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### RESEARCH ARTICLE

#### TAX PLANNING AND FIRMS' PERFORMANCE IN NIGERIA.

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#### Abstract

Inability of tax payers to plan their taxes lead to high tax liabilities. Companies in an attempt to avoid tax, end up paying more than what is statutorily required to tax fraudsters because they lack adequate knowledge of tax planning. It is against this background that this work examined the impact of tax planning on firms' performance of listed companies in Nigeria. The research adopted survey and expost-facto design. Financial statements of selected companies from Manufacturing, banking and insurance sectors, between 2003 and 2012 were analyzed. The population of the study is 240 listed companies on the Nigerian Stock Exchange market as at April, 2012. Using simple and stratified sampling techniques, fifteen companies were sampled for the study, five companies from each of the sectors under study. The hypothesis for the study states that tax planning has no significant effect on firms' performance, the result indicate that tax planning exerts insignificant positive effect on reported earnings (  $P - val = 0.199 > 0.05$ ).  $R^2 = 0.515$ , which means that 51.5% of change in reported earning can be attributed to timing effect, information content and tax liability. The study therefore concluded that tax planning has no significant effect on firms' performance. It was recommended that there should be enlightenment of various tax payers on the need for voluntary compliance and that specialisation should also be encouraged in the work of tax advisers.

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#### Introduction:-

The reluctance to pay tax does not manifest only on the personal income tax, it pervades all other forms of taxation, including companies' income tax which is expected to be paid by a corporate body. This has made both tax evasion and avoidance a household name in the context of Nigerian tax system with consequential effect on reduction in the Federal government income accruing from taxation. The cause of this cankerworm is, no doubt, corruption which has eaten deeply into our economic systems. Nigerians maximize whatever opportunity that comes their way, both positively and negatively, hence, the "I must make it syndrome" (Jibo, 2009).

Kiabel and Akenbor (2014) state that Nigerian incorporated companies, on several occasions, under-disclose their earnings when reporting to the appropriate tax authorities. Thus, they intentionally reduce company tax liability to government tax authorities, some under creative accounting do not report profit at all (Gillespine and Lewis, 2005). This scourge notwithstanding, Nigeria fiscal system is faced with the problem of capturing the small and un-

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incorporated companies into the tax net, such that the required amount can be paid by them (Kiabel and Akenbor, 2014). The phobia many people exercise is paying a huge amount of money into the government coffer. In the word of Alm (2013) the beneficiaries of successful tax evasion are basically the evaders. This is however, with distributional effects that extensively favour those individuals within the high income bracket. In a situation when there is general equilibrium adjustments in commodity and factor prices, there will be a complicated effects on the income and output as well. The effect is distributional in the sense that, it may benefit either the low or high income earners. For instance, tax evasion by domestic assistants, such as house cleaners, baby sitters, and domestic workers will benefit their employers who are likely going to be high-income households.

Tax planning is perceived by Avl-yonnah (2005) as being important in the sense that, it arrogates more income to the relevant tax authorities and leads to tax savings for the organization. It often involves huge cost, this is the concept of under-sheltering puzzle as explained by (Weisbach, 2002). Clausen, (2003) is of the opinion that the business entity concept to some extent can create the problem of double taxation, whereby tax is payable on the dividend in the hand of the shareholders which is paid from after tax earnings. The planning strategy to be employed by various organizations according to Rohaya (2010), depends on the size, ability and the nature of the companies. Effective tax planning minimizes the tax payment and consequently increases the after tax rate of return (Alshular and Grubert, 2005). The objective of this paper therefore is to determine the effect of tax planning on firms' performance in Nigeria. To achieve the objective, this hypothesis is formulated:

H<sub>0</sub>: Tax planning has no significant effect on firms' performance.

### **Conceptual and Theoretical Literature Review:-**

#### **The concept of Tax Planning:-**

Desai and Dharmapala (2006) opined that, tax planning can lead to a reduction in firm value when managers have both the opportunity to undervalue reported accounting profit and the incentive to reduce company income tax liability by understating taxable income. Also, it will be valued negatively by shareholders in a situation where corporate governance is weak. This encourages undervaluation of accounting profit. When corporate governance provision is strong, it is not possible to undervalue accounting profit, so this will have no effect on tax planning. Potential costs can exist such that tax planning can be challenged by a tax administration which can also affect reputational costs (Abdul-Wahab, 2010). Tax planning is initially believed to increase after tax earnings and therefore to be in the interest of shareholders.

Dessai and Dharmapala (2006) argued that managers may tend to satisfy their cardinal interest when there is an information asymmetry between managers and shareholders with respect to tax planning. This may result in a negative association between tax planning and firm value. Corporate governance is one of the measures that can moderate the potential implications of a tax related shareholder-manager information asymmetry.

Erard (1993) discovered that audited taxable income prepared by professional accountants and legal practitioners have more audit adjustments and that tax agents taxable income exhibited non-compliance. Murphy and Byng (2002) explain that organizations are responding to the demands of their clients by engaging in aggressive tax planning, and they are lured into investment following their trust on the proposal given to them. Sakurai and Braithwaite, (2003) indicate that many taxpayers expect their tax agent to assume an honest role and prepare an accurate return that is presentable and useful to the respective users of the financial statement. However, Attwell and Sawyer (2001) observed that tax experts viewed their clients as the initiators of aggressive tax reporting. In recent years tax executives have assumed changing their firms tax function focus from managing effective tax rates (ETRs) and tax planning to compliance and accurate financial reporting (Ernst & Young, 2006; KPMG, 2006).

The theory reviewed include the cost of service theory which represents the view of some economists that the state should charge its citizens the actual cost of the service rendered, that is, only when they can satisfy the equity principle of taxation. This theory is applicable in area where the cost of certain public services can be determinable with ease, for instance, the postal service, the railway or transportation services, the supply of electricity, to mention but a few. This theory is faulted by the fact that, it is not easy to determine the cost of service per head of each citizen in an economy for services such as police, armed forces and the judiciary. There is no principle of quid pro qua in tax under this theory.

Scholes and Wolfson (1992) developed a concept that revolutionized tax planning theory throughout the world, through a theory called theory of tax planning and the scholes- Wolfson frame work. They brought in "all parties, all

taxes and all costs as the three basic aspects of efficient tax planning. The concept of tax efficiency was introduced and the analysis of tax planning actions was made in a better and broader way. Scholes states that efficient tax planning must take all parties involved into consideration. All taxes levied, both implicit and explicit, and all related costs, whether certain or not must be considered. They further posit that only tax liability can be influenced by tax planning (Scholes *et al.*, 2008). Implicit taxes were defined using the concept of risk and return as the marginal difference of the acquisition cost of an asset, that brings in a certain rate of return, relative to what it should be in case there is a change in the tax rate (Scholes *et al.*, 2008).

The concept of tax clienteles was equally introduced with its definition similar to implicit taxes. Implicit tax captures the marginal effect of the asset's cost before and after a change in its tax burden (time section). The tax clientele extracts this difference by comparing the tax burden of an asset in comparison with a similar one (cross section) with the same risk, subtracting the effect of the difference from the transaction cost. The two concepts are based on the theory of efficient markets, which is often characterized with the absence of arbitrage, except in transaction cost, the theory of balanced prices and the theory of risk and return. Implicit taxes and tax clienteles are both based on financial theory.

This theory improves the theory of risk because it includes tax aspect as a relevant factor for studying, understanding, analyzing and empirical demonstration of risk. It is the only theory that approaches the tax aspect of the asset pricing by considering both implicit and the explicit tax rate applicable to a firm, net of the tax benefit of debt financing, called tax shielding. The effect of tax planning on pricing of asset transcends tax shield. Scholes *et al.* (2008) perceived all costs as an integral part of tax planning and concluded that all direct and indirect costs should be monitored in tax planning.

This work therefore adopts the Scholes-Wolfson, (1992) theory of tax planning in view of its comprehensiveness and the inclusion of various costs in monitoring tax planning.

#### **Empirical Review:-**

Desai and Hines (2002) provide evidence on firm performance and tax planning behaviour of firms, by investigating the relationship between tightening of tax systems and market value of firms. They used a population of 850 listed US firms. A purposive sample was selected to reflect the desired characteristics. The study was cross sectional in nature. A Correlative-description design was adopted using data relating to year 2000. Simple regression and t-tests were used to establish the relationships and it was established that, there is relationship between intensive tax planning and higher firm performance. Conversely, the study showed that tightening of the tax system is positively associated with higher market performance of firms. This is in line with the findings of Chen, Chen & Chen, (2010). Desai and Dharmapala (2007) provided a more detailed study that combines tax planning, corporate governance and firm performance. The study used 4,492 observations on 862 firms from 1993 to 2001 using panel data that was drawn from the Compustat and Execucomp databases, merged with data on institutional ownership of firms from the CDA/Spectrum database. They measured firms' performance using Tobin's Q and they, proxy governance quality by the level of institutional ownership. Tax planning is measured through the book-tax gap that is the difference between the income reported to capital markets and tax authorities using two analysis models of the OLS IV estimation model. The OLS results show that there is no relationship between tax planning and firm performance but reports a positive association between tax planning savings and performance for well-governed firms. The study concluded that corporate governance mediates the tax planning-firm performance relationship. The IV estimate shows a higher effect of corporate governance on firm performance.

Ayers, Jiang and Laplante, (2009) investigate the effect of tax planning on earnings quality and find that tax planning and low earnings quality have contrasting effects on the information content of taxable income. They also assert that tax planning and events that result in low earnings quality can give rise to book-tax differences. They concluded that existing tax-planning and low earnings-quality proxies are sufficiently powerful to detect settings where book-tax differences are likely attributable to discretion in reporting book or taxable income.

Kawor and Kporgbi (2014) sought to ascertain the level of tax planning of firms and explore whether there is relationship between tax planning and firms' market performance. They employed 22 non-financial companies in Ghana Stock Exchange market over a twelve year period from 2000 using the longitudinal correlative design. The conclusions reached are that firms' tax savings decrease as tax authorities reduce the statutory corporate income tax

rates. This means a reduction in tax leakages as a result of intensive tax planning of firms when tax authorities maintain low corporate income tax rates.

Chen, Dhahwal and Trombley (2007) conducted a research on the effect of tax planning and earnings management on the relative informativeness of book and taxable income. Two different sets of test was carried out on documenting the incremental effect of tax planning and earnings management on the relative informativeness of book and taxable income and the relationship between voluntary conformity and the relative informativeness of book and taxable income of entities. It was concluded that, the relative informativeness of book and taxable income is affected by tax planning and earnings quality.

Finally, Ayers, Jiang and Laplante, (2009) came up with evidence that taxable income becomes less informative for high tax-planning firms and more informative for firms with low earnings quality and also that investors, can distinguish sources of book-tax differences.

### Methodology:-

The research work employed expost facto design. The population is all listed companies on the Nigerian Stock Exchange, which amount to total of two hundred and forty (240) as at April, 2012. Simple and stratified sampling techniques were employed to select fifteen companies from banking, insurance and manufacturing sectors. The financial statements of these companies were analysed for the period of ten years (2003 – 2012). Data was analysed through multiple regression. The model for the study is  $PTI = \alpha_0 + \alpha_1 TE + \alpha_2 IC + \alpha_3 TL + \mu$

### Test of Hypothesis:-

Tax planning has no significant effect on firms' performance.

**Table 4.2.1a:-** Goodness of the fit of the Model

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.717	0.515	0.272	63477.29187

a. predictors: (constant), Timing effect, information content, Tax liability.

### Source: Researcher's computation using SPSS, 2015

From table 4.2.1a, R square gives 0.515 which stipulates that 51.5% of change in reported earnings can be attributed to the tax planning techniques of timing effect of transaction, the amount of tax liability that is paid at a particular point in time and the information content of the financial statement. The adjusted R squared which attempts to correct R square closely reflects the goodness of the fit of the model is 0.272.

**Table 4.2.1b:-** Regression Result of the Model 1

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	22726.815	48711.121		0.467	0.657
	Timing Effect	.956	0.633	0.441	1.511	0.182
	Information Content	-0.335	0.312	-0.317	-1.075	0.324
1	Tax Liability	1.135	0.947	0.344	1.199	0.276

Dependent Variable: Pre Tax Income

### Source: Researcher's computation using SPSS, 2015

From Table 4.2.1b above, the coefficients of timing effect, information content and tax liability are respectively  $\alpha_1 = +0.956$ ,  $\alpha_2 = -0.3351$ ,  $\alpha_3 = +1.135$ , which are both positive and negative. The level of significance of each of the independent variable which is 0.657 for the constant, 0.182 for TE, 0.324 for IC and 0.276 for TL shows that they are higher than the significant level of 0.05. Hence this shows that there is a relationship between tax planning practices and the reported earnings of listed companies in Nigeria. Therefore a model that can be formulated from the table is as shown below.

$$PTI = \alpha_0 + \alpha_1 TE + \alpha_2 IC + \alpha_3 TL + \mu$$

$$PTI = 22726.815 + 0.956TE - 0.335IC + 1.135TL$$

**Table 4.2.1c:- ANOVA**

	Sum of Squares	df	Mean Square	F	Sig.
Regression	25632157643	3	8544052548	2.120	0.199
1 Residual	24176199503	6	4029366584		
Total	49808357146	9			

a. Dependent Variable: Pre Tax Income

b. Predictors: (constant), Timing Effect, Info. Content, Tax Liability

#### Source: Researcher's computation using SPSS, 2015

It is evident from Table 4.2.1c above that on the basis of the prob. (F – stat), the simultaneous influence of the independent variables are insignificant (prob. F – stat. = 0.199 > 0.05).

#### Interpretation of Results:-

The result shows that tax planning practices have an insignificant effect on firms' performance. Therefore  $H_{01}$  is accepted.

#### Discussion of Findings:-

Timing effect of the transaction shows a significant positive relationship with the pre-tax income ( $\alpha = +0.956$ ). In order for the pre-tax income to be reduced, the time of asset acquisition needs to be planned. This will consequently reduce tax liability payable and thus lead to an increased profit attributable to owners. This is in line with prior studies such as Kawor & Kportorgbi, (2014) which state that firms' tax savings decrease as tax authorities reduce the statutory corporate income tax rates and Desai & Hines (2002) states that tightening of tax system is positively associated with higher market performance of firms. This means a reduction in tax leakages as a result of intensive tax planning of firms when tax authorities maintain low corporate income tax rates. The timing effect is positive in insurance with ( $\alpha = +0.258$ ) which is consistent with the combined analysis, while in both manufacturing and banking industries, the coefficients of timing effect are ( $\alpha = -3.63$ ) and ( $\alpha = -5.586$ ) respectively which are not in line with the summation of Desai and Hines (2002).

It further explains the theory of tax planning and Scholes – Wolson framework on which this study is based, that the effect of tax planning on pricing of assets goes beyond tax shield and that both direct and indirect cost should be monitored in tax planning. The t result of timing effect of transaction shown in Table 4.2.1b shows that the probability of this result occurring by chance was 0.182 which is above the level of significant 0.05 and hence timing effect of transaction is not statistically significant. This means that timing effect of a transaction which is a tax planning practice, has a positive insignificant impact on the reported earnings.

Information content shows a negative relationship with the pre-tax income ( $\alpha = -0.335$ ). When the time of asset acquisition is adequately planned, allowable deduction would be increased, thus leading to a reduction in pre-tax income and consequent decrease in the tax liability payable. This result is in agreement with the research of Chen, Dhahwal and Trombley (2007) that relative informativeness of book and taxable income is affected by tax planning and earnings quality. It is also consistent with the conclusion of Ayers, Jiang and Laplante (2009) that taxable income are less informative for high tax planning firms and more informative for firms with low earnings quality. The t result of information content shown in Table 4.2.1b reveals that the probability of this result occurring by chance is above 0.05 (that is, 0.324) and hence information content is not statistically significant. This means that information content which is a tax planning indicator has a negative insignificant impact on the pre-tax income.

Tax liability shows a positive relationship with the pre – tax income ( $\alpha = +1.135$ ). When pre –tax income is higher, the tax liability on it must be higher too. Simple analogy from this is that increase tax liability results in more income to the government and less reported earnings by various listed companies in Nigeria. This is in consonance with the Scholes-Wolson theory adopted in this study. The t result of tax liability shown in Table 4.2.1b reveals that the probability of this result occurring by chance is 0.276 which is more than the level of significant 0.05. Therefore, the tax liability is not statistically significant at  $P > 0.05$  level. This means that tax liability which is a tax planning parameter, has a positive insignificant impact on the reported earnings of the listed companies.

### Summary and Conclusion:-

Timing effect of transaction shows no significant positive effect on reported earnings of listed companies ( $\alpha = +0.956$ ). This is shown in tables 4.2.1b. This indicates that when acquisition of non-current asset is effectively planned, the capital allowance claimable will increase, leading to a reduction in tax liability and consequently increasing the reported earnings.

Information content shows a negative effect on the pre-tax income ( $\alpha = -0.335$ ). This is displayed in Table 4.2.1b. Therefore, tax planning practice reduces the information content of taxable income. The more tax is planned, the lesser the information that an organisation may be willing to disclose in the taxable income.

Tax liability shows an insignificant positive effect on the pre-tax income ( $\alpha = +1.135$ ). The higher the profit before tax (pre-tax income), the higher the amount of tax liability to pay, since tax liability is a percentage on the pre-tax income reported.

The model formed from the regression analysis of Table 4.2.1b shows that tax planning has no significant relationship with the firms' performance. ( $PTI = 22726.815 + 0.956TE - 0.335IC + 1.135TL$ ).

The paper therefore concluded that tax planning has no significant effect on firms' performance. The followings are however recommended: There is the need for organisations to plan tax effectively since this would benefit investors by a way of increasing their wealth. Tax education needs to be encouraged among tax payers in order to plan their tax and promote voluntary compliance and reduce the incidence of tax evasion. Tax agents should quantify the risk exposure of their client and determine the level of tax minimisation that will be reasonable. There is the need for tax agents and tax authorities to come together to intensify efforts in sensitisation campaign on how every tax payer would plan taxes as this will assist voluntary compliance.

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