

The Influence of The Covid-19 Pandemic on Tax Avoidance

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Abstract

The Covid-19 pandemic contributes to the slowdown of Indonesia's economy; therefore, the government provides tax incentives to particular sectors during this pandemic. This research seeks to investigate the influences of the Covid-19 pandemic and tax incentives on tax avoidance. This research uses Multiple Regression Analysis to process research data of firms from consumer financing institutions, insurance firms, and banks listed on the Indonesia Stock Exchange (IDX). We generate the data from IDX's and firms' official websites. This research documents that the Covid-19 pandemic has a significant relationship with tax avoidance, and firms receiving tax incentives during the Covid-19 pandemic are less likely to avoid taxes. In conclusion, during the Covid-19 pandemic, firms tend to avoid taxes to reduce losses and avoid bankruptcy. However, tax incentives given by the government demotivate firms to avoid taxes.

Keywords: Covid-19 Pandemic, Tax Incentives, Tax Avoidance

Pengaruh Pandemi Covid-19 Terhadap Penghindaran Pajak

Abstrak

Pandemi Covid-19 berkontribusi pada kejatuhan ekonomi Indonesia. Oleh karena itu, pemerintah memberikan insentif pajak untuk beberapa sektor perusahaan selama kondisi pandemi ini. Penelitian ini bertujuan untuk menginvestigasi pengaruh pandemi Covid-19 terhadap penghindaran pajak serta efek dari insentif pajak yang diberikan selama pandemic Covid-19 terhadap penghindaran pajak. Penelitian ini menggunakan analisis regresi berganda untuk memproses data perusahaan pembiayaan konsumen, perusahaan asuransi, dan bank yang diambil dari laman Bursa Efek Indonesia (BEI) dan laman perusahaan. Penelitian ini menemukan bahwa pandemi Covid-19 mempunyai hubungan signifikan terhadap penghindaran pajak, dan perusahaan yang mendapat insentif pajak selama pandemi cenderung tidak melakukan penghindaran pajak. Kesimpulannya, selama pandemi Covid-19, perusahaan dapat melakukan penghindaran pajak untuk mengurangi kerugian dan menghindari kebangkrutan. Tetapi, insentif pajak yang diberikan oleh pemerintah menghindarkan perusahaan dari penghindaran pajak.

Kata kunci: Pandemi Covid-19, Insentif Pajak, Penghindaran Pajak

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INTRODUCTION

The Covid-19 pandemic started to emerge in Indonesia in March 2020. The pandemic drastically reduces firms' revenues and productivity due to social restrictions to control the pandemic. Nasution, Erlina, & Muda (2020) argue that the global economic slowdown due to the pandemic heavily affects Indonesian economic growth. The Covid-19 pandemic affects not only Indonesia's export and import but also its trade sector, as indicated by declining tax revenues (Nasution et al., 2020). Declining tax revenues

arguably cause a serious problem for the Indonesian economy since tax contributes the most to the Indonesian budget revenues (Tandean & Winnie, 2016).

Tax avoidance is an effort to minimize tax expenses by exploiting applicable regulations (Tandean, 2016). According to Foroughi and Mohammadi in Gandoman (2019), firms' managers and shareholders are motivated to avoid taxes because paying taxes reduces after-tax earnings. Gandoman (2019) explains that financial crisis is significantly associated with corporate tax avoidance. Moreover, Maulani, Norisanti, & Sunarya (2021) suggest that Covid-19 reduces tax revenues. Therefore, firms are more likely to avoid taxes to preserve their earnings during the Covid-19 pandemic.

The Covid-19 pandemic greatly affects the Indonesian economy (Devi et al., 2020). Statistics Indonesia (2021) indicates that Indonesia's constant Gross Domestic Product (GDP) in 2020 was 15.434,2 trillion rupiahs, implying that Indonesia has experienced declining GDP growth during the Covid-19 pandemic. Devi et al. (2020) document that publicly listed firms exhibit lower liquidity and profitability ratios during the Covid-19 pandemic. Firms exhibiting declining performance belong to the property, real estate and building construction, trade, finance, services, and investment industries (Devi et al., 2020).

Although most firms have experienced declining productivity during the Covid-19 pandemic, some still manage to report positive earnings and pay taxes. Ha et al. (2017) observe that managers are more willing to engage in tax avoidance when their firms are financially distressed, and hence, firms are less motivated to pay taxes. Based on these arguments, the recent economic slowdown due to the Covid-19 pandemic likely affects tax avoidance. Therefore, we first predict that firms are motivated to avoid taxes to preserve their earnings levels.

The Indonesian government has launched tax incentives to help firms survive the Covid-19 pandemic. It is expected that firms can pay their tax obligations more robustly once the economy returns to normal levels (Indonesian Ministry of Finance, 2021). Moreover, Padyanoor (2020) indicates that governments use tax incentives to preserve their tax revenues and tax collection effectiveness during the pandemic. The Indonesian Ministry of Finance issues these new tax policies. The first version is the Ministry of Finance Regulation Number 23/PMK.03/2020 concerning Tax Incentives for Taxpayers Affected by the Covid-19 Pandemic that offers tax incentives for firms in certain manufacturing sectors.

The financial industry has also experienced declining liquidity and profitability during the Covid-19 pandemic (Devi et al., 2020). Ministry of Finance Regulation Number 9/PMK.03/2021 concerning Tax Incentives for The Taxpayers Affected by the Covid-19 Pandemic extends the previous list of industries entitled to receive tax incentives, including the financial industry (in particular customer financing institutions and insurance firms).

The Organization for Economic Cooperation and Development (OECD) informs that providing tax incentives during the Covid-19 pandemic is highly subject to misuse (MUC Consulting, 2020). According to Santoso (2020), firms may exploit tax incentives

to avoid taxes regardless of the Covid-19 pandemic. However, firms are less likely to avoid taxes when they are required to have online tax reporting and close cooperation with firms receiving tax incentives (Santoso, 2020). Based on these arguments, we predict that firms receiving tax incentives are less likely to engage in tax avoidance. Thus, this study then identifies whether firms belonging to the industries receiving tax incentives engage in less tax avoidance than those belonging to the industries that do not receive tax incentives.

Although the financial sector is heavily affected by the Covid-19 pandemic, not all financial firms receive tax incentives. Therefore, this research will investigate whether the Covid-19 pandemic influences tax avoidance behavior. Moreover, because not all subsectors in the financial sector receive tax incentives based on the Ministry of Finance Regulation Number 110/PMK.03/2020, this research will also test whether firms receiving tax incentives exhibit different tax avoidance behavior than those that do not receive the incentives. Our study contributes to the literature by empirically demonstrating tax avoidance behavior before and during the Covid-19 pandemic. This research also informs policymakers in evaluating the effectiveness of tax incentives in the Covid-19 pandemic era.

Covid-19 Pandemic and Tax Avoidance

The social restrictions due to the Covid-19 pandemic negatively affect firm performance. Shen et al. (2020) document that the Covid-19 outbreak significantly harms listed Chinese firms' performance, like declining investments or total revenues. They also indicate that the pandemic negatively affects production, operation, and sales, resulting in negative return rates.

Moreover, lockdown highly affects real outputs and GDPs (Khurshid & Khan, 2021). The International Monetary Fund (2020) indicates that the world's 2020 real GDP growth was -4.4 percent. Khurshid & Khan (2021) also observe that the pandemic shock will decrease the GDP by 1.32% in 2021 and at an annual average of 1.25% in the next four years.

The global economic slowdown significantly influences Indonesia's economic growth due to the Covid-19 pandemic (Nasution et al., 2020). Nasution et al. (2020) explain that every 1% slowdown in China's economy will reduce Indonesia's economic growth by 0.09%. The Indonesian Central Statistics Agency declares that Indonesian economic growth contracted by 2.07% in 2020 (c-to-c) from last year. From the expenditure side, almost all firms have experienced contracted sales (Statistics Indonesia, 2021).

Tandean (2016) defines tax avoidance as minimizing tax expenses by using applicable regulations. Firms arguably seek to maximize profits and minimize tax payments without violating tax regulations (Tandean & Winnie, 2016). In this respect, reducing tax payments will increase after-tax earnings. Firms avoid taxes through one of three means: paying taxes lower than the legally required levels, paying taxes not in countries where profits are generated, and paying taxes much later than when profits are earned (Fisher in Chytis, Tasios, & Filis, 2020)

The recent economic crisis has harmed firm performance in Indonesia and worldwide (Devi et al., 2020). Consequently, firms are motivated to preserve their profitability. Yan & Li (2020). Managers manage their earnings during uncertain periods to reduce losses and avoid bankruptcy, including by avoiding taxes. Financially distressed firms continued to avoid taxes, albeit at lower levels, during the financial crisis (Ha et al., 2017). Moreover, the Indonesian government plans to reduce the income tax tariff to 20% in 2022. Thus, firms have the opportunity to minimize their earnings until the implementation of a 20% income tax tariff (Arief & Elena, 2021). Therefore, during the Covid-19 period, firms can avoid taxes to increase their earnings.

Richardson et al. (2015) explain that the global financial crisis increases the relationship between financial distress and tax avoidance. Gandoman (2019) also documents that the global financial crisis is significantly associated with tax avoidance. Because the Covid-19 pandemic also contributes to the global economic slowdown, we predict that the Covid-19 pandemic significantly affects tax avoidance.

H₁: The Covid-19 pandemic is significantly associated with tax avoidance.

Tax Avoidance between Firms Receiving and Not Receiving Tax Incentives

The new Ministry of Finance Regulation concerning tax incentives for the taxpayers affected by the Covid-19 pandemic does not provide tax incentives for all firms and sectors. The most recent regulation (Ministry of Finance Regulation Number 110/PMK.03/2020), especially article 25, only includes particular sectors (1.013 *KLU*), *KITE* taxpayer, and bonded zones, including the service, manufacturing, trading, and transportation industries (Tax Directorate General, 2020).

Article 25 of this ministry of finance regulation provides tax discounts to firms' monthly tax payments. However, the percentage of the deduction has been changed several times. Hence, the applied percentage on the latest ministry of finance regulation and the actual percentage of incentives used in 2020 likely differ. The exact percentage of tax incentives used in 2020 can be identified from the difference between total tax expense and cash tax paid.

Rombe, Rahardjo, & Hartanto (2017) argue that tax incentives (income tax rate reduction) motivate firms to avoid taxes because firms still aim to minimize their tax expenses (Rombe et al., 2017). However, tax avoidance must be prevented because the government initiates tax incentives to stabilize the economy.

Santoso (2020) reveals that the government assures that account representatives' knowledge about taxpayers' backgrounds applying for tax incentives enables them to take corrective steps if taxpayers misuse the incentives. Furthermore, Darussalam indicates that tax incentives misuse can be anticipated through the online submission and reporting and controlling through cooperation with other activity management-related parties that receive incentives (Santoso, 2020). The arguments motivate us to predict that firms belonging to the sectors that receive tax incentives are less likely to avoid taxes.

H₂: Firms receiving tax incentives are less likely to avoid taxes.

METHOD

This quantitative research uses secondary data from firms' financial statements on the Indonesian Stock Exchange (IDX) and firms' official websites. Our population is all listed firms in three subsectors in the financial industry in 2019-2020: consumer financing institutions, insurance, and banks. The first two subsectors receive tax incentives up to 25% of income tax, while banks do not receive the incentives. Samples are selected using the purposive sampling technique with the following criteria: 1) listed firms in the observation years (2019-2020), and 2) firms generating profits during the observation years.

Our dependent variable is tax avoidance. Rombe et al. (2017) argue that tax incentives only affect total tax expenses, not current ones. Graham et al. in Chytis et al. (2020) indicate that managers emphasize the GAAP ETR and cash tax expenses. Therefore, this study measures tax avoidance using the GAAP effective tax rate (GAAP ETR). The GAAP ETR is calculated by comparing the total tax expense with earnings before tax.

$$\text{GAAPETR} = \frac{\text{Total Tax Expense}}{\text{Earning before Tax}}$$

The independent variable for the first hypothesis is the Covid-19 pandemic. To formally test the impact of the Covid-19 pandemic on tax avoidance, this study operationalizes the variable with a dummy indicator (C19) that equals one if the observation year is 2020 (the pandemic year) and zero otherwise.

The independent variable of the second hypothesis is tax incentives. To analyze different tax behaviors between firms receiving and not receiving tax incentives, this study uses a dummy variable (ICT) that equals one if the firm receives tax incentives and zero otherwise.

Our control variables are firm age (FAGE) and firm size (SIZE). FAGE is operationalized by deducting the observation year with the firm's establishment year. FAGE arguably indicates firms' experiences in reducing tax expenses (Sadjiarto et al., 2020). SIZE measures the firm's total assets, and we proxy SIZE with the logarithm of total assets. Larger firms are more likely to avoid taxes (Tandean & Winnie, 2016).

We test the hypotheses using multiple regression analysis to identify the relationship between one dependent variable and many independent variables. The following is the multiple regression formula to test our first hypothesis:

$$TA_i = \alpha + \beta_1 C19_i + \beta_2 FAGE_i + \beta_3 SIZE_i + e_i$$

While the following empirically test the second hypothesis:

$$TA_i = \alpha + \beta_1 ICT_i + \beta_2 FAGE_i + \beta_3 SIZE_i + e_i$$

Where:

TA = tax avoidance (operationalized by GAAPETR)

- i = company
- α = constant
- C19 = dummy variable (equals one if the observation is during the Covid-19 pandemic, zero otherwise)
- ICT = dummy variable (equals one if the firm receives tax incentives, zero otherwise)
- FAGE = firm age
- SIZE = firm size
- e = the error term

FINDING AND DISCUSSION

Our samples are customer financing institutions, insurance, and banks listed on the Indonesia Stock Exchange (IDX) in 2019-2020. They are selected using the purposive sampling method, as illustrated in Table 1 below.

Table 1. *Research Sample*

Explanation	2019	2020
Financial institution companies listed on IDX 2019-2020	17	16
Insurance companies listed on IDX 2019-2020	17	17
Bank listed on IDX 2019-2020	45	46
Newly Listed Firms	2	2
Delisted Firms	2	0
Total Available Firms	75	77
Number of Sample Firms	40	
Number of 2019-2020 Samples	80	
Outlier Data	10	
End Samples	70	

Table 2 presents the descriptive statistics of our research variables, consisting of the minimum, maximum, mean, and standard deviation values.

Table 2. *Descriptive Statistics*

	N	Minimum	Maximum	Mean	Std. Deviation
TA	70	.07	.39	.24	.08
FAGE	70	21	74	43.73	15.02
SIZE	70	11.83	21.08	16.56	2.20
C19	70	0	1	.47	.503
ICT	70	0	1	.24	.432

Table 2 shows the descriptive statistics of the research variables. Tax avoidance (as operationalized by GAAPTER) has a mean (standard deviation) value of 0.24 (0.08), implying that the data is not biased because the mean value is higher than the standard deviation. Asuransi Multi Artha Guna Tbk. and Maskapai Reasuransi Indonesia Tbk. in 2019 have the minimum value of tax avoidance of 0.07, while Bank BRI Syariah

Indonesia Tbk., Bank Mayapada Internasional Tbk., and Tifa Finance Tbk. in 2020 have the maximum value of tax avoidance of 0.39.

The mean (standard deviation) value of the firm age variable (FAGE) is 43.73 (15.02). The mean is higher than the standard deviation, indicating that the data distribution is not biased. Bank Mandiri (Persero) Tbk. in 2019 has a minimum value of FAGE of 21, while Bank Negara Indonesia (Persero) Tbk. in 2020 has a maximum value of 74. The mean (standard) value of the firm size variable (SIZE) is 16.56 (2.20). The mean is higher than the standard deviation, implying that the data distribution is not biased. Fuji Finance Indonesia Tbk. in 2019 has a minimum SIZE value of 11.83, and Bank Mandiri (Persero) Tbk. in 2020 has a maximum size value of 21.08.

The C19 and ICT are the dummy variables. C19 (the proxy of the Covid-19 pandemic) has a mean (standard deviation) value of 0.47 (0.503). The ICT dummy variable (a proxy of firms receiving incentives in the Covid-19 pandemic period) has a mean (standard deviation) value of 0.49 (0.503).

Classical Assumption Test

Before running the regression equations, we run the classical assumption test, consisting of the normality, heteroscedasticity, multicollinearity, and autocorrelation tests. We run the tests based on the regression models with the first model consists of the C19 dummy variable, SIZE, and FAGE (70 samples), while regression model 2 uses the ICT dummy variable, SIZE, and FAGE (33 samples). Table 3 presents the summarized results of the classical assumption tests.

Table 3. Summarized Results of the Classic Assumption Tests

Model	Test	Critical Value	Test Result	Conclusion
1	Normality	K-S >0.05	0.200	Normal
	Heteroscedasticity	Glejser >0.05	Constant = 0.478 C19 = 0.151 FAGE = 0.384 SIZE = 0.367	No Heteroscedasticity
	Multicollinearity	Variance Inflation Factor <10	C19 = 1.002 FAGE = 1.178 SIZE = 1.180	No Multicollinearity
	Auto-correlation	Durbin Watson 1.7028 - 2.2972	1.963	No Auto-correlation
2	Normality	K-S >0.05	0.200	Normal
	Heteroscedasticity	Glejser >0.05	Constant = 0.784 C19 = 0.541 FAGE = 0.551 SIZE = 0.966	No Heteroscedasticity
	Multicollinearity	Variance Inflation Factor <10	C19 = 1.152 FAGE = 1.982 SIZE = 1.825	No Multicollinearity
	Auto-correlation	Durbin Watson 1.6511 - 2.3489	1.750	No Auto-correlation

Hypothesis Testing

The data for the first model is Lag Dat using the Cochrane-Orcutt method to mitigate the autocorrelation problem. Meanwhile, the data for the second model regression is normal. Table 4 demonstrates the results of the multiple regression analyses. Therefore, the equation for regression model 1 is:

Table 4. *Result of Multiple Regression Analyses for Models 1 and 2*

Model 1				Model 2			
Variable	B	t	Sig.	Variable	B	t	Sig.
Constant	0.036	0.727	0.470	Constant	0.293	1.988	0.056
Lag_C19	0.021	1.744	0.086*	ICT	-0.085	-2.355	0.025**
Lag_FAGE	-0.001	-2.035	0.046**	FAGE	-0.002	-1.949	0.061*
Lag_SIZE	0.014	2.949	0.004***	SIZE	0.005	.589	0.561
R			0.408				0.574
Adjusted R Square			0.128				0.261
F			4.316				4.759
Sig.			0.008				0.008

* $\alpha = 10\%$, ** $\alpha = 5\%$, *** $\alpha = 1\%$

$$TA = 0.036 + 0.021C19 - 0.001FAGE + 0.014SIZE + e$$

Meanwhile, the equation for regression model 2 is:

$$TA = 0.293 - 0.085ICT - 0.002FAGE + 0.005SIZE + e$$

Result Interpretation

Regression Model 1

Table 4 Model 1 presents the influences of the Covid-19 pandemic, firm age, and firm size on tax avoidance. The coefficients of Covid-19 and firm size are positive, while the coefficient of firm age is negative. The constant value is 0.036, implying that the magnitude of tax avoidance is 0.036 even when all the independent variables are zero. The coefficient of the Covid-19 variable is 0.021, suggesting tax avoidance increases by 2.1% during the Covid-19 pandemic. Further, the coefficient of the firm age variable is -0.001, suggesting that tax avoidance decreases by 0.1% for an increase of firm age by one unit. Lastly, the coefficient of the firm size variable is 0.014, indicating that tax avoidance will increase by 1.4% when firm size increases by 1 unit.

Table 4 also informs that the adjusted R square value of Model 1 is 0.128. Hence, the independent variables explain 12.8% of the total variation of tax avoidance. The F value of model 1 is 4.316, with a significance of 0.008. Therefore, the independent variable and control variables affect tax avoidance simultaneously.

The significance value of the Covid-19 pandemic variable is 0.086 (lower than 0.1). Thus, the Covid-19 pandemic is significantly related to tax avoidance. Therefore, hypothesis 1 is supported. Furthermore, the significance value of FAGE and SIZE are 0.046 and 0.004 (lower than 0.05 and 0.01, respectively). Thus, firm age and firm size significantly affect tax avoidance.

Our results support Gandoman (2019) and Richardson et al. (2015) who document that the global financial crisis is significantly related to tax avoidance. Firms are more motivated to avoid taxes during the pandemic because Covid-19 diminishes their performance. Moreover, the Covid-19 pandemic increases business uncertainty. Hence, we find that firms likely avoid taxes to reduce potential losses and avoid bankruptcy driven by Covid-19-initiated uncertainty.

Moreover, Arief & Elena (2021) reveal that the income tax rate will reduce to 20% in 2022, thus motivating firms to shift their income in the Covid-19 pandemic years to subsequent years. Furthermore, such income shifting is legal (Arief & Elena, 2021). Therefore, firms are more likely to avoid taxes during the Covid-19 pandemic.

Regression Model 2

Table 4 Model 2 demonstrates the influences of tax incentives, firm age, and firm size on tax avoidance. The constant value of 0.293 indicates that the magnitude of tax avoidance is 0.293 even when all the independent variables are zero. The coefficient of the tax incentives variable is -0.085, implying tax incentives reduce tax avoidance by 8.5%. The coefficient of the firm age variable is -0.002, suggesting that tax avoidance will decrease by 0.02% if the firm age increases by 1 unit. The coefficient of the firm size variable is 0.005. Thus, tax avoidance will increase by 0.05% for a unit increase in firm size.

Further, the adjusted R square value is 0.261, implying that the independent variables explain 26.1% of the total variation of tax avoidance. The F value of model 2 is 4.759, with a significance of 0.008 (smaller than 0.05). Therefore, the independent variable and control variables affect tax avoidance simultaneously.

The significance value of tax incentives is 0.025 (lower than 0.05). Hence, tax incentives significantly reduce tax avoidance, supporting hypothesis 2, predicting that firms receiving tax incentives are less likely to avoid taxes. The significance value of FAGE is 0.061 (lower than 0.1), implying that firm age significantly affects tax avoidance at $\alpha = 10\%$. Thus, older firms are less likely to avoid taxes. Lastly, SIZE does not significantly affect tax avoidance (significance value of 0.561).

Our results are not in line with Rombe et al. (2017) who observe that firms receiving tax incentives continue to minimize their tax expenses. The findings support that firms are less willing to decrease their tax expenses when receiving tax incentives. Thus, the government's tax incentive program has already been well-implemented.

Tax incentives also discourage firms from avoiding taxes because of the government's preventive actions. The government does not take firms' tax returns at face value, and its account representatives must assess tax returns and make corrections when they indicate misappropriation (Santoso, 2020). Therefore, our results support the government's decision to provide tax incentives during the Covid-19 pandemic and its well-implemented actions to prevent misappropriation.

CONCLUSION

This study aims to analyze the effects of the Covid-19 pandemic and tax incentives on tax avoidance. The results demonstrate a significant relationship between the Covid-19 pandemic and tax avoidance. Firms are motivated to avoid taxes to reduce losses and bankruptcy due to greater Covid-19-initiated uncertainty. Further, we find that firms receiving tax incentives are less likely to avoid taxes likely because of effective tax incentive implementation and prevention of program misappropriation.

This research only uses firm age and firm size as the control variables, and these control variables only contribute to 12.8% in model 1 and 26.15 in model 2, respectively. Thus, we advise future studies to include other control variables. Furthermore, future studies can also add industries and observation periods in their analyses to understand the research issue better.

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