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THE EFFECT OF FINANCIAL DISTRESS AND CAPITAL INTENSITY ON TAX AVOIDANCE

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Abstract

This study aims to examine the effect of financial distress and capital intensity on tax avoidance in non-cyclical consumer sector companies listed on the Indonesia Stock Exchange (IDX) during the 2019-2023 period. Tax avoidance is an important concern because although legal, this practice can reduce potential state revenue, especially in a situation of economic recovery after the COVID-19 pandemic. This research is motivated by the inconsistency of previous research results regarding the relationship between financial distress and capital intensity variables with tax avoidance. The method used is a quantitative approach with descriptive research type. Data were obtained through purposive sampling technique from 32 companies, and analyzed using multiple linear regression. The results showed that financial distress has a significant negative effect on tax avoidance, while capital intensity has no significant effect. These findings indicate that companies in financial distress tend to avoid additional risk through tax avoidance. This study contributes to the understanding of corporate behavior in tax management and the importance of financial stability in fiscal compliance.

Keywords: Financial Distress, Capital Intensity, Tax Avoidance

INTRODUCTION

In Tax is an obligation attached to every individual and corporate taxpayer that must be fulfilled as a form of contribution to the state. Refers to the provisions stipulated in the applicable laws and regulations. This obligation is an obligation that cannot provide direct benefits to taxpayers, but tax revenues are utilized by the state to finance public interests. to support public financing and encourage the achievement of optimal public welfare. According to (Mardiasmo, 2016), tax can be defined as a mandatory contribution paid in the form of money and collected by the government referring to the provisions of the law and applicable laws and regulations without deviating from the existence of contraprestasi without direct reward, which is then allocated to finance state expenses. Within the framework of the national economy, tax has a crucial role, given its position as the main reference for state revenue. Data from the Central Bureau of Statistics (2021) shows that more than 80% of the total one of the components of most sources of state revenue income listed in the State Budget (APBN). obtained from the taxation sector. While the rest is obtained from non-tax state revenues and grants.

Taxes are used as a source of financing for various work programs organized by the government with the aim of fulfilling the public interest and improving the level of public welfare. However, the level of realization of tax revenue in Indonesia, the realization is still below the predetermined standard. On the other hand, the Coronavirus Disease 2019 (Covid-19) pandemic has further worsened the performance of tax revenue, which has decreased significantly. 2020 was marked by a 16.9% decline in tax revenue compared to the previous period, where in the previous period tax revenue was able to record an average growth of 7.4% per year. Tax revenue in the period between 2021 and 2022 experienced a recovery and managed to meet the target, but the realization still did not fully match the level of revenue in the pre-pandemic period (Kemenkeu.go.id, 2023).

Tax avoidance is a transaction scheme which is part of the company's strategy to have the aim of optimizing tax expenditures so that the liabilities borne are lower. by taking advantage of loopholes or weaknesses in the applicable tax regulations. (Gusti Maya Sari, 2014) in (Handayani, 2018). The practice of tax avoidance is considered not unlawful as long as it is in accordance with the legal provisions and legal provisions currently applied. However, tax avoidance is perceived as an undesirable activity, especially determined by the government, because it can reduce state revenue and is considered a form of non-compliance. As a party obliged to fulfill tax obligations, companies tend to try to reduce tax payments to a minimum in order to maximize profits for shareholders (Tang & Firth, 2011) in (Rahmadani et al., 2020); (Jusman & Nosita, 2020). Tax avoidance has the potential to reduce tax revenues needed to support the country's economy (Sunarsih et al., 2019). Most companies implement tax avoidance strategies with a specific purpose to divert the tax budget into a budget to fulfill other obligations (Dharma & Ardiana, 2016) in (Mahdiana & Amin, 2020). For example, in the case of PT Coca Cola Indonesia (CCI), it is known that the company carried out tax engineering which resulted in an underpayment of the amount of tax payable of IDR 49.24 billion. This case was then followed up by the Directorate General of Taxes (DGT), which found that PT CCI manipulated tax payments by inflating costs, which in turn had an impact on reducing the tax burden that must be paid (http://money.kompas.com) as well as a tax avoidance case recorded in 2019 involving PT Adaro Energy Tbk which was allegedly involved in tax avoidance efforts through a transfer pricing mechanism between entities in a group company.

The practice of Tax Avoidance is a relevant object of study for further research, considering that even though it is legally considered legal and refers to regulations that have been established through applicable legal provisions, this practice is not expected by the government because it has the potential to reduce state revenue (Rani, 2017).

Financial distress is one element that is anticipated to influence the use of tax evasion. Financial distress represents a situation when the company is in a serious financial condition, this is reflected in the company's inability to fulfill its financial obligations and is at risk of going into a financial crisis (Anugerah et al., 2022). Swandewi and Noviari (2020) state that the condition of financial stress can be the main driver for companies in implementing tax avoidance as part of the company's strategy to maintain the company's operational sustainability.

Based on the empirical findings of research conducted by Swandewi (2020), (Lutfitriyah & Anwar, 2021), Maulana et al. (2018), financial distress is proven to have a positive influence on the company's tendency to implement tax avoidance. The findings of this investigation do not align with the findings submitted by (Monika & Noviari, 2021), and (Alifianti et al., 2017), which indicate that the financial distress situation actually has a negative impact on the implementation of tax avoidance. Meanwhile, research conducted by Rani (2017) produced different findings, where no significant relationship was found between financial distress and tax avoidance.

One of the factors that can influence the level of capital intensity activity is an aspect related to tax avoidance practices that reflect the company's decision to allocate its investment in fixed assets (Akun et al., 2020). Research conducted by Anindyka S et al. (2018) and Yustrianthe (2022) reveal that high capital intensity significantly encourages companies to practice tax avoidance. In contrast, different results were presented by (Puspitasari et al., 2022) and (Alifianti et al., 2017), which found that capital intensity actually has a negative impact on tax avoidance practices. In addition, several studies put forward by (Monika & Noviari, 2021), (Tebiono et al., 2019), Maulana et al. (2018), and Hermanto & Puspita (2022) also become references in this study indicating that capital intensity does not have a significant impact on company decisions regarding tax avoidance.

Based on the analysis of various previous studies, this research was conducted to deepen the understanding of the phenomenon under study. This study is consistent with some of the previous findings. For example, Maulidini and Abubakar (2020) suggest that financial distress negatively affects tax avoidance activities. Meanwhile, capital intensity is considered to have a positive impact on the company's tendency to engage in tax avoidance, as reflected in the results of their analysis. However, these findings contradict the study by (Rengganis & Soetardjo, 2023), which shows a positive influence of financial distress in relation to tax avoidance. Being in the scope of companies categorized based on referring to the applicable sectors based on the Indonesia Stock Exchange (IDX), the use of process indicators to measure Financial Distress through the Altman Z-Score which was developed based on the previous model and designed for companies in general, covers a study period that reflects different conditions than the previous period, given the emergency conditions of Covid-19. This analysis aims to strengthen or weaken tax avoidance practices, hoping to provide inconsistencies in empirical findings related to the effect of the relationship between Financial Distress conditions and the level of Capital Intensity with tax avoidance activities.

REVIEW OF LITERATURE

Tax Avoidance

In Tax avoidance is defined as a legal mechanism employed by entities to minimize tax liabilities by exploiting ambiguities or loopholes within prevailing tax regulations (Suryarini & Tarmudji, 2012). Although not unlawful, this practice is often perceived as unethical due to its potential to undermine government revenue (Sunarsih et al., 2019). Tang and Firth, as cited in Rahmadani et al. (2020), suggest that corporations often engage in tax avoidance to maximize shareholder value. Empirical evidence illustrates that such practices are frequently executed through transfer pricing arrangements and cost manipulation, as observed in notable cases involving PT Coca Cola Indonesia and PT Adaro Energy Tbk, where these entities reduced their taxable obligations through tax engineering strategies.

Financial Distress and Tax Avoidance

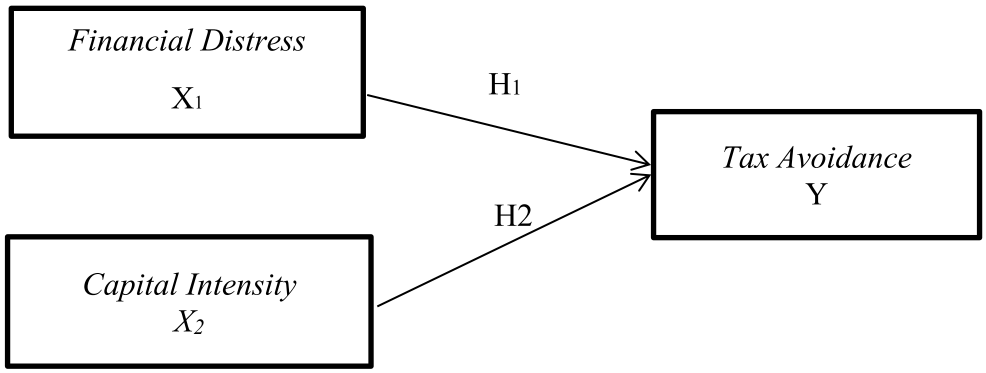
Financial distress refers to a critical financial condition in which a firm struggles to fulfill its financial obligations and is consequently exposed to a heightened risk of insolvency or bankruptcy (Anugerah et al., 2022). Within the framework of agency theory, financial distress may influence managerial discretion, particularly in utilizing tax avoidance strategies as a mechanism to maintain operational viability (Swandewi & Noviari, 2020). Several studies (e.g., Maulana et al., 2018; Swandewi, 2020; Lutfitriyah & Anwar, 2021) provide evidence of a positive relationship between financial distress and the inclination to engage in tax avoidance. Conversely, other empirical investigations, such as those by Monika & Noviari (2021) and Alifianti et al. (2017), indicate a negative or non-significant relationship. Rani (2017), for instance, found no statistically significant association. These divergent findings underscore the need for further empirical inquiry into the nature of this relationship.

Capital Intensity and Tax Avoidance

Capital intensity denotes the extent to which a firm allocates resources to fixed assets relative to its total assets (Suprianto & Aqida, 2020). According to agency theory, firms with higher capital intensity are afforded greater opportunities to reduce taxable income through depreciation-related deductions, thereby potentially facilitating tax avoidance (Anindyka et al., 2018; Yustrianthe, 2022). However, the empirical literature presents mixed findings. While some studies suggest a positive association, others—such as Puspitasari et al. (2022) and Alifianti et al. (2017)—identify a negative influence. Additionally, Monika & Noviari (2021), Tebiono et al. (2019), and Hermanto & Puspita (2022) report statistically insignificant relationships. These inconsistencies suggest that the impact of capital intensity on tax avoidance may be context-dependent and warrant further exploration, particularly during the post-pandemic recovery era when firms are restructuring their financial strategies.

Conceptual Framework

This study is grounded in agency theory, which posits that conflicts of interest often arise between principals (owners) and agents (managers), especially when asymmetrical information is present (Jensen & Meckling, 1976). In such situations, managers may act in ways that optimize their personal utility rather than align with shareholders' interests, including the strategic use of tax avoidance practices.



Based on these considerations, this study proposes the first hypothesis as follows :
H1 : Financial Distress has no significant effect on Tax Avoidance
H2 : Capital intensity has no significant effect on tax avoidance

RESEARCH METHOD

This Research methods refer to a series of systematic procedures designed to achieve research objectives and answer questions or problem formulations that have been set. The research used a quantitative approach with the application of descriptive methods. The quantitative approach was chosen because it allows analysis of research variables objectively through number-based data. Meanwhile, the descriptive method is used to present a systematic, factual, and accurate description of the characteristics of a population or phenomenon that is the object of study (Zulkarnaen et al, 2020). This study utilizes data collection in this research is carried out indirectly by utilizing secondary data from various open references available to the public in the form of verified documents and publications. The study material is derived from the annual and sustainability reports of firms in the consumer non-cyclicals sector listed on the Indonesia Stock Exchange (IDX) from 2019 to 2023.

The Indonesia Stock Exchange's official website (www.idx.co.id) and the official websites of each company provided the data used in this study. Purposive sampling is used in the sample selection procedure.The population in this study includes all entities that are the object of research, with the aim that the findings obtained can represent the population in general. The population in question involves all companies in the Costumer Non-Cyclicals sector listed on the Indonesia Stock Exchange (IDX) during the 2019-2023 period. The sample of 131 companies was selected based on certain criteria, namely: (1) companies that provide complete financial data for 2019-2023 for the calculation of financial distress and capital intensity, and (2) companies that are continuously listed on the Indonesia Stock Exchange (IDX) throughout the study period (3) companies that consistently publish financial reports during the study period, and (4) companies that did not experience a deficit during the period.

Table 1.
Criteria Sample

Sample Criteria	**Total**
Population	131
Companies that are listed consecutively on the Indonesia Stock Exchange (IDX) during the observation period from 2019 to 2023	(26)
Companies that publish financial reports consecutively during the observation period from 2019 to 2023	(13)
Companies that have never incurred losses	(60)
Total companies that meet the criteria	24

This study consists of 2 independent variables, namely: Financial Distress and Capital Intensity. There is 1 dependent variable, namely Tax Avoidance. The following is an operationalization table.

Table 2.
Operational Definition of Variables

Variable	**Concept**	**Indicator**	**Scala**
Financial Distress	Financial distress is a condition in which the company is under serious financial pressure, which is reflected in its inability to carry out financial obligations that must be met, and if it continues, it can increase the risk of bankruptcy (Anugerah et al., 2022).	Z-Score = 1,21X1+1,4X2 + 3,3X3+0,6X4+1,0X5 X1 : Current assets - current debt / Total Assets X2 : Retained earnings / Total Assets X3 : Profit before tax / Total Assets X4 : Number of shares x price per share / total debt X5 : Sales / Total Assets	Rasio
Capital Intensity	According to Noviari (2017), Capital Intensity is an investment made by the company, which is specifically related to the distribution of capital in fixed assets and inventory.	*Capital Intensity* : Total Fixed Assets / Total Assets	Rasio
Tax Avoidance	Tax Avoidance is a tax expenditure efficiency strategy carried out through a tax avoidance strategy carried out with transactions that are not included in the tax object	Income Tax Expense / Profit Before Tax	Rasio

	(Suryarini and Tarmudji, *2012).*		

In a scientific study that applies a regression model as an analytical tool, it is very important to ensure that the model has met the various requirements set out in the basic assumptions, this process includes testing for normality, autocorrelation, multicollinearity, and heteroscedasticity. The fulfillment of these requirements aims to ensure the validity and reliability of the analytical results obtained, as well as to minimize the possibility of bias or estimation errors that can affect the interpretation and conclusions of the research conducted (K. Novi and W. Suryatmin, 2022).

In this study, a multiple linear regression model is used as an analytical method tool that aims to predict Tax Avoidance. This model is also utilized in order to identify the level of contribution of all independent variables based on simultaneously, these variables have an influence on the dependent variable which is the object of analysis in this study (Teku and Mulyadi, 2023). The calculation formula for the linear regression model applied to the formulation of this study is presented as follows :

$$\boldsymbol{Y = \alpha + \beta 1 . CI + \beta 2 . II + \varepsilon}$$

Description of the linear regression equation formula :

- Dependent Variable (Y): The value of tax avoidance.
- Constant (α): The basic value of tax avoidance when all independent
- Independent Variable 1
  - Capital Intensity (CI)
  - The effect is measured by the coefficient (β1).
  - The contribution to tax avoidance is β1 * CI.
- Indenpenden variable 2
  - Capital Intensity (II)
  - The effect is measured by the coefficient (β2).
  - The contribution to tax avoidance is β2 * II.
- Error (ε): A component that reflects variation in tax avoidance that is not explained by the model.

RESULT AND DISCUSSION

This research aims to analyze the impact of the influence of financial distress and capital intensity on the application of tax avoidance strategies by companies. The data processing and analysis steps in this study were carried out by utilizing SPSS statistical software, which serves as a tool in the application of multiple linear regression analysis to test the relationship between variables.

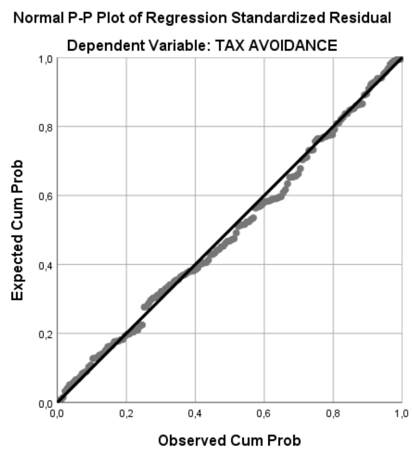
Classical assumption test
Multicollinearity

Coefficients[a]

Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.	Collinearity Statistics Tolerance	Collinearity Statistics VIF
1	(Constant)	,221	,008		28,067	,000		
	FINANCIAL DISTRESS	,000	,001	,033	,411	,682	,971	1,030
	CAPITAL INTENSITY	,005	,017	,022	,275	,784	,971	1,030

a. Dependent Variable: TAX AVOIDANCE

Multicollinearity testing is carried out with the aim of identifying the potential linear relationship between independent variables in the regression model. From the test results, it is known that the resulting Tolerance value is 0.971. For the Financial Distress and Capital Intensity variables, the test results indicate that the Variance Inflation Factor (VIF) value on both variables is 1.030.



Normality Test (Kolmogorov-Smirnov)

One-Sample Kolmogorov-Smirnov Test

		Unstandardized Residual
N		161
Normal Parameters[a,b]	Mean	,0000000
	Std. Deviation	,03511995
Most Extreme Differences	Absolute	,055
	Positive	,055
	Negative	-,028
Test Statistic		,055
Asymp. Sig. (2-tailed)		,200[c,d]

a. Test distribution is Normal.
b. Calculated from data.
c. Lilliefors Significance Correction.
d. This is a lower bound of the true significance.

Kolmogrov-smirnov Test: From the results of normality testing using Kolmogorov-Smirnov, a value of significance (Asymp. Sig. (2-tailed)) of 0.200.

Autocorrelation Test (Durbin-Watson)

Model Summary[b]

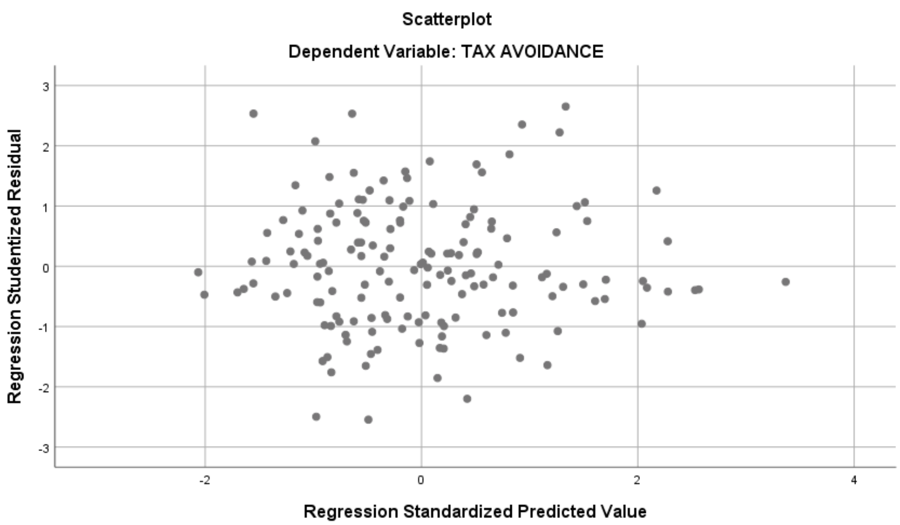
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	,037[a]	,001	-,011	,03534	1,363

a. Predictors: (Constant), CAPITAL INTENSITY, FINANCIAL DISTRESS

b. Dependent Variable: TAX AVOIDANCE

The Autocorrelation test is carried out to ensure that there is no correlation between residuals (prediction errors) in the regression model. The du value from the Durbin-Watson table is 1.363. These results show a DW value of 1.363, which meets the criteria. This means that the model does not show a repeating pattern, so the model is considered free from autocorrelation.

Heteroscedasticity Test



The purpose of performing the heteroscedasticity test is to identify whether the residuals generated from each observation have different variances compared to other observations. The scatterplot is used as a tool to evaluate this test. The scatter pattern indicates that the regression model does not show the presence of heteroscedasticity symptoms.

Multiple Linear Regression Test

The multiple linear regression analysis method testing process is used to identify and measure the extent to which the independent variable affects the dependent variable provided that all model assumptions have been met. The multiple linear regression model applied in this study is structured with the following equation :

$$\boldsymbol{Y = \alpha + \beta 1.CI + \beta 2.II + \varepsilon}$$

The interpretation of the regression equation is:

- Constant (0.291)

- Financial Distress Regression Coefficient (-0.372) : These results indicate that an increase of one unit in the Financial Distress variable will result in a decrease in the level of Tax Avoidance by 0.372.
- Capital Intensity Regression Coefficient (-0.157) : These results indicate that with an increase of one unit in the Capital Intensity variable, it will cause a decrease in the level of Tax Avoidance value achieved by . 0,157.

Hypothesis test

Hypothesis testing is carried out with the intention of evaluating the level of significance of the relationship between the independent variable and the dependent variable, both simultaneously and individually.

F Test (Significance Test)

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	,000	2	,000	,106	,900[b]
	Residual	,197	158	,001		
	Total	,198	160			

a. Dependent Variable: TAX AVOIDANCE

b. Predictors: (Constant), CAPITAL INTENSITY, FINANCIAL DISTRESS

To assess whether the variables of Financial Distress and Capital Intensity simultaneously significant influence on Tax Avoidance analyzed through the application of the F test. Based on the results of the analysis, the calculated F value is 106 with a significance level of 0.900.

Test t (Partial Significance Test)

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	,221	,008		28,067	,000
	FINANCIAL DISTRESS	,000	,001	,033	,411	,682
	CAPITAL INTENSITY	,005	,017	,022	,275	,784

a. Dependent Variable: TAX AVOIDANCE

- Financial Distress: The analysis results produced a value of 0.411 with a significance level of 0.628. This finding indicates that the Financial Distress variable does not have a significant effect, because the level of significance obtained (0.628) is above the specified significance threshold, which is 0.05.
- Capital Intensity: Based on the test results, a significance level of 0.784 is obtained, which is higher than the t count of 0.022. Thus, partially, Capital
- Intensity does not have a significant influence on the variables studied.

Coefficient of Determination

The coefficient of determination (R^2) serves to assess the extent to which the model is able to explain the variations that occur in the dependent variable. In this study, the resulting R^2 value is 0.001, which indicates that the model is only able to explain 1% of the variation in Tax Avoidance practices.

The results of this study reveal that Financial Distress has a positive and significant influence on Tax Avoidance practices. However, the second hypothesis in this study cannot be accepted, because the empirical findings actually show the opposite relationship, namely the higher the level of Financial Distress, the lower the level of tax avoidance

CONCLUSION

This study aims to examine the impact of Financial Distress and Capital Intensity on the practice of Tax Avoidance Practices in companies operating in the non-cyclical consumer sector and listed on the Indonesia Stock Exchange (IDX) during the period 2019 to 2023. Based on the results of data analysis that has been carried out and the findings obtained, the conclusions that can be conveyed from this study are as follows :

- Financial Distress does not have a significant influence on Tax Avoidance practices, with a significance level of 0.628. Thus, the first hypothesis in this study cannot be accepted.
- Capital Intensity also has no significant effect on Tax Avoidance, as indicated by the significance level of 0.784. Therefore, the second hypothesis is also not accepted.
- In addition, simultaneously, the two variables also do not have a significant impact on Tax Avoidance in companies that are the object of research.

Thus, Financial Distress and Capital Intensity do not act as the main factors in influencing Tax Avoidance in non-cyclical consumer sector companies during the 2019-2023 period.

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