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CORPORATE FINANCIAL DYNAMICS UNDER THE SHADOW OF FINANCIAL DISTRESS AND TAX AVOIDANCE STRATEGIES

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Abstract

An efficient and equitable tax system is vital for fostering national economic growth. However, tax avoidance remains a major challenge, particularly in the infrastructure sector which holds strategic importance. This study aims to examine the effect of thin capitalization, rentability, and operating cash flow on tax avoidance, with financial distress as a mediating variable. Using a quantitative approach with secondary data from the financial statements of 220 infrastructure firms listed on the IDX during 2019–2023, the analysis employed multiple linear regression and the Sobel test. The results indicate that all three independent variables significantly influence both financial distress and tax avoidance, directly and indirectly. Thin capitalization and operating cash flow increase tax avoidance incentives, while financial distress reduces such tendencies. These findings support agency, trade-off, and signaling theories. The study's implications highlight the need for balanced tax policy oversight and corporate financial management, especially under financial pressure. Theoretical contributions include the use of the book-tax difference proxy, while practical insights are intended for policymakers and corporate managers to formulate fair and sustainable tax strategies.

Keywords: *Tax Avoidance; Financial Distress; Thin Capitalization; Rentability; Operating Cash Flow.*

Abstrak

Sistem pajak yang efisien dan adil sangat penting dalam mendukung pertumbuhan ekonomi nasional. Namun, praktik penghindaran pajak masih menjadi tantangan utama, terutama dalam sektor infrastruktur yang memiliki peran strategis. Penelitian ini bertujuan untuk menguji pengaruh thin capitalization, rentabilitas, dan arus kas operasi terhadap penghindaran pajak, dengan financial distress sebagai variabel mediasi. Menggunakan pendekatan kuantitatif dengan data sekunder dari laporan keuangan 220 perusahaan infrastruktur yang terdaftar di BEI selama 2019–2023, analisis dilakukan menggunakan model regresi linear berganda dan uji Sobel. Hasil menunjukkan bahwa ketiga variabel independen memiliki pengaruh signifikan terhadap financial distress dan penghindaran pajak, baik secara langsung maupun tidak langsung. Thin capitalization dan arus kas operasi meningkatkan insentif penghindaran pajak, sementara financial distress menurunkan kecenderungan tersebut. Temuan ini mendukung teori agensi, trade-off, dan signaling. Implikasi penelitian ini menekankan pentingnya pengawasan kebijakan pajak dan manajemen keuangan korporat yang berimbang, khususnya dalam menghadapi tekanan finansial. Kontribusi teoretis diberikan melalui penggunaan proxy book-tax difference, sementara kontribusi praktis menyasar regulator dan manajemen dalam merumuskan strategi pajak yang adil dan berkelanjutan.

Kata Kunci: Penghindaran Pajak; *Financial Distress; Thin Capitalization*; Rentabilitas; Arus Kas Operasi.

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INTRODUCTION

An efficient and equitable tax system is a fundamental element for a country's economic growth. As a primary source of revenue, taxation plays a vital role in funding various national development programs (Ajeigbe et al., 2024; Yahaya & Yusuf, 2020). The obligation to pay taxes is binding under applicable regulations, making every taxpayer responsible for fulfilling their fiscal duties (Al-shawabkeh et al., 2025; Paramitha & Kurnia, 2023). Nevertheless, tax avoidance remains a significant challenge in tax administration as it can substantially reduce state revenues (Gazali et al., 2020; Harifath & Kurnia, 2024; Sidauruk & Putri, 2022). Tax avoidance has become a common phenomenon within tax systems. This legally sanctioned method of reducing tax obligations through the utilization of regulatory loopholes is commonly employed by taxpayers (Mocanu et al., 2021; Nadhifah & Arif, 2020). This situation reflects a conflict of interest between corporate goals to reduce tax expenses and the government's objective to maximize revenue collection, thus creating a complex dynamic within the taxation system (Gazali et al., 2020; Harifath & Kurnia, 2024). Although tax avoidance does not directly violate the law, it remains controversial due to its perceived reduction in taxpayer contributions to national development (Curry & Fikri, 2023; Lokanan, 2023).

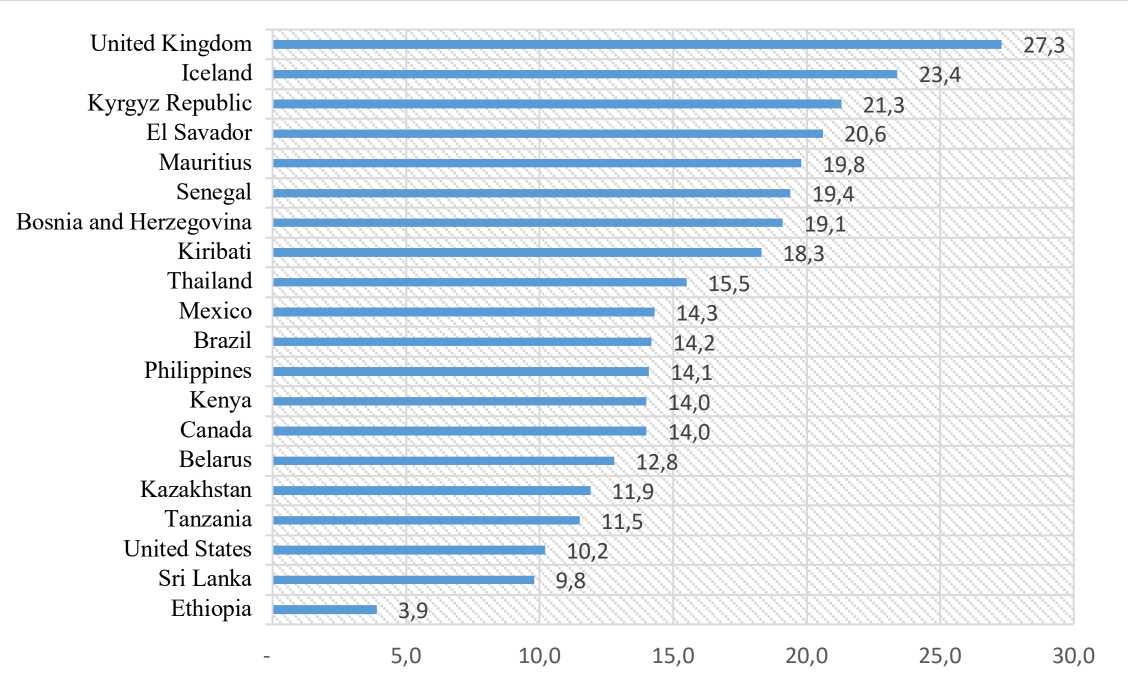

Figure 1. Tax-to-GDP Ratio of Countries Around the World in 2023.
Source: World Bank (2024)

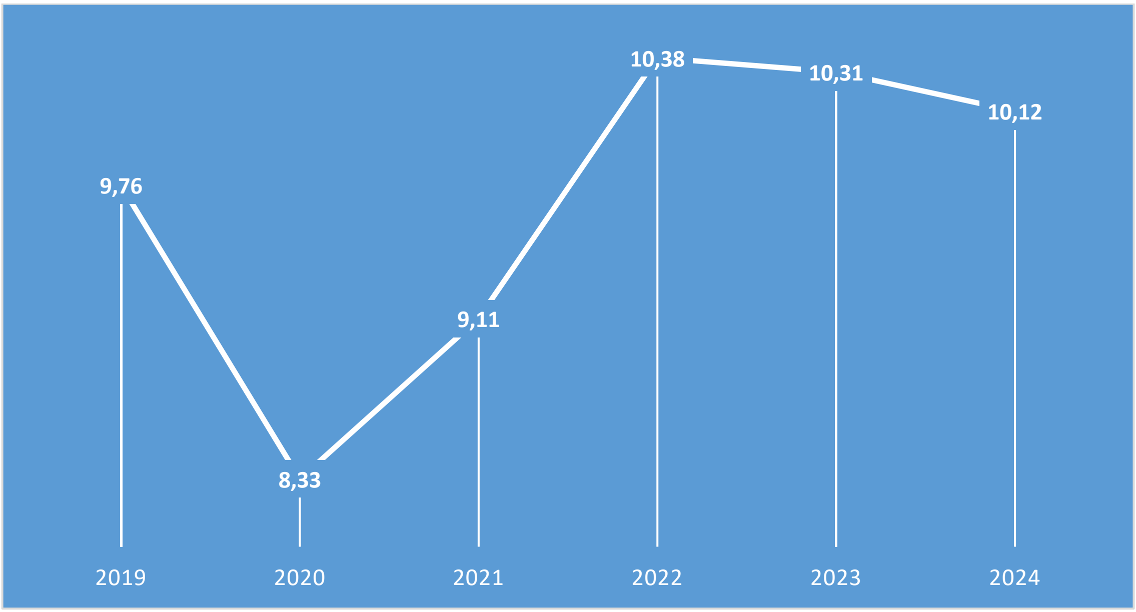

Figure 2. Indonesia's Tax-to-GDP Ratio from 2019 to 2024
Source: Parliamentary Analysis Center, Expertise Agency, Secretariat General of the House of Representatives of the Republic of Indonesia (2024)

The phenomenon of tax avoidance has become a significant global issue, as reflected in the disparity of tax-to-GDP ratios among countries. The International Monetary Fund (IMF) has set the ideal tax ratio to support national development at 15% of GDP (Fahira, 2024). However, 2023 data show that only a small number of countries were able to meet or exceed this threshold. The United Kingdom recorded the highest ratio at 27.3%, followed by Iceland (23.4%) and the Kyrgyz Republic (21.3%), while Ethiopia had the lowest at 3.9%. Major economies such as Mexico, Brazil, Canada, and even the United States only recorded a ratio of 10.2%, indicating that the size of an economy does not necessarily correlate with the effectiveness of tax collection (World Bank, 2024). In Indonesia, the issue of tax avoidance has also significantly impacted the country's low revenue collection. The tax-to-GDP ratio was recorded at 9.76% in 2019 and declined to 8.33% in 2020 due to the COVID-19 pandemic. Although it slightly improved to 10.38% in 2022, it dropped again to 10.12% in 2024. Compared to other ASEAN countries such as Singapore (12.96%), Vietnam (16.21%), and Thailand (17.18%), Indonesia still lags behind (Parliamentary Analysis Center, Expertise Agency, Secretariat General of the House of Representatives of the Republic of Indonesia, 2024). The ongoing prevalence of tax avoidance among taxpayers is one of the primary reasons for the low ratio (Hossain, Ali, Ling, et al., 2024; Putra, 2024).

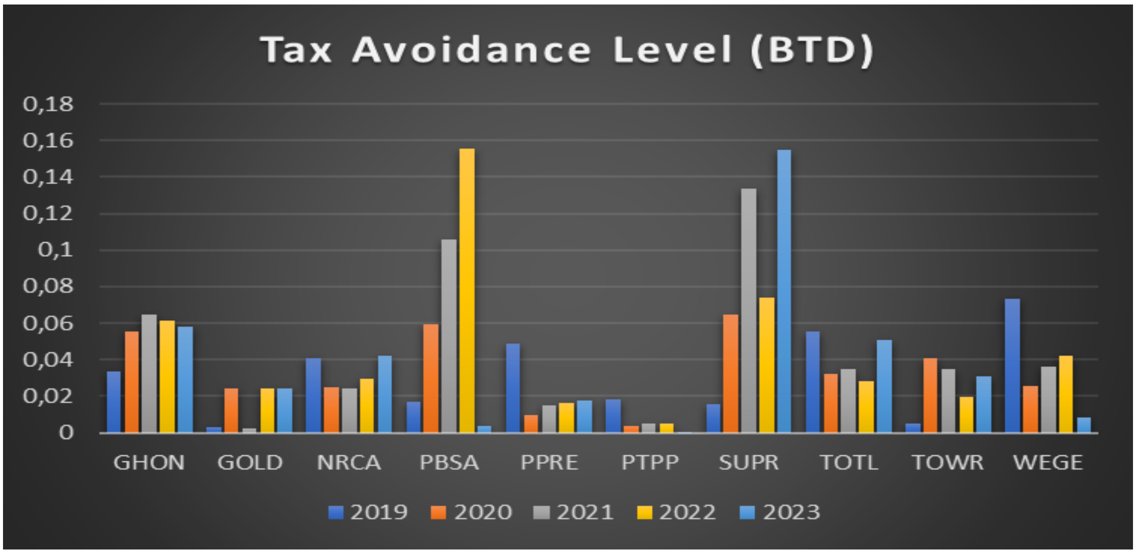

Figure 3. Tax Avoidance Level of Infrastructure Companies (2019–2023).
Source: Processed data from Excel.

To provide further evidence at the industry level, tax avoidance practices are also reflected in the infrastructure sector through fluctuations in the book-tax difference (BTD). As shown in Figure 3, several infrastructure companies such as PBSA and SUPR reported relatively high BTD values in 2021–2023, indicating a widening gap between accounting profits and taxable income. This phenomenon suggests that firms in the infrastructure industry actively exploit regulatory opportunities to minimize their tax liabilities. The persistence of high BTD values in certain companies confirms that tax avoidance remains a relevant and pressing issue in this sector, thereby justifying the selection of infrastructure as the focus of this study.

Thin capitalization, involving an increased proportion of debt relative to equity in a firm's capital structure, is commonly employed as a strategy to reduce tax liabilities (Curry & Fikri, 2023; Nadhifah & Arif, 2020). This strategy poses challenges to the tax system resulting from the different tax treatments of equity and debt; equity financing does not result in tax deductions, while debt allows for the reduction of taxable income through interest expenses (Anggara & Khairunnisa, 2023). According to the notion of trade-offs, companies tend to utilize debt to gain tax advantages, thereby significantly reducing their tax liabilities (Curry & Fikri, 2023; Gazali et al., 2020). Rentability, which gauges management's capacity to turn a profit, has an impact on tax avoidance in addition to capital structure (Kusmawati et al., 2022; Nuryani, 2023; Shubita, 2024). Because owners (principals) and managers (agents) have different objectives, managers frequently try to reduce tax obligations in order to increase reported profits (Elen et al., 2024; Khan & Nuryanah, 2023; Tanjaya & Nazir, 2021). An increase in taxable income leads to higher tax payments, which in turn motivates companies to implement strategies aimed at minimizing their tax liabilities (Budiman et al., 2024; Sidauruk & Putri, 2022; Sudibyo, 2022; Tampubolon, 2021). Additionally, operating cash flow plays a crucial role of this strategy; a firm's capacity to make a sizable profit is reflected in its strong operating cash flow, which in turn provides an incentive to lower tax obligations through a variety of legal strategies (Gazali et al., 2020; Harifath & Kurnia, 2024; Sánchez-Ballesta & Yagüe, 2024; H. Wijaya, 2022). Therefore, thin capitalization, rentability, and operating cash flow are key determinants in the study of tax avoidance.

Financial distress is adopted in this study as a mediator to explain the relationship between a company's internal factors and tax avoidance. It is chosen under the premise that a firm's financial health influences its approach to tax planning (Mahardini & Framita, 2022), in line with agency theory (Monika & Noviari, 2021). In times of financial difficulty, investors tend to avoid companies with high risks related to tax avoidance practices (Curry & Fikri, 2023; Monika & Noviari, 2021; A. D. Pratiwi & Sasongko, 2023), while aggressive tax avoidance may also damage corporate reputation by signaling weak transparency and compliance (Compagnie & Torsin, 2025; Nadhifah & Arif, 2020).

However, research in this field remains relatively scarce and shows several limitations. First, only a limited number of studies have positioned financial distress as a mediating variable, and most existing evidence is sector-specific, focusing on mining (Gazali et al., 2020; Paramitha & Kurnia, 2023), manufacturing (Nadhifah & Arif, 2020; Nugraha & Rahmawati, 2024), consumer goods (A. D. Pratiwi & Sasongko, 2023), food and beverage (Elen et al., 2024), and property and real estate (Curry & Fikri, 2023). Even at the national level, research in Indonesia (Susanto, 2022), Nigeria (Yahaya & Yusuf, 2020), Romania (Mocanu et al., 2021), and Vietnam (Dang & Tran, 2021) has produced fragmented findings with limited generalizability. Second, many studies rely on short observation periods of only three years, which reduces the robustness of their conclusions (Paramitha & Kurnia, 2023; Sidauruk & Putri, 2022; H. Wijaya, 2022). Third, the effective tax rate (ETR) is predominantly used as a proxy for tax avoidance, despite its limitations in fully capturing the extent of tax avoidance practices (Monika & Noviari, 2021).

This study addresses these limitations by examining the infrastructure sector, which is both underexplored and strategically important, particularly after receiving a 100% corporate income tax exemption in 2023 due to negative growth since 2022 (Santo & Sari, 2024). Furthermore, the study extends the observation window to five years (2019–2023), enhancing representativeness, and employs the book-tax difference (BTD) as a more comprehensive proxy for tax avoidance that reflects both tax planning and earnings management (Mocanu et al., 2021; Thayyib, 2025). The novelty of this study lies in combining these three contributions—sectoral focus on infrastructure, extended observation period, and the adoption of BTD—while analyzing the mediating role of financial distress, which has not been simultaneously addressed in prior research.

Thus, the primary goal of this study is to analyze the variables influencing tax avoidance, specifically the role that financial distress plays as a mediator in the relationship between thin capitalization, rentability, and operating cash flow. It is expected that the findings will provide theoretical contributions to taxation and financial management literature and practical recommendations for policymakers and corporate managers in designing more effective, equitable, and sustainable fiscal strategies.

LITERATURE REVIEW

The theoretical framework of this study is grounded in three main theories: trade-off theory, signaling theory, and agency theory. Trade-off theory explains that firms must balance the benefits of debt financing against its potential costs. Debt provides a tax shield because interest expenses are deductible, thereby reducing taxable income and enhancing firm value (Brigham & Houston, 2022). However, excessive reliance on debt increases the probability of financial distress and bankruptcy, which can erode firm value.

According to Brealey et al. (2023), companies seek an optimal capital structure by weighing the marginal benefits of debt against its marginal costs, which differ across industries and firms. Ross et al. (2023) further highlight that while debt can discipline managers and improve efficiency, too much leverage magnifies agency conflicts and reduces financial flexibility.

Signaling theory explains how managers communicate firm quality to investors when information asymmetry exists. Managers possess private knowledge about profitability and cash flow prospects, while investors rely on observable signals to infer this information. According to Brigham & Houston (2022), corporate actions such as dividend policy, capital structure, or disclosure choices serve as credible signals that influence market perceptions of firm value. Scott & O'Brien (2020) further emphasize that signals must be sufficiently costly so that low-quality firms cannot easily imitate them.

Agency theory explains the conflict of interest that arises when shareholders, as principals, delegate decision-making authority to managers, as agents. Managers possess superior information and may act opportunistically to maximize their own benefits rather than shareholder value (Deegan, 2023). Such behaviors can include engaging in tax avoidance strategies to report higher short-term profits, which may increase managerial compensation or reputation. However, these practices can expose firms to reputational damage, regulatory scrutiny, and heightened financial distress. According to Scott & O'Brien (2020), agency problems create monitoring, bonding, and residual costs that reduce firm value. In this study's context, thin capitalization, rentability, and operating cash flow provide opportunities for managers to influence tax strategies, but financial distress may amplify agency conflicts by intensifying managerial incentives to prioritize immediate survival over long-term sustainability.

The Relationship Between Thin Capitalization and Financial Distress

Thin capitalization refers to a corporate financing structure in which debt is used more extensively than equity to fund operational activities. In line with trade-off theory, debt provides tax advantages through interest deductibility, but excessive reliance on leverage increases the probability of financial distress and reduces financial flexibility (Brealey et al., 2023; Brigham & Houston, 2022; Ross et al., 2023). According to the trade-off theory, a high level of debt can provide substantial operational financing benefits (Esghaier, 2024; Syavira et al., 2024); however, it also requires effective management to prevent an increased risk of financial distress. Previous studies have shown that firms capable of managing debt effectively can generate operational profits that are then used to fulfill financial obligations, thereby avoiding financial distress (Bukhari & Linda, 2022; Efendi et al., 2023; Kalash, 2023). Debt is also utilized to support business expansion and enhance company profitability, reflecting strong performance and reducing the likelihood of financial difficulties (Abdullah et al., 2023; Syavira et al., 2024; J. Wijaya & Suhendah, 2023). When debt is optimally managed, it can enhance firm performance and minimize the risk of financial distress (Oktapani & Maryani, 2024). Therefore, the proposed hypothesis is:
H_1: Thin capitalization has a negative effect on financial distress.

The Relationship Between Rentability and Financial Distress

A firm's rentability, representing its efficiency in earning returns on assets, significantly contributes to lowering financial distress risk. In line with signaling theory, profitability acts as an observable signal through which managers communicate firm quality under information asymmetry; high earnings serve as credible signals of financial health that low-quality firms cannot easily imitate (Brigham & Houston, 2022; Scott & O'Brien, 2020). High profits indicate sound financial performance and the company's capacity to avoid financial difficulties (Fitriyani et al., 2024; Kebede et al., 2024). From the perspective of signaling theory, financial statements of firms with high profitability communicate favorable signals to stakeholders, implying that the company can manage its assets efficiently, cover operational costs, and meet its obligations, thereby lowering the risk of financial distress (Abdu, 2022; Dwiantari & Artini, 2021; Kalbuana et al., 2022; Syavira et al., 2024). Conversely, low profitability levels convey negative signals about the firm's financial health, potentially increasing the likelihood of financial distress due to limited funds to meet obligations (Nuryanti & Ramdhani, 2023; Syavira et al., 2024). Based on this reasoning, the proposed hypothesis is:
H_2: Rentability has a negative effect on financial distress.

The Relationship Between Operating Cash Flow and Financial Distress

A firm's operating cash flow is an essential indicator of its ability to generate sufficient cash from core activities to support internal demands without seeking outside financing. Based on signaling theory, high operating cash flow sends a positive signal to stakeholders that the firm maintains strong financial performance, effectively manages its cash, and is capable of meeting its obligations without facing financial pressure (A. D. Pratiwi & Sasongko, 2023). Strong and consistent operating cash flow provides a positive signal to investors and creditors that the firm can cover operational needs and financial commitments, a position that weaker firms would find difficult to imitate (Brigham & Houston, 2022; Scott & O'Brien, 2020). Previous studies have shown that a high operating cash flow ratio reduces the chance of facing financial difficulties, as it provides confidence to creditors regarding the firm's ability to fulfill its financial obligations (Aiyyuffi et al., 2022; Jia & Li, 2022; Oktasari et al., 2022). Moreover, strong operating cash flow reflects financial stability, which strengthens the firm's ability to avoid financial distress (Juliani & Muslihat, 2021; A. D. Pratiwi & Sasongko, 2023). Therefore, the proposed hypothesis is:
H_3: Operating cash flow has a negative effect on financial distress.

The Relationship Between Thin Capitalization and Tax Avoidance

Thin capitalization, or the excessive use of debt in a firm's capital structure, is frequently linked to tax avoidance practices. In line with trade-off theory, debt provides tax benefits through interest deductibility, enabling firms to reduce taxable income and enhance firm value (Brealey et al., 2023; Brigham & Houston, 2022). However, the same theory also recognizes that excessive leverage increases the risk of financial distress, meaning firms must balance the benefits of tax savings against potential costs (Ross et al., 2023). The higher a firm's level of debt, the greater the interest payments, which directly lower taxable income and reduce corporate tax liabilities (Elen et al., 2024; Hendayana et al., 2024). Previous studies have shown that highly leveraged firms tend to use interest expenses as a tax shield, thereby reducing tax payments and even engaging in aggressive tax avoidance strategies (Dang & Tran, 2021; Hossain, Ali, Islam, et al., 2024; Susanto,

2022; Yahaya & Yusuf, 2020). Pratiwi et al. (2021) also found that increasing corporate debt is often exploited to minimize a firm's tax burden. On the basis of this logic, the following hypothesis is suggested:
H$_4$: Thin capitalization has a positive effect on tax avoidance.

The Relationship Between Rentability and Tax Avoidance

Rentability reflects a firm's ability to generate earnings from its assets and directly influences its tax burden. According to agency theory, there is a potential conflict of interest between owners (principals) and managers (agents), whereby managers—focused on performance—may engage in tax minimization strategies to increase net income and maintain their compensation levels (Sudibyo, 2022; Tanjaya & Nazir, 2021). Deegan (2023) further explains that such opportunistic actions occur because managers possess superior information, while (Scott & O'Brien, 2020) highlight that these behaviors generate agency costs that ultimately reduce firm value. Empirical evidence suggests that companies generating substantial profits are more inclined to adopt tax avoidance strategies, as high tax liabilities can significantly reduce their net income (Hendayana et al., 2024; Sidauruk & Putri, 2022; Tampubolon, 2021). Moreover, firms with high levels of profitability often take advantage of regulatory loopholes through tax professionals or accounting strategies to lower their tax obligations (Elen et al., 2024). Therefore, the proposed hypothesis is:
H$_5$: Rentability has a positive effect on tax avoidance.

The Relationship Between Operating Cash Flow and Tax Avoidance

The cash flow from operations indicates how effectively a company generates income from its regular activities. According to agency theory, a potential conflict of interest may arise between owners and managers, where managers—possessing more information—may use operating cash flow to manipulate financial reports in order to minimize tax liabilities (Gazali et al., 2020). Managers tend to act opportunistically by pursuing tax avoidance practices to increase reported earnings and secure personal benefits, even though such actions can generate agency costs and expose the firm to reputational or regulatory risks (Deegan, 2023; Scott & O'Brien, 2020). Firms with high operating cash flows are likely to face increased tax burdens due to rising income, thereby prompting them to participate in tax-reducing activities to reduce these obligations (Gazali et al., 2020; Harifath & Kurnia, 2024; Yang et al., 2022). Research has shown that companies often pursue methods to lower their tax obligations through the management of operating cash flows, as higher taxes can affect their gross earnings (H. Wijaya, 2022). Therefore, the proposed hypothesis is:
H$_6$: Operating cash flow has a positive effect on tax avoidance.

The Relationship Between Financial Distress and Tax Avoidance

Financial distress refers to a condition in which a firm experiences financial pressure and struggles to meet its obligations. According to agency theory, when facing severe financial pressure, managers often avoid aggressive tax avoidance practices because such actions can increase agency costs, trigger sanctions from tax authorities, and damage the firm's reputation (Deegan, 2023; Scott & O'Brien, 2020). Firms experiencing financial distress tend to avoid engaging in tax avoidance practices due to the perceived risks, which may worsen their financial condition (Ariff et al., 2023; Monika & Noviari, 2021). Aggressive or illegal tax avoidance strategies can attract sanctions from tax authorities,

damage the company's reputation, and send negative signals to investors, further increasing the risk of bankruptcy (Adrian et al., 2023; Curry & Fikri, 2023; N. P. D. Pratiwi et al., 2021). In difficult financial situations, companies are more likely to refrain from risky activities such as tax avoidance in order to maintain their public image and avoid additional burdens (Monika & Noviari, 2021; Nadhifah & Arif, 2020). Based on this rationale, the proposed hypothesis is:
H_7: Financial distress has a negative effect on tax avoidance.

Tax avoidance is often influenced by a company's financial condition. Thin capitalization, which reflects a financing structure dominated by debt rather than equity, creates opportunities for tax avoidance through the tax shield mechanism, as interest payments are recognized as deductible expenses that reduce taxable income (Elen et al., 2024; Gazali et al., 2020). A high debt burden does not necessarily increase the risk of financial distress if the firm is capable of managing its obligations effectively. However, when a company is under financial pressure, tax avoidance strategies tend to become more conservative due to the additional risks posed by tax penalties and investor scrutiny (Curry & Fikri, 2023).

On the other hand, firms with high profitability frequently adopt more aggressive tax avoidance strategies to enhance net income, despite the fact that such profitability generally lowers the risk of financial distress (Sidauruk & Putri, 2022; Sudibyo, 2022). On the other hand, Strong cash flows from operations signify that the firm is capable of sustaining revenue generation through its central business processes, offering greater flexibility in fulfilling tax obligations. Nevertheless, companies with strong cash flows may also possess stronger motivations to adopt tax avoidance practices to reduce expenditures that could diminish net income (Gazali et al., 2020; Wijaya, 2022).

Within this framework, financial distress functions as an intermediary variable that connects a firm's financial health to its tax avoidance decisions. Financially distressed companies often refrain from adopting aggressive tax avoidance practices in order to minimize additional risks that could exacerbate their financial strain (Monika & Noviari, 2021). Therefore, the proposed hypotheses are:
H_8: Thin capitalization has a positive effect on tax avoidance through financial distress.
H_9: Profitability has a positive effect on tax avoidance through financial distress.
H_{10}: Operating cash flow has a positive effect on tax avoidance through financial distress.

RESEARCH METHODS

This research is quantitative and empirical. The study's focus is Indonesian infrastructure businesses that are publicly traded. Secondary data from financial statements for the years 2019–2023 were used. Purposive sampling is the sampling technique used, and it is based on particular criteria that are shown in the table below. Following this screening procedure, 220 samples in total were acquired. The following table provides an overview of the sampling procedure:

Table 1. Sample Selection Criteria

Description	Total
The Indonesia Stock Exchange (IDX) lists companies in the infrastructure industry	70
Minus: Companies not listed on IDX during 2019–2023	(20)
Minus: Companies experiencing capital deficiency between 2019–2023	(6)
Final sample (total over 5-year observation period)	220

Source: Indonesia Stock Exchange (2025).

Three different kinds of variables are used in this study: mediating, independent, and dependent variables. Tax avoidance serves as the dependent variable, while thin capitalization, rentability, and operating cash flow are the independent variables. In addition, financial distress functions as the mediating variable.

Table 2. Variables Measurement

Variabel	Code	Measurements	References
Tax Avoidance	TAV	Book Tax Difference $= \frac{Accounting\ Profit - Taxable\ Income}{Total\ Assets}$	(Mocanu et al., 2021)
Thin Capitalization	THC	Debt to Equity Ratio $= \frac{Total\ Liabilities}{Total\ Equity}$	(Curry & Fikri, 2023)
Rentability	REN	Return on Equity $= \frac{Net\ Income}{Total\ Equity}$	(Nugroho et al., 2024)
Operating Cash Flow	OCF	Operating Cash Flow Ratio $= \frac{Net\ cash\ flow\ from\ Operating\ Activities}{Total\ Assets}$	(Gazali et al., 2020)
Financial Distress	FD	Zmijwski Model $= -4.3 - 4.5 \times ROA + 5.7 \times DAR + 0.004 \times Current\ Ratio$	(Ambarwati & Sriwardany, 2021; Apsari et al., 2024; Rachmawati & Sulbahri, 2020)

Multiple linear regression using a mediation model, which is implemented in EViews 9 software, is used for data analysis. Model validity is guaranteed by the traditional assumption tests, such as the multicollinearity and normality tests. The significance of the dividend policy's mediating effect is assessed using the Sobel test. The Chow, Hausman, and Lagrange multiplier tests are used in model selection to identify the best-fit regression strategy.

To calculate the coefficient of determination in the case of mediation, we adopt the approach used by Cao et al. (2023). This approach follows established methods in the literature for estimating mediation effect sizes, considering potential biases and estimation accuracy under varying sample conditions.

RESULT AND DISCUSSION

Research data must satisfy the traditional assumptions in order for regression modeling to be accurate. A multicollinearity test was performed in this panel data analysis to guarantee the correctness of the model. The test results indicated that the model did not suffer from multicollinearity, as evidenced by the correlation coefficients between variables not exceeding the threshold of 0.85. Additionally, model estimation testing was used to determine which regression model was the best. The findings demonstrated that the Fixed Effect Model (FEM) is the best model for the regression equation, both prior to and following interaction with the moderating variable.

Table 3. Regression Results from EViews and Sobel Test

Variable	t-value	Prob.	Effect	Decision
THC → FD	-4.152489	0.0001	Significant Negative	Accepted
REN → FD	-13.10190	0.0000	Significant Negative	Accepted
OCF → FD	-2.316744	0.0217	Significant Negative	Accepted
THC → TAV	9.305493	0.0000	Significant Positive	Accepted
REN → TAV	9.619137	0.0000	Significant Positive	Accepted
OCF → TAV	2.192425	0.0297	Significant Positive	Accepted
FD → TAV	-11.36623	0.0000	Significant Negative	Accepted
THC → FD → TAV	3.900395	0.0001	Significant Positive	Accepted
REN → FD → TAV	8.585699	0.0000	Significant Positive	Accepted
OCF → FD → TAV	2.270068	0.0232	Significant Positive	Accepted

Source: Processed data using EViews 9.

The regression analysis reveals several significant relationships among the observed variables. Thin capitalization is shown to have a significant negative effect on financial distress with a t-value of -4.152489 and a probability of 0.0001, thereby supporting H1. Rentability also exhibits a significant negative effect on financial distress, confirmed by a t-value of -13.10190 and a probability of 0.0000, supporting H2. Similarly, operating cash flow demonstrates a significant negative relationship with financial distress ($t = -2.316744$; $p = 0.0217$), providing evidence for H3. In addition, financial distress is found to negatively affect tax avoidance, with a t-value of -11.36623 and a probability of 0.0000, leading to the acceptance of H7.

Regarding the direct effects, thin capitalization significantly increases tax avoidance ($t = 9.305493$; $p = 0.0000$), and its indirect effect through financial distress is also significant ($t = 3.900395$; $p = 0.0001$), thus supporting H4 and H8. Rentability likewise shows a positive and significant impact on tax avoidance both directly ($t = 9.619137$; $p = 0.0000$) and indirectly through financial distress ($t = 8.585699$; $p = 0.0000$), thereby supporting H5 and H9. Finally, operating cash flow demonstrates a positive and significant effect on tax avoidance directly ($t = 2.192425$; $p = 0.0297$) as well as indirectly via financial distress ($t = 2.270068$; $p = 0.0232$), confirming H6 and H10.

This study confirms that thin capitalization exacerbates financial distress, highlighting the critical importance of maintaining an optimal balance between debt and equity. The finding reinforces the trade-off theory, which argues that while debt provides tax benefits and supports business expansion, excessive leverage increases the likelihood of financial difficulties (Syavira et al., 2024). Additionally, this study supports earlier research that indicates effective debt management can enhance liquidity and maximize operational revenues, hence lowering the likelihood of financial crisis (Bukhari & Linda, 2022; Efendi et al., 2023). Moreover, an appropriate debt utilization strategy enables companies to grow, increase profitability, and strengthen competitiveness without facing excessive financial pressure (Oktapani & Maryani, 2024; Wijaya & Suhendah, 2023).

Rentability, as another internal factor, also plays a crucial role in mitigating financial distress. High rentability serves as a protective factor against financial distress as it reflects efficient asset management and business sustainability. This result is consistent with the signaling hypothesis, which holds that a company's high rentability gives stakeholders a good indication of its financial health, operational capacity, and ability to easily fulfill financial commitments (Dwiantari & Artini, 2021; Kalbuana et al., 2022). Additionally, this finding is in line with earlier research showing that profitable businesses typically have steady cash flows and sufficient liquidity, which increases their ability to fend off the risk of financial trouble (Fitriyani et al., 2024; Syavira et al., 2024). Conversely, low profitability increases the potential for financial difficulties due to limited funds to meet obligations and finance operations (Nuryanti & Ramdhani, 2023).

Operating cash flow likewise contributes to lowering the risk of financial distress, as strong internal cash generation ensures liquidity and the continuity of business activities. In line with signaling theory, robust operating cash flow serves as a credible indicator of financial stability, demonstrating the firm’s ability to cover operational costs and meet obligations without depending on external financing (Pratiwi & Sasongko, 2023). Moreover, this result aligns with previous studies stating that companies with positive operating cash flows are more trusted by creditors and investors, thereby minimizing the risk of financial distress (Aiyyuffi et al., 2022; Oktasari et al., 2022). Furthermore, high operating cash flow reflects efficient asset management and financial stability, which strengthens the company's resilience against economic pressures (Juliani & Muslihat, 2021).

Financial distress is found to reduce tax avoidance, as firms under financial pressure tend to prioritize compliance in order to minimize additional risks that could further deteriorate their condition. From the perspective of agency theory, managers act more cautiously when facing financial constraints, avoiding opportunistic strategies that may expose the company to penalties or reputational damage (Monika & Noviari, 2021). Additionally, this outcome is in line with earlier studies indicating that companies under financial pressure tend to avoid aggressive tax avoidance strategies, as such actions may attract attention from tax authorities, pose the risk of penalties, and damage their reputation in the eyes of investors and stakeholder (Curry & Fikri, 2023; Pratiwi et al., 2021). Additionally, companies facing financial difficulties are more focused on rescue and restructuring strategies rather than engaging in high-risk tax avoidance practices (Nadhifah & Arif, 2020).

Thin capitalization is shown to increase tax avoidance, both directly and indirectly through financial distress, highlighting the dual role of leverage in corporate tax strategies. Firms with high debt levels often exploit interest expenses as a tax shield to reduce taxable income and lower their tax liabilities (Elen et al., 2024; Gazali et al., 2020). However, excessive debt also increases the risk of financial distress, which may drive companies to further engage in tax avoidance as a survival strategy under financial pressure. This supports the trade-off theory, which states that businesses should balance the tax advantages of debt with the possible expenses of filing for bankruptcy (Dang & Tran, 2021; Susanto, 2022). Moreover, as the risk of financial distress increases, companies may shift toward more conservative tax avoidance strategies to avoid tax penalties and preserve their reputation in the eyes of investors (Curry & Fikri, 2023).

Rentability is found to increase tax avoidance, both directly and indirectly through financial distress, underscoring the role of profitability in shaping corporate tax strategies. From the perspective of agency theory, managers may exploit high profitability by adopting tax minimization practices to boost reported earnings and secure personal benefits such as compensation or reputational gains (Sudibyo, 2022; Tanjaya & Nazir, 2021). Although more profitable firms face lower financial pressure, in certain conditions, they are still driven to adopt tax avoidance as a strategic measure to preserve liquidity and avoid potential financial distress (Sidauruk & Putri, 2022; Sudibyo, 2022). However, the financial flexibility provided by high profitability can also reduce the need to rely on aggressive tax strategies, as such companies are not overly burdened with the need to cut taxes drastically to maintain their financial stability.

Operating cash flow is shown to promote tax avoidance, both directly and indirectly through financial distress, indicating that liquidity plays a key role in shaping corporate tax behavior. Firms with substantial cash flows typically face larger tax liabilities, creating incentives to adopt strategies that minimize their tax obligations (Gazali et al., 2020; Harifath & Kurnia, 2024). According to agency theory, managers utilize the flexibility of cash flows in managing tax reporting to maintain earnings stability or enhance shareholder value (Wijaya, 2022). However, the role of financial distress as a mediator indicates that companies under financial pressure are more likely to avoid taxes in order to preserve cash flow and reduce their financial burdens. Nonetheless, firms in financial distress also face greater risks of tax penalties if their tax avoidance strategies are too aggressive (Monika & Noviari, 2021). Conversely, companies with strong cash flows have greater flexibility in choosing tax strategies, allowing them to engage in more aggressive tax avoidance without significantly increasing the risk of bankruptcy (Gazali et al., 2020; Wijaya, 2022).

The overall findings of this study also resonate with the phenomenon of tax avoidance highlighted in the introduction. The persistence of low tax-to-GDP ratios in Indonesia and the relatively high book-tax difference (BTD) observed in several infrastructure companies, such as PBSA and SUPR during 2021–2023, confirm that tax avoidance remains a pressing issue in this sector. The evidence that thin capitalization and operating cash flow increase tax avoidance, while financial distress reduces such practices, provides empirical support for these observed patterns. It suggests that the strategic importance of infrastructure, coupled with its recent tax incentives, makes this sector particularly vulnerable to aggressive tax planning. By demonstrating how firm-level financial dynamics translate into tax avoidance behavior, this study strengthens the relevance of its contribution to both academic literature and policy debates on sustainable tax regulation in Indonesia’s infrastructure industry.

Table 4. Coefficient of Determination

Model	Adjusted R-squared
Direct Effect	0.838659
Through Mediation	0.662169

Source: Processed data using EViews 9.

The direct model's coefficient of determination, as determined by the Adjusted R-squared, is 0.838659, which means that thin capitalization, rentability, and operating cash flow account for 83.87% of the variation in tax avoidance, with other factors outside the model influencing the remaining 16.13%. Meanwhile, in the model with financial distress as a mediating variable, the independent factors and the mediator account for 66.22% of the variation in tax avoidance, according to the Adjusted R-squared value, which drops to 0.662169. This decline implies that financial hardship does act as a moderator; however, the independent variables' direct influence continues to be more significant in explaining tax avoidance. Overall, the high Adjusted R-squared value, particularly in the direct model, suggests that the study's variables have been appropriately selected and possess strong predictive power for the dependent variables.

CONCLUSION

According to the study's findings, operating cash flow, rentability, and thin capitalization all significantly impact both tax avoidance and financial distress. Financial distress also proved to be a significant mediating variable in the relationship between the three independent variables and tax avoidance, although the direct influence of the independent variables remains more dominant. These findings reinforce the trade-off theory, signaling theory, and agency theory in explaining how thin capitalization, rentability, and cash flow affect corporate financial decisions. Practically, these results imply that financial managers and tax regulators should pay closer attention to leverage levels and cash management strategies to avoid financial distress and reduce excessive incentives for tax avoidance.

However, this study has several limitations, including the use of secondary data that may not fully reflect the actual conditions of the companies, as well as the limited inclusion of other variables that could influence financial distress and tax avoidance, such as corporate governance policies and tax regulations. Therefore, future research is recommended to consider additional factors, expand the scope across industry sectors, and adopt a more comprehensive longitudinal approach to gain deeper insights into the dynamics of financial distress and corporate tax avoidance strategies.

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