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How Political Connections Shape Sustainability's Impact on Tax Aggressiveness in Indonesia

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Abstract

This study examines the effect of corporate sustainability on tax aggressiveness, with political connections as a moderating variable. The population of this study consists of companies listed on the Indonesia Stock Exchange (IDX) from 2017 to 2022. The research method used is panel data analysis with the Moderated Regression Analysis (MRA) approach. The results indicate that corporate sustainability positively influences tax aggressiveness (consistent with agency theory). While political connections significantly increase tax aggressiveness, their moderating effect not only attenuates but completely inverts the positive sustainability-tax aggressiveness relationship, resulting in a negative association (aligning with legitimacy theory). These findings suggest that sustainability reporting may serve as a facade for legitimacy, whereas political connections present both advantages and risks. This study makes theoretical contributions by agency theory and legitimacy perspectives to examine corporate behaviour in emerging markets, particularly Indonesia, while offering practical implications for enhancing regulatory oversight of sustainability disclosures and politically affiliated firms.

Keywords

Tax Aggressiveness, Corporate Sustainability, Political Connections, Agency Theory, Legitimacy Theory, Indonesia

JEL Classification

Q56, H26, P48

Introduction

Tax aggressiveness and corporate sustainability have become key topics in accounting research amid rising demands for corporate social responsibility. Indonesia has responded by issuing Financial Services Authority Regulation (POJK) No 51 /POJK.03/2017, mandating sustainability reporting. This reflects the growing recognition that businesses must integrate stakeholder interests to maintain legitimacy and competitiveness in an increasingly socially conscious market (Primasari, 2025). However, widespread tax avoidance practices (Lanis & Richardson, 2012) risk undermining the positive impact of these sustainability initiatives, raising questions about the consistency between corporate sustainability and tax strategies.

From the perspective of agency theory Jensen & Meckling (1976), conflicts of interest between management (agents) and shareholders (principals) drive aggressive tax behaviour. Management tends to maximize personal gains, which may conflict with shareholders' goal of tax minimization. This incentivizes agents to engage in tax aggressiveness to boost reported earnings, indirectly increasing their compensation (Abner & Ferrer, 2019; Velte, 2023). However, such actions risk sanctions and disciplinary measures from shareholders, prompting management to strengthen their position—often through enhancing their commitment to corporate sustainability (Gao & Zhang, 2015; Rahmawati et al., 2014).

Additionally, legitimacy theory underscores the need for corporations to align with societal values and norms (Dowling & Pfeffer, 1975; Suchman, 1995). Legitimacy is achieved when corporate actions are perceived as consistent with public expectations. In this context, sustainability reporting and corporate social responsibility (CSR) engagement are often leveraged to gain public legitimacy, particularly when companies are involved in tax avoidance (Lanis & Richardson, 2015; Sulistiana & Istianingsih, 2018). Companies engaged in sustainability activities through ESG (Environmental, Social, and Governance) disclosure may use it to conceal unethical

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practices such as tax aggressiveness (Amarna et al., 2025), while simultaneously enhancing corporate legitimacy, even though their primary objective remains profit maximization (Fallan & Fallan, 2019; Friedman, 1970).

Empirical research on the relationship between corporate sustainability and tax aggressiveness has produced inconsistent findings and appears to be highly context-dependent, leaving no comprehensive conclusion to date (Mitroulia et al., 2025). Several studies, particularly in developed countries, support legitimacy theory by reporting a negative association, whereby sustainable firms tend to be less tax aggressive (Karbala & Vincenzo, 2024; Lanis & Richardson, 2018; Martinez & Ramalho, 2017; Ortas & Gallego-Álvarez, 2020). However, evidence from developing countries such as China demonstrates a positive association, where ESG performance is linked to higher tax aggressiveness, especially among non-state-owned enterprises (Zhang & Yuan, 2025). Similar positive relationships have also been reported in Egypt (Abdelfattah & Aboud, 2020) and in a cross-country analysis by Zeng (2019). Meanwhile, other studies in Malaysia (Mohanadas et al., 2020), Brazil (Montenegro, 2021), and Indonesia (Kristiadi et al., 2020) found no significant effect. In Indonesia, the most recent findings remain paradoxical. On the one hand, Asmoro et al. (2024) found that ESG disclosure based on specific reporting standards can effectively reduce tax aggressiveness, while on the other hand, Nasih et al. (2024) highlighted the potential use of sustainability reporting as a tool to obscure tax avoidance practices. These inconsistencies underscore the need for further research using approaches and moderating variables that can better explain the underlying mechanisms of this relationship.

Given the inconsistency of prior findings, this study proposes to investigate the role of contextual variables, particularly political connections, which are suspected to be a key moderating factor in the relationship between sustainability and tax aggressiveness. Political connections in Indonesia possess unique characteristics, such as the military's involvement in the economy and a multiparty presidential democracy system, both of which play an important role in shaping corporate tax policies (Harymawan, 2018; Rudyanto et al., 2023). Studies by Tsai et al. (2021) and Ajili & Khlif (2020) demonstrate that political connections can influence corporate tax policies, often enabling firms to circumvent strict regulations and exploit legal loopholes. This study seeks to fill a gap in the literature by exploring the role of political connections as a moderator in the relationship between corporate sustainability and tax aggressiveness in Indonesia. Rudyanto et al. (2023) suggest that political connections can function as a double-edged sword, depending on the ethical standards of the firm. In situations where business ethics are strong, political connections may be leveraged to reduce tax aggressiveness, whereas in less ethical contexts, such connections may exacerbate aggressive tax practices.

This study aims to explore the influence of corporate sustainability on tax aggressiveness and to examine the role of political connections as a moderating factor. By understanding this dynamic, the research is expected to contribute to the literature on corporate tax strategies and the policy implications of sustainability, particularly in developing countries like Indonesia. The findings of this study can serve as a guide for policymakers in designing more effective and equitable regulations, as well as for corporations in formulating sustainability strategies that align with both social and economic interests.

This study offers originality by integrating agency theory and legitimacy theory to analyse the relationship between corporate sustainability and tax aggressiveness, with political connections as a moderating variable. Few prior studies have examined the effect of corporate sustainability on tax aggressiveness using political connections as a moderating variable. Most previous research has focused on the separate effects of political connections and corporate sustainability on tax aggressiveness. Additionally, prior studies have primarily concentrated on developed countries, with limited exploration of developing nations.

This research is conducted in Indonesia, representing a developing country context. As the largest economy in Southeast Asia, Indonesia faces significant challenges in enhancing transparency, tax accountability, and corporate sustainability. The Indonesian tax system continues to grapple with issues such as tax avoidance, low compliance, and uneven oversight (Sinaga & Firmansyah, 2022; Supriyati & Anggraini, 2021).

Moreover, the unique characteristics of political connections in Indonesia—including the military's role, multiparty democratic system, and corporate board dualism—make this study particularly relevant for understanding how political factors influence corporate tax strategies. Rudyanto et al. (2023) demonstrate that political connections in Indonesia often serve as a double-edged sword, providing strategic advantages while simultaneously increasing public scrutiny of involved corporations.

This research is especially significant given the growing regulatory push for sustainability practices in Indonesia, exemplified by Financial Services Authority Regulation No. 51/POJK.03/2017, which mandates sustainability reporting for public companies. However, despite increasing sustainability reporting, the actual transparency and its impact on business practices—including tax aggressiveness—remain subjects of ongoing debate (Triwacananingrum & Wijaya, 2022).

Literature Review

Agency Theory

First proposed by Jensen & Meckling (1976), agency theory posits a contractual relationship between agents (management) and principals (shareholders). However, when both principals and agents seek to maximize their own benefits, agents may not always act in the principals' best interests (Tricker, 2003). Khan & Nuryanah (2023) highlight this principal-agent conflict: while managers aim to increase compensation through higher returns, shareholders prefer minimizing tax burdens by reporting lower earnings. Such conflicting interests motivate managers to engage in tax aggressiveness. From this theoretical perspective, management's motivation for tax aggressiveness is fundamentally self-serving (Velte, 2023). These actions prioritize personal gain over shareholder objectives (Abner & Ferrer, 2019), creating a classic agency problem.

The conflict of interest between agents and principals often triggers disciplinary actions by principals. When management faces potential sanctions from shareholders for engaging in tax aggressiveness, they may devise strategies to strengthen their position, one of which is through corporate sustainability practices. Zhang & Yuan (2025) explain that managerial decisions regarding tax avoidance are frequently driven by self-interest in relation to both corporate sustainability and tax aggressiveness. Furthermore, Alomair & Metwally (2025) emphasize that corporate sustainability can reduce information asymmetry between management and shareholders, thereby mitigating potential agency conflicts. In this context, sustainability disclosure serves as an informational bridge between management and stakeholders, demonstrating that savings from tax aggressiveness may be allocated to sustainability initiatives while simultaneously shaping shareholder perceptions of tax practices, thus alleviating agency conflicts.

Legitimacy Theory

Legitimacy is essential for organizations, representing the alignment between social values and accepted behavioural norms within the broader social system where organizations operate. This underscores the importance of analysing organizational behaviour within its environmental context (Dowling & Pfeffer, 1975). Suchman (1995) defines legitimacy as the generalized perception that an entity's actions are desirable, proper, or appropriate within a socially constructed system of norms, values, beliefs, and definitions. Consequently, companies continuously strive to ensure their operational activities remain within societal norms and boundaries (Deegan, 2002). These concepts collectively suggest that according to legitimacy theory, organizations are integral parts of society and must therefore align their activities with social norms to enhance corporate credibility.

Previous research has found that organizational actions attracting significant public attention for failing to meet societal expectations can impact corporate legitimacy (Deegan, 2002; Guthrie & Parker, 1989; Lanis & Richardson, 2013). As noted by (Mashuri & Ermaya, 2020), a company's operations depend on its relationships with society and the surrounding environment, consistent with legitimacy theory as explained by (Dowling & Pfeffer, 1975).

Dowling & Pfeffer (1975) emphasize that corporate activities should align with the social values of their environment. There are two key dimensions for gaining legitimacy support: (1) Corporate activities must be congruent with societal value systems; (2) Corporate reporting should reflect these social values. Thus, managers must demonstrate compliance with the social contract by disclosing information that meets societal expectations (Lanis & Richardson, 2013).

Several studies have employed legitimacy theory to examine the relationship between tax aggressiveness and sustainability performance indicators (Lanis & Richardson, 2013) (Supriyati & Anggraini, 2021) de Andrade et al. (2020) Elalfy et al. (2021). Fallan & Fallan (2019) argue that companies engage in corporate sustainability activities primarily to enhance their profits, a perspective aligned with (Friedman, 1970) assertion that the social responsibility of business is to increase its profits. According to legitimacy theory, companies engaging in tax aggressiveness require additional disclosures to meet societal expectations, such as environmental, social, and governance (ESG) disclosure, which represents key aspects of corporate sustainability.

Tax Aggressiveness and Sustainability in Indonesia

In Indonesia, tax aggressiveness is frequently employed by companies as a strategy to minimize their tax burden (Supriyati & Anggraini, 2021), albeit through controversial means (Triwacananingrum & Wijaya, 2022). While legal, such practices are often viewed as unethical by stakeholders (Montenegro, 2021). Echoing this perspective, Anggraeni & Hastuti (2020; Khan & Nuryanah (2023); Martinez & Ramalho (2017) highlight that tax aggressiveness represents corporate efforts to reduce tax liabilities, which may involve both legal and illegal methods. Corporate sustainability can play a pivotal role in fostering more stable, long-term tax management (Ma & Park, 2021). In Indonesia, sustainability reporting remains voluntary, although government regulations increasingly encourage companies to classify social and environmental activities as tax-deductible operational

expenses (Supriyati & Anggraini, 2021).

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Tax aggressiveness—commonly used by firms to minimize tax obligations—has emerged as a critical issue in Indonesia. The relationship between tax aggressiveness and sustainability reveals intriguing dynamics. Sinaga & Firmansyah (2022) emphasize that tax aggressiveness tends to increase the cost of equity capital, as investors perceive such strategies as elevating legal and reputational risks.

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Corporate sustainability, through ESG disclosure, serves as a vital tool for managing public and stakeholder perceptions. Companies with robust sustainability disclosures typically demonstrate higher tax compliance, thereby reducing aggressive tax practices (Anggraeni & Hastuti, 2020; Supriyati & Anggraini, 2021). However, Triwacananingrum & Wijaya (2022) observed that during the COVID-19 pandemic, sustainability disclosures paradoxically correlated with increased tax aggressiveness, suggesting firms prioritized profitability while maintaining a positive public image. Furthermore, transparent sustainability reporting enhances public and investor trust, ultimately lowering capital costs and bolstering corporate reputation (Nogueira, 2021).

Corporate Sustainability and Tax Aggressiveness

Within agency theory framework, corporate managers may utilize sustainability disclosures as a tool to conceal opportunistic behaviors—including tax avoidance—for personal gain (Zeng, 2019). Multiple studies demonstrate a positive relationship between corporate sustainability and tax aggressiveness (Abdelfattah & Aboud, 2020; Davis et al., 2016; Lanis & Richardson, 2013; Ma & Park, 2021; Sikka, 2010; Triwacananingrum & Wijaya, 2022; Zeng, 2019). These findings align with the foundational agency theory premise that corporations represent contracts between shareholders and managers, with the singular objective of shareholder wealth maximization (Jensen & Meckling, 1976).

In practice, engagement in sustainability activities that is not accompanied by sufficient profitability may negatively affect business continuity (Widuri et al., 2024), while simultaneously creating room for agency conflicts when managers exploit sustainability for personal gain (Friedman, 1970). Cross-country empirical evidence also supports a positive association between sustainability and tax aggressiveness, as documented in China (Lee, 2024; Zhang & Yuan, 2025), North America (Chandrasena et al., 2024), Europe (Amarna et al., 2025), and Egypt (Abdelfattah & Aboud, 2020). Meanwhile, in Indonesia, studies by Nasih et al. (2024) and Triwacananingrum & Wijaya (2022) reveal that sustainability reporting may serve as a mechanism to obscure tax avoidance practices, particularly under specific conditions such as during the pandemic. Based on these considerations, the hypothesis of this study is formulated as follows:

H1: Corporate sustainability has a positive effect on tax aggressiveness

Political Connections and Tax Aggressiveness

Political connections refer to relationships or networks that individuals maintain with persons or groups holding power or influence in bureaucratic, regulatory, and legal spheres (Primasari et al., 2024). The business world and political connections share an especially close relationship in developing countries like Indonesia. The phenomenon of political connections in Indonesia has persisted as a longstanding issue for years (Faisal et al., 2023). Indonesia's political connections possess unique characteristics that make them particularly compelling for research. Rudyanto et al. (2023) summarize these characteristics into three categories: (1) the military, (2) a multiparty presidential democracy system, and (3) a two-tier board structure.

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First, the military plays a central role in Indonesian politics and economics. Military personnel are generally disciplined, skilled, and capable leaders, which is expected to influence corporate tax aggressiveness levels (Harymawan, 2018). Second, Indonesia adheres to a presidential system with multiparty democracy, where the president is directly elected by the people through general elections. Each presidential election results in the formation of new political coalitions among various political parties (Nasih et al., 2020). In this context, political connections tend not to provide stable or sustainable benefits for their holders. Third, Indonesian companies operate under a two-tier board structure. This dual-board system requires companies to have a Board of Directors responsible for daily operations and a Board of Commissioners tasked with supervising and monitoring director performance. Thus, the integrity of politically connected Board of Commissioners becomes a determining factor in the relationship between corporate sustainability and tax aggressiveness.

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Within Jensen & Meckling (1976) agency theory framework, sustainability can be utilized by managers as a tool to mitigate shareholder pressure regarding tax aggressiveness practices. Managers may leverage corporate sustainability disclosures to conceal aggressive tax strategies, particularly by crafting a responsible public image (Lanis & Richardson, 2013). Conversely, (Dowling & Pfeffer, 1975) legitimacy theory posits that companies use sustainability reporting as a means to gain stakeholder support. In this context, extensive sustainability disclosures may help companies mask aggressive tax avoidance practices, thereby enhancing social legitimacy despite tax strategies that contradict public interests (Montenegro, 2021). High levels of sustainability disclosure correlate positively with tax aggressiveness, as companies frequently employ them for reputation management (Abdelfattah & Aboud, 2020; Zeng, 2019).

companies to maintain aggressive tax strategies while preserving a positive image (Supriyati & Anggraini, 2021). (Deng et al., 2020) found that politically connected firms frequently exploit these connections to reduce tax risks, including through investments in tax havens. Similarly, (Lin, 2021) demonstrated that political lobbyists can secure benefits in the form of lower effective tax rates, increasing opportunities for aggressive tax strategies. This suggests sustainability can be strategically deployed to maintain corporate image while continuing tax avoidance practices. Based on this theoretical foundation and empirical support, the study hypothesizes:

H2: Political connections positively influence tax aggressiveness

Corporate Sustainability, Political Connections, and Tax Aggressiveness

Corporate sustainability is frequently employed as a means to enhance legitimacy in the eyes of stakeholders. Within (Dowling & Pfeffer, 1975) legitimacy theory framework, sustainability disclosures can help companies gain public trust, even when engaged in aggressive tax strategies. Montenegro (2021) demonstrates that companies often utilize sustainability to create a positive image that may obscure aggressive tax avoidance practices. Similarly, Rashid et al. (2024) note that firms with low environmental and social performance tend to exhibit greater tax aggressiveness, suggesting sustainability can function as a corporate strategy.

Political connections may alter this dynamic by modifying the relationship between corporate sustainability and tax aggressiveness. Drawing on Jensen & Meckling's (1976) agency theory, political connections provide strategic advantages such as regulatory protection and access to favourable policies (Tsai et al., 2021). This reduces companies' reliance on social responsibility as a legitimization tool, as political connections already offer protective mechanisms. Deng et al. (2020) study reveals that politically connected firms frequently leverage these relationships to invest in tax havens, indicating political connections often safeguard aggressive tax strategies.

Conversely, political connections also intensify regulatory scrutiny, prompting companies to exercise greater caution in adopting aggressive tax approaches (Lin, 2021). In this scenario, political connections weaken the positive relationship between corporate sustainability and tax aggressiveness. Politically connected firms thus demonstrate higher tax compliance despite robust sustainability disclosures, due to additional external oversight pressures. This reflects the complex role of political connections in corporate tax strategy.

H3: Political connections weaken the relationship between corporate sustainability and tax aggressiveness.

Methods

Population and Sample

The population in this study consists of companies listed on the Indonesia Stock Exchange (IDX) from 2017 to 2022. The reason for selecting this research period is based on the issuance of (Financial Services Authority Regulation Number 51/POJK.03/2017 Concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies, 2017b) No. 51 in 2017, which mandates companies to disclose sustainability reports. POJK No. 51/POJK.03/2017 states that the mandatory year for companies to disclose sustainability reports is 2020; however, this study seeks to examine the impact after the regulation was enacted. The year 2022 was chosen as the final test year because the latest available data for testing at this time is from that year. The sampling technique used was purposive sampling, a method of obtaining samples based on criteria relevant to the research objectives.

Variable measurement

This study examines the relationship between tax aggressiveness (dependent variable), corporate sustainability (independent variable), and political connections (moderating variable), along with several control variables, including audit quality, firm age, leverage, revenue growth, and firm size. Tax aggressiveness refers to Frank et al. (2009) and is measured using book-tax difference (BTD), which reflects the gap between accounting income and taxable income (Yuan & Lin, 2023). Corporate sustainability, based on the Brundtland concept (Keeble, 1988), is measured using ESG (Environmental, Social, and Governance) scores from Bloomberg (Jarboui et al., 2020). Meanwhile, political connections refer to the involvement of board commissioners in government or military roles (Joni et al., 2020).

Audit quality is proxied by Big Four affiliation (Deloitte, EY, KPMG, PwC) due to their reputation for maintaining independence (Bacha et al., 2021; DeAngelo, 1981). Firm age is calculated from the year of establishment (Kücher et al., 2020) and influences innovation and sustainability (Pellegrino & Piva, 2020; Schumpeter, 2021). Leverage is measured using the debt-to-equity ratio (DER) (Aftab et al., 2023; Myers, 1984), while revenue growth is assessed based on annual income increases (Bodhanwala & Bodhanwala, 2018). Firm size is measured using the natural logarithm of total assets (Schwoy et al., 2023), where larger firms tend to be more sustainable due to higher visibility (Choi et al., 2020; Udayasankar, 2008).

Research Model

The statistical technique used to test the hypotheses in this study is Moderated Regression Analysis (MRA)

also known as interaction testing. The type of data used in this study is secondary data, obtained from annual reports, audited financial statements of companies listed on the Indonesia Stock Exchange (IDX), Bloomberg, reputable media sources, and the official websites of the sampled companies. The data structure is panel data, which is analysed using Stata 17 software. The reason for choosing Stata is due to its comprehensive features for data processing. Stata can generalize the common effect model (CEM), fixed effect model (FEM), and random effect model (REM). Selecting the appropriate model for panel data analysis is crucial for ensuring accurate results, as each model has different assumptions. Therefore, a series of statistical tests is required to determine the most suitable model.

Table 1. Variable measurement.

No	Variables and Sources	Measurement	Data Source
1	Tax Aggressiveness (Frank et al., 2009)	Total Book-Tax Difference (BTD) BTD = (Pretax Income - Current Tax Expense / Statutory Tax Rate) / Total Assets	Bloomberg (Pretax Income, Current Tax Expense, Total Assets) Tax Regulation (Statutory Tax Rate)
2	Corporate Sustainability (Jarboui et al., 2020)	ESG Score	Bloomberg (ESG Disclosure Score)
3	Political connection (Joni et al., 2020)	The percentage of board of commissioner's members with political connections relative to the total number of board commissioners.	Annual Reports (list of board members) Official Government & Parliament Websites (dpr.go.id, setkab.go.id) Google search engine (News and profile)
4	Audit quality (Bacha et al., 2021)	Big Four (the four largest global audit firms).	Annual Report (Independent Auditor's Report)
5	Firm age (Kücher et al., 2020)	Year of study – year of company establishment	Annual Report (Company Profile or Brief History)
6	Leverage (Aftab et al., 2023; Myers, 1984).	Dept to Equity Ratio = $\frac{\text{Total Equity}}{\text{Total Debt}}$	Bloomberg (total equity, total debt)
7	Revenue Growth (Bodhanwala & Bodhanwala, 2018)	$\frac{\text{Revenue (t) – revenue (t – 1)}}{\text{pendapatan (t – 1)}}$	Bloomberg (revenue)
8	Firm size (Schwoy et al., 2023)	Ln (Total Asset)	Bloomberg (total asset)

First, the Chow test is used to compare CEM and FEM. If the Chow test is significant, FEM is more appropriate because it indicates that fixed characteristics specific to each entity need to be accounted for. Next, the Hausman test compares FEM and REM. If the result is significant, FEM should be selected. This test examines whether REM can provide consistent estimates under the assumption that differences across entities are uncorrelated with the independent variables. The final test is the Lagrange Multiplier (LM) test, which compares CEM with REM. The LM test evaluates whether the variation across entities can be considered random. If the LM test is significant, REM is preferable to CEM because REM can capture random variation across entities. Choosing the right model based on data characteristics ensures that the analysis results can be accurately interpreted. Equation (1) below presents the basic model that provides the conceptual framework for this research:

$$\text{Tax aggressiveness}_{it} = a + b_1 \text{corporate sustainability}_{it} + b_2 \text{political connection}_{it} + b_3 \text{corporate sustainability}_{it} * \text{political connection} + b_4 \text{audit quality}_{it} + b_5 \text{firm age}_{it} + b_6 \text{leverage}_{it} + b_7 \text{revenue growth}_{it} + b_9 \text{firm size}_{it} + \epsilon \dots \dots \dots (i) \tag{1}$$

Results

Model Selection Test

The model selection test is conducted prior to the regression analysis to determine the best model among the Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM). In this study, the

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model selection test begins with the Chow test to assess whether the CEM is preferable to the FEM or vice versa. The Chow test results yield a probability value of 0.0002, which is lower than the 0.05 significance level. This indicates that the FEM is selected for further analysis, while the CEM is rejected.

The subsequent test is the Hausman test, which compares the Random Effect Model (REM) with the Fixed Effect Model (FEM). The null hypothesis posits that the REM is more appropriate; however, the p-value of 0.000 is lower than 0.05, leading to its rejection. Based on the results of the Chow and Hausman tests, the Fixed Effect Model (FEM) is selected as the most suitable model. The Lagrange Multiplier (LM) test, which compares the CEM and REM, is not performed because the Chow and Hausman test results already confirm that the FEM is the most appropriate model for this study.

Table 2. Model Selection Test.

Test	Probability	Selected Model
Chow test	0.0002	FEM
Hausman test	0.0000	FEM

Classical Assumption Test

Before conducting regression analysis, classical assumption tests are required to ensure valid and unbiased estimation results. In this study, the normality test was not performed because the fixed effects model employed does not require normally distributed residuals, as it relies on within-unit variation (changes within observational units). The results of the classical assumption tests indicate that there is no multicollinearity problem in the research model, as all VIF values are below 10 and the tolerance values (1/VIF) are close to 1. The variables corporate sustainability, political connection, their interaction, audit quality, firm age, leverage, revenue growth, and firm size all meet the criteria of being free from multicollinearity. In addition, the heteroskedasticity test produced a probability value of 0.1622, which is greater than 0.05, indicating no heteroskedasticity. The autocorrelation test also showed a probability value of 0.3493, exceeding 0.05, which means there is no autocorrelation issue. Thus, the regression model used has fulfilled the classical assumptions and is suitable for further analysis.

Table 3. Classical Assumption Test.

Test	Prob	VIF	1/VIF	Conclusion
Multicollinearity				No multicollinearity problem
Corporate sustainability		1.06	0.9403	
Political connection		1.52	0.6570	
Corporate sustainability * political connection		1.46	0.6865	
Audit quality		1.36	0.7369	
Firm age		1.01	0.9897	
Leverage		1.18	0.8478	
Revenue growth		1.09	0.9210	
Firm size		1.60	0.6238	
Heteroskedasticity	0.1622			No heteroskedasticity
Autocorrelation	0.3493			No autocorrelation

Regression analysis Results

Table 4 presents the results of the regression tests for both the main model and the robust model. The main regression results indicate that the regression model employed is reliable and reasonably fit to explain the variability in the data, as evidenced by the F-statistic p-value of 0.0002. The adjusted R² value of 0.1233 implies that the model explains only 12.33% of the variability in Tax Aggressiveness, while the remaining variance is accounted for by other factors outside the model.

The hypothesis testing results show that corporate sustainability has a positive effect on tax aggressiveness with a coefficient of 0.2895 and a p-value of 0.047. Similarly, political connection (coefficient 11.9583; p-value 0.000) exerts a positive influence on tax aggressiveness. However, the interaction between corporate sustainability and political connection exhibits a negative effect with a coefficient of -1.0265 and a p-value of 0.004. These findings suggest that political connection weakens the positive impact of corporate sustainability. Meanwhile, audit quality, firm age, leverage, revenue growth, and firm size show no significant effect on tax aggressiveness.

The robust test with adjusted standard errors provides consistent results and reinforces the findings of the main model. Although the significance level of corporate sustainability weakens to 10% (p-value 0.066), its positive effect remains statistically significant. The significance of political connection and its interaction with corporate sustainability becomes even stronger, with a p-value of 0.001. At the same time, all control variables remain insignificant, consistent with the main regression results. The robust test strengthens the validity of the findings, confirming that political connection serves as a strong moderator in the relationship between corporate sustainability and the dependent variable. Thus, it can be concluded that the results of this study are both robust and consistent.

Table 4. Regression Analysis Results.

Main test	Coefficient	Prob
Probability (F-statistic)	0.0002	
Adjusted R^2	0.1233	
Constanta	472.7041	0.000***
Corporate sustainability	0.2895	0.047**
Political connection	11.9583	0.000***
Corporate sustainability * political connection	-1.0265	0.004***
Audit quality	30.2099	0.193
Firm age	-0.8887	0.734
Leverage	-0.0114	0.932
Revenue growth	-0.0916	0.148
Firm size	-0.3587	0.338
Robust test	Coefficient	Prob
Probability (F-statistic)	0.0002	
Adjusted R^2	0.1233	
Constanta	472.7041	0.000***
Corporate sustainability	0.2895	0.066*
Political connection	11.9583	0.001***
Corporate sustainability * political connection	-1.0265	0.001***
Audit quality	30.2099	0.288
Firm age	-0.8887	0.751
Leverage	-0.0114	0.927
Revenue growth	-0.0916	0.158
Firm size	-0.3587	0.270
Test of difference (period effect)	Coefficient	Prop
Period (2020-2022)	-3.3940	0.901
Period * Corporate sustainability	0.2217	0.336
Period * Political connection	2.7797	0.605
Period * Corporate sustainability * Political connection	-0.0067	0.890

Note: ***significant at the 1% level, **significant at the 5% level, *significant at the 10% level

In addition to the main and robustness tests, this study also conducted a test of difference (period effect) to examine whether the model differs before and after 2020. The estimation results indicate that the period variable, as well as its interactions with corporate sustainability and political connection, are not statistically significant (p-value > 0.3). This suggests that there is no meaningful difference in the relationship between corporate sustainability, political connection, and tax aggressiveness before and after 2020. In other words, the pandemic period did not provide an additional significant effect on the model, implying that the relationships among the main variables remain consistent across periods.

Discussion

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This study reveals intriguing dynamics between corporate sustainability, political connections, and tax aggressiveness in Indonesia—a context where business practices are often caught between profitability demands and social pressures. The results support the hypothesis that corporate sustainability positively influences tax aggressiveness. This study also proves consistent during the unstable period of 2020–2022, which encompassed the COVID-19 pandemic. The period-difference test confirms that external shocks caused by the pandemic did not significantly affect the dynamics of the relationships among the main variables. This indicates that the practice of using sustainability as a legitimizing tool for tax avoidance activities has become deeply embedded in the Indonesian business environment, occurring not only under normal business conditions but also persisting even amid a global health crisis that affected all sectors of the economy.

This finding aligns with agency theory (Jensen & Meckling, 1976), suggesting that managers may use sustainability disclosures as a tool to conceal opportunistic practices, including tax avoidance (Zeng, 2019). These results are consistent with findings in several other developing countries. For instance, studies by Lee (2024), Ma & Park (2021), and Zhang & Yuan (2025) in China, as well as Abdelfattah & Aboud (2020) in Egypt, also report a positive association between corporate sustainability and tax aggressiveness. This suggests that in institutional contexts where stakeholder oversight may be suboptimal, sustainability practices can be used as a legitimizing tool for less transparent activities. However, these findings contrast with evidence from developed countries, such as the United States (Lanis & Richardson, 2018) and OECD cross-country studies (Ortas & Gallego-Álvarez, 2020), which associate sustainability practices with higher tax compliance. This divergence confirms the meta-analysis by Mitroulia et al. (2025), which emphasizes that the ESG–tax avoidance relationship is highly context-dependent, with governance characteristics and the degree of social pressure playing a critical role.

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The study also confirms that political connections significantly increase tax aggressiveness, supporting the second hypothesis. This finding reinforces the argument that politically connected firms enjoy privileged access to lenient tax policies or protection from penalties (Deng et al., 2020; Lin, 2021). These results are consistent with the study by Wahab et al. (2017) in Malaysia, which also found that politically connected firms tend to be more tax aggressive. This indicates a similar pattern in Southeast Asia, where proximity to power can be leveraged to mitigate risks inherent in aggressive tax strategies. Political connections may serve as a unique corporate resource or, at the very least, provide additional facilities to secure government support and resources (Primasari et al., 2024). In Indonesia, unique characteristics such as the military's involvement in business and the multiparty presidential system (Rudyanto et al., 2023) allow firms to exploit political ties to reduce tax burdens. This study reinforces empirical evidence that political connections function as a “shield,” enabling firms to engage in tax avoidance without significant concern over legal consequences (Harymawan, 2018).

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Meanwhile, the third hypothesis posited that political connections would weaken the positive relationship between corporate sustainability and tax aggressiveness. However, the results reveal that political connections not only diminish but actually reverse this relationship. This contrasts with initial expectations but can be explained through legitimacy theory. Firms with strong political ties may not rely on sustainability for legitimacy, as they already enjoy political protection (Tsai et al., 2021). This moderating finding adds a new dimension to the literature. While studies such as Chandrasena et al. (2024) in North America found that internal governance mechanisms (e.g., sustainability committees) can weaken the positive ESG–tax avoidance relationship, this study reveals that in Indonesia, external factors (political connections) exert a similar weakening effect. Moreover, prominent political ties may actually heighten public and regulatory scrutiny (Rudyanto et al., 2023). In such contexts, firms with strong political connections may act more cautiously, avoiding the combination of aggressive tax practices and conspicuous sustainability reporting in order not to attract further attention. Consequently, they may reduce tax aggressiveness despite maintaining strong sustainability disclosures. This finding aligns with the notion that political connections can serve as a “double-edged sword” (Montenegro, 2021), offering advantages on one hand but exposing firms to greater reputational risks and regulatory oversight on the other.

Conclusion

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The findings of this study indicate that corporate sustainability and political connections play a significant role in influencing corporate tax behaviour in Indonesia. The results demonstrate that corporate sustainability has a significant positive relationship with tax aggressiveness, meaning that firms more focused on sustainability practices tend to engage more in tax avoidance strategies. Political connections have a significant positive influence on tax aggressiveness, suggesting that politically connected firms are more likely to engage in tax avoidance. However, political connections exhibit a significant and negative moderating effect on the relationship between corporate sustainability and tax aggressiveness. These findings imply that political connections may mitigate the positive impact of sustainability on tax aggressiveness, possibly due to increased public scrutiny or pressure on politically connected firms.

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These findings suggest that while sustainability can serve as a tool to enhance legitimacy, it may also be exploited to conceal opportunistic behaviour. This study also confirms that political connections can play a dual role—both as a means to facilitate tax avoidance strategies and as a control mechanism to ensure better compliance and oversight of corporate practices.

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Practically, this study offers several important implications. First, regulators need to tighten oversight of sustainability disclosure practices to prevent their misuse as a tool for mere legitimacy. Second, the findings on the role of political connections highlight the need for reforms toward a more independent tax oversight system, free from political influence. Future research could explore governance reinforcement mechanisms to ensure that sustainability practices and political connections genuinely contribute to equitable economic development.

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This study has several limitations. First, it is limited to firms listed on the Indonesia Stock Exchange, so the findings may not be generalizable to other contexts, particularly in countries with different political and economic structures. Second, the measurement of political connections is based solely on-board affiliations, which may not fully capture all relevant forms of political ties. Future research should address these limitations by expanding the sample beyond Indonesia and refining the measurement of political connections to go beyond board members.

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