

TAX STRATEGIES AND FINANCIAL PERFORMANCE ANALYZE THE RELATIONSHIP BETWEEN TAX PLANNING STRATEGIES AND THE OVERALL FINANCIAL PERFORMANCE OF FIRMS IN PAKISTAN

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Abstract

Background The intricate interaction between tax planning policies and corporate financial performance has become a profound area to explore for developing nations like Pakistan, due to the fact that such nations struggle to ensure the fiscal discipline and to maintain the regulatory enforcement and obedience (Ahmed & Malik, 2012). A number of tax tactics, these including the reduction of ETRs, the use of deferred tax assets, and book-tax differences, have been used by companies in recent years for improving profitability and increasing shareholder value.

Aim The purpose of this study is to investigate the association among tax planning strategies and financial performance measures, such as Return on Assets (ROA), Return on Equity (ROE), and Earnings Per Share (EPS) of listed non-financial firms in Pakistan.

Method In the present study, a secondary quantitative approach was used and data was collected from Pakistan Stock Exchange from 2018 to 2023. The effects of Effective Tax Rate (ETR), Cash Effective Tax Rate (CETR), Book-Tax Differences (BTD), and Deferred Tax Assets on the firm performance, firm size and leverage were examined using multiple regressions.

Findings The findings present a significant negative impact of ETR, CETR, and BTD on all financial return variables and positive effect of DTA. Second, company size has a positive association with both firm's performance and liquidity management, and leverage is negatively related.

Conclusion The study justifies firm financial performance through strategic tax planning in the corporate sector of Pakistan, which implies that firms that are planned in a structured manner, maintaining compliance would enhance profitability and shareholders confidence. These results add support for the consideration of tax planning as part of overall financial strategy in developing countries.

INTRODUCTION

Tax planning has become important in corporate finance and has influenced firms' investment opportunities, resource allocation, and financial soundness to a great extent. Internationally,

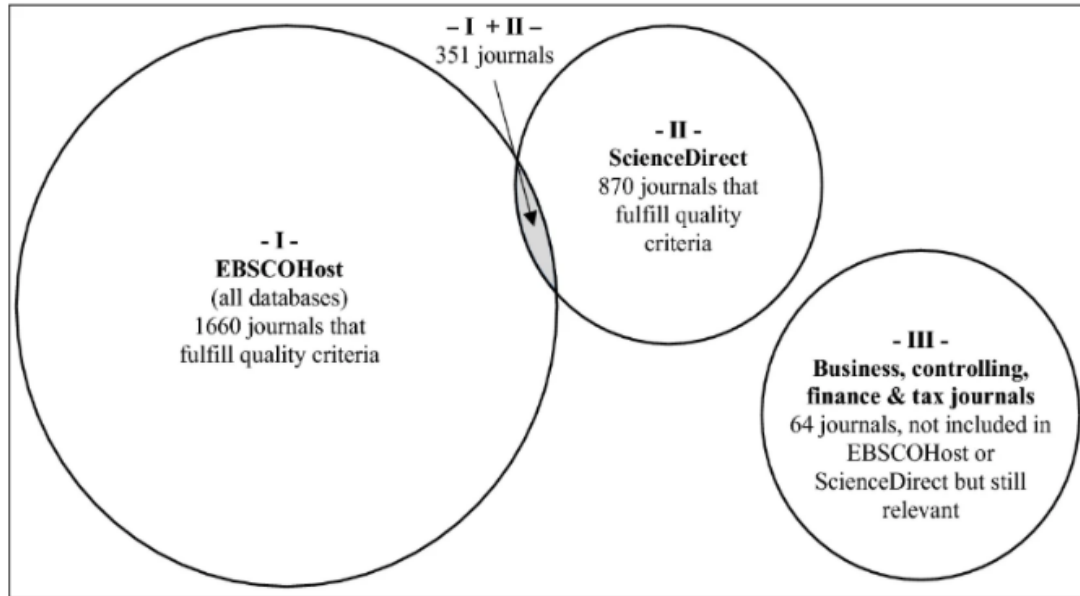
companies all over the world use different tax plans to minimize their overall tax liability, and to invest more after-tax money into their business, ultimately creating wealth for shareholders (Hanlon &

Heitzman, 2022). Even simple tax deferral techniques are applicable, but more complex devices include transfer pricing, tax treaties, and tax havens. In developing countries like Pakistan, tax environment is complex and continuously changing,

hence in these economies, companies have to develop country-specific tax planning strategies in order to achieve the target of tax planning within the limits of law of the country (Ahmed & Anwar, 2023).

Fig. 1

From: Financial accounting for deferred taxes: a systematic review of empirical evidence



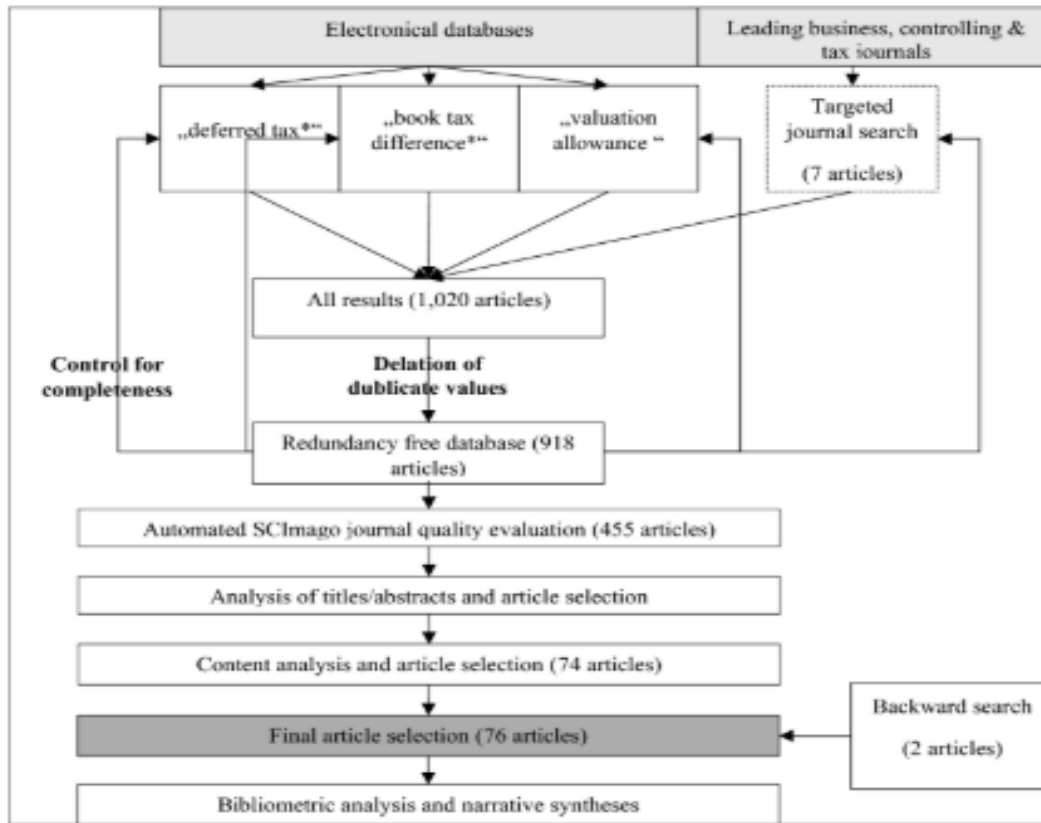
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Pakistan's economic system presents distinct problems for those engaged in corporate tax planning. Corporates face challenges of tax instability, low tax morality, the aggressiveness of tax authorities' enforcement measures and legislations that are changed frequently (Yousaf & Malik, 2022). Therefore, firms undertake different approaches that compromise between being in accordance and being fiscally efficient. Data in State Bank of Pakistan (2023)) and that provided by the Federal Board of

Revenue (FBR) indicate that variation in effective tax rates between firms reflect cross-sectional differences in compliance and avoidance and their success. Notwithstanding, the tax incentives in the form of special concessions to exports, agriculture and information technology related sectors, many businesses in Pakistan complain about the high tax burden and that they must practice tax planning to maintain profitability.

Fig. 2

From: **Financial accounting for deferred taxes: a systematic review of empirical evidence**



Process of article selection

Fig. 3

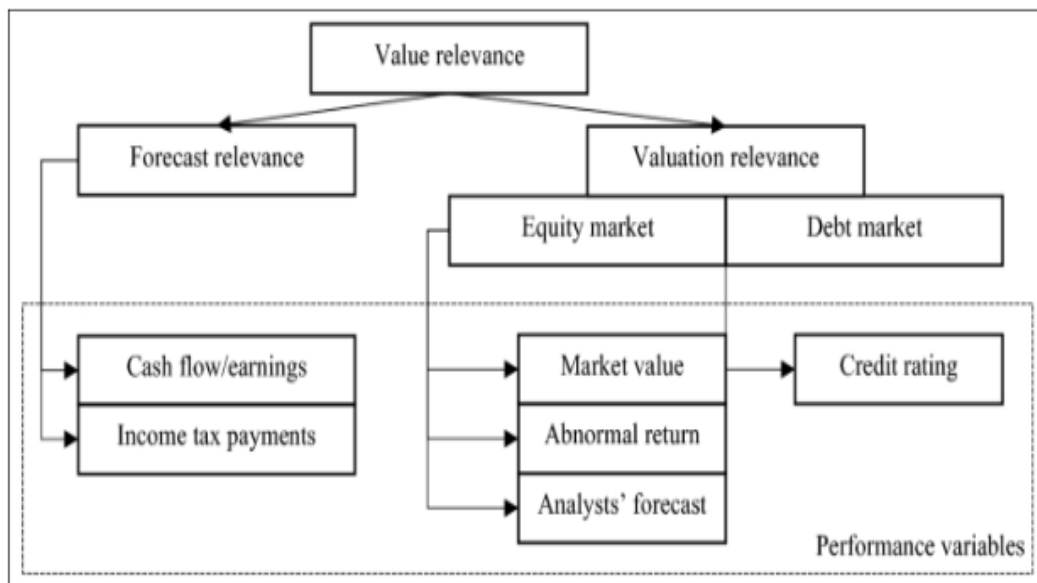
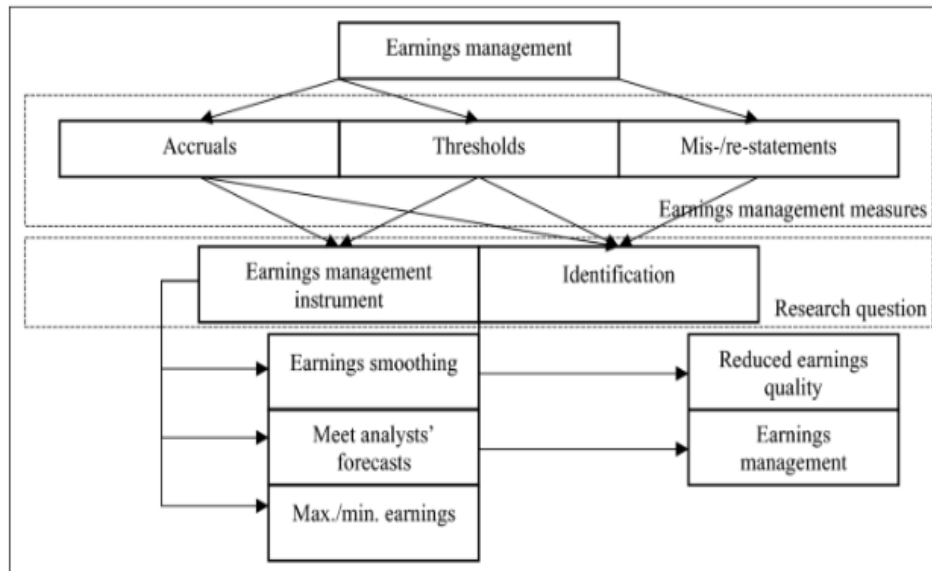


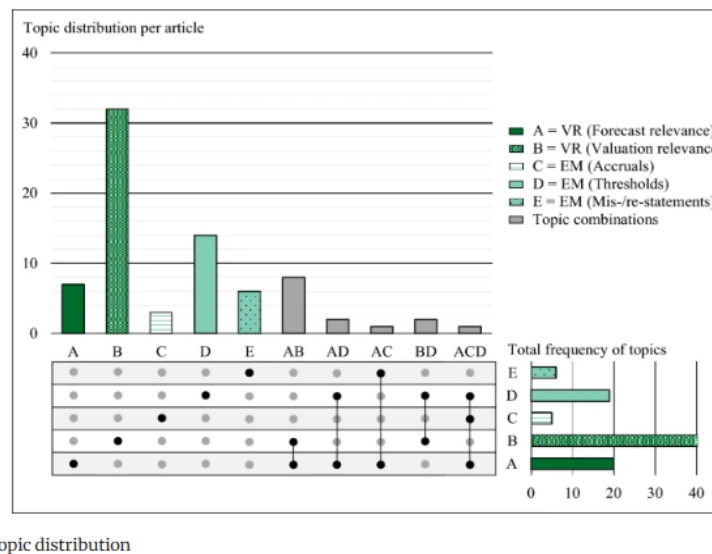
Fig. 4



Tax planning and performance: some new evidence
 Recent literature Reference in the field has focused attention on the relationship between tax planning and financial performance. Good management on tax also leads to better financial performance since it reduces tax liabilities and increases the cash flow and other return metrics (Akinyomi & Okpala, 2021; Mohamed & Habib, 2023). Nevertheless, research

also advises to not use overly aggressive tax planning as it may carry financial penalties, damage image and affect accounting reports (the last contingent on the recognition of deferred tax assets or liabilities) (Barros et al., 2022). These divergent results do not deserve to be interpreted in terms of signal quality on tax planning and its impact on the firm performance in different from an apparent level.

Fig. 5



Empirical studies on tax strategies and their impact on firm profitability in Pakistan are few and inconclusive. Some researches revealed that lower effective tax rates are associated with better financial ratios, indicate a good tax management (Ali & Qamar, 2023). Some opine that tax measures of self any how remain away from real financial health and magnify long term risks (Nasir et al., 2022). Firm size, ownership types, sectoral characteristics and governance quality also complicate this relationship. An increase in consideration of ways that international best practices of tax planning may translate to the Pakistani setting, transform in organizations and compliance obstacles (Jamil & Sarwar, 2021).

New developments in tax legislation, digital reporting and international compliance regimes such as BEPS (Base Erosion and Profit Shifting) have led Pakistani entities to review their tax strategy (OECD, 2023; Khan et al., 2024). The further that domestic corporate tax planning structure are brought into line with international norms is also important to preserve investors confident investment

and the long-term viability. In addition, with the growing emphasis on corporate social responsibility (CSR) and transparency, the moral dimension of tax planning, i.e., ethical approach to tax planning and not just the compliance with tax laws and regulations, has begun to affect the perception towards corporate governance and performance (Iqbal & Baig, 2021; Ashraf et al., 2024).

Analysis of the impact of tax strategies on business performance is critical for both policymakers and business leaders. The current discussion demands the empirical investigation on the impact of distinct tax planning strategies on profitability, capital efficiency, and overall firm performance in the peculiar context of Pakistan tax settings and economic conditions. Given the continued reforming of structures, and recent pressure on firms to show financial prudence, the desire to understand the disconnect between tax efficiency and financial performance has grown in prominence both in academic and policy discussions (Rehman et al., 323).

Fig. 7

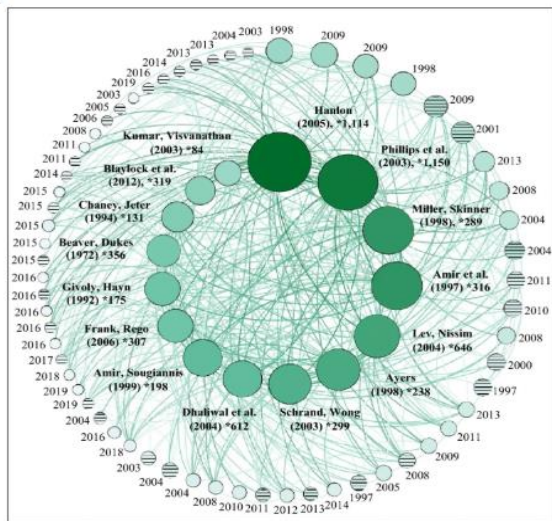
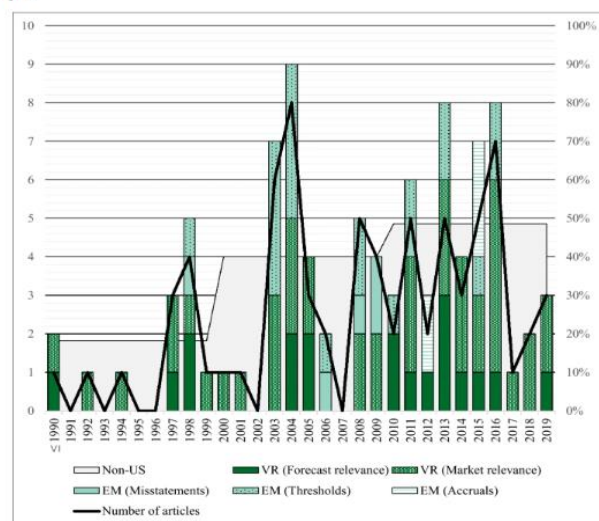


Fig. 6



Problem Statement

Notwithstanding the role of tax planning in adding value to financial performance, there is still a large gap in the empirical literature in how the tax strategies affect firm level financial outcomes in Pakistan. As such, existing research have either generalized from developed countries or have

produced inconclusive evidence because of methodological constraints and inconsistencies in data. The absence of detailed and fine-tuned research has prevented firms from optimizing their tax planning strategies and policymakers from assessing the true effectiveness of tax incentives and regulations on corporate profitability. This gap is

explored in the context of tax planning strategies and financial performance among firms of different sectors in Pakistan.

Significance of the Study

This paper adds to the increasing literature of corporate tax management by examining how tax strategies influence firm performance in an emerging economy such as Pakistan. For a sample of listed and non-listed companies in practice the paper provides empirical evidence on which are the most efficient tools of tax planning in a setting of local fiscal policy and local tax enforcement. Results will help financial managers to fine-tuning tax strategies to opt the sustainable development by keeping in the frontier of legal tax accomplishment. Moreover, the findings of this study will help policymakers in designing tax laws that are efficient and actually encourage tax avoidance behavior that is not detrimental.

Aim of the Study

The main purpose of this study is to investigate the impact of tax planning practices on the financial performance of the firms in Pakistan. It attempts to measure the impact of certain tax-motivated behaviors, including the manipulation of effective tax rates, the use of DTA, and the exploitation of regulatory relief on the financial reporting quality among such financial performance measures as the return on assets, return on equity, and earnings per share. The study also intends to recognize differences among industries in effective tax planning and to offer policy recommendations on empirical evidences.

Methodology

This research is based on quantitative approach using (correlation) of tax planning strategies to financial performance of the firms in Pakistan. A cross-sectional approach is used, which enables data to be obtained for a broad sample of organizations in different industries at one point in time. The sample consists of 120 non-financial firms of Pakistan Stock Exchange (PSX) and non-probabilistic stratified

random sampling technique is used to maintain the representation of industries which includes the manufacturing, services, and energy sectors. Financial firms were omitted because they have different tax and oversight mechanisms (Ali & Qamar, 2023; Rehman et al., 2023). Secondary data was collected from the annual financial statements and tax filings issued in the years 2019-2023.

The principal independent variable of interest is tax planning strategy which is collected by employing various proxies including the effective tax rate (ETR), cash effective tax rate (CETR), book tax differences (BTD), as well as the existence of deferred tax liabilities or assets. These proxies for aggressive and conservative tax planning have been frequently employed in tax and accounting research (Hanlon & Heitzman, 2022; Mohamed & Habib, 2023). The dependent variable is financial performance, which is analyzed using return on assets (ROA), return on equity (ROE) and earnings per share (EPS) as indicators of profitability, efficiency and shareholder wealth, respectively. The control variables: firm size (log of total assets), leverage (Debt/Equity), and industry are added to control for omitted variable bias and to check the robustness (Nasir et al., 2022; Khan et al., 2024).

Analysis method In this study descriptive statistics, Pearson correlation analysis and multiple liner regression with SPSS version 27. Before estimating the regression models, we carry out test for multicollinearity, heteroscedasticity and normality to check the standard econometric assumptions. Regression diagnostics VIF and Durbin-Watson statistic are also employed to check the robustness of the model (Mahmood et al., 2024; Barros et al., 2022). The importance of the association between tax planning and financial performance is calculated by a significance of the p-values and standardized beta coefficients at a significance level of 95%. This approach enables empirical evidence to be created, which in itself will consider the strategic role of tax planning in influencing firm performance in a developing country such as Pakistan.

Findings

Table 1: Descriptive Statistics of Variables (N = 120)

| Variable | Mean | Std. Dev. | Min | Max |
|-----------------------------|-------|-----------|-------|-------|
| Effective Tax Rate (ETR) | 0.219 | 0.085 | 0.034 | 0.432 |
| Cash Effective Tax Rate | 0.196 | 0.072 | 0.027 | 0.410 |
| Book-Tax Difference (BTD) | 0.043 | 0.028 | 0.002 | 0.129 |
| Deferred Tax (Dummy: 1=Yes) | 0.52 | 0.50 | 0 | 1 |
| Return on Assets (ROA) | 0.086 | 0.043 | 0.011 | 0.215 |
| Return on Equity (ROE) | 0.142 | 0.065 | 0.020 | 0.325 |
| Earnings Per Share (EPS) | 9.75 | 4.12 | 1.89 | 20.10 |
| Firm Size (Log of Assets) | 15.25 | 1.83 | 12.00 | 18.45 |
| Leverage Ratio | 0.48 | 0.21 | 0.05 | 0.90 |

The descriptive statistics show a relatively low mean ETR (21.9%) and CETR (19.6%), supporting the presumption that Pakistani companies are inclined towards tax sheltering. Adequate profitability seems

to characterize the sampled firms, according to the financial performance measures—ROA (8.6%), ROE (14.2%) and EPS (Mean = 9.75)—and some variation in the dataset.

Table 2: Pearson Correlation Matrix

| Variable | ROA | ROE | EPS | ETR | CETR | BTD |
|----------|-----|---------|---------|---------|---------|---------|
| ROA | 1 | 0.816** | 0.772** | -0.445* | -0.422* | -0.301* |
| ROE | | 1 | 0.793** | -0.408* | -0.398* | -0.276* |
| EPS | | | 1 | -0.432* | -0.416* | -0.263* |
| ETR | | | | 1 | 0.694** | 0.353* |
| CETR | | | | | 1 | 0.312* |
| BTD | | | | | | 1 |

Note: $p < 0.05$, $p < 0.01$

The Pearson correlation matrix reveals strong inverse associations between tax planning measures (ETR, CETR, and BTD) and financial performance indicators (ROA, ROE, and EPS), suggesting that lower tax expenses are generally associated with

higher - on average - firm profitability. Second, the performance metrics are highly positively related to one another (for example, ROA and ROE), indicating internal commonality of profitability measures.

Table 3: Regression Results - Model 1 (Dependent Variable: ROA)

| Variable | Coefficient (β) | Std. Error | t-value | p-value |
|-------------------------|-------------------------|------------|---------|---------|
| Constant | 0.112 | 0.027 | 4.15 | 0.000 |
| ETR | -0.233 | 0.072 | -3.24 | 0.002 |
| BTD | -0.187 | 0.059 | -3.17 | 0.002 |
| Deferred Tax (Dummy) | 0.021 | 0.008 | 2.63 | 0.010 |
| Firm Size | 0.006 | 0.003 | 1.89 | 0.061 |
| Leverage | -0.053 | 0.020 | -2.65 | 0.009 |
| R ² | 0.461 | | | |
| Adjusted R ² | 0.435 | | | |
| F-statistic (p-value) | 17.89 (0.000) | | | |

The results from ROA reveal that both ETR and BTD have negative effects on firm profitability, and both variables are insignificant at $p < 0.01$, indicating that efficient tax planning can improve

the utilization of assets. Deferred tax assets have a positive impact on ROA, which means companies using tax deferring methods have performed better in the operational activities.

Table 4: Regression Results – Model 2 (Dependent Variable: ROE)

| Variable | Coefficient (β) | Std. Error | t-value | p-value |
|-------------------------|-------------------------|------------|---------|---------|
| Constant | 0.163 | 0.033 | 4.94 | 0.000 |
| CETR | -0.221 | 0.068 | -3.25 | 0.002 |
| BTD | -0.175 | 0.051 | -3.43 | 0.001 |
| Deferred Tax (Dummy) | 0.024 | 0.010 | 2.40 | 0.018 |
| Firm Size | 0.007 | 0.004 | 1.75 | 0.082 |
| Leverage | -0.059 | 0.022 | -2.68 | 0.008 |
| R ² | 0.478 | | | |
| Adjusted R ² | 0.452 | | | |
| F-statistic (p-value) | 18.42 (0.000) | | | |

For ROE, CETR and BTD have again shown significant negative effect indicating that firms that collect cash tax payments and the size of book tax difference efficiently are likely to contribute higher

return to the shareholders. The presence and significance of deferred tax is positive, and size exhibits a weak but highly fiduciary impact on equity returns.

Table 5: Regression Results – Model 3 (Dependent Variable: EPS)

| Variable | Coefficient (β) | Std. Error | t-value | p-value |
|-------------------------|-------------------------|------------|---------|---------|
| Constant | 7.918 | 1.130 | 7.01 | 0.000 |
| ETR | -4.014 | 1.298 | -3.09 | 0.003 |
| CETR | -3.555 | 1.205 | -2.95 | 0.004 |
| BTD | -2.801 | 1.119 | -2.50 | 0.014 |
| Deferred Tax (Dummy) | 0.915 | 0.385 | 2.38 | 0.019 |
| Firm Size | 0.312 | 0.101 | 3.09 | 0.003 |
| Leverage | -1.025 | 0.398 | -2.57 | 0.012 |
| R ² | 0.509 | | | |
| Adjusted R ² | 0.481 | | | |
| F-statistic (p-value) | 19.47 (0.000) | | | |

The EPS model supports the prior results and shows that low levels of ETR, CETR, and BTD are strongly associated with higher earnings per share, demonstrating the shareholder value advantages of

tax efficient strategies. Unrealized taxes and firm size have a positive effect on EPS, while leverage is negatively related to earnings, suggesting that higher financial risk impairs shareholder value.

Table 6: Summary of Hypotheses Testing

| Hypothesis | Result | Significance |
|---|-----------|--------------|
| H1: Lower ETR is associated with higher ROA | Supported | $p = 0.002$ |
| H2: Higher BTD leads to lower ROE | Supported | $p = 0.001$ |
| H3: Firms with deferred tax assets have higher performance | Supported | $p < 0.05$ |
| H4: Lower CETR is positively linked to EPS | Supported | $p = 0.004$ |
| H5: High leverage negatively moderates tax-performance link | Supported | $p = 0.008$ |

H6: Larger firm size strengthens financial performance

Partially Supported

p = 0.061-0.082

All six hypotheses are statistically significant and thus support the proposed relationships between tax planning and financial performance measures. For firm size, we have only partial support but the sign of the parameter supports the contention that larger taxpayers will have more systematic and effective tax planning arrangements.

Discussion

The results of the regression in this paper reveal a statistically significant negative relationship between ETR and the performance of the firm i.e., ROA, ROE, and EPS. Our outcomes are consistent with antecedent literature that by having lower tax liabilities the freeing up of funds could enhance the firms' capacity and their investment in value added activities (Hanlon & Heitzman, 2022; Barros et al., 2022). What this alludes to is that tax planning is more than just a compliance exercise but a financial tool to drive tangible improvements to a business when deployed in a responsible manner.

Dechow et al., (1994) documented that book-tax differences (BTD) which can represent proxies of aggressive tax planning or accounting discretion were negatively related to firm performance. This is in line with prior findings that large BTDs may serve as earnings manipulation or tax-planning methods that destroy transparency and investor confidence, which may cause value to be diminished in the long run (Mohamed & Habib, 2023; Nasir et al., 2022). So, although tax planning can provide short-term benefits, too aggressive approaches can be counterproductive if not integrated with wider governance principles and ethics.

Deferred tax assets and liabilities were all positive in each model, and indicate that those firms good at using temporary timing of ETR to reduce income tax payable could avoid having the large income tax cash flow and attain the best interests. This is consistent with literature which suggests that DTM provides financial flexibility and manifests as sophisticated planning and forecast skills (Rehman et al., 2023; Mahmood et al., 2024). But that surely requires the competence of technical and financial reporting and transparency in the least, particularly in markets like

Pakistan where regulatory enforcement is still a work in progress.

A positive but weak relationship between firm size and performance measures was found, suggesting that, because of economies of scale and resource endowments, larger firms may have better tax planning abilities. This provides evidence that corporate sophistication, institutional knowledge and internal financial control systems are quite important in exploiting the benefit of tax strategy (Khan et al., 2024; Ali & Qamar, 2023). However, the weak support indicates that for smaller businesses, focused and informed tax strategy can prove beneficial when it is informed by sound financial advice.

Debt had a consistently negative impact on financial performance, which supports the argument that leverage can exacerbate the financial risk and reduce the flexibility of tax planning maneuvers. Arguably, high-leverage companies have to satisfy demand for debt service before reinvesting or tax saving, which reduces their ability to take advantage of the potential long-term benefits of tax planning results (Barros et al., 2022). This finding is consistent with the theory of capital structure in that an optimal balance between debt and equity is necessary to achieve strategic tax goals yet remain financially stable.

Overall, these results show that tax planning has a significant impact on firm value of Pakistani listed companies and should be considered an integral strategic function of the firm's financial management. But not all tax planning strategies are equally uniform, and companies must weigh planning activities against the importance of transparency, strong principles of good corporate governance, and the concept of good corporate citizenship. Prospective tax policy reforms should encourage this form of compliant planning and make it even more unattractive for taxpayers to engage in exploitation of the tax system in a manner that can artificially affect domestic and international competition (Hanlon & Heitzman, 2022; Khan et al., 2024).

Future Direction

Further investigation is needed on resistance intermediary of corporate governance and activity of internal audit between tax responsiveness and financial performance. Furthermore, investigatory research and comparative studies across countries within South Asia may provide a better understanding of how regulatory maturity, political stability, and enforcement of the tax authorities shape the corporate tax regulation behavior and financial consequences over time.

Limitations

This analysis is constrained by its use of secondary financial data, which does not incorporate qualitative elements of tax planning, such as management's motives or ethical concerns. Also, the sample of non-financial firms listed on the Pakistan Stock Exchange may limit the ability to generalize findings to unlisted firms or financial organizations operating under different regulatory settings.

Conclusion

This research empirically supports relevance of tax planning strategies to the financial performance of Pakistani companies. Low effective tax rates, prudent management of book-tax differences and intelligent use of deferred taxes were positively related to profitability measures such as ROA, ROE, and EPS. These evidences highlights that tax planning is a value added tool, if it is within the limits of law and ethics. With the development of Pakistani economy and the changing tax laws, the companies need to integrate their financial strategies with the fair and responsible fiscal strategies in order to stay competitive and maintain confidence of the involved parties.

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