
Capital Allowance and Net Profit Margin of Quoted Agro-Allied Companies in Nigeria

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Abstract

This paper investigated the relationship between capital allowance and net profit margin of quoted agro-allied companies in Nigeria. The data used were collected from both primary and secondary sources. Eighty-nine copies of well-structured questionnaire were distributed to staff of selected quoted Agro-allied companies. Eighty-two copies of the completed questionnaire were returned. The data were collected and analysed with the aid of the Statistical Package for Social Science. Specifically, descriptive statistical tools were used to assess the frequency of the study variables. To test the null hypotheses, Spearman's rank correlation coefficient was used. The regression analysis was also employed to determine the effects of the explanatory variables on the dependent variable. It was established that there is a direct positive relationship between effective capital allowance and net profit margin of quoted agro-allied companies in Nigeria. This has led to efficient financial performance of organisations in the agro-allied sector. The study recommends that companies in agro-allied businesses should take advantage of investment allowance and rural investment allowance as these encourage the acquisition and utilisation of machinery, equipment, and other qualifying non-current assets in productive activities.

Key words: Capital allowance; net profit margin; agro-allied; companies.

1. Introduction

Oriakhi & Osemwengie (2013) are of the view that Nigeria's experience in the granting of tax incentives is traceable to the inception of British Administration in the territory, when all sorts of reliefs, allowances, and tax holidays were granted to British Companies and individuals as an attraction to establish trade links with the country. Specifically, tax incentives for industrial development came on stream in 1958 and included: (i) Pioneer companies relief, which exempted companies operating in pioneer industries for up to 5 year from paying company income tax; (ii) Companies Income Tax relief which gave capital allowances regarding investments in machinery, building, loss carry-forward facility, etc.; (iii) Import duties relief which exempted selected pioneer companies from paying import duties on imported inputs; and (iv) Approved user scheme, under which import duties were refunded to approved enterprises, which imports in the export-tuned production. National Tax Policy (2017) Tax Policy provides a framework for a sustainable system that would ensure reliable sources of revenue to government and support the economic development of the nation. The National Tax Policy provides the fundamental guidelines for the orderly development of the Nigeria tax system. The Policy is expected to achieve the following specific objectives, among others:-guide the operation and review of the tax system; provide the basis for future tax legislation and administration; serve as a point of reference for all

stakeholders on taxation; provide benchmark on which stakeholders shall be held accountable; and provide clarity on the roles and responsibilities of Stakeholders in the tax System. According to Oyewo (2013), taxation, besides its revenue-generation capacity can also be used as a fiscal tool to shape the economy. Considering that the Nigerian tax laws have witnessed significant changes over the period, it becomes very necessary to assess the performance of such policies judging by the effect it has had on the economy so far. National Tax Policy (2017) is poised to create a competitive edge by reducing the Number of taxes. This requires that taxes should be few in number, broad-based and high revenue-yielding. The administration of the taxes should also be simplified for ease of enforcement and compliance. Special arrangements should be sector-based and not directed at entities or persons. Also, special arrangements such as free zones and other tax incentives or waivers should not be arbitrarily terminated unless such arrangement of termination was provided for in the enabling legal framework or treaties at the time of creation. Government may still provide tax incentives to specific sectors or for such specific activities in order to stimulate or retain investment in the sector. Concerted efforts should be made to attract investments in length and breadth of all sectors of the economy, with more focus on promoting investment in some specific sectors as the Nigerian government may deem fit in the overall interest of the country from time to time. This will definitely help to boost a formidable base for optimum revenue generation.

Oriakhi & Osemwengie (2013) also maintained that generally speaking, tax incentives have operated under the following sub-heads in Nigeria: Tax holidays; Investment allowance; rural investment allowance; Tax free interest; Deductible capital allowance; Research and development; Tax-free dividends; Tax treaties; Reliefs and allowances. However, this research work categorises Investment Allowance, and Rural Investment Allowance as parts of Capital Allowance. No doubt tax incentives are desirable elements in a tax system. The regular changes caused by their applications create loopholes and complicates the tax system. Tax incentives tend to increase the required dosage of tax effort and, and therefore places an extra cost on tax administration. For instance, tax allowances; deductions and credits do create loopholes on the tax system, which clever tax payers may exploit. It may cost tax administration some extra funding to detect and investigate such practices; without additional finance tax administration gathers the dust of inefficiency and ineffectiveness. Tax incentives can therefore widen the scope for corrupting the tax system (Kuewumi, 1996).

2. Literature Review

Theoretical Framework

Normative Theory: The normative theory clearly describes how the development of the government's institutional structure enables the creation of a set of incentives as well as constraints within which governments and other actors operate. These incentives play key roles in shaping the path of development, and may evolve in different ways, according to what is of priority to the government. Hence not all of which are efficient. Tax policy-making and tax administrative reform therefore evolve simultaneously and symbiotically. The institutional theory developed here provides a generalizable framework that we believe can be used to better understand the development of tax policy and administration across time and cultures. It offers an attractive model for description, explanation and prediction (Tresch, 2014). This theory also covers all the objectives since it gives an overview of actions taken by players in an administration due to incentives which are provided by that administration. In line with this theory, Chua (1995) posits that every incentive has advantages and disadvantages, and it is therefore extremely difficult to determine one set of incentives which work for very different economies with different challenges and circumstances. Broadway

and Shah (1994) argue that any benefit such as an incentive allocated by public servants or politicians is potentially open to abuse and corruption. There is therefore a strong argument that incentives should be automatically available to all investors who meet a set of open and transparent criteria. However, an alternative argument is that firms should receive just enough incentive to induce them to invest, and no more.

Conceptual Framework

Capital Allowance

As discussed by Kiabel (2014) capital expenditure is not an admissible expense in earning profits. However, capital expenditure often results in the creation of non-current assets, like plant, machinery, building etc. which are used mainly for the purpose of generating profits. It is therefore reasonable to grant relief for the purposes of taxation in respect of these items on which expenditure has been incurred. Special allowances usually referred to as capital allowances provide this form of relief. When a fixed asset is put into use by a business entity, its value gets eroded due to physical wear and tear. The passage of time can also lead to obsolescence. Oyedele and Erukume (2015) describe capital allowance as that which is granted on tangible non-current assets in lieu of depreciation. With exception to Research and Development, other intangible non-current assets are not regarded as qualifying for the purpose of capital allowance. Oyedele and Erukume (2015) describe capital allowance as that which is granted on tangible non-current assets in lieu of depreciation. With exception to Research and Development, other intangible non-current assets are not regarded as qualifying for the purpose of capital allowance. Capital allowance can be viewed as a relief that is granted to the taxpayer who has incurred qualifying capital expenditure during a basis period in respect of assets in use for the purposes of income-generating trade or business. The 5th schedule to PITD, 1993 contains the relevant provisions specifying the rates and circumstances under which the allowances are granted. The rates are subject to adjustment from time to time with the passing of the appropriate legislation. In this study, the predictor variable (capital allowance) is operationalized into Investment allowance and Rural Investment Allowance

Investment Allowance: According to Oyedele and Erukume (2015) Investment Allowance is granted at the rate of 10% to corporate organization (companies) that incur expenditure on plant and equipment. It is calculated on cost and granted in the first year in which the asset is first to used. It has no bearing on the calculation of the tax written down value of the asset. Kiabel (2011) is of the view that Investment Allowance is only available in the first year, and it is not deductible from the cost of the asset. Olaleye, Memba, & Riro (2015) state that the available investment allowance under the Nigerian tax system presently are: 10% investment allowance on plant and machinery for business in the agricultural sector; 10% investment allowance on production machinery in use by manufacturing concerns; and 15% investment allowance on plant and machinery acquired as a replacement for obsolete ones.

Rural Investment Allowance:

In order to stimulate and encourage investment in the rural areas, a new capital allowance called Rural Investment Allowance was introduced effective from 1993 year of assessment. This new allowance is granted to companies that incur expenditures on the provision of such facilities as electricity, water, tarred road or telephone where such facilities are not provided by the government in the area where the business is located and carried out. According to Kiabel (2011), this incentive or allowance is aimed at encouraging industries to locate and establish in the rural areas. Such areas must be at least 20 kilometres from such facilities. According to Adelegan (2008), rural investment allowance is granted to manufacturing

companies that are sited at 20 kilometers from the provision of electricity, water, tarred road or telephone for the purpose of their trade and have provided the facilities that the government has failed to provide. The company can claim the rural investment allowance in addition to the initial allowance only in the capital expenditure incurred. Where there is a lack of the following facilities, the accompanying percentage can be claimed on agricultural assets in use: no telephone (5%), no tarred road (15%), no water (30%), and no electricity (50%). However; where there is no facility at all a manufacturing firm can claim 100% of expenditure allowance on assets use.

Net Profit Margin (NPM)

Net profit is profit that is generated from all phases of the business, including interest and taxes. This is the “bottom line” that garners most of the attention in discussions of a company’s profitability. The net profit margin (net margin) compares net income to sales. A consistently high net margin is often indicative of a company with one or more competitive advantages. Furthermore, a high net margin provides a company with a cushion during downturns in its business. Anwaar (2016) describes *Net profit margin* as the percentage of post-tax and interest profits to sales. It shows how much of the earnings by the company are translated into profits. A company’s net profit margin represents the percentage of revenues that end up on the bottom line. The bigger a company’s net profit margin (its ratio of net profit to net revenues) the better the company’s profitability.

Empirical Review

Agundu & Ohaka (2013) critically examined the extent to which capital allowance served as a veritable investment incentive to stakeholders in the Nigerian manufacturing sector. The corporate financial performance measures considered were profit after tax (PAT), return on total assets (ROTA), and return on shareholders' equity (ROSE). Statistical results proved the efficacy of capital allowance as it had significant association with PAT, ROTA and ROSE. Abdulrahman and Kabir (2017) conducted a study titled “Tax Incentive as a Real Modifier for Industrial Growth and Development in Nigeria.” The study looked at tax incentive as a modifier for industrial growth and development in Nigeria. The study was primarily undertaken to evaluate the effectiveness of tax incentives in the development of the Nigerian economy and the extent to which individuals and companies have been responding to the incentive scheme, and how these incentives have been stimulating and motivating these bodies on employment opportunities. This empirical study used a well-structured questionnaire to assess the relationship that exists between tax incentives, industrial development and economic growth among the four different incorporated industries and firms selected in Jos, Plateau State. It was discovered that the tax incentives granted were not sufficient enough to sustain the desired development for which it was granted.

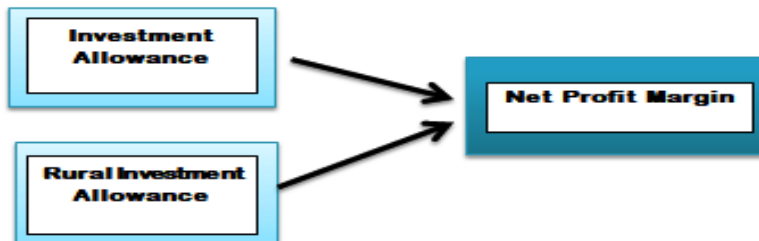
Chukwumerije and Akinyomi (2011) conducted a study on “the impact of the tax incentives on the overall performance of registered small scale industries in Rivers State”. Eleven, out of the twenty two registered small scale food and beverages manufacturing industries in Rivers State were selected randomly for the study. By means of questionnaires, responses were gathered from 260 persons. The researchers used Frequency distribution and chi-square in the analysis of data and hypotheses testing respectively. The research findings showed that tax incentives have a positive and significant effect on the profitability, staff strength, growth, and development of small scale industries positively. To guide the study, the following hypotheses have been formulated:

H₀₁: There is no significant association between Investment Allowance and Net Profit Margin:

H₀₂: There is no significant association between Rural Investment Allowance and Net Profit Margin.

3. Methodology

This study, impact of capital allowance on net profit margin of quoted agro-allied companies in Nigerian. The predictor variable (capital allowance) is operationalized into Investment allowance and Rural Investment Allowance.



The population of this study comprised the entire quoted agro-allied companies in Nigeria as found in the Nigerian Stock Exchange in the fact book of 2016. According to information obtained from the Nigerian Stock Exchange, there are currently five (5) quoted agro-allied companies in Nigeria. Twenty-three (23) members of staff were selected from each of the five companies making a total of one hundred and five (115) respondents. In addition, the sample size was obtained using Taro Yamane formula. The formula is illustrated as follows:

$$n = \frac{N}{1 + n(0.05)^2}$$

Where n= sample size

e= level of significance

N= Population size.

Using the Taro Yamane formula, the sample size is computed as shown below:

$$\frac{N=115}{1+115(0.05)^2} = 89$$

Based on this, the sample element consists of 89 respondents of the quoted agro-allied companies in Nigeria.

4. Presentation and Analysis of Data

Table 4.1: Distribution for Investment Allowances

Descriptive Statistics

	N	Min	Max	Mean	Std. Dev
Investment Allowance given to this company for a period of time boosts the financial performance of Agro-allied companies	82	3	5	3.90	.713
Investment Allowance enables this company to save more of its taxable income within the period it is granted.	82	3	5	3.90	.713
Investment Allowance savings are expected to be ploughed back into the business to assist the company to stabilize	82	3	5	3.89	.703
Valid N (listwise)	82				

Source: SPSS Output, 2018

The result of the analysis indicates that the items of Investment Allowance all have significant levels of affirmation for their various expressions of their generation; substantial mean values indicating significant levels of affirmation to the indicators and manifestations of Investment Allowance in the quoted agro-allied companies in Nigeria. This is also the observed summary mean (\bar{x}) value for the measure Investment Allowances = **3.89**

Table 4.2: Distribution for Rural Investment Allowance

Descriptive Statistics					
	N	Min	Max	Mean	Std. Dev
Rural Investment Allowance encourages investment in rural areas, where amenities are lacking	82	3	5	3.90	.713
Rural Investment Allowance enables this company to save more of its taxable income within the period it is granted.	82	3	5	4.00	.703
Savings from Rural Investment Allowance are expected to be ploughed back into the business to assist in the improvement of its financial performance.	82	3	5	4.04	.693
Valid N (listwise)	82				

Source: SPSS Output, 2018

The result shows that the indicators of Rural Investment Allowance all have significant levels of affirmation as regards the various representations of Tax Incentives in the selected organizations; All indicators carry $\bar{x} > 2.50$ substantial mean values indicating significant levels of affirmation to the indicators and manifestations of Rural Investment Allowance in the selected organizations of the study. Thus the summary mean (\bar{x}) Rural Investment Allowance = **3.98**

Table 4.3: Distribution for Net profit Margin

Descriptive Statistics					
	N	Min	Max	Mean	Std. Dev
A consistently high Net Profit Margin is often indication that a company has one or more competitive advantages.	82	3	5	4.16	.618
Higher Net Profit Margin can be encouraged by the purchase and utilization of qualifying equipment and machinery which boost production thereby reducing the cost of production	82	3	5	3.87	.681
Investment Allowance and Rural Investment Allowance can encourage business owners to invest in qualifying non-current assets which boost production thereby reducing the cost of production and paving way for higher Net Profit Margin	82	3	5	3.83	.717
Valid N (listwise)	82				

Source: SPSS Output, 2018

The analysis on the indicators of Net Profit Margin shows that all the indicators have significant levels of affirmation as a result of respondents perceptions and experience of such within the selected organizations; All indicators carry $x > 2.50$ substantial mean values therefore implying significant levels of affirmation to the indicators and manifestations of the measure, Net Profit Margin in the selected organizations. The summary mean (\bar{x}) for Net Profit Margin = **3.95**

Bivariate Data Analysis

Table 4.4: Secondary Level Analysis Results

			IA	RIA	NPM
Spearman's rho	IA	Correlation Coefficient	1.000	.744**	.080
		Sig. (2-tailed)	.	.000	.000
		N	82	82	82
	RIA	Correlation Coefficient	.744**	1.000	.079
		Sig. (2-tailed)	.000	.	.000
		N	82	82	82
	NPM	Correlation Coefficient	.080	.079	1.000
		Sig. (2-tailed)	.000	.000	.
		N	82	82	82

Source: SPSS Output, 2018

The secondary level analysis examined the relationship between capital allowance and net margin of quoted agro-allied companies in Nigeria; two null hypotheses were postulated and herein tested using the Spearman's rank order correlation coefficient at a 95% confidence interval and a 0.05 level of significance given the non-directional characteristic of the assumptions. The $P < 0.05 < P$ critical region is adopted as the decision rule in the acceptance (where $P > 0.05$) or rejection ($P < 0.05$) of the null hypotheses.

Test of Hypotheses (Bivariate)

H₀₁: There is no significant association between Investment Allowance and Net Profit Margin: Data (Table 4.4) reveals a significant relationship between Investment Allowance and net profit margin in the selected organizations (where $\rho = .080$ and $P = .000$); hence the null hypothesis is rejected based on the significant coefficient ($p < 0.05$) of the association.

H₀₂: There is no significant association between Rural Investment Allowance and Net Profit Margin: Data (Table 4.4) reveals a significant relationship between Rural Investment Allowance and net profit margin in the selected organizations (where $\rho = .079$ and $P = .000$); hence the null hypothesis is rejected based on the significant coefficient ($p < 0.05$) of the association. Therefore based on the findings of the study, all two previously hypothesized statements of non-significant associations between the constructs of the study are rejected as the findings of the analysis support significant levels of association between the dimensions of capital allowance (investment allowance and rural investment allowance) and net profit margin of quoted agro-allied companies in Nigeria.

5. Conclusion and Recommendation

Management has the ultimate responsibility to properly implement the given capital allowance incentive in the organization for the essence of profitability. Proper computation of capital allowance should be put in for the survival and good performance of the organization. Many industries that have experienced losses from capital allowance tax incentives issues experienced such because it was not properly handled. Therefore a great need for qualified

accountants to be engaged to assist in the area of computation of capital allowance.

Recommendations

On the basis of the findings of this study, the following recommendations are hereby made:

- i. All agro-allied companies in Nigeria should be conducted in compliance with applicable laws and regulations, supervisory requirements and internal policies and procedures, which are necessary for its survival.
- ii. Companies in the agro –allied businesses should take great advantage of capital allowances as it encourages the acquisition and utilisation of machinery, equipment, and other qualifying non-current assets in productive activities.
- iii. Many companies have experienced losses irrespective of the availability of tax incentives because it was not properly handled. Therefore qualified accountants must be engaged to assist in the area of computation of capital allowance.

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