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Prudence Accounting, Financial Distress, and Foreign Operations on Tax Avoidance: Leverage's Moderating Role

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ABSTRACT

Purpose : The study investigates the effect of prudence accounting, financial distress, and foreign operations on tax avoidance, while also examining the moderating role of leverage in these relationships. The research addresses inconsistencies in prior studies regarding the influence of these factors and highlights their relevance in Indonesia's financial sector, which is highly regulated and susceptible to aggressive tax strategies.
Method : Using secondary data from audited financial statements of financial sector companies listed on the Indonesia Stock Exchange (IDX) from 2020 to 2023, this study employs panel data regression analysis. The fixed effect model was chosen as the best fit after Chow and Hausman tests.
Findings : The results reveal that prudence accounting and financial distress positively and significantly affect tax avoidance, while foreign operations show no significant impact. Furthermore, leverage weakens the positive relationship between both prudence accounting and financial distress with tax avoidance, but does not moderate the relationship between foreign operations and tax avoidance.
Novelty : The study offers a comprehensive framework by integrating prudence accounting, financial distress, and foreign operations with leverage as a moderating variable, providing empirical evidence on how these factors interact in shaping tax avoidance strategies in the regulated Indonesian financial sector.

INTRODUCTION

Indonesia's tax revenue exceeding targets in 2021–2023 is seen as an illusory success because a high share still comes from extra effort audits (13–15%) instead of voluntary payments, which ideally should be at least 95%, and the actual revenue remains below potential, with a tax gap of 6–8.5%, higher than the OECD benchmark of 3.5% (Maghfiroh & Fajarwati, 2016). This gap reflects persistent tax avoidance practices, which exploit legal loopholes and undermine tax optimization. Tax avoidance, unlike illegal tax evasion, is a lawful strategy to reduce tax burdens (Hidayat, 2018), and it has become more complex with cross-border transactions and advanced accounting techniques (Ghina et al., 2024). Even with tighter regulations like AEoI, ILAP, and BEPS 2.0, companies continue finding ways to minimize taxes (Yanuar, 2023).

Tax avoidance undermines the principle of fairness in taxation, with Indonesia potentially losing trillions of rupiah annually due to tax abuse, primarily through transfer pricing and tax haven schemes (Tax Justice Network). In 2020, the tax revenue loss peaked at 5.30% of total tax revenue, then declined to 2.06% in 2021 and remained below 2020 levels through 2023, partly due to improved compliance and recovery from the COVID-19 economic downturn (State of Tax Justice). Such practices create market unfairness, as compliant firms must compete with large multinationals that save an estimated 10–15% of their income through tax avoidance strategies (Beer et al., 2020). In Indonesia, the issue is compounded by sectoral vulnerabilities, particularly in finance, energy, and infrastructure, which are closely monitored for such practices (Oktania & Putra, 2023). Understanding the sectors and economic, legal, and operational factors driving tax avoidance remains crucial to addressing its impact on state revenue and market competition.

The financial sector, despite its strategic role in supporting sustainable economic growth, remains highly vulnerable to tax avoidance yet often overlooked, due to its operational complexity involving diverse regulations, cross-

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border transactions, foreign currencies, and varied financial products (Hasanah, 2022). Such complexity enables firms to legally minimize taxes, though ethically questionable, and has led to major cases in Indonesia, such as Bank Central Asia in 2014 and Bank Panin in 2021, where tax avoidance escalated into aggressive and illegal practices (Hafidzullah et al., 2024). According to Finance Minister Sri Mulyani in a 2022 parliamentary session, the financial sector is crucial for providing diverse and reliable financing instruments to drive economic development, but weak governance and law enforcement evidenced by rising complaints to the Financial Services Authority (OJK) since late 2020 create opportunities for unhealthy practices, including tax avoidance, which threaten state revenue and long-term economic stability.

Companies engage in tax avoidance due to various factors, one of which is the principle of prudence accounting. Prudence accounting reflects a cautious approach by delaying the recognition of assets or income (good news) and accelerating the recognition of expenses or bad debt reserves (bad news) to anticipate risks under uncertainty (Odang & Rangkuti, 2023). This principle allows firms to maintain conservative reserves and cautious reporting, which can affect how they report income and tax liabilities (Dewi & Dewi, 2020). However, in extreme cases, prudence can lead to overly pessimistic financial statements that do not reflect the company's actual condition. In line with previous studies, prudence accounting in this context tends to lean toward a more conservative stance.

Previous research on the effect of prudence accounting on tax avoidance has shown mixed results. While studies by Karlina & Utami (2023), Djajanti (2021), Hasnita et al. (2023), and Ellyanti & Suwarti (2022) found a positive effect, others like Febriyanto (2022), reported no significant effect. Similarly, the role of financial distress a condition where declining financial performance increases bankruptcy risk (Sadaa et al., 2023), also shows a research gap. Several studies Tabroni & Haq (2024), Dang & Tran (2021), Sadjiarto et al. (2020), Ariff et al. (2023), Nugroho (2022), and Yantine & Rahayuningsih (2023) identified a positive influence, while others Febriyanto (2022), Ari & Sudjawoto (2017), and Anjeltusuwa et al. (2021) found no effect. Another debated factor is foreign operations, cross border activities adding complexity to governance and offering tax planning opportunities. Ferdiawan (2017); Nourani et al. (2022); Pratiwi (2024); Siregar et al. (2022) found that foreign operations positively affect tax avoidance, while studies by Alianda et al. (2021) and Yudawirawan et al. (2022) reported no influence.

This study differs by introducing leverage as a moderating variable, which measures a firm's debt level and its ability to meet financial obligations (Jati, 2019). Leverage can enhance returns and growth but also raises risks, and the interest on debt reduces taxable income (Pratiwi et al., 2025; Sarah & Saleh, 2023). Prior studies have also shown mixed findings: while some Dang & Tran (2021), Nugroho (2022), Wahyuni et al. (2017), Ernawati et al. (2019), Mulyati et al. (2019), Widyastuti et al. (2022), Radiany et al. (2022), and Noviyani & Muid (2019) found leverage positively influences tax avoidance by reducing taxable income, others Sulaeman (2021), Paramita et al. (2023), and Prabowo & Sahlan (2022) observed a negative effect due to creditor scrutiny and reduced incentive for aggressive strategies. This study also controls for profitability measured by return on assets to account for firm-specific performance, as supported by Kusumaningsih & Mujiyati (2024), Ikhsan & Wahyuni (2020), Yantine & Rahayuningsih (2023), Prabowo & Sahlan (2022), Sulaeman (2021) ensuring a more comprehensive understanding of tax avoidance behavior.

Despite numerous studies investigating the effect of leverage on tax avoidance, there remains an empirical gap regarding its role as a moderating variable between prudence accounting, financial distress, and foreign operations toward tax avoidance. Prior research has mostly examined the direct effect of leverage, producing inconsistent findings some showing a positive impact while others finding a negative or insignificant relationship yet very few have tested its interaction effects in shaping tax avoidance strategies. Moreover, there is a contextual gap, since most previous studies were conducted in manufacturing or non-financial industries, leaving limited evidence from the financial sector, which is highly regulated and uniquely complex. This study addresses both the empirical and contextual gaps by focusing on financial sector companies in Indonesia, thereby clarifying the inconsistencies and extending the scope of prior research.

The novelty of this study lies in its integrated approach by simultaneously examining prudence accounting, financial distress, and foreign operations on tax avoidance while incorporating leverage as a moderating variable, specifically within the Indonesian financial sector context. Unlike previous studies that primarily focused on direct effects, this research provides new insights into how leverage interacts with accounting conservatism and financial distress to shape tax avoidance behavior in highly regulated industries. By controlling for profitability and focusing on financial sector firms listed on the IDX, the study offers a more comprehensive and industry-specific understanding, thereby contributing original evidence to the tax avoidance literature.

Based on the aforementioned background, the purpose of this study is to: (1) examine the effect of prudence accounting on tax avoidance; (2) examine the effect of financial distress on tax avoidance; (3) examine the effect of foreign operation on tax avoidance; (4) assess the moderating role of leverage in the relationship between prudence accounting and tax avoidance; (5) assess the moderating role of leverage in the relationship between financial distress and tax avoidance; and (6) assess the moderating role of leverage in the relationship between foreign operation and tax avoidance. Based on the background described above, the hypotheses proposed in this study is explained in the following paragraph.

According to agency theory, the existence of information asymmetry between principals and agents allows managers to adopt accounting policies that serve their own interests, including in tax management (Lismiyati &

Herliansyah, 2021). The principle of prudence, which emphasizes delaying revenue recognition and accelerating expense recognition, may reduce taxable income and encourage tax avoidance (Ellyanti & Suwarti, 2022).

H_1: Prudence accounting has a positive effect on tax avoidance

From the perspective of agency theory, financial distress intensifies conflicts of interest since managers are incentivized to adopt short-term strategies to secure liquidity, one of which is tax avoidance (Ariff et al. 2023). Empirical evidence by Dang & Tran (2021) confirms that firms under higher financial pressure are more likely to engage in tax-reducing strategies.

H_2: Financial distress has a positive effect on tax avoidance

Based on positive accounting theory, accounting decisions are influenced by economic and tax incentives, particularly in cross-border activities. Firms with foreign operations may delay the recognition of foreign exchange gains to reduce tax obligations (Ferdiawan, 2017). Supporting this view, Siregar et al. (2022) found that firms with international activities tend to exploit such opportunities to engage in tax avoidance.

H_3: Foreign operation has a positive effect on tax avoidance

The debt covenant hypothesis, derived from agency theory, suggests that highly leveraged firms face pressure to comply with debt agreements, which may drive managers to use prudence accounting in reducing tax liabilities (Susanto & Ramadhani, 2016). Sulaeman (2021) argues that creditor oversight in highly leveraged firms may weaken this relationship by restricting managerial discretion in aggressive tax planning.

H_4: Leverage moderates the relationship between prudence accounting and tax avoidance

Within the framework of agency theory, leverage magnifies the risk of financial distress, thereby motivating managers to adopt tax avoidance strategies to relieve cash flow pressures (Wahyuni et al., 2017). Yet, consistent with Sulaeman (2021), stronger creditor monitoring in highly leveraged firms may weaken this relationship by prioritizing transparency and compliance.

H_5: Leverage moderates the relationship between financial distress and tax avoidance

According to positive accounting theory, firms with high leverage have greater incentives to exploit accounting policies, including foreign operations, to minimize tax burdens (Wahyuni et al, 2017). Sulaeman (2021) highlights that high debt pressure may shift managerial focus toward meeting debt obligations, thereby weakening the effect of foreign operations on tax avoidance.

H_6: Leverage moderates the relationship between foreign operation and tax avoidance

RESEARCH METHODS

The research in this study adopts a positivistic paradigm, using a quantitative causal design to empirically test the relationships between prudence accounting, financial distress, and foreign operations on tax avoidance, with leverage as a moderating variable. The population consists of financial sector companies listed on the Indonesia Stock Exchange (IDX) during 2020–2023, chosen because of their operational complexity and relevance to tax avoidance issues. Secondary data are used, primarily financial statements and supporting literature, analyzed through descriptive statistics, classical assumption tests, and multiple linear regression with interaction terms to assess moderation effects. The dependent variable, tax avoidance, is measured using the Effective Tax Rate (ETR); independent variables include prudence accounting (CONACC), financial distress (Altman Z-Score), and foreign operation (foreign asset ratio); leverage as the moderating variable is measured by the Debt to Assets Ratio (DAR); and profitability (ROA) serves as a control variable. Data are processed with Excel and E-Views 12, ensuring robust and generalizable results. The operational definition of the variables can be seen in Table 1.

The sample selection process was carried out by applying a number of predetermined criteria to obtain a population to be used as a sample in the study. The population in this study included all financial sector companies listed on the Indonesia Stock Exchange (IDX), totaling 105 companies. The population was then selected based on specific criteria to obtain a sample that met the research objectives. This study uses company financial reports for the period 2020 to 2023 (4 years), resulting in 100 company-years of observation data for further analysis. The data used has time series characteristics because it covers several years of observation, and cross-sectional characteristics because it involves many companies. Therefore, the observational data falls into the panel data category. The sample was selected using a purposive sampling technique, with the criteria presented in Table 2.

The sampling method is purposive sampling, excluding companies that do not meet specific criteria to ensure data relevance (Creswell & Creswell, 2018). Data collection involves documentation and literature review, while statistical analysis includes classical assumption tests (normality, multicollinearity, heteroscedasticity, and autocorrelation), multiple regression, and significance tests (t-test, F-test, and R^2) (Ghozali, 2018). This study aims to provide deeper insights into how prudence, financial distress, and foreign operations influence tax avoidance in the financial sector and how leverage moderates these relationships (Creswell & Creswell, 2023). The findings are expected to

Table 1. Operational Definition of Variables

Variable	Formula	Indicator / Proxy	Scale
Tax Avoidance (Y)	ETR = Tax Expense / Pre-tax Income	Lower ETR → higher tax avoidance	Ratio
Independent Variables			
Prudence Accounting (X_1)	CONACC = (NIO + DEP – CFO) / Total Assets	Negative accruals indicate conservatism	Ratio
Financial Distress (X_2)	Z-Score = 3.25 + 6.56A + 3.26B + 6.72C + 1.05D	Lower Z-Score → higher financial distress	Ratio
Foreign Operation (X_3)	Foreign Asset Ratio = Foreign Assets / Total Assets	Higher ratio → greater foreign operation exposure	Ratio
Moderating Variable			
Leverage (Z)	DAR = Total Liabilities / Total Assets	Higher DAR → higher financial risk	Ratio
Control Variable			
Profitability (ROA)	ROA = Net Income After Tax / Total Assets	Higher ROA → higher profitability	Ratio

Source: Processed Data (2025)

offer empirical evidence and practical implications for corporate management and stakeholders in understanding the factors driving tax avoidance behavior, particularly in the financial industry.

This research framework emphasizes that prudence accounting, financial distress, and foreign operations have the potential to influence corporate tax avoidance practices. Prudence accounting encourages prudence in profit and asset recognition, financial distress reflects financial pressures that encourage tax reduction, while foreign operations relate to the complexity of international transactions that open up opportunities for tax avoidance. Leverage acts as a moderating variable that can strengthen or weaken this relationship. Companies with high leverage may be encouraged to engage in tax avoidance to reduce their debt burden, but on the other hand, deductible interest obligations and oversight by creditors and regulators can suppress their incentives to engage in tax avoidance. This study aims to examine how leverage moderates the relationship between these variables and tax avoidance.

RESULTS AND DISCUSSIONS

Based on the descriptive statistics in Table 3, the tax avoidance variable (Y) has a mean value of -0.21985 and a low standard deviation (0.05154), indicating that most companies in the sample tend to engage in tax avoidance at a relatively consistent level. The prudence accounting variable (X_1) has a mean close to zero (0.00045) and a standard deviation of 0.10205, suggesting variability in the application of conservative accounting principles across companies. Meanwhile, the financial distress variable (X_2) shows a significantly low mean (-3.64667) with a high standard deviation (2.96830), reflecting substantial differences in financial health, from severely distressed firms to relatively stable ones.

Furthermore, the foreign operation variable (X_3) has a mean of 0.0936 and a median of 0.0591, indicating that most companies have low international involvement, although a few are highly active abroad. The leverage variable (Z) displays a relatively high average (0.7623) with a fairly even distribution, showing that the majority of firms heavily rely on debt in their capital structure, which is common in the financial sector. The control variable

Table 2. Purposive Sampling

No	Criteria	Count
1	Financial sector companies listed on the IDX	105
2	Financial sector companies listed on the IDX after December 31, 2020	(4)
3	Companies in the special monitoring board category	(13)
4	Companies with negative net profit before tax	(29)
5	Companies with positive tax burden or overpaid taxes	(7)
6	Companies with incomplete or unavailable data	(27)
7	Total companies used in the research sample	25
8	Number of years of observation	4
9	Number of samples	100

Source: Processed Data (2025)

Table 3. Descriptive Statistics

Variable	N	Mean	Median	Max	Min	Std. Dev
Y	100	-0.21985	-0.22050	-0.03980	-0.36070	0.05154
X1	100	0.00045	-0.00805	0.28210	-0.23900	0.10205
X2	100	-3.64667	-2.75410	-0.03510	-14.7569	2.96830
X3	100	0.09364	0.05910	0.30090	0.00002	0.09125
Z	100	0.76234	0.80805	0.91890	0.23870	0.12714
ROA	100	0.01825	0.01270	0.12160	0.00060	0.01878

profitability (ROA) shows a mean of 0.01825, indicating that the efficiency in using assets to generate profit remains relatively low, though it varies across firms (standard deviation of 0.01878). This underscores the importance of controlling for financial performance in the subsequent regression analysis.

The Chow test, also known as the Redundant Fixed Effect Test, is used to determine whether the Fixed Effect Model (FEM) is more appropriate than the Common Effect Model (CEM) in panel data analysis by comparing the chi-square probability value with a significance level of 0.05. If the chi-square probability is below 0.05, the FEM is preferred. Based on the Chow test results shown in Table 4, the chi-square probability of 0.0000 is less than 0.05, indicating that FEM is more suitable than CEM. However, to confirm whether FEM is superior to the Random Effect Model (REM), a Hausman test is necessary. If the Hausman test favors FEM over REM, then FEM is chosen; otherwise, if REM performs better, the Lagrange Multiplier test should follow.

The Hausman test is used to determine whether the Fixed Effect Model (FEM) or the Random Effect Model (REM) is more appropriate for panel data analysis by comparing the chi-square probability of the cross-section random effect with a significance level of 0.05. If the chi-square probability is below 0.05, FEM is preferred. Based on the Hausman test results shown in Table 4, the chi-square probability of 0.0140 is lower than 0.05, indicating that the Fixed Effect Model (FEM) is more suitable than the Random Effect Model (REM) for this analysis. After conducting the regression model selection tests (Chow Test and Hausman Test), it can be concluded that the Fixed Effect Model (FEM) is chosen for the subsequent stages of the research. This conclusion is based on the results of both the Chow and Hausman tests, which consistently identified the FEM as the most appropriate model.

The normality test is a method used to assess whether the data in a group or variable follow a normal distribution pattern (Fahmeyzan et al., 2018). In this study, the Jarque-Bera test was employed, where a probability value greater than 0.05 indicates normal distribution, and a value below 0.05 indicates non-normal distribution. As shown in Figure 1, the Jarque-Bera value is 0.0000000, which is below 0.05, leading to the conclusion that the data in this study are not normally distributed.

Normality is not a strict requirement for meeting the BLUE (Best Linear Unbiased Estimator) criteria, and some experts argue that it is not always necessary (Iqbal, 2015). In this study, the normality test refers to the assumptions of the Central Limit Theorem (CLT), a fundamental principle in statistics stating that the sampling distribution of the mean approaches normality as the sample size becomes sufficiently large, regardless of the population's original distribution. According to the CLT, data can be considered normally distributed if the sample size exceeds 30, as widely applied in previous studies. Therefore, since this study uses 100 observations, it can be assumed that the data follow a normal distribution.

The multicollinearity test is conducted to identify whether there is a high correlation among independent variables in a regression model, as excessive multicollinearity can destabilize coefficient estimates and complicate result interpretation (Iqbal, 2015). One way to detect multicollinearity is by examining the correlation matrix of the independent variables; if correlations exceed certain thresholds, it indicates multicollinearity. According to Napitupulu et al. (2021), correlations below 0.9 or above -0.9 are still acceptable and not considered problematic. Based on the results shown in Table 5, no correlations exceed these thresholds, indicating that the model does not suffer from multicollinearity and remains valid and interpretable without further adjustments.

The heteroscedasticity test is one of the classical assumption tests in regression, aimed at determining whether the variance of the residuals remains constant or not (Iqbal, 2015). If the residual variance changes systematically, heteroscedasticity occurs, which can make the regression coefficient estimates inefficient. Ideally, a model should exhibit homoscedasticity, meaning the residual variance stays constant. One commonly used method to detect heteroscedasticity is by examining the residual plot, where the pattern of residual distribution can indicate

Table 4. Chow and Hausman Test Results

Test	Statistic	d.f.	Prob.
Chow Test (Cross-section F)	2.451532	(24.67)	0.0021
Chow Test (Cross-section Chi-square)	63.029299	24	0.0000
Hausman Test (Cross-section random)	Chi-Sq. Statistic = 19.155861	Chi-Sq. d.f. = 8	0.0140

Source: E-Views version 12 application

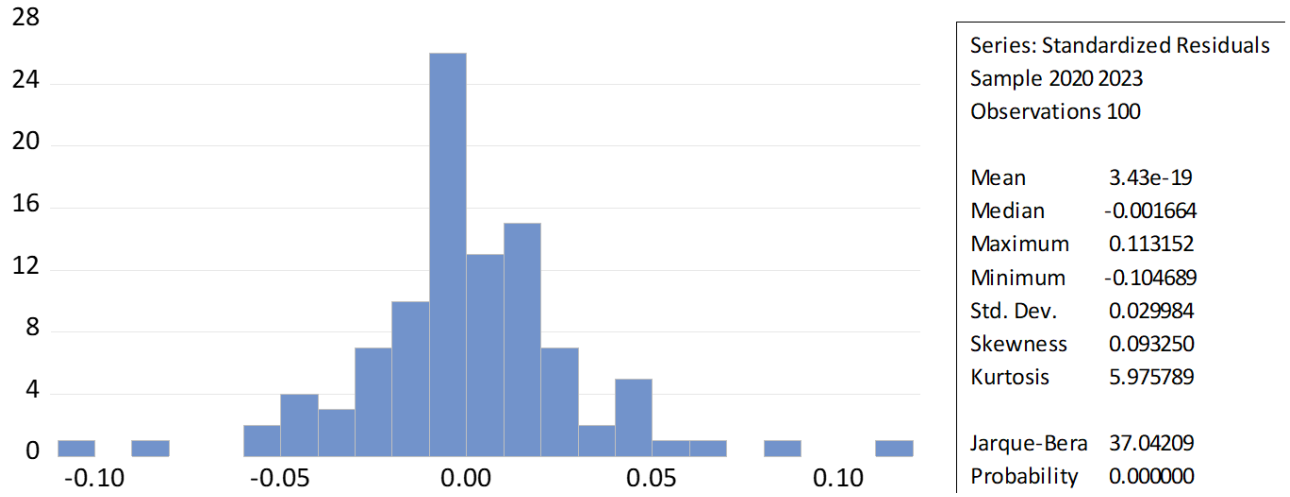

Figure 1. Normality Test Results
Source: E-Views version 12 application

whether systematic variance changes are present in the regression model (Napitupulu et al., 2021).

Based on the residual plot shown in Figure 2, the residual values appear randomly scattered around zero without forming any clear pattern. Although some fluctuations are observed at certain points, the residuals remain within a relatively small range. According to Napitupulu et al. (2021), if the residual values do not exceed the ±500 threshold, it can be concluded that heteroscedasticity is not present in the regression model. In this case, the residuals are well below that threshold, indicating that the variance of the residuals is constant. With no indication of heteroscedasticity, the regression model meets the assumption of homoscedasticity, ensuring that the estimated coefficients remain efficient and unbiased. Therefore, the model can be used for valid inference without requiring further adjustments or transformations to address heteroscedasticity issues.

The autocorrelation test is a statistical analysis method used to detect whether there is a correlation between variables in a predictive model over time. This test is crucial when dealing with time series data, as autocorrelation indicates that the value of an observation at a given time is influenced by the value at a previous time (Napitupulu et al., 2021). The purpose of the test is to examine whether data at period t are correlated with data at period t–1, and it is performed using the Durbin-Watson statistic. Autocorrelation issues are identified if the Durbin-Watson value falls outside the range between the Durbin-Upper (dU) and 4–dU, where the dU is determined from the Durbin-Watson table available at http://www.stanford.edu, in this case based on 100 observations and 8 independent variables.

Based on Table 6, the results indicate the presence of autocorrelation in the research model, as the obtained Durbin-Watson (dW) value falls outside the acceptable range between dU and 4–dU. Thus, the model does not pass the autocorrelation test. However, this outcome is not considered problematic. According to Iqbal (2015) and other studies, autocorrelation is a characteristic that typically appears only in time series data. Therefore, testing for autocorrelation in cross-sectional or panel data has little relevance or significance. Consequently, this study assumes that the model satisfies the autocorrelation assumption.

Based on Table 6, the R-squared value for this research model is 0.661534, indicating that 66.15% of the variation in the dependent variable (tax avoidance) is explained by the independent variables, while the remaining 33.85% is influenced by factors outside the model. However, one limitation of R-squared is its tendency to be biased by the number of independent variables included, as it often increases even when additional variables have no significant effect on the dependent variable (Ghozali, 2018). This can create the misleading impression of a strong predictive ability when the model may actually be ineffective or overfitted. To address this, adjusted R-squared provides a more accurate measure by adjusting for the number of predictors, increasing or decreasing depending on whether added variables genuinely contribute to the model. According to Table 6, the adjusted R-squared value for

Table 5. Multicollinearity Test Result

	X_1	X_2	X_3	Z	ROA
X_1	1.000000	0.152464	0.064631	0.205844	-0.217590
X_2	0.152464	1.000000	0.240644	0.887925	-0.613646
X_3	0.064631	0.240644	1.000000	0.207163	-0.225628
Z	0.205844	0.887925	-0.207163	1.000000	-0.671197
ROA	-0.217590	-0.613646	-0.225628	-0.671197	1.000000

Source: E-Views version 12 application

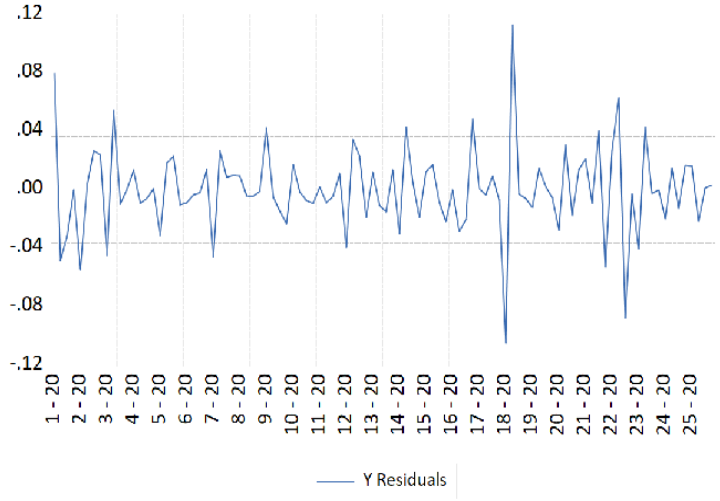

Figure 2. Residual Plot of Heteroscedasticity Test
Source: E-Views version 12 application

this model is 0.499878, meaning that approximately 49.99% of the variation in tax avoidance is explained by the independent variables, while the remaining 50.01% is attributed to other factors beyond the model.

The simultaneous test, or F-test, in panel data regression is used to determine whether the independent variables collectively have a significant effect on the dependent variable. If the F-test probability value is lower than the predetermined significance level (0.05), the regression model as a whole is considered significant, indicating that all independent variables simultaneously influence the dependent variable. Based on the F-test results in Table 7 the F-statistic probability is 0.000001, which is much lower than 0.05. Therefore, it can be concluded that the independent variables in the model significantly affect the dependent variable simultaneously, suggesting that the regression model has good predictive power in explaining the variation in the dependent variable. Table 7 presents the t-test results for all independent variables on the dependent variable (tax avoidance). The research model applied in this study explains a multiple linear regression equation formulated as, which can be seen in Formula 1

$$Y=\beta_0+\beta_1X_1+\beta_2X_2+\beta_3X_3+\beta_4Z+\beta_5Z*X_1+\beta_6Z*X_2+\beta_7Z*X_3+\beta_8ROA \quad \text{.....1}$$

Based on the regression analysis using the selected fixed effect model with E-Views version 12, the resulting regression equation for the dependent variable tax avoidance is shown in Formula 2.

$$Y = 0.2986 + 0.7619X_1 + 0.0509X_2 + 0.1123X_3 - 0.7414Z - 1.0049Z*X_1 - 0.0603Z*X_2 + 0.0511Z*X_3 + 3.9992ROA \quad \text{.....2}$$

The regression equation shows that the intercept ($\beta_0 = 0.2986$) indicates the baseline value of tax avoidance when all independent variables are zero. Prudence accounting ($\beta_1 = 0.7619$) and financial distress ($\beta_2 = 0.0509$) both have positive effects, meaning that an increase in these variables raises the level of tax avoidance, while foreign operation ($\beta_3 = 0.1123$) also shows a positive but relatively small effect. In contrast, leverage ($\beta_4 = –0.7414$) negatively affects tax avoidance, indicating that higher debt levels reduce the tendency for tax avoidance. The interaction terms further demonstrate that leverage weakens the influence of prudence accounting ($\beta_5 = –1.0049$) and financial distress ($\beta_6 = –0.0603$) on tax avoidance, while it slightly strengthens the effect of foreign operation ($\beta_7 = 0.0511$). Lastly, profitability measured by ROA ($\beta_8 = 3.9992$) shows a strong positive impact, implying that more profitable firms have a higher level of tax avoidance when other variables are held constant.

The Effect of Prudence Accounting on Tax Avoidance

The test results confirm that prudence accounting positively influences tax avoidance. This suggests that applying a cautious approach in financial reporting can be strategically exploited by firms to reduce their tax burden.

Table 6. Autocorrelation Test and Coefficient of Determination Analysis

Test / Model	Indicator	Score / Value
Durbin-Watson Test	dU	1.8498
	4-dU	2.1502
	Durbin-Watson (dW)	2.9161
Coefficient of Determination	R-squared Value	0.661534
	Adjusted R-squared Value	0.499878

Source: The Processed Data (2025)

Table 7. F-Test and Hypothesis Test Results

Description	Expected	Coefficient	Prob. Value (F-Statistic) / Prob.	One-Tailed Prob.	Conclusion / Hypothesis Result
F-Test (Fixed Effect Model)	–	–	0.000001	–	Simultaneous
Hypothesis Test					
X_1	Positive	0.761918	0.0573	0.02865	Accepted
X_2	Positive	0.050850	0.0046	0.00230	Accepted
X_3	Positive	0.112278	0.9135	0.45675	Rejected
$Z*X_1$ (Moderating)	Moderating	-1.004989	0.0554	0.02770	Accepted
$Z*X_2$ (Moderating)	Moderating	-0.060309	0.0117	0.00585	Accepted
$Z*X_3$ (Moderating)	Moderating	0.051065	0.9687	0.48435	Rejected

Source: The Processed Data (2025)

In other words, the higher the degree of prudence adopted by a company, the greater its tax avoidance efforts. One explanation is that most firms in the study exhibit negative accruals, where operating income is lower than cash flows from operations, indicating a conservative accounting practice consistent with the theory of prudence. This occurs because revenue recognition is deferred, while certain non-cash expenses such as depreciation, amortization, or provisions are recognized earlier, thereby reducing reported income without lowering operating cash flow.

Another explanation lies in the flexibility provided by IFRS 9 and PSAK 71, particularly in the banking industry, where subjective estimates for credit loss provisions (CLP/CKPN) can be increased as a prudent buffer, consequently reducing taxable profit. Since PSAK 71 is principle-based, banks have discretion in setting CLP policies internally, and despite regulatory limits on deductible provisions, the subjective nature of assessments still allows room for earnings management. This aligns with the political cost hypothesis, which suggests that large firms adopt income-decreasing methods to reduce scrutiny and tax exposure (Sari & Mayangsari, 2024). Nonetheless, other studies (Sumarna, 2021) indicate that prudence may instead enhance transparency depending on the regulatory environment. Overall, the findings support prior research by (Karlina & Utami, 2023) which conclude that prudence accounting positively affects tax avoidance.

The Effect of Financial Distress on Tax Avoidance

The findings show that financial distress positively affects tax avoidance, implying that companies under financial strain are more likely to pursue tax reduction strategies. One reason is the increase in non-performing loans (NPL) during 2020–2023, which raised provisions (CKPN) and reduced taxable income (Napitupulu et al. 2021). This was a response to inadequate risk analysis in lending, with higher NPLs requiring larger CKPN, thereby lowering reported earnings and taxes. In addition, companies with higher current liabilities than current assets also scored lower on Altman Z-Score, signaling financial distress and incentivizing tax avoidance.

Firms with weak liquidity, high short-term debt, and low operating profits are more exposed to distress and more inclined to offset these risks through tax avoidance strategies. However, they may also use short-term debt to cover obligations, which already generates tax-deductible interest expenses (Tabroni & Haq, 2024). The low operating profits further pressure firms to minimize tax burdens. These findings align with earlier studies by Dang & Tran (2021) which confirm a positive association between financial distress and tax avoidance.

The Effect of Foreign Operation on Tax Avoidance

The analysis shows that foreign operations do not significantly affect tax avoidance, indicating that the proportion of foreign assets does not play a major role in reducing tax obligations. Despite financial firms' exposure to foreign currency assets, these are not commonly leveraged for tax benefits. On average, foreign assets made up only 9.36% of total assets from 2020–2023, and strict regulatory oversight limits their use as a tax avoidance instrument.

Moreover, foreign currency fluctuations and their unpredictability diminish the incentive to delay exchange gains, since small foreign exposure yields negligible tax advantages. In financial sectors, foreign assets tend to serve operational and liquidity purposes rather than tax planning (Pratiwi, 2024). This contrasts with sectors like manufacturing or mining, where foreign operations are more easily exploited via transfer pricing or tax haven strategies (Siregar et al. 2022). The findings reflect the unique constraints of the financial industry, which faces higher scrutiny and less flexibility in exploiting foreign operations for tax purposes.

The Moderating Role of Leverage in the Prudence–Tax Avoidance Relationship

The results reveal that leverage weakens the positive effect of prudence accounting on tax avoidance. This suggests that firms with higher debt levels are less able or less inclined to use prudence aggressively for tax purposes.

Companies with substantial debt obligations focus more on meeting their liabilities and maintaining creditor confidence, which discourages overly conservative earnings practices. Additionally, higher leverage often attracts stricter oversight from creditors and regulators, limiting flexibility in accounting policies.

This aligns with the debt covenant hypothesis, which posits that highly leveraged firms adopt income-increasing methods to appear creditworthy. Tax shields from debt interest also reduce the need for prudence-based tax strategies. During 2020–2021, the pandemic-induced stress on financial firms increased their reliance on debt and liquidity management, further diminishing the role of prudence in tax avoidance. These findings are consistent with studie by Paramita et al. (2023), which found leverage negatively associated with tax avoidance.

The Moderating Role of Leverage in the Financial Distress–Tax Avoidance Relationship

The study finds that leverage weakens the positive link between financial distress and tax avoidance. Highly leveraged firms, despite facing distress, have limited room for aggressive tax planning due to their debt obligations and creditor monitoring. Regulatory requirements in the financial sector also restrict their ability to maneuver tax strategies freely. Debt covenants impose constraints on financial decisions, including tax-related choices.

Moreover, debt already provides tax advantages through interest deductibility (tax shield), reducing the necessity for further tax avoidance. The COVID-19 pandemic heightened financial distress but was offset by government tax incentives, diminishing the urgency for tax strategies. The structural nature of high leverage in financial firms, driven by their business model and regulatory capital requirements, further limits aggressive tax practices even during distress. These findings confirm results from Prabowo & Sahlan (2022), which reported a negative moderation effect of leverage on the distress–tax avoidance relationship.

The Moderating Role of Leverage in the Foreign Operation–Tax Avoidance Relationship

The analysis shows that leverage does not moderate the relationship between foreign operations and tax avoidance. Whether firms have high or low leverage, foreign operations remain insignificant in influencing tax avoidance strategies. This finding reflects the fact that foreign assets in financial sector firms are generally small in proportion and primarily serve operational or liquidity purposes, rather than being utilized as tax planning instruments. In such cases, leverage does not provide any additional effect because the opportunities for tax avoidance through international exposure are already limited.

Leverage itself offers a tax shield through interest deductibility, which diminishes the need for firms to rely on foreign operations as a means of reducing taxable income. Financial sector companies also operate under strict regulatory frameworks that restrict the extent to which foreign transactions can be manipulated for tax purposes. These conditions explain why leverage neither strengthens nor weakens the link between foreign operations and tax avoidance, reinforcing the conclusion that foreign operations do not play a decisive role in shaping tax avoidance strategies in this industry (Pratiwi, 2024).

CONCLUSIONS

This study investigates the effects of prudence accounting, financial distress, and foreign operations on tax avoidance, while also examining the moderating role of leverage in these relationships. The sample consists of financial sector companies listed on the Indonesia Stock Exchange (IDX) during 2020–2023. The findings reveal that prudence accounting and financial distress both have a positive and significant effect on tax avoidance, indicating that higher prudence or distress levels are associated with greater tax avoidance efforts. Conversely, foreign operations have no significant effect on tax avoidance, suggesting that the proportion of foreign assets is not a determining factor. Additionally, leverage weakens the positive effect of both prudence accounting and financial distress on tax avoidance, implying that highly leveraged firms tend to be more passive in using these strategies. However, leverage does not moderate the relationship between foreign operations and tax avoidance, as foreign operations remain insignificant regardless of leverage levels.

Based on these results, the study offers several suggestions for future research and practice. Future research could expand the sample beyond the financial sector, extend the observation period, explore alternative proxies for foreign operations and tax avoidance, and consider additional variables and moderators to deepen understanding of tax avoidance behavior. For the Indonesian Directorate General of Taxes (DGT), the findings suggest integrating variables such as prudence, distress, and leverage into risk management systems, enhancing the financial analysis capabilities of tax officers through training, and prioritizing oversight of firms exhibiting conservative accounting or distress conditions. Despite its contributions, the study has limitations, including the narrow measurement of foreign operations using only foreign asset proportion and the reliance solely on effective tax rate (ETR) as a proxy for tax avoidance, which may not fully capture the complexity of tax avoidance strategies.

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