbin-Watson stat	0.180197	Prob(F-statistic)		0.000000

As evidenced by the data presented in the table above, the probability value associated with the F-statistic is less than 0.05, which provides sufficient evidence to conclude that the regression model is an accurate representation of the data. The probability value associated with tax avoidance (TA) is 0.0000, as measured by the Effective Tax Rate (ETR), which falls below the value of 0.05. This observation leads to the conclusion that there is a negative relationship between ETR and firm value. A higher ETR value signifies that the company is not engaging aggressive tax avoidance. Therefore, ETR has a negative effect on firm value. A higher ETR corresponds to a lower firm value, indicating that a high ETR is indicative of low tax avoidance. The findings of this study indicate that an increase in a company's tax avoidance levels is associated with an increase in its valuation.

This finding is not aligned with the conclusions of prior research conducted by Chen et al. (2014), Guedrib & Marouani (2023), and Dyussemina & Park (2024). These studies posit that tax avoidance practices have a negative impact on firm value. The findings of this study align with those of Desai & Dharmapala (2009) and Hasan et al. (2021), which report a positive impact on firm value. The practice of tax avoidance by companies results in tax savings, which in turn lead to an increase in firm value. Nevertheless, Desai & Dharmapala (2009) posit that the positive effect of tax avoidance on firm value can only be observed in companies that have effective governance structures in place. Moreover, Hasan et al. (2021) posit that tax avoidance enhances firm value for companies that possess the requisite knowledge, capabilities, culture, business processes, and systems to facilitate efficiency. The present study employs a relatively brief observation period of four years, which allows for the conclusion that, in the short term, tax avoidance will increase firm value.

### Robustness Test

#### Robustness test was conducted to prevent endogeneity issues.

Table 4. Robustness Test for Tax Avoidance and Corporate Risk

Variable	TA-CR Model		Robust Model	
C	4.186527	0.0000	4.499777	0.0000
TA	-0.864391	0.0375	-0.945070	0.0346
SIZE	-3.955248	0.0001	-2.644248	0.0082
ROA	2.699543	0.0070	4.250744	0.0000

DER	3.600101	0.0003	1.287677	0.1979
INDUSTRI	2.445613	0.0146	2.245907	0.0247

Table 5. Robustness Test for Tax Avoidance and Firm Value

Variable	TA-FV Model		Robust Model	
C	19.66008	(0.0000)	23.55434	(0.0000)
TA	-2.911711	(0.0037)	-4.350402	(0.0000)
SIZE	-9.073833	(0.0000)	-11.28096	(0.0000)
ROA	2.605329	(0.0093)	2.561726	(0.0104)
DER	5.098883	(0.0000)	7.825012	(0.0000)
INDUSTRI	4.035271	(0.0001)	4.374192	(0.0000)

The robustness test results show results that are consistent with the regression test, so it can be said that the results in this study pass the model robustness test.

## 5. Conclusion

The findings of the research study demonstrate that investors respond to the implementation of tax avoidance practices by companies. Investors respond negatively to tax avoidance practices by companies, resulting in elevated volatility in company stock returns. The degree of tax avoidance practiced by a company is directly correlated with the level of risk it assumes. Nevertheless, in the short term, the implementation of tax avoidance practices has been demonstrated to enhance a company's valuation, largely due to the tax savings that result from such actions. Nevertheless, it is imperative for companies to recognize that the potential for tax avoidance to enhance corporate value is contingent upon the presence of robust governance structures, a comprehensive understanding of the subject matter, the capacity to execute effectively, a supportive organizational culture, streamlined business processes, and reliable technological systems (Desai & Dharmapala, 2009; Hasan et al., 2021). Therefore, further research on this topic is required.

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