# Assessment of Tax Planning Practices and Reported Earnings on Financial Performance of Listed Firms in Nigeria

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***Abstract***
*Most profit making organizations generally aim at maximizing benefit by minimizing their cost, without considering the social and legal implication of this. Nigerian companies are rigidly committed to traditional tax evasion and avoidance practices which are one of the reasons why the government is losing a huge amount of money to tax fraud each year. This calls for the need to examine how tax planning affect reported earnings of listed companies in Nigeria. This work adopts diffusion theory of taxation which was propounded by Everelt Rogers in 1995. The research adopted survey and ex-post-facto design. Financial statements of selected companies from manufacturing, banking and insurance companies 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. Simple and stratified sampling techniques were used to select fifteen companies for study. The hypothesis of the study states that timing effect has no significant impact on the reported earnings of organization. The result indicated that, the joint effect of timing effect on profit after tax is positive but insignificant (p value = 0.298 > 0.05). $R^2$ = 0.498, which indicates that timing effect, information content and tax liability account for 49.8 % change in profit after tax. It was concluded that tax timing effect has no significant effect on reported earnings of listed companies in Nigeria. The paper therefore recommends that tax laws should be reviewed intermittently and tax payers should be made to have a deep understanding of it to apply it.*

**Key words:** *Tax Planning, Earnings, Timing effect, tax evasion, listed companies*

## Introduction

The aim of every profit making organisations is to maximise benefit and minimize cost. Many Businesses pursue their aggressive profit motive without recourse to their social, economic or legal environment, thus, not minding whatever implication foul practices such as tax evasion and deliberate under-disclosure of financial statement can have. Costs generally are either controllable or otherwise. Statutory cost like tax liability is adjudged controllable because, it can be kept to the barest minimum without compromising the integrity of the organization.

A professional approach can be introduced to minimize the organization's tax liability within the realm of the law which at the same time sanitizes organizations' reputation, this is called tax planning. The practice of tax planning is traceable to 1947 in the case of *Commissioner v. Newman*, in the United States of America (USA), when the judge held that there is nothing sinister in arranging ones affairs so as to keep taxes as low as possible. This argument is supported by Hoffman (1961). According to him, firms must understand the prevailing tax laws in their jurisdiction and apply them in a manner that will reduce their tax exposure. He posits that there is no economic sense in paying more tax than what the law demands and there is the need for corporate organizations to engage in tax planning. A company would be regarded as being successful, if it operates in line with its tax rules and regulations (Scholes and Wolfsons, 1992).
Tax planning is a veritable tool at the disposal of tax payer to reduce the burden of tax paid or payable. It is defined by Kiabel and Akenbor (2014) as any action that must be taken by a business entity to inflate taxable income or reported earnings in a given period before tax loss expires. It is perceived indeed in different ways in that it includes various aspects which include arranging accrued income, expenditure to be incurred, how various investment plan can be made, as well as retirement plan to include all statutory deductions (AbdulWahab, 2010). It is usually undertaken in order to have access to all exemptions, deductions and rebates as it is contained in the relevant legislations.

The causal relationship between application of the tax planning strategies and reported earnings of various organizations in Nigeria need to be empirically established in order to determine whether or not, it is effective. The reluctance in the use of this concept in Nigeria calls for researchers' attention. Nigerian companies are rigidly committed to traditional tax evasion and avoidance practices which are one of the reasons why the government is losing a huge amount of money to tax fraud each year (Kiabel and Akenbor, 2014). This economic crime is perpetrated by both companies and the officials of various relevant tax authorities. Companies in attempt to avoid tax, end up paying more than what is statutorily required to tax fraudsters. A more legitimate approach is thus required to assist these organisations in the determination and payment of required tax liability. This study is therefore on assessment of tax planning practices and reported earnings on financial performance of listed firms in Nigeria
The hypothesis formulated for the study is:
$H_0$: Timing effect has no significant effect on the reported earnings of organization.

**Review of Literature**
**Conceptual Framework**
In the word of Webber (2012), company income taxes are often one of the organizations' largest costs, they engage in tax planning to minimize it. Tax planning is the use of every legal means to arrange business activities in a way to reduce tax obligations. Bruce, Deskins and Fox, (2005) aver that policy makers are more concerned about how higher rates of tax or wider tax bases will contribute to economic development. This, thus, calls for tax planning, or how various organizations can increase their reported after-tax profits by varying tax policy using financial arrangements within related companies. The practice of tax planning is prevalent among businesses organizations in the sense that most accounting firms and several other financial advisors are assisting organizations in making arrangements on how to reduce their tax liability. Blouin and Tuna, (2007) state that government and the relevant tax authorities are increasingly signifying their reluctance to support the use of tax planning. It was claimed that this is

responsible for the dwindling nature of corporate income tax bases on yearly basis. To forestall this, a stringent reporting requirement was introduced that will minimize the extent at which pre-tax profit can be reduced (Houghton, Hogroian and Weinreb 2004).

Tax planning will have a positive effect on economic efficiency, however that will be an economy that is too capital intensive, Inman and Rubinfeld (1996) say that efficiency may be retarded when tax are levied on mobile capital below an efficient level. Efficiency changes depend on both revenue and administrative compliance cost. The size of an organization determines its potentiality to plan tax. This is evident in Rego (2003) that larger multinationals that are more profitable, are able to reduce their tax liability through adequate tax planning.
A form of tax planning is prevalent among multinational corporations called corporate inversion. This is when a corporation having foreign subsidiary in a low or no tax area inverse its organizational structure by making the foreign subsidiary to become the parent company and the parent now becomes the subsidiary (Bruce, Deskin and Fox, 2005). This system is used to minimize tax liability on foreign income and to maintain pre-tax profit until earnings are repatriated to the intended economic destination. The possibility of this practice according to Desai and Hines, (2002) hinges on the size of the firm, the leverage status, availability of overseas assets and low tax rates in foreign countries.

Tax planning is categorized by Gentry and Hubbard (1998) into three forms: discouraging incorporation, encouraging borrowing and altering the timing of transactions. The classification of income as business and non-business income is another way employed to plan tax, since corporate income tax is payable only on business income. Other forms of planning can be by a way of creating passive investment income and single member limited liability Company. Other forms include transfer pricing (Bruce, Deskin and Fox, 2005). Tax planning can generate a great deal of tax savings that has beneficial effect on both immediate and potential shareholders (Tucker, 2006; Wilson, 2009).

These authors discussed tax planning as a concept within the tax law but did not relate it to the performance of various organizations. Hence this study is looking at the tax planning as it affects earnings reported by these companies.

**The Concept of Earnings**
Chen, Dhaliwal and Trombley, (2007) in their assessment of voluntary book-tax conformity discovered that differences in voluntary conformity results in net effect of differences in both earnings management and tax aggressiveness. They likened earnings management generally to income-increasing book accounting choices while tax aggressiveness is synonymous with income-reducing tax accounting choices. They further assert that when voluntary compliance increases, this will involve either reducing the use of free earnings management devices (i.e those that increase accounting income but not taxable income) or decrease the use of free tax planning devices (those that decrease taxable income but not accounting income), or both. This means that, when voluntary conformity increases, it reduces tax aggressiveness, or increases the quality of earnings or both simultaneously.

Chen, Dhaliwal and Trombley, (2007) affirms that book income and taxable income are dependent. The adequate preparation of one impedes the degree to which the other can be

effectively managed. This is because tax planning and earnings management have the possibility of affecting both book income and taxable income. A tax planning mechanism that reduces taxable income will either reduce the accounting earnings or leave it unchanged. In similar vein, when an earnings management device increases the reported book income, it may either increase the taxable income or leave it unchanged. Acharya (2009) observes that private equity firms need to meet and consult with the managers of their portfolios to bring industry and operating expertise to portfolio firms using a professional hand. This expertise and resources of private equity firms would affect the tax strategies to be employed. Effective tax strategies require greater financial and operational resources, and tax expert to perform complex tax shelter transactions (Crocker and Slemrod, 2005; Robinson, Sikes and Weaver, 2009). This means that modern tax planning needs a minimum level of corporate professionalism that requires access to managerial experience.

It was observed that, while these researchers opined that earnings management and other characteristics are not related to tax avoidance, they have not studied the effect of tax planning on it which this work intends to do.

**Tax Incentives and Tax Holidays in Nigeria**

One of the incentives is granting "pioneer status" to a business pursuant to the provisions of the Industrial Development (Income Tax Relief) Act, Cap 17, Laws of the Federation of Nigeria, 2004. Another one is the Nigeria Liquefied Natural Gas (Fiscal Incentives, Guarantees and Assurances) Act, ("the NLNG Act"). This is a Nigerian legislation with tax holiday provisions granted specifically to favour Nigeria LNG ("NLNG or the Company"). This is because the company is considered as one of the most significant economic projects carried out in Nigeria, with the aim of increasing the gross domestic product (GDP) and harnessing Nigeria's vast natural gas resources. The relevant provisions of the NLNG Act under consideration include sections 6 (8) (9) (10) 7(7). Section 6 (8) of the NLNG exempts any shipping company owned directly or indirectly by the Company or one or more of the shareholders of the Company from company income tax in pursuant to section 14 of the Companies Income Tax Act, or any other law, on the profits derived from that business.

Section 6 (9) of the NLNG also exempts the NLNG from withholding tax or any other impost from payments made to shipping companies as defined in Section 6 (8) of the NLNG Act. Again, Section 7(7) prohibits the payment of export duties, taxes or other duties, levies, charges or impost of a similar nature on the export of liquefied natural gas or other hydrocarbons produced by the Company.

Like Pioneer Legislation, Section 2 of the NLNG Act provides that the tax relief period for the NLNG shall commence on the production day of the company but with extension to a period of ten years. However, this opportunity is terminable in the first anniversary date after the first five years when the cumulative average sales price of liquefied natural gas reaches US 3 dollars/mmbtu. It should be noted that, neither the Company nor its shareholders in their capacity as shareholders in the Company, shall in any way be subject to new laws, regulations, taxes, duties, imposts or charges of whatever nature which are not applicable generally to companies incorporated in Nigeria or to shareholders in companies incorporated in Nigeria respectively.

On the strength of the foregoing, it can be argued that the NLNG is exempted from subsequent legislations impose on it. Obligations to pay any form of tax, levies duties, etc. of whatever nature, in so far as these taxes, levies, duties are not generally applicable to companies in Nigeria or to shareholders of companies incorporated in Nigeria.

According to Kiabel and Akenbor (2014) a company with at least 25% foreign equity capital is exempted under the minimum tax rule in Nigeria (Section 33, CITA, 2004). There is no restriction for companies engaging in agricultural and manufacturing business in claiming their capital Allowance, while others are limited to two-third of their assessable profit; there is also an additional five percent initial allowance for companies in plant and machinery used in manufacturing, agricultural production, ranching and plantations, construction, and public transportation with a fleet of not less than three buses; companies with pioneer status enjoy tax holiday for a minimum of three years and for an additional maximum of two years, maximum, their dividend is also tax free in the hand of the recipient. This is in accordance with the provision of Industrial Development (Income Tax Relief) Act, (1990). Losses in the agricultural sector can be carried forward indefinitely while companies in other sectors can carry forward their losses for a maximum of four years. Also available is the provision of a hundred percent (100%) capital allowance on Qualifying capital expenditure incurred on motor vehicles used for public transportation (inter-city); there is also a provision of five-percent additional annual capital allowance on plant and machinery used by business such as a manufacturing exporter. Also available is the provision for small business with turnover of not more than one million naira (₦1,000,000.00) engaging in manufacturing, agriculture, wholly export trade or mining of solid minerals, to enjoy a lower rate of tax at twenty percent on its total profit for a minimum period of three years and a maximum of five years from the date of commencement; Section 27 of the Companies Income Tax Act (CITA), (2004) (as amended) grant investment allowances on qualifying capital expenditure incurred on plant and machinery used in manufacturing business and in agricultural production other than marketing and processing in the first year of acquisition at the rate of fifteen percent which is not deducted from the cost of the asset in arriving at the residue of qualifying expenditure for annual allowance purposes. The nature of capital employed by a business affects its tax liability. The reward for debt capital is interest, while that of equity capital is dividend. Under the tax laws, interest cost is an allowable expense which gives rise to tax savings, while dividend is not a tax deductible expense.

Effective tax planning is also required with regards to when to commence a new business, what appropriate date should be chosen for reporting and when to close down an existing business. In line with the Nigerian tax law, commencement should be planned toward the end of the government fiscal year in order to reduce the basis period and consequently the total profit, while the date of cessation should be planned toward the beginning of the fiscal year for the choice of a reporting period. It should be planned in such a way that the accounting year end is as close as possible to the government tax year. All these will result in a substantial tax advantage. Asset disposal should be made in the earlier period of assessment in order to make use of the proceed for a long time since capital gain tax is on current basis (Kiabel and Nwikpasi, 2001).

Tax Alert, (2012) informed that there is a bill currently sponsored to amend the Companies Income Tax Act Cap C21 LFN 2004 (CITA) which has recently passed through the second reading at the National Assembly (Senate). It has amendments which are designed to provide

further tax incentives for gas utilization, mining sector and companies operating from areas with inadequate infrastructure. Prominent among the changes include an upward shift in the rate of rural investment allowance from ten to twenty percent for companies that incur capital expenditure on roads where no tarred road has been provided by the government within ten kilometers as against what is obtainable in the present.

Another amendment is spotted in the introduction of a new Section 34A which explains the provision of a ten (10) year tax holiday for any company established in a place where there is no electricity, water, or tarred road etc. provided by the government. Tax free period for mining companies was increased from three to five years. The bill also includes an increase in the tax free period for companies engaging in gas utilization (downstream operations) to seven years.
Good tax reforms are positive for the economy as they attract more investors, encourage business expansion and create more jobs in Nigeria. Price Water & Coopers (PWC) accountancy professionals suggested that it would be of great benefit to complement this with other changes such as the removal of commencement rule which taxes same profits twice after the tax holiday or the dividend taxation which taxes retained earnings when distributed. The proposed tax incentive should perhaps apply to all companies in Nigeria, all Nigerian companies (including those located in cities) should be eligible for the incentive. The tax laws and provisions provide various clues, where a close compliance with the tax laws can prove beneficial and support the reduction of the tax burden (Bimler, 2010).

This work adopts diffusion theory of taxation which was propounded by Everelt Rogers in 1995. It is the belief of this theory that when taxes are levied it will be absolved into the entire economy. The advocates of the theory opine that tax imposed on any commodity is transferred to the consumers, therefore the burden of tax is borne by individual according to the ability to bear. The theory is based on the assumption of perfect market which does not exist in the real world. If this theory is to hold, the financial controller of the state may not need to worry over the burden of any tax imposition. Gresik (2001) reviewed this theory and state that there are many innovations that are valuable for the masses. The theory has not gained practicability in the real world because some set of taxation such as income tax, inheritance tax, and toll tax have no absorption at all.

**Empirical review**

Altshuler, Newlon and Randolph (1995) concluded that the tax price effects on dividend repatriations measure largely the effect of the timing of dividend repatriations designed to take advantage of intertemporal variation in tax prices. These timing opportunities may arise either internally, through tax planning that affects both tax prices and dividend payments, or through externally caused variations in tax prices.

Bradertcher, Katz and Rego, (2010) conducted a research using three measures of tax avoidance which reflect tax planning that reduces a firm's tax liability without reducing the firm's income reported in the financial statement. It was concluded that Private Earnings (PE) backed firms engaged in significantly more nonconforming tax planning and had lower marginal tax rates than other private firms. Particularly, it was discovered that PE-backed firms pay 14.2 percent less income tax per dollar of adjusted pre-tax income than non-PE-backed private firms, despite the fact that net operating losses and debt tax shields are controlled. Also, that majority PE-backed

firm engage in more tax avoidance than minority PE-backed firms, and portfolio firms that are owned by larger PE firms engage in more tax avoidance than portfolio firms that are owned by the smaller firms.

**Methodology**

The research adopted survey and expost-facto design. Financial statements of selected companies 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. Data was analyzed using multiple regression

**Test of Hypothesis**

$H_0$: Timing effect has no significant effect on the reported earnings of organization.

**Table 4.3.1a: Goodness of the Fit of Model**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | 0.706 | 0.498 | 0.247 | 334195.1332 |

a. Predictors: (constants), Timing effect, Info. Content, Tax liability

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

From Table 4.3.1a above, R square gives 0.498 which means that the independent variables of timing effect of transaction, information content and tax liability account for 49.8% change on reported earnings. The adjusted R square gives 0.247 which attempts to correct R squared closely reflects the goodness of fit of the model.

**Table 4.3.1b: Regression Result of Model 2**

| Model | | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | 387014.164 | 256454.222 | | 1.509 | 0.182 |
| | Timing effect | 2.695 | 3.331 | 0.240 | 0.809 | 0.449 |
| | Information content | -1.919 | 1.641 | -0.350 | 1.169 | 0.287 |
| | Tax liability | -9.979 | 4.985 | -0.584 | -2.002 | 0.092 |

a. Dependent Variable: Profit after tax

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

From Table 4.3.1b above, the coefficients of the timing effect, information content and tax liability which are all independent variables (tax planning practice) respectively are $\alpha_1 = +2.695$, $\alpha_2 = -1.919$, $\alpha_3 = -9.979$, which are both positive and negative. The level of significance of each of the independent variable which is 0.182 for the constant, 0.449 for TE, 0.287 for IC and 0.092 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 profit after tax reported by various entities. A model that can be formulated from the table is as shown below.

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

$$PAT = 387014.164 + 2.695TE - 1.919IC - 9.979TL$$

**Table 4.3.1c: ANOVA**

| Model | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|
| Regression | 6.655E + 11 | 3 | 2.218E + 11 | 1.986 | 0.218 |
| Residual | 6.701E + 11 | 6 | 1.117E + 11 | | |
| Total | 1.336E + 12 | 9 | | | |

A. Dependent Variable: Profit After Tax
b. Predictors: (constant), Timing Effect, Information Content, Tax Liability

**Source: Researcher's computation using SPSS, 2015**
From Table 4.3.1c above, on the basis of the prob. (F – stat), the joint effect of the timing effect of transactions variables surrogated on reported earnings is insignificant (prob. F – stat. = 0.218 > 0.05).

**Interpretation of Result**
The coefficients of timing effect of the transaction are positive, while that of information content and tax liability are negative. This shows that there is a relationship between tax planning and profit after tax reported by various entities. All the independent variables have levels of significance greater than 0.05 which is the significant level. This implies that the isolated effects of tax planning surrogates are not significant.

The result indicates that timing effect has no significant effect on the reported earnings of the organisations. Therefore, $H_0$ is accepted.

**Discussion of Findings**
Individually, timing effect of the transaction shows a positive relationship with the profit after tax (α = +2.695). Timing effect of a transaction can increase the statutory deductions, thereby increasing the profit after tax. Riza (2003) posit that some organisations purchase more assets towards the end of the fiscal year so as to increase the value of reported assets. The practice of considering the statutory deductions in arriving at the profit to be taxed as explained by the relevant tax law needs to be adhered to.

The *t* result of timing effect of transactions shown in Table 4.3.1b reveals that the probability of this result occurring by chance was 0.449 hence, timing effect is not statistically significant at P > 0.05 level. This means that timing effect of a transaction which is a tax planning practice has a positive impact on the reported earnings.

Information content on the other hand shows a negative relationship with profit after tax (α = -1.919). The more an organisation plans its tax, the lesser information it may want to disclose in the financial statement. This is in line with the conclusion of Chen, Dhahwal and Trombley (2007) that tax planning affects relative in formativeness of book and taxable income. It is also consistent with the research conducted by Ayers, Jiang and Laplante, (2009) where it was concluded that existing tax planning and low earnings-quality proxies are sufficiently powerful to detect settings where book-tax differences are likely to be attributable to discretion in reporting book or taxable income and that taxable income becomes less informative for high tax planning firms.

In Table 4.3.1b the probability of this result occurring by chance is 0.287 and hence the information content of the financial statement is not statistically significant at $P > 0.05$ level. This means that information content which is a tax planning surrogate has a negative insignificant impact on the profit after tax of listed companies in Nigeria.

Tax liability shows a negative relationship with profit after tax ($\alpha = -9.979$). When an organisation pays higher tax liability, it will have a resultant effect of reducing the profit after tax. In an ideal situation, tax liability is a function of pre-tax income. This is because, company income tax is a function of pre-tax profit and it is based on 30% as prescribed by the Company Income Tax Act ( CITA) Cap C 10 2004 LFN. This however, is consistent with the conclusion of Bruce, Deskin and Fox, (2005) which state that state corporate tax rate reduces by seven percent for every one percent – point increase in the marginal corporate income tax rate in the United States.

**Summary and Conclusion**

From Table 4.3.1b, timing effect of a transaction shows no significant positive effect on the profit after tax ($\alpha = +2.695$). When acquisition of qualifying capital expenditure is adequately planned, it will give rise to an increased profit after tax.

Information content on the other hand also shows an insignificant negative effect on profit after tax ($\alpha = -1.919$). When tax is planned, the information content of taxable income will reduce. Similarly, Tax liability shows that there is no significant effect on the profit after tax reported ($\alpha = -9.979$). When tax liability is higher, the consequential effect is a reduction in profit after tax which will be available for shareholders to be distributed.

The model formed from the regression analysis of Table 4.3.1b indicates that there is no significant effect of timing effect on the reported earnings of listed organization in Nigeria. ($PAT = 387014.164 + 2.695TE - 1.919IC - 9.979TL$). The study therefore concludes that tax planning has no significant relationship with the reported earnings of listed companies in Nigeria.

The followings are however recommended: Some taxpayers have legitimate excuse for misinterpreting the tax law. Government attention should be directed towards how such tax payers could have better understanding of relevant provisions of the law. After which defaulters should be brought to book. There is need to have periodic review of various tax legislations with a view to spotting the loopholes and get it corrected. This is the basis for tax planning.

Relevant professional bodies (Institute of Chartered Accountants of Nigeria and Chartered Institute of Taxation in Nigeria) should be approached on the need to have laid down rules and procedures for professional conduct of tax experts, as it is the case with Auditing.

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