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The Triad of Tax Avoidance: Analyzing the Effects of Financial Distress, Executive Characteristics and Leverage

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ABSTRACT : *This study examines the impact of financial distress, executive characteristics, and leverage on tax avoidance in mining sector companies listed on the Indonesia Stock Exchange (IDX) from 2021 to 2023. Using a quantitative associative approach, the research analyzed 104 data points from 43 companies after outlier removal. Data were processed using multiple linear regression analysis via SPSS V.25. The results indicate that financial distress and executive characteristics do not significantly influence tax avoidance, while leverage has a significant positive effect. The findings suggest that companies with higher leverage are more likely to engage in tax avoidance, possibly due to the tax-deductible nature of interest expenses. This study contributes to the literature by employing distinct measurements for executive characteristics (EBIT/total assets) and leverage (debt-to-equity ratio), addressing inconsistencies in prior research. The outcomes provide empirical evidence for stakeholders, including policymakers and corporate managers, to enhance tax compliance strategies and governance frameworks*

KEYWORDS: *Financial distress, executive characteristics, leverage, tax avoidance, effective tax rate (ETR)*

I. INTRODUCTION

One of the largest sources of state revenue comes from revenue in the taxation sector. State revenues sourced from taxation will be used for state expenditure financing activities related to the purpose of people's prosperity. Taxes are one form of state revenue with the largest percentage contributor compared to other revenue sectors such as oil and gas and non-oil and gas, the success of a country in collecting taxes from its citizens will benefit the country's economic stability. The Ministry of Finance reported that state tax revenue in the first semester of 2023 reached IDR 970.2 trillion. This amount grew 9.9% compared to the same period last year (year-on-year/yoy). Finance Minister Sri Mulyani Indrawati said that the performance of tax revenue in the first half of this year was still growing positively. “However, the rate of growth continues to normalize or decline,”. The growth of state tax revenue in January 2023 still grew 48.7% on an annual basis (yoy). Then, the growth continued to decline as shown in the graph above, until the January-June 2023 period which only grew 9.9% (yoy).

This research was conducted in the mining sector listed on the Indonesia Stock Exchange. Mining companies in Indonesia are companies that contribute a lot to taxation. The reason for using mining companies as research subjects is because mining companies are 1) the tax contribution of mining companies is very small compared to other sector companies, especially in 2022, 2) Mining companies are a group of high-profile industries, in their operations are directly related to broad interests and are of concern to the government, investors, the public, in the strict payment of taxes, 3) there are 30% of large mining companies that are transparent about tax reporting in 2022, while other companies are not transparent.

For companies, taxes are a burden incurred by the company that can reduce the company's profit or profit so that the company makes one effort not to pay taxes by doing tax avoidance [1]. Tax avoidance arises due to agency problems caused by a conflict of interest between the government (principal) and management (agent). While principals are interested in entering into contracts that improve their welfare through increasing profits, agents are interested in maximizing their financial and psychological needs, especially in terms of investment, financing, and obtaining compensation contracts to meet their needs. Companies can reduce their tax obligations by complying with existing regulations (tax avoidance) or by not complying with existing regulations (tax evasion).

Tax avoidance can be both legal and illegal depending on the transaction activity. It is considered legal if it has a good purpose for the company, does not violate any laws, only takes advantage of legal loopholes, and does not manipulate financial statements, including financial transactions. Conversely, actions that contradict this are called unlawful tax avoidance actions. Tax avoidance methods are usually facilitated by utilizing loopholes in tax regulations that are unclear so that they have great potential for tax avoidance [1]. Maximizing profits is not the only reason why companies avoid taxes. There are other possible causes that can cause companies to avoid taxes, one of which is the effect of financial difficulties.

Financial Distress is a symptom of bankruptcy which is indicated by financial difficulties. The financial difficulties of a company generally arise because the company's business activities become difficult to manage, resulting in the financial condition of a company becoming chaotic and unstable [2]. If a company is in a phase of high financial difficulty, the company will increase bankruptcy so that it tends to do Tax Avoidance [3]. Research conducted by [4] and [3] states that financial distress affects tax avoidance. A company experiencing Financial Distress will decide to reduce its obligation to pay taxes and is more concerned with fulfilling its internal obligations. Meanwhile, according to [1]; [5] financial distress has no effect on tax avoidance. Financial distress (FD) will always experience losses or not get profit or income, so the company does not make the decision to do tax avoidance. Because companies that experience losses will get compensation regardless of the tax burden, so companies will choose not to do tax avoidance.

When a company is in financial distress, managers must make important decisions that will determine the survival of the company. In this case, the nature of the company's operations will determine what decisions will be taken by considering the various risks involved. Leadership characteristics are about business leaders who tend to have a tendency to take risks and avoid risks, which is reflected in the amount of business risk they take. If the leader of a company has a risk taker or risk averse personality trait, it will affect the decisions taken and affect the survival of the Company [4]. The higher the risk of a company, executives tend to be risk takers. Conversely, the lower the risk of a company, the executives will be risk averse. This study wants to determine the role of top management in tax avoidance. The role of top management is seen in the form of risk in this study [6]. Research conducted [7] stated that executive character affects tax avoidance, this is because in this study the executive character is more risk taker, namely executives who are brave in making business decisions. With the nature of risk takers, executives will tend to take risks and dare to make business decisions and do tax avoidance.

The factor that causes tax avoidance besides executive character is leverage. Leverage is the company's ability to obtain capital by way of loans from banks or other parties. The company's ability to obtain capital from loans indicates that the lender believes in the company's credibility in the past and believes in the company's future progress so that it can pay its debts [8]. Tax calculations are influenced by the use of sources of funds used by the company. Tax avoidance that will be carried out is influenced by several indicators, one of which is the funding policy or decision used by the Company [9]. Research conducted by [10] stated that leverage affects the high possibility of companies taking tax avoidance actions Meanwhile, according to [11] leverage has no effect on tax avoidance.

Based on the description above, it can be concluded that tax avoidance practices are influenced by various factors, including financial distress, executive characteristics, and leverage. However, the results of previous studies still show inconsistencies, especially in the context of the mining sector which has a significant contribution to tax revenue but is also vulnerable to the risk of non-compliance. This study aims to re-examine the effect of these three variables with a different measurement approach, especially on executive characteristics (EBIT/total assets) and leverage (debt-to-equity ratio). The findings are expected to provide more comprehensive empirical evidence for stakeholders, including the government and businesses, in formulating tax control policies and more effective corporate governance strategies. Thus, this study not only contributes to the development of tax accounting literature but also supports efforts to improve tax compliance and business sustainability in Indonesia.

II. LITERATURE REVIEW

Based on agency theory, it is said that the relationship between the company's shareholders as owners and management as managers of the company is based on a contractual relationship [12]. Based on agency theory, management as the agent is given the authority to manage the company which at the end of the year will report the results of its performance to the principals in the form of financial statements. This obligation encourages management (agent) to manipulate financial statements so that the performance of the agent will look better. The above can then certainly cause conflicts of interest and communication breakdowns between the owners and managers of the company. This is very natural considering that each party has different interests, and each party tries to protect its own interests sometimes without thinking about the other party. If something like this has happened, the party that will be more disadvantaged is the owner of the company, because they are not directly involved in managing the company's activities so that they are relatively only passive and receive reports and information from the company manager. This imbalance and difference in information owned by company owners and managers is often referred to as information asymmetry. Information and reporting asymmetry, as well as incomplete and inaccurate information provided by management to management, can come from various sources, including in the field of corporate tax policy. The tax laws and regulations in Indonesia are still largely based on the self-assessment system, where the government gives freedom to taxpayers to assess and calculate their own tax obligations, and of course routine checks by officials of the

Directorate General of Taxes (Dirjen Pajak). Taxation under supervision This is considered favorable to the agent because in addition to information asymmetry towards the principal, it also allows the agent to manipulate the company's tax burden by reducing the company's taxable income [4].

The relationship between agency theory in tax avoidance is the difference in interests between the taxation authority (principal) and the company (agent). The company prioritizes its interests such as maximizing profits. The company has certain goals to achieve. The success in achieving the goals of a company is the result of the work of the management team or the body that runs the company [13]. Companies that earn large profits will indirectly cause an increase in the tax burden that must be paid. Therefore, companies will look for all ways to reduce their tax costs. One way to reduce tax costs is tax avoidance [11].

The Effect of Financial Distress on Tax Avoidance

Financial distress refers to a situation where a company is having financial difficulties to pay its expenses. Financial distress is a condition in which a company's finances are unhealthy or critical [14]. This situation can cause a company to experience bankruptcy if it experiences financial difficulties [5]. The management of companies that are in financial distress will conclude that tax officials pay less attention to their financial statements so that the risks considered are less and assume that the tax avoidance they do is more acceptable to tax officials and the general public. Companies experiencing financial distress have the potential to manipulate accounting policies to increase operating income to reduce expenses in paying debts. If companies are aggressive in terms of accounting policies, it is possible that they are also aggressive in their tax planning provisions [1]. Tax avoidance during financial distress will also increase due to the need for greater funds and the need to maintain the Company's credit rating [15]. Research conducted [16] states that financial distress affects tax avoidance. That companies that make tax avoidance efforts, namely when the company is in a financial distress position, this will cause a decrease in the company's image. Companies that are losing money will be free from the income tax burden and get.

The Effect of Executive Characteristics on Tax Avoidance

Agency theory explains that agents will try to maximize their own interests to get incentives in various ways. One way to do this is to reduce the tax burden called tax avoidance practices to optimize company profits which will reflect the performance of the agent [17]. The higher the profit earned by the company, the higher the incentive the agent will get. The policy to practice tax avoidance depends on the agent as the company executive [18]. A leader may have a risk taker or risk averse character that is reflected in the size of the company's risk. The higher the risk of a company, the executive tends to be a risk taker, on the contrary, the lower the risk of a company, the executive tends to be risk averse. Executive character is measured by looking at how much company risk the executive takes. The higher the risk of the company taken, the greater the possibility of the company's executives being brave in tax avoidance. Research conducted [18] states that executive character affects tax avoidance

The Effect of Leverage on Tax Avoidance

Leverage is used to measure how much debt burden the company bears in fulfilling assets. The goal is to provide profits greater than fixed costs (fixed rate of return). The interest paid by the company through debt is a fixed expense, thus increasing returns for shareholders [19]. The leverage ratio is used to measure the company's ability to pay off long-term debt. Financing the company through long-term debt will generate interest costs that are fiscally deductible from income so that the tax paid is also reduces [15]. Companies that prefer to use external funding such as debt will result in the emergence of interest expense which can be a deduction from taxable income [20]. Companies that have a leverage value indicate higher debt-sourced capital, which will result in higher interest costs due to the incurrence of debt. The higher the leverage value, it can affect the company to do tax avoidance. Debt will cause interest expense which will ultimately reduce the amount of taxable profit [9]. Companies that have a leverage value indicate higher debt-sourced capital, which will result in higher interest costs due to the incurrence of debt. The higher the leverage value, it can affect the company to do tax avoidance. Debt will cause interest expense which will ultimately reduce the amount of taxable profit. Research conducted [2] states that leverage affects tax avoidance.

III. METHODOLOGY

This research uses a quantitative approach. The method used in this research is an explanatory method (Explanatory Research) where information data is collected from the population, the results are collected and then analyzed with the aim of measuring the effect of one variable on another. This method explains the causal relationship between variables through hypothesis testing. In this study, the dependent variable is tax avoidance while the independent variables are financial distress, executive characteristic and leverage.

The population that is the object of this research is mining companies that have been listed on the

Indonesia Stock Exchange (IDX) from 2021 to 2023. Mining companies are classified by the Indonesia Stock Exchange into 7 sub-sectors, namely Coal Production, Oil & Gas Production & Refinery, Gold, Iron & Steel, Diversified Metals & Minerals, Cooper and Aluminum. The research method in sampling uses purposive sampling method. Based on the results of the sampling that has been carried out, there are sample objects of 67 mining companies that have become research samples for 3 periods so that 129 (43 x 3 periods) research sample data are obtained.

Tax Avoidance can be measured using the effective tax rate (ETR) by calculating the income tax expense divided by profit before tax. ETR is the amount of tax calculated by multiplying the tax base by the applicable tax rate. ETR can be used as an indicator for effective tax planning. ETR is a negative proxy. High ETR means low tax avoidance, low ETR means high tax avoidance. Tax Avoidance is measured using the ETR proxy which has the following formula:

$$ETR = \frac{Tax\ Expense}{Earnings\ Before\ Tax}$$

Financial distress is a condition that can hit a company where the company experiences a decline in performance in its business processes. Financial Distress is an independent variable calculated with the Altman Z-score proxy

$$Z = 1.2A + 1.4B + 3.3C + 0.6D + 1E$$

Description:
A = (Current asset – Current liabilities) / Total Asset
B = Retained earnings / Total Asset
C = Earning before tax / Total Asset
D = Total Equity / Total Liablities
E = Sales / Total Asset

In the Altman Z-Score, the potential for bankruptcy will be reflected in the Z value. If the Z value is > 2.99, then the company is in the safe zone, which is free from distress. If the Z value is < 2.99, it means the company is in the gray zone, and finally, if the Z value is < 1.81, then the company is in the distress zone.

Company risk reflects the policies taken by company managers. The nature of the people (managers) who run the company, whether they are risk averse or risk averse, is reflected in the size of the existing company risk. The calculation to get Executive Characters who are Risk Taking or Risk Averse by using the calculation of Company Risko [9]. Executive characteristics can be reflected through company risk as measured by calculating EBIT (Earnings Before Interest, Tax) divided by total assets which is formulated into the following formula:

$$Company\ Risk = \frac{EBIT}{Total\ Asset}$$

Leverage is a ratio that describes the ratio of debt to equity to determine the extent to which a company uses debt financing. This leverage measurement uses the Debt to Equity Ratio (DER). Debt to Equity Ratio is obtained through the proportion between total debt and total equity owned by the company. Leverage measurement is measured by the following formula:

$$DER = \frac{Total\ Liabilities}{Total\ Equity}$$

The analysis method used in this research is the panel data regression method because the data used in this study is a combination of time series and cross section data. In this study, several tests were carried out including descriptive statistics, normality test, classical assumption test (multicollinearity, heteroscedasticity, autocorrelation), hypothesis testing (coefficient of determination, model fit test, partial t test). In this study, there is a research model carried out, namely multiple linear regression analysis.

ETR = β1ZScore + βEC + βLEV + e

IV. RESULTS AND DISCUSSION

Table 1. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Tax Avoidance	104	.00431	.69496	.2248400	.15743668
Financial Distress	104	.43675	7.57203	3.4391611	1.64549045
Executive Characteristics	104	-.07787	.63735	.1625781	.13534168
Leverage	104	.13371	3.17723	.9477685	.71792670
Valid N (listwise)	104				

Tax avoidance is carried out legally and safely from the taxpayer's point of view without violating applicable tax regulations. The average value is 0.22 which means that tax avoidance carried out by development sector companies is categorized as moderate and indirectly indicated as tax avoidance. This is evidenced by the ETR value of 0.22 which is smaller than the Company's effective tax rate of 25%. Analysis of the state of financial health can assess the company's ability to meet its short-term obligations, capital structure and others and predict how much risk of bankruptcy. The average value is 3.43 which means that the average mining sector company is in a safe zone, which is not indicated by financial difficulties. Executive characteristics are a combination of personality, skills, experience and behavior that drive organizational performance and strategic decision making owned by executives. The average value is 0.1625, which means that the average executive characteristics of mining companies are risk averse because they have a small value. Leverage shows how far the company is financed by debt or outside parties with the company's ability described by capital. The average value is 0.947 times, which means that the leverage proxied by the debt to equity ratio is ideal because it is below 1 or below 100%. A low DER means that total liabilities are lower than equity or the ability to pay debts based on own capital is high.

Table 2. Koefisien Determinasi
Model Summary[b]

Model	R	R Square	Adjusted R Square
1	.385[a]	.148	.123

The R Square value is 0.148 or 14.8%. This means that the variables of financial distress, executive characteristics and leverage can explain tax avoidance only by 14.8%. the remaining 85.2% are other factors not examined in this study.

Table 3. Goodness of Fit Test
ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.379	3	.126	5.810	.001[b]
	Residual	2.174	100	.022		
	Total	2.553	103			

a. Dependent Variable: Tax Avoidance
b. Predictors: (Constant), Leverage, Executive Characteristics, Financial Distress

The results of testing the suitability of the model or the F test, stating the sig value. $0.001 \leq 0.05$ means that the data model in this study is feasible to use to examine tax avoidance and can be tested at the next stage.

Table 4. Hypothesis Test

Variabel	t value	Sig	Conclusion
Financial Distress (H1)	-1.468	0.145	Not Supported
Executive Characteristics (H2)	1.452	0.150	Not Supported
Leverage (H3)	1.959	0.050	Supported

Discussion

The Effect of Financial Distress on Tax Avoidance

Financial distress has an effect but not significant on tax avoidance. Thus the first hypothesis is not supported. This can happen because companies experiencing financial distress try to avoid bankruptcy, so the company tries to minimize the Company's burden by not using tax avoidance to reduce the tax burden, but choosing other options, such as borrowing from other companies or affiliated companies. However, there are things that contradict agency theory, namely companies that experience financial distress ultimately make the relationship between agents and shareholders stretched. Shareholders certainly want to invest in a healthy and stable company. Therefore, if the financial condition worsens, the agent will definitely look for ways to minimize costs in order to maintain relations with shareholders. One possible way to achieve this is to reduce relations with the government, for example by delaying or avoiding income tax payments. This is in line with research [17] and [5] which states that financial distress has an effect but is not significant to tax avoidance. However, the results of this study contradict those conducted by [18].

The Effect of Executive Characteristics on Tax Avoidance
Executive characteristics have an effect but are not significant on tax avoidance. Thus the second hypothesis is not supported The results of this study contradict agency theory which explains how the relationship between the principal, namely the owner of the company, will supervise or intervene with the agent who is the executive or holder of power where the characteristics of the executive will affect the decision-making process that will be carried out. [21]. Although managers are risk takers, it does not mean that they will do more tax avoidance. So that executive characteristics have no effect on tax avoidance. The results of this study are in line with [9]; [6] and [22] which states that executive characteristic has a significant effect on tax avoidance. The implementation of tax avoidance is inseparable from executive decisions, where there are two executive characters, namely risk takers and risk averse [23]. The high and low executive character produced by the company does not affect tax avoidance, because in this study the value of executive character is smaller than the value of tax avoidance.

The Effect of Leverage on Tax Avoidance
Leverage has an effect but not significant on tax avoidance. Thus the third hypothesis is supported. There is evidence that the Company takes tax avoidance actions, which can be seen from its funding policy. One of the financing policies is the leverage policy. This is the amount of debt the company uses to finance its business activities. Increased debt results in interest expense that must be paid by the company. Interest paid on debt is deducted from the company's net income, thereby reducing tax payments and maximizing profits. Companies have the opportunity to use debt for their operational and investment needs. However, debt incurs a fixed cost (to earn income) called interest. The increase in interest costs reduces the company's tax burden. The higher the value of corporate debt, the lower the Company's ETR value so that indications of tax avoidance are greater. The results of this study are in line with those conducted [2] which states that leverage proxied by DER has a significant effect on tax avoidance. According to [24] the higher the company's leverage, the higher the tax avoidance. Companies that utilize debt to minimize the corporate tax burden even tend to be aggressive towards taxes, this is because companies that have high debt will get tax incentives in the form of deductions for loan interest. So that companies that have a high tax burden can make tax savings by increasing corporate debt. By increasing debt in order to obtain large tax incentives, it can be said that the company is avoiding taxes.

V. CONCLUSION

This study examined the impact of financial distress, executive characteristics, and leverage on tax avoidance in mining sector companies listed on the Indonesia Stock Exchange (IDX) from 2021 to 2023. The findings revealed that leverage has a significant positive effect on tax avoidance, while financial distress and executive characteristics do not exhibit a significant influence. Specifically, companies with higher leverage were more likely to engage in tax avoidance, likely due to the tax-deductible nature of interest expenses, which reduces taxable income. In contrast, financial distress and executive characteristics did not significantly on tax avoidance.

The results align with agency theory in the case of leverage, as companies may prioritize debt financing to minimize tax burdens and maximize profits. However, the lack of significance for financial distress and executive characteristics suggests that other factors, such as internal policies or external regulatory pressures, may play a more critical role in tax avoidance decisions. These findings contribute to the existing literature by addressing inconsistencies in prior research and providing empirical evidence for stakeholders, including policymakers and corporate managers, to refine tax compliance strategies and governance frameworks. Future research could explore additional variables or contextual factors to further understand the dynamics of tax avoidance in the mining sector and other industries.

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