# Financial Constraints and Cash Tax Savings

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## ABSTRACT

We investigate the association between financial constraints and cash savings generated through tax planning. We predict that an increase in financial constraints leads firms to increase internally generated funds via tax planning. We measure financial constraints based on changes in firm-specific and macroeconomic measures. We find that firms facing increases in financial constraints exhibit increases in cash tax planning. Our results indicate that among profitable firms, firm-years with the largest increases in firm-specific constraints are associated with declines in firms' cash effective tax rates ranging from 3.00 to 5.14 percent, which equate to between 2.87 and 4.82 percent of operating cash flows. We also find that (1) the impact of financial constraints on tax planning is greatest among firms with low cash reserves, and (2) constrained firms achieve a substantial portion of their current tax savings via deferral-based tax planning strategies, despite the lack of a financial statement benefit.

**JEL Classifications:** E69; H25; H60.

**Data Availability:** Data used in this study are available from public sources identified in the paper.

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**Keywords:** **tax planning**, **cash taxes**, **financial constraints**

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