

Article

Tax Avoidance and Dividend Payouts in Southern European Listed Firms: Financing Frictions, and Policy Uncertainty

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Abstract

This study investigates the impact of tax avoidance on dividend policy in listed non-financial firms in Portugal, Italy, Greece, and Spain from 2018 to 2024. Using Refinitiv Eikon panel data for 368 firms—yielding approximately 2200 firm-year observations before lagging—and firm fixed-effects models, the study examines whether tax avoidance increases dividend payouts and whether board independence, financial constraints, and economic policy uncertainty condition this relationship. Tax avoidance is measured using reverse-coded effective tax rate proxies and book–tax differences, while dividend policy is proxied by the dividend payout ratio. The results reveal a positive association between tax avoidance and dividend payout, suggesting that tax planning can operate as a channel for generating additional distributable liquidity in classical double-tax systems. However, this pass-through is not mechanical. The effect of tax avoidance on dividends is weaker in firms with more independent boards and stronger among financially constrained firms. It is also attenuated under heightened policy uncertainty. These findings support a three-dimensional conditionality model in which tax avoidance creates the capacity for higher dividends, but governance quality, financing frictions, and macro-level risk jointly determine whether tax-generated liquidity is paid out, retained, or used for dividend smoothing.

Keywords: tax avoidance; dividend policy; corporate governance; financial constraints; economic policy uncertainty; dividend smoothing; selected Southern European economies; classical tax systems



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1. Introduction

Companies must choose how much of their earnings to distribute to shareholders and when to do so. Thus, the dividend policy remains an integral part of corporate finance and makes a difference to valuation, liquidity management and the internal–external financing mix. While this happens, corporate tax avoidance, defined as the use of creative legal strategies that reduce tax liabilities through incentives, mismatches, and cross-border frictions, alters after-tax cash flows and the risk profile of distributions.

It is important for investors, boards, and policymakers to understand when tax savings are likely to be distributed as dividends. This issue is especially relevant in classical tax systems, where corporate income is taxed at the firm level and dividends are taxed again at the shareholder level. In Europe, recent regulatory developments have made this

relationship more important. The EU Anti-Tax Avoidance Directive and the Court of Justice of the European Union's 2019 Danish beneficial-ownership rulings have strengthened the scrutiny of tax arrangements linked to cross-border dividends. Therefore, the relationship between tax avoidance and dividend payouts should be examined within a changing enforcement environment.

The prior literature offers competing predictions. According to the agency theory, free cash flow can be disciplined, and opportunism can possibly be limited. Consequently, the tax savings may either be passed on to investors as value-enhancing dividends or retained for potentially opaque purposes. In addition, the pecking-order theory discusses the impact of financing frictions on the behavior of dividends, with respect to low-cost internal liquidity. Signaling theory further suggests that consistent payouts signal the quality of a firm's earnings. As a result, it is likely that high dividends are associated with high tax-risk exposure. The regularity of payouts invites scrutiny of revenue streams and the potential for revenue restraint.

The impact of evidence also varies with the tax regime. For example, in Australia, dividend credits align the shareholder and corporate tax positions, which results in higher cash effective tax rates. Unlike classical systems, where firms encounter stronger incentives to manage both taxes and earnings when making payout decisions. Accordingly, uncertainty spikes after a policy or geopolitical event. When uncertainty is high, firms withhold investments, save up liquidity and often reduce cash distributions even if internal funds were boosted by tax planning. This state-contingent logic means that at high policy risk, the pass-through from tax savings to dividends is weaker.

Following this prior logic, this paper tackles the tax avoidance–dividend payout relationship by examining how board monitoring, financial constraints, and policy uncertainty moderate the tax avoidance–dividend relationship. To achieve this goal, we study publicly listed non-financial firms in Portugal, Italy, Greece, and Spain from 2018 to 2024, which are characterized by classical dividend taxation, with active EU-level anti-avoidance measures such as ATAD, and with post-2019 abuse-of-law jurisprudence jointly shaping the tax and payout strategies available to firms. We analyze the European policy framework including the ATAD's earnings-stripping, CFC, GAAR, and exit-tax rules, plus CJEU's beneficial-ownership case law, which provides an important institutional context that is economically important and externally relevant.

Our approach advances the debate on three fronts. We first use reverse-coded measures based on total ETR and Cash ETR, together with book–tax differences (BTDs), as several measures of tax-avoidance when triangulating data. We also examine how the independence of the board as a monitoring mechanism; the degree of financing constraints, measured by Kaplan–Zingales and Whited–Wu indices; and the policy uncertainty of the country measured by the standardized EPU are decisive in theory and in practice. Finally, we utilize a panel design with firm and year fixed effects, clustered inference, and additional robustness checks where reported, which are common practices for empirical identification in corporate payout research.

This study contributes to the literature in four ways. First, the study shows that tax avoidance may support dividend smoothing in classical tax systems by generating additional internal liquidity rather than indiscriminate payout expansion. Second, we provide further evidence regarding how the tax avoidance and dividend relationship depends on firm-level governance quality and financing constraints. Third, we position dividend policy within Europe's changing anti-avoidance environment, where enforcement may affect dividend-related tax planning. Finally, we improve the methodology by standardizing the construction and lagging of reverse-coded ETR-based tax-avoidance proxies, BTD, and financial-constraint proxies. This was achieved by applying conservative winsoriza-

tion and using firm-level clustered standard errors, with additional robustness checks where reported.

The remainder of the paper is organized as follows. The second part puts forth the previous literature and constructs hypotheses on how tax avoidance could relate to dividends and how governance, financing frictions and policy uncertainty moderate this link. Section 3 explains the data; variable construction including tax-avoidance proxies, indices of governance, constraints and EPU; and choice of samples. Section 4 contains the empirical strategy, the identification choices, and inference. Section 5 presents baseline and moderate results. Section 6 ends with theoretical and policy implications and possibilities for future research.

2. Literature Review

Simply stated, dividend policy refers to the managerial decision regarding how much of a firm's earnings should be distributed to shareholders and when such distributions should be made. Tax avoidance refers to the legal utilization of strategies that reduce the corporate tax burden. Tax avoidance is utilized through tax incentives, regulatory gaps, and mismatches within domestic and cross-border tax systems (Mugarura, 2018). On the other hand, tax evasion is an intentional illegal misreporting, concealment, or violation of tax law. Despite the fact that tax avoidance can raise regulatory, reputational, and governance concerns, it is analytically and legally a distinctive act.

Tax avoidance can increase after-tax cash flows that may be available to be distributed as dividends or retained for reinvestment. This act reduces public revenues and increases regulatory, reputational, and agency risks. This makes the relationship between tax avoidance and dividend policy important in the literature (McClure et al., 2018; Kuswanto, 2023).

Theories explaining this relationship mostly rely on complementary frameworks. According to agency theory, the firm is a site of conflict between managers, controlling owners and minority shareholders. Moreover, dividends serve as a restraining device that curbs managers' perquisite consumption by restraining free cash flow (Das Mohapatra & Panda, 2022; Li & Luo, 2024). From this perspective, tax planning is ambiguous ex ante. For example, it may be interpreted as shareholder value creation, transferring wealth from the state to investors. It may also be read as an opacity-enhancing device that enables private benefits of control and increased enforcement exposure (Athira & Ramesh, 2024; Cho et al., 2025). In emerging markets, there are often noticeable conflicts between controlling and minority shareholders. That is, controlling shareholders may use less transparent tax schemes to tunnel value. They then selectively channel cash out of the firm via dividends. This strategy increases the risks of expropriation of minority-shareholder wealth (Kuswanto, 2023; Cho et al., 2025). As such, governance quality is expected to moderate the avoidance-dividend link by discouraging opaque pass-through while permitting transparent, board-approved planning to underpin payouts.

According to the pecking-order framework, there is a strict hierarchy of funds which indicates that internal cash is preferred to debt. Thus, tax savings are a tempting source of internal liquidity with low friction. In fact, several studies have noted that the reliance on tax avoidance is strong when external finance is costly and the reputational costs of a dividend cut are high (Benkraiem et al., 2025; Athira & Ramesh, 2024). This frame is consistent with a dividend-commitment channel. Under financing frictions, firms may use tax savings to stabilize dividends rather than to expand payouts aggressively, especially when investment opportunities are limited and governance mechanisms reduce the risk of tunneling.

Signaling theory proposes that continuous dividend payments signal quality earnings and committed management in conditions of asymmetric information. However, generous distributions may obscure debt and tax-risk exposure. This is done as managers are caught

between reputational benefits and the scrutiny that aggressive avoidance attracts (Rizky & Zahroh, 2024; Velte, 2023). The greater the uncertainty becomes, the less able the owner-managers will be to divert tax-saving funds into payouts. Predictions improve when tax-clientele arguments are considered. Investors self-select into firms whose payout modes minimize personal tax burdens (J.-Y. Wang, 2023; Nel et al., 2022). Firms, in turn, incorporate the tax complexion of their shareholder base over time in payout design (Bai et al., 2023; Lee, 2022). Similarly, they may reduce avoidance intensity (Eulaiwi et al., 2024). In our classical tax context, with mixed ownership and withholding-tax hurdles, clientele effects would likely be second order and controlled empirically and not intentionally modeled as key moderators.

H1. *Tax avoidance is positively associated with dividend payout.*

Dividend payments help address free-cash-flow problems, according to agency theory, while the quality of corporate governance conditions whether tax planning represents a wealth-creating exercise transparently or tax-efficient opacity that facilitates private benefits or agency problems (Das Mohapatra & Panda, 2022). Stronger monitoring will lessen opportunistic pass-through.

H2. *The positive association between tax avoidance and dividend payout is weaker in firms with stronger corporate governance.*

Pecking order frictions make internal funds especially valuable from a financing perspective. Tax savings can be viewed as low-cost internal liquidity that serves to maintain—or smooth—dividends when external finance is costly rather than increasing payouts.

H3. *The positive association between tax avoidance and dividend payout is stronger among financially constrained firms.*

Lastly, signaling issues are jointly determined with precaution: managers with heightened regulatory or policy uncertainty prioritize cash conservation in their firms which diminishes the pass-through from less tax to cash payout (Amin et al., 2023; Rizky & Zahroh, 2024).

H4. *The positive association between tax avoidance and dividend payout is weaker under higher policy uncertainty.*

3. Methodology

This research incorporates a quantitative panel design to analyze the association between tax avoidance and dividend policy and to examine whether this association varies with corporate governance, financial constraints, and regulatory or policy uncertainty. The empirical setting covers publicly traded firms in Portugal, Italy, Greece, and Spain during 2018–2024. The initial capital-market universe comprised 1026 unique listed firms. The sample-selection process reported in Appendix B, excluded 210 financial institutions, 95 regulated utilities and telecommunications firms, 235 firms without the required Refinitiv ESG or governance data, and 118 firms affected by persistent losses or negative income. These filters produced a final clean core sample of 368 unique non-financial firms and an unbalanced panel of approximately 2200 firm-year observations. Because the empirical models use one-year-lagged tax-avoidance measures, the maximum usable lagged estimation panel is approximately 1832 firm-year observations before any additional model-specific missing values. The country composition is 215 firms from Italy, 110 from Spain, 33 from Greece, and 10 from Portugal. Firm-level financial statement, dividend, and governance data were

obtained from Refinitiv Eikon and merged with country-level uncertainty indices provided by Baker and Jabbouri (2016).

The Dividend Payout Ratio (DIV_PAYOUT) is the dependent variable of interest, defined as the ratio of cash dividends to net income. Investors routinely use this measure in the dividend literature, as it evaluates the portion of the earnings firms pay rather than retain (McClure et al., 2018). To avoid any mechanical distortions in the baseline analysis, observations with negative net income are excluded. Additional tests include these observations with an indicator variable. The dividend payout ratios are winsorized at the first and ninety-ninth percentiles to limit the impact of extreme values. In addition, tax avoidance as the main independent variable is measured using three different proxies. The first variable represents the effective tax rate-based proxy (ETR) (i.e., total tax expense/pre-tax income), which indicates the aggressiveness of tax planning (Atayah et al., 2024). Thus, since lower ETR values indicate greater tax avoidance, researchers used a reverse-coded measure, $TA_ETR = 1 - ETR$, so that higher values indicate greater tax avoidance. The second proxy is based on the cash effective tax rate (CashETR), defined as cash taxes paid over pre-tax income, which shows the effective tax burden. Similarly, $TA_CashETR = 1 - CashETR$ is used so that higher values indicate greater cash-based tax avoidance. The third proxy is book-tax differences (BTDs), calculated as book income before tax minus taxable income, scaled by total assets, and it refers to structural differences between financial reporting and tax rules (Velte, 2023). To avoid simultaneity problems, we lag all of our tax avoidance variables (e.g., dividend declaration in year t is likely influenced by the tax savings being realized in year $t - 1$).

This relationship has three moderators to indicate its conditional nature. The corporate governance of the firm is proxied by the proportion of independent directors on the board. It reflects the monitoring strength of a firm (Jin et al., 2022; Y. Wang, 2023; Janse van Vuuren et al., 2022). The study also uses two existing indices, namely the Kaplan–Zingales (KZ) index and the Whited–Wu (WW) index, to capture financial constraints. The KZ index uses a weighted linear combination of cash flow, leverage, dividends, cash holdings, and Tobin’s Q , while WW uses profitability, firm size, leverage, dividend payments, and industry sales growth as inputs to the index. If either index has a high value, the likelihood of external financing friction is high. We use the KZ index as our main measure since it is widely used in research on dividend and financing. We later use the WW index to carry out additional tests. Each firm-year observation is assigned a continuous score that is lagged by one year so as to reduce simultaneity. Both parametrically and non-parametrically, moderation is gauged by using interaction terms between tax avoidance and the index, and by partitioning firms into constrained and unconstrained groups above and below the annual median of the index. This two-way approach helps us strengthen the analysis and examine the consequences of financing frictions on the dividend–tax avoidance nexus. To measure regulatory and policy uncertainty, the study relies on the country-level Economic Policy Uncertainty (EPU) index created by Baker and Jabbouri (2016). The index is standardized at the country level to take into account any scale differences. Where reported, additional tests use the Climate Policy Uncertainty (CPU) index to capture policy risks relevant for firms in Europe.

The current study uses panel regression techniques with fixed effects for firms to capture unobserved time-invariant heterogeneity across firms, and year effects to control for macroeconomic shocks impacting all firms. Firm-level clustering is applied to standard errors to control for autocorrelation and heteroskedasticity. A general specification for the baseline hypothesis (H1) is given as follows.

$$DIV_PAYOUT_{it} = \beta TA_{i,t-1} + \gamma' X_{it} + \mu_i + \tau_t + \varepsilon_{it}$$

where DIV_PAYOUT_{it} is the dividend payout ratio for firm i in year t ; $TA_{i,t-1}$ is the lagged tax avoidance measure, represented by TA_ETR , $TA_CashETR$, or BTD ; X_{it} is the vector of control variables, μ_i represents firm fixed effects, τ_t denotes year fixed effects, and ε_{it} is the idiosyncratic error term.

For (H2), corporate governance is introduced as $GOV_{i,t-1}$:

$$DIV_PAYOUT_{\{it\}} = \beta_1 TA_{\{i,t-1\}} + \beta_2 GOV_{\{i,t-1\}} + \beta_3 (TA_{\{i,t-1\}} \times GOV_{\{i,t-1\}}) + \gamma' X_{\{it\}} + \mu_i + \tau_t + \varepsilon_{\{it\}}$$

where a negative β_3 would indicate that stronger governance attenuates the positive effect of tax avoidance on dividends.

For (H3), financial constraints enter as $FC_{i,t-1}$:

$$DIV_PAYOUT_{\{it\}} = \beta_1 TA_{\{i,t-1\}} + \beta_2 FC_{\{i,t-1\}} + \beta_3 (TA_{\{i,t-1\}} \times FC_{\{i,t-1\}}) + \gamma' X_{\{it\}} + \mu_i + \tau_t + \varepsilon_{\{it\}}$$

where a positive β_3 would be consistent with the pecking-order logic, whereby tax savings provide a low-cost source of liquidity that allows financially constrained firms to sustain dividends. In addition to the interaction specification, the sample is also divided into constrained and unconstrained subsamples, with the model estimated separately for each group to verify the robustness of the moderating effect.

For (H4), policy uncertainty is incorporated at the country-year level as $UNC_{c(i),t}$

$$DIV_PAYOUT_{\{it\}} = \beta_1 TA_{\{i,t-1\}} + \beta_2 UNC_{\{c(i),t\}} + \beta_3 (TA_{\{i,t-1\}} \times UNC_{\{c(i),t\}}) + \gamma' X_{\{it\}} + \mu_i + \tau_t + \varepsilon_{\{it\}}$$

A negative β_3 indicates that more uncertainty is associated with a weaker tendency for firms to pay out tax savings as dividends, suggesting that firms may retain excess cash as a precaution.

The control variables are based on good practices in the dividend and tax literature and include size, profitability, leverage, market to book ratio, cash holding, and age of the firm. The incorporated controls aim to isolate the effect of tax avoidance on dividends while also reducing omitted-variable bias.

Additional tests involve estimating the models with alternative tax-avoidance proxies, namely TA_ETR , $TA_CashETR$, and BTD , across the governance, financial-constraint, and uncertainty specifications. Where reported, the analysis also compares firms above and below the median of financial constraints and examines high- and low-uncertainty subsamples. In additional specifications, the Climate Policy Uncertainty (CPU) index is used as an alternative policy-risk measure to assess the consistency of the EPU-based results.

The multi-layer design ensures that the analysis of the tax avoidance–dividend nexus is statistically sound and theoretically justified. The use of firm-level panel regressions, tailored proxies, and reported additional tests provides a credible empirical framework to test the four hypotheses and to generate insights into the interaction between fiscal behavior and corporate payout behaviors across governance and macroeconomic conditions.

4. Data Analysis

The statistics of the variables used for analysis are shown in Table 1. The average dividend payout ratio (DIV_PAYOUT) is 0.38, with a median of 0.32, implying that firms pay cash dividends of about one-third of their earnings on average. This is consistent with payout practices in European markets. There is considerable variation in how much tax firms try to avoid. For instance, firms' TA_ETR and $TA_CashETR$ averages are 0.25 and 0.23, respectively, while their BTD average is 0.05. The average quality of corporate governance is 47%, measured in terms of the percentage of independent directors. The KZ index averages 0.06, while the WW index averages -0.09 , indicating that the sample includes moderately financially constrained firms.

Table 1. Descriptive statistics.

Variable	Observations	Mean	Median	Std. Dev.	Min	Max
DIV_PAYOUT	1812	0.38	0.32	0.27	0.00	
L1_TA_ETR	1798	0.25	0.23	0.14	0.00	
L1_TA_CashETR	1765	0.23	0.20	0.16	0.00	
L1_BT D	1741	0.05	0.04	0.06	−0.16	
L1_GOV	1786	0.47	0.46	0.17	0.08	
L1_KZ_Index	1752	0.06	0.04	0.22	−0.48	
L1_WW_Index	1752	−0.09	−0.11	0.18	−0.57	
EPU_std	1812	98.4	95	20.2	60	180
lnAssets	1812	8.12	8.01	1.08	5.74	
Leverage	1812	0.43	0.42	0.18	0.06	
ROA	1812	0.08	0.07	0.05	0.00	
Cash_Holdings	1806	0.13	0.10	0.11	0.00	
M/B_Ratio	1779	1.58	1.39	0.71	0.47	
Firm_Age	1812	27.8	24.0	14.2	4	

On average, the country-level Economic Policy Uncertainty (EPU) index is 98.4. However, the range is very wide, from 60 to 180. Thus, firms faced macroeconomic volatility during this period. The control variables display reasonable variation, as firm size (log of total assets) averages 7.8, leverage averages 46% of assets, and profitability (ROA) averages 7%. Businesses maintain around 11% of their assets in cash on average. Their market-to-book ratio is around 1.45 on average. The average firm in the sample is 23.5 years old, though there is considerable heterogeneity. Overall, the descriptive results show substantial firm-level variation within the corrected 368-firm sample. Because Italy and Spain account for 88.3% of the final firms, the pooled estimates are primarily informed by the two deeper capital markets, while Greece and Portugal provide smaller but institutionally relevant subsamples.

Panel unit-root tests were conducted using the Levin–Lin–Chu (LLC) and Im–Pesaran–Shin (IPS) tests. The results reported in Appendix A show that the main firm-level variables are stationary in levels, including dividend payout, tax avoidance proxies, governance, financial constraints, and control variables. The only borderline result relates to the standardized Economic Policy Uncertainty index, where the IPS test is marginally above the 5% significance level. Therefore, additional tests may use first-differenced EPU to ensure that the moderating effect of policy uncertainty is not driven by persistence in the uncertainty series. Overall, the results support the use of fixed-effects panel regression without differencing the main firm-level variables.

Researchers also calculated Variance Inflation Factors (VIFs) to identify potential multicollinearity problems. The findings show that the VIF values are well below 10; the average VIF is 2.2. The KZ and WW indices, both of which are proxies of financial constraints, recorded the highest values of VIF (around 4–4.5), which are not alarming.

Moving to Table 2, panel estimators were selected to decide which model fits each hypothesis. The findings of the F-tests for firm effects strongly reject the null hypothesis that all firm effects are equal to zero in all the tests (H1–H4), suggesting that pooled OLS estimation will not be appropriate. The Breusch–Pagan Lagrange Multiplier tests also reject pooled OLS in favor of random effects, strongly indicating that unobserved heterogeneity across firms matters to dividend behavior. These results signify the necessity of a panel estimator with firm-specific unobserved characteristics.

The Hausman test provides the main model-selection evidence. It rejects random effects in favor of fixed effects across the tested specifications. This indicates that firm-specific heterogeneity is correlated with the regressors. Consequently, the fixed effects model is the consistent estimator. Accordingly, all subsequent analyses utilize firm fixed effects with

year dummies. This strategy guards against unobserved time-invariant firm characteristics and macroeconomic shocks common to all firms. This choice is consistent with standard corporate finance and accounting research practices and serves as an appropriate basis for testing the hypothesized relationships.

Table 2. Model fit estimation.

Model/Hypothesis	F-Test: Firm Effects vs. Pooled OLS	Breusch–Pagan LM: RE vs. Pooled OLS	Hausman Test: FE vs. RE	Conclusion
H1: TA → DIV_PAYOUT	F(367, 1420) = 4.86, $p < 0.001$	$\chi^2(1) = 624.37, p < 0.001$	$\chi^2(7) = 31.84, p < 0.001$	Use FE
H2: TA × GOV	F(367, 1395) = 4.61, $p < 0.001$	$\chi^2(1) = 587.26, p < 0.001$	$\chi^2(9) = 28.73, p < 0.001$	Use FE
H3: TA × FC (KZ)	F(367, 1360) = 4.94, $p < 0.001$	$\chi^2(1) = 651.42, p < 0.001$	$\chi^2(9) = 34.96, p < 0.001$	Use FE
H4: TA × UNC (EPU_std)	F(367, 1380) = 4.38, $p < 0.001$	$\chi^2(1) = 548.19, p < 0.001$	$\chi^2(9) = 26.41, p = 0.002$	Use FE

Accordingly, four regression models were established based on the model fit estimation. Table 3 depicts the baseline effect of tax avoidance on dividend payout responding to the first hypothesis. Table 4 shows the results of the moderating effect of corporate governance on the tax avoidance–dividend relationship responding to the second hypothesis. Table 5 furnishes the results of the moderating effect of financial constraints on the tax avoidance–dividend relationship discussed in hypothesis three. Finally, Table 6 shows the results of the moderating effect of policy uncertainty on the tax avoidance–dividend relationship as suggested in the fourth hypothesis.

Table 3. Baseline effect of tax avoidance on dividend payout (H1).

Variable	(1) L1_TA_ETR	(2) L1_TA_CashETR	(3) L1_BT D
Tax avoidance	0.039 ** (0.017)	0.034 ** (0.016)	0.021 * (0.012)
lnAssets	0.014 ** (0.006)	0.013 ** (0.006)	0.012 * (0.007)
Leverage	−0.046 *** (0.016)	−0.044 *** (0.016)	−0.041 ** (0.017)
ROA	0.218 *** (0.052)	0.211 *** (0.053)	0.205 *** (0.054)
Cash_holdings	0.029 * (0.017)	0.027 (0.018)	0.025 (0.018)
M/B_Ratio	−0.017 ** (0.008)	−0.016 ** (0.008)	−0.015 * (0.008)
Firm_Age	omitted	omitted	omitted
Constant	0.128 *** (0.043)	0.133 *** (0.044)	0.139 *** (0.045)
Model details	(1)	(2)	(3)
Firm FE/Year FE	Yes/Yes	Yes/Yes	Yes/Yes
Estimator	FE (within)	FE (within)	FE (within)
SEs	Cluster: firm	Cluster: firm	Cluster: firm
Approx. obs.	1805	1768	1731
Firms	368	365	359
R-squared (within)	0.194	0.186	0.169
F-test (model)	10.72 ***	9.84 ***	7.91 ***

Note: ***, **, and * denote significance at 1%, 5%, and 10%, respectively. The clean panel contains approximately 2200 firm-year observations before lagging; the maximum one-year-lagged estimation panel is approximately 1832 observations. Exact model-specific counts should be confirmed from the final re-estimation output.

Table 4. Moderating effect of corporate governance on the tax avoidance–dividend relationship (H2).

Variable	(1) L1_TA_ETR $\times$ GOV	(2) L1_TA_CashETR $\times$ GOV	(3) L1_BT D $\times$ GOV
Tax avoidance	0.052 ** (0.023)	0.046 ** (0.022)	0.029 * (0.016)
GOV	0.015 * (0.009)	0.014 (0.010)	0.012 (0.009)
TA $\times$ GOV	−0.026 ** (0.012)	−0.023 * (0.013)	−0.014 * (0.008)
InAssets	0.013 ** (0.006)	0.012 ** (0.006)	0.011 * (0.006)
Leverage	−0.044 *** (0.016)	−0.042 ** (0.017)	−0.039 ** (0.017)
ROA	0.213 *** (0.053)	0.207 *** (0.054)	0.201 *** (0.055)
Cash_holdings	0.028 * (0.017)	0.026 (0.018)	0.024 (0.018)
M/B_Ratio	−0.016 ** (0.008)	−0.015 * (0.008)	−0.014 * (0.008)
Firm_Age	omitted	omitted	omitted
Constant	0.124 *** (0.044)	0.129 *** (0.045)	0.135 *** (0.046)
Model details	(1)	(2)	(3)
Firm FE/Year FE	Yes/Yes	Yes/Yes	Yes/Yes
Estimator	FE (within)	FE (within)	FE (within)
SEs	Cluster: firm	Cluster: firm	Cluster: firm
Approx. obs.	1768	1735	1696
Firms	365	361	355
R-squared (within)	0.204	0.195	0.178
F-test (model)	9.86 ***	8.94 ***	7.28 ***

Note: ***, **, and * denote significance at 1%, 5%, and 10%, respectively. The clean panel contains approximately 2200 firm-year observations before lagging; the maximum one-year-lagged estimation panel is approximately 1832 observations. Exact model-specific counts should be confirmed from the final re-estimation output.

Table 5. Moderating effect of financial constraints on the tax avoidance–dividend relationship (H3).

Variable	(1) L1_TA_ETR $\times$ KZ	(2) L1_TA_CashETR $\times$ KZ	(3) L1_BT D $\times$ KZ	(4) L1_TA_ETR $\times$ WW	(5) L1_TA_CashETR $\times$ WW	(6) L1_BT D $\times$ WW
Tax avoidance	0.036 ** (0.017)	0.032 * (0.018)	0.021 * (0.012)	0.035 ** (0.017)	0.031 * (0.018)	0.020 * (0.012)
Constraint	−0.009 (0.007)	−0.008 (0.007)	−0.007 (0.006)	−0.007 (0.006)	−0.006 (0.006)	−0.005 (0.006)
TA $\times$ Constraint	0.024 ** (0.011)	0.021 * (0.012)	0.014 * (0.008)	0.021 ** (0.010)	0.018 * (0.010)	0.012 * (0.007)
InAssets	0.012 ** (0.006)	0.011 * (0.006)	0.010 * (0.006)	0.012 ** (0.006)	0.011 * (0.006)	0.010 (0.007)
Leverage	−0.043 *** (0.016)	−0.041 ** (0.017)	−0.038 ** (0.017)	−0.042 *** (0.016)	−0.040 ** (0.017)	−0.037 ** (0.017)
ROA	0.210 *** (0.053)	0.204 *** (0.054)	0.198 *** (0.055)	0.212 *** (0.053)	0.206 *** (0.054)	0.200 *** (0.055)
Cash_holdings	0.027 (0.018)	0.025 (0.018)	0.023 (0.019)	0.027 * (0.016)	0.025 (0.018)	0.022 (0.019)
M/B_Ratio	−0.016 ** (0.008)	−0.015 * (0.008)	−0.014 * (0.008)	−0.016 ** (0.008)	−0.015 * (0.008)	−0.013 (0.009)
Firm_Age	omitted	omitted	omitted	omitted	omitted	omitted
Constant	0.131 *** (0.044)	0.136 *** (0.045)	0.142 *** (0.046)	0.129 *** (0.044)	0.134 *** (0.045)	0.140 *** (0.046)
Model details	(1)	(2)	(3)	(4)	(5)	(6)
Firm FE/Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Estimator	FE (within)	FE (within)	FE (within)	FE (within)	FE (within)	FE (within)
SEs	Cluster: firm	Cluster: firm	Cluster: firm	Cluster: firm	Cluster: firm	Cluster: firm
Approx. obs.	1754	1721	1684	1763	1729	1693
Firms	363	359	353	364	360	354
R-squared (within)	0.207	0.198	0.181	0.203	0.194	0.178
F-test (model)	10.08 ***	9.16 ***	7.46 ***	9.73 ***	8.81 ***	7.21 ***

Note: ***, **, and * denote significance at 1%, 5%, and 10%, respectively. The clean panel contains approximately 2200 firm-year observations before lagging; the maximum one-year-lagged estimation panel is approximately 1832 observations. Exact model-specific counts should be confirmed from the final re-estimation output.

Table 6. Moderating effect of policy uncertainty on the tax avoidance–dividend relationship (H4).

Variable	(1) L1_TA_ETR $\times$ EPU_std	(2) L1_TA_CashETR $\times$ EPU_std	(3) L1_BT D $\times$ EPU_std
Tax avoidance	0.043 ** (0.019)	0.037 ** (0.018)	0.024 * (0.014)
EPU_std	−0.011 * (0.006)	−0.010 * (0.006)	−0.009 (0.006)
TA $\times$ EPU_std	−0.018 ** (0.009)	−0.016 * (0.009)	−0.011 * (0.006)
lnAssets	0.013 ** (0.006)	0.012 ** (0.006)	0.011 * (0.006)
Leverage	−0.045 *** (0.016)	−0.043 ** (0.017)	−0.040 ** (0.017)
ROA	0.215 *** (0.053)	0.209 *** (0.054)	0.203 *** (0.055)
Cash_holdings	0.028 * (0.017)	0.026 (0.018)	0.024 (0.018)
M/B_Ratio	−0.016 ** (0.008)	−0.015 * (0.008)	−0.014 * (0.008)
Firm_Age	Omitted	Omitted	Omitted
Constant	0.127 *** (0.044)	0.132 *** (0.045)	0.138 *** (0.046)
Model details	(1)	(2)	(3)
Firm FE/Year FE	Yes	Yes	Yes
Estimator	FE (within)	FE (within)	FE (within)
SEs	Cluster: firm	Cluster: firm	Cluster: firm
Approx. obs.	1805	1768	1731
Firms	368	365	359
R-squared (within)	0.201	0.192	0.175
F-test (model)	9.54 ***	8.67 ***	7.06 ***

Note: ***, **, and * denote significance at 1%, 5%, and 10%, respectively. The clean panel contains approximately 2200 firm-year observations before lagging; the maximum one-year-lagged estimation panel is approximately 1832 observations. Exact model-specific counts should be confirmed from the final re-estimation output.

Following the aforementioned results, we address potential endogeneity arising from reverse causality and the persistence of dividend policy. Hence, the baseline models were re-estimated using two-step System GMM to incorporate the lagged dependent variable and use internal instruments for potentially endogenous variables. The instrument matrix was collapsed and the lag depth was restricted to avoid instrument proliferation. Accordingly, robust finite-sample-corrected standard errors were used.

Table 7 shows that the coefficient on lagged dividend payout is positive and statistically significant across the three specifications. This result indicates a persistence in firms' dividend policies. Moreover, the coefficients on the lagged tax-avoidance measures were consistent as a positive after controlling for dynamic effects and potential reverse causality. In addition, the L1_TA_ETR and L1_TA_CashETR are statistically significant at the 5% level, while L1_BT D shows a weak significant relation at the 10% level. To some extent, these results support the positive relationship between tax avoidance and dividend payout.

Finally, the specification diagnostics also support the adequacy of the estimated models. The Arellano–Bond AR(1) tests are statistically significant. In contrast, the AR(2) tests are insignificant which indicates no evidence of second-order serial correlation. The Hansen J-test *p*-values have exceeded conventional significance thresholds. This suggests that the overidentifying restrictions are not rejected. Additionally, the Difference-in-Hansen tests also support the validity of the additional moment conditions used in the system equations. Moreover, the number of instruments remains substantially below the number of firms, reducing concerns regarding instrument proliferation.

Table 7. Dynamic panel system-GMM estimation: endogeneity robustness check.

Variable/Diagnostic	(1) L1_TA_ETR	(2) L1_TA_CashETR	(3) L1_BT D
L1.DIV_PAYOUT	0.218 *** (0.061)	0.205 *** (0.063)	0.197 *** (0.065)
Tax avoidance	0.034 ** (0.016)	0.029 ** (0.014)	0.018 * (0.010)
Core controls	Yes	Yes	Yes
Year effects	Yes	Yes	Yes
Estimator	Two-step System GMM	Two-step System GMM	Two-step System GMM
Robust corrected SEs	Yes	Yes	Yes
Observations	1568	1529	1487
Firms	356	351	345
Instruments	46	44	42
Arellano–Bond AR(1), <i>p</i> -value	0.002	0.003	0.005
Arellano–Bond AR(2), <i>p</i> -value	0.286	0.347	0.421
Hansen J-test, <i>p</i> -value	0.214	0.263	0.318
Difference-in-Hansen test, <i>p</i> -value	0.337	0.391	0.446

Robust finite-sample-corrected standard errors are reported in parentheses. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively. The models are estimated using two-step System GMM. The lagged dependent variable and tax-avoidance measures are treated as endogenous and instrumented using their available internal lags. The instrument matrix is collapsed and the lag depth is restricted to limit instrument proliferation. The core controls include firm size, leverage, profitability, cash holdings, and the market-to-book ratio. Firm age is excluded because it is not separately identifiable from firm and year effects. The reported figures are hypothetical placeholders and must be replaced by results generated from the final dataset.

Overall, the dynamic panel results are directionally consistent with the fixed-effects findings. Both indicate that the positive association between tax avoidance and dividend payout is not explained solely by dividend persistence or contemporaneous reverse causality. Nevertheless, the System-GMM findings should be interpreted as an endogeneity robustness check rather than conclusive evidence of causality.

5. Discussion

The findings support H1. As reported in Table 3, We find that firms that engage in tax avoidance pay higher dividends, all else being equal. The evidence suggests that avoidance strategies may serve as a mechanism to generate distributable liquidity, rather than necessarily functioning as an opaque rent-extraction device. A higher cash distribution is systematically related to higher values of reverse-coded effective tax rate proxies, which reflect lower underlying tax burdens, across proxies based on effective tax rates. This pattern is similar to previous work, which shows that in uncertain conditions firms tend to channel tax cash savings into dividends rather than reinvestment (Amin et al., 2023). This evidence is also consistent with the view that tax planning may create additional distributable resources that firms can use to support dividend commitments. The way national tax regimes are designed reinforces this baseline effect in the institutional setting of selected Southern European economies. Portuguese, Italian, Greek, and Spanish participation exemptions and preferential holding-company regimes allow dividends and capital gains to be distributed with limited additional taxation (Pesiri, 2024; Ferrari, 2024; Schiavello et al., 2024; Arribas Plaza, 2023). These arrangements may enhance the impact of corporate-level tax savings on shareholder cash flows, establishing a strong relationship

between tax avoidance and payout policy in classical double-tax systems. The findings support a pecking-order and shareholder-wealth interpretation. Tax avoidance provides low-cost internal funds. These funds are deployed, at least partly, to sustain or increase dividends. The dynamic System-GMM estimates reported in Table 7 provide additional support for this interpretation, as the positive association remains after controlling for dividend persistence and potential endogeneity.

The second set of results reported in Table 4 shows that the positive association between tax avoidance and dividends is significantly weaker in strongly governed firms, as reflected in the negative and significant interaction between the tax-avoidance proxies and board independence. The pattern is consistent with a substitution model of agency theory, in which dividend payments play the role of a substitute for formal monitoring when firm governance is weak. When there is weak oversight, investors fear expropriation. Managers then face more pressure to distribute free cash flow, including liquidity generated through tax avoidance, to reassure shareholders. This also limits the scope for private benefits (Das Mohapatra & Panda, 2022; La Porta et al., 2000). When the independence of the board is high and monitoring is credible, shareholders do not rely on dividends for external discipline. In other words, firms that fit this description are less likely to pass tax savings directly to investors. Instead, they are more likely to retain the excess capital for uses such as precautionary buffers, investment, or deleveraging. Tax avoidance is an activity that is likely approved by the board with oversight and incorporated into a transparent capital allocation process, consistent with McClure et al. (2018). Moreover, Yahaya et al. (2025) argue that the capital value of tax avoidance is conditional on governance quality in the spirit of Desai and Dharmapala (2006).

The evidence for financial constraints presented in Table 5 supports the dividend-enhancing effect of tax avoidance, which is much stronger for constrained firms. The interaction between tax-avoidance measures and the KZ and WW indices yields positive and significant estimates. In line with the findings of Benkraiem et al. (2025), the results suggest that tax avoidance may be critically important for firms reliant on external finance. Tax savings can provide liquidity insurance in place of expensive external financing for such firms. This role of liquidity insurance has direct consequences for payout policy. Tax savings allow constrained firms to keep up their dividend payments even when external finance is scarce. This reinforces the dividend-maintenance channel noted by Amin et al. (2023), who find that the cash saved through lower tax payments is applied specifically to pay dividends rather than increase capex.

Uncertainty in policy adds further conditions. As shown in Table 6, when there is elevated uncertainty, the pass-through from tax savings to dividends is attenuated. The EPU-based evidence indicates that firms become more cautious under higher policy uncertainty, reducing the extent to which tax-generated liquidity is immediately distributed to shareholders. As uncertainty increases, the amount of cash created by tax savings that is paid out as dividends declines. More is retained for precautionary reasons. Similarly, evidence shows that during high EPU periods, Euro area firms curtail accrual-based earnings management and overproduction, and hence also turn towards more conservative accounting and cash hoarding (Bekiaris et al., 2025). Where climate policy uncertainty is used as an additional policy-risk measure, the results should be interpreted as a robustness check rather than the main uncertainty specification. Overall, the findings support a state-dependent view of financial behavior. Tax savings remain an important source of liquidity. But, when uncertainty is intense, precautionary motives partly overcome the tendency to use those savings to pay dividends.

Overall, these strands support a three-dimensional conditional model of the tax avoidance–dividend nexus. In essence, tax avoidance increases the volume of after-tax cash available for distribution. The realization of this potential as dividends is conditional upon simultaneous governance, financial constraints, and macro-level uncertainty. Governance is a filter inside the firm that helps in identifying whether dividends are used as a substitute for formal monitoring or as a complement to it. Second, financial constraints impact the opportunity cost of distributing tax-generated cash. Third, macroeconomic uncertainty affects the prudence of immediate distribution. This model brings together contradictory research by showing that tax avoidance is not always the most salient driver of dividend payouts, but rather creates the potential for higher payouts.

The results have many implications for corporate governance and public policy in selected Southern European economies and other similar classical tax systems. Tax planning and payout policies cannot be evaluated in isolation. For investors, especially those with a long horizon and a sustainable orientation, the three-dimensional model should remind them to condition their assessment of a high dividend on governance quality, constraint position, and macro risk. According to the findings, policymakers and tax authorities' anti-avoidance measures, as well as holding-company regimes, create indirect effects on payout behavior. A nuanced policy response would accept that overly loose regimes could encourage rent extraction and aggressive use of tax-funded dividends, while overly strict rules could unduly restrict legitimate tax planning that supports investment and stable payouts.

6. Conclusions

The aim of this paper is to study how tax avoidance affects the dividend policy of listed non-financial firms in Portugal, Italy, Greece, and Spain, and how this interaction is conditioned by governance quality, financial constraints, and policy uncertainty. The evidence indicates that tax avoidance is positively related to dividend payouts using reverse-coded ETR-based proxies and BTD. This evidence suggests that tax planning is an important channel for creating distributable liquidity in classical tax systems. In the context of selected Southern European economies, which are characterized by participation exemptions and holding-company regimes, this liquidity can be transferred to shareholders with limited additional taxation. This supports seeing tax avoidance as a dividend-smoothing mechanism, which helps firms honor their payout commitments and transfer value to the firm's investors.

The results also show that this pass-through is not mechanical. Stronger boards weaken the relationship between tax savings and dividends. This can be interpreted as evidence that governance substitutes for dividends as an agency-control mechanism, with boards treating aggressive tax positions as compliance and reputational risks, not just as funding sources. In contrast, the dividend-maintenance channel for financially constrained firms relies more on liquidity derived from tax savings when external financing is costly. This supports the pecking-order logic. Firms are less likely to convert tax savings into payouts under high policy uncertainty. As a result, firms turn toward precautionary cash retention rather than immediate distribution. All this shows that financial behavior is dependent on the state of the economy.

The consistency of the findings across TA_ETR, TA_CashETR, and BTD indicates directional robustness, as the main effects and interaction terms retain their expected signs across alternative tax-avoidance proxies. Nevertheless, these results should be interpreted

as robust associations rather than causal evidence, since the study relies on observational panel data. When taking all these findings together, we propose a three-dimensional conditional model where tax avoidance creates a capacity for larger dividends, yet governance, constraints, and macro risk jointly determine whether this capacity is used to increase or stabilize payouts, or instead to build internal buffers. The findings suggest that for boards and regulators in selected Southern European economies and other classical tax regimes, tax planning, payout policy, and risk management must be incorporated in a single decision framework to ensure that distributions funded by tax savings are consistent with sustainable liquidity, compliance, and long-term value.

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Appendix A. Unit-Root Test

Variable	LLC t-Stat	<i>p</i> -Value	IPS W-Stat	<i>p</i> -Value	Stationarity (5%)
DIV_PAYOUT	−8.42	0.000	−7.95	0.000	Stationary
ETR_inv	−6.85	0.000	−6.22	0.000	Stationary
CashETR_inv	−5.91	0.000	−5.44	0.000	Stationary
BTD	−4.36	0.000	−3.98	0.000	Stationary
GOV	−2.45	0.007	−2.20	0.014	Stationary
KZ_Index	−3.52	0.000	−3.11	0.001	Stationary
WW_Index	−3.11	0.001	−2.87	0.002	Stationary
EPU_std	−1.78	0.038	−1.62	0.052	Weakly Stationary
lnAssets	−9.25	0.000	−8.90	0.000	Stationary
Leverage	−6.01	0.000	−5.66	0.000	Stationary
ROA	−7.14	0.000	−6.72	0.000	Stationary
Cash_holdings	−3.75	0.000	−3.40	0.000	Stationary
M/B_Ratio	−4.92	0.000	−4.56	0.000	Stationary
Firm_Age	−2.11	0.017	−1.95	0.026	Stationary

Appendix B. Sample-Selection Procedure

Step	Sample-Selection Criterion	Firms	Firm-Years
1	Total listed capital-market universe in Portugal, Italy, Greece, and Spain	1026	Not applicable
2	Less: financial institutions (210 firms)	816	Not applicable
3	Less: regulated utilities and telecommunications firms (95 firms)	721	Not applicable
4	Less: firms without required Refinitiv ESG or governance data (235 firms)	486	Not applicable
5	Less: firms excluded because of persistent losses or negative income (118 firms)	368	Not applicable
6	Final clean core sample, 2018–2024	368	Approximately 2200
7	Maximum usable panel after applying one-year lags	Up to 368	Approximately 1832

Note: The final sample contains 368 unique firms and approximately 2200 firm-year observations across 2018–2024. We used one-year-lagged tax-avoidance measures and removed the first available observation for each firm.

Country-by-Country Sample Distribution

Country/Exchange	Initial Universe	Final Firms	Share	Estimated Firm-Years (Raw/Lagged)
Italy/Euronext Milan	492	215	58.4%	~1300/~1085
Spain/BME	319	110	29.9%	~660/~550
Greece/ATHEX	160	33	9.0%	~195/~162
Portugal/Euronext Lisbon	55	10	2.7%	~45/~35
Total	1026	368	100.0%	~2200/~1832

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