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Does Institutional Ownership Reduce Corporate Tax Avoidance? The Moderating Role of Audit Quality

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ABSTRAK

Penelitian ini bertujuan untuk menguji secara empiris bagaimana kualitas audit memoderasi pengaruh kepemilikan institusional terhadap perilaku penghindaran pajak perusahaan. Penelitian ini menggunakan pendekatan kuantitatif dengan fokus pada sektor manufaktur yang tercatat di Bursa Efek Indonesia. Sampel ditentukan melalui purposive sampling method dan menghasilkan 760 observasi. Analisis statistik yang digunakan adalah moderated regression analysis dengan bantuan software SPSS. Hasil penelitian menemukan bahwa keberadaan kepemilikan institusional tidak memiliki pengaruh terhadap aktivitas penghindaran pajak perusahaan, baik dengan proporsi kepemilikan yang tinggi ataupun rendah. Hasil pengujian diperkuat dengan analisis tambahan yang mendapatkan hasil yang serupa ketika penghindaran pajak diukur dengan GAAP ETR. Kualitas audit terbukti memiliki peran moderasi memperkuat pengaruh negatif kepemilikan institusional terhadap penghindaran pajak. Namun, kualitas audit tidak mampu memoderasi pengaruh kepemilikan institusional terhadap penghindaran pajak ketika kualitas audit diukur dari sisi output, yaitu akrual diskresioner. Hal ini dapat disebabkan karena adanya kelemahan penggunaan pengukuran akrual diskresioner, yaitu bersifat less direct. Penelitian ini memberikan informasi bagi perusahaan bahwa keberadaan kepemilikan institusional tetap harus diikuti oleh kualitas audit untuk memastikan agar penghindaran pajak tidak terjadi.

Kata kunci: *Kepemilikan institusional, penghindaran pajak, kualitas audit*

ABSTRACT

The objective of this research is to empirically investigate how audit quality moderates the influence of institutional ownership on corporate tax avoidance behavior. A quantitative approach is employed, focusing on manufacturing entities traded on the Indonesia Stock Exchange. A purposive sampling technique was employed to select the sample, which ultimately yielded 760 observations. The analysis is conducted using moderated regression analysis supported by SPSS software. The findings reveal that institutional ownership, whether high or low in proportion, does not significantly affect the extent of tax avoidance practices. This result is further reinforced by additional tests using GAAP ETR as an additional proxy to measure corporate tax avoidance, which yield consistent outcomes. However, audit quality has been demonstrated to strengthen the negative effect of institutional ownership to corporate tax avoidance practices. Conversely, when audit quality is measured using an output-based proxy, namely discretionary accruals, its moderating effect becomes statistically insignificant, possibly due to the less direct nature of this measurement. This study provides information for companies that the presence of institutional ownership must still be accompanied by audit quality to ensure that tax avoidance does not occur.

Keywords: Institutional ownership, tax avoidance, audit quality

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INTRODUCTION

Taxation plays a pivotal role as the predominant source of government revenue in Indonesia, accounting for over 82% of the national budget (APBN) as reported by the Ministry of Finance in 2024. Despite this, a persistent tension exists between the government's aim to maximize tax collections and companies' efforts to preserve earnings. From the corporate standpoint, taxes are generally seen as an expense that reduces the amount of their profits (Almaharmeh et al., 2024). Since tax payments do not yield direct returns to firms, businesses tend to minimize their tax obligations by employing strategies such as tax avoidance (Duhoon & Singh, 2023).

Tax avoidance is defined as a legally sanctioned method by which firms exploit gaps or ambiguities in tax law to reduce their payable taxes, without directly violating statutory rules (Benkraiem et al., 2021). Although these strategies may carry reputational or legal risks, many firms still engage in them to increase short-term profitability. This creates a problematic scenario, as such practices, although legal, can significantly diminish government tax revenue and ultimately undermine public finances. One governance mechanism believed to restrain aggressive tax behavior is institutional ownership, which can enhance oversight over management and encourage compliance with ethical corporate conduct (Velte, 2023).

One prominent case that illustrates tax avoidance practices in Indonesia is the dispute between PT Adaro Energy Tbk and the Directorate General of Taxes (DGT), in which Adaro was alleged to have shifted profits to its subsidiary in Singapore, where the tax rate is lower. The coal sales transactions between the parent company and its foreign affiliate were deemed inconsistent with the arm's length principle, prompting the DGT to issue a significant tax adjustment. The dispute escalated to a judicial review at the Supreme Court in 2019, which ultimately ruled in favor of the DGT. This case highlights not only the vulnerability of tax authorities to transfer pricing practices by multinational corporations, but also underscores the importance of rigorous oversight and enforcement of cross-border tax regulations (Wahyuningtias et al., 2025).

Based on agency theory, formal contractual relationship between principals and agents and in most cases where their interests differ (Jensen & Meckling, 1976). There are strategies that can be adopted by managers in the favor of the managers instead of shareholders, like tax avoidance. According to Hanlon & Heitzman (2010), agency conflicts exist to address the presence of misaligned incentives in the form of tax avoidance. As various studies suggest, the strategic decision-making process in a firm will largely be impacted by its ownerhsip structure regarding tax planning (Almaharmeh et al., 2024; Jiang et al., 2020; Kovermann & Velte, 2019).

In particular, institutional investors are perceived as effective monitors who can limit managerial opportunism and mitigate agency costs related to tax planning (Velte, 2023). Madyan & Arianto (2019) note that institutional investors currently dominate trading on the Indonesia Stock Exchange, accounting for 73.14% of activity.

The mixed findings across prior research have led scholars to consider the role of moderating variables. A moderating variable serves to adjust the strength or nature of the connection between an independent and a dependent variable (Park & Yi, 2023). From an agency theory perspective, principals bear agency costs to monitor managers. Tax avoidance may increase these costs, particularly when external parties are needed to assess financial disclosures. Audit quality, as an element of these agency costs, provides an external and independent assessment of a company's financial condition, thereby reducing information asymmetry (Lungu et al., 2023). Khairunisa et al. (2017) demonstrate that higher audit quality can constrain management to involve with tax avoidance practices. This research therefore emphasizes the role of audit quality in reducing agency conflicts that arise between investors and management (Shafiq et al., 2024). In cases where internal governance is weak, external audits become crucial in exerting oversight (Hung, 2024).

This study enriches the literature by assessing how the quality of audits moderates the influence of institutional ownership on corporate tax avoidance behavior, using both input-based (Big Four vs. non-Big Four affiliation) and output-based (discretionary accruals) measures. It also conducts a supplementary analysis by classifying institutional ownership into high and low categories to assess whether ownership magnitude influences its monitoring role. This research focuses on manufacturing entities traded on the Indonesia Stock Exchange (IDX) during 2010 – 2019. The cut-off in 2019 is deliberate to capture firms' tax avoidance behavior under stable economic conditions before the extraordinary effects of the COVID-19 pandemic and subsequent tax reforms. Consistently, recent studies such as Utami & Afif (2025); Wang et al. (2024); Kałdoński & Jewartowski (2024) also limited their samples to pre-pandemic years to avoid distortions from COVID-19. In addition, employing a decade-long observation period provides sufficient longitudinal variation to capture governance and tax planning trends, thereby enhancing the robustness of the findings (Dyreng et al., 2008; Jiang et al., 2020; Minnick & Noga, 2010; Velte, 2023).

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Agency Theory

Within the framework of agency theory, institutional ownership is viewed as an effective governance tool for mitigating agency conflicts among managers and investors by aligning managerial decisions with shareholder objectives. Because institutional investors typically prioritize the maximization of long-term value creation, they are less inclined to support aggressive tax strategies that could pose future risks (Velte, 2023; Benkraiem et al., 2021). These investors are also willing to incur monitoring costs, such as hiring high-quality auditors, to safeguard their investments. Audit quality, therefore, serves as a key external monitoring mechanism that enhances the reliability of financial disclosures, identifies aggressive tax behavior, and offers objective assessments of management's actions (Rizqia & Lastiati, 2021; Guenther et al., 2017). In this regard, robust audit quality reinforces the function of institutional shareholders in curbing aggressive tax strategies activities.

The Effect of Institutional Ownership on Tax Avoidance

Institutional ownership pertains to equity holdings managed by institutions, which are often among the founding shareholders or long-term stakeholders of a firm (Kordsachia et al., 2022). Agency theory suggests that shareholders expect managers to operate in their best interests (Jensen & Meckling, 1976). Thus, institutional investors can exert influence to discourage overly aggressive tax strategies. Given their preference for sustainable performance, these investors generally avoid short-term gains that could result in penalties or reputational damage. As such, institutional ownership can function as a governance mechanism that discourages opportunistic tax behavior. Chen et al. (2019) emphasize that institutional investors have the capacity to reduce a firm's inclination toward tax avoidance.

Recent studies emphasize that institutional shareholders with substantial ownership stakes and voting power act as effective monitors who can discipline managers and align corporate decisions with firm performance rather than personal interests (Drobetz et al., 2024; Velte, 2023). Their active role in monitoring management decisions positions them as effective agents of corporate oversight. Institutional investors are also highly motivated to ensure managers do not pursue risky or unethical tax strategies that could negatively impact shareholder value (Benkraiem et al., 2021).

Li et al. (2021) highlight that institutional shareholders are sensitive to tax-related risks in the firms they back. These investors recognize that short-term tax savings may jeopardize long-term sustainability and expose firms to scrutiny from consumers, regulators, and government bodies (Velte, 2023). Consequently, tax avoidance does not always result in enhanced shareholder value, instead, it may incur substantial reputational and regulatory costs. Excessive tax avoidance could facilitate managerial rent extraction, diminishing firm value and reducing institutional investors' returns, particularly when governance mechanisms are weak (Almaharmeh et al., 2024; Duhoon & Singh, 2023).

Jiang et al. (2020) argues that high levels of institutional ownership afford substantial power to oversee and influence managerial behavior. This dynamic can lower agency conflicts and, in turn, reduce the firm's inclination to pursue tax avoidance. Empirical support for this notion is evident in studies by Velte (2023); Benkraiem et al. (2021); Krisna (2019); Chen et al. (2019), who collectively observe a negative relationship between institutional ownership and aggressive tax strategies behavior. Therefore, the study's first hypothesis is stated as follows:

H_1: Institutional ownership negatively influences tax avoidance.

The Effect of Institutional Ownership on Tax Avoidance with Audit Quality as a Moderating Variable

According to agency theory, audit quality is instrumental in mitigating agency problems by serving as a control mechanism over managerial discretion. As part of broader corporate governance practices, high-quality audits reduce the potential for financial misreporting and discourage fraudulent activities (DeAngelo & Masulis, 1980). Like institutional ownership, audit quality contributes to monitoring by enhancing transparency and ensuring accountability. When companies are subject to high-quality audits, the resulting disclosures allow institutional investors to assess managerial decisions more accurately and intervene when necessary. This suggests that audit quality may strengthen institutional ownership's capacity to deter aggressive tax planning (Gaaya et al., 2017).

Shafiq et al. (2024) find quality of audit reduces tax aggressiveness as they provide stronger audit control. That result, which is consistent with the findings of Gaaya et al. (2017), suggests that family-owned companies audited by high-quality auditors engage in a lower degree of aggressive tax management. Kouaib & Jarboui (2014) also discovered that the interaction effects between institutional ownership and quality of external audit substantially mitigate the earnings management practices. These results suggest a synergistic relationship between institutional monitoring and auditor scrutiny in in curtailing opportunistic managerial behavior.

Lungu et al. (2023) conclude that the quality of external audits contributes to the transparency of the financial reports and limits practices of tax avoidance by showing that external parties are capable of objectively examining financial information from an independent viewpoint. The impact of institutional control is reinforced by the availability of capable independent auditors who can identify manipulative practices and ensure compliance with sound governance practices. Firms under high-quality audits which have a large institutional ownership are likely to refrain from aggressive tax planning given higher risks of discovery and consequent reputational costs. Institutional investors are well suited to providing the discipline for responsible tax practice in such settings. In addition, Khan et al. (2016) also highlighted the role of audit quality for controlling agency costs and improving monitoring effectiveness. Accordingly, the study's second hypothesis is stated as follows:

H_2: Audit quality moderates the effect of institutional ownership on tax avoidance.

RESEARCH METHODS

Population and Sample Selection

The research focuses on manufacturing sector firms listed on the IDX during 2010 to 2019. The cut-off in 2019 is deliberate to capture firms' tax avoidance behavior under stable economic conditions before the extraordinary effects of the COVID-19 pandemic and subsequent tax reforms. Consistently, recent studies such as Utami & Afif (2025); Wang et al. (2024); Kałdoński & Jewartowski (2024) also limited their samples to pre-pandemic years to avoid distortions from COVID-19. In addition, employing a decade-long observation period provides sufficient longitudinal variation to capture governance and tax planning trends, thereby enhancing the robustness of the findings (Dyreng et al., 2008; Jiang et al., 2020; Minnick & Noga, 2010; Velte, 2023).

The study employed purposive sampling to determine the sample, using the following criteria:

1. The firm must be categorized as a manufacturing company and be publicly listed on the IDX during 2010–2019.
2. The firm must report financial statements ending on December 31 and provide complete data relevant to this study.
3. The firm must not report a loss during the observation period and must exhibit an Effective Tax Rate (ETR) between 0 and 1.

Table 1. Sample Selection Criteria

Criteria	Sample
Manufacturing entities listed on the IDX during 2010–2019	1469
Companies that published financial statements not ending on Dec 31 / incomplete data	295
Companies that incurred losses during the research period and had ETR outside the 0–1 range	402
Outlier	12
Final Sample	**760 observations**

Operational Definitions and Data Measurement

Institutional Ownership

Institutional ownership is positioned as the independent variable in this research, representing the proportion of a company's total outstanding shares held by institutional investors, which may include government agencies, insurance providers, financial institutions, and other similar entities (Ngadiman & Puspitasari, 2017). The proportion of institutional ownership is calculated by dividing the total shares owned by institutional investors by the company's total outstanding shares, expressed as a percentage. This measurement approach follows the method outlined by Velte (2023).

$$INST = \frac{Number\ of\ shares\ owned\ by\ institutional\ investor}{Total\ outstanding\ shares} \times 100\%$$

Tax Avoidance

Tax avoidance serves as the dependent variable in this study, defined as the strategies employed by taxpayers to legally reduce their tax obligations without breaching existing tax laws (Duhoon & Singh, 2023). This variable is measured using the Current Effective Tax Rate (Current ETR) which is the ratio of the corporate income tax that a company pays during a given fiscal year. It is a ratio of the corporate tax burden since it compares the income which is subject to taxation with the statutory rate of tax. The lower the Current ETR value, the higher the level of tax avoidance (Shafiq et al., 2024; Duhoon & Singh, 2023). To maintain consistency of interpretation and consistency with the direction of the proposed relationship, the computed ETR values are multiplied with negative one before analysis. The Current ETR is computed using the following formula:

$$Current\ ETR = \frac{Current\ Tax\ Expense}{Pre - Tax\ income}$$

Audit Quality

Audit quality is employed as the moderating variable in this study. As outlined by Shafiq et al. (2024), audit quality encompasses the auditor’s capacity to conduct effective oversight that upholds the credibility and reliability of financial reporting, which is reinforced by the auditor’s professional reputation. Consistent with prior research by Gaaya et al. (2017) and Jihene & Moez (2019), this study operationalizes audit quality using auditor affiliation with one of the Big Four accounting firms (EY, PwC, Deloitte, or KPMG). Following DeFond & Zhang (2014), Big Four affiliation is widely recognized as a robust proxy for superior audit quality, given their extensive resources, global expertise, and rigorous auditing standards. The variable is measured using a binary coding scheme, where a value of 1 denotes companies audited by a Big Four firm, and 0 indicates those audited by non-Big Four auditors.

Control Variables

Leverage

The leverage variable is assessed by computing the proportion of total debt to total assets of the company (Cen et al., 2017). The formula used to calculate leverage is as follows:

$$Leverage = \frac{Total\ debt}{Total\ asset}$$

Return on Asset (ROA)

ROA is determined by dividing a firm's net profit after taxes by its total assets (Chen et al., 2019). The formula is presented below:

$$Return\ on\ Asset = \frac{Earnings\ after\ tax}{Total\ asset}$$

Firm Size

In accordance with Kubick et al. (2015), the size of the firm is calculated by taking the natural logarithm of its total assets. The formula for this calculation is outlined below:

$$Firm\ Size = LN\ (Total\ Asset)$$

Firm Age

The age of the firm is measured as the difference in years between its establishment date and the observation period (Prasetyoningrum, 2019). The formula used to calculate firm age is as follows:

$$Firm\ Age = Year\ of\ Observations\ - Year\ of\ Establishment$$

Pre-Tax Margin

Pre-tax margin is calculated by measuring the amount of net income before tax relative to the company's sales (Dyreng et al., 2017). The formula used to measure pre-tax margin is as follows:

$$Pre - Tax\ Margin = \frac{Pre - Tax\ Income}{Total\ Sales}$$

Return on Equity (ROE)

ROE is measured by dividing net income after tax by the company's total equity (Cen et al., 2017). The formula used to calculate ROE is as follows:

$$Return\ on\ Equity = \frac{Earnings\ after\ tax}{Total\ equity}$$

Moderated Regression Analysis (MRA)

This research employs Moderated Regression Analysis (MRA) to evaluate how audit quality moderates the impact of institutional ownership on corporate tax avoidance. As outlined by Ghozali (2011), MRA represents an extended application of multiple linear regression that includes interaction terms, facilitating the examination of whether and how a moderating variable impacts the strength or direction of the relationship between an independent variable and a dependent variable. In this study, the analytical framework is adapted from the model proposed by (Sharma et al., 1981), ensuring that the interaction effects are explicitly captured. The regression equations developed for this analysis are presented as follows:

Model 1

$$TA = \alpha + \beta_1 INST + \beta_2 LEV + \beta_3 ROA + \beta_4 SIZE + \beta_5 AGE + \beta_6 PMRG + \beta_7 ROE + \varepsilon \quad (1)$$

Model 2

$$TA = \alpha + \beta_8 INST + \beta_9 AQ + \beta_{10} LEV + \beta_{11} ROA + \beta_{12} SIZE + \beta_{13} AGE + \beta_{14} PMRG + \beta_{15} ROE + \varepsilon \quad (2)$$

Model 3

$$TA = \alpha + \beta_{16} INST + \beta_{17} AQ + \beta_{18} INST\_AQ + \beta_{19} LEV + \beta_{20} ROA + \beta_{21} SIZE + \beta_{22} AGE + \beta_{23} PMRG + \beta_{24} ROE + \varepsilon \quad (3)$$

Description:

TA	=	Tax Avoidance
INST	=	Institutional Ownership

AQ	=	Audit Quality
LEV	=	Leverage
ROA	=	Return on Assets
SIZE	=	Firm Size
AGE	=	Firm Age
PMRG	=	Pre-Tax Margin
ROE	=	Return on Equity
α	=	Constant
$\beta_1 - \beta_{24}$	=	Regression Coefficients
ε	=	Error Term

RESULTS AND DISCUSSIONS

Descriptive Statistics

Descriptive statistical techniques are utilized in this study to provide a concise overview of the fundamental characteristics of the research data. This includes reporting the minimum and maximum values, the arithmetic mean, and the standard deviation for each variable under investigation. Such analysis facilitates an initial understanding of the distribution and variability of the dataset. Table 2 presents a summary of these descriptive statistics for all variables examined across the observation period from 2010 to 2019.

Table 2. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
INST	760	0.05098	0.99711	0.689998	0.1929042
TA	760	-0.83285	-0.00307	-0.256436	0.0995949
LEV	760	0.00418	8.82372	0.581171	0.8624340
ROA	760	0.000782	139.8239	0.534177	5.3295410
SIZE	760	18.3078	26.58677	21.63804	1.6146348
AGE	760	1	118	38.24	17.946
PMRG	760	0.00095	0.66489	0.107628	0.0951182
ROE	760	-24.8025	322.8815	0.923044	12.216201
Valid N (listwise)	760				

Classical Assumption Testing

Normality Test

This study employs the normal probability plot to conduct the normality test. The results of the normal probability plot test are illustrated in the Figure 1.

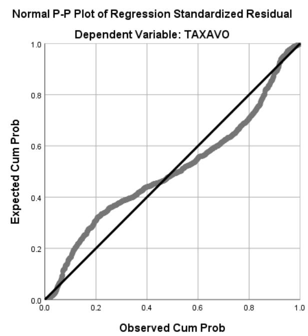

Figure 1. Normality Test

Based on the Figure 1, the distribution of data points appears to align closely with the diagonal line pattern, indicating a consistent dispersion around the line. Therefore, it can be inferred that the data utilized in this study exhibit a normal distribution pattern (Ghozali, 2011). Consequently, the data are suitable for further analysis. Referring to the central limit theorem, it is stated that research with a large sample size tends to exhibit a normal distribution (Islam, 2018; Kwak & Kim, 2017; LaPlace, 1810).

Heteroscedasticity Test

This research employs the scatterplot test to examine heteroscedasticity. The results of the scatterplot test are illustrated in the Figure 2.

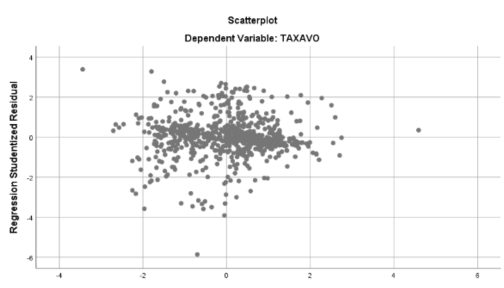

Figure 2. Heteroscedasticity Test

Referring to Figure 2, the data points appear to be scattered above, below, and around the zero line without forming any clear pattern. This indicates that there is no sign of heteroscedasticity in the data (Ghozali, 2011). Therefore, the data used in this study are homoscedastic and suitable for further analysis.

Hypothesis Testing

This research uses MRA with three models to test the effect of institutional ownership on tax avoidance and the moderating role of audit quality, as presented in Table 3.

Table 3. Main Regression Results

Variable	Model 1			Model 2			Model 3		
	β	t	Sig.	β	t	Sig.	β	t	Sig.
Constant	-0.303	-5.861	0.000	-0.469	-8.431	0.000	-0.475	-8.593	0.000
INST	-0.010	-0.532	0.595	0.015	0.814	0.416	0.064	2.804	0.005***
AQ				-0.058	-6.892	0.000***	0.044	1.546	0.122
INST_AQ								-0.144	-3.733
LEV	0.004	0.666	0.506	0.005	0.903	0.367	0.007	1.304	0.193
ROA	-0.003	-0.950	0.342	-0.004	-1.335	0.182	-0.006	-1.756	0.079*
SIZE	0.001	0.489	0.625	0.009	3.490	0.001***	0.007	2.906	0.004***
AGE	0.000	1.122	0.262	0.000	1.506	0.133	0.000	1.634	0.103
PMRG	0.171	4.333	0.000***	0.244	6.125	0.000***	0.261	6.568	0.000***
ROE	0.002	1.087	0.277	0.002	1.549	0.122	0.003	1.962	0.050**
R Square			0.032			0.089			0.106
Adjusted R Square			0.023			0.079			0.095
F-Stat			3.503			9.192			9.859
Sig. F-Stat			0.001			0.000			0.000

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Model 1 demonstrates that institutional ownership (INST) has a negative but insignificant coefficient (t = –0.532; p = 0.595), indicating no meaningful impact on tax avoidance. The Adjusted R^2 of 0.023 suggests that institutional ownership and the included control variables explain only 2.3% of the variation in tax avoidance. Consequently, Hypothesis 1 (H1), which proposed that institutional ownership negatively affects tax avoidance, is rejected. This indicates that the presence of institutional investors alone does not exert significant control over corporate tax avoidance behavior.

Model 2 incorporates audit quality (AQ) as an additional variable. Institutional ownership remains insignificant (t = 0.814; p = 0.416), but audit quality shows a highly significant negative relationship with tax avoidance (t = –6.892; p < 0.01). The Adjusted R^2 increases to 0.079, meaning that audit quality and control variables account for a greater share of the variance compared to Model 1. These findings indicate that while institutional ownership alone does not constrain tax avoidance behavior, audit quality independently plays a role in curbing aggressive tax strategies by enhancing transparency and limiting managerial discretion.

Model 3 introduces the interaction term between institutional ownership and audit quality (INST_AQ). The interaction coefficient is –0.144 and statistically significant (t = –3.733; p < 0.01), with an Adjusted R^2 of 0.095. This result confirms Hypothesis 2 (H2), demonstrating that audit quality strengthens the negative relationship between institutional ownership and tax avoidance. In this context, audit quality functions as a quasi-moderator, acting both as an independent variable that directly reduces tax avoidance and as a moderating factor that enhances the monitoring effectiveness of institutional investors.

Additional Analysis

This study conducts additional analyses to assess whether varying measurement methods for the research variables produce different results, including a classification of institutional ownership into high and low categories.

Additional Analysis 1

The first additional analysis in this study is conducted by measuring the tax avoidance variable using GAAP ETR. The results of Additional Analysis 1 are summarized in Table 4.

Table 4. Additional Analysis 1

Variable	Model 1			Model 2			Model 3		
	β	t	Sig.	β	t	Sig.	β	t	Sig.
Constant	-0.310	-3.991	0.000	-0.435	-5.085	0.000	-0.440	-5.159	0.000
INST	0.033	1.143	0.253	0.052	1.790	0.074*	0.100	2.844	0.005***
AQ				-0.044	-3.376	0.001***	0.058	1.308	0.191
INST_AQ							-0.143	-2.398	0.017**
LEV	-0.004	-0.486	0.627	-0.003	-0.383	0.702	-0.001	-0.125	0.900
ROA	-0.003	-0.552	0.581	-0.004	-0.730	0.465	-0.005	-0.997	0.319
SIZE	-2.35E-05	-0.007	0.995	0.006	1.482	0.139	0.004	1.101	0.271
AGE	1.50E-05	0.049	0.961	6.77E-05	0.221	0.825	9.05E-05	0.296	0.767
PMRG	0.226	3.803	0.000***	0.280	4.585	0.000***	0.297	4.846	0.000***
ROE	0.001	0.684	0.494	0.002	0.898	0.369	0.002	1.158	0.247
R Square			0.027			0.041			0.048
Adjusted R Square			0.018			0.031			0.037
F-Stat			2.937			4.030			4.244
Sig. F-Stat			0.005			0.000			0.000

* *p* < 0.1, ** *p* < 0.05, *** *p* < 0.01

Based on Table 4, when tax avoidance is measured using GAAP ETR, institutional ownership (INST) shows no significant effect (p = 0.253), while audit quality (AQ) has a significant negative effect (p < 0.01). The interaction term (INST_AQ) is also significant (p < 0.05), indicating that higher audit quality strengthens the ability of institutional ownership to reduce tax avoidance. These results align with the main findings, where Hypothesis 1 is rejected and Hypothesis 2 is accepted.

Additional Analysis 2

The second additional analysis in this study is conducted by measuring the audit quality variable using absolute discretionary accruals, following the approach of Dechow et al. (1995). The results of Additional Analysis 2 are summarized in Table 5.

Table 5. Additional Analysis 2

Variable	Model 1			Model 2			Model 3		
	B	t	Sig.	β	t	Sig.	β	t	Sig.
Constant	-0.292	-5.547	0.000	-0.309	-5.955	0.000	-0.318	-6.080	0.000
INST	-0.011	-0.549	0.583	-0.010	-0.507	0.612	0.007	0.307	0.759
AQ				-0.129	-4.939	0.000***	-0.249	-2.745	0.006***
INST_AQ							0.179	1.382	0.167
LEV	0.004	0.756	0.450	0.000	0.039	0.969	0.000	-0.029	0.977
ROA	-0.003	-0.975	0.330	-0.003	-0.786	0.432	-0.002	-0.725	0.469
SIZE	0.001	0.282	0.778	0.001	0.393	0.694	0.001	0.344	0.731
AGE	0.000	0.851	0.395	0.000	1.454	0.147	0.000	1.444	0.149
PMRG	0.188	4.529	0.000***	0.164	3.984	0.000***	0.163	3.951	0.000***
ROE	0.002	1.117	0.264	0.001	0.923	0.356	0.001	0.863	0.389
R Square			0.034			0.066			0.068
Adjusted R Square			0.025			0.056			0.057
F-Stat			3.656			6.352			5.865
Sig. F-Stat			0.001			0.000			0.000

* *p* < 0.1, ** *p* < 0.05, *** *p* < 0.01

Based on Table 5, institutional ownership (INST) is insignificant (p = 0.583), while audit quality (AQ) shows a significant negative effect on tax avoidance (p < 0.01). The interaction term (INST_AQ) is not significant (p = 0.167), indicating that audit quality does not moderate the relationship between institutional ownership and tax avoidance when measured using discretionary accruals. These results support Hypothesis 1 but not Hypothesis 2.

Additional Analysis 3

The third additional analysis is conducted by measuring tax avoidance using GAAP ETR and measuring audit quality using discretionary accruals, based on the approach by Dechow et al. (1995). The results of Additional Analysis 3 are summarized in Table 6.

Table 6. Additional Analysis 3

Variable	Model 1			Model 2			Model 3		
	β	t	Sig.	β	t	Sig.	β	t	Sig.
Constant	-0.255	-4.735	0.000	-0.279	-5.346	0.000	-0.285	-5.408	0.000
INST	-0.010	-0.488	0.625	-0.008	-0.432	0.666	0.002	0.085	0.932
AQ				-0.183	-6.981	0.000***	-0.257	-2.818	0.005***
INST_AQ							0.110	0.847	0.398
LEV	-0.011	-1.892	0.059*	-0.016	-2.953	0.003***	-0.016	-2.990	0.003***
ROA	-0.001	-0.294	0.769	-4.946E-5	-0.015	0.988	7.11E-05	0.022	0.983
SIZE	-0.002	-0.798	0.425	-0.002	-0.673	0.501	-0.002	-0.702	0.483
AGE	7..86E-05	0.368	0.713	0.000	1.219	0.223	0.000	1.212	0.226
PMRG	0.316	7.426	0.000***	0.282	6.787	0.000***	0.281	6.762	0.000***
ROE	0.001	0.543	0.587	0.000	0.261	0.794	0.000	0.224	0.823
R Square			0.094			0.151			0.152
Adjusted R Square			0.085			0.142			0.141
F-Stat			10.611			15.992			14.289
Sig. F-Stat			0.000			0.000			0.000

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Based on Table 6, institutional ownership (INST) is insignificant (p = 0.625), while audit quality (AQ) shows a significant negative effect on tax avoidance (p < 0.01). The interaction term (INST_AQ) is not significant (p = 0.398). This indicates that when tax avoidance is measured using GAAP ETR and audit quality is measured using discretionary accruals, audit quality does not moderate the relationship between institutional ownership and tax avoidance.

Additional Analysis 4

The fourth additional analysis is conducted by classifying institutional ownership into two categories: high and low. This classification is based on a mean cut-off value of 0.689. Ownership values equal to or greater than 0.689 are categorized as high, while ownership values below 0.689 are categorized as low. The test results are presented in Table 7.

Table 7. Additional Analysis 4

Variable	High			Low		
	β	t	Sig.	β	t	Sig.
Constant	-0.277	-3.035	0.003	-0.356	-5.090	0.000
INST	0.098	1.567	0.118	-0.026	-0.677	0.499
LEV	-0.015	-1.943	0.053*	0.018	2.229	0.026**
ROA	-0.005	-1.058	0.291	0.003	0.501	0.617
SIZE	-0.003	-1.037	0.301	0.002	0.606	0.545
AGE	0.000	0.779	0.436	0.001	1.882	0.061
PMRG	0.085	1.824	0.069*	0.326	4.765	0.000***
ROE	0.003	1.342	0.180	-0.001	-0.397	0.692
R Square			0.058			0.107
Adjusted R Square			0.041			0.089
F-Stat			3.461			5.930
Sig. F-Stat			0.001			0.000

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Based on Table 7, institutional ownership (INST) is not significant in either the high-ownership group (p = 0.118) or the low-ownership group (p = 0.499). These results indicate that institutional ownership does not influence corporate tax avoidance regardless of whether the ownership proportion is high or low. This finding reinforces the results of Hypothesis 1 testing, confirming that institutional investors, irrespective of their ownership levels, do not serve as an effective mechanism to constrain aggressive tax practices in the observed sample.

Discussions

The Effect of Institutional Ownership on Tax Avoidance

The analysis and hypothesis testing reveal that institutional ownership does not have a significant effect on corporate tax avoidance. This indicates that the proportion of shares held by institutional investors, whether high or low, does not substantially influence a firm’s inclination to engage in tax minimization. According to the study by Setiawati & Hidayatinnisa (2025); Arianandini & Ramantha (2018), this means that other governing mechanism or other external issues may prove more correct in the corporate tax practices.

In light of the agency theory, institutional ownership should be able to reduce interest conflicts between the managers and shareholders (Benkraiem et al., 2021). This is expected because institutional shareholders have greater incentive to check upon managerial performance since they are the ones who own the majority of the shares. They will be required to intensify supervision of the decision-making process of the management as principals (Velte, 2023). However, this control may only be more inefficient in cases where the managers are intent on concealing information to their favor. Lungu et al. (2023) note that only when case managers are transparent, the institution ownership established can improve the effectiveness of the oversight. Large institutional ownership alone is ineffective in alleviating information asymmetry in the cases where management conceals earnings or other material information.

Low level of information transparency in the company often leads to the absence of intense monitoring of managerial actions (Li et al., 2021). Such a lack of transparency may create conflict of interest among the parties within the organization. Under those circumstances, managers might get a chance to conceal bad news and present falsified data to investors. Managers frequently take advantage of the information asymmetry to reap personal gains or rents against shareholders (Chung et al., 2019). The growing uncertainty of the information disclosed makes the monitoring role by institutional owners increasingly harder to execute over the activities of the company.

Based on the additional analyses conducted using alternative proxies for tax avoidance, the results demonstrate a high degree of consistency across different measurement approaches. Specifically, institutional ownership is found to have no statistically significant effect on corporate tax avoidance, regardless of whether tax avoidance is measured using the Current ETR or GAAP ETR. Moreover, further analysis based on the proportion of institutional ownership, whether categorized as high or low, shows no significant influence on the firm’s tendency to engage in tax avoidance practices. These results suggest that institutional investors, irrespective of their ownership levels, do not serve as an effective deterrent to aggressive tax strategies in the observed sample.

The Moderating Role of Audit Quality in the Relationship Between Institutional Ownership and Tax Avoidance

The empirical results demonstrate that audit quality amplifies the negative relationship between institutional ownership and corporate tax avoidance. Firms subjected to high-quality audits exhibit a reduced propensity to engage in aggressive tax strategies. High audit quality enhances financial transparency, because external auditors deliver independent and objective verification of a company's financial statements (Shafiq et al., 2024). In this context, audit quality functions as a reinforcing governance mechanism that complements institutional ownership. By improving the reliability and accessibility of financial information, audit quality empowers institutional investors to exercise more effective monitoring over managerial behavior, thereby mitigating the likelihood of aggressive tax planning activities (Lungu et al., 2023).

These findings are consistent with agency theory, which posits that the moderating factor is the quality of the audit, which annulfs the conflict of interests between the investor and the manager. Effective prevention of manipulative or opportunistic behavior by managers can be achieved through high-quality external audits (Gaaya et al., 2017). Moreover, the interaction of institutional ownership with the quality of the audit can considerably reduce the degree of aggressive tax approach. The quality of auditing will reduce tax avoidance activities since managers will not risk using aggressive tax planning when they are efficiently monitored and there is good company governance. This is because of the repercussions they might have when auditors identify aggressive tax positions that will be discovered by tax authorities (Guenther et al., 2017). Shafiq et al. (2024) also states that tax avoidance is limited by high audit quality because it highly restricts financial reporting discretion of managers. Hence, a joint monitoring by institutional owners and auditors that have the power to identify managerial misconduct can be a good deterrent on managers to commit tax avoidance.

Audit quality is considered an important factor for improving the quality and reliability of financial information as it not only provides independent evaluation of the financial information of the company but also boosts the confidence of the stakeholders regarding financial disclosures (Lungu et al., 2023). High quality audits can collect and analyze appropriate evidence. The monitoring performed by auditors says the truth about the economic condition of clients, thus improving the quality of information. Thereby, corporate information transparency is enhanced. This increased transparency enables institutional ownership to apply more efficient monitoring and control over managers, which results in the ability to restrain managers from engaging in aggressive tax planning (Shafiq et al., 2024).

According to various studies, high-quality auditors are also less motivated to use tax avoidance practices to serve their clients (Gaaya et al., 2017; Jihene & Moez, 2019). This is because when such auditors are found by the tax authorities to have engaged in aggressive reporting, they are at risk of being seriously penalized. Another consequence of aggressive tax avoidance by firms is that the auditors would be held liable by a legal action as a result of any failure or oversight in tax matters that are reflected in the financial statements by the board of directors (Benkraiem et al., 2021). Also, auditors risk the loss of reputation and trust to their profession in case they are caught with tax evasion practices. Big audit firms, because of their high public visibility, tend to primarily value their reputations (Kovermann & Velte, 2019), which makes them stricter and less forgiving of tax avoidance by their clients.

The results from additional analyses reveal that the research findings vary depending on the measurement of audit quality used. When audit quality is measured using an input proxy, specifically the classification of audit firms as Big 4 and Non-Big 4 (DeFond & Zhang, 2014), the results show that audit quality strengthens the relationship between institutional ownership and tax avoidance. Conversely, when audit quality is measured using an output proxy such as discretionary accruals (DeFond & Zhang, 2014), it does not appear to moderate the relationship. These findings suggest that the results of audit quality moderation tests depend on the measurement approach used, whether input-based (Big 4 vs. Non-Big 4) or output-based (discretionary accruals). This study does not conclude which approach is superior, as each has its own characteristics. Using auditor size, such as Big 4 classification, reflects the presence of incentives and high competence in delivering audit services, which is believed to produce better audit quality. On the other hand, an approach based on financial reporting quality such as discretionary accruals closely relates to audit quality, as financial statements are the result of collaboration between management and auditors. However, this proxy has limitations due to its less direct nature, considering that the auditor’s influence on financial reporting quality tends to be limited.

CONCLUSION, IMPLICATIONS, SUGGESTIONS, AND LIMITATIONS

This research aims to investigate how audit quality moderates the influence of institutional ownership on corporate tax avoidance behavior. The empirical findings indicate that institutional ownership, whether at high or low levels, does not exert a statistically significant influence on tax avoidance. This conclusion remains robust across different tax avoidance proxies, including both Current ETR and GAAP ETR, as confirmed through additional analyses. A notable finding of the study is the moderating role of audit quality. When proxied by auditor size (i.e., Big Four affiliation), audit quality enhances the negative association between institutional ownership and tax avoidance. This suggests that high audit quality strengthens institutional investors' ability to oversee managerial behavior and limit aggressive tax strategies. However, when audit quality is measured using discretionary accruals, which represent audit outcomes, the moderating effect is not observed. This discrepancy may arise from limitations inherent in discretionary accrual metrics, which tend to be less direct and more susceptible to estimation errors.

The findings of this study have practical and theoretical implications. Practically, they highlight the importance of high audit quality in enhancing the effectiveness of institutional ownership in curbing aggressive tax strategies. Regulatory bodies and company stakeholders should recognize the synergistic role of ownership structure and external audits in promoting financial transparency and discouraging aggressive tax behavior. For institutional investors, audit quality should serve as a key consideration in governance oversight and risk management. Theoretically, this study enriches agency theory by demonstrating that governance mechanisms such as ownership and audit quality interact rather than operate in isolation. Furthermore, the use of both input- and output-based proxies for audit quality offers insights into how this variable can be more accurately conceptualized in future research.

Notwithstanding its contributions, this study acknowledges the presence of certain limitations. First, the use of secondary data restricts the scope of control over variable completeness and data quality. Second, audit quality was only measured using two proxies, namely auditor size and discretionary accruals, which may not fully reflect the multi-dimensional nature of audit effectiveness. Future research is encouraged to incorporate alternative or more nuanced measures of audit quality and to explore different ownership structures or industry settings.

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