

**TAX AVOIDANCE AND TAX RISK EFFECT TO COST OF DEBT FOR
MANUFACTURING COMPANIES SURVIVING COVID-19 CRISIS**

IRWANTO HANDOJO

Trisakti School of Management,
Kyai Tapa Street No. 20, West Jakarta 11440, Indonesia

NOVIKA CHANDRA

Trisakti School of Management,
Kyai Tapa Street No. 20, West Jakarta 11440, Indonesia

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ABSTRACT

This study examines the impact of tax avoidance and tax risk on the cost of debt in manufacturing companies listed on the Indonesia Stock Exchange (IDX) from 2021 to 2023. Using multiple regression analysis, this research evaluates how corporate tax strategies and related risks affect lenders' risk perceptions and the resulting cost of debt. The findings indicate that corporate tax avoidance practices create tax risk perceptions that increase the cost of debt. On the other hand, tax risk shows a positive effect on the cost of debt in the context of the COVID-19 impact, aligning with the influence of profitability. The instability of tax payments indicating low tax risk in this study can be interpreted as an effort to time tax avoidance appropriately, as tax avoidance in Indonesia actually increases tax risk for companies. Therefore, instability in tax payments due to tax avoidance only being carried out at opportune times provides a low-risk perception for creditors. Thus, the instability in company profitability due to the impact of COVID-19 is closely related to company risk when engaging in tax avoidance in tax reporting. In the context of the impact of COVID-19, the instability of tax payments due to profitability instability actually reflects reality. Therefore, the instability of tax payments provides a low tax risk perception also because tax avoidance is not carried out at COVID-19 impact times, and vice versa. Additionally, company size, profitability, foreign ownership, and institutional ownership are proven to reduce the cost of debt, while government ownership has no effect, and managerial ownership shows a positive effect on the cost of debt, indicating the perception of agency risk by lenders. These results emphasize the importance of conservative tax management, financial health, and corporate governance control structures in minimizing borrowing costs and enhancing the financial stability of companies.

KEYWORDS: - Cost of Debt, Tax Avoidance, Tax Risk, Firm Size, Profitability, Foreign Ownership, Institutional Ownership, Government Ownership, Managerial Ownership.

1.0 INTRODUCTION

Company may have options to finance the operational of the firm by using equity or debt. Cost of debt is generally lower than the cost of equity due to tax savings and other benefits associated with debt financing (Van Binsbergen et al., 2010). Typically, for an operational enterprise, the utilization of internal financing derived from profits constitutes the most economical form of funding (Shrotriya, 2019). In instances where internal financing proves inadequate for supporting operational expansion and capital investment, resorting to debt emerges as a viable alternative (Almeida & Campello, 2010). Understanding the implications of each financing option is crucial, as debt can lead to tax advantages through interest deductions, while equity may dilute ownership but sometimes does not require repayment (Graham, 2000; Burkart & Zhong, 2022). Choosing the right mix of debt and equity financing can significantly impact a company's overall cost of capital, influencing both profitability and financial stability in the long term.

Usually, for growing company, the preference often leans towards debt financing, as it allows for leveraging growth opportunities without sacrificing ownership control, provided that the company can manage its repayment obligations effectively. Having debt from creditors need requirement to be settled. This obligation necessitates careful cash flow management and strategic planning to ensure that the company can meet its financial commitments while continuing to invest in growth initiatives.

As creditors, it is essential for them to assess the company's financial health and stability, as their returns depend on the firm's ability to generate sufficient cash flow to service its debt obligations. Debt financing can be obtained from various sources, such as banks, non-bank financial institutions, bonds, and loans from investor institutions. Effective communication and transparency between the company and its creditors can further strengthen this relationship, fostering trust and potentially leading to more favorable financing terms in the future.

One matter that should be observed by creditors is a matter of tax obligation. Tax is an obligation to government that must be fulfilled, and any attempts to evade or minimize tax liabilities can lead to significant legal repercussions and damage the company's reputation (Baudot et al., 2020). Maintaining compliance with tax regulations not only safeguards the company from potential penalties but also enhances its credibility in the eyes of investors and stakeholders, ultimately contributing to long-term sustainability.

Regarding that tax is an expense, it is essential for companies to incorporate effective tax planning strategies that align with their overall financial goals. Companies always try to minimize expenses while ensuring they remain within the legal framework, as this balance is crucial for optimizing their financial performance and maintaining a competitive edge in the

market. Tax planning that is legal is usually called as tax avoidance (Duhoon & Singh, 2023). Tax avoidance involves strategically organizing a company's financial affairs to take advantage of available deductions, credits, and exemptions, thereby reducing the overall tax burden without crossing legal boundaries (Siew Yee et al., 2018). To gain the trust of lenders, proper tax obligation management becomes crucial. One factor that influences lender trust is how companies manage their tax obligations, which can directly impact the cost of debt borne by the company. Effective management of tax obligations can increase lender confidence in the company's financial stability.

Theoretically, tax avoidance can be interpreted in two ways. first, tax avoidance may be considered as tax saving where companies strategically plan their finances to minimize tax liabilities through legal means (Duhoon & Singh, 2023). By having tax saving from tax avoidance practice, company may have more available cash flow, which can enhance its ability to meet debt obligations and invest in growth opportunities (Edwards et al., 2016). On the other hand, tax avoidance can also be viewed negatively if it involves aggressive strategies that exploit loopholes or lack transparency, potentially damaging the company's reputation and relationship with stakeholders. If companies engage in aggressive or excessive tax avoidance, even if legal, it can cause problems, uncertainties, and inconsistencies in the company's tax position (Payne & Raiborn, 2018). In this matter, tax avoidance may be considered as risk exposure effect. In the context of risk exposure effects, one may observe the escalation of agency risk, the augmentation of tax audit risk, and the exacerbation of information asymmetry (Medhioub & Boujelbene, 2024). Understanding the dual nature of tax avoidance is crucial for companies as they navigate their financial strategies, balancing the benefits of increased cash flow against the potential risks to their reputation and stakeholder trust.

The consequences of the perspectives may be discerned in the expense associated with debt. Positive view of tax avoidance from the creditors, may implied in the form of lower interest rates, as lenders perceive a company that engages in tax avoidance as more financially savvy and capable of managing its obligations effectively. However, the negative perception from other stakeholders can lead to increased scrutiny and potential backlash, ultimately affecting a company's long-term sustainability and market position.

Apart from tax avoidance, companies also need to consider tax risk, which is the uncertainty regarding future tax liabilities that may arise due to changes in tax policies or differing interpretations of regulations (Brown et al., 2024). This tax risk includes potential unexpected tax liabilities or fines that can disrupt the company's cash flow. For lenders, this uncertainty increases their investment risk. Companies facing high tax risks may be perceived as more vulnerable to policy changes or non-compliance, potentially increasing the cost of debt they face.

Tax risks often arise when companies operate in multiple jurisdictions with varying tax regulations, or when companies cannot accurately predict tax policy changes that may affect their future tax costs and obligations. This uncertainty regarding future tax liabilities increases the perceived risk by lenders. If companies face high tax risks, it can indicate potential difficulties in managing their tax obligations in the future, which can disrupt their financial stability (Artemenko et al., 2017). High tax risks can also increase the likelihood of disputes with tax authorities, leading to fines or other additional costs that can damage the company's financial performance.

To have a better understanding of how creditors in Indonesia assess these two views of tax avoidance and tax risks then this research is done. Specifically, this research also aims to understand the effect of tax avoidance and tax risk in the context of manufacturing companies that pay dividends to cost of debt. It is interesting to include the idea of dividend Payer Company, as companies that distribute dividends are often scrutinized for their financial practices, making the implications of tax avoidance particularly significant in maintaining investor confidence and ensuring long-term sustainability. As dividend payers' company, the quality of earnings of this company usually may enable company to have sufficient cash flow to pay the dividend to shareholders (Skinner & Soltes, 2011). In line of this idea, usually dividend payers' companies also have sufficient cash flow to fulfill their responsibility to government in the matter of tax.

The other condition that may also influence of this research is that this research is done for period of 2021 to 2023 where the effect of covid 19 is still being felt across various sectors, impacting both corporate earnings and tax obligations as companies navigate the challenges of recovery and adaptation in a post-pandemic economy. This period of uncertainty has prompted many businesses to reassess their financial strategies, focusing on maintaining liquidity and ensuring sustainable growth while balancing shareholder expectations and regulatory requirements. Understanding these dynamics is crucial for evaluating how companies can effectively manage their resources and obligations during such tumultuous times, ultimately shaping their long-term viability and resilience in the market.

This research may contribute to enhance the understanding of how creditors may view the tax avoidance and tax risk especially of the companies that pay dividend. Such insights can inform investment decisions and risk assessments, providing a clearer picture of the interplay between corporate governance, financial performance, and tax strategies in shaping investor confidence and market stability. This exploration will also highlight the importance of transparency and ethical practices in corporate finance, as stakeholders increasingly demand accountability from firms regarding their tax strategies and overall governance. Understanding how creditors

perceive tax avoidance strategies, particularly in companies that distribute dividends, is crucial for evaluating potential risks and rewards associated with their investments.

2.0 LITERATURE REVIEW AND DEVELOPMENT HYPOTHESIS

2.1 Tax Avoidance and Cost of Debt

Duhoon and Sigh (2023) explain that tax avoidance decisions are viewed as the legal transfer of funds from the government to businesses. The adoption of tax avoidance practices within an organization is influenced by (a) agency issues due to the separation of management and shareholders, (b) social needs, and (c) the perceived legitimacy of these tax avoidance decisions. Agency issues may arise when companies or manager have the interest to maximising the shareholder value or the remuneration of the manager by minimising the tax liability. Social needs refer to when tax avoidance is related to the ethical values held by a company at the control of society, questioning whether tax avoidance is an ethical practice to undertake. Legitimacy approach is considering tax avoidance as the practice that create legitimacy risk for organization.

Medhioub and Boujelbene (2024) examine two perspectives in tax avoidance effect. There are two perspectives in understanding tax avoidance. The first perspective is the tax saving effect and the second is the risk exposure effect. These two perspectives provide different insights into how individuals or companies manage their tax obligations, as well as the impact on financial decisions and the risks faced. While the tax saving effect perspective emphasizes strategies used to legally reduce tax obligations, the risk exposure effect focuses more on the potential risks arising from tax avoidance, including reputational impact and legal consequences.

Kovermann (2018) supports tax saving perspective by finding that tax avoidance generally reduces the cost of debt. This study aligns with the cash-substitution hypothesis, which argues that tax savings generated from tax avoidance strategies can be used to pay down debt, thereby reducing default risk. This perception encourages creditors to offer lower interest rates as they see the company having stronger cash flows and a greater ability to meet its financial obligations. However, there are competing theories that show a different relationship between tax avoidance and the cost of debt. Beladi et al. (2018) found that tax avoidance is associated with higher bank loan costs, but this effect is lower for companies with higher levels of corporate transparency. This highlights the importance of information asymmetry and transparency in this relationship. Companies with higher transparency levels tend to minimize uncertainties arising from tax avoidance activities, thereby reducing the perceived risk by creditors.

Conversely, Kovermann (2018) found a negative relationship between tax avoidance and the cost of debt in large companies in bank-dominated economies. Banks in Germany have access to

private information regarding the tax avoidance risk of their debtors, which can influence the cost of debt. This may be more relevant for SMEs, where strong lending relationships with banks can help reduce information asymmetry issues and set more efficient interest rates. More specifically, complex and non-transparent tax avoidance activities tend to increase company risk, whereas simpler strategies, such as special depreciation schemes or tax incentives, tend to have lower risks (Goh et al., 2016; Bergner et al., 2017). Therefore, creditors may not view these practices as significantly increasing the company's risk.

However, in the context of this study, there is risk exposure perspective that companies engaged in tax avoidance risk increasing uncertainties related to tax compliance. This can attract attention from authorities, which then impacts the company's reputation and raises risk levels. As explained by Lee (2022), companies engaging in tax avoidance may face legal risks related to tax compliance, potentially harming the company's financial and reputational standing. With this increased tax-related risk, companies that engage in tax avoidance are likely to face higher costs of debt, as creditors tend to view these companies as more risky. Combining these various perspectives, the relationship between tax avoidance and the cost of debt can be ambivalent. On one hand, effectively and transparently conducted tax avoidance can reduce risk and lower the cost of debt. On the other hand, more complex and non-transparent tax avoidance practices can increase risks related to tax compliance and reputation, thereby increasing the cost of debt. Based on the above literature review, the hypothesis proposed in this study is:

Hypothesis (H1): Tax avoidance has a positive impact on the cost of debt

2.2 Tax Risk and Cost of Debt

Tax risk is described as a form of uncertainty in tax management that arises during business operations (Shuping et al., 2021). It is an inherent risk that cannot be completely eliminated as long as a company exists. This risk can lead to increased business costs if tax-related matters are not handled properly. Tax risk reflects the uncertainty associated with a company's tax positions and potential future tax liabilities, which can affect creditors' perceptions of risk.

According to Kovermann (2018), while tax avoidance can initially reduce debt costs through perceived cash savings, the presence of tax risk can offset these benefits. Creditors differentiate between successful tax avoidance, which leads to stable tax expenses, and unsuccessful tax avoidance, which results in volatile tax outcomes. Firms with unstable tax positions are often perceived as riskier by creditors, leading to increased borrowing costs.

Guedrib and Hamdi (2024) finds that tax risk has a positive and significant impact on the cost of debt. This means that as tax risk increases, creditors perceive a higher risk in lending, which

leads to an increase in the cost of debt. It is revealed that companies facing greater tax uncertainties are likely to incur higher borrowing costs, as lenders adjust their risk assessments accordingly. This finding emphasizes the importance of effective tax management in minimizing tax-related uncertainties and reducing financing costs. Similarly, Angie et al. (2024) demonstrated that firms with high tax risk are perceived as high-risk entities by creditors, prompting lenders to demand higher interest rates as compensation for the added uncertainty. Furthermore, increased tax risk often results in higher monitoring costs from creditors, contributing to an overall increase in the cost of debt. Different effect of tax risk is when tax risk is disclosed, it finds a negative association between extensive tax risk disclosures and the cost of debt (Axelton, 2022). This means that when firms provide more detailed tax risk disclosures, they tend to incur lower costs when obtaining debt financing it can lead to increased transparency and potentially foster trust among investors, as stakeholders are better informed about the financial uncertainties facing a company.

These studies collectively highlight the critical role of tax risk in shaping creditors' risk perceptions and influencing borrowing costs. Effective management of tax risk can help firms maintain financial stability and secure financing at more favorable terms. Based on the literature review above, it can be concluded that tax avoidance has a significant influence on the cost of debt. Therefore, the hypothesis proposed in this study is as follows:

Hypothesis 2 (H2): Tax risk has a positive impact on the cost of debt

2.3 Firm Size and Cost of Debt

Firm size is an important factor often associated with the cost of debt. Theoretically, larger companies are considered to have better access to capital markets, higher credit ratings, and stronger perceptions of stability in the eyes of lenders (Aktan et al., 2019). However, recent research shows that the relationship between firm size and the cost of debt is not always significant and is context-dependent. Fajarwati (2023) notes that although larger companies are generally considered more stable and have more collateral, this factor does not always directly correlate with lower debt costs. This research indicates that other variables, such as capital structure, market conditions, and risk management, can have a more significant influence on determining debt costs than the size of the company itself. Therefore, although there are theoretical arguments supporting a negative relationship between firm size and debt costs, empirical evidence shows that the relationship is not significant.

Similarly, Utami (2021) states that firm size, measured by total assets, does not have a significant impact on debt costs. Although large companies are often considered more stable and have more assets as collateral, this research emphasizes that other factors, such as capital structure and

macroeconomic conditions, are more determinant in influencing debt costs. Gea and Johan (2021) also find that firm size does not have a significant impact on debt costs. Although larger companies may have advantages such as diversified operations and better perceptions of stability, these advantages do not always translate into lower borrowing costs. This study shows that market conditions, industry characteristics, and the overall economic environment play a more crucial role in determining the cost of debt.

Moreover, this research highlights that even small companies can negotiate competitive loan terms if they have strong financial performance or unique market positions. This challenges the conventional view that larger companies inherently enjoy lower debt costs and emphasizes that the relationship between firm size and debt costs is more complex and not always linear. Overall, the literature indicates that the relationship between firm size and debt costs is not consistent, and in many cases, other external and internal factors dominate in influencing debt costs more than the size of the company itself. Based on the above literature review, the hypothesis proposed in this study is as follows:

Hypothesis 3 (H3): Firm size does not have a significant impact on the cost of debt

2.4 Profitability and Cost of Debt

High profitability generally reflects a company's ability to generate sufficient income to meet its financial obligations, ultimately improving creditors' perception of the company's creditworthiness. According to Angie et al. (2024), companies with strong profitability tend to be viewed as lower-risk entities by creditors, thus obtaining lower loan interest rates. This can be explained by the tendency of such companies to rely more on internal funding, like retained earnings, rather than external funding, thus reducing the level of debt and associated costs. However, other factors like market conditions and financial risk can also influence the cost of debt.

On the other hand, research by Dhiva and Gunawan (2023) supports the view that profitability has a negative impact on the cost of debt. Their study reveals that companies with high levels of profitability are perceived as more capable of meeting their debt obligations, thus enhancing credibility in the eyes of lenders and reducing debt costs. They also highlight the important role of sustainable financial disclosures and sustainability report assurance in enhancing transparency and reducing risk perceptions from lenders. Thus, the relationship between profitability and the cost of debt is complex and can be influenced by various factors, including funding strategies, market conditions, and the level of financial information disclosure by the company. Therefore, the hypothesis proposed in this study is as follows:

Hypothesis 4 (H4): Profitability has a negative impact on the cost of debt

2.5 Foreign Ownership and Cost of Debt

According to Van Vu Thi Thuy et al. (2022), foreign ownership has a negative and significant impact on the cost of debt at a 1% significance level. This study shows that the higher the proportion of foreign ownership in a company, the lower the cost of debt incurred. This is due to increased transparency, improvements in corporate governance, and reduced information asymmetry between the company and creditors. Foreign investors tend to have better capabilities in monitoring managerial practices, thus increasing creditor confidence and lowering the perceived risk towards the company. As a result, companies with higher levels of foreign ownership tend to obtain funding at lower costs.

Similarly, Tran (2022) also found that foreign ownership negatively and significantly affects the cost of debt in emerging markets such as Vietnam. Using a sample of 3,263 observations from 405 companies listed on the Vietnam stock market during the period 2009–2017, this study found that the negative relationship between foreign ownership and the cost of debt is stronger in non-state-owned enterprises (non-SOEs) and financially constrained firms. The positive effect of foreign ownership on reducing the cost of debt mainly stems from improvements in corporate governance and reduced information asymmetry between management and creditors. Foreign investors, with global investment experience and financial expertise, have better capabilities in monitoring company management activities, reducing excessive investment risks, and increasing transparency and trust from creditors. Overall, the research emphasizes that foreign ownership can enhance corporate governance, reduce information asymmetry, and increase transparency, which ultimately leads to a reduction in risk perception by creditors and lower debt costs. Therefore, foreign ownership plays an important role in creating a more efficient funding structure for companies, especially in developing countries.

Hypothesis 5 (H5): Foreign ownership has a negative impact on the cost of debt

2.6 Institutional Ownership and Cost of Debt

Institutional investors, such as pension funds, mutual funds, and insurance companies, possess the resources and expertise necessary to monitor management activities more effectively compared to individual investors. According to Fajarwati (2023), significant institutional ownership can reduce agency costs by aligning the interests of management and shareholders, ultimately lowering the perceived risk by creditors. Furthermore, the presence of dominant institutional investors in the ownership structure can enhance the company's credibility in the eyes of lenders, as it indicates stringent oversight of the company's management. Creditors tend

to view companies with high institutional ownership as lower-risk entities, which is eventually reflected in lower loan interest rates.

Research by Thanatawee (2023) also supports this view, showing that an optimal level of institutional ownership is necessary to ensure effective oversight and risk management. On the other hand, a study by Angie et al. (2024) adds that institutional ownership can influence the relationship between tax avoidance and the cost of debt, where strong governance can reduce the risk perception from aggressive tax management activities. Overall, various studies agree that institutional ownership has a significant negative impact on the cost of debt, with effective oversight and improved governance being the main mechanisms. Based on the literature review above, it can be concluded that tax avoidance has a significant influence on the cost of debt. Therefore, the hypothesis proposed in this study is as follows:

Hypothesis 6 (H6): Institutional ownership has a negative impact on the cost of debt

2.7 Government Ownership and Cost of Debt

According to Borisova and Megginson (2011), the higher the proportion of government ownership, the lower the cost of debt incurred by the company. This is due to the implicit guarantee from the government, providing a sense of security to creditors regarding the company's ability to meet its debt obligations. With government involvement, the risk of default is considered lower as there is an expectation that the government will intervene if the company faces financial difficulties. However, the same study also found that fully privatized companies have lower debt costs compared to those that are only partially privatized. Better operational efficiency, improved company performance, and reduced conflicts between bondholders and shareholders after full privatization are the main factors driving the reduction in debt costs. Conversely, a prolonged and gradual privatization process can increase uncertainty among investors, ultimately leading to higher debt costs during the transition period. Thus, the relationship between government ownership and debt costs is non-linear, where debt costs decrease with high government ownership, increase during partial privatization, and decrease again after the company is fully privatized. Similarly, Le (2020) in his research in Vietnam found that companies with high levels of government ownership, especially state-owned enterprises (SOEs) with government ownership of 50% or more, tend to enjoy lower debt costs compared to private companies. This is due to political connections and access to more favorable financing terms from state-owned banks, as well as lower perceived risk among creditors. The implicit guarantee from government ownership mitigates creditors' concerns about default risk, allowing companies to obtain funding at lower costs. Furthermore, the research also shows that companies that no longer have government ownership after full privatization tend to experience an increase in debt costs. This highlights the importance of government affiliation in maintaining low debt

costs, especially in transitional economies like Vietnam. Overall, the literature indicates that government ownership significantly influences debt costs, with benefits stemming from implicit guarantees, political connections, and access to more stable funding sources. However, this relationship is complex and can be influenced by the stage of privatization and the broader economic context. Therefore, the hypothesis proposed in this study is as follows:

Hypothesis 7 (H7): Government ownership has a negative impact on the cost of debt

2.8 Managerial Ownership and Cost of Debt

Managerial ownership reflects the extent to which a company's management team holds its shares. Theoretically, this ownership structure can mitigate agency problems by aligning managers' interests with those of shareholders. However, empirical findings on its impact on the cost of debt (COD) vary. For example, Alhady and Risanty (2023) concluded that managerial ownership has an insignificant positive effect on COD in healthcare companies listed on the IDX during 2017–2021. Their study suggests that the low proportion of managerial ownership in these companies fails to significantly influence creditors' risk assessments. As a result, managerial ownership does not contribute to lower borrowing costs. This finding highlights that creditors may focus more on other corporate governance mechanisms or financial metrics when assessing the risk and pricing debt for companies.

Hypothesis 8 (H8): Managerial ownership has a positive impact on the cost of debt

2.9 Theoretical Framework

2.9.1 Agency Theory

Agency theory is a theory that discusses the relationship between principals (owners) and agents (managers) in a business context. This theory arises from the recognition that there is a potential conflict of interest between principals and agents, where agents may not always act in the best interests of the principals. This issue is often caused by differences in information and incentives between the two parties.

Agency theory emphasizes the importance of control mechanisms, such as contracts and incentives, to align the interests of principals and agents. By creating the right incentive structures, companies can encourage agents to act in the best interests of the principals. This is important to ensure that the decisions made by managers align with the company's goals and the interests of other stakeholders by creating mechanism to align them (Jensen et al., 1976).

2.9.2 Signalling Theory

Signaling theory is a concept that explains how individuals or organizations communicate information to others, especially when there is an information asymmetry between the parties (Connelly et al., 2011). This theory posits that when one party (the signaler) has more information than the other party (the receiver), the signaler can provide signals or messages to reduce this information gap. These signals are often used to convey credibility, competence, or intentions, particularly in contexts where trust is crucial, such as in business, recruitment, or investment decision-making.

According to signaling theory, the signaler provides signals about their quality or intentions by performing observable actions, which are then interpreted by the receiver as reliable information (Connelly et al., 2024). These signals must have a cost or be difficult to fake, thereby making them more trustworthy in conveying honest information. For example, a company might signal its future prospects by announcing dividends or making public announcements, which investors then interpret as signs of stability and strong performance. Signaling theory suggests that in situations where there is an information imbalance, the signaler engages in actions or sends signals to convey important information to the receiver, and these signals need to be trustworthy (Choudhury, 2024).

3.0 METHODOLOGY

This study focuses on manufacturing sector companies listed on the Indonesia Stock Exchange (IDX) during the period from 2020 to 2023. The research object included sectors in category of: basic materials (B), industrials (C), consumers non-cyclical (D), consumers cyclical (E), and healthcare (E) by excluding sub sectors category of retailing, services, media and entertainment. Initially, it is identified a total of 313 companies listed on the IDX. The companies included in the sample were selected because they meet the following criteria: 1. Availability of financial statements in the public domain, 2. Use of rupiah as the reporting currency, 3. Disclosure of interest data related to financial liabilities, 4. Having long-term debt, and 5. The tax avoidance score calculation value is between 0 and 1. Thus, our final sample consisted of 60 companies of 180 data number that met all the established selection criteria.

Model Specification

This study aims to examine the influence of tax avoidance, tax risk, firm size, profitability, foreign ownership, institutional ownership, government ownership, and managerial ownership on the cost of debt. In addition, dividend policy, liquidity, and market-to-book ratio are used as control variables to ensure the robustness of the model. The empirical model used in this study is formulated as follows:

$$COD_{it} = \alpha + \beta_1 TAX_AVOID_{it} + \beta_2 TAX_RISK_{it} + \beta_3 SIZE_{it} + \beta_4 PROF_{it} + \beta_5 FOR_OWN_{it} + \beta_6 INST_OWN_{it} + \beta_7 GOV_OWN_{it} + \beta_8 MGR_OWN_{it} + \beta_9 DIV_POLICY_{it} + \beta_{10} LIQ_{it} + \beta_{11} MTB_{it} + \epsilon_{it}$$

Where:

COD_{it} = Cost of Debt of firm i in year t (dependent variable)

TAX_AVOID_{it} = Tax Avoidance of firm i in year t

TAX_RISK_{it} = Tax Risk of firm i in year t

$SIZE_{it}$ = Firm Size of firm i in year t

$PROF_{it}$ = Profitability of firm i in year t

FOR_OWN_{it} = Foreign Ownership of firm i in year t

$INST_OWN_{it}$ = Institutional Ownership of firm i in year t

GOV_OWN_{it} = Government Ownership of firm i in year t

MGR_OWN_{it} = Managerial Ownership of firm i in year t

DIV_POLICY_{it} = Dividend Policy of firm i in year t (control variable)

LIQ_{it} = Liquidity of firm i in year t (control variable)

MTB_{it} = Market-to-Book Ratio of firm i in year t (control variable)

ϵ_{it} = Error term

TABLE 1 Operational Description, Measurements and Sources

Variable	Symbol	Type	Measurement	Sources
Cost of Debt	COD	Dependent	COD is measured as the ratio of total interest expenses for the year to the average of short-term and long-term debt, multiplied by 100	Bacha et al. (2021)
Tax Avoidance	TAX_AVOID	Independent	Tax avoidance is measured using the Effective Tax Rate (ETR), calculated by dividing the total tax expense by pre-tax income	Angie et al. (2024)
Tax Risk	TAX_RISK	Independent	Tax risk is measured using the standard deviation of the Cash Effective Tax Rate (CETR) over a three-year period. CETR for a specific year (t) is calculated as the total cash taxes paid divided by pre-tax income for that year	Angie et al. (2024)
Firm Size	FSIZE	Independent	Firm size is measured as the natural logarithm of total assets	Orazalin and Akhmetzhanov (2019)

Profitability	PROF	Independent	Profitability is measured using Return on Assets (ROA), calculated as net income divided by total assets, multiplied by 100	Bacha et al. (2021)
Foreign Ownership	FOR_OWN	Independent	Foreign ownership is measured as a dummy variable, which is 1 for the existence of foreign ownership and 0 for no existence of foreign ownership	Van Vu Thi Thuy et al. (2022)
Institutional Ownership	INST_OWN	Independent	Institutional ownership is commonly measured as the ratio of shares held by institutional investors to total outstanding shares	Dhoraisingam Samuel et al. (2022)
Government Ownership	GOV_OWN	Independent	Government ownership is measured as a dummy variable, which is 1 if shares are held by government institutions and 0 otherwise	Dhoraisingam Samuel et al. (2022)
Managerial Ownership	MGR_OWN	Independent	Managerial ownership is measured as a dummy variable, which is 1 if one or more directors hold shares and 0 otherwise	Dhoraisingam Samuel et al. (2022)
Dividend Policy	DIV_POLICY	Control	Dividend policy is measured using a dummy variable, where the value is 1 if the company pays dividends and 0 otherwise	Bacha et al. (2021)
Liquidity	LIQ	Control	Liquidity is measured by dividing current assets by current liabilities	Orazalin and Akhmetzhanov (2019)
Market to Book Ratio	MTB	Control	MTB is calculated by dividing the company's market capitalization by its total book value	Bacha et al. (2021)

4.0 RESULT AND DISCUSSION

The descriptive statistical test provides the minimum, maximum, mean, and standard deviation values for each variable analysed in the study. The test was performed using a total sample of 180 companies' data. The detailed results are presented in the table below:

TABLE 2 Descriptive Statistic Result

Variable	N	Minimum	Freq	Maximum	Freq	Mean	Std. Deviation
Dependent							
COD	180	1.177		19.186		6.857	2.525
Independent							
TAX_AVOID	180	0.008		0.725		0.241	0.106
TAX_RISK	180	0.003		5.480		0.314	0.671
FSIZE	180	26.639		32.860		29.212	1.510
PROF	180	-0.152		0.412		0.066	0.072
FOR_OWN	180	0.000	125	1.000	55	0.305	0.462
INST_OWN	180	0.019		0.997		0.664	0.205
GOV_OWN	180	0.000	164	1.000	16	0.088	0.285
MGR_OWN	180	0.000	62	1.000	118	0.655	0.476
Control							
DIV_POLICY	180	0.000	46	1.000	134	0.744	0.437
LIQ	180	0.085		14.207		2.319	2.055
MTB	180	-0.054		6.509		1.627	1.359

In general, the companies in the sample are manufacturing sector companies (non-services) that have long-term debt. During the observation period, there were companies that incurred losses and generated profits, and more companies paid dividends (74%) compared to those that did not pay dividends. Only 30% of companies have foreign ownership, and 65% have managerial ownership, although with relatively low managerial ownership composition. Institutional ownership composition on average dominates ownership within the company (66%), and government ownership is only 8.8% of the total companies in the sample.

When only considering the R² value in a model, an increase in the R² value indicates that the independent variables included in the model are capable of explaining the variation that occurs in the dependent variable. The coefficient of determination (R²) for Model 1 is 0.016, In Model 2, R² increases to 0.103, R² in Model 3 rises to 0.109, and Model 4 has the highest R² at 0.200. The same is confirmed by the adjusted R² value. Started by model 1, the Adj R² value of 0.005 indicates that this model has a very low ability to explain the relationship between variables. Then, the Adj R² value of 0.067 of model 2 shows that this model has an improved ability to explain the relationship between variables compared to Model 1. The Adj R² value of 0.078 of

model 3 indicates that this model has a better explanatory ability compared to Model 2. Finally, for model 4, the Adj R² value of 0.148 indicates that this model has a better explanatory ability compared to the other models and conforming that each independent variables that inserted into the model may have explanation power for the variation of dependent variable. Having sig F test for model 2, model 3 and model 4 that is below 0,01 confirm also that the model is fit.

TABLE 3 Multiple Regression Test Result

Variable	Model1		Model2		Model3		Model4	
	β	Sig.	β	Sig.	β	Sig.	β	Sig.
Independent								
TAX_AVOID	-2.782	0.120	-3.856	0.034**	-3.358	0.055***	-4.886	0.006*
TAX_RISK	0.222	0.431	-0.221	0.473	0.049	0.862	-0.470	0.122
FSIZE			-0.274	0.043**			-0.229	0.089***
PROF			-8.732	0.004*			-10.144	0.001*
FOR_OWN					-1.074	0.011**	-0.882	0.043**
INST_OWN					-1.410	0.124	-1.951	0.038**
GOV_OWN					0.675	0.317	0.776	0.241
MGR_OWN					0.565	0.155	0.727	0.069***
Control								
DIV_POLIC			0.058	0.907			-0.068	0.894
Y								
LIQ			-0.035	0.710			-0.037	0.678
MTB			0.188	0.194			0.195	0.159
N		180		180		180		180
R2		0.017		0.094		0.110		0.197
AdjR2		0.006		0.057		0.079		0.144
SigFTest		0.226		0.016		0.002		0.000

Dependent Variable: Cost of Debt

*Sig < 0,01; **Sig < 0,05; ***Sig < 0,10

The t-test results show that the tax avoidance variable yields varying outcomes across different models. In Model 1, the significance value (sig.) of 0.120 is greater than 0.05, indicating that there is no significant effect of tax avoidance on the cost of debt. However, in Models 2, 3, and

4, the sig. values of 0.034, 0.055, and 0.006, respectively, indicate significant results at certain confidence levels. The sig. value of 0.034 in Model 2 is significant at the 5% level (< 0.05), the sig. value of 0.055 in Model 3 is significant at the 10% level (< 0.10), while the sig. value of 0.006 in Model 4 is significant at the 1% level (< 0.01). This indicates that tax avoidance strategies indicating the risk exposure effect to lenders, supporting hypothesis H1 in Models 2, 3, and 4.

This positive effect is supported by the views of Guedrib and Hamdi (2024), when tax avoidance is perceived as high risk, it positively influences the cost of debt. Another explanation of the positive effect is tax-avoiding firms pay higher costs of debt due to information asymmetries and agency problems (Medhioub & Boujelbene, 2024). Empirically, the result does not support the idea that tax avoidance can enhance a company's cash flow, thereby reducing risk and debt costs. This result does not align with the finding of Kovermann (2018), who explains that tax avoidance strategies may increase cash flow stability, attracting creditor interest with lower interest rates. The idea of risk exposure results is not supported by the findings of Goh et al. (2016) and Bergner et al. (2017), who note that transparent and straightforward tax avoidance strategies can boost creditor confidence and lower the perceived risk of company debt.

The t-test results show that the tax risk variable does not have a significant impact on the cost of debt in Models 1, 2, 3, and 4, with significance values (sig.) of 0.431, 0.473, 0.862, and 0.122, respectively, all of which are greater than 0.10. This indicates that there is no evidence supporting a significant influence of tax risk on the cost of debt in these four models. This result does not support hypothesis H2, which states that tax risk has a positive influence on the cost of debt. This explanation is not in line with the findings of Ayu et al. (2024), who found that companies with higher tax risks tend to face higher debt costs due to creditors' perception of the uncertainty posed by such tax risks. It seems that lenders adjust their interest rates to compensate for the uncertainty, resulting in lower debt costs for the company. Angie et al. (2024) revealed that tax risk increases the monitoring costs incurred by creditors, which ultimately affects the overall cost of debt. However, the result of this research presents the opposite finding, indicating that higher tax risk is associated with a lower cost of debt. This result requires further discussion.

The t-test results indicate that the firm size variable has a significance value (sig.) of 0.043 in Model 2 and 0.089 in Model 4, showing significant results at the 5% (< 0.05) and 10% (< 0.10) confidence levels, respectively. However, the negative β coefficient suggests that firm size negatively affects the cost of debt (COD), which differs from the initial hypothesis stating that firm size has no significant impact on COD. These results imply that the larger the firm, the lower the cost of debt tends to be.

This can be explained by several factors. First, larger firms typically have more resources to enhance transparency and reputation in the capital markets, thereby reducing the risk perceived by creditors. Second, larger companies often have easier access to financing at lower interest rates, particularly in more developed capital markets. Consequently, this negative influence reflects the economies of scale that larger companies benefit from in obtaining cheaper financing. However, these results differ from previous research, such as Utami (2021) and Gea and Johan (2021), which stated that the relationship between firm size and COD is often not significant due to more determining factors such as market conditions, capital structure, and risk management. The negative results in this study indicate that firm size remains an important indicator in reducing creditors' risk perception, thereby resulting in lower debt costs.

The t-test results indicate that the profitability variable has a significance value (sig.) of 0.004 in Model 2 and 0.001 in Model 4, which are significant at the 1% confidence level (< 0.01). The negative β coefficient value shows that profitability negatively affects the cost of debt (COD). These results support the hypothesis that the higher the company's profitability, the lower the debt costs it must bear. High profitability reflects the company's ability to generate stable and sufficient income to meet its financial obligations. As a result, creditors view highly profitable companies as low-risk entities and tend to offer loans with lower interest costs. This finding is consistent with the research by Dhiva and Gunawan (2023), who state that high profitability enhances creditors' perception of the company's credibility, thereby reducing the cost of debt (COD). Additionally, Angie et al. (2024) highlight that companies with good profitability often rely more on internal funding, such as retained earnings, thus reducing dependence on external debt. Therefore, the results of this study underscore the importance of profitability as a key indicator in maintaining financial stability and obtaining cheaper financing.

The t-test results indicate that the foreign ownership variable has a significance value (sig.) of 0.011 in Model 3 and 0.043 in Model 4, which are significant at the 5% confidence level (< 0.05) in both cases. The negative β coefficient value shows that foreign ownership negatively affects the cost of debt. These results support the hypothesis that higher foreign ownership can reduce the company's debt costs. Foreign ownership is often associated with increased transparency, better corporate governance, and reduced information asymmetry between the company and creditors. As a result, creditors have higher confidence in companies with significant foreign ownership, thereby lowering perceived risk and ultimately offering lower loan interest rates.

The data processing results show that the effect of tax avoidance is consistent across the four models. The positive effect of tax avoidance indicates that lenders view this action as risky, potentially leading to government audits. Therefore, the higher the tax avoidance, the higher the cost of debt imposed. In contrast, tax risk only shows its effect when included in the complete

model, where profitability, size, foreign ownership, institutional ownership, managerial ownership, and market-to-book ratio also influence the cost of debt.

The companies studied are those manufacturing companies that pay dividends, although not always consecutively. This indicates that the companies included in the sample have the ability to pay cash compensation to shareholders through their cash holdings and profits, enabling them to generate cash. Additionally, the context to consider in this study is the research period, which shows the negative impact of COVID-19 on the sustainability of companies, affecting their profits and taxes, which are calculated based on the profits generated.

To understand the impact of tax risk, a comprehensive analysis is needed. Control by institutional and foreign shareholders can provide confidence to lenders, resulting in a lower cost of debt. However, managerial ownership does not provide the same assurance, as companies are perceived to prioritize managers' interests over the company's. Another risk factor that leads to a higher cost of debt is the market-to-book ratio. The riskier the company is perceived by the market, the higher the cost of debt imposed by lenders. Therefore, the positive effect of tax risk can be explained by lenders' fair assessment of the risks faced by debtor companies. Lenders in this study show that greater risk demands higher compensation due to the increased risk to the company's sustainability.

If the effect of tax risk on the cost of debt is positive, meaning higher tax risk (i.e., higher volatility in tax payments to the government) results in a lower cost of debt. Tax risk measured by the stability of tax payments needs to be understood in the context of the impact of COVID-19 and the company's awareness that untimely tax avoidance will increase risk for the company. Therefore, the instability of tax payments should be interpreted as the company choosing the right time to engage in tax avoidance practices. If tax avoidance practices are not carried out appropriately, the company will make proper tax payments to avoid tax issues. Creditors seem to understand that companies capable of timing their tax avoidance practices correctly reduce company risk, leading creditors to impose a lower cost of debt. In this case, creditors still consider the risk of tax avoidance practices by the company. Companies that engage in risky tax avoidance will be subject to higher cost of debt.

This is also true in the context of the COVID-19 impact, which causes unstable but still profitable company earnings. The high or low volatility in tax payments is not due to tax avoidance intentions but reflects the reality of companies facing the COVID-19 impact during the research period, striving to survive and grow in difficult times compared to companies that are relatively resigned to the situation. In this context, stable tax payments are not due to the ability to generate stable profits but rather due to the inability to increase profits or the presence

of low, stable profits due to the COVID-19 impact. Therefore, higher tax risk, indicating a company's effort to overcome the negative impact of COVID-19 despite instability, is rewarded with a relatively lower cost of debt compared to companies struggling to recover from the COVID-19 impact, which, although stable, have low profitability and are burdened with a relatively high cost of debt.

Overall, model 4 shows that understanding the influence of tax avoidance and tax risk needs to include operational factors and corporate governance control in the model. By incorporating other variables, it can be concluded that the risk perception understood by creditors heavily considers the company's ability to generate profits. Companies that can generate profits provide a low-risk perception for creditors. Similarly, larger companies also receive a lower risk perception from creditors. The more experienced a company is in producing good operational performance, the lower the risk perception for creditors, allowing creditors to offer a lower cost of debt for such companies.

On the other hand, control exerted by institutional ownership and foreign ownership provides higher trust for creditors compared to managerial ownership, which is risky due to agency problems. Therefore, higher institutional and foreign ownership gives creditors higher confidence in imposing a lower cost of debt.

5. CONCLUSION

The results show that several factors have a significant influence on COD, with significant impacts demonstrated by tax avoidance, firm size, profitability, foreign ownership, and institutional ownership, while other factors such as tax risk, government ownership, and managerial ownership show weaker or insignificant effects.

Tax avoidance strategies are found to significantly increase debt costs. These results confirm that tax avoidance practice increase the risk exposure perceived by lenders. However, tax risk though only has a significant impact in one complete model, should be interpreted in line with profitability variable. It is volatile tax payment because of volatility in profitability that perceive low tax risk that bring lower cost of debt by creditors. Tax avoidance needs to be aligned with profitability to avoid tax risks for the company. Timely tax avoidance, although causing instability in tax payments, is perceived positively by creditors with a lower cost of debt.

Firm size shows a negative influence on debt costs, contrary to some previous studies that indicate larger firms tend to obtain lower interest rates due to greater stability, better market access, and lower perceived risk by creditors. Profitability consistently reduces debt costs in several models, supporting the view that highly profitable companies, as low-risk entities, are

rewarded with cheaper financing options. These findings are consistent with existing literature, which emphasizes the importance of internal cash flows and financial strength in obtaining lower-cost debt.

Ownership structure also plays a significant role in determining debt costs. Both foreign ownership and institutional ownership have significant negative effects, indicating that these types of ownership enhance transparency and corporate governance, reduce perceived risk by creditors, and thereby lower debt costs. On the other hand, government ownership and managerial ownership do not show significant effects, indicating that the governance benefits from government ownership are not substantial enough or that managerial ownership can lead to riskier decision-making, thereby increasing perceived risk by creditors.

Overall, the findings of this study highlight the importance of conservative strategic tax management, strong financial health, and robust corporate governance mechanisms in reducing debt costs. This study also calls for further research to explore contextual factors that may influence these dynamics, particularly in diverse macroeconomic and industry settings.

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