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MARKET PERFORMANCE AND CORPORATE TAX AVOIDANCE: EMPIRICAL EVIDENCE FROM PANEL DATA ANALYSIS

A.D Rosilawati Shafaruddin[1], Nuruu Ain Fauzi[2]*, Norhidayah Abdullah[3], Emelin Abdul Wahid[4], Nursia Yuhanis[5], Nazhatulshima Nolan[6]

[1]Faculty of Accountancy, Universiti Teknologi MARA (UiTM), Johor Branch, Segamat Campus, Johor, Malaysia
adros.shafaruddin@uitm.edu.my https://orcid.org/0009-0004-9574-7402

[2] Faculty of Accountancy, Universiti Teknologi MARA (UiTM), Johor Branch, Segamat Campus, Johor, Malaysia
nuruuainfauzi@uitm.edu.my https://orcid.org/0009-0008-3149-3908

[3] Faculty of Accountancy, Universiti Teknologi MARA (UiTM), Johor Branch, Segamat Campus, Johor, Malaysia
norhi498@uitm.edu.my https://orcid.org/0009-0007-9415-5829

[4] Faculty of Accountancy, Universiti Teknologi MARA (UiTM), Johor Branch, Segamat Campus, Johor, Malaysia
emeli459@uitm.edu.my https://orcid.org/0009-0002-8781-4025

[5] Faculty of Accountancy, Universiti Teknologi MARA (UiTM), Johor Branch, Segamat Campus, Johor, Malaysia
nursia@uitm.edu.my https://orcid.org/0009-0007-6240-0981

[6] Academy of Language Studies, Universiti Teknologi MARA (UiTM), Johor Branch, Segamat Campus, Johor, Malaysia
nazhatulshima.nolan@gmail.com https://orcid.org/0009-0000-9892-986X

*Corresponding Author

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Abstract:

The current study investigates the connection between market performance and corporate tax avoidance using two important indicators of market performance which are Dividend Payout Ratio (DPR) and Earnings Per Share (EPS). Prior studies often focus on overall profitability rather than simultaneously analysing dividend policy and market performance. The study employed fixed effects panel regression model using data from 193 listed companies comprising 579 firm-year observations. Corporate tax avoidance is measured using log tax avoidance metric (logtaxavoid), while market

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performance is measured using Dividend Payout Ratio (DPR) and Earnings Per Share (EPS1). Furthermore, this study considers some control variables such as Return on Assets (ROA), firm size (LOG_TA), Net Profit Margin (R_NPM), Current Ratio (R_CR) and Financial Leverage (R_LEV). The empirical results indicate that Dividend Payout Ratio (DPR) is positively associated with Corporate Tax Avoidance (CTA) at 10% significance level which supports Hypothesis H1a. This indicates that higher cash dividend payouts are associated with increased tax avoidance. On the other hand, Earnings Per Share (EPS) has a negative but statistically insignificant association with tax avoidance and cannot be used to support Hypothesis H1b. Tax avoidance shows positive and significant relationship with ROA while NPM and Leverage showed negative association with tax avoidance for the control variables. This study contributes to the tax literature by providing empirical evidence on market performance indicators and how it affects tax planning. This study offers tax authorities a key diagnostic indicator by establishing high dividend payout ratios as a warning sign for tax avoidance. For investors and market analysts, these findings warn them that cash distributions may rely on tax-sheltering rather than operational growth. Finally, it provides corporate decision makers and governance authorities with actionable insights on aligning dividend policy with transparent and sustainable tax compliance.

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Keyword:

Dividend Payout Ratio, Earnings Per Share, Fixed-Effects Panel Model, Market Performance, Tax Avoidance,

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Introduction

The subject of corporate tax avoidance is a crucial issue in accounting research and corporate governance and financial management as a whole, not only in Europe but all over the world. Corporate tax strategies have a direct impact on the cash flows of the corporations, on the shareholders' wealth and public revenue streams (Desai & Dharmapala, 2006). The use of tax aggressive measures to minimise the income tax liability of the firms is a way of maintaining the liquidity of the firms to invest in capital and pay dividends to shareholders (Hanlon & Heitzman, 2010; Khuong et al., 2020). But, at the same time, there are agency problems, reputational risks and transparency risks that arise from extreme tax planning, and that corporate tax is a significant factor in market valuation (Desai & Dharmapala, 2006; Duhoon & Singh, 2023; Kovermann & Velte, 2019).

Tax aggressive practices in accordance with statutory frameworks and ethical considerations are closely related to sustainable corporate governance policies and the United Nations Sustainable Development Goals (SDGs), specifically SDG 16 (Peace, Justice, and Strong

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Institutions) and SDG 8 (Decent Work and Economic Growth). Transparent tax compliance and fair tax contribution are fundamental pillars of good corporate governance and a key to a healthy public infrastructure and fiscal stability (OECD, 2021). The transparency of tax reporting has become important to minimize financial risks and to not be greenwashing or symbolic CSR to protect investor confidence in the past (Elamer et al., 2024; Velte, 2023).

There is a lot of empirical evidence in the world on the linkages between pressures on the capital markets and tax planning by companies. Empirical studies in developed and emerging markets have found that two factors – perceived risk and earning transparency and dividend signaling – are important determinants of capital markets' responses to corporate tax changes (Armstrong et al., 2015; Badertscher et al., 2013; Nebie & Cheng, 2023). Other studies find that tax aggressive reporting by high market performers can be stifled by capital cost penalties or by price discounts by high market performers (Hanlon & Slemrod, 2009; Malik et al., 2025; and Nebie & Cheng, 2023), although other studies have found that high market performers engage in tax aggressive strategies to support higher valuations in the equity market (Chen et al., 2014; Inger, 2014). The sample for the study is public listed companies for the reporting years which gives 579 firm-year observations for 193 different companies. The analysis of firm level dynamic panel data offers solid empirical evidence for market driven corporate behaviours in public capital markets.

While there is a literature on the question of tax avoidance, the empirical literature has not investigated how the two market performance measures that directly affect tax avoidance, namely payout signaling (Dividend Payout Ratio) and profitability valuation (Earnings Per Share), explain tax avoidance, with both of them controlled for in the panel fixed-effects model. There are many previous papers based on the operational profitability and they don't differentiate between the stock market valuation signal (Duhoon & Singh, 2023; Khuong et al., 2020). This study seeks to address this empirical gap by simultaneously considering the market earnings indicators and the payout policy in a controlled dynamic panel setup.

Based on the empirical results, the Dividend Payout Ratio (DPR) of the stock market positively and significantly affects the level of corporate tax avoidance at the 10% level (β=0.0223, p=0.097) which supports H1a. On the other hand, Earnings Per Share (EPS) is negatively correlated with tax avoidance, but the value is not statistically significant (β = -0.2064, p = 0.158), in the sense that it will not be accepted. The findings show that the control variables such as Return on Assets (ROA), Net Profit Margin (R_NPM), and Financial Leverage (R_LEV) are statistically significant at 1% significance level ($p<0.001$).

To systematically study these dynamic relationships, this paper focuses on the main Research Question (RQ): Does market performance affect a firm's tax avoidance? The related Research Objective (RO) is studying the relationship between the performance of the market and tax avoidance. The results of the literature review and the generation of hypotheses are presented in next section, followed by research design and modelling, the empirical results, and finally, conclusions, policy implications and future research.

Literature Review

Market performance can be seen as the metric that gauges the value of public investors' assessment of the firm's operational efficiency, the ability to sustain dividend payments, and the growth potential. Signaling Theory (Bhattacharya, 1979; Miller & Rock, 1985) suggests

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dividend payments are a good indicator of a company's cash position and stability. Companies with a high dividend payout ratio have large cash outflows to pay shareholders. There is an incentive for managers to undertake tax avoidance measures to create internal cashflow to service high cash payments to shareholders without additional external equity financing or debt service payments (Desai & Dharmapala, 2006). Tax avoidance acts as an internal capital generation mechanism that allows dividend paying companies to ensure a positive shareholder yield and ensure the companies' liquidity. Corporate tax savings are found to be directly invested in cash distribution policies, and the capital allocation process in public capital markets (Chen et al., 2010; Nebie & Cheng, 2023). This study proposes the following hypothesis:

H1a: Market performance measured by dividend payout ratio is positive and significantly affects tax avoidance.

Earnings Per Share (EPS) is a key valuation metric in the capital markets and has a significant impact on equity analyst projections and management compensation. Agency Theory (Jensen & Meckling, 1976) suggests that there is a higher degree of public scrutiny, analyst coverage and regulatory scrutiny for high EPS firms (Kovermann & Velte, 2019). Companies with high per-share earnings also have good operating cash flows and profit margins, making them less dependent on aggressive or risky tax sheltering strategies (Frank et al., 2009; Khuong et al., 2020). In addition, extremely lucrative companies would be subject to serious political limits and bad public reception if they are caught using illegal or too aggressive tax schemes (Watts & Zimmerman, 1986). Thus, managers in the firms with higher EPS can opt for conservative tax compliance policy to protect firm's reputation and avoid any destruction of firm value (Annuar et al., 2014; Duhoon & Singh, 2023). In this study, we therefore propose the following hypothesis:

H1b: Market performance measured by earning per share is negative and significantly affects tax avoidance.

Research Design

Sample Selection

The first data set consisted of panel data for multiple financial years. However, 579 firm-year observations remain after data cleaning, excluding any observations with missing balances and correcting extreme outliers, from 193 distinct corporate entities.

Measurements

Independent Variable (Tax Avoidance) is measured as natural log of corporate tax avoidance proxy, logtaxavoid. An increase in logtaxavoid indicates increased tax aggressive positions or decreased effective tax burdens based on accounting income (Hanlon & Heitzman, 2010).

Market performance is operationalized using two main equity indicators as independent variables: Dividend Payout Ratio (DPR) and Earnings Per Share (EPS). The Dividend Payout Ratio (DPR) is measured as the ratio of total cash dividends paid to net income, indicating the proportion of earnings distributed to shareholders as dividends. Meanwhile, Earnings Per Share

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(EPS) is measured as the ratio of net income available to common shareholders to the weighted average number of ordinary shares, reflecting the earnings attributable to each ordinary share. There are five control variables included in the analysis to account for firm-level characteristics and operational performance: Return on Assets (ROA), measured as operating income divided by total assets; Firm Size (LOG_TA), measured as the natural logarithm of total assets; Net Profit Margin (R_NPM), measured as net income divided by net sales revenue; Liquidity (R_CR), measured as current assets divided by current liabilities; and Financial Leverage (R_LEV), measured as total financial debt divided by total assets.

Model Specification

To test the research hypotheses, we estimate a fixed-effects panel regression model as formulated in Equation (1):

$$logtaxavoid_it = \beta0 + \beta1\ DPR_it + \beta2\ EPS1_it + \beta3\ ROA_it + \beta4\ LOG_TA_it + \beta5\ R_NPM_it + \beta6\ R_CR_it + \beta7\ R_LEV_it + u_i + \varepsilon_it \quad (1)$$

Where logtaxavoid_it denoting corporate tax avoidance for firm i in year t, DPR_it the dividend payout ratio, EPS1_it the earnings per share, ROA_it the return on assets, LOG_TA_it the size of the firm, R_NPM_it the net profit margin, R_CR_it the current ratio, R_LEV_it the leverage ratio, u_i the unobserved firm fixed effects, and ε_it the firm-specific error.

Discussion

Descriptive Statistics

Descriptive statistics of all variables used in the analysis are summarized in Table 1. The tax avoidance metric (logtaxavoid) records a mean value of -0.7052 (SD = 0.3935; median = -0.6353), ranging from -2.5526 to 0.8143 across 799 observations. There is significant variation among the performance measures in the market; the average and SD of the Dividend Payout Ratio (DPR) is 0.5652 (SD = 1.0551; median = 0.4143) based on 824 observations, and the highest payout ratio is 17.1601. Earnings Per Share (EPS1) records an average of 0.0449 (SD = 0.1104; median = 0.0201) across 963 observations, ranging from -0.6058 to 1.2814. Operational control metrics indicate mean Return on Assets (ROA) of 0.4082 (SD = 2.4365), firm size (LOG_TA) averaging 8.6036 (SD = 0.7857), Net Profit Margin (R_NPM) averaging 0.0152 (SD = 0.7114), Current Ratio (R_CR) averaging 2.6862 (SD = 3.2866), and Financial Leverage (R_LEV) averaging 0.4506 (SD = 0.2258).

Table 1: Descriptive Statistics of Variables

Variable	N	Mean	Median (p50)	Std. Dev.	Min	Max
logtaxavoid	799	-0.7052	-0.6353	0.3935	-2.5526	0.8143
DPR	824	0.5652	0.4143	1.0551	0.0000	17.1601
EPS1	963	0.0449	0.0201	0.1104	-0.6058	1.2814
ROA	1,192	0.4082	0.0591	2.4365	-1.2116	29.8460
LOG_TA	1,223	8.6036	8.5132	0.7857	5.7135	10.3971
R_NPM	1,189	0.0152	0.0639	0.7114	-13.2809	3.4737
R_CR	1,174	2.6862	1.8247	3.2866	0.0066	46.5133

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Variable	N	Mean	Median (p50)	Std. Dev.	Min	Max
R_LEV	1,221	0.4506	0.4447	0.2258	0.0053	1.6151

Correlation Statistics

Table 2 reports the pairwise Pearson correlation coefficients and significance levels. Tax avoidance (logtaxavoid) is positively correlated with Dividend Payout Ratio (r = 0.0664, p = 0.0909), showing statistical significance at the 10% level. The bivariate correlation with EPS1 is positive but statistically insignificant (r = 0.0367, p = 0.3401). Among control variables, logtaxavoid exhibits a significant negative correlation with ROA (r = -0.1981, p < 0.001) and a significant positive correlation with firm size LOG_TA (r = 0.1069, p = 0.0027) and Financial Leverage R_LEV (r = 0.0858, p = 0.0161). Crucially, correlation coefficients among predictor variables remain below 0.60 (e.g., EPS1 and DPR r = 0.0225; LOG_TA and ROA r = -0.2614; R_CR and R_LEV r = -0.5389), confirming that severe multicollinearity is absent from the multivariate specification.

Table 2: Pearson Pairwise Correlation Matrix

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
(1) logtaxavoid	1.0000							
(2) DPR	0.0664*	1.0000						
(3) EPS1	0.0367	0.0225	1.0000					
(4) ROA	-0.1981***	-0.0078	0.0777**	1.0000				
(5) LOG_TA	0.1069***	0.0003	0.1361***	-0.2614***	1.0000			
(6) R_NPM	-0.0467	-0.0439	0.1031***	-0.0392	0.1122***	1.0000		
(7) R_CR	-0.0326	0.1728***	-0.0544*	-0.0067	-0.2315***	0.0440	1.0000	
(8) R_LEV	0.0858**	-0.0866**	0.0055	-0.0284	0.2891***	-0.2298***	-0.5389***	1.0000

Multiple Regression Analysis

Table 3 presents the fixed-effects panel regression results estimating Equation (1). The model incorporates 579 firm-year observations across 193 company groups. The overall model is statistically significant ($F(7, 343) = 5.41$, $p < 0.0001$; F-test for firm fixed effects $u_i = 0$ yields $F(192, 343) = 7.57$, $p < 0.0001$, confirming the appropriateness of fixed-effects panel estimation). The within R^2 is 0.0994, between R^2 is 0.1116, and overall R^2 is 0.0293, with the fraction of variance due to firm fixed effects (ρ) at 0.9509.

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Table 3: Fixed-Effects Panel Regression Results (DV = logtaxavoid)

Variable	Coef. (β)	Std. Error	t-statistic	p-value	95% Conf. Interval
DPR	0.0223*	0.0134	1.66	0.097	[-0.0040, 0.0486]
EPS1	-0.2064	0.1458	-1.42	0.158	[-0.4931, 0.0803]
ROA	0.5801***	0.1579	3.67	0.000	[0.2695, 0.8906]
LOG_TA	-0.0300	0.1182	-0.25	0.800	[-0.2625, 0.2025]
R_NPM	-0.6647***	0.1684	-3.95	0.000	[-0.9958, -0.3335]
R_CR	-0.0054	0.0112	-0.48	0.628	[-0.0275, 0.0166]
R_LEV	-0.5719***	0.1618	-3.53	0.000	[-0.8902, -0.2536]
_cons	-0.1705	1.0620	-0.16	0.873	[-2.2594, 1.9184]

Hypothesis Testing and Empirical Discussion

Hypothesis H1a (Supported): Hypothesis H1a posits that market performance measured by Dividend Payout Ratio (DPR) positively and significantly affect tax avoidance. In Table 3, DPR yields a positive coefficient of 0.0223 ($t = 1.66$, $p = 0.097$). Because the p-value is significant at the 10% level ($p < 0.10$), Hypothesis H1a is supported. This confirms that higher dividend payout ratios induce managers to engage in increased tax avoidance to preserve liquidity under cash outflow pressures.

Hypothesis H1b (Not Supported): Hypothesis H1b posits that market performance measured by Earnings Per Share (EPS1) negatively and significantly affects tax avoidance. The regression results show a negative coefficient for EPS1 ($\beta = -0.2064$, $t = -1.42$, $p = 0.158$). However, because the p-value exceeds the 10% significance threshold ($p > 0.10$), Hypothesis H1b is not statistically supported.

Control Variables: Return on Assets (ROA) displays a strongly positive and statistically significant coefficient ($\beta = 0.5801$, $t = 3.67$, $p < 0.001$), indicating that highly asset-efficient firms actively utilize tax planning to maximize retained earnings. Conversely, Net Profit Margin (R_NPM $\beta = -0.6647$, $p < 0.001$) and Financial Leverage (R_LEV $\beta = -0.5719$, $p < 0.001$) display strongly negative impacts, indicating that high profit margin firms and highly leveraged firms experience reduced tax avoidance due to institutional oversight and interest tax shield substitution.

Conclusion

An empirical study was conducted to analyze how market performance affects corporate tax avoidance, which resulted in a panel fixed-effects approach with 193 listed companies (579 firm-year observations). The main purpose of the study was to assess the impact of equity market signaling variables like Dividend Payout Ratio (DPR) and Earnings Per Share (EPS) on tax avoidance strategy. The empirical results show that both Dividend Payout Ratio and Earnings Per Share have a positive effect and statistically significant on tax avoidance at 10% level (supporting H1a) while Earnings Per Share having a negative effect and not statistically significant on tax avoidance at 10% level (fails to support H1b). Control measures show that

asset return (ROA), profit margin (R_NPM) and leverage (R_LEV) have a significant influence on corporate tax behavior.

The empirical results support Hypothesis H1a, which is consistent with the findings of Signaling Theory and the literature on cash flow constraints (Bhattacharya, 1979; Chen et al., 2010; Nebie & Cheng, 2023). The "strength-signal" of the public companies in the form of large cash dividends raises the pressure of internal capital constraints. Management takes advantage of tax planning to protect operating cash flows from fiscal levies (Desai & Dharmapala, 2006) to offset the liquidity that it entrusts to equity distributions. Conversely, the insignificance of EPS when measured statistically implies that the intensity of tax shelter is not directly related to accounting profit per share once accounting profitability (ROA) is considered.

The results have key implications for policy makers, capital market regulators, investors, and corporate governance authorities. Dividend-paying corporations should be carefully watched by tax authorities, because if a company has a high dividend payout ratio, it could be a warning sign for tax aggression, which may be a result of cash flow pressures. The investors and capital market analysts should be aware that cash payouts are linked to tax avoidance, which might lead them to question the sustainability of the operational growth of the company behind it, or whether it is driven by tax avoidance (Elamer et al., 2024; Velte, 2023). There is need for regulatory institutions to push forward policies for tax transparency with a view of ensuring that the signals of payouts are in line with ethical corporate governance and SDG 16.

There are several limitations to this study that indicate where future research can be conducted. In the first, the proxy of tax avoidance (logtaxavoid) is targeted at one measure of the operation of the tax system; other studies might be able to incorporate other measures of tax avoidance, such as cash effective tax rates (CETR) or book-tax differences (BTD), as proxied by Khuong et al. (2020) and Velte (2023), respectively. Second, the study sample can be extended over longer longitudinal range and to different economic sectors to account for industry-specific variability. Consideration of moderating factors like institutional ownership structure, board independence or ESG governance ratings may be another factor to consider in future research to further explain the market performance-tax avoidance relationship (Elamer et al., 2024; Malik et al., 2025; Kovermann & Velte, 2019).

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Declaration on the Use of Artificial Intelligence (AI) "The author(s) declare that generative AI or AI-assisted technologies were used during the preparation of this manuscript. The following tool(s) were used: ChatGPT and Stealth Writer. The ChatGPT was used for English language editing, grammar checking, improving sentence clarity, while Stealth Writer was used to rephrase sentences and improve the natural flow and readability of the text. All AI-assisted content was reviewed and verified by the author(s), who take full responsibility for the accuracy, originality, integrity, and final content of the manuscript."

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