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CHAPTER ONE

INTRODUCTION

1.0 Background to the Study

Tax is one of the major instruments of fiscal policy for regulating the economy of any nation. At various times, successive governments in Nigeria have employed the instrument of tax policy to encourage industrial and corporate growth in the private sector (Nwaobia,2013). On the opposing side, taxation and tax policies in Nigeria do equally act as disincentive to manufacturing firms to create value for stakeholders and enhance the value of the firms. As noted by Gatsi, Gadzo, and Kportorgbi (2013) taxation, observably, plays a role in the misfortunes of the manufacturing sector because tax policies, apart from generating revenue for the state, serve several other purposes. It can be used as an avenue to protect infant industries, create incentive for investors to invest in certain areas of the economy or to create is incentive for other activities (Gatsi, Gadzo and Kportorgbi,2013). For example, Ihendinihu (2009) in Dickson and Nwaobia (2012) noted that unfriendly tax policies are one of the many reasons for the growth of the underground economy, where law-abiding individuals and corporate citizens seek refuge from wrongs inflicted on them by government.

The major challenge of corporate entities, and in particular oil and gas firms, come in a midst of high corporate tax rates and multiples of other taxes that lead to high effective tax rates far above the statutory company income tax rate. With the introduction of the Information Technology tax, there are about forty different taxes levied on companies and individuals (Taxes and Levies, Approved List for Collection Act 1998, Bammeke,2012). Many of these taxes from the different

levels of government overlap and are forcefully extracted from corporate organizations. The effect of these exactions of course is high cost structure for firms (Nwaobia, 2013). One will not fail to agree with Nnadi and Akpomi (2008) that a tax policy defines the cost structure of firms as it is factored into pricing. In addition, tax costs and eventual payout deplete the disposable income of individuals as well as the distributable profits of corporate organizations. These taxes in fact, do translate to a substantial cost to organizations and if not properly planned and managed can have adverse impact on the bottom line, cash flow and capacity to invest. To mitigate the effect of taxes on liquidity and profitability of corporate bodies and by extension firm value, tax planning becomes imperative. But unfortunately, many companies are ignorant of the strategies they can adopt to legally mitigate their tax burdens. Over the years, experience has shown that the tax authorities can dip the largest possible shovel into the resources of an organization if left vulnerable. Fortunately, the law supports a tax payer if he arranges his affairs in such a way that the tax chargeable is minimized or even avoided (Ayrshire Pullman Motor services and David, Ritchie. Commissioner of Inland Revenue (1929) in TC 745. In this case, the Lord President (Lord Dennis) stated as follows: -

“No man in this country is under the smallest obligation, moral or otherwise, so as to arrange his legal relations to his business or to his property as to enable the Inland Revenue to put the largest possible shovel into his stores. The Inland Revenue is not slow and quite rightly to take every advantage which is open to it under the taxing statutes for the purpose of depleting the taxpayer’s pocket. And the taxpayer is in like manner entitled to be astute to prevent so far as he honestly can the depletion of his means by the Revenue.”

This view was reiterated in IRC V. Duke of Westminster (1936) 19 TC 490 by Lord Temlin when he averred that:

"Every man is entitled if he can, to order his affairs so that the tax attracting under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity he cannot be compelled to pay an increased tax."

Therefore, a company is not a bad corporate citizen if it can organize its business or trade in a legal manner to minimize its tax liability. Tax planning in essence involves the application of relevant incentive provisions for corporate tax payers based on enabling laws such as the CITA, PITA, VAT and other enactments. An in-depth understanding of the tax policies and other regulations as clearly stated in the nation's government fiscal policies is required for effective tax planning. The Corporate tax planning incentives as contained in the CITA, PPTA and other laws include: pioneer status incentive, commencement rule, cessation rule, investment allowance, and roll-over loss relief. Others include business location or area of operation (free trade zone, rural area investment allowances), tax exemption benefits on interest on a loan granted by a foreign company to any business in Nigeria, asset acquisition timing for claims of capital allowances. Several other tax shelters and incentives which a company can take advantage of based on the provisions of CITA CAP C21 LFN 2004, (Fowokan,2009); (Ezejelue and Ihendinihu,2006). Indeed, Companies Income Tax Act, LFN 2004 contain varying provisions that give the corporate tax manager the opportunity to mitigate the company's tax liability. One of the most important responsibilities for corporate tax manager is to strategize on minimizing a company''s overall tax liability.

Theoretically, firm's tax liability is proportionally related to its profitability; attaining firm's wealth maximization objective through diverse means of increasing profitability poses more challenge on firm's ability to reduce its tax liability. Consequently, the tax planning strategy tends to give a positive impact on a firm''s cash flow and its after tax rate of returns; however, tax planning strategies have a negative impact on the government''s revenue and further, increase the compliance cost of collecting taxes. Corporate tax planning is among the major strategic tools use by tax managers to minimize the amount of tax liability by their company. Taxation has remained the major bottleneck in modern corporations as it involves the application of predetermine rate against the profitability of the companies.

Firm value is generally taken to mean an economic measure reflecting the market value of a whole business. It is a summation of the claims of all contributors to the assets of a firm namely: creditors (secured and unsecured) and equity holders. In finance literature, firm value is the sum of the market value of equity and the market value of debt (Nwaobia, Kwarbai, and Ogundajo,2016). Firm value is enhanced when shareholders' wealth is increased through profits and improved cash flow; hence the importance of tax planning as an integral part of the financial planning programme of any entity. Tax planning is an integral part of financial planning and the area of financial structure decisions offers a tax manager and the company an opportunity to mitigate the company's tax liability and improve on the financial performance of the firm.

The petroleum industry in Nigeria is of two sectors, the upstream and the downstream sectors. The upstream sector deals with oil exploration and production activities, while the downstream sector deals with storage, transportation, refining, hydro processing, marketing and distribution. The sector has a market capitalization of N763.28 Billion as at December, 2015 with an all-share index of N356.56 Billion. In addition to this, the NSE in 2015 rated the oil and gas sector as the seventh most liquid sector of the Nigerian

Economy. Despite the above performance, no study to the best of the researcher's knowledge examine the influence of effective tax planning on the market value of listed oil and gas companies in Nigeria. This study therefore sought to provide evidence on the effectiveness of these selected tax planning strategies in driving firm value of oil and gas firms in Nigeria.

1.1 Statement of the Problem

Despite the relevance of tax planning to companies, very limited studies were conducted in the area of corporate tax planning and firm market value in emerging economy. Previous studies have concentrated in the developed economy. In African context, studies on corporate tax planning and firm performance were mixed and inconclusive. Desai and Hines (2002), Chen, Chen, Chen and Shevlin (2010). Desai and Dharmapala (2009) supported the assertion that tax planning enhances the financial performance of an entity; while Kawor and Kportorgbi (2014) found that tax planning enhanced after tax earnings does not reflect in the firm's value, this allied with the studies of Abdul-Wahab and Holland (2012) and Ftouhi, Ayed and Zemzem (2014). Overall, the results of the joint effects of the tax planning proxies on firm value are inconclusive for various studies, the individual effects of the tax planning strategies on firm value for each of the studies is also considered below.

Firm's profitability can influence effective tax rate especially when profitability is measured based on pre-tax income; we expect more profitable firms to have higher earnings and hence pay more taxes. Gupta and Newberry (1997); Minnick and Noga (2010); found a positive relationship between firms' profitability and ETR. Rego (2003) and Derashid and Zhang (2003) opined that more profitable firms have a lower cost associated with managing taxes because they have more resources to invest in the planning activities that contribute to lower effective tax rates which therefore indicates a positive relationship between ETR and firm value. Even though, Bryant-Kutcher, Guenther and Jackson (2011) found a negative correlation between ETR and firm value. According to them, differences in company income tax rate are not completely offset by non-tax expenses. The negative correlation is justified on the ground that, there are constraints on analysts' forecast in conveying earnings information in the short-run, and this leads to omission of value related information in the prediction.

Age is the length of time during which a being or thing has existed. We defined firm age as the number of years of incorporation of the company; even though some believe that listing age, should define the age of the company (Shumway, 2001). According to him, listing age is more economical since listing is a defining moment in the company' life. Shumway''s argument is debunked from the perspective of the company as a legal personality (Waelchi & Pdferer. 2011). As a legal person, a company is born through incorporation Gitzmann, 2008; Pickering, 2011). Hence our preference for the year of incorporation as the definition of the age of the company. The relationship between firm age and profitability is contentious. While some reported the positive and significant relationship between age and profitability (Halil & Hasan, 2012; Papadogonas, 2007; Akinyomi & Olagunju, 2012). Others have reported negative relationship (Majumdar, 1997; Dogan, 2013 and Coad, Segarra & Teruel, 2007). This mixed reaction has made the debate inconclusive.

The leverage ratio is widely used to measure the portion of long term debts towards total assets of business organization's activities. It means the capability of a business organization in financing its total assets with long-term debt (Danelova and Sarka, 2011). Fama and French (2002) found a positive relationship between leverage and firm value. On the contrary, Rajan and Zingales (1995) found a negative relationship between leverage and profitability. The study result is consistent with De Wet (2006) who opined that a significant

amount of value can be unlocked in moving closer to the optimal level of gearing. Modigliani and Miller (1963) conclude that the cost of equity of a firm increases the debt of the firm increases. The combination of negative and positive results on the relationship between leverage and firm value shows that the issue is largely unsettled, and this creates a gap which requires further clarification. Hence, we propose an insignificant relationship between leverage and firm value.

There are different measures of firm size such as the number of employees, log of revenue, log of total assets and value added. The relationship between firm size and firm value is mixed. Hall and Weiss (1967), Majumdar (1997), Josson (2007), Serrasqueiro and Nunes (2008), Stierwald (2009), Saliha and Abdessatar (2011) found a positive relationship between firm size and profitability because profitability increases as the size of the firm expand. Big firms have more competitive power when compared to small firms and because they have a bigger market share, they have the opportunity to make more profit (Stierwald,2009). On the contrary, Banchuenvijit (2012), Becker-Blease, Keen, Etebari and Baumann (2010) found a negative relationship between profitability and firm size because organization costs increase with firm size, at some points, these costs will outweigh the benefits from economies of scale and hence profitability will fall. These inconsistencies in results and extant literature of scholars on corporate tax planning and firm performance present a knowledge gap which forms a reasonable motivation for further study.

1.2 Objective of the Study

The general objective of this study is to examine the relationship that exist between Corporate Tax planning and firm performance of Oil and Gas companies listed on the Nigerian Stock Exchange Market (NSE). To achieve the general objective, the following specific objectives are to: -

I. examine the relationship that exist between effective tax rate and firm performance of Oil and Gas companies listed on the Nigerian Stock Exchange Market (NSE).

II. evaluate the relationship that exist between firm age and firm performance of Oil and Gas companies listed on the Nigerian Stock Exchange Market (NSE).

III. assess the relationship that exist between financial leverage and firm performance of Oil and Gas companies listed on the Nigerian Stock Exchange Market (NSE).

IV. identify the relationship that exist between firm size and firm performance of Oil and Gas companies listed on the Nigerian Stock Exchange Market (NSE).

1.3 Research Questions

I. What relationship exists between effective tax rate and firm performance of Oil and Gas companies listed on the Nigerian Stock Exchange Market (NSE)?

II. What relationship exists between firm age and firm performance of Oil and Gas companies listed on the Nigerian Stock Exchange Market (NSE)?

III. What relationship exists between financial leverage and firm performance of Oil and Gas companies listed on the Nigerian Stock Exchange Market (NSE)?

IV. What relationship exists between firm size and firm performance of Oil and Gas companies listed on the Nigerian Stock Exchange Market (NSE)?

1.4 Research Hypotheses

H_{o1}: There is no significant relationship between effective tax rate and firm performance of Oil and Gas companies listed on the Nigerian Stock Exchange Market (NSE)?

H_{o2}: There is no significant relationship between firm age and firm performance of Oil and Gas companies

listed on the Nigerian Stock Exchange Market (NSE).

H_{o3}: There is no significant relationship between financial Leverage and firm performance of Oil and Gas companies listed on the Nigerian Stock Exchange Market (NSE).

H_{o4}: There is no significant relationship between firm size and firm performance of Oil and Gas companies listed on the Nigerian Stock Exchange Market (NSE).

1.5. Significance of the Study

The findings of this study will be important to managers of listed companies in formulating appropriate Tax planning strategies and taking advantages of loopholes in the tax laws.

The study of the effect of corporate tax planning on the performance of listed oil and Gas firms in Nigeria is expected to be beneficial to a number of parties such as policy makers. It is hoped that the study will provoke policy makers to give more attention to the tax planning given its contribution to the performance of firms. Examples of interested policy makers include Federal Inland Revenue Service Board (FIRSB) and other relevant tax authorities.

The study will contribute to the body of knowledge and hence will be of interest to both researchers, academics and other necessary third party who seek to explore the relationship between tax planning and firm value and pave way for new era of further research.

Also the result to be gathered from this piece of work will be applicable for accounting regulators to use in making rules that will enhance the preparation of qualitative financial statement.

In addition to the extant literature on corporate tax planning in most developed nations, the finding from this study will shed more light on the attributes of the corporate tax planning in developing economies such as Nigeria.

1.6 Scope of the Study

The main objective of this study is to determine the possible effect of corporate tax planning (effective tax rate, firm age, financial leverage and firm size) on firm performance on oil and gas companies listed on the Nigerian Stock Exchange Market. The research will focus on the annual report of five (5) oil and gas firms listed on the Nigeria Stock Exchange covering a period of 6 years (2011- 2016).

1.7. Operationalization of Variables

In analyzing the connection that exists between effective tax rate, firm age, and financial leverage and firm size on firm performance of listed Oil and Gas firms on the Nigeria Stock Exchange Market in Nigeria. The independent variable will be measured using effective tax rate, firm age and financial leverage and firm size while the dependent variable being the firm performance will be measured by the Return on Asset (ROA).

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