

The Impact of ESG Performance and Financial Constraint on Tax Avoidance: Evidence from ASEAN 5

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Abstract

Purposes: This study examines the relationship between ESG performance, financial constraints, and corporate tax avoidance. It investigates whether ESG performance reduces tax avoidance by promoting socially responsible practices and whether financial constraints lead to increased tax avoidance as a strategy to generate internal funds. Specifically, it seeks to assess how ESG practices and financial constraints influence tax avoidance behavior among publicly listed firms in ASEAN countries. Various determinants of tax avoidance have been identified in the literature; however, ESG performance and financial constraints have received less attention in association with tax avoidance from a regional perspective in a group of countries with similar yet diverse institutional contexts, such as ASEAN. It offers new insights into these relationships in a multi-country, emerging market setting.

Methods: Using an unbalanced panel dataset of 242 publicly listed companies in ASEAN-5 over the 2019–2023 period with generalized least squares (GLS) regression.

Findings: ESG performance is negatively associated with tax avoidance, as evidenced by higher Effective Tax Rate (ETR). Additionally, firms facing financial constraints exhibit a positive relationship with tax avoidance, leading to lower ETR. Financially constrained companies are hindered in accessing external funds, thus pursuing aggressive tax planning strategies to generate additional internal funds.

Novelty: This study contributes to the literature by extending the understanding of tax avoidance behavior in emerging markets and at a regional level. It provides empirical evidence from the ASEAN market, which has been underrepresented in prior studies.

Keywords: ASEAN, ESG, Financial Constraint, Tax Avoidance.

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INTRODUCTION

This study examines the impact of ESG performance and financial constraints on tax avoidance among ASEAN-listed firms. It investigates whether ESG performance reduces tax avoidance by promoting socially responsible practices and whether financial constraints lead to increased tax avoidance as a strategy to generate internal funds. Taxes are an important component

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of national fiscal revenue and play a key role in maintaining the national government's ability to manage the country and develop the social economy. However, tax payments increase cash outflows, motivating companies to avoid tax, which involves exploiting tax laws for unintended benefits (Prebble & Prebble, 2017). Tax avoidance is a rational business strategy that balances costs and benefits, often preferred under uncertainty (Xiang et al., 2023). It is a global issue with significant complexity and economic implications (Hanlon & Heitzman, 2010; OECD, 2013).

Studies suggest that corporate tax behavior is influenced by ethical beliefs and legal considerations, with potential links to CSR attitudes (Christensen & Murphy, 2004; Desai & Dharmapala, 2006). Growing attention to climate and environmental issues has spurred investments considering ESG factors (Hartzmark & Sussman, 2019). ESG emphasizes a company's business activities and strategic development, extending CSR (Jiang et al., 2024). It evaluates environmental, social, and governance practices, aligning with the United Nations' 2030 Agenda for Sustainable Development and the 17 SDGs. Demands for sustainable development and ESG commitments involve multidimensional and costly investments, affecting motivations for tax avoidance behavior (Ariff et al., 2024; Jiang et al., 2024). Adopting ESG principles can alter corporate strategies, prioritizing a balance between economic and social values. These changes have led to a reassessment of the determinants influencing corporate tax avoidance. Examining corporate tax avoidance behavior provides a more comprehensive understanding of the economic consequences of sustainability commitments through ESG practices. Therefore, further research on the relationship between ESG performance and tax avoidance is necessary (Hanlon & Heitzman, 2010).

While determinants of tax avoidance like corporate governance, CEO characteristics, debt, analyst coverage, internal information environment, and profitability have been widely studied (Armstrong et al., 2015; Baghdadi et al., 2022; Gallemore & Labro, 2015; Lanis & Richardson, 2011; Minnick & Noga, 2010), studies on the role of ESG reporting in tax avoidance remain limited (Du & Li, 2023). Few studies have examined the impact of a company's ESG performance on strategic decision-making, such as tax avoidance (Jiang et al., 2024). However, limited studies examine its relationship with corporate environmental and social responsibility (Abdelfattah & Aboud, 2020). Kovermann & Velte (2021) documented a bidirectional relationship between corporate taxes and ESG, but not specifically in terms of tax avoidance.

Corporate culture theory (Kreps, 1990) posits that a company's behavior is shaped by its cultural values. In this view, CSR engagement reflects a commitment to ethical practices and "doing the right thing" (Kreps, 1990). A culture emphasizing ethics and social responsibility leads to less aggressive tax avoidance (Hermalin, 2000; Murray, 1986). Firms with higher involvement in ESG are typically associated with lower tax avoidance (Yoon et al., 2021). From the perspective of capital structure trade-off theory (Kraus & Litzenberger, 1973), financially constrained firms, with limited access to debt or external financing, may be unable to utilize an optimal capital structure. Hence, these firms tend to prefer internally generated funds over external sources. Support a positive relationship between financial constraints and tax avoidance, as firms may use tax-saving strategies to preserve internal resources.

A financially constrained firm faces increased external financing costs or difficulties accessing external funds (Denis & Sibilkov, 2010; Whited & Wu, 2006). Managers often employ tax avoidance strategies to reduce corporate tax payments, as traditional funding sources like debt and equity become more expensive or inaccessible during financial constraints. Tax planning provides cash flow savings by reducing taxable income or increasing tax credits, serving as an alternative funding source (Edwards et al., 2016). Although extensive literature provides evidence on the influence of firm characteristics on tax planning strategies, little evidence shows how firm-specific incentives and the fundamental dynamics of their financial status may influence tax avoidance choices (Chen & Lai, 2012). Although financial constraints have been widely studied in the literature (Hadlock & Pierce, 2010; Kaplan & Zingales, 1997; Whited & Wu, 2006), studies

have explored the relationship between financial constraints and tax incentives (Albring et al., 2011; Dyreng & Markle, 2016; Edwards et al., 2016; Law & Mills, 2015) all within U.S. firms.

A few latterly published studies examining how ESG affects corporate tax avoidance have generally been single-country studies, such as China (Jiang et al., 2024), Korea (Yoon et al., 2021), Indonesia (Hidayat & Zuhroh, 2023), and France and the UK (Salhi et al., 2020), leaving regional analyses relatively neglected. This is particularly notable in the ASEAN region, which presents unique traits, such as a strong emphasis on ESG issues and a low tax-to-GDP ratio compared to developing Asia and OECD averages (Asakawa, 2024). ESG discussions in the ASEAN region are advancing, with Indonesia and Malaysia leading in climate-related taxonomies, positioning sustainability as a potential competitive advantage for ASEAN (Yifan, 2024). However, the ASEAN corporate tax rate declined from 25.1% in 2010 to 21.7% in 2020 (VEPR et al., 2020). Indonesia and the Philippines have significantly higher corporate tax gaps than the OECD average (VEPR et al., 2020), indicating weak tax enforcement despite increasing ESG awareness. Moreover, studies on the relationship between financial constraints and tax avoidance in the ASEAN setting have not received sufficient attention. Previous research by Albring et al. (2011), Dyreng & Markle (2016), Edwards et al. (2016), and Law & Mills (2015) examined financial constraints and tax incentives, all within U.S. firms. This underlines the need to investigate whether such contradictory patterns are also evident in ASEAN economies.

Corporate culture theory (Kreps, 1990) posits that a company's behavior is influenced by its cultural values, with a culture emphasizing ethics and social responsibility leading to less aggressive tax avoidance (Hermalin, 2000; Murray, 1986). CSR engagement reflects a commitment to ethical practices and "doing the right thing" (Kreps, 1990), and greater involvement in ESG typically correlates with lower tax avoidance (Yoon et al., 2021). Supporting perspectives from stakeholder theory explain this by suggesting that ESG and tax avoidance act as complements, with companies adopting a stakeholder-oriented approach, thus reducing tax avoidance (Lanis & Richardson, 2012). Kiesewetter and Manthey (2017) identified a negative relationship between social performance and tax avoidance across 20 European countries. Watson (2015) found that socially responsible U.S. firms are less likely to avoid taxes, similar to Hoi et al. (2013), Huseynov & Klamm (2012), López-González et al. (2019). In developing countries, Muller & Kolk (2015) found that Indian firms with better CSR reputations were less aggressive in tax avoidance, and similar results were found in studies of Chinese firms (Mao, 2019) and Nigerian firms (Mgbame et al., 2017).

Yoon et al. (2021) found a negative relationship between ESG performance and tax avoidance in Korean firms from 2011 to 2017, which is more evident in non-chaebol firms. Silvera et al. (2022) found a negative relationship between CSR and tax avoidance in 141 public companies in Indonesia. Jiang et al. (2024) examined non-financial firms listed on China's A-share market from 2009 to 2021, finding that ESG performance reduces tax avoidance. The effects of ESG performance include reducing financial constraints, improving internal controls, and strengthening external oversight. ESG performance mitigates agency costs by reducing information asymmetry through enhanced non-financial disclosures. Firms with higher agency costs benefit more from ESG mechanisms, which strengthen internal governance, reduce agency costs, and improve internal controls. These findings underscore the importance of ESG commitments in promoting better governance and discouraging opportunistic behaviors like tax avoidance.

Competing theory from risk management theory suggests that companies prioritize shareholders' interests, including reputation, and engage in more ESG activities to reduce reputational risk and enhance their image (Godfrey, 2005; Minor & Morgan, 2011). ESG and tax avoidance can act as substitutes driven by risk management practices (Davis et al., 2016), supporting a positive relationship between ESG performance and tax avoidance. Abdelfattah & Aboud (2020), Carroll & Joulfaian (2005), Davis et al. (2016), and Preuss (2010) show a positive association between ESG and tax avoidance. Lanis & Richardson (2012) also identified a positive link between CSR disclosure and tax aggressiveness, as did cross-country studies by Ortas &

Gallego-Álvarez (2020) and Ariff et al. (2024). Despite contrasting views, most studies suggest a negative association between ESG performance and tax avoidance (Chouaibi et al., 2022). According to corporate culture theory, companies with a culture emphasizing ethics and social responsibility tend to use less aggressive tax strategies.

H₁: ESG performance is negatively associated with tax avoidance

Tax avoidance is often associated with financial constraints, particularly in companies with poor governance (Bayar et al., 2018). Capital structure trade-off theory (Kraus & Litzenberger, 1973) explains that financially constrained firms (e.g., with limited access to debt or external financing) may not be able to utilize an optimal capital structure, so financially constrained firms prefer internally generated funds over external sources. Financially constrained firms use more aggressive tax avoidance strategies to generate cash flow for internal funds, as external financing is costly (Chen & Lai, 2012). Cumming & Nguyen (2024) showed that asset specificity impacts tax avoidance through financial constraints, with constrained firms showing lower tax rates. Edwards et al. (2016) found that these firms use more cash tax planning to improve cash flow and financial reporting while minimizing disruptions. They prioritize accumulating cash to compensate for limited external financing and focus on maximizing internal cash flows to increase firm value (Cumming & Nguyen, 2024; Faulkender & Wang, 2006). Supporting the cash flow effect theory perspective, financially constrained firms often use tax planning strategies to alleviate financial pressures. This theory emphasizes that changes in cash flow influence corporate decisions related to investment, operations, and financing. The capital structure trade-off and cash flow effect theories support a positive relationship between financial constraints and tax avoidance.

Law & Mills (2015) found that financially constrained firms, identified through negative language in 10-K filings, were more likely to engage in aggressive tax planning. Richardson et al. (2015), using proxies like the Altman Z-score, Ohlson O-score, and financial distress index, also identified a positive link between financial constraints and tax avoidance during the 2008 Global Financial Crisis. However, Dyreng & Markle (2016) found that constrained firms were less likely to shift income abroad, indicating that financial constraints can limit income-shifting strategies. While some studies suggest that financial constraints might restrict certain tax avoidance activities, the evidence shows that financial constraints are positively associated with tax avoidance. According to capital structure trade-off theory, financially constrained firms adopt more aggressive tax strategies to generate internal funds.

H₂: Financial constraints are positively associated with tax avoidance

METHODS

This study focuses on non-financial firms listed on stock exchanges in ASEAN-5 countries: Indonesia (IDX), Singapore (SGX), Philippines (PSE), Thailand (TSE), and Malaysia (BM)—during the 2019–2023 period. Exclude companies from the financial industry such as banks, life insurance firms, non-life insurance firms, real estate investments and services, real estate investment trusts, suspended equities, and financial services due to their specific regulations in comparison to other sectors and companies, consistent with prior research (Francis & Wang, 2008; Velte, 2017). This period included the post-COVID-19 era, considering corporate priorities shifting toward core business activities after the pandemic (Ariff et al., 2024). With its significant markets and increasing discourse on ESG issues, the ASEAN region provides a compelling context. Especially as ASEAN-5 countries, including Indonesia, Malaysia, Thailand, Singapore, and the Philippines, as a sample in this study, generally exhibit higher ESG risks than those in Europe and North America (Pan, 2021). The ASEAN Community Vision Beyond 2025 complements the United Nations' SDGs, and this study examines the evolution of corporate tax avoidance and ESG practices during and after the pandemic, extending prior research by Ariff et al. (2024). This research relies on secondary data from the Thomson Reuters/Refinitiv database, the OSIRIS

database, company reports, and the World Bank. The dataset includes financial and corporate governance data, ESG scores, and national-level indicators like GDP and inflation. Due to limited ESG data and incomplete tax-related details, the panel dataset is unbalanced. Robust estimation models are applied to address missing data, ensuring the validity of the findings.

Table 1. Sample selection

	Obs.
Initial sample	14.930
Thomson Reuters Eikon dan Osiris Database	
Minus:	
Disclosure is not available	11.470
Database mismatch	2.428
Final sample: Total available firm-year observations	1.032
Source: Processed Data by the Author (2025)	

The initial sample was derived from ESG disclosure data from the Thomson Reuters Refinitiv database for 2019–2023. The sample was limited to companies listed in the ASEAN-5, resulting in 14,930 firm-year observations. Second, economic and financial information was sourced from the Osiris database for the same period. At this stage, the data collected from Thomson Reuters Refinitiv and Osiris were merged. Firm-year observations with unavailable disclosures (11,470 out of 14,930) and database mismatches (2,428 out of 14,930) were excluded, resulting in a final sample of 1,032 firm-year observations from 276 companies for the 2019–2023 period. This produced an unbalanced panel dataset of 1,032 firm-year observations spanning 2019–2023 ($i = 242$; $y = 5$).

Table 2. Sample list by country

No	Country	Total Firms					Total Obs.
		2019	2020	2021	2022	2023	
1	Indonesia	32	31	35	34	33	165
2	Malaysia	32	45	47	48	47	219
3	Singapore	31	32	42	35	36	176
4	Thailand	50	67	84	86	78	365
5	Philippine	21	22	21	23	20	107
	Total						1.032

Source: Refinitiv Eikon Database Processed by the Author (2025)

Aggressive tax avoidance is often perceived as unethical and a societal burden, leading companies with higher ESG scores to avoid such practices to reduce public scrutiny (Ariff et al., 2024). Conversely, socially irresponsible firms may refrain from tax avoidance to protect their CSR reputation, as engaging in it could further harm their social standing (Godfrey, 2005). While most studies on financial constraints and tax avoidance have focused on U.S. companies (Chen & Lai, 2012; Edwards et al., 2016; Law & Mills, 2015), this research extends the analysis to publicly listed companies in ASEAN, contributing to the broader literature.

This study measures corporate tax avoidance using the effective tax rate (ETR), following Huseynov & Klamm (2012) and Du & Li (2023). Higher ETR values indicate less tax avoidance (Luo et al., 2020), while lower values suggest more aggressive tax strategies (Amin et al., 2023). Tax avoidance reduces corporate taxes relative to pre-tax accounting income, reflecting discretionary managerial policies (Abdelfattah & Aboud, 2020). Other measures include GAAP ETR, CETR dodger, and book-tax difference (BTD), which captures discretionary book-tax differences (Desai & Dharmapala, 2006).

ESG performance is assessed using Thomson Reuters ESG scores, with higher scores indicating stronger ESG performance (Ariff et al., 2024). These scores objectively measure a firm's performance across 10 themes, including resource use, emissions, workforce, and CSR strategy, based on over 400 metrics reported by companies (Thomson Reuters Eikon, 2018). Financial constraints are measured using the Altman (1968), which evaluates liquidity, profitability, and leverage, with higher scores indicating better financial health (Cumming & Nguyen, 2024). Edwards et al. (2016) and Richardson et al. (2015) also used Z-Score and alternatives like the KZ Index and WW Index, which capture constraints related to investments and financing difficulties (Kaplan & Zingales, 1997; Whited & Wu, 2006).

Table 3. Operational definition of variables

Variable	Definition	Measurement
Dependent variable		
Corporate Tax Avoidance	Effective tax rate (ETR)	$ETR = \frac{Income\ Tax\ Expenses}{Pre - Tax\ Income}$
Independent variable		
ESG Performance	Thomson Reuters ESG Score	Thomson Reuters ESG Score (0–100) A range of values from 0 to 1, with 0 indicating the lowest score and 1 indicating the highest score.
Financial Constraint	Altman z-score (1968)	Altman Z-score= 1.2*working capital + 1.4*retained earnings + 0.6*E/D + 1.0*revenue +3.3* EBIT
Control variable		
Size	Firm size	$Ln\ Total\ Asset$
ROA	Return on assets	$ROA = \frac{Net\ Profit}{Assets\ Total} \times 100\%$
Loss	Firm loss	Dummy variable, one if the company incurs a loss in a given period; valued at zero otherwise.
LEV	leverage	Total debt divided by total assets
MTB	Market-to-Book Ratio	
Age	Firm age	$Ln\ (the\ number\ of\ years\ a\ company\ has\ been\ publicly\ traded)$
BDSIZE	Board Size	The total number of directors on the board.
GDP	Gross Domestic Product	$Ln\ (GDP\ per\ capita)\ by\ World\ Bank$
Inflation	Inflation Rate	Inflation rate per GDP (World Bank)

Source: Processed by the Author (2025)

The sample in this study is unbalanced (unbalanced panel) due to the ESG performance metrics (aggregate ESG scores) not being available in a balanced format and inconsistent data availability across regions and companies. In the early years of the sample, specifically 2019 and 2020, these scores were available for only a few companies in ASEAN. However, starting in 2021, the trend of ESG disclosure in ASEAN increased, making such data available for many companies in recent years. Additionally, differences in tax regulations and macroeconomic policies between industries and specific periods are controlled (Guenther et al., 2017). Outliers are winsorized to ensure data normality, and the Hausman test is conducted to determine the appropriate model for hypothesis testing. The Hausman test results indicate a p-value of 0.109, greater than 0.05, suggesting that the random effects model is better than the fixed effects model. Data were

analyzed using a Generalized Least Squares (GLS) regression to address heteroscedasticity and autocorrelation in model testing. GLS regression ensures the model is robust to heteroscedasticity and autocorrelation problems, which complies with classical assumptions (Gujarati & Porter, 2009). Using a linear regression model with the following equation:

$$CTA = \beta_0 + \beta_1 ESGScore + \beta_2 Altman + \beta_3 Size + \beta_4 ROA + \beta_5 Loss + \beta_6 LEV + \beta_7 MTB + \beta_8 Age + \beta_9 BoardSize + \beta_{10} GDP + \beta_{11} Inflation + Year\ effect + Industry\ effect + Country\ effect + \varepsilon \dots \dots \dots (1)$$

CTA refers to corporate tax avoidance. This study follows the approach of Dyreng et al. (2008) and Du & Li (2023) using the effective tax rate (ETR). This measurement is commonly used in many existing studies and is widely recognized as an appropriate proxy to capture tax avoidance in recent academic research (Lanis & Richardson, 2012). Corporate tax avoidance is proxied by dividing income tax expenditure by pre-tax profit. A higher ETR level indicates that the company avoids less tax (Luo et al., 2020). A lower ETR indicates a more aggressive position on the tax planning continuum (Amin et al., 2023).

ESGScore represents the ESG score, and Altman denotes Altman Z-score as measurement for financial constraint. Previous studies have identified various firm attributes that explain the determinants of tax avoidance. Capital structure and profitability significantly impact taxes (Yoon et al., 2021). Firms raise capital by issuing debt to obtain tax deductions on interest payments (Fama, 1980). Additionally, higher profitability increases a firm's marginal tax rate, providing incentives for tax avoidance. This study controls for these effects by including leverage (DAR) and ROA as variables. Financial leverage (LEV) supports tax shield benefits through higher levels of external debt. Edwards et al. (2016) suggest that higher profitability (ROA) is less motivated to engage in extensive tax avoidance activities. Size and Age are included in the model. Larger, dividend-paying firms are likely to be older and may have different incentives for tax avoidance than smaller, younger firms (Yoon et al., 2021). This study includes other commonly used control variables in tax avoidance literature, such as loss, MTB (market-to-book ratio), and BSize (board size) (Luo et al., 2020; Wongsinhirun et al., 2024). Chen et al. (2010) show that firms with higher losses have incentives to adopt more aggressive tax strategies. The study also controls for country-level variables, using the natural logarithm of gross domestic product and the inflation rate to account for economic cycles (Menicacci & Simoni, 2024).

RESULT AND DISCUSSIONS

Descriptive Statistics

Table 4 presents the descriptive statistics for the variables used in this study. The average ETR in the ASEAN market is 19.456%, lower than the statutory corporate tax rates applied in most ASEAN countries, typically between 20% and 25%. ETR is used as an inverse proxy for tax avoidance, with a lower ETR reflecting a more aggressive stance on tax avoidance. A lower ETR suggests that firms pay a smaller amount of tax compared to their pre-tax income. This condition may indicate that many companies engage in legal tax avoidance strategies through tax planning strategies. The aggregate ESG score ranges from 0 to 100 by default, with an average of 52.861. There has been an effort to improve the transparency of disclosures and the performance of sustainable practices. A notable trend of rapid increase is observed in individual pillar E, S, and G scores and the aggregate ESG score from 2021 until 2023, indicating companies' response to increasing regulations and stakeholder expectations regarding ESG commitments. The financial constraint variable, measured by the Altman Z-score, shows an average of 4.967, indicating that, generally, companies in ASEAN have a relatively healthy financial condition. An Altman score above three is typically considered a sign that the company is in the safe category, with higher scores indicating a lower risk of bankruptcy.

Table 4. Statistic descriptive

Variable	Obs	Min	Max	Mean	Std. Dev.
ETR_Tax Avoidance	1221	-8.126	46.278	19.456	11.713
ESGSCORE	1323	3.109	91.921	52.861	17.401
CONSTRAINT_Altman	1380	-.956	14.785	4.967	3.912
ROA	1240	-16.49	17.995	5.205	6.06
MTB	1380	0	7.162	1.988	1.864
SIZE	1240	18.065	37.816	25.332	4.834
AGE	1337	0	4.771	2.919	.767
BOARDSIZE	1321	3	22	9.618	3.122
LOSS	1380	0	1	.118	.323
LEV	1240	.051	61.006	30.31	17.46
GDP	1380	8.079	11.39	9.284	.994
INFLATION	1380	-3.069	13.478	2.406	3.987

Source: Processed Data, Output from Stata 17 (2025)

The average profitability (ROA) of 5.205% indicates the ASEAN companies' efficiency in using their assets to generate profits, with an average positive ROA performance. The average leverage of 30.31 suggests that companies in ASEAN use debt to finance 30.31% of their assets on average, implying a moderate use of debt in a relatively low structure. The average age of companies in ASEAN is 2.919, the firm size is 25.332, and the average LOSS is 0.118. The average board size in ASEAN companies is 9.618, and the average market-to-book ratio is 1.988. The country-level variables, measured by GDP per capita and the inflation rate per GDP, have averages of 9.284 and 2.406, respectively, in the ASEAN market.

Regression Result and Discussion

The data has passed the classical assumption tests, ensuring the validity of the regression analysis. Tests for heteroscedasticity and normality confirm that the residuals are homoscedastic and normally distributed, with p-values above 0,05. Regarding the correlation between the independent, control, and moderator variables, all correlation values are < 0.8, indicating no multicollinearity issues. The Pearson correlation analysis shows that ETR and ESG performance score are positive ($r = 0.112$), indicating that ESG information disclosure increases ETR. Furthermore, the correlation between ETR and the Altman Z-score as a financial constraint measure is negative ($r = -0.150$), suggesting that financially constrained companies tend to have lower ETR. However, regression analysis will test this relationship in a multivariate form further.

Table 5 presents the hypothesis test results, showing the regression coefficients, standard errors, and p-values for each variable tested. The association between ESGSCORE, financial constraints (Altman), and ETR is analysed using generalised least squares regression to address heteroscedasticity and autocorrelation. Table 7 displays the results. Column (1) shows the main regression analysis, where ESGSCORE is positively and statistically significantly related to ETR (coefficient = 0.0719), indicating that better ESG performance corresponds to higher ETR and lower tax avoidance, consistent with H1. This indicates that companies with better ESG scores

Table 5. Hypothesis Test Result

Hypothesis	Path Coefficient	Standard Error	Testing Result
H ₁ (ESG → Tax avoidance)	0.071***	0.008	Supported
H ₂ : (Financial constraints → Tax avoidance)	-0.208***	0.034	Supported

Source: Processed Data (2025)

(performing better in environmental, social, and governance disclosures) tend to have higher effective tax rates (ETR), meaning that a higher ETR indicates that the company pays more taxes relative to the profits it generates.

Conversely, CONSTRAINT_Altman is negatively and statistically significantly associated with ETR (coefficient = -0.2082), suggesting that financially constrained firms have lower ETR, reflecting higher tax avoidance, supporting H2. A lower ETR indicates that the company is more effective in reducing its tax liabilities, paying less tax than the profits it generates. Column (2) tests ESGSCORE with country-level controls but excludes Altman, while Column (3) excludes ESGSCORE. Both produce similar results to the main model, reinforcing H₁ and H₂.

The control variables are statistically significant for the main model, except for AGE and LEV. More profitable, larger, and older companies exhibit lower ETRs. This is consistent with (Zimmerman, 1983), who stated that firms tend to be more aggressive in tax planning if their size exceeds the sample average. Additionally, MTB, the board size, and LOSS are positively and significantly associated with ETR. Among country-level control variables, GDP is negatively and significantly associated with ETR, while inflation is positively and significantly associated with ETR.

The effect of ESG performance on tax avoidance

The analysis results confirm that ESG performance is negatively associated with tax avoidance, supporting the first hypothesis. Higher levels of CASH_ETR and ETR indicate that firms engage in less tax avoidance (Luo et al., 2020), whereas lower ETR reflects a more aggressive stance on the tax planning continuum (Amin et al., 2023). ESG performance leads to higher ETR, suggesting that firms are less aggressive in avoiding taxes, as they pay a greater percentage of their income as taxes. The findings show that ESGScore is positively and statistically significantly associated with ETR. Tax laws support national sustainability policies, with taxes contributing to fiscal revenue and national development.

Tax laws are designed to require companies to contribute to society, including by supporting national policies on sustainability, and by creating tax incentives (Ariff et al., 2024). In ASEAN, various tax incentives support ESG activities, such as Malaysia's Green Investment Tax Allowance (GITA) and Green Income Tax Exemption (GITE) (MGTC, 2024), Indonesia's Tax Holiday for renewable energy, and Thailand's Bio-Circular-Green (BCG) economy incentives (PwC, 2024). Companies engaged in sustainability are more likely to utilize legal tax incentives rather than engage in aggressive tax avoidance practices. Increasing incentive compensation tends to reduce the level of tax avoidance, with this negative effect mainly driven by firms with relatively weak governance arrangements (Desai & Dharmapala, 2006).

ESG engagement, as an extension of CSR, reflects companies' responsibility for considering the economic, social, environmental, and external impacts of their business decisions (Kreps, 1990). This is consistent with corporate culture theory, which indicates that corporate cultures emphasizing social responsibility and ethics tend to avoid aggressive tax avoidance practices. Greater CSR engagement is associated with lower tendencies for tax avoidance (Yoon et al., 2021), suggesting that the relationship between tax avoidance and CSR is negative.

This negative relationship can also be explained through the perspective of stakeholder theory. The stakeholder theory suggests that managers should balance multiple stakeholders' benefits to maximize all stakeholders' interests (Freeman, 1984). In line with this theory, companies are expected to be more stakeholder-oriented and less likely to use CSR as a risk shield. Suggest that CSR and tax avoidance act as complements. Companies are responsible to stakeholders, so ESG practices and tax compliance complement each other. As a result, firms with higher CSR commitments tend to engage less in tax avoidance (Lanis & Richardson, 2012). Unethical and irresponsible practices, such as aggressive tax avoidance, which contradict the interests of corporate stakeholders, should be minimized (Du & Li, 2023). Socially responsible companies strive to avoid tax manipulation, which imposes costs on their societies. Top of Form

Table 6. The Impact of ESG Performance and Financial Constraint on Tax Avoidance

VARIABLES	GLS	GLS	GLS
ESGSCORE	0.071*** (0.008)	0.074*** (0.007)	
CONSTRAINT_Altman	-0.208*** (0.034)		-0.177*** (0.030)
ROA	-0.417*** (0.027)	-0.411*** (0.023)	-0.417*** (0.025)
MTB	0.355*** (0.081)	0.431*** (0.081)	0.320*** (0.075)
SIZE	-0.376*** (0.118)	-0.312*** (0.097)	0.059 (0.113)
AGE	-0.105 (0.150)	-0.023 (0.111)	0.196 (0.126)
BOARDSIZE	0.220*** (0.044)	0.204*** (0.043)	0.259*** (0.035)
LOSS	23.374*** (1.327)	23.975*** (1.654)	23.586*** (1.220)
LEV	0.012 (0.009)	0.024*** (0.008)	0.005 (0.008)
GDP	-14.188*** (1.987)	-15.924*** (1.612)	-14.756*** (1.815)
INFLATION	0.346*** (0.035)	0.317*** (0.037)	0.327*** (0.034)
Constant	152.931*** (16.785)	164.805*** (13.805)	146.560*** (15.114)
Year effect	YES	YES	YES
Country effect	YES	YES	YES
Industry effect	YES	YES	YES
Observations	1,032	1,032	1,032
R-squared			
Number of companies	242	242	242

Robust standard errors in parentheses

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

Source: Processed Data, Output from Stata 17 (2025)

This aligns with findings by Watson (2015), Kieseewetter & Manthey (2017), Hoi et al. (2013), Huseynov and Klamm (2012), Jones et al. (2017), and López-González et al. (2019), who documented a negative relationship between social performance and tax avoidance. These studies suggest that more socially responsible firms are less likely to avoid tax payments. Recent studies by Jiang et al. (2024) in China, Korea (Yoon et al., 2021), and Indonesia (Hidayat & Zuhroh, 2023) also found a negative relationship. In contrast, studies by Abdelfattah & Aboud (2020),

Ariff et al. (2024), Carroll & Joulfaian (2005), Davis et al. (2016), Lanis & Richardson (2012), Ortas & Gallego-Álvarez (2020), and Preuss (2010) documented a positive association between CSR performance and tax avoidance. In the ASEAN market context, ESG performance and tax avoidance do not act as substitutes driven by risk management practices (Davis et al., 2016). Davis et al. (2016) argued that firms with higher CSR commitments view CSR and tax payments as substitutes within the internal risk management framework.

The effect of financial constraints on tax avoidance

The results confirm that corporate financial constraints positively correlate with tax avoidance, supporting the second hypothesis. Firms experiencing financial distress, as measured by the Altman Z-score, exhibit lower ETR, indicating that they pay taxes at a smaller proportion of their taxable income. This suggests that companies tend to be more aggressive in avoiding taxes when facing financial difficulties. The findings show that *Constraint_Altman* is negatively and statistically significantly associated with ETR. This aligns with the results of studies by Chen & Lai (2012), Law & Mills (2015), Richardson et al. (2015), Edwards et al. (2016), and Bayar et al. (2018). Companies facing increased financial constraints demonstrate heightened cash tax planning efforts.

Financially constrained firms seek ways to maximize internal cash flow and reduce tax burdens. This behavior is explained by the capital structure trade-off theory, which posits that financially constrained firms may be unable to utilize optimal capital structures, and the cash flow effect theory emphasizes the need to enhance internal cash flow to address financial constraints. Firms under financial constraints prefer internally generated funds over external sources. Two reasons why firms with greater external financial constraints are more likely to engage in tax planning to generate internal financing: (1) tax planning is less likely to impact operations compared to other cost-cutting methods negatively; (2) firms prioritize tax strategies that provide both cash flow and financial reporting benefits, indicating that deferred tax planning remains a viable option (Edwards et al., 2016).

Firms tend to accumulate more cash when external financing is insufficient to meet their capital needs (Faulkender & Wang, 2006). This highlights that companies facing financial constraints have incentives to increase internal cash flow, retain it, obtain higher market valuations for that cash flow, and use it to maximize firm value (Cumming & Nguyen, 2024). Firms that invest heavily in specific assets may face higher financial constraints, ultimately increasing their need to adopt tax planning strategies. Financially constrained firms will seek ways to maximize internal cash flow and reduce their tax burden by optimizing internal cash flows or manipulating capital and tax structures. Cumming & Nguyen (2024) found that asset specificity influences corporate tax avoidance through the financial constraint pathway, with constrained firms exhibiting lower cash-effective tax rates, consistent with the findings of this study. However, conflicting results have been reported by Dyreng & Markle (2016), who found that financial constraints limit firms' ability to implement tax avoidance strategies, including income shifting, similar to Albring et al. (2011).

Robustness Test

This study conducts a robustness test by considering whether the main results remain consistent with an alternative measure of ESG performance. To validate the consistency of the findings, the study uses ESG Grade as an alternative measure. Thomson Reuters ESG Grade is a rating that measures a company's Environmental, Social, and Governance performance with values ranging from A+ (highest) to D- (lowest). For the analysis, the letter-based ratings in ESG Grade are quantified on a scale of 1-12, with 12 representing the highest rating. The relationship between ESG performance and ETR remains positive and statistically significant. Therefore, the higher the ESG grade, the lower the tendency for tax avoidance, showing a negative association. The results are consistent with the relationship between ESG performance and tax avoidance, even with a different measurement approach.

Table 7. Robustness test

VARIABLES	GLS	GLS
ESGGRADE	0.498*** (0.067)	0.535*** (0.065)
CONSTRAINT_Altman	-0.194*** (0.034)	
ROA	-0.400*** (0.027)	-0.411*** (0.024)
MTB	0.329*** (0.080)	0.406*** (0.081)
SIZE	-0.297** (0.120)	-0.276*** (0.097)
AGE	0.008 (0.156)	-0.026 (0.100)
BOARDSIZE	0.205*** (0.045)	0.193*** (0.043)
LOSS	23.496*** (1.420)	23.961*** (1.699)
LEV	0.006 (0.009)	0.022** (0.008)
GDP	-14.127*** (1.921)	-14.972*** (1.557)
INFLATION	0.329*** (0.036)	0.306*** (0.035)
Constant	150.041*** (16.3306)	156.230*** (13.245)
Year effect	YES	YES
Industry effect	YES	YES
Country effect	YES	YES
Observations	1,032	1,032
R-squared		
Number of companies	242	242

Source: Processed Data, Output from Stata 17 (2025)

CONCLUSIONS

The relationship between ESG performance, financial constraints, and tax avoidance remains underexplored, especially in the ASEAN context. Using a sample of 242 companies from 2019 to 2023, this study finds that higher ESG scores are positively associated with the effective tax rate (ETR), suggesting that better ESG performance reduces aggressive tax avoidance. Additionally, financial constraints are negatively related to ETR, indicating that financial constraints lower the ETR. This suggests that companies exhibit more aggressive tax avoidance behavior when facing financial difficulties in generating internal financing, given their limited access to external funding. Therefore, financial constraints are positively associated with tax avoidance.

This study contributes to the growing body of literature on tax avoidance, using empirical evidence from emerging markets with a regional focus. It offers unique insights by presenting

empirical findings from the ASEAN region, which has been underexplored in existing research. It addresses varying perspectives on tax avoidance, ESG performance, and financial constraints within ASEAN countries with similar institutional settings. This adds to the argument on tax avoidance and corporate environmental and social performance that is often based on a single country setting and focused on US companies. Develops theoretical insights by explaining cash flow effect theory, risk management theory, corporate culture theory, and stakeholder theory related to corporate motivations to engage in tax avoidance behavior. Responding to the call by Ariff et al. (2024) for regional-level research in contexts with shared institutional frameworks but diverse characteristics, such as ASEAN, this study provides meaningful insights for tax authorities and policymakers.

This study has several limitations that could serve as areas for future research: (1) This study uses a sample from ASEAN-5 countries, so the findings may not be generalizable to the broader Asian region or other countries globally; (2) The study uses ETR as the only measure for tax avoidance; future research could use other tax avoidance measurements such as GAAP ETR, Cash ETR, long-term cash ETR, long-term ETR, and book-tax differences; (3) There are many alternative measures for financial constraints, such as the WW index and the KZ index, as well as qualitative disclosures using the number of negative words (Law & Mills, 2015). However, this study uses the Altman Z-score, which may capture a different perspective on financial constraints. The KZ index explains constraints related to investment, while the Z-score captures financial distress.

Companies are encouraged to strengthen their ESG policies, as better ESG practices improve corporate reputation and sustainability and reduce the risks associated with aggressive tax avoidance. Companies facing financial constraints should seek alternative funding sources, such as green bonds, sustainability-linked loans, or strategic partnerships, to reduce reliance on tax avoidance as a source of liquidity. Developing tax incentives or special financing schemes for companies committed to ESG can discourage them from engaging in aggressive tax avoidance during financial difficulties. Companies can balance tax compliance, social responsibility, and long-term economic growth by promoting sustainable tax strategies.

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