



ESG RISK AND TAX AVOIDANCE: SIGNALING INSIGHTS FROM INDONESIAN PUBLIC FIRMS

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Abstract

This study investigates the effect of Environmental, Social, and Governance (ESG) Risk on corporate tax avoidance among publicly listed firms in Indonesia. While prior research has widely examined the influence of ESG performance and disclosure on corporate fiscal behavior, limited attention has been paid to ESG Risk as a signal of sustainability governance weaknesses. Drawing on signaling theory, this study explores whether firms with higher ESG Risk scores, reflecting greater exposure to unmanaged ESG issues, are more likely to engage in tax avoidance practices. The analysis is based on a quantitative approach using cross-sectional data from 69 companies listed on the Indonesia Stock Exchange in 2022 that Sustainalytics has rated. Multiple linear regression analysis results reveal a significant negative relationship between ESG Risk and tax avoidance. This suggests that firms facing higher sustainability-related risks may attempt to restore their reputation or stakeholder trust by adopting more compliant fiscal strategies. The findings contribute to the literature by demonstrating how ESG Risk may function as a reputational signal that shapes corporate behavior beyond sustainability disclosures.

Keywords: ESG Risk, Governance, Signaling Theory, Sustainability, Tax Avoidance

INTRODUCTION

Climate change, social pressure, and governance crises have driven a paradigm shift in business from a short-term profit orientation to a more inclusive and sustainable approach. Environmental, Social, and Governance (ESG) has become a vital framework for companies in building long-term sustainability. ESG is no longer merely viewed as a non-financial reporting mechanism but as representing a company's values and ethics in addressing complex environmental, social, and governance challenges (Gutterman, 2024; Ozili, 2021). As investor and public awareness of corporate responsibility increases, companies integrate ESG elements into their business strategies in response to global demands for sustainability (Gutterman, 2024; Ozili, 2021).

The implementation of ESG principles has become part of corporate communication strategies to build public trust, wherein companies aim to position themselves not only as economic entities but also as social actors accountable to the environment and society (Ozili, 2021; Turiman et al., 2024). Through sustainability reports, companies disclose various non-financial activities such as carbon emission management, energy efficiency, social engagement, and accountable governance structures, strengthening ethical reputations and long-term credibility (Gutterman, 2024; Wagenhofer, 2024). These reports are strategic narratives shaping stakeholder perception and meeting market demands for sustainability transparency (Yan, 2024). However, within the context of information asymmetry, concerns have arisen that ESG may be utilized as a symbolic signal that does not necessarily reflect substantive sustainability practices (Ozili, 2021; Scott, 2015). This occurs when companies issue selective or cosmetic disclosures to gain public approval and regulatory relief without truly internalizing sustainability values into their core operations.

A growing concern in sustainable business practice is the misalignment between the socially responsible image portrayed through ESG reporting and the actual fiscal behavior of companies, particularly regarding tax avoidance. ESG is frequently used to demonstrate a company's commitment to environmental, social, and governance issues and build public



legitimacy while attracting sustainability-conscious investors (Gutterman, 2024; Yan, 2024). Through sustainability disclosures, firms construct narratives of climate action, community development, and governance integrity (Wagenhofer, 2024). Nevertheless, behind such narratives, some companies continue to engage in tax avoidance, business decisions that may be lawful but often contradict ethical standards and principles of social responsibility. Tax avoidance includes profit shifting to low-tax jurisdictions, the misuse of tax incentives, or transfer pricing arrangements, all aimed at minimizing tax liabilities without directly violating laws (Hanlon & Heitzman, 2010; Lietz, 2013). In such cases, ESG is potentially used as a reputational signal to obscure opportunistic tax behavior, exploiting stakeholder information gaps. The discrepancy between the sustainability narrative and actual tax behavior raises critical questions about the integrity of ESG practices, whether companies are genuinely committed to comprehensive sustainability, including fiscal responsibility, or whether ESG is merely a tool for strategic self-presentation without substantive behavioral alignment.

This inconsistency between ESG signals and tax behavior casts doubt on the authenticity of corporate sustainability commitments and the reliability of ESG as a credible signal. Amid rising expectations for responsible corporate conduct, ESG is widely employed as a communication device to indicate concern for environmental, social, and governance matters (Gutterman, 2024; Ozili, 2021). In the signaling theory framework (Spence, 1973), ESG functions as a positive signal sent by management to investors and the public to reduce information asymmetry and enhance the perception of ethical and transparent conduct. However, not all signals reflect actual practices. In reality, companies may continue to engage in tax avoidance, while legal, often perceived as unethical due to its impact on state revenue and social equity (Hanlon & Heitzman, 2010; Lietz, 2013), despite publicly promoting ESG compliance. Companies facing high ESG risk, which may indicate weaknesses in sustainability governance, are suspected of being more inclined toward tax avoidance. Therefore, examining the relationship between ESG risk and tax avoidance is essential for deepening our understanding. Such investigation is necessary to ensure that ESG reflects a company's integrity, including fiscal compliance, and to contribute meaningfully to sustainability accounting literature and regulatory oversight practices.

Several studies have explored the relationship between ESG and tax avoidance, yielding mixed results. Agustini et al. (2023) find that companies with higher ESG performance tend to engage less in aggressive tax avoidance, reinforcing the view that ESG can function as a control mechanism for ethical corporate behavior, including tax matters. In the context of Chinese firms, Jiang et al. (2024) show that attention to ESG improves external monitoring and internal control quality, ultimately reducing tax avoidance. Elgharabawy & Aladwey (2025) find a generally negative association between ESG scores and tax avoidance in the UK but also note that higher governance scores may increase the potential for systematic tax planning. Domestically, Khusna & Subandi (2025) report that ESG disclosure by large Indonesian companies negatively correlates with tax avoidance, indicating that sustainability reporting can signal fiscal compliance. Focusing on Indonesian state-owned enterprises, Khairin & Firmansyah (2025) show that ESG disclosure moderates the relationship between company growth strategies and tax avoidance. However, the direct influence of ESG on such practices is not always consistent. Oktiani & Sanulika (2024) explicitly find that firms with strong ESG commitments are more tax-compliant. A similar conclusion is reached by Sadjiarto et al. (2024), who find that higher ESG performance is associated with lower levels of tax avoidance, suggesting that sustainability-oriented firms are more transparent in their tax reporting. Meanwhile, although Sugimin et al. (2024) utilize ESG Risk Ratings from Sustainalytics, their interpretation aligns more closely with ESG performance,



where lower ESG Risk scores (indicating better ESG standing) are associated with reduced tax avoidance. These studies collectively emphasize the role of ESG-related indicators—particularly performance metrics—in shaping corporate tax behavior, though they do not precisely frame ESG risk as unmanaged sustainability exposure. Interestingly, Hidayat & Herawaty (2025) find a positive relationship between ESG disclosure and tax avoidance in specific sectors, suggesting that ESG may be used strategically to deflect public and regulatory scrutiny. Son (2024) emphasizes that negative ESG incidents or realized reputational risks can pressure firms to reduce tax avoidance.

Despite these findings, there remains a gap in the literature regarding the specific influence of ESG risk, distinct from ESG performance or disclosure, on corporate tax avoidance, especially in developing countries like Indonesia. ESG risk reflects a firm's exposure to failures in meeting sustainability expectations, which can directly affect reputation, operational stability, and regulatory relationships. Thus, high ESG risk may signal a broader inconsistency between declared sustainability values and actual practices, including tax management.

This study aims to examine the effect of ESG risk on tax avoidance empirically. In this context, using signaling theory is relatively uncommon in previous research. ESG signals that companies adhere to responsible business practices, particularly through external disclosures and ratings. However, little is known about whether ESG risk, as an indicator of misalignment between sustainability claims and operational realities, relates to other managerial behaviors such as tax avoidance. In contrast to prior studies that have focused on ESG disclosure or ESG performance, this research positions ESG risk as a key variable reflecting deficiencies in sustainability and governance management that may influence corporate fiscal decisions. Theoretically, this study contributes to the development of sustainability accounting literature by highlighting the role of ESG as a signal that not only shapes market perception but is also connected to real economic behaviors such as tax compliance. Practically, the findings are expected to provide strategic insights for tax authorities in designing risk-based supervision approaches that consider non-financial risk profiles. This study is also relevant for capital market regulators and standard-setters, as it may serve as a foundation for developing more substantive and integrity-driven ESG reporting systems, thereby preventing the use of ESG merely as a reputational tool and ensuring that it genuinely reflects the values and conduct expected from companies in promoting long-term sustainability.

LITERATURE REVIEW

In signaling theory, the relationship between firms and external stakeholders—such as investors, tax authorities, and the public—is characterized by information asymmetry, where management possesses internal information that is not fully accessible to outsiders. To bridge this information gap, firms send observable signals, such as disclosures, ESG ratings, or policies, that can be interpreted as indicators of their values, performance, or governance quality (Spence, 1973). Signaling theory explains that managers deliberately use such signals to influence how the market perceives the firm's ethical behavior, value orientation, or strategic commitment (Ross, 1977). In sustainability, disclosing ESG information or achieving high ESG scores is often regarded as a credible signal of a company's responsibility toward environmental, social, and governance issues.

However, not all signals accurately reflect a firm's underlying behavior. In many cases, firms may use ESG-related disclosures as strategic tools to enhance legitimacy and avoid external scrutiny, especially without strong enforcement mechanisms or third-party verification. As noted by Firmansyah et al. (2023), the absence of standardized ESG assurance creates room for firms to



manage perceptions through symbolic compliance rather than through substantive action. This concern raises the possibility that ESG reporting may be used to construct a sustainable image while masking managerial practices that deviate from the values of transparency and accountability.

One of the practices that may contradict sustainability values is tax avoidance. While tax avoidance is legal, it is often viewed as ethically questionable because it reduces a firm's fiscal contribution to society and undermines the principles of social equity (Hanlon & Heitzman, 2010; Lietz, 2013). In this regard, signaling theory also suggests that there can be a divergence between the signals projected by the firm and its actual behavior, especially when firms have incentives to maintain a responsible image while engaging in opportunistic financial practices. This creates room for signaling failure, where the firm's outward commitment to ESG is inconsistent with its internal decision-making, particularly in tax-related strategies.

Previous studies have mostly focused on the relationship between ESG performance or ESG disclosure and corporate tax avoidance practices. The results of studies by Agustini et al. (2023), Elgharabawy & Aladwey (2025), Jiang et al. (2024), and Khusna & Subandi (2025) show that companies with high ESG performance or good transparency tend to have lower levels of tax avoidance. This finding strengthens the view that ESG can function as an ethical and reputational constraint on opportunistic behavior. Similar findings were also put forward by Oktiani & Sanulika (2024) who explicitly stated that companies with strong ESG commitments tend to comply more with tax obligations. Sadjiarto et al. (2024) also concluded that increased ESG performance is negatively associated with tax avoidance, indicating that more sustainability-oriented companies will be more transparent in their tax reporting. Meanwhile, although Sugimin et al. (2024) using ESG Risk Rating from Sustainalytics, their interpretation is closer to the concept of ESG performance, where lower ESG risk scores (reflecting better ESG positions) are associated with lower levels of tax avoidance. Thus, these studies emphasize the role of ESG performance indicators in influencing corporate fiscal behavior and have not explicitly framed ESG risk as exposure to sustainability failures that have not been adequately managed.

This study takes a different approach by shifting the focus from ESG performance to ESG risk (ESG Risk). This construct reflects corporate exposure to environmental, social, and governance issues that have not been addressed or are not well managed. Unlike ESG performance, which emphasizes achievement and disclosure, ESG risk highlights the vulnerability and lack of corporate readiness to meet sustainability obligations. Fachrezi et al. (2024) explain that ESG risk indicates a company's failure to achieve sustainability goals and reflects structural weaknesses in the sustainability governance, transparency, and internal oversight systems. Within the framework of signaling theory (Spence, 1973), high ESG risk can be a negative signal to external stakeholders because it indicates a mismatch between claimed sustainability values and actual company practices. Companies with high levels of ESG risk may be encouraged to prioritize short-term financial efficiency, including through aggressive tax avoidance strategies, as a form of compensation for weak sustainability management.

Although the literature that directly examines the relationship between ESG risk and tax avoidance is still limited, several recent studies have begun to support the direction of this relationship. Sugimin et al. (2024), within the framework of interpreting ESG risk as a proxy for sustainability performance, found that companies with higher ESG risk scores tend to engage in greater tax avoidance than companies with lower risk. This finding provides an initial foundation for further research that positions ESG risk as a signal of weak sustainability governance that can encourage opportunistic fiscal behavior.



Thus, it can be inferred that high ESG risk does not reflect a genuine commitment to sustainability but signals managerial failure in overseeing and integrating ESG principles into business decisions. This weakness may stem from poor internal controls, lack of board oversight, or a dominant focus on short-term financial outcomes, including tax minimization strategies. In such cases, managers may exploit the gap between perception and practice, using positive ESG rhetoric while engaging in aggressive tax behavior. Therefore, this study posits that companies with high ESG risk are more likely to engage in tax avoidance than those with well-managed and transparent ESG systems.

H₁: ESG risk is positively associated with corporate tax avoidance.

METHODS

This study employs a quantitative approach using secondary data from the annual financial statements of companies listed on the Indonesia Stock Exchange (IDX) that have been assigned ESG Risk Ratings by the independent agency Sustainalytics. ESG Risk data were collected from financial platforms such as <https://finance.yahoo.com> and the official IDX website <https://www.idx.co.id>. The sample was selected using a purposive sampling method with the following main criteria: (1) the company is listed on the IDX, (2) the company has an ESG Risk Rating score for the year 2022, and (3) the company has complete and relevant financial data for the year 2022 following the research variables. Based on these criteria, this study's total number of observations is 69 companies.

This study uses tax avoidance as the dependent variable, which is measured using the proxy $ETR_x - 1$, where ETR refers to the Effective Tax Rate, calculated by dividing tax expense by pre-tax income. By subtracting this ratio from 1, the value reflects how much a firm reduces its tax obligations relative to the statutory tax rate. A higher value of this proxy indicates a higher degree of tax avoidance. The use of effective tax rate as a basis for measuring tax avoidance is consistent with the approach employed in several prior studies (Hanlon & Heitzman, 2010; Nidaurrifa et al., 2024), who emphasized its relevance in capturing firms' tax planning behavior within the bounds of legal compliance.

The independent variable in this research is ESG Risk, which is measured based on the ESG Risk Rating issued by Sustainalytics. This rating assesses a company's exposure to industry-specific environmental, social, and governance risks and evaluates how effectively the company manages those risks. The ESG Risk score incorporates governance structure, material ESG issues, and idiosyncratic exposure, where a higher score indicates that a company faces higher unmanaged ESG risks. This measurement framework has been widely adopted in recent studies on ESG-related corporate behavior, including Fachrezi et al. (2024) and Firmansyah et al. (2023), particularly in emerging market settings.

The study includes three control variables for firm characteristics influencing tax behavior. Firm size is proxied by the natural logarithm of total assets. Larger firms tend to attract more public and regulatory attention, which may affect their tax strategies, as shown in studies such as Jiang et al. (2024). Leverage is measured by the ratio of total liabilities to total assets, representing the extent to which a company relies on debt financing. Firms with higher leverage may benefit from interest deductibility, potentially reducing their taxable income, as discussed by Elgharabawy & Aladwey (2025). Profitability is captured by return on assets (ROA), calculated as net income divided by total assets. Firms with higher profitability generally have more taxable income, which may result in higher effective tax payments unless tax planning is involved. This approach is supported by previous research, including (Hidayat & Herawaty, 2025).



To test the relationship between ESG Risk and tax avoidance, this study employs multiple linear regression analysis using cross-sectional data from 2022. The cross-sectional approach is appropriate because the research focuses on observing the behavior of a group of companies at a single point in time without tracking changes across multiple periods. This method allows for examining how ESG Risk and selected control variables influence tax avoidance practices among publicly listed firms in Indonesia. Before the regression, the dataset was tested for classical linear regression assumptions, including normality, multicollinearity, and heteroscedasticity, to ensure that the model meets the minimum statistical requirements for validity and reliability.

The regression model used in this study is designed to test the direct effect of ESG Risk on tax avoidance while controlling for other firm-specific factors such as firm size, leverage, and profitability. The model specification is as follows:

$$TAXAV_i = \beta_0 + \beta_1 ESGRISK_i + \beta_2 SIZE_i + \beta_3 LEV_i + \beta_4 ROA_i + \varepsilon_i$$

Where TAXAV represents the firm's level of tax avoidance, measured using the ETRx-1 proxy; ESGRISK is the ESG Risk score based on the Sustainalytics rating; SIZE is the natural logarithm of total assets, representing firm size; LEV is the ratio of total liabilities to total assets, representing leverage; ROA is return on assets, calculated as net income divided by total assets, representing profitability; ε is the error term.

RESULTS AND DISCUSSIONS

Table 1 presents the descriptive statistics for all variables used in this study, based on 69 firm-year observations. The variables include the dependent variable (TAXAV), the main independent variable (ESG Risk), and the control variables (SIZE, LEV, and ROA).

Table 1 Descriptive Statistics

Variabel	Mean	Med.	Max.	Min.	Std. Dev.	Obs.
ESG Risk	31.1404	29.7600	53.1000	18.1400	8.9736	69
SIZE	31.3440	31.1467	35.2282	28.1479	1.4843	69
LEV	0.1452	0.0986	0.5418	0.0000	0.1467	69
ROA	0.0962	0.0725	0.4543	0.0002	0.0923	69
TAXAV	-0.2558	-0.2158	-0.0049	-0.9285	0.1651	69

The average ESG Risk score across the sample is 31.14, with a minimum of 18.14 and a maximum of 53.10, indicating a fairly wide range of ESG risk levels among the observed firms. The standard deviation of 8.97 suggests moderate variation in ESG risk exposure. The median ESG Risk score is 29.76, slightly lower than the mean, which may indicate a right-skewed distribution. For firm size (SIZE), the mean is 31.34, with values ranging from 28.15 to 35.23 and a standard deviation of 1.48. This reflects that the sample firms are relatively large and exhibit moderate variation in total assets, as the natural logarithm of total assets typically measures SIZE.

The leverage ratio (LEV) has a mean of 0.145, with values ranging from 0.00 to 0.54 and a standard deviation of 0.15. The relatively low mean and median (0.10) suggest that most firms in the sample operate with conservative debt levels, although there are firms with significantly higher leverage. The average return on assets (ROA) is 0.096, with a minimum of 0.0002 and a maximum of 0.454, indicating varying levels of profitability across firms. The standard deviation of 0.092 shows a moderate dispersion in performance. The dependent variable, tax avoidance (TAXAV), has a negative mean of -0.256, with a median of -0.216, a minimum of -0.929, and a maximum of approximately -0.005. This negative mean indicates that, on average, firms report effective tax rates



below the statutory rate, consistent with the practice of tax avoidance. The standard deviation of 0.165 implies a moderate degree of variation in the extent of tax avoidance.

In summary, the descriptive statistics reveal several key characteristics of the firms in the sample. Overall, firms exhibit a moderate level of ESG risk, with a fairly wide distribution, suggesting varying degrees of exposure to environmental, social, and governance issues. The size of the firms is relatively large with moderate variation, reflecting the inclusion of well-established companies. Leverage levels are generally low, indicating that most firms adopt conservative financial structures, though a few are more highly leveraged. Profitability, as measured by ROA, varies considerably across the sample, showing differences in operational efficiency. Importantly, the negative average value of tax avoidance (TAXAV) indicates that many firms are engaged in tax avoidance behavior, as reflected in effective tax rates lower than statutory benchmarks. Together, these patterns provide a meaningful foundation for further analysis of how ESG risk and firm characteristics relate to tax avoidance behavior.

After passing the classical assumption tests, including normality, multicollinearity, heteroscedasticity tests, the multiple linear regression analysis was conducted to examine the effect of ESG Risk and control variables on tax avoidance. The results of the hypothesis testing are summarized in Table 2 below.

Table 2 The Summary of Hypothesis Test

Variable	Coeff	t-Stat	Prob.	
C	-0.4102	-4.3908	0.0001	***
ESG Risk	-0.0028	-13.0797	0.0000	***
SIZE	0.0073	2.5746	0.0067	***
LEV	0.0037	0.1302	0.4485	
ROA	0.2825	3.6049	0.0004	***
R-squared	0.8250			
Adjusted R-squared	0.8094			
F-statistic	53.0231			
Prob(F-statistic)	0.0000			

The regression results indicate a significant negative relationship between ESG Risk and tax avoidance, meaning that firms with higher ESG Risk scores tend to be less involved in aggressive tax minimization strategies. This finding suggests that companies facing greater exposure to environmental, social, and governance risks are more likely to act transparently in fulfilling their tax obligations. Rather than engaging in practices that would further jeopardize their reputation or invite scrutiny, these firms appear to demonstrate stronger compliance with tax regulations. This result, however, contradicts the initial hypothesis, which proposed a positive relationship between ESG Risk and tax avoidance. The hypothesis was grounded in the assumption that companies with poor sustainability governance, as reflected in higher ESG Risk, would also be inclined toward other opportunistic behaviors, such as tax avoidance, due to weak internal controls, poor ethical culture, or a strong focus on short-term financial outcomes. From this standpoint, ESG Risk was expected to function as a negative signal of overall managerial quality, increasing the likelihood of aggressive tax behavior.

Nonetheless, the empirical evidence from this study offers a different narrative. It aligns with prior findings in both local and international contexts that reveal an inverse relationship between ESG-related indicators and tax avoidance. For instance, Agustini et al. (2023) and Jiang



et al. (2024) report that firms with stronger ESG performance are likelier to demonstrate tax compliance. Furthermore, although Sugimin et al. (2024) used ESG Risk Ratings as the proxy, their interpretation of the metric aligns with ESG performance, and they similarly found that firms with better ESG standing (i.e., lower risk scores) were less likely to avoid taxes.

Additional insights can also be drawn from the work of Hidayat & Herawaty (2025), who found a positive relationship between ESG disclosure and tax avoidance in specific sectors. This suggests that some firms may use ESG reporting not to reflect genuine sustainability practices but as a strategic tool to deflect public and regulatory scrutiny, allowing them to engage in opportunistic fiscal behavior behind a veil of responsible image. Meanwhile, Son (2024) emphasizes that realized ESG-related incidents—such as environmental or social controversies—can lead to reputational damage that pressures firms to reduce tax avoidance, indicating that external visibility of ESG shortcomings can act as a disciplining force.

These findings suggest a more nuanced understanding of ESG Risk and its relationship with tax behavior. While high ESG Risk might theoretically signal a permissive environment for aggressive tax planning, in practice, it may also trigger reputational safeguards, such as more cautious fiscal strategies, particularly in settings where stakeholders closely monitor ESG metrics. From a signaling theory perspective, this highlights the dual role of ESG risk: not only as a warning sign of internal deficiencies but also as a driver for corrective behavior when the potential for reputational or regulatory backlash becomes salient.

From the signaling theory perspective, this result can still be explained logically. According to Ross (1977) and Spence (1973), signals are tools firms use to influence the perception of external parties, particularly when there is asymmetric information between internal management and outside stakeholders. High ESG Risk normally acts as a negative signal, indicating that a firm may not manage its sustainability responsibilities effectively. However, when such a signal becomes publicly visible or widely monitored, it can trigger corrective behavior. Firms may attempt to offset the reputational damage caused by their poor ESG profile by demonstrating accountability in other areas, including tax compliance. This pattern aligns with the concept of reputational repair signaling, where companies consciously adopt more ethical practices in one area to compensate for weaknesses in another.

Firmansyah et al. (2023) support this notion by arguing that ESG Risk visibility pressures companies to adjust their behavior, particularly when the firm is under scrutiny by regulators, investors, or the media. When a firm's ESG risk is high and known, tax behavior becomes part of the firm's broader narrative to restore stakeholder confidence. Also, Son (2024) finds that distribution companies experiencing higher ESG incidents, reflecting realized sustainability failures—are less likely to engage in aggressive tax avoidance. This suggests that such companies may proactively adopt more conservative tax strategies to manage reputational risk and preserve stakeholder trust, especially in sectors susceptible to ESG scrutiny.

This behavior may be especially common in countries like Indonesia, where sustainability issues gained stronger regulatory and public attention in 2022. The OJK, IDX, and DJP have increasingly emphasized transparency and corporate responsibility, including integrating non-financial risks like ESG into investor and regulatory evaluations. Firms with high ESG Risk may anticipate more intense scrutiny, not just of their ESG disclosures but of their overall ethical conduct, including tax payments. As a result, instead of compounding the negative signal, these firms may choose to be more fiscally conservative to avoid reinforcing public doubts about their governance.



Additionally, Fachrezi et al. (2024) argue that institutional pressures in emerging markets such as Indonesia are becoming more influential in shaping corporate behavior. ESG Risk, in such environments, is no longer a hidden internal concern; it has become a factor in stakeholders' external evaluations. Thus, to avoid regulatory penalties or reputational losses, firms with high ESG Risk might prefer to demonstrate compliance in visible areas such as taxation, which are increasingly monitored and easy to verify.

Thus, although the negative relationship between ESG Risk and tax avoidance contradicts initial expectations, it makes sense when viewed through the dynamic lens of signaling behavior. High ESG Risk can be an indicator of weakness and a trigger for behavioral correction. Firms may reduce tax avoidance to preserve or rebuild legitimacy, signaling a willingness to act responsibly despite sustainability shortcomings. This finding highlights the complex and adaptive nature of corporate signaling, especially in environments where public trust, regulation, and reputational capital play a growing role in business strategy.

CONCLUSION

This study examines ESG Risk's effect on corporate tax avoidance among publicly listed companies in Indonesia. The results show a significant negative relationship, indicating that firms with higher ESG Risk tend to engage less in tax avoidance practices. While this finding contradicts the initial hypothesis that a positive association is expected, it can be explained through signaling theory. ESG Risk may trigger corrective behavior, where firms attempt to signal their accountability by improving their tax compliance in response to reputational or regulatory pressures. In the Indonesian context, especially amid increasing attention to sustainability and tax governance, this pattern reflects an emerging tendency among firms to offset ESG weaknesses with more responsible fiscal practices. This study provides new insights into how non-financial risk indicators such as ESG Risk interact with fiscal behavior, expanding the application of signaling theory in sustainability accounting.

This study has several limitations that should be noted. First, the sample is limited to 69 observations from companies listed on the Indonesia Stock Exchange with available ESG Risk ratings, which may not fully represent the entire population of Indonesian firms. Second, the study uses cross-sectional data from a single year (2022), which limits the ability to capture changes or trends over time. Third, the analysis does not include qualitative dimensions of ESG implementation or detailed managerial motivations behind tax decisions, which could provide deeper contextual insights. Future research could expand the sample by including multiple years (panel data) to analyze dynamic relationships between ESG Risk and tax avoidance over time. Future research may also consider including moderating or mediating variables, such as board characteristics, institutional ownership, or public ESG controversies, to explain variations in signaling behavior. Additionally, qualitative approaches such as interviews or content analysis of sustainability reports could enrich an understanding of how companies internally perceive and respond to ESG-related risks in relation to fiscal strategies.

For the tax authority (DJP), this study highlights the relevance of integrating non-financial risk indicators, such as ESG Risk ratings, into risk-based supervision systems. Firms with high ESG Risk may not always engage in tax avoidance, but their behavioral response may depend on external monitoring. Therefore, DJP is encouraged to collaborate with other regulatory bodies to incorporate ESG information into its compliance profiling, enhancing early detection and targeted guidance. For the capital market authority (OJK), the findings underscore the importance of encouraging firms to disclose ESG performance and manage ESG risks comprehensively. ESG



Risk ratings should be given more weight in investor disclosures, and firms should be incentivized to strengthen internal ESG governance. OJK and IDX could consider developing an integrated reporting framework that links ESG management quality with financial integrity, including tax compliance, to promote more holistic corporate accountability in the capital market.

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