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The Effect of Financial Performance, Thin Capitalization, and Capital Intensity on Tax Avoidance

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Abstract

Indonesia's persistently low tax ratio, coupled with widespread tax avoidance practices, highlights the urgency of examining how corporate financial performance, capital structure, and ownership influence tax avoidance behavior. This study aims to analyze the influence of financial performance, thin capitalization, and capital intensity on tax avoidance by analyzing differences in foreign ownership. The research sample consists of 56 manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the 2019–2023 period, with a total of 56 samples. The research method uses a quantitative approach with panel data regression. The results of the study show that financial performance has a positive and significant effect on tax avoidance in companies with foreign ownership. Thin capitalization has a negative on tax avoidance in companies without foreign ownership, but it has no effect on companies with foreign ownership. Capital intensity has a negative effect on tax avoidance in companies without foreign ownership, while it has no effect on companies with foreign ownership. These findings show that there are differences in tax avoidance strategies between companies with foreign and non-foreign ownership.

Keywords

Capital Intensity, Financial Performance, Foreign Ownership, Tax Avoidance, Thin Capitalization.

1. Introduction

Taxes are one of the main sources of state revenue that contribute to the State Revenue and Expenditure Budget (*Anggaran Pendapatan dan Belanja Negara*/APBN). The trends in Indonesia's tax ratios make this vulnerability even more obvious. The ratio dropped from 10.31% of GDP in 2023 to 10.07% in 2024, substantially behind the OECD's average of about 34% and much below the ASEAN norm of 14–15%. Indonesia's tax percentage has stayed constant around 9% to 12% for almost 20 years (Salma, 2025). This condition is exacerbated by the rampant practice of tax avoidance carried out by domestic and multinational companies, so that it has the potential to reduce the government's fiscal capacity to finance development. Globally, the issue of tax avoidance has come under scrutiny through the Base Erosion and Profit Shifting (BEPS) initiative by the OECD and the G20, which emphasizes the importance of monitoring cross-border profit shifting practices. In the Indonesian context, weak control over tax avoidance strategies not only threatens state revenue but also creates injustice among taxpayers, where companies with specific capital and ownership structures have a greater chance of reducing the tax burden than other companies (Bimo et al., 2019).

The tax justice network report estimates that Indonesia loses USD 4.86 billion per year due to tax evasion. Cases such as PT Rajawali Nusantara Indonesia and PT Bentoel Internasional Investama show that tax evasion practices are not only carried out by local companies, but also by multinationals with foreign ownership. This phenomenon confirms that ownership structures have the potential to affect a company's strategy in managing its tax burden (Alkurdi & Mardini, 2020). Tax avoidance is a serious problem because it reduces state revenue (Bird & David, 2018). Several internal factors of the company can influence this practice. High profitability can make companies more compliant, but it can also encourage companies to look for ways to reduce tax burdens so that profits remain large. Capital structures with a high proportion of debt (thin capitalization) offer repayment opportunities for tax deductions through interest paid on loans. Similarly, capital intensity due to fixed assets allows for some form of depreciation (Rizki & Nugroho, 2024). In addition, foreign ownership allegedly encourages companies to evade taxes through the strategy of diverting profits to countries with lower taxes.

The results of previous research on the influence of profitability, thin capitalization, and capital intensity on tax avoidance still vary. Based on research conducted by Hariani and Waluyo (2019), Novianto (2021), and Hossain et al. (2024), it is shown that profitability has an effect on tax avoidance, but this study is not in line with the research conducted by Mulyati et al. (2019), Marlinda et al. (2020), and Sari et al. (2021), showing that profitability has no effect on tax avoidance. Research conducted by Nadhifah and Arif (2020) shows that thin capitalization has a positive effect on tax avoidance. Meanwhile, research by Winarto and Daito (2021) stated that thin capitalization hurts tax avoidance. However, research conducted by Mulrita (2023) states that thin capitalization has no effect on tax avoidance. Research conducted by Urrahmah and Mukti (2021) and Amni et al. (2023) shows that capital intensity has a positive effect on avoidance. Research conducted by Hidayah (2023) shows that capital intensity has an adverse effect on tax avoidance. In contrast to this, the research conducted by Marlinda et al. (2020) and Marsahala et al. (2020) suggests that capital intensity has no effect on tax avoidance. Research conducted by Susilawati and Tarmidi (2024) shows that the structure of foreign ownership has a positive effect on tax avoidance, where the larger the portion of foreign ownership, the greater the rate of tax avoidance carried out.

From a theoretical perspective, tax avoidance can be explained through agency theory, which highlights the conflict of interest between managers and shareholders, as well as political cost theory, which explains how companies seek to minimize tax

burdens in order to maintain profits (Jensen & Meckling, 1976). Internal factors such as profitability, capital structure, and asset intensity remain important variables in tax avoidance strategies. Empirically, this issue is increasingly relevant in Indonesia as the flow of Foreign Direct Investment (FDI) increases, which increases the proportion of foreign ownership in domestic companies.

Cases involving multinational companies in the mining, banking, and manufacturing sectors show indications of the practice of shifting profits to jurisdictions with lower tax rates. Therefore, research on the influence of financial performance, thin capitalization, and capital intensity on tax avoidance, as well as the comparison between companies with foreign and non-foreign ownership, is important both for the development of science and to support tax supervision policies in Indonesia. By contrasting businesses with foreign and non-foreign ownership, this study aims to examine the impact of financial performance, thin capitalization, and capital intensity on tax evasion.

2. Literature Review & Hypothesis Development

2.1. Agency Theory and Foreign Ownership

Agency theory describes a contract in which one or more people (principals) use another person (agent) to work on behalf of the principal, which includes delegating authority to the agent in decision-making (Jensen & Meckling, 1976). Agency Theory is an approach that studies the relationship between agents (company management) and principals (shareholders) in the context of finance and accounting (Ghozali et al., 2024). Companies see foreign ownership as a valuable resource since it allows them to track and enhance business performance. According to Suranta et al. (2020), Foreign investment or foreign direct investment, commonly known as Foreign Direct Investment (FDI), is a process in which residents of a country (country of origin) have asset ownership to control the production, distribution, and activities of other companies in other countries.

Research indicates that foreign investment has a positive effect on initiatives to lower tax payments (Susilawati & Tarmidi, 2024). The likelihood that management will devise a scheme to lower tax payments increases with the proportion of a company's shares held by foreign investors. This is allegedly due to the lack of attention from foreigners to the regulatory and tax compliance context in Indonesia, so their main focus is more directed towards achieving maximum returns from the investments. Under these circumstances, management of the corporation often exploits regulatory gaps to lessen the tax burden, which leads to tax evasion. Therefore, as part of their financial planning approach, corporations may be more inclined to engage in tax avoidance if they have a foreign ownership structure.

2.2. The Effect of Financial Performance on Tax Avoidance

Financial performance indicates a company's ability to generate profits or returns on the resources invested in it (Larasati, 2023). The ability of a business to turn a profit is measured by profitability. Return on assets (ROA), which characterizes a business's capacity to produce a profit from its whole asset base, is one of the most popular metrics used to evaluate profitability. Profit-making businesses are required to prepare taxes that will be paid on their earnings. Tax aggression will be higher by lowering the tax burden through a tax avoidance strategy because the more money a firm makes, the more tax it must pay. Based on research conducted by Hossain et al. (2024) on a significant and positive relationship with tax avoidance activities, the higher the company's profit, the higher the amount of tax that must be paid, so that tax aggressiveness will be higher by reducing the value of the effective tax rate. The results of the study are in accordance with the research by Hariani and Waluyo (2019) on profitability and tax avoidance. This is due to the fact that

fluctuations in profits mirror the trend of tax evasion. As a result, businesses that are highly profitable are probably more inclined to engage in tax evasion.

H1: Financial performance has a positive effect on tax avoidance.

2.3. The Effect of Thin Capitalization on Tax Avoidance

Thin Capitalization is the formation of a company's capital structure with a much larger proportion of debt (Tambunan & Samaria, 2025; Ramadhan et al., 2025). The Government of Indonesia, through Regulation PMK-169/PMK.010/2015, establishes guidelines for calculating a company's debt-to-equity ratio for tax purposes, setting the maximum ratio at 4:1. This policy aims to control excessive use of debt financing that can lead to thin capitalization. Thin capitalization occurs when a company relies more on debt than equity, which may create tax advantages since interest payments on debt are deductible, whereas returns on equity are taxable. This imbalance can reduce taxable income and potentially increase tax avoidance practices. Research by Nadhifah and Arif (2020) and Amni et al. (2023) indicates that higher debt ratios are positively associated with corporate tax avoidance, as firms strategically exploit debt-related deductions to minimize tax burdens and enhance after-tax profitability. This implies that the likelihood of businesses using debt as the primary component of their financing increases with the value of thin capitalization. A similar study was also conducted by Curry and Fikri (2023), stating that thin capitalization has a positive effect on tax avoidance practices. When companies take advantage of gaps in fulfilling obligations through thin capitalization, they are also more aggressive in minimizing their tax burden.

H2: Thin capitalization has a positive effect on tax avoidance.

2.4. The Effect of Capital Intensity on Tax Avoidance

Capital Intensity is an investment activity carried out by a company that is associated with investment in the form of fixed assets (Jusman & Nosita, 2020). Capital intensity is measured using total fixed assets without distinguishing between productive and non-productive assets. This is done because in principle, all fixed assets, both those that directly generate income and those that function as operational support, both reflect the company's capital allocation in long-term tangible assets. Fixed asset ownership will have an effect on reducing the tax payment that will be paid by the company, because fixed assets cause depreciation costs. Research by Kalbuana et al. (2020) states that capital intensity has a significant effect on tax avoidance. The results of the research by Urrahmah and Mukti (2021) and Sofiamanan et al. (2023) stated that capital intensity has a positive effect on tax avoidance, meaning that the higher the value of a company's capital intensity due to the use of fixed assets as a form of investment, the higher the level of tax avoidance carried out by the company.

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

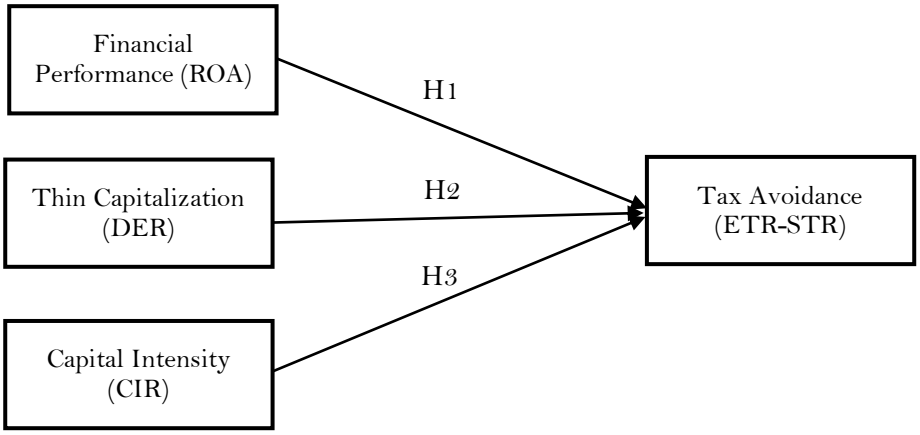

Figure 1. Research Framework

Figure 1 illustrates the conceptual model of this study. Financial performance (measured by Return on Assets/ROA), thin capitalization (measured by the Debt-to-Equity Ratio/DER), and capital intensity (measured by the Capital Intensity Ratio/CIR) are proposed as independent variables that influence tax avoidance (measured by the difference between the statutory tax rate and the effective tax rate, STR–ETR). The framework formulates three hypotheses: H1 posits that financial performance has an effect on tax avoidance; H2 proposes that thin capitalization has an effect on tax avoidance; and H3 suggests that capital intensity has an effect on tax avoidance. This framework serves as the basis for empirical testing to examine the determinants of tax avoidance practices among firms.

3. Methods

This study used quantitative analysis techniques with a panel data regression approach to test the hypothesis using the STATA application. Before conducting regression analysis, the panel data will be processed through several stages. First, descriptive statistics were carried out to provide an overview of the research variables, including minimum, maximum, average, and standard deviation values. Next, the data will be tested to meet classical assumptions such as normality, multicollinearity, and heteroscedasticity, to ensure that the regression model used is valid and unbiased. After that, to choose the most suitable panel data regression model among Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM), a series of tests will be carried out, namely the Chow Test and the Hausman Test. The results of this test will determine which model is most efficient for further analysis. Hypothesis testing will be based on the significance value (p-value) of the regression coefficient. If the p-value is smaller than the set significance level (α), then the research hypothesis will be supported.

A public manufacturing business that is listed on the Indonesia Stock Exchange (IDX) is the focus of this study, and the financial statements for 2019–2023 serve as the research object. Purposive sampling is the foundation for sample selection. The research sample was determined through a purposive sampling process applied to manufacturing companies listed on the Indonesia Stock Exchange. Initially, 220 companies were identified as the population. Several screening criteria were then applied to ensure data suitability and consistency for the 2019–2023 period. Companies that were not continuously listed on the IDX during the observation period were excluded, reducing the sample by 39 firms. A further 56 companies were removed for not publishing complete financial statements, followed by 24 companies

that did not use the Indonesian rupiah as their reporting currency. Additionally, 45 companies were excluded due to not recording profits during the study period. Finally, 12 firms were omitted due to incomplete capital ownership data. After applying these criteria, 56 companies qualified as research samples, consisting of 44 non-foreign ownership and 12 foreign ownership firms. Considering the five-year observation period, the total panel data used in the study amounted to 280 firm-year observations.

In this study, the variable of tax avoidance was quantified using Tax Avoidance, which is the difference between the Effective Tax Rate (ETR) and the tax rate as stipulated by the law (Statutory Tax Rate, or STR). In accordance with Susilawati and Tarmidi's methodology, this variable is quantified using ratios (2024).

Financial performance is measured by the *Return on Assets* (ROA) indicator, this variable uses a ratio scale, as referred to in the research of Sari et al. (2021). Thin Capitalization is measured by the indicator used is the Debt-to-Equity Ratio (DER). This variable is measured by ratio, as used in the research of Winarto and Daito (2021). Capital Intensity is measured by the indicator used is Capital Intensity Ratio, this variable is measured as a ratio, according to research by Amni et al. (2023).

TA = STR – ETR
STR = Tariff Article 17 of the Income Tax Law

$$\text{ETR} = \frac{Current\ Tax}{Income\ before\ Tax}$$

$$ROA = \frac{Net\ Profit\ After\ Tax}{Total\ Asset}$$

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

$$Capital\ Intensity = \frac{Total\ Fixed\ Asset}{Total\ Asset}$$

4. Results

Based on the results of purposive sampling, there were 280 panel data in model 1 or combined data, while there were 220 panel data in model 2 or company classification without foreign ownership, and 60 panel data in model 3 or company classification with foreign ownership processed using STATA. The following are descriptive statistics in the study.

Table 1. Descriptive Statistics

Variable	Tax Avoidance	Financial Performance	Thin Capitalization	Capital Intensity
Mean	-0.0193568	0.0900336	0.6164882	0.3870294
Maximum	0.2531755	0.4163203	3.928398	0.814416
Minimum	-0.5869032	0.0005258	0.0024865	0.0001441
Std. Dev	0.0985471	0.0735792	0.5572389	0.1959329
Observation	280	280	280	280

Table 1 shows that descriptive statistics from the research variables, consisting of tax avoidance, financial performance, thin capitalization, and capital intensity, with a total of 280 observations. tax avoidance has an average value of -0.019, a maximum value of 0.253, and a minimum value of -0.586. According to statistical data, financial performance has an average value of 0.090, a maximum value of

0.4163, and a minimum value of 0.0005. The data's maximum value is 3.928, the lowest is 0.002, and the average is 0.616 for thin capitalization. The data indicates that the average value of capital intensity is 0.387, with the highest value being 0.814 and the lowest being 0.0001.

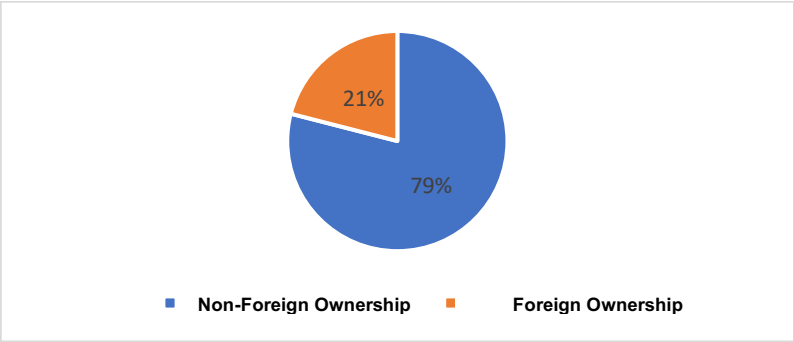

Figure 2. Comparison of Number of Companies

Figure 2 shows a comparison of the number of foreign-owned and non-foreign-owned companies. Companies with non-foreign ownership amounted to 44 companies or 79% of the total companies. Meanwhile, foreign-owned companies amounted to 12 companies or as much as 21%. Panel Data Regression Model Selection.

Table 2. Conformity Test Results for Models I, II, and III

Model	Types of Testing	Tested Models	Test Results	
I	Chow	EMC vs EMF	Prof > F = 0.000	FEM
	Hausman	FEM vs REM	Prob>chin2 = 0.2670	BRAKE
	Lagrange Multiple	REM vs EMC	Prob>chibar2 (0.0000)	BRAKE
II	Chow	EMC vs EMF	Prob>F = 0.0988	EMC
	Hausman	FEM vs REM	-	Not Tested
	Lagrange Multiple	REM vs EMC	Prob>chibar2 = 0.2402	EMC
III	Chow	EMC vs EMF	Prob>F = 0.0000	FEM
	Hausman	FEM vs REM	Prob>chin2 = 0.3042	BRAKE
	Lagrange Multiple	REM vs EMC	Prob>chibar2 = 0.0000	BRAKE

Based on the results presented in Table 2, the model suitability tests indicate different approaches for each regression model used in this study. For Model I, the Random Effect Model (REM) was determined to be the most appropriate, while for Model II, the Common Effect Model (CEM) provided the best fit. Meanwhile, the estimation of Model III also employed the Random Effect Model (REM), as it was found to be the most suitable among the alternatives tested.

The research on model I and model III use a random effect model, which is the Generalised Least Squares (GLS) estimation method. According to Ghozali and Ratmono (2017), when using the GLS estimation method, it can be stated that the model has met classical assumptions, so that classical assumption testing is no longer needed. The research on model II that was selected was the Common Effect Model (CEM), for which a classical assumption test must be carried out. The classical assumption test used is multicollinearity and heteroscedasticity (Napitupulu et al., 2021).

Table 3. Multicollinearity and Heteroscedasticity Test

Test	Indicators	Result	Action
Multicollinearity	Correlation less than 0.85	-0.309 to 0.2457	There is no multicollinearity
Heteroscedasticity	Prob>Chi2 exceeds 0.050	Prob>Chi2 = 0.0002	Indication of heteroscedasticity, robust standard error

Based on Table 3, the classical assumption test of model II, it is known that the analyzed panel data passed the multicollinearity test, and for the heteroscedasticity test, this shows that the regression model has not fully met the assumption of homoscedasticity, so adjustments are needed. One solution that can be used is to use regression with a robust standard error to correct potential bias in standard error estimation.

Table 4. Hypothesis Testing

Variable	Model I (Sum)		Model II (Non-Foreign Ownership)		Model III (Foreign Ownership)		Result
	Coef.	Prob T-Stat	Coef.	Prob T-Stat	Coef.	Prob T-Stat	
ROA (X1)	0.297048	0.003**	0.136972	0.204	0.3787004	0.061**	Different
Debt Equity Ratio (X2)	-0.02792	0.043**	-0.02756	0.078**	-0.012897	0.663	Different
Capital Intensity (X3)	-0.05504	0.164	-0.08944	0.005**	-0.114068	0.438	Different
N	280		220		60		

Note: * significance 10% ** significant 5% *** significant 1%

Based on the results in Table 4, in Model I, the variable financial performance measured by Return on Assets (X1) has a positive and significant effect on tax avoidance (Coef = 0.297, p = 0.003 < 0.05) and also on companies with foreign model ownership in Model III (Coef = 0.379; p < 0.1). However, in companies with non-foreign ownership (Model II), the effect of profitability (ROA) was not significant (p = 0.204). This shows that there is a difference in the influence of profitability (ROA) between foreign and non-foreign companies.

For the thin capitalization variable measured by the debt-to-equity ratio (X2), the test results showed a negative effect on tax avoidance in Model I (Coef = –0.028; p < 0.05) and Model II (Coef = –0.028; p < 0.1). In contrast, in Model III (foreign companies), the effect was not significant (p = 0.663). This means that the capital structure plays a greater role in influencing tax avoidance in non-foreign companies than in companies with foreign ownership.

Meanwhile, the capital intensity variable (X3) only showed a negative influence on companies with non-foreign ownership (Model II; coef = –0.089; p < 0.01). In the model i and model III, the effect was not significant. This indicates that fixed asset intensity is more related to tax avoidance strategies in domestic companies than in foreign-owned companies. These results confirm that there is a difference in the influence of variables on tax avoidance when comparing foreign-owned and non-foreign-owned companies.

Table 5. R-Square and F-Test Result

Test	Model I (Sum)	Model II (Non-Foreign Ownership)	Model III (Foreign Ownership)
R Square	0.0771	0.09	0.091
Prob. F	0.0015**	0.0001***	0.2914

Note: * significance 10% ** significant 5% *** significant 1%

Table 5 shows the value of the determination coefficient (R-Square) and the results of the F test for the three research models. Model I has an R-Square of 0.0771 with a significant probability value of F 0.0015 at the level of 5%, so that the independent variables together are able to explain the variation in tax avoidance, even though the contribution is relatively small. Model II shows similar results with an R-Square of 0.09 and a significant probability of F of 0.0001 at the level of 1%, indicating that this model is quite statistically robust. In contrast, Model III only has an R-Square of 0.091 with an insignificant F probability of 0.2914, so the variables tested are unable to explain the variation in tax avoidance in foreign-owned companies.

5. Discussion

The study shows differences in the effect of financial performance, thin capitalization, and capital intensity on tax avoidance between foreign and non-foreign-owned companies. In Model II, profitability does not significantly affect tax avoidance, consistent with Mulyati et al. (2019), Marlinda et al. (2020), and Sari et al. (2021). By contrast, Model III supports findings by Hariani and Waluyo (2019), Novianto 2021), and Hossain et al. (2024), showing that profitability positively influences tax avoidance in foreign-owned firms. This aligns with Susilawati and Tarmidi (2024), who found that foreign ownership increases tax avoidance. From the perspective of agency theory, pressure from foreign shareholders to sustain profitability and maximize returns can drive managers to adopt more aggressive tax avoidance strategies.

Model II test findings demonstrate that tax avoidance is significantly and negatively impacted by thin capitalization. This indicates that a company's tax evasion rate decreases with increasing thin capitalization. Other research, nevertheless, produces different findings. According to Nadhifah and Arif (2020), tax evasion is really positively impacted by thin capitalization. However, in model III, businesses with foreign ownership of shares demonstrate that thin capitalization has no discernible impact on tax evasion. The H2 hypothesis is therefore accepted. Through the perspective of agency theory, companies with non-foreign ownership (Model II) use high debt to reduce tax avoidance practices. The existence of debt can reduce agency conflicts between managers and owners by suppressing opportunistic behavior, including in tax strategies. In contrast, in foreign-owned companies (Model III), the effect of thin capitalization on tax avoidance is not significant. This condition shows that funding decisions in foreign companies are more influenced by the global strategy of the parent group rather than solely by the decisions of managers at the local level.

According to the model I tested, capital intensity has no discernible impact on tax evasion. Capital intensity, however, has a negative and substantial impact on model II. These findings show that tax evasion methods decrease with increasing fixed asset intensity. This result is consistent with studies that demonstrate the detrimental impact of capital intensity on tax evasion by Hidayah (2023). However, these findings contrast with research by Urrahmah and Mukti (2021) and Amni et al. (2023), which discovered that capital intensity had a favorable impact on tax evasion by Mukarramah and Nugroho (2025).

Capital intensity was shown to have no discernible impact on tax evasion in Model III enterprises with foreign ownership of shares. These results are in line with research that found no relationship between capital intensity and tax evasion by Marlinda et al. (2020) and Marsahala et al. (2020). Consequently, the H3 theory is approved. Within the framework of agency theory, high capital intensity in non-foreign companies can suppress tax avoidance practices because large fixed assets increase transparency and minimize the room for managers to act opportunistically. In contrast, in foreign companies, the influence of capital intensity is not significant because fixed asset investment decisions are influenced more by global parent strategies than by local managers' agency incentives.

The results of this study provide important implications for tax authorities and companies. For tax authorities, the difference in the influence of variables on foreign-owned and non-foreign-owned companies indicates the need for more specific supervision policies, especially regarding tax avoidance practices in multinational companies. For companies, these findings confirm that funding strategies and asset management not only impact financial performance but also tax compliance, hence the need for more transparent governance to minimize agency conflicts and tax risks in the future.

6. Conclusion

The study's findings on the impact of capital intensity, thin capitalization, and financial performance on tax avoidance, along with a separate examination of foreign ownership in manufacturing firms listed on the Indonesia Stock Exchange between 2019 and 2023, suggest that the impact of financial performance on tax avoidance varies depending on whether the company's shares are owned by foreigners or not. Thin capitalization has a different impact on tax evasion for businesses with foreign ownership of their shares than for businesses without foreign ownership. Capital intensity has a different impact on tax evasion for businesses with foreign ownership of their shares than for businesses without foreign ownership.

This study has several limitations. First, the relatively low R-Square values indicate that financial performance, thin capitalization, and capital intensity explain only a small portion of tax avoidance, suggesting that other factors such as corporate governance, firm size, or industry characteristics may also play important roles. Second, the observation period and sample size are limited, which may restrict the generalizability of the findings. Third, the study only distinguishes between foreign and non-foreign ownership without considering the proportion or type of foreign investors, which could yield deeper insights.

Future research is recommended to include additional variables such as corporate governance mechanisms, firm size, and industry sectors to enhance explanatory power. Expanding the observation period and sample coverage will also provide more robust results. Moreover, analyzing the level and type of foreign ownership could offer a clearer understanding of how ownership structure influences tax avoidance behavior.

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