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Family ownership on tax avoidance: The moderating role of political connections

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***Abstract*---**Tax avoidance is essentially an agency problem caused by information asymmetry. Tax avoidance involves companies retaining corporate cash resources that should rightfully belong to the government. This study aims to analyze the effect of family ownership on tax avoidance, with political connections serving as a moderating variable. Tax avoidance in this study is measured using the Cash Effective Tax Rate (CETR). The research was conducted on manufacturing companies listed on the Indonesia Stock Exchange (IDX) consecutively from 2021 to 2023. The results show that family ownership has a negative and significant effect on CETR, indicating a positive and significant effect on tax avoidance. However, political connections do not strengthen the effect of family ownership on tax avoidance.

***Keywords*---**Family ownership, tax avoidance, political connections.

Introduction

Tax avoidance is essentially an agency problem caused by information asymmetry. One of the common tax avoidance schemes used by multinational companies is transfer pricing, which aims to shift tax obligations to affiliated entities located in countries with lower tax rates, thereby reducing tax liabilities

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in higher-tax jurisdictions. Transfer pricing generally occurs in profit-oriented firms, as companies with higher profitability tend to engage in tax avoidance to minimize tax burdens (Hariana, 2022).

Wang et al. (2020) argue that tax avoidance involves companies retaining cash resources that should belong to the government. Such retention may enhance firm value and shareholder wealth. However, this practice reflects an agency problem arising from the separation between shareholders (principals) and management (agents). Agency theory explains this conflict, where managers as agents exploit tax avoidance for personal gain, potentially harming shareholders. Additionally, managers' tax avoidance actions may clash with the principals' social responsibility expectations. Agency theory posits a contractual relationship where one or more principals engage agents to perform services on their behalf, granting decision-making authority to the agents (Jensen & Meckling, 2008). This agent-principal relationship suggests that ownership structure influences corporate strategies and decisions regarding tax avoidance (Wang et al., 2020).

Although tax avoidance is primarily considered an agency problem rooted in information asymmetry (Yulyanti et al., 2022), prior studies have identified several other influencing factors, including: (1) executive incentives (Armstrong et al., 2015; Jihene & Moez, 2019), (2) social trust (Xia et al., 2017), (3) political connections (Firmansyah et al., 2022; Maulina & Mu'arif, 2024), (4) executive publicity (Duan et al., 2018), (5) ownership structure (Fuadi et al., 2024), (6) corporate social responsibility (Zeng, 2019), and (7) corporate governance (Taylor & Richardson, 2013). Wang et al. (2020) further emphasized that political connections and family ownership significantly influence corporate directors' and owners' attitudes toward risky behaviors such as tax avoidance. Specifically, political connections represent external social network factors affecting directors' decisions, while family ownership internally influences such decisions.

Tax avoidance is often linked to family ownership. Wirdaningsih et al. (2018) define family-owned firms as companies where control, ownership, and operations are conducted by family members. Such ownership may affect corporate tax policies, including tax avoidance strategies. Dominant family ownership enables controlling shareholders to replace managers who do not meet expectations, potentially increasing tax avoidance to maximize family wealth. Managers may have little resistance due to the threat of dismissal (Kovermann & Wendt, 2019).

Family shareholders, as majority owners, wield significant control and are prone to engage in private benefit extraction at the expense of minority shareholders. Tax avoidance becomes a likely strategy to retain higher cash flows and manipulate external perceptions regarding firm profitability (Ibrahim et al., 2021). Family firms may also use tax avoidance to conceal poor performance, hide actual profits, and mislead minority shareholders (Almaharmeh et al., 2024).

Conversely, some studies suggest the opposite. Hidayat (2017) found that family-owned firms tend to engage less in tax avoidance compared to non-family firms, as family owners may prefer paying higher taxes over facing penalties or reputational damage from tax audits. Family firms often view their business as a long-term asset and an extension of family reputation, encouraging more compliant tax behavior (Bimo et al., 2019).

Prior studies on the relationship between family ownership and tax avoidance remain inconsistent. Research by Chalevas et al. (2024) showed that family ownership negatively affects tax avoidance, supported by Xiang et al. (2023), Rabbil et al. (2022), Mangoting et al. (2022), and Wahyu & Zulma (2016). However, studies by Saiman & Putri (2023), Surono & Mayangsari (2022), Gaaya et al. (2017), and Kusnadi & Pandoyo (2022) reported a positive relationship between family ownership and tax avoidance.

Due to these mixed findings, this study incorporates a moderating variable—political connections—to examine the conditions under which family ownership affects tax avoidance. Political connections play a crucial role in many major global industries (Fisman, 2001) and can significantly influence corporate strategies (Goldman et al., 2009). In Indonesia, political connections are regulated under the Financial Services Authority Regulation No. 12/2017, which addresses Politically Exposed Persons (PEPs) primarily to prevent money laundering in financial services (Sukmana & Djumena, 2018). The regulation defines PEPs as foreign or domestic political figures or individuals authorized by international organizations, including heads of state, senior politicians, senior government officials, military or judicial officials, executives of state-owned enterprises, and party officials.

Directors with political ties can provide firms with advantages, such as easier access to public policy information and the ability to influence policy-making processes (Ibrahim et al., 2021). Mirza et al. (2019) found that politically connected directors may benefit from favorable tax policies, increasing the likelihood of tax avoidance.

Family shareholders, as major stakeholders, are also motivated to build political connections to create a favorable regulatory environment for their businesses. These connections may influence corporate tax decisions (Haque et al., 2011). This study does not examine money laundering in financial firms; instead, it focuses on tax avoidance in manufacturing companies listed on the Indonesia Stock Exchange (IDX). It adopts the definitions from Adhikari et al. (2006), Faccio (2010), Iswari et al. (2019), and Sudibyo & Jianfu (2016), where a firm is considered politically connected if shareholders own at least 10% of shares or if any directors or commissioners are current or former members of parliament, cabinet ministers, political party members, or government/military officials at national or regional levels.

Literature Review and Hypothesis Development

The relationship between shareholders as principals and management as agents is one of the central relationships discussed in agency theory. The objective of this theory is to align the performance of managers with the interests of shareholders, who may have diverse ownership structures (Homayoun, 2015). Ownership composition is a fundamental aspect of a firm's organizational structure and may include family groups, single-family ownership, government, institutions, and foreign ownership. This study specifically focuses on family ownership, interpreted as direct ownership of publicly listed companies.

Agency conflicts frequently occurring in family-owned firms are categorized as Type II agency conflicts—conflicts between majority and minority shareholders. These conflicts arise when majority shareholders possess stronger control, allowing them to influence decision-making processes to their own benefit at the expense of minority shareholders. One way majority shareholders may pursue personal benefits is by engaging in tax avoidance, disregarding the interests of minority shareholders (Ibrahim et al., 2021).

Previous studies have found that ownership characteristics can influence tax avoidance behavior. Claessens et al. (2000) reported that most ownership structures in Indonesia are pyramidal. Rusydi & Martani (2014) argued that companies in Indonesia exhibit different tax avoidance behaviors based on whether their ownership is family-based or non-family-based. Wirawan & Sukartha (2018) found that family-owned firms tend to engage more in tax avoidance, viewing the tax savings benefits as outweighing the potential costs of such practices.

Similarly, Saiman & Putri (2023) found a positive relationship between family ownership and tax avoidance. Their findings are supported by other studies, such as those by Fortuna & Herawaty (2022), Gaaya et al. (2017), and Kusnadi & Pandoyo (2022). Higher levels of family ownership increase the likelihood of tax avoidance, as controlling shareholders may seek to maximize personal benefits at the expense of minority shareholders.

Based on these theoretical and empirical reviews, it can be concluded that the higher the family ownership ratio, the more likely the firm is to engage in tax avoidance.
H1: Family ownership has a positive effect on tax avoidance.

Resource dependence theory posits that political connections within a firm can create a more favorable external environment. Political connections are often cultivated as a strategic response to reduce uncertainties, particularly in relation to government policies. Firms with political connections may enjoy easier regulatory access and influence in policy-making, including tax regulations. Other benefits include advanced access to information regarding future tax changes, reduced scrutiny from tax authorities, and protection against risky behaviors (Kim & Zhang, 2016).

Political connections are maintained by firms to strengthen their positions, especially in relation to government authorities (Badertscher et al., 2013). These connections can facilitate aggressive tax management, though such strategies may also incur significant costs (Hidayati & Diyanty, 2018). Family-owned firms also maintain political connections to advance their economic interests. Haque et al. (2011) reported that family businesses in Bangladesh often establish political connections to benefit their economic activities.

Previous research by Hidayati & Diyanty (2018) demonstrated that political connections amplify the influence of family ownership on tax avoidance, consistent with resource dependence theory, which suggests that political ties ease regulatory burdens, including taxes. Additional studies have also found that political connections are positively associated with tax avoidance (Imanuella & Damayanti, 2022; Sahrir et al., 2021; Maidina & Wati, 2020). Firms with political ties tend to engage in tax avoidance due to the regulatory advantages they gain from such connections.

Based on these theoretical and empirical findings, it can be concluded that the higher the level of family ownership, the greater the likelihood of tax avoidance, especially in the presence of political connections.
H2: Political connections strengthen the influence of family ownership on tax avoidance.

Methods

This study was conducted on manufacturing sector companies listed on the Indonesia Stock Exchange (IDX) during the 2021–2023 period, given that this sector served as a major contributor to Indonesia's economic recovery following the COVID-19 pandemic. The research focuses on three main variables: family ownership as the independent variable measured by the number of individual shares owned by the family divided by the total number of shares outstanding, tax avoidance as the dependent variable measured by the Cash Effective Tax Rate (CETR), and political connections as the moderating variable measured by dummy variable.

The population consists of all manufacturing companies listed on the IDX, with the sample selected using a purposive sampling method. The selection criteria include companies that were consistently listed from 2021 to 2023, published annual reports for those years, reported positive earnings, and had CETR values ranging between 0 and 1. This study includes 219 manufacturing-sector companies in the observation year, with 82 companies meeting the selection criteria, yielding a total of 246 firm-year observations over the three-year period.

Secondary data were utilized, obtained from annual reports and the official IDX website. Data collection employed archival research, using corporate annual reports and financial statements. To examine both the direct and indirect effects among variables, as well as the moderating effect of political connections, the study employed the Moderated Regression Analysis (MRA) technique. This regression method was applied to assess whether political connections significantly strengthen or weaken the relationship between family ownership and tax avoidance among manufacturing companies listed on the IDX.

Result and Discussion

Moderated Regression Analysis Test

This study employed moderated regression analysis (MRA) to test hypotheses H1 and H2, namely, the effect of family ownership on tax avoidance and the moderating role of political connections on the relationship between family ownership and tax avoidance. The regression results are presented in Table 1.

Table 1. Moderated Regression Analysis

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	0.246	0.012		20.870	0.000
Family Ownership (X)	-0.061	0.020	-0.234	-3.077	0.002
Political Connections (Z)	-0.037	0.019	-0.201	-1.953	0.052
X*Z Interaction	0.047	0.036	0.142	1.321	0.188

Source: Secondary data analyzed, 2025

Based on Table 1, the regression equation can be formulated as follows:

$$Y = 0.246 - 0.061X - 0.037Z + 0.047XZ$$

The interpretation of this equation is as follows:

1. The constant (α) of 0.246 suggests that if family ownership, political connections, and their interaction are zero, the Cash Effective Tax Rate (CETR) value would be 0.246.
2. The coefficient of family ownership (β_1) is -0.061, indicating that a 1% increase in family ownership reduces the CETR value by 0.061, holding other variables constant.
3. The coefficient of political connections (β_2) is -0.037, meaning a one-unit increase in political connections reduces the CETR value by 0.037, with other variables held constant.
4. The interaction coefficient (β_3) of 0.047 implies that a 1% increase in the interaction between family ownership and political connections increases CETR by 0.047, assuming other variables remain constant.

Coefficient of Determination (R^2)

The coefficient of determination (R^2) measures the model's ability to explain variations in the dependent variable. Adjusted R^2 is preferred due to its adjustment for the number of predictors included in the model. The test results are presented in Table 2.

Table 2. Coefficient of Determination

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.209	0.044	0.032	0.087801

Source: Secondary data analyzed, 2025

Table 2 indicates an adjusted R^2 of 0.032, meaning that 3.2% of the variance in tax avoidance (CETR) can be explained by family ownership moderated by political connections, while the remaining 96.8% is explained by other factors not included in this model.

Model Feasibility Test (F-Test)

The F-test assesses whether all independent variables collectively influence the dependent variable. The test results are shown in Table 3.

Table 3. Model Feasibility Test (F-Test)

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	0.085	3	0.028	3.677	0.013
Residual	1.866	242	0.008		
Total	1.951	245			

Source: Secondary data analyzed, 2025

The F-statistic value of 3.677 with a significance level of 0.013 (< 0.05) suggests that the regression model is statistically significant and suitable for hypothesis testing.

Hypothesis Test (t-Test)

The t-test was conducted to examine the effect of each independent variable on the dependent variable individually, using a significance level of 5% ($\alpha = 0.05$). The results are presented in Table 4.

Table 4. Hypothesis Test (t-Test)

Variable	t-Statistic	Sig.	Interpretation
(Constant)	20.870	0.000	
Family Ownership (X)	-3.077	0.002	H1 Supported
Political Connections (Z)	-1.953	0.052	
X*Z Interaction	1.321	0.188	H2 Not Supported

Source: Secondary data analyzed, 2025

In this analysis, a negative t-value corresponds to a positive relationship because CETR is inversely related to tax avoidance (i.e., a lower CETR indicates higher tax avoidance). Therefore, a negative coefficient implies a positive effect on tax avoidance.

The results show that family ownership has a significant negative coefficient on CETR ($t = -3.077$; $p = 0.002$), indicating a positive and significant effect on tax avoidance. However, the interaction term between family ownership and political connections is not significant ($t = 1.321$; $p = 0.188$), meaning political connections do not moderate the relationship between family ownership and tax avoidance in this study. This suggests that political connections function as a potential moderating variable (homologiser moderation), without significantly altering the relationship.

The Effect of Family Ownership on Tax Avoidance

The hypothesis testing results indicate that the family ownership variable yields a negative coefficient, with a t-value of -3.077. This suggests a positive effect of family ownership on tax avoidance, given the measurement of CETR, which implies that a lower CETR ratio reflects a higher degree of tax avoidance and vice versa (Krisyadi & Anita, 2022). The significance level for the family ownership variable is 0.002, which is below the 0.05 threshold, confirming that family ownership has a statistically significant effect on tax avoidance. Consequently, the first hypothesis is accepted.

The findings of this study are consistent with those of Saiman & Putri (2023), Fortuna & Herawaty (2022), Gaaya et al. (2017), and Kusnadi & Pandoyo (2022), all of which found that firms with family ownership tend to engage in tax avoidance. Family-owned firms often perceive the benefits of tax avoidance to outweigh its potential costs, leading them to be more proactive in undertaking such practices.

Tax avoidance represents a form of agency conflict commonly occurring within firms. Family ownership is often considered a contributing factor to tax avoidance. Firms with dominant family ownership are characterized by majority shareholders wielding greater influence over decision-making compared to minority shareholders. This majority control creates opportunities for personal gain at the expense of minority shareholders (Ibrahim et al., 2021). The authors suspect that, in the sampled firms, family owners as majority shareholders may have leveraged their control for personal benefit. Tax avoidance may have been employed as a strategy to preserve larger cash flows for the family, while simultaneously manipulating information to obscure losses from minority shareholders.

The Moderating Role of Political Connections in the Relationship Between Family Ownership and Tax Avoidance

The hypothesis testing results show that the t-value for the moderating effect of political connections on the relationship between family ownership and tax avoidance is 1.321. Although this indicates a negative direction of moderation due to the inverse relationship inherent in the CETR measure (Krisyadi & Anita, 2022), the significance value of 0.188 exceeds the 0.05 threshold. Therefore, political connections are deemed unable to moderate the relationship between family ownership and tax avoidance. Based on this result, the second hypothesis is rejected.

This finding aligns with previous studies conducted by Ibrahim et al. (2021), Tsai et al. (2021), Iswari et al. (2019), and Wicaksono (2017). In the sampled firms, political connections held by family members tended to attract greater scrutiny from various external stakeholders. Rather than using political ties to engage in risky activities such as tax avoidance, family owners utilized these connections to safeguard the company's reputation (Ibrahim et al., 2021). Supporting this, Chen et al. (2010) found that family firms typically refrain from leveraging political connections for tax-related benefits. The presence of politically connected directors and commissioners in family firms does not necessarily influence tax policies.

Resource Dependence Theory posits that political connections can provide firms with a more favorable environment. Such connections—gained through the presence of directors, shareholders, or board members with current or prior governmental positions—are seen as influential across major economic sectors globally (Fisman, 2001). However, these connections often attract stricter oversight from external stakeholders. When firms engage in overly aggressive tax avoidance, it can lead to public controversy and damage the owner's reputation (Pramesti & Laili, 2024). Moreover, political connections often promote greater compliance with tax regulations due to enhanced scrutiny (Siciliya, 2021). In this context, family owners tend to use political ties to enhance corporate value and protect the company's reputation, rather than for tax avoidance purposes (Ibrahim et al., 2021). Thus, this study does not support the resource dependence theory in the context of political connections moderating the relationship between family ownership and tax avoidance.

Conclusion

The findings reveal that family ownership has a positive and significant influence on tax avoidance. This suggests that higher levels of family ownership are associated with increased tax avoidance practices, indicating that family-controlled firms tend to prioritize tax-saving strategies to maximize their cash holdings and personal benefits, often at the expense of minority shareholders.

However, the study finds that political connections do not significantly moderate the relationship between family ownership and tax avoidance. This indicates that although politically connected firms may enjoy greater access to regulatory information and government resources, such connections do not necessarily enhance the likelihood of tax avoidance. In fact, political ties may lead to increased scrutiny, prompting firms to maintain compliance with tax regulations to protect their reputation and long-term business interests.

In summary, while family ownership fosters greater tax avoidance behavior, political connections fail to strengthen this effect. These findings highlight the agency conflicts inherent in family-owned firms and suggest that political connections, rather than facilitating opportunistic tax behavior, may instead act as a mechanism for maintaining corporate legitimacy and reputational stability. Furthermore, future researchers can add control variables to avoid bias in research, such as profitability and debt to equity ratio. Further research may also consider using other measurements such as the effective tax rate (ETR), and book-tax difference (BTD).

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