The Impact of Government Tax Incentives on Corporate Financial Performance

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Abstract. This study aims to explore the impact of government tax incentives on corporate financial performance and its mechanisms. By analyzing data from A-share listed companies, the study finds that tax incentives can effectively reduce the tax burden of enterprises, enhance liquidity and investment capacity, thereby promoting improvements in profitability and financial performance. The study also finds that the impact of tax incentives is more significant for small-scale enterprises and certain regions, particularly in the economically developed eastern and central regions. However, the effectiveness of tax incentives is more limited in large enterprises, and excessive reliance on tax incentives may suppress innovation capacity and market competitiveness.

Keywords: Component; Government Tax Incentives; Corporate Financial Performance; Tax Burden; Liquidity.

1. Introduction

With the acceleration of global economic integration, governments worldwide have increasingly adopted diverse policy tools to promote economic development and industrial upgrading. Among these, tax incentives—as a critical fiscal policy instrument—directly influence corporate financial performance and market competitiveness by reducing tax burdens, incentivizing innovation investments, and supporting specific industries. In China, where economic structural optimization and industrial transformation have become urgent priorities, the design and implementation of tax incentive policies have garnered significant attention from both academic and practical perspectives. Tax incentives not only help lower operational costs and enhance capital accumulation capabilities for enterprises but also optimize resource allocation to improve financial performance.

This study aims to investigate how government tax incentives affect corporate financial performance through diverse channels and uncover the underlying mechanisms influencing operational and long-term development outcomes. While extensive research has explored the relationship between tax incentives and corporate outcomes, debates persist regarding their specific pathways and efficacy. On one scholars argue that tax incentives significantly enhance financial performance by reducing tax liabilities, boosting profitability, and improving return on investment—particularly for SMEs and high-tech enterprises . On the other hand, critics caution that overreliance on tax incentives may breed dependency, diverting focus from internal innovation and market competitiveness. Consequently, the impact of tax incentives on financial performance exhibits heterogeneity, shaped by factors such as firm size, industry characteristics, and market dynamics. To address this gap, this paper employs empirical analysis methods using A-share listed company data to systematically examine the mechanisms through which tax incentives influence financial performance in China’s unique economic context. The findings aim to inform policy refinements and support high-quality corporate development.

2. Literature Review

In the context of macroeconomic transformation, the effectiveness evaluation of tax incentives holds special significance. Data from the World Bank shows that the GDP growth elasticity coefficient of tax incentive policies in developing countries is 0.32, significantly higher than the 0.18 observed in developed countries [4]. As the world's largest emerging economy, China’s tax incentive

policies exhibit distinct "three-dimensional characteristics": focusing on supporting small and medium-sized enterprises (SMEs) in the entity dimension, promoting the development of the central and western regions in the regional dimension, and targeting strategic emerging industries in the industrial dimension [5]. While this multi-dimensional policy design enhances regulatory precision, it has also increased the complexity of evaluating policy effectiveness, particularly the "cost-benefit" balance of incentive policies, which urgently requires empirical testing.

Existing studies have constructed a multi-dimensional analysis framework around the "policy tools—enterprise behavior—financial performance" transmission chain. In theoretical models, tax incentive theory emphasizes that incentive policies affect enterprise performance through dual pathways: the direct pathway reflects profit increases from tax burden reduction, while the indirect pathway alleviates financing constraints and promotes innovation investment [6]. Agency theory reveals the boundary conditions of policy effectiveness, pointing out that information asymmetry may lead enterprises to use tax savings for non-productive expenditures such as executive compensation, thereby weakening the incentive effects [7]. Dynamic capabilities theory further suggests that the long-term value of tax incentives depends on whether enterprises can transform the policy benefits into organizational routine updates [8].

Empirical studies show significant regional and industry variations. Panel data analysis of Korean listed companies shows that tax incentives have a short-term effect on ROA and ROE, increasing by 12.3% and 9.7%, respectively, but the effect declines to 4.1% after three years [9]. In the context of China, studies have found that the tax incentive elasticity coefficient for high-tech enterprises is 0.58, significantly higher than the 0.29 for traditional manufacturing industries (Guo Genlong et al., 2023), while the policy multiplier effect in the western regions is only 63% of that in the eastern regions [10]. It is worth noting that the mediating effect of R&D investment remains controversial: in the information technology sector, the mediating contribution rate reaches 42% (Han Xue, 2021), while in the pharmaceutical manufacturing industry, the transmission path is weakened by capitalized accounting treatments [11].

3. Theoretical Foundation and Research Hypotheses

Theoretically, the government, through tax incentives, can directly affect a company’s cost structure, resource allocation, and long-term development potential. Tax incentives typically manifest as tax burden reductions, which directly increase the disposable funds of enterprises, providing more capital for expanding production, enhancing technological innovation, and optimizing operational efficiency [12]. Moreover, tax incentives can effectively alleviate the financial pressure on enterprises during the early stages, encouraging greater investment in research and development (R&D) and innovation activities, thereby enhancing the market competitiveness and long-term development capabilities of enterprises. Therefore, tax incentive policies can theoretically promote corporate financial performance through multiple channels.

However, the impact of tax incentives on corporate financial performance is not a simple linear relationship. While enjoying tax incentives, the internal resource allocation and market response of enterprises may also be affected. Over-reliance on tax incentives might reduce a company's sensitivity to market changes, impair innovation capability, and even lead to the formation of "dependent" enterprises. In such cases, tax incentives may hinder the enterprise’s autonomous development drive, thus negatively affecting long-term financial performance [13]. Therefore, the effect of tax incentives on corporate financial performance involves a complex dual mechanism and needs to consider multiple factors such as enterprise size, industry characteristics, and market environment.

Based on the above theoretical analysis, this study proposes the following research hypotheses:

H1: Government tax incentives have a positive effect on corporate financial performance. Tax incentives reduce the tax burden, enhance liquidity, and increase investment capacity, thereby improving profitability and financial performance. In particular, in capital-intensive and technology

innovation-intensive industries, tax incentives can effectively promote capital accumulation and R&D investment, further boosting corporate financial performance.

H2: The role of corporate R&D investment in the financial performance improvement induced by tax incentives. Tax incentives directly influence corporate R&D spending, especially in high-tech and innovative enterprises. Tax incentives provide financial support, motivating enterprises to increase R&D investment, which in turn drives technological progress and innovation, enhancing market competitiveness and financial performance.

H3: The impact of government tax incentives on corporate financial performance varies regionally. Due to significant differences in economic development levels, market mechanisms, and policy environments across regions in China, the effect of government tax incentives may show regional heterogeneity. In particular, in the eastern regions where marketization is more advanced, enterprises are more efficient in utilizing tax incentives, so the effect on financial performance improvement in these regions may be more significant.

H4: The impact of government tax incentives on corporate financial performance differs across ownership types. Tax incentives may have significantly different effects on state-owned, private, and foreign enterprises. State-owned enterprises, with their stronger government relationships and stable funding sources, may be better able to utilize tax incentive policies. In contrast, private enterprises, due to their greater flexibility and market adaptability, may better improve their financial performance with the support of tax incentives.

4. Research Design

4.1. Sample Selection and Data Sources

The sample data used in this study comes from A-share listed companies on the Shanghai and Shenzhen stock exchanges in China, covering the period from 2015 to 2022. The data is primarily sourced from the CSMAR database. A-share listed companies are chosen as the sample because they hold significant positions in the domestic economy, and their financial data is transparent and publicly available, which allows for a more accurate reflection of the impact of government tax incentive policies on corporate financial performance.

To ensure the representativeness and validity of the sample, this study conducted a strict screening process. First, companies with significant financial risks, such as ST, *ST, and PT companies, were excluded because the instability of their financial data could interfere with the research results. Second, financial and insurance companies were excluded, as their financial characteristics differ greatly from those of traditional manufacturing and other service industries, and they do not fully represent the characteristics of general enterprises. Additionally, companies with significant data missing were also excluded to ensure the completeness and reliability of the final sample. After these screenings, a dynamic panel data sample consisting of 4,634 A-share listed companies was obtained.

4.2. Variable Selection and Explanation

(1) Dependent Variable: Corporate Financial Performance (ROA). This study selects Return on Assets (ROA) as the core indicator to measure corporate financial performance. ROA comprehensively reflects a company's ability to generate profit using its total assets and is an important indicator for evaluating a company’s operational efficiency and asset utilization. By analyzing a company’s ROA, its financial performance can be objectively assessed.

(2) Core Independent Variable: Government Tax Incentives (Tax Incentive). Government tax incentives, the core independent variable in this study, refer to the tax support provided to enterprises by the government, such as tax reductions, lower tax rates, and tax rebates. Tax incentives can directly reduce the tax burden of enterprises, improve their liquidity, and potentially promote investment and innovation. To measure the degree of tax incentives, this study uses the ratio of tax incentives to total tax burden as the representative indicator of government tax incentives.

(3) Control Variables: To control for other factors that may affect corporate financial performance, the following control variables were selected:

Enterprise Size (Size): Enterprise size is generally positively correlated with financial performance. Larger enterprises have more resources and stronger risk resistance, allowing them to better utilize government policies to improve financial performance.

Leverage (Lev): Leverage reflects a company's financial leverage level. A higher leverage ratio may bring a greater debt burden, which could affect financial performance.

Ownership Concentration (First): Ownership concentration reflects the shareholder structure of a company. A higher concentration of ownership may improve decision-making efficiency, which in turn can influence financial performance.

Enterprise Growth (Growth): Enterprise growth reflects the future development potential of a company. Companies with stronger growth potential usually have better investment attractiveness and market competitiveness.

Operating Cash Flow (Ocf): Operating cash flow represents the actual cash flow generated from business activities. Strong operating cash flow helps maintain stable financial performance during operational difficulties, thus enhancing financial performance. As shown in Table 1.

Table 1. Explanation of Variables.

Type	Variable Name	Variable Symbol	Variable Definition
Dependent Variable	Corporate Financial Performance	ROA	Net profit / Total assets
Independent Variable	Government Tax Incentives	Tax Incentive	Tax incentives / Total tax burden
Control Variables	Enterprise Size	Size	Natural logarithm of total assets
	Leverage	Lev	Total liabilities / Total assets
	Ownership Concentration	First	Proportion of shares held by the largest shareholder
	Enterprise Growth	Growth	Revenue growth rate
	Operating Cash Flow	Ocf	Net operating cash flow / Total assets

4.3. Model Specification

To explore the impact of government tax incentives on corporate financial performance, this study adopts a panel data regression model. Considering that a company's financial performance may vary across different time points, and that there may be heterogeneity between individual enterprises, the study uses a two-way fixed effects model (Fixed Effects Model) for analysis. The two-way fixed effects model can effectively control for both individual effects of enterprises and time effects, thereby avoiding potential omitted variable bias and improving the reliability of the regression results. The specific regression model is set as follows:

$$ROA_{i,t} = \alpha + \beta_1 TaxIncentive_{i,t} + \sum_j \beta_j Controls_{i,t} + u_i + c_{i,t} \quad (1)$$

Where: ROA_{it} represents the financial performance of enterprise i in year t, measured by the return on assets (ROA); $TaxIncentive_{it}$ represents the government tax incentives for enterprise i in year t, such as tax reductions and exemptions; Controls represents the control variables, including enterprise size (Size), leverage (Lev), ownership concentration (First), and enterprise growth (Growth) and operating cash flow (Ocf), etc.; u_i represents the individual effect of the enterprise, capturing the fixed characteristics of the enterprise that do not vary over time, and ϵ_{it} represents the random error term, indicating the unexplained variation that the model cannot capture.

5. Empirical Analysis

From the variable correlation matrix, it can be seen that ROA (corporate financial performance) has a strong positive correlation (0.424) with operating cash flow (Ocf), indicating that adequate cash flow helps improve financial performance. Additionally, ROA also shows a significant positive correlation with enterprise size (Size) and ownership concentration (First), suggesting that large-scale

enterprises and those with concentrated ownership may have better financial performance. The correlation between the proportion of tax incentives to total assets and ROA is weak (0.037), but still significant, indicating that tax incentives may have a slight positive impact on corporate financial performance. There is also some correlation between tax incentives and control variables such as enterprise size and leverage. As shown in Table 2.

Table 2. Correlation Matrix Analysis.

	ROA	Tax Incentive	Size	Lev	First	Growth	Ocf
ROA	1.000						
Tax Incentive	0.037***	1.000					
Size	0.035***	-0.182***	1.000				
Lev	-0.335***	-0.085***	0.482***	1.000			
First	0.139***	-0.024***	0.190***	0.032***	1.000		
Growth	-0.000	0.004	0.024***	0.017***	0.001	1.000	
Ocf	0.424***	0.053***	0.077***	-0.162***	0.109***	-0.019***	1.000

5.1. Benchmark Regression Results

The benchmark regression results show that the proportion of tax incentives to total assets has a significant positive effect on ROA (corporate financial performance), with coefficients of 0.284 and 0.355, indicating that tax incentives can effectively improve corporate financial performance. Additionally, control variables such as enterprise size (Size), leverage (Lev), ownership concentration (First), and operating cash flow (Ocf) also have a significant impact on financial performance. Notably, operating cash flow (Ocf) is strongly positively correlated with ROA (0.391), emphasizing the importance of cash flow for corporate financial health. Although there is no significant relationship between enterprise growth (Growth) and ROA, the model's R-squared significantly increases after adding control variables (from 0.038 to 0.311), showing that the control variables have a stronger explanatory power for financial performance. Overall, both tax incentive policies and the allocation of resources within the enterprise have a significant impact on financial performance, as shown in Table 3.

Table 3. Benchmark Regression Results.

Variable	(1)	(2)
	ROA	ROA
Tax Incentive	0.284***(3.322)	0.355***(4.847)
Size		0.012***(29.924)
Lev		-0.152***(-58.810)
First		0.000***(15.775)
Growth		0.000(1.233)
Ocf		0.391***(63.848)
Year	Control	Control
Industry	Control	Control
Constant	0.036***(56.247)	-0.208***(-24.010)
Observations	25827	25827
R-squared	0.038	0.311
Number of Stkcd	4634	4634

5.2. Robustness Check

To verify the robustness of the empirical results, this study conducted several tests on the benchmark regression under the two-way fixed effects model. First, after excluding industries that are less sensitive to government tax incentives, manufacturing enterprises were selected as the sample for regression analysis. The results show that government tax incentives have a significant positive effect on the financial performance (ROA) of manufacturing enterprises, supporting the theoretical hypothesis. Second, Tobin's Q (TobinQ) was used as an alternative dependent variable for regression analysis, further confirming the positive impact of tax incentives on corporate financial performance.

Table 4. Regression Results after Sample Exclusion.

Variable	(1)
	ROA
Tax Incentive	0.306***(3.901)
Size	0.013***(25.707)
Lev	-0.154***(-50.463)
First	0.000***(13.268)
Growth	0.000(0.256)
Ocf	0.436***(60.658)
Year	Control
Industry	Control
Constant	-0.215***(-20.781)
Observations	17138
R-squared	0.355
Number of Stkcd	3263

As shown in Table 4, the regression results after excluding samples indicate that government tax incentives have a significant positive effect on the financial performance (ROA) of manufacturing enterprises (with a coefficient of 0.306 and significance ***) . Additionally, factors such as enterprise size, leverage, and operating cash flow also have an important impact on financial performance. Larger size and good cash flow help improve financial performance, while high leverage has a negative effect on financial performance. Overall, the results further confirm the positive effect of tax incentive policies on corporate financial performance.

Table 5. Regression Results with Replaced Dependent Variable.

Variable	(1)
	TobinQ
Tax Incentive	14.908***(8.213)
Size	-0.394***(-39.594)
Lev	-0.106*(-1.677)
First	-0.002***(-3.026)
Ocf	1.582***(10.595)
Year	Control
Industry	Control
Constant	10.893***(51.521)
Observations	25470
R-squared	0.193
Number of Stkcd	4632

As shown in Table 5, the regression results after replacing the dependent variable indicate that the proportion of tax incentives to total assets has a significant positive effect on Tobin's Q (TobinQ) (with a coefficient of 14.908 and significance ***), suggesting that tax incentives can effectively enhance a company's market value and growth potential. Enterprise size (Size) is significantly negatively correlated with TobinQ (-0.394), indicating that larger enterprises may have relatively lower market valuations. Leverage (Lev) has a negative and marginally significant impact on TobinQ (-0.106), meaning that higher leverage may reduce a company’s market value. Operating cash flow (Ocf) has a significant positive effect on TobinQ (1.582), emphasizing the role of good cash flow in enhancing a company's market performance.

Considering that the effect of government tax incentives may lag behind the current period, and to capture this effect and alleviate potential endogeneity issues, this study adopts lagged tax incentives as the explanatory variable for regression analysis. As shown in Table 6, the lagged tax incentives have a significant positive effect on ROA (with a coefficient of 0.330 and significance ***), indicating that tax incentives have a lagged effect. Enterprise size (Size) and operating cash flow (Ocf)

both have a positive impact on financial performance, while leverage (Lev) has a negative effect on ROA, showing that high leverage weakens financial performance. Ownership concentration (First) and enterprise growth (Growth) also have a positive effect on ROA, suggesting that higher ownership concentration and stronger growth potential help improve corporate financial performance.

Table 6. Regression Results with One-Period Lagged Tax Incentives.

Variable	ROA
TaxIncentive_Lag1	0.330***(4.183)
Size	0.014***(30.564)
Lev	-0.158***(-53.721)
First	0.000***(14.083)
Growth	0.004***(13.668)
Ocf	0.397***(57.030)
Year	Control
Industry	Control
Constant	-0.249***
	(-25.585)
Observations	20891
R-squared	0.321
Number of Stkcd	4108

5.3. Heterogeneity Analysis

5.3.1. Regional Heterogeneity Test

Due to significant differences in economic development levels, resource allocation, marketization, and policy enforcement across the eastern, central, and western regions of China, the same policy measures may have different effects in different regions. To explore this regional heterogeneity in depth, this study divides China into three regions: the eastern, central, and western regions, and analyzes the impact of government tax incentives on corporate financial performance in each region. By making this regional division, the study reveals how corporate financial performance in different regions may be affected differently by government tax incentives. The empirical analysis results are shown in Table 7, which presents the policy effect differences across regions.

Table 7. Regional Heterogeneity.

Variable	(1)	(2)	(3)
	Eastern Region	Central Region	Western Region
	ROA	ROA	ROA
TaxIncentive	0.413***	0.501**	0.113*
	(4.459)	(2.422)	(0.782)
Size	0.012***	0.015***	0.013***
	(25.540)	(12.088)	(12.681)
Lev	-0.154***	-0.165***	-0.153***
	(-49.081)	(-22.385)	(-24.297)
First	0.001***	0.000***	0.000***
	(14.178)	(4.335)	(6.344)
Growth	0.000	0.004***	0.002***
	(0.356)	(6.042)	(6.761)
Ocf	0.398***	0.346***	0.367***
	(55.056)	(18.563)	(25.062)
Year	Control	Control	Control
Industry	Control	Control	Control
Constant	-0.213***	-0.256***	-0.233***
	(-20.701)	(-9.823)	(-10.332)
Observations	18586	3265	3961
R-squared	0.310	0.325	0.361

As shown in Table 7, the impact of government tax incentives on corporate financial performance varies significantly across different regions. In the eastern region, the regression coefficient for tax incentives is 0.413, showing a strong positive impact, which is related to the higher level of marketization and policy implementation efficiency in the eastern region. The regression coefficient for the central region is 0.501, which is slightly lower but still shows a significant positive effect. In contrast, the regression coefficient for the western region is 0.113, indicating a weaker impact of tax incentives on financial performance. This may be related to the delayed economic development and imperfect market mechanisms in the western region. The effects of tax incentive policies are more significant in the eastern and central regions, while the effect is weaker in the western region, indicating that the policy effect is influenced by regional economic differences.

5.3.2. Enterprise Size Heterogeneity Test

The sample data is grouped based on the median enterprise size, with enterprises below the median categorized as small-sized and those above the median categorized as large-sized enterprises.

Table 8. Enterprise Size Heterogeneity.

Variable	(1)	(2)
	Small-sized enterprises	Large-sized enterprises
	ROA	ROA
TaxIncentive	0.521***	0.128
	(4.802)	(1.337)
Size	0.015***	0.008***
	(12.263)	(14.936)
Lev	-0.156***	-0.151***
	(-38.509)	(-46.799)
First	0.001***	0.000***
	(13.490)	(9.365)
Growth	-0.000	0.000**
	(-0.915)	(2.500)
Ocf	0.382***	0.393***
	(40.235)	(52.125)
Year	Control	Control
Industry	Control	Control
Constant	-0.285***	-0.111***
	(-10.634)	(-8.885)
Observations	12913	12903
R-squared	0.279	0.377

As shown in Table 8, tax incentives have a significant positive effect on the financial performance of small enterprises (with a coefficient of 0.521 and significance ***), indicating that small enterprises benefit from the alleviation of financial pressure provided by tax incentives. However, the effect on large enterprises is smaller (with a coefficient of 0.128, and not significant), possibly due to the stronger financial and resource advantages that large enterprises already possess. Control variables show that enterprise size, leverage, ownership concentration, and operating cash flow have significant effects on financial performance in both groups, with cash flow playing a particularly prominent role in both groups.

6. Conclusion

Based on the analysis of the impact of government tax incentives on corporate financial performance, it can be concluded that tax incentive policies significantly enhance corporate financial performance. By reducing tax burdens, tax incentives effectively increase the liquidity and investment capacity of enterprises, further improving profitability and financial health. In particular, for small

enterprises, tax incentives can effectively alleviate their financial pressure, improving their financial performance. In contrast, for large enterprises, the effect of tax incentives is relatively smaller, as these enterprises already have advantages in resources and capital. Moreover, the effects of tax incentive policies also vary by region, with the positive impact of tax incentives being more significant in the economically developed eastern and central regions. However, excessive reliance on government tax incentives may lead enterprises to neglect innovation and the improvement of market competitiveness, thus affecting their long-term development. The impact of tax incentives on corporate financial performance is multifaceted, with both positive promoting effects and potential negative impacts from over-reliance.

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