Leverage, Capital Intensity, and Institutional Ownership as Determinants of Tax Avoidance in Indonesian Manufacturing Firms

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Abstract. This study investigates the impact of leverage, capital intensity, and institutional ownership on tax avoidance in manufacturing companies listed on the Indonesia Stock Exchange (IDX) from 2020 to 2022. Using multiple linear regression analysis, tax avoidance was assessed through the Effective Tax Rate (ETR). The results indicate that leverage significantly affects tax avoidance, with a p-value of 0.0010, suggesting that higher leverage leads to greater tax avoidance, as companies use debt interest payments to reduce taxable income. In contrast, the capital intensity ratio does not significantly influence tax avoidance, with a p-value of 0.0743, indicating that capital investment does not play a major role in reducing taxes. Institutional ownership, however, shows a significant positive effect on tax avoidance, with a p-value of 0.0025. This suggests that companies with higher institutional ownership are more likely to engage in tax avoidance strategies, likely due to increased pressure from institutional investors. The findings emphasize that while leverage and institutional ownership significantly contribute to tax avoidance, capital intensity does not have a substantial impact. This study offers valuable insights into the financial and governance factors influencing tax behavior in Indonesian manufacturing firms.

Keywords: Tax Avoidance, Leverage, Capital Intensity Ratio, Institutional Ownership, IDX.

1 Introduction

A tax is a significant financial obligation for companies that directly affects their net income. As mandatory taxpayers, companies must comply with tax regulations, and failure to do so results in penalties that can harm the business [1, 2]. However, tax payments are often met with resistance from companies because of the conflicting interests of businesses and the government as tax collectors [1, 4]. While the government expects substantial tax payments, companies aim to minimize the amount of tax they own to preserve as much of their profits as possible. This scenario leads many companies to seek methods to reduce their tax burdens [1, 6]. One common strategy is tax avoidance, which can be achieved through legal means by exploiting weaknesses or ambiguities in tax laws, or in some cases, through illegal methods. Tax

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avoidance involves efforts to avoid undesirable tax consequences and, although not entirely illegal, often relies on loopholes in the tax code. Companies generally follow a three-step approach to minimizing taxes: first, by attempting to avoid taxes both legally and illegally; second, by reducing tax liabilities as much as possible; and third, if those approaches fail, they pay the necessary taxes [1, 8]. Tax avoidance strategies frequently exploit grey areas in tax regulations.

This study examines three factors that influence tax avoidance: leverage, capital intensity ratio, and institutional ownership. Leverage refers to the assets a company uses in its operations, providing a ratio that reflects how companies manage their debt to generate profits and fulfill financial obligations [1, 9]. Firms with higher leverage typically rely more on external financing, which may affect their tax planning. Debt financing, offering tax benefits through interest deductions, is often favored by these companies. Conversely, firms with lower leverage may miss out on these tax advantages, potentially leading to different tax strategies [1, 10].

The capital intensity ratio, representing a company's investment in fixed assets, is another important factor in tax avoidance. Depreciation on fixed assets reduces taxable income, thereby lowering tax liabilities [1, 11]. Companies with high capital intensity benefit from these deductions, which can encourage tax avoidance practices. A similar effect is observed in firms that make substantial investments in assets, as the depreciation benefits help to lower their overall tax burden [1, 12].

Institutional ownership significant role in shaping tax avoidance strategies. Firms with higher institutional ownership are more inclined to adopt tax avoidance practices, as institutional investors influence management decisions [8, 14]. When institutional investors hold a larger stake, they often increase pressure on management to maximize profits, which may include minimizing tax liabilities. This is due to the fact that institutional investors generally focus on financial returns and may encourage companies to cut costs, including taxes [1, 13].

While tax avoidance has garnered significant attention in corporate finance research, only a limited number of studies have explored the combined effects of leverage, capital intensity, and institutional ownership on tax avoidance especially within Indonesia's manufacturing sector [9, 16]. Much of the current literature tends to isolate variables like profitability or firm size, without integrating financial and ownership factors in a comprehensive framework. Prior investigations often concentrate on certain industries or regions, overlooking the distinctive characteristics inherent in manufacturing firms. Additionally, institutional ownership, a critical component of corporate governance, has not been extensively analyzed, and existing studies offer mixed conclusions regarding its influence on tax avoidance behavior [1, 14].

Research specific to Indonesian manufacturing companies remains sparse, as most previous work has focused on developed economies or non-manufacturing industries, which may not adequately represent the Indonesian business environment [10]. This study seeks to bridge this gap by evaluating the joint impact of leverage, capital intensity, and institutional ownership on tax avoidance within Indonesia's manufacturing landscape a sector marked by its diversity and high resource dependency. Given the manufacturing industry's essential role in the national economy and the distinct fiscal challenges it encounters compared to other sectors, identifying

the key determinants of tax avoidance is essential for informed decision-making by regulators and corporate stakeholders alike [1, 15]. One important aspect that has been insufficiently explored in the literature is the interaction between leverage, capital intensity, and institutional ownership. It is important to understand how these factors interact, as companies do not operate in isolation [2, 20]. For example, while higher leverage may encourage tax avoidance through interest deductions, capital intensity may also influence depreciation costs that lower taxable income [1, 17]. Furthermore, institutional ownership could moderate this relationship, either encouraging or discouraging tax avoidance, depending on the ownership structure and governance mechanisms.

Additionally, the role of corporate governance in shaping tax avoidance strategies needs further investigation. Some studies suggest that institutional ownership positively impacts tax avoidance, but it remains unclear whether this effect is consistent across all sectors or regions [5]. The manufacturing sector, with its diverse activities and capital requirements, presents unique challenges and opportunities for governance. The extent to which institutional investors can influence management to minimize tax liabilities may vary depending on the company's market position, resource intensity, and governance structure. By focusing on Indonesian manufacturing firms, this study aims to provide deeper insights into how institutional ownership affects tax behavior in a sector that plays a vital role in the economy. This research will help fill a gap in the literature that overlooks sector-specific governance structures and their influence on corporate tax strategies [1, 18].

Finally, tax avoidance remains a critical issue for both companies and governments. While efforts to improve tax collection and reduce avoidance continue, the complexity of corporate tax behavior, influenced by various financial and ownership factors, makes enforcement challenging. This study will contribute valuable empirical insights to the ongoing discussion on improving tax compliance and reducing revenue losses in emerging economies.

2 Literature Review

2.1 Agency Theory

Explains the dynamics between the principal (business owner) and the agent (management), focusing on the contractual arrangements that govern their interactions in managing the business and making decisions aimed at maximizing the principal's profits [1, 20]. The principal is responsible for compensating the agent for performing designated tasks and fulfilling their duties [1, 21]. A central concept in agency theory is the issue of information asymmetry, where the agent often possesses more detailed knowledge about the company's operations and financial status than the principal [1, 22]. This imbalance can be mitigated through transparent financial reporting, which helps reduce the information gap between both parties. Agency theory assumes that individuals may sometimes act in their self-interest, potentially at the expense of the principal's objectives. As a result, agents might use the authority delegated to them for personal benefit, which could ultimately undermine the principal's goals. Therefore,

consistent monitoring and oversight are essential to ensuring that both the principal's and agent's interests remain aligned.

A significant issue in agency theory is the "agency problem," which stems from the conflicting interests between the principal and the agent. The principal expects the agent to run the business efficiently to increase profits and provide optimal returns, especially through dividends. However, the agent is motivated to enhance profitability to receive favorable evaluations from the principal [23]. Problems arise when higher profits lead to increased tax liabilities, which the principal may find unfavorable. The conflict between maximizing profits and managing tax obligations can lead the agent to adopt strategies like tax avoidance. While these strategies may provide short-term benefits for the agent, they might not align with the principal's long-term objectives, resulting in potential conflicts. Therefore, resolving these conflicting interests is crucial for maintaining a balanced and effective principal-agent relationship.

2.2 Tax Avoidance

Refers to the process by which taxpayers, whether individuals or businesses, organize their activities to exploit various loopholes within tax regulations in order to minimize the amount of tax payable. It involves carefully planning and structuring transactions to ensure that the tax burden is kept to a minimum, while remaining within the boundaries of the law [14, 28]. This strategy is designed to result in a lower tax liability, both in terms of income tax (PPh) and other forms of taxation. Tax avoidance, as defined, is an organized effort to control and mitigate the imposition of undesirable taxes by making use of legal loopholes without violating any tax laws. The primary objective of tax avoidance is to minimize the tax burden while maximizing the company's after-tax profits.

The primary goals of tax avoidance, as outlined in the literature, include reducing the overall tax liabilities of a company, ensuring the efficiency of tax expenses, and maximizing post-tax profits. Furthermore, tax avoidance aims to ensure that a company's tax obligations are met in an effective and efficient manner, aligning with the regulations in place. This includes adhering to administrative requirements to avoid administrative and criminal sanctions, as well as ensuring that all tax-related obligations concerning marketing, purchasing, and finance functions such as tax withholding and collection are executed properly [24]. Effective Tax Rate (ETR) helps assess the effectiveness of tax payment strategies by revealing the extent to which tax obligations are minimized while maximizing company profits. This metric is particularly useful for understanding how effectively a company manages its tax liabilities in the context of its overall financial health.

2.3 Leverage

This ratio is crucial in understanding how a company uses debt to finance its assets [5, 20]. It plays an important role in financial strategy by reflecting the company's ability to utilize debt financing to generate returns and maintain operations. Conversely, a lower leverage ratio means the company faces less financial risk due to its reliance on

less external debt. As a result, the leverage ratio is key to evaluating a company's financial health and the level of risk it faces, as increased leverage can exacerbate potential losses during economic downturns.

Higher Debt to Equity Ratio (DER) indicates that the company is more dependent on debt financing. However, if leverage becomes excessively high, it may limit the company's ability to secure additional financing, as lenders may consider the company too risky and doubt its capacity to meet debt obligations. This concern stems from the belief that highly leveraged firms may struggle to repay loans with their assets, potentially leading to financial instability. Therefore, finding the right balance in leverage is essential for managing risk and ensuring financial stability, making it a critical aspect of corporate financial management.

2.4 Capital Intensity Ratio

The capital intensity ratio measures the level of investment a company makes in fixed assets and inventories, reflecting how the company utilizes its assets. A company's capital intensity is evident in how it leverages its fixed assets to boost production and sales capacity [1, 25]. A higher capital intensity indicates that a larger proportion of the company's resources is allocated to fixed assets, which can influence its tax obligations due to the depreciation of these assets. Companies with more fixed assets typically face lower tax burdens compared to those with fewer assets, as depreciation can be used as a tax-deductible expense. This relationship highlights the importance of capital investment in reducing taxable income and, as a result, the overall tax burden.

In this study, capital intensity is quantified using the fixed asset intensity ratio, which shows the proportion of fixed assets relative to total assets. A higher share of fixed assets suggests a greater potential for tax reduction through depreciation. As such, this ratio is a key indicator for understanding a company's investment strategy and its ability to lower tax obligations via depreciation. This ratio is critical for evaluating a company's financial strategy and tax planning, making it an important tool for assessing its financial health and tax management practices.

2.5 Hypothesis Development

Leverage on Tax Avoidance. The debt ratio, or leverage, is an important financial metric used to evaluate a company's short-term financial stability. Leverage allows a company to meet its operational and investment needs by using debt. However, as leverage increases, so does the cost of monitoring, which is crucial for managing the principal-agent relationship [1, 26]. According to agency theory, effective monitoring is essential to align the interests of the principal (owner) and the agent (management). Companies with higher leverage typically have more detailed financial information, but this also leads to higher costs.

When it comes to leverage and tax avoidance, the interest payments related to high leverage play a significant role in reducing taxable income [1, 27]. Interest on debt is tax-deductible, which increases the company's operational profit after tax. Previous research has shown that leverage positively influences tax avoidance, as higher levels

of debt increase the capital available to the company, enabling it to finance its activities. This suggests that companies with more debt are more likely to adopt tax avoidance strategies by utilizing interest payments to lower their overall tax burden.
H1: Leverage has a positive impact on tax avoidance.

Capital Intensity Ratio on Tax Avoidance. The capital intensity ratio reflects a company's investment in fixed assets and inventory, which are essential financial decisions. This ratio is determined by comparing the inventory value to the company's total assets [1, 28]. A higher level of inventory intensity leads to increased management costs associated with maintaining it. The capital intensity ratio is also linked to agency theory, as the choice to invest excess funds in fixed assets can impact a company's tax obligations. Research has shown that the extent of investment in fixed assets significantly influences tax management. Depreciation on these assets helps reduce a company's overall tax burden, leading to a decrease in taxes owed.
H2: capital intensity ratio is positively related to tax avoidance.

Institutional Partnership on Tax Avoidance. Institutional ownership refers to the possession of company shares by organizations such as banks, insurance firms, investment companies, and other similar entities. It is viewed as a means to reduce agency conflicts by aligning the interests of management with those of the shareholders. According to agency theory, a higher degree of institutional ownership enhances the influence and monitoring power of institutional investors [1, 29]. This increased oversight can positively affect a company's performance, especially in terms of profit generation. The presence of institutional ownership tends to lead to stronger management supervision, which can improve operational efficiency. However, the effect is relatively small, as institutional investors may not always prioritize tax avoidance in their governance decisions [1, 30]. These findings are in line with previous studies that highlight institutional ownership as a factor influencing tax avoidance, although its impact can vary. Other studies propose the opposite, arguing that institutional ownership may lead to reduced tax avoidance depending on the specific corporate governance framework in place.
H3: Institutional ownership has a positive influence on tax avoidance.

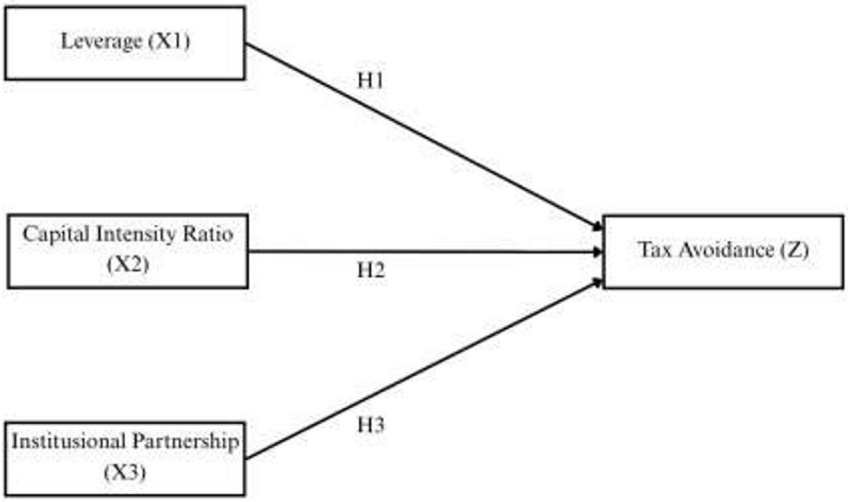

Fig. 1. Conceptual Framework

3 Research Methodology

The research was conducted between July 2023 and December 2023, utilizing online data sourced from Indonesia Stock Exchange (IDX) and other relevant platforms. For statistical analysis, Eviews software will be employed. Eviews (Statistical Package for the Social Sciences) is a robust tool for conducting a variety of statistical tests, including regression analysis.

Table 1. Sample Criteria

No.	Criteria for Sample Selection	Total
1	2020-2022 period.	194
2	Not classified as primary companies.	-104
3	2020-2022 period.	-9
4	Companies using currencies other than Rupiah.	-15
5	Companies that incurred losses during the 2020-2022 period.	-19
6	Total sample of manufacturing companies for the year	47
7	Total data for the 2020-2022 period	47 companies x 3 years = 141

Source: Processed Data, 2025

3.1 Operational Definition

Table 2. Operational Definition

No	Variable	Formula
1	Tax Avoidance	$ETR = \frac{Tax\ Expenses}{Income\ Before\ Tax}$ (1)
2	Leverage	$DER = \frac{Liabilities}{Equity}$ (2)
3	Capital Intensity Ratio	$FAI = \frac{Fixed\ Assets}{Assets}$ (3)
4	Institutional Partnership	$PIO = \frac{Institutional\ Shares}{Oustanding\ Shares}$ (4)

Source: Data Processed 2025.

4 Results

4.1 Descriptive Statistic Analytic

Table 3. Descriptive Statistic

	N	Mean	Median	Max.	Min.	
LOG Y	123	-0.648770	-0.653268	-0.502510	-0.873148	0.055285
LOG X1	123	-0.319640	-0.319434	0.554207	-1.172182	0.358994
LOG X2	123	-0.512582	-0.456902	-0.110131	-1.591315	0.278325
LOG X3	123	-0.204678	-0.124691	-0.001256	-1.029849	0.211262

Source: Data Processed 2025

The table provides the descriptive statistics for the study's variables, with 123 observations for each. The tax avoidance variable (LOG Y) has an average of -0.648770 and a median of -0.653268, with values ranging from -0.873148 to -0.502510, indicating a relatively low level of tax avoidance among the sample. The leverage variable (LOG X1) shows an average of -0.319640 and a median of -0.319434, with values from -1.172182 to 0.554207, suggesting that companies exhibit varying levels of debt usage. The capital intensity ratio (LOG X2) has an average of -0.512582 and a median of -0.456902, with values ranging from -1.591315 to -0.110131, reflecting differences in the allocation of assets toward fixed investments. Lastly, institutional ownership (LOG X3) has an average of -0.204678 and a median of -0.124691, with a range from -1.029849 to -0.001256, showing variation in the proportion of shares owned by institutional investors within the companies analyzed.

4.2 Multiple Linear Regression Analysis of Panel Data

Table 4. Multiple Linear Regression

V	C	SE	t	P
C	-0.614823	0.008003	-76.82861	0.0000
LOGX1	0.032391	0.009575	3.382694	0.0010

V	C	SE	t	P
LOGX2	0.022137	0.012285	1.802036	0.0743
LOGX3	0.048550	0.015688	3.094783	0.0025

Source: Data Processed 2025.

Table 4 presents the results of a regression analysis with estimated coefficients, standard errors (SE), t-values, and p-values for each variable. The variable C has a coefficient of -0.614823 and a p-value of 0.0000, indicating a significant impact on the model. LOGX1 shows a coefficient of 0.032391 with a p-value of 0.0010, also demonstrating a significant relationship. LOGX2, with a coefficient of 0.022137 and a p-value of 0.0743, does not show a significant effect at the 5% level, though it can still be considered relevant at a more lenient significance level. Meanwhile, LOGX3 has a coefficient of 0.048550 and a p-value of 0.0025, indicating a significant influence on the dependent variable. Overall, most variables in this model exhibit significant relationships, except for LOGX2, which shows a weaker impact.
The empirical pattern in this study—leverage and institutional ownership significantly lowering the effective tax rate (ETR), with capital intensity only weakly related—aligns with well-established tax-shield and governance channels in the corporate tax literature. The positive association between leverage and tax avoidance is consistent with the interest-deductibility mechanism: debt generates recurring shields that reduce taxable income and, mechanically, firms' ETRs [9, 37]. Beyond pure mechanics, debt choices often travel together with cash-management and efficiency policies that heighten incentives to optimize after-tax outcomes in emerging markets, helping explain the strength of the leverage coefficient in Indonesian manufacturing [15, 20, 29]. Governance can further amplify this channel; ownership and board architectures that encourage or accommodate higher indebtedness also shape how aggressively interest shields translate into realized tax savings [39, 22].

That capital intensity does not reach conventional significance, despite its potential to create sizeable depreciation shields, likely reflects both measurement and period effects. A stock ratio such as fixed assets to total assets is a coarse proxy for the annual depreciation expense that drives ETR in a short, pandemic-affected window; more proximal measures—depreciation intensity, use of accelerated allowances, or temporary book–tax differences—tend to map more tightly to effective tax outcomes [37, 13]. Capital intensity also raises collateral and debt capacity, meaning part of its tax effect is indirectly captured by the leverage variable in multivariate models; this multicollinearity can mute its incremental explanatory power even when real investment responds to tax incentives [38, 29, 13].

5 Discussion

The positive link between institutional ownership and tax avoidance suggests monitoring and performance pressure from large shareholders extend to the tax line. Prior work shows institutions can steer reporting and real decisions toward

sophisticated tax planning when perceived benefits outweigh reputational costs, consistent with our finding of lower ETRs where institutional blocks are larger [17, 34]. Still, this governance channel is heterogeneous. The interaction of CEO power with institutional ownership can tilt outcomes toward more or less aggressive strategies, and market assessments increasingly price tax behavior through an ESG lens—both factors that can condition the payoff to avoidance [31, 10]. Differentiating investor types (domestic vs. foreign; transient vs. dedicated) and their objectives would likely sharpen these inferences in the Indonesian setting [14, 33].

Interpretation should also heed construct and context. ETR is informative but noisy: it blends structural planning with transitory items (loss carryforwards, special incentives, timing differences), so triangulating with cash ETR or multi-year (long-run) ETR can reduce measurement error and better isolate avoidance intensity [37, 9]. The 2020–2022 horizon spans COVID-era disruptions and policy adjustments that affected earnings, investment cycles, and tax baselines; such shocks can dampen detectable capital–tax links while accentuating ownership and financing gradients in the data [29, 20]. In addition, unobserved governance levers—board/audit-committee strength, audit quality, and broader governance systems—may mediate or confound the reported coefficients, suggesting a role for richer governance controls in future specifications [35].

Taken together, the evidence points to tax avoidance as a financial–governance outcome in Indonesian manufacturing. Capital structure and ownership architecture exert first-order influence on effective tax burdens, whereas asset heaviness per se does not reliably translate into lower ETRs unless it is converted into realized tax shields. For researchers, interacting leverage with institutional ownership, replacing coarse asset ratios with depreciation intensity, and separating institutional investor types are promising steps to unpack when financial policy and ownership structure become durable engines of lower effective tax rates in emerging-market manufacturing [36, 17, 14].

6 Conclusions

This research explored the influence of leverage, capital intensity, and institutional ownership on tax avoidance in Indonesian manufacturing companies listed on the IDX between 2020 and 2022. The study found that leverage and institutional ownership positively impacted tax avoidance, while capital intensity had a minimal effect. These findings suggest that companies with higher leverage tend to utilize debt to reduce taxable income through interest deductions, and those with greater institutional ownership are more likely to engage in tax avoidance strategies due to the pressure from institutional investors. However, the capital intensity ratio, which typically provides tax advantages through depreciation, was not significantly linked to tax avoidance in the studied companies.

Several limitations were present in this study.Future studies could adopt a longitudinal approach to explore how tax avoidance strategies evolve. This research focused on manufacturing firms in Indonesia, which might not be representative of all

sectors or countries. Expanding the scope to other industries or regions could offer a broader understanding of tax avoidance behaviors. Third, while this study examined leverage, capital intensity, and institutional ownership, future research could include other financial or governance factors such as corporate social responsibility or political connections. Finally, exploring alternative proxies for tax avoidance. These avenues could further enrich the understanding of corporate tax strategies in emerging economies.

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