The Effect of Political Connections, Leverage, and Capital Intensity on Tax Avoidance

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A B S T R A C T

Tax serves as the largest contributor to state revenue, playing a crucial role in funding infrastructure development aimed at improving public welfare. The government continuously strives to maximize tax revenue as one of the primary sources of national financing. However, corporate management often engages in tax avoidance strategies to reduce their tax obligations. This study aims to analyze the effect of political connections, *Leverage*, and *capital intensity* on *tax avoidance* in banking sub-sector companies listed on the Indonesia Stock Exchange (IDX) during the period 2021–2023. The Effective Tax Rate (ETR) is used as a proxy to measure the level of corporate *tax avoidance*. Political connections are measured using the natural logarithm (Ln), *Leverage* is measured using the Debt to Equity Ratio (DER), and *capital intensity* is measured by the ratio of total assets to total sales. This study employs purposive sampling to select the research sample, resulting in 34 companies as the final sample. Data analysis was conducted using multiple linear regression with the assistance of IBM SPSS version 26. The results show that political connections have no significant effect on *tax avoidance*, while *Leverage* and *capital intensity* have a significant negative effect on *tax avoidance*.

1. Introduction

Tax is a mandatory contribution that must be paid to the state by individuals or organizations in accordance with legal regulations. Taxes are paid without receiving direct compensation, and their utilization is intended for the benefit of the state to achieve the optimal welfare of its citizens (Law No. 16 of 2009 concerning General Provisions and Taxation Procedures). Taxes play a vital role as a pillar of the State Budget (APBN), especially in financing infrastructure development, public service provision, and Government strategic programs.

APBN data show that tax revenues during the 2021–2023 period exceeded the set targets, with realization percentages of 125.9%, 114%, and 102.8%, respectively. These achievements reflect economic recovery strategies and improved tax compliance. However, tax revenue growth tends to decline or normalize. This decline is influenced by several factors, including post-COVID-19 tax incentives, the implementation of the Voluntary Disclosure Program (PPS) in 2022, and the decline in commodity prices and import activities in 2023.

The financial services and insurance sectors made a significant contribution to tax revenues, ranging from 10.9% to 12.9% during 2021–2023. Nevertheless, this contribution showed fluctuations caused by various factors. In 2022, for example, a reduction in credit restructuring and an increase in the Bank Indonesia benchmark interest rate led to decreased credit demand and reduced profitability in the banking sector. These conditions cannot be interpreted as the absence of tax avoidance behavior among companies, thus warranting further investigation.

The government and businesses often have conflicting interests in taxation. For the government, tax revenue is crucial for national development; for companies, tax is seen as a burden that reduces net profit. This encourages management to develop tax efficiency strategies, both legal (tax avoidance) and illegal (tax evasion). Tax avoidance is a legal strategy to reduce tax liabilities by exploiting loopholes in tax regulations. Such strategies may include interbank loan schemes, setting up branches in low-tax jurisdictions (tax havens), and deferring dividend payments. Factors that are believed to influence corporate tax avoidance include political connections, leverage, and capital intensity.

Political connections refer to special relationships between companies and the government or political figures aimed at gaining advantages and simplifying business processes. Firms with such ties often receive lenient tax treatment, are less frequently audited, or gain access to favorable tax policies, which may lead to more aggressive tax avoidance and reduced transparency in financial reporting. This pattern is observable in some state-owned or state-affiliated banks.

Leverage reflects the use of debt in financing a company's operations and investments. In the banking subsector, leverage is a structural characteristic due to the reliance on third-party funds and short-term liabilities. Interest expenses from such debt can reduce taxable income and hence lower corporate tax obligations.

Capital intensity indicates a firm's allocation of assets into fixed or tangible assets. The ownership of tangible assets may be utilized to reduce tax liabilities through depreciation. Increased investments in such assets raise depreciation costs, which can reduce taxable income and promote tax avoidance behaviors.

Based on an analysis of tax avoidance in the banking subsector during 2021–2023, measured using the Effective Tax Rate (ETR) indicator, it was found that the ETR values were consistently below the statutory corporate income tax rate of 22%. Referring to Imanuella and Damayanti (2022), an ETR below the statutory rate may indicate a higher tendency for tax avoidance.

This study aims to analyze the effect of political connections, leverage, and capital intensity on tax avoidance in banking subsector companies listed on the Indonesia Stock Exchange during 2021–2023. The findings reveal that leverage and capital intensity have a significant negative

effect on tax avoidance, while political connections show no significant influence. The practical implication of these results suggests that banks with higher debt ratios or higher investment in tangible assets are likely to engage in less aggressive tax avoidance, possibly due to stronger financial discipline or regulatory oversight.

2. Theoritical Framework and Hypothesis

2.1 *Agency Theory*

Agency theory was first developed by Jensen and Meckling (1976), explaining the contractual relationship between the principal and the agent. The fundamental concept of this theory emphasizes the existence of a relationship between individuals who delegate authority (principals) and those who receive that authority (agents), established through a form of cooperation contract. Agency theory states that individuals are inherently driven by self-interest, which can lead to conflicts of interest between the principal and the agent. In this study, the relevance of agency theory and tax avoidance focuses on the third agency relationship of ghozali, namely the government as the principal and company managers in the banking sector as agents. The relationship between the government and companies in the context of taxation is a normative contractual relationship, formed as a consequence of tax regulations and the self-assessment system applied in Indonesia (Law on General Provisions and Tax Procedures, Article 12 Paragraph 1). The government, as the principal, grants full trust to companies (taxpayers), through managers as agents, to independently calculate, pay, and report their tax obligations (Mahdiana & Amin, 2020; Nurhidayah et al., 2021).

Agency theory emphasizes that conflicts of interest between agents and principals may lead to information asymmetry, which refers to unequal access to information between the two parties. This imbalance can give rise to moral hazard, where one party takes actions that may harm the other due to asymmetric information. In the context of this study, moral hazard arises when the tax authority (fiscus) aims to maximize state revenue through taxation as one of the primary sources of national funding, while company management instead engages in tax avoidance strategies to reduce their tax liabilities and increase corporate profits. Such behavior ultimately harms the fiscus, as it may lead to a decline in national tax revenues (Nurhidayah et al., 2021).

2.2 Tax Avoidance

Tax avoidance is a strategy used to minimize tax payments by exploiting loopholes or deficiencies within a country's tax system. This strategy is carried out without violating existing legal provisions, and is therefore often equated with tax planning practices. In this context, tax avoidance includes actions that are legally permissible, such as taking advantage of specific arrangements within tax regulations to reduce the amount of tax payable, as well as actions that may be considered in violation of the spirit of the law (Junaid et al., 2021)

2.3 Leverage

Leverage is one of the financial ratio measures that indicates the relationship between a company's total debt and its equity or assets. This ratio is used to show the extent to which a company relies on external financing, particularly debt, to support its operational and investment activities. In the banking sector, leverage is an inherent structural characteristic, as most of a bank's financial activities are funded by third-party funds such as public deposits and short-term liabilities (Suciarti et al., 2020).

A high leverage ratio indicates that a company relies heavily on debt financing, which implies a larger interest expense. Under Article 6 of Law No. 36 of 2008, interest expenses can be classified as deductible expenses from gross income, thus reducing taxable income. Therefore, companies with high leverage tend to have lower tax obligations because their fiscal profit is reduced due to deductible interest expenses (el Fira et al., 2024).

2.4 ***Capital Intensity***

Capital intensity in this study serves as an indicator of how much a company allocates its investments in fixed assets. This ratio, known as the Capital Intensity Ratio, is calculated by comparing fixed assets to total assets. It reflects the company's efficiency in utilizing fixed assets to support operational activities, especially in generating revenue from sales. When companies have idle funds, those funds can be redirected into investments in fixed assets as part of a long-term strategy (Suciarti et al., 2020).

One of the advantages of owning fixed assets is the depreciation expense, which can be utilized for tax purposes. Depreciation on fixed assets can be used as a deduction from taxable income, and management often takes advantage of this policy to reduce the tax burden. This strategy also provides an opportunity for managers to enhance the company's financial efficiency and improve performance through tax savings. As a result, managerial incentives such as bonuses or performance-based compensation become more attainable (Prawati et al., 2020).

2.5 Connection Political

Political connections refer to special relationships between a company and the government or political figures aimed at gaining benefits and facilitating business operations. These relationships may be direct or indirect, and often take the form of share ownership, executive positions, or personal affiliations between top corporate officials and political figures. Companies with political connections are more likely to receive lenient treatment from tax authorities, avoid audits, or gain access to favorable tax policies, making them more willing to engage in tax avoidance and less transparent in their financial reporting (Imanuella & Damayanti, 2022).

2.6 Hypothesis

2.6.1 The Effect of Political Connections on Tax Avoidance

Based on agency theory, the contractual relationship between the government as the principal and corporate managers as agents inherently contains a conflict of interest. Company managers, acting as agents, may exploit the firm's political connections to behave opportunistically by minimizing tax liabilities, taking advantage of relaxed oversight, limited tax audits, and a reduced likelihood of sanctions. On the other hand, the government, as the principal, seeks to maximize tax revenues, given the central role of taxation in financing national development. This conflicting interest creates information asymmetry, as managers possess more comprehensive knowledge of internal company conditions than the tax authorities. Agency theory supports the idea that political connections can increase a firm's tendency to engage in tax avoidance (Az'ari & Lastiati, 2022). According to a prior study conducted by Imanuella & Damayanti (2022), political connections were found to have a positive effect on tax avoidance. Similarly, research by Az'ari and Lastiati (2021) revealed that political connections are used strategically by companies to reduce their tax burdens. Based on these theoretical and empirical foundations, it can be concluded that companies with strong political ties are more likely to minimize tax obligations through influence over regulations or oversight mechanisms, thereby increasing tax avoidance behavior. Thus, the hypothesis formulated is:

H1: Political connections have a positive effect on tax avoidance.

2.6.2 The Effect of Leverage on Tax Avoidance

According to agency theory, managers as agents rely more heavily on debt than equity to finance operational activities. Interest expenses arising from this debt can reduce taxable income, thereby decreasing the firm's tax liabilities. This financing structure gives rise to a conflict of interest, wherein agents prefer using debt financing to benefit the company, while this may be contrary to the interests of the government as the principal. Leverage, therefore, becomes a tool used by agents as part of their tax avoidance planning strategy (Suciarti et al., 2020). The study by El Fira and Alfa (2023) showed that leverage has a positive effect on tax avoidance in manufacturing firms. Similarly, Mahdiana and Amin (2020) supported this finding, stating that leverage is often used by companies as a strategy for tax avoidance. Companies with high levels of debt are more likely to reduce taxable income through interest expenses. Based on these theoretical and empirical findings, it can be concluded that companies with high leverage are more likely to reduce their tax burden through interest deductions, thereby increasing tax avoidance. Thus, the hypothesis proposed is:

H2: Leverage has a positive effect on tax avoidance

2.6.3 The Effect of Capital Intensity on Tax Avoidance

Based on agency theory, managers as agents have the authority to determine asset structures and allocate investments. In this context, managers may choose to invest in fixed assets with the objective of maximizing depreciation expenses to reduce taxable income, making it a tax avoidance strategy. While the principal expects fair tax compliance, agents may exploit depreciation policies to minimize tax obligations, thus creating a potential conflict of interest between the agent and the principal (Ciptani & Situmorang, 2023). A prior study conducted by Amalia & Dedik (2021) revealed that capital intensity has a positive effect on tax avoidance. This indicates that firms with a high proportion of fixed assets tend to take advantage of depreciation to reduce their tax burden, thereby increasing their level of tax avoidance. Based on the theoretical framework and previous empirical studies, it can be concluded that firms with high capital intensity tend to utilize depreciation as a way to reduce taxable income. Thus, the hypothesis formulated is:

H3: Capital intensity has a positive effect on tax avoidance.

3. Research Methodology

The secondary data used in this study were obtained from banking sector companies listed on the Indonesia Stock Exchange (IDX), totaling 57 banks during the 2021–2023 period. This study aims to explain the effect of Political Connections (X1), Leverage (X2), and Capital Intensity (X3) as independent variables on Tax Avoidance (Y) as the dependent variable. A purposive sampling technique was employed to determine the sample based on specific criteria in accordance with the research objectives. Over the three-year period, a total of 102 observations were collected. After identifying outliers, 15 data points were excluded. Thus, the final number of observations used in the analysis was 87. The data were obtained from company websites, the official IDX website (www.idx.co.id), YouTube, and related news sources.

The scoring of the Political Connection Index (PCI) in this study is based on the level of Government institutions and the political affiliation status of board members. Board members connected to active politicians are assigned scores ranging from 3 (lowest) to 8 (highest), while those connected to former politicians receive scores ranging from 2 to 7. Meanwhile, board members with familial or close personal ties to politicians are assigned a score of 2 if the politician is active, and 1 if inactive. Companies with no political connections are given a score of 0. The total political connection score of each company is then calculated using the natural logarithm, with one point added beforehand to avoid undefined values. The formula used is:

$$Ln\ PCI = ln(1 + Total\ Political\ Connection\ Score)$$

The proxy for Leverage in this study is the Debt to Equity Ratio (DER). DER represents the proportion between a company's debt and its equity, indicating the extent to which the company is financed by debt rather than shareholders' capital.

$$\boldsymbol{Leverage = \frac{Total\ Debt}{Total\ Asset}}$$

The Capital Intensity variable serves as one of the indicators used to assess the composition of a company's assets, which can provide insights into the investment decisions made by the company.

$$\boldsymbol{CAPINT = \frac{Total\ Net\ Assets}{Total\ Assets}}$$

4. Results and Discussion

4.1 Descriptive Statistic Analysis

According to Ghozali (2021), the purpose of descriptive statistical analysis is to provide a summary of the mean, standard deviation, minimum, and maximum values for each variable. Table 1 presents the results of the descriptive statistical analysis that has been conducted. The hypothesis results are shown in Table 2.

Table 1. Descriptive Statistic Analysis

	Min	Max	Mean	Std. Dev
Tax Avoidance	0.18	0.26	0.21	0.01
Connection Political	0.00	3.04	0.77	1.09
Leverage	0.00	15.31	4.66	3.14
Capital_Intensity	0.00	0.10	0.02	0.01

Source: Data processed, 2025

Table 2. Partial Hypothesis Testing (T-Test)

	Unstd Coefficients		Stad Coeff		
Variable	B	Std. Error	B	t	Sig.
(Constant)	0.231	0.005		50.971	0.000
Connection P	-0.001	0.002	-0.071	-0.676	0.501
Leverage	-0.001	0.001	-0.257	-2.462	0.016
Capital_Intensty	-0.256	0.112	-0.243	-2.290	0.025

Source: Data processed, 2025

Hypothesis 1 proposed that political connections would have a significant positive effect on tax avoidance. However, the regression results show a significance value of 0.501 and a beta coefficient of -0.071. Since the significance value is greater than 0.05 and the coefficient is

negative, it is concluded that political connections do not significantly influence tax avoidance and tend to have a negative direction. Therefore, **Hypothesis 1 is rejected**. Hypothesis 2 stated that leverage would have a significant positive effect on tax avoidance. The results show a significance value of 0.016 with a beta coefficient of -0.257. Although the effect is statistically significant (sig < 0.05), the direction of the effect is contrary to the hypothesis (negative rather than positive). Thus, **Hypothesis 2 is rejected**. Hypothesis 3 proposed that capital intensity would have a significant positive effect on tax avoidance. The regression results reveal a significance value of 0.025 and a beta coefficient of -0.243. As with the previous case, although the effect is statistically significant, the direction is negative, not positive as hypothesized. Therefore, **Hypothesis 3 is rejected**.

4.5 Discussion

The Effect of Political Connections on Tax Avoidance

The results of the study show that political connections do not have a significant effect on tax avoidance. This is indicated by a significance value of 0.501 (> 0.05) and a negative coefficient of -0.071, thus H0 is accepted and H1 is **rejected**. This means that political connections do not contribute significantly to the likelihood of tax avoidance. In fact, the direction of the relationship is negative, implying that stronger political connections tend to reduce tax avoidance. This finding contradicts agency theory, which suggests that managers (agents) with political ties may act opportunistically by exploiting their connections to reduce tax obligations through regulatory leniency or reduced enforcement.

This discrepancy can be explained by the sample characteristics. Of the 34 banking companies included in the study, only around 35% had political connections, and most were not government-owned. Additionally, the banking sector is subject to strict regulation by authorities such as the Financial Services Authority (OJK), Bank Indonesia (BI), and the Directorate General of Taxes (DJP), which enforce high standards of transparency and compliance. Therefore, even when political connections exist, they are unlikely to be used as a tool for tax avoidance. This result is in line with El Fira (2022), but contradicts the findings of Imanuella & Damayanti (2022) and Az'ari & Lastiati (2021), who found that political connections influence tax avoidance.

The Effect of Leverage on Tax Avoidance

Leverage in this study has a significant negative effect on tax avoidance, as shown by the significance value of 0.016 (< 0.05) and a negative coefficient of -0.257. Although statistically significant, the negative direction of the coefficient leads to the **rejection of Hypothesis 2**, which initially expected a positive relationship. This means that the higher the company's leverage, the lower its tendency to engage in tax avoidance. These findings contradict agency theory, which posits that managers might exploit interest expenses from debt to reduce taxable income and thus avoid taxes.

This result may be explained by the specific financial structure of banking companies. In this sector, funding is largely sourced from third-party funds such as customer deposits rather than traditional debt. Therefore, the tax deduction benefits from interest expenses may already be inherent in the business model, reducing the need for aggressive tax planning. Furthermore, the banking industry is heavily regulated by financial authorities such as OJK and BI, which limits the opportunity for tax avoidance. These findings support the research by Luthfia and Firmansyah (2022), but differ from the results of El Fira & Alfa (2022) and Mahdiana & Amin (2020), who found a positive relationship between leverage and tax avoidance.

The Effect of Capital Intensity on Tax Avoidance

Capital intensity has a significant negative effect on tax avoidance, with a significance value of 0.002 (< 0.05) and a regression coefficient of -0.243. This indicates that the higher the company's capital intensity (investment in fixed assets), the lower its tendency to avoid taxes. As a result, Hypothesis 3, which predicted a positive relationship**, is rejected.** This finding is not in line with agency theory, which suggests that managers may utilize depreciation on fixed assets to reduce taxable profits legally as a tax avoidance strategy.

However, in the context of banking firms, fixed assets are typically used productively and reported transparently, leaving limited room for financial manipulation. Companies with high fixed asset intensity usually have greater public exposure and are subject to closer scrutiny by

regulators, which encourages careful and compliant financial reporting. Therefore, capital intensity in the banking sector reflects operational efficiency and fiscal compliance rather than an opportunity for tax avoidance. These findings align with Suciarti et al. (2020), but contradict the results of Ahdiyah & Triyanto (2021) and Ciptani & Situmorang, who found either a positive or non-significant relationship.

5. Conclusion

Hypothesis 1 is rejected, as the results provide evidence that political connections do not have a significant effect on tax avoidance, with a negative coefficient direction. This indicates that the stronger the political connections, the lower the level of tax avoidance tends to be in banking subsector companies listed on the Indonesia Stock Exchange (IDX) during the 2021–2023 period. Hypothesis 2 is rejected**,** as the results show that leverage has a significant negative effect on tax avoidance. This suggests that the higher the level of leverage, the lower the percentage of tax avoidance in banking companies listed on the IDX during the 2021–2023 period. Hypothesis 3 is rejected**, as the results provide evidence** that capital intensity has a significant negative effect on tax avoidance in companies within the banking subsector. This means that the greater the capital intensity applied by a bank, the lower the likelihood that the company will engage in tax avoidance

This study has several limitations that need to be considered. First, the sample size used is relatively small, consisting of only 87 observations from 34 banking companies over the 2021–2023 period, which may not fully represent the entire population. Second, the presence of outlier data affected the normal distribution of the dataset, requiring specific treatment to ensure the validity of the analysis. Third, although the study included three independent variables—political connections, leverage, and capital intensity—the coefficient of determination (R^2) was only 7.2%, indicating that 92.8% of the variation in tax avoidance is influenced by other variables not included in this model.

Suggestions: Future research is advised to expand the sample scope in terms of both the number of companies and the observation period, so that the findings can be more generalizable and representative of real conditions. Researchers should also be more meticulous in managing data, particularly in identifying and handling outliers to ensure normal data distribution. Moreover, it is strongly recommended to include additional and more diverse variables to address the remaining 92.8% unexplained variation in tax avoidance, such as profitability, firm size, institutional ownership, and corporate governance practices.

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