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CORPORATE TAX AVOIDANCE OF LISTED FIRMS IN NIGERIA

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ABSTRACT
The study focuses on the long run corporate tax avoidance of listed firms in Nigeria with a view to examine the ability of listed firms to pay low amount of cash taxes in naira of pre-tax earnings over a long run period of twelve years. A sample of 19 listed firms were selected based on purposive sampling technique from the list of NSE 30 listed firms on the Nigeria stock exchange. The long-run cash effective tax rate developed by Dyreng, Hanlon, and Maydew (2008) to measure long run tax avoidance was adopted. The study finds that there is variation across the firms in tax avoidance at long run with some firms achieving a lower amount of cash taxes in naira of pre-tax earnings compared to others. The study concludes that firms in the consumer sector pay more taxes than financial service sector though financial service sector firms declare more profit before tax than the consumer sector firms. The study recommends than financial service sector firms should contribute more to education tax in Nigeria.

Key words: Cash Effective Tax Rate, Tax avoidance, Pre-Tax Earnings.

JEL Classification: E62, E63, H260

1. INTRODUCTION
Business organisations that are incorporated as private and public limited corporations are subjected to corporate income tax in Nigeria under the Company Income Tax Act (CITA) N0 11 LFN 2007 as amended at the rate of 30% and 2% education tax on the assessable profit respectively. These taxes are significant costs to businesses as they reduce the distributable profit to be declared by managers of the incorporated entities. The distributable profit reported by the managers is one of the indicators of their performance and competence, hence, they would legally engage in tax avoidance strategies with a view to exploiting tax codes/laws to their advantage to boost the reported earnings. This is presumed to benefit the shareholders that are the ultimate beneficiaries of the reported distributable profit and the principal in the principal-agent relationship.

Several authors have expressed divergent views on the definition of tax avoidance and their views were based on their respective research objectives. According to Dyreng *et al*. (2008) tax avoidance is the ability to pay a low amount of tax per dollar of reported pre-tax financial accounting income while Frank *et al.* (2009) posited that tax avoidance is the downward manipulation of taxable income through tax planning that may or may not be considered fraudulent tax evasion. It is essential to emphasise that tax avoidance does not necessarily implies illegal acts by taxpayers to reduce their tax liabilities, this position is supported empirically by Lennox *et al.* (2013) as they found that tax aggressive U.S. public firms are less likely to commit accounting fraud which would amount to illegality in their tax planning activities.

There are tax codes that tax payers utilize to their advantage in reducing their tax liability legally (e.g. capital allowance claims and donation to institutions recognised by law in Nigeria and allowable as expenses to reduce assessable profit) and in practice there are instances in which the tax laws are unclear on specific steps to take in tax assessment, especially in complex transactions (e.g. business acquisition and mergers) and tax payers will like to adopt practices that will reduce their tax liability in such instances. For this study, tax avoidance is adopted as defined and measured by Dyreng *et al.* (2008). It encompasses anything that reduces the firms' cash effective tax rate over a long period of twelve years as against ten years used by Dyreng *et al.* (2008) in their measure of long run cash effective tax rate and in compliance with the tax laws in Nigeria.

Academic Scholars have adopted many approaches to explain the concept of tax avoidance in corporate listed entities **(**Manzon and Plesko, 2002; Desai and Dharmapala, 2006; 2009a; 2009b; Gebhart, 2017). These prior studies focus on the use of annual effective tax rate to measure annual tax avoidance of corporate entities and studies on measuring the corporate tax avoidance in Nigeria are often short run to the best of the researchers' knowledge. It is therefore uncertain if corporate entities are avoiding payment of corporate taxes in the long run. Hence, the study adopts the use of long run cash effective tax rate as developed by Dyreng *et al.* (2008) to examine whether corporate firms in Nigeria can avoid corporate income taxes in the long run because of the weakness of other measures of tax avoidance.

The study would be useful to tax researchers, tax consultants, and fiscal policy makers. Tax researchers and consultant will use the study to ascertain the level of tax avoidance practices of listed firms while fiscal policy makers will use the study to formulate unambiguous tax policies that would induce economic development. The remainder of this paper is arranged as follows: Section 2 reviews the literature. Section 3 presents the methodology, while section 4 presents the results and discussion. Section 5 the study states the conclusion and recommendation.

2. LITERATURE REVIEW

Corporate income taxes in Nigeria represent a significant expense to corporate entities' shareholders because of its negative impact on reported earnings of listed firms. Notwithstanding the above, corporate tax avoidance which is defined as the payment of low cash taxes in naira of pre-tax earnings of corporate entities (Hanlon and Heitzman, 2010; Dyreng, *et al.* 2008), seems not fully studied as there are significant cross-sectional variations of tax avoidance practices (Dyreng *et al.* 2008) among firms. These empirical patterns lead to call by researchers for more studies (Shackelford and Shevlin, 2001; Hanlon and Heitzman, 2010) on corporate tax avoidance from both the tax professionals in practice and tax academic researchers. The under listed empirical studies are relevant to the study.

Lee and Swenson (2008) examined long-run corporate tax avoidance for majority of traded companies, representing 86 countries across U.S, Europe, and Asia including four African countries which are South Africa, Namibia, Kenya and Zimbabwe. Secondary data generated from sample of 9,076 listed firms selected across the countries are estimated with ETR computation and OLS. They documented significant differences across countries in terms of effective tax rates. They also found that, across countries, companies' tax avoidance is relatively consistent with studies of US companies' avoidance, which are functions of firm size, leverage, depreciation tax shield, and industry membership. In addition, multinational factors are also effective in explaining tax avoidance. These factors include opportunities for transfer pricing, tax rate arbitrage, incorporation in a tax haven country, and likelihood of audit detection.

Dyreng *et al.* (2008) investigated the extent to which some firms can avoid corporate taxes over a long-run period of ten years and determined how predictive one-year tax rates are for long-run tax avoidance in U.S for the period 1995 to 2004. They developed and described a new measure of long-run corporate tax avoidance which they labelled as long-run cash effective tax rate. Sample of 2,077 listed firms were selected from 2,439 firms based on positive reported earnings before tax. Descriptive statistics and OLS estimation technique were used to estimate the data. They found that there is considerable cross-sectional variation in tax avoidance among the firms and some of the firms have ability to pay low cash taxes of their pre-tax earnings than others. For example, approximately one-fourth of the sample firms can maintain long-run cash effective tax rates below 20 percent, compared to a sample mean tax rate of approximately 30 percent. They also found that annual cash effective tax rates are not very good predictors of long-run cash effective tax rates and, thus, are not accurate proxies for long-run tax avoidance. While there is some evidence of persistence in annual cash effective tax rates, the persistence is asymmetric.

Cai and Liu (2009) examined the impact of product market competition on corporate tax avoidance in China for the period from 2000 to 2005. They analysed a large annual survey dataset of all industrial firms developed and maintained by National Bureau of Statistics in China with sales above a certain level. On average they have 190,000 industrial firms per year that accounted for most of China's industrial value added and have 22% of China's urban employment in 2005. They

estimated the effects of competition on the relationship between firms' reported accounting profits and their imputed profits based on the national income account using both OLS and 2SLS regression techniques instrumenting for both the imputed profit and competition. To cope with measurement errors (such as imputed profit) and potential endogeneity (such as competition), they used instrumental variables, exogenous policy shocks and other robustness analysis. They found robust and consistent evidence that firms in more competitive environments engage in more tax avoidance activities i.e competition encourages the underreporting of profits by firms. Also, they found that firms in relatively disadvantageous positions demonstrate stronger incentives to avoid corporate income tax.

Desai and Dharmapala (2009b) examined the extent to which corporate tax avoidance activity is valued by investors in a large-scale sample of U.S firms. Secondary panel data of the sample of 862 U.S firms were evaluated using a data set with 4,492 observations over the period 1993 – 2001. Firm values measured using Tobin's q, as an independent variable, governance quality which is proxied for by the level of institutional ownership, reflecting the ability of institutional owners to monitor managerial performance more aggressively and tax avoidance which is measured by inferring the difference between income reported to capital markets and tax authorities—the book-tax gap—and controlling for accruals and other measures of earnings management as dependent variables are estimated Using OLS estimation techniques. They found that the effect of tax avoidance on firm value is a function of firm governance, as predicted by an agency perspective on corporate tax avoidance. The results suggested that the simple view of corporate tax avoidance as a transfer of resources from the state to shareholders is incomplete given the agency problems characterizing shareholder-manager relations. They concluded that incorporating agency issues into the analysis of corporate tax avoidance as a moderating variable in necessary for robust analysis rather than purely taking managers as agents of the shareholders because firms with huge reported earnings but with poor corporate governance will not be well valued by the shareholders.

Taylor and Richardson (2012) investigated the international corporate tax avoidance practices of publicly listed Australian firms. A hand collected sample of 203 publicly listed Australian firms over the 2006- 2009 period are selected from the population of the listed firms. Using OLS estimation techniques to analyse the data, the results indicated that there are several practices Australian firms use to aggressively reduce their tax liabilities. These practices include thin capitalization, transfer pricing, income shifting, multi-nationalism, and tax haven utilization as they are significantly associated with tax avoidance. They found that thin capitalization and transfer pricing are major drivers of tax avoidance whereas, income shifting, and tax haven utilization are less important. Furthermore, their finding reveal that tax havens are likely to be used together with thin capitalization and transfer pricing to maximise international tax avoidance opportunities via increased complexity of transactions carried out through tax havens.

There are several measures of tax avoidance in Literature which have been used by researchers to measure tax avoidance. These measures which differ from one another are presented below.

2.1 Effective Tax Rate Measures

The Effective Tax Rate is basically the average tax rate a corporation pays on its pre-tax profits and is calculated by dividing a measure of tax liability by a measure of pre-tax income.

$$ETR = \frac{Measure\ of\ tax\ liability}{Measure\ of\ Pre-tax\ income} \quad (1)$$

ETR based measures can be compared with the statutory tax rate. If an ETR measure is below the statutory tax rate, then it could be an evidence of tax avoidance. The ETR can be calculated on different measures of tax liability, which could be total tax expense, current tax expense, cash tax expense and pre-tax income, and can vary in terms of periods included in the measure. There are annual ETR measures and long-run ETR measures.

2.2 Annual Effective Tax Rate Measures

2.2.1 GAAP ETR

The basic form of annual ETR measures is the annual GAAP Effective Tax Rate (GAAP ETR), which is disclosed by firms in their financial statements. It is defined as:

$$GAAP\ ETR = \frac{Total\ tax\ expense}{Pre-tax\ income} \quad (2)$$

This basic form of ETR suffers from severe limitations as Dyreng *et al*. (2008), criticized the GAAP ETR for not measuring tax deferral strategies. They argued that total tax expense encompasses both current and deferred tax expense, but tax deferral strategies will reduce current tax expense and simultaneously increase deferred tax expense, these tax planning activities will not have any influence on GAAP ETR. Furthermore, the reliance on pre-tax income in the denominator limits GAAP ETR to non-conforming tax avoidance (Badertscher *et al.* 2015; Hanlon and Heitzman, 2010; Salihu *et al,* 2013). Thus, GAAP ETR would, for instance, not capture the tax effects of interest deductibility, because this reduces both taxable and financial income (Hanlon and Heitzman, 2010). Due to these limitations it becomes clear, that the GAAP ETR does not measure a considerable portion of tax avoidance. Moreover, GAAP ETR does not distinguish between reductions in tax liabilities due to actual tax planning strategies.

Truncation bias which is when pre-tax income is negative is a significant limitation of GAAP ETR rates (Henry and Sansing 2014). This truncation bias makes researchers to often drop loss years because of the difficulty in interpreting negative ETR. According to (Henry and Sansing 2014) this practice also leads to an asymmetrical treatment of income and loss years, which may distort the results. Because of these shortcomings, there have been attempts to modify the GAAP ETR to increase the power of Effective Tax Rate measures.

2.2.2 Current ETR

To overcome the limitation of the GAAP ETR only measuring permanent tax avoidance, one could use current tax expense in the numerator instead which yields the Current Effective Tax Rate (Current ETR) measure. This is calculated as follows:

$$Current\ ETR = \frac{Current\ tax\ expense}{Pre-tax\ income} \quad (3)$$

This variation allows measurement of tax deferral strategies (Salihu *et al.* 2013), because a reduction in current tax expense will not get compensated by an increase in the deferred tax expense, as this was the case using total tax expense (as described above). Current ETR measure suffers from the same problems as the GAAP ETR and besides, current tax expense may be over- or understated in comparison to the actual tax expense, which may distort the Current ETR.

2.2.3 Cash ETR

Cash Effective Tax Rate (Cash ETR), defined as:

$$Cash\ ETR = \frac{Cash\ taxes\ paid}{Pre-tax\ income} \quad (4)$$

Using cash taxes paid in the numerator instead of total or current tax expense makes the measure overcome the limitation of GAAP and Current ETR. It also considers the tax effects of employee stock options (Dyreng *et al.*, 2008; Chen *et al.* 2010) which is the main factor stated by Hanlon (2003) for an overstatement of current tax expense which is not subjected to overstatement under cash ETR. On the other hand, cash taxes paid could also include tax payments of former periods as it includes all taxes paid in one year regardless of which periods they arose in (e.g. tax payment related to Federal Inland Revenue Service audit of former years), which could lead to a mismatch of numerator and denominator and thus distort the Cash ETR (Hanlon and Heitzman, 2010; Dyreng *et al*., 2008) Therefore, Cash ETR also suffers from the remaining problems of GAAP ETR, not fixed by using cash taxes paid in a year.

2.3 Adoption of Long-Run Cash Effective Tax Rate proposed by Dyreng *et al.* (2008)

The study attempts to overcome the limitations of GAAP ETRs by adopting the long run cash effective tax rate as developed by Dyreng *et al.* (2008). They developed and described a new measure of long-run corporate tax avoidance which they labelled as long-run cash effective tax rate. They measured effective tax rates over a period of 10 years by adding a firm's total cash taxes paid over a ten-year period and dividing that by the sum of its total pre-tax income (excluding the effects of special items) over the same ten-year period. This produces an effective tax rate that reflect the firms' tax expenses over a ten-year. They also measured effective taxes using cash taxes paid generated from the statement of cash flow of the selected firms rather than GAAP tax expense. They developed the resulting long run cash effective tax rate for firm i measured over the period t 1 to N ($CASH\ ETR_i$) is:

$$LG\ CASH\ ETR_i = \frac{\sum_{t=I}^{N} Cash\ Tax\ Paidit}{\sum_{t=I}^{N}(Pre{-}tax\ incomeit{-}\ Special\ Itemsit)} \quad (4)$$

The long run cash effective tax rates will incorporate payment to and from tax authorities arising from settlement of tax disputes that arose in the past years. Therefore, the long run measure of tax avoidance is appropriate as the income to which these taxes relate will more likely be included in the same ratio as the taxes. This reinforces the importance of looking over long horizons of not ten years as proposed by Dyreng *et al.* (2008) but by extension of additional two years when measuring corporate tax avoidance of Nigerian listed firms with a view to determining their ability to pay low cash taxes in relation to their pre-tax earnings.

3. METHODOLOGY

The study focuses on the listed companies that constitute the Nigeria Stock Exchange index 30 as the population of the study. The NSE 30 companies make up 95% of market capitalisation of the Nigerian stock market and contribute significantly to the total corporate income taxes paid annually by listed firms in Nigeria. Sample of nineteen (19) firms of the NSE 30 firms were purposively selected based on the availability of data for twelve years period of 2006- 2017 while petroleum companies that are subjected to tax under Petroleum Income Tax Act are excluded. The period selected incorporate both pre and post global financial crises period. Secondary data on taxable income, taxes paid, and pre-tax income were extracted from the financial statements of the sample of listed firms and data gathered were analysed using descriptive statistics.

4. RESULTS AND DISCUSSION

Analysis of the secondary data collected from the financial statements of the selected NSE 30 firms are analysed in this section.

4.1 Individual Firms Analysis of Long run Cash ETR of Selected NSE 30 firms.

Table 1: Long run Cash Effective Tax Rates of Selected NSE 30 firms

S/N	Company	Exchange Sector	Long-run Cash ETR (12 years)
1	Okomu Oil Palm Plc	Agriculture	0.12
2	Presco Plc	Agriculture	0.08
3	7 Up Bottling Company	Consumer	0.26
4	Flour Mills of Nigeria Plc	Consumer	0.22
5	Guinness Nigeria Plc	Consumer	0.25
6	Nestle Nigeria Plc	Consumer	0.16
7	Nigeria Breweries Plc	Consumer	0.28
8	PZ Cussons Plc	Consumer	0.26
9	UAC of Nigeria Plc	Consumer	0.25
10	Unilever Nigeria Plc	Consumer	0.20
11	Dangote Sugar Plc	Consumer	0.28
12	Access Bank Plc	Finance	0.15
13	First Bank Holdings	Finance	0.22

14	Guaranty Trust Bank Plc	Finance	0.15
15	UBA Plc	Finance	0.18
16	Zenith Bank Plc	Finance	0.17
17	GlaxoSmithKline Nigeria	Healthcare	0.32
18	Julius Berger Plc	Construction & Real Estate.	0.07
19	Dangote Cement	Construction & Real Estate	0.02

Source: Author's Compilation (2018)

Table 1 depicts the twelve years long run cash effective tax rate of the selected firms of NSE 30 firms. The computed long run cash effective tax rate reveals that all the firms engage in tax avoidance practices as their respective long run cash effective tax rates are less that the statutory corporate tax rate of 32% (Statutory rate of 30% and education tax rate of 2%) except GlaxoSmithKline which has a computed long run effective tax rate of 32% which is at equilibrium with the statutory corporate tax rate of 30% and education tax of 2%.

The descriptive summary statistics as presented in fig. 1 depicts a mean of 18.6% for all the firms selected. This is an indication that all the firms in NSE 30 index of the Nigeria Stock Exchange are moderate in their practices of tax avoidance. Firms whose long run cash effective tax rate falls in the range of 1-19% are very moderate in tax avoidance practices, while those with long run cash effective tax rate of 20-29% are aggressive and those with 32% are at equilibrium. It should be noted that those with 33% and above in long run cash effective tax rates are not taking advantages of several tax incentives available in the Nigerian tax laws to reduce their tax liability.

Ten (10) firms out of the nineteen selected firms have long run cash effective tax rate above the mean of 18.6%. This indicates that there are varying degrees of tax avoidance practices among the firms. The minimum is 2% while the maximum is 32%. The negative skewness of -0.55 shows that some of the selected firms have long run effective tax rates that are negatively skewed towards the statutory rate of 32%. This is corroborated by the histogram that shows divergence in long run cash effective tax rates of some firms towards the statutory tax rate.

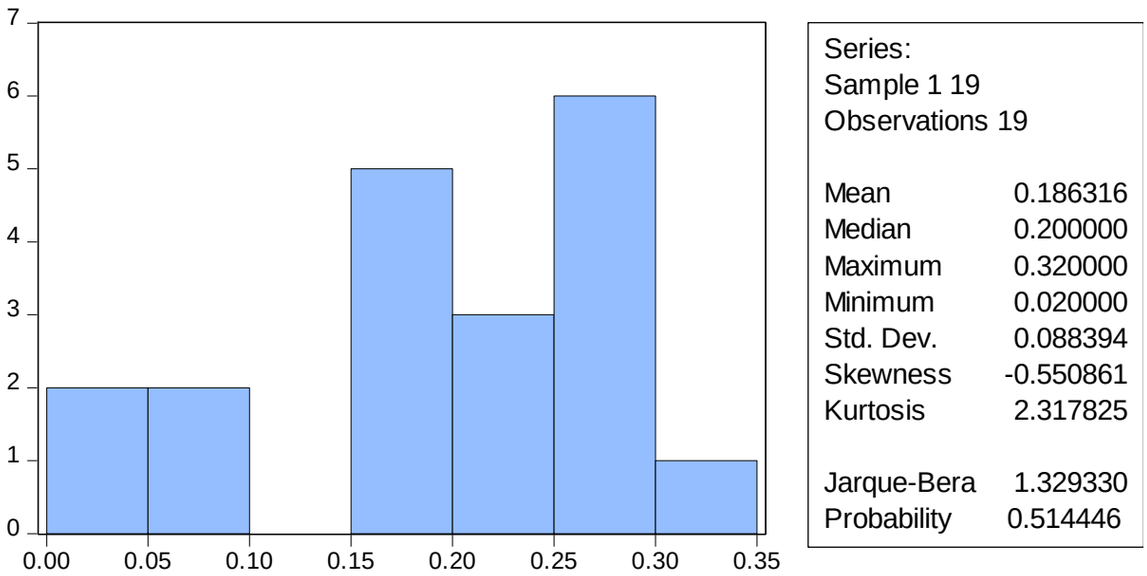
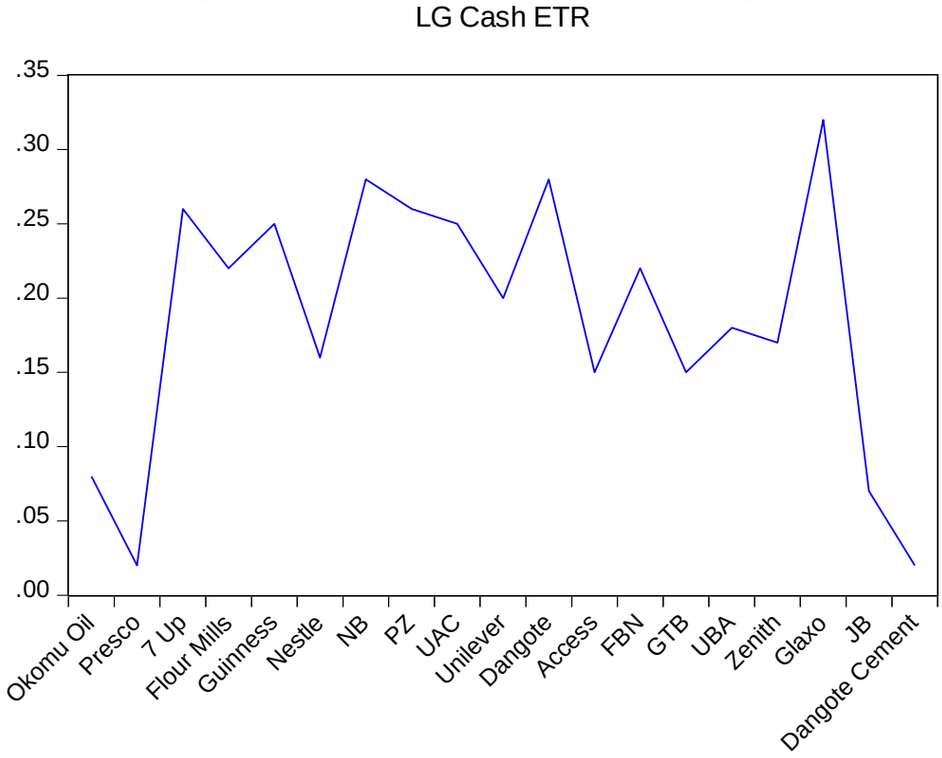


Figure 1: The Histogram of the long run cash effective tax rates of selected NSE 30 firms and their descriptive statistics.

The graphical presentation of the long run cash effective tax rate of selected firms in the NSE 30 index as presented in Fig. 2 shows the level of tax avoidance of each of the firms. Okomu Oil Palm Plc, Presco Plc, Julius Berger Plc and Dangote Cement Plc are companies with significantly low long run cash effective tax rates. This is connected to enormous tax incentives available for firms

in the Agricultural sectors of the Nigeria economy and the



pioneer status enjoyed by Dangote Cement Plc.

Fig 2: The graphical presentation of long run cash effective tax rate of selected NSE 30 firms.

4.2 **Industry Analysis of Long run Cash ETR of Selected NSE 30 firms**.

Table 2: Industry Analysis of Average Long run Cash ETR of Selected NSE 30 firms.

S/N	Industry	No of NSE 30 firms selected	Average long-run cash ETR
1	Agriculture	2	0.10
2	Consumer	9	0.24
3	Financial Institutions	5	0.17
4	Healthcare	1	0.32
5	Construction & Real Estate	2	0.045

Source: Author's Compilation (2018)

Table 2 depicts the industry average long run cash effective tax rates of the selected firms in the NSE 30 index. Agricultural and Construction & Real Estate sectors have the lowest average long run cash effective tax rate of 10% and 4.5% respectively. The Financial Institutions have an industrial average of 17%. While Healthcare and Consumer sectors has the highest of 32% and 24% respectively. Firms in the financial institutions, Healthcare and Consumer sectors are paying high cash amount in taxes in naira of their pre-tax earnings in the long run compared to other firms in the Agricultural and Construction & Real Estate sectors in Nigeria. This is also graphically presented in Fig. 3. Through bar chart.

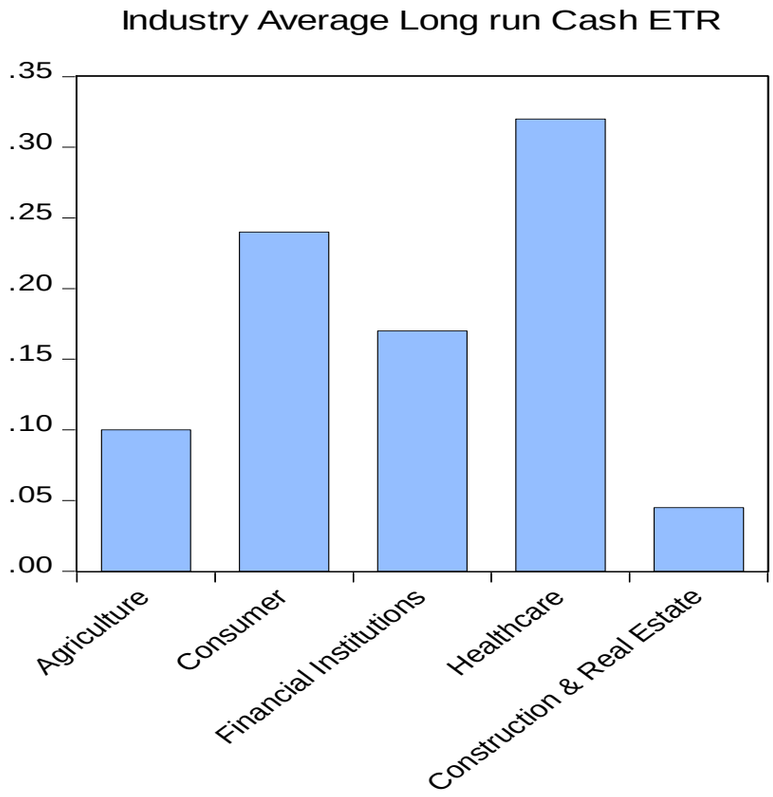


Figure 3: Bar Chat of the Industry Average Long Run Cash Effective Tax Rate of Selected NSE 30 Firms.

5. CONCLUSION AND RECOMMENDATIONS

The study finds that eighteen (18) out of the selected sample of nineteen (19) listed firms avoid payment of corporate taxes in the long run and that there is variation across the firms in tax avoidance at long run with some firms having a lower long run cash effective tax rate than others and invariably achieving a better percentage of tax avoidance. The study also finds that firms in the Agricultural and Construction & Real Estate sectors of the NSE 30 firms pay low amount of cash taxes in naira of their pre-tax income over a long run period compare to listed firms in the Financial, Consumer and Healthcare sectors of the Nigeria economy. Furthermore, firms in the consumer and Healthcare sectors pay more taxes than firms in the financial sector though firms in the financial sector declare higher profit before taxes than all the NSE 30 firms.

The study recommends that listed firms in Healthcare sectors should engage competent tax professionals to manage their tax planning units to reduce their long run cash effective tax rates and assist to guide against tax disputes that may cause collateral damage to the reputation of the firms which often arise from tax litigations in the process of tax planning. Furthermore, the tax administrators and policy makers should incorporate into tax laws the payment of more education tax by financial institutions as they paid a lower cash taxes in the long run than firms in the consumer sector even though the financial institutions declare higher pre-tax earnings than all NSE 30 firms.

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