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Tax Planning Strategies and Governance Measures: A Test of Competing Hypotheses
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ABSTRACT
As companies hand over most of their profits in the form of tax payments, there is likely to be little left over for shareholders. This study examines empirically the effect of tax planning strategies on board size of companies in Nigeria. The study adopts a combination of survey and causal – comparative research design. This was augmented with primary data on 15 selected tax mitigation strategies obtained from 140 respondents using researcher – designed questionnaire validated by experts and shown to have reliability co-efficient of .93%. Descriptive and multiple regression analysis were used in analyzing the data with the aid of special package for social sciences (SPSS) version 22.0. With an r .813, r² of 0.463 and f-ratio of 18.243 significant at 1% level, the investigation reveals a positive and significant influence of tax planning strategies on board size of companies in Nigeria. The study concludes that the tax planning strategies exerts a positive and significant influence on board size of companies in Nigeria. We recommend that corporate executive and tax planner should posses sound knowledge of tax laws and apply tax mitigation strategies endorsed by law to existing alternatives in every business transactions with the view to choosing the options that produce the highest tax savings.

Introduction
Since the 21st century, previous empirical and theoretical research works have explained the variations in tax burdens in terms of firm characteristics. It is only recently that their attention has turned to understanding the underlying motivations for these variations and any potential equity valuation consequences. Tax planning is one of the means of motivation for these variations. It is defined as the downward management of taxable income through tax planning activities (Gupta & Newberry, 1997; Holland, 1998; Frank etal, Roog; Cheuetal, 2010; Abdul Wahab& Holland, 2012; Akenbor&Kiabel, 2014; Nwaiwu&Chioma, 2015). Tax planning represents a significant cost to the firm and shareholders. Although, the tax reduction can entail an increase of after tax profits through tax planning, however, non tax costs can be generated and accompanied by tax planning activities, particularly those arising from agency problems. Thus, the shareholders have to control the managers on the decision taken in fiscal subject. Interestingly, Wilson (2009) provides evidence of a negative relationship between the Effective Tax Rates (ETR’s) and the share price. In the same context, Slemrod (2004), Nwaiwu (2015) suggests linking manager’s compensation to describe outcome such as ETR.

Governance can play the role of a mediator between tax planning and performance. In particular, internal governance considers the board of directors as the main vehicle to exercise an actual control over the management, such as the rules which require a board dominated by external directors. Therefore, the board becomes a key mechanism to monitor managers’ behaviour and to advise them on the identifications and the implementation of the strategy. In this content, Viaro (2007), examined the effect of board of directors on performance, and found that board composition and size are related to directors’ ability to monitor and advice management. Thus, the inclusion of more directors should benefit the monitoring and advisory functions, improve governance, and raise returns.

Extensive empirical literature exists globally on the influence of tax planning strategies and corporate governance, but the results are rather mixed (Altshuler&Grubert, 2005; Amir &Sougiannis, 2009). Unfortunately, the empirical assessment of the influence of the planning strategies and corporate governance in Nigeria has been sparse. The few known studies that have examined the influence of tax planning strategies on corporate governance in Nigeria have also produced conflicting results (see Atwood & Reynolds, 2008, Amir &Sougrannis 2009). It is, therefore, possible that tax planning strategies per se may not adequately address the recurring problem of dismal corporate governance of Nigerian quoted companies. The main adjective of this paper, therefore, is to ascertain whether changes or variations in tax planning strategies have significant influence on the corporate governance of Nigerian firms.

Review of Related Literature
The theory of planned behaviour states that the behaviour of individuals within the society are under the influence of definite factors, originate from certain reasons and emerge in a planning way (Erten, 2002). Benketal (2011) stated that the ability to perform a particular behaviour depends on the fact that the individual has a purpose towards that behaviour. Therefore, the factors that determine the purpose towards that
behaviour are attitude towards behaviour, subjective norms and perceived behavioural control (Oyerinde, 2010). Ajzen (2002) says that these factors are under the influence of behavioural beliefs, normative beliefs and control beliefs. Wenzel (2004), Braithwaith (2003) highlighted that sociological and psychological factors have proved to be important in understanding the high levels of tax compliance, in such analyses, concepts such as trust in authorities (Murphy, 2004). Perceived fairness of the system (Wenzel, 2008), moral considerations and norms (Frey, 2003, Wenzel, 2008) are used to promote better understanding of tax compliance. Therefore, the study anchored on Huffman theory (1961) Prof – Audit – The multiple Roles – tax planning.

On Hoffman theory (1961), in elaborating the theory of tax planning activities, introduces principles and concepts of tax planning that are mostly applicable to tax practitioners. However, these principles and concepts are considered below because tax payers are likely to conduct tax planning based on the advice of the practitioners. The author highlights four important points of tax planning. Firstly, in the case of property handled, tax planning is not a simple process. Secondly, much gain will be obtained if the process of tax planning is conducted as a formalized procedure. Thirdly, many tax planners do not practice tax planning to the greatest possible advantage and finally, tax planning could benefit many tax payers but few are aware of its advantages.

Further, the author highlights that it is essential for tax planners to note that tax planning could not be sustained for a long – term period unless the tax planning activities are “flexible” in the sense of a continuity of the strategies. This is especially applicable for the cases of tax planning strategies that rely on tax law ambiguities, since the law is revised on an ongoing basis. Therefore, tax planning strategies should be time-oriented and consistent in the sense that “consistency requires the past time, the present and the future but the present must be further circumscribed in the light of the tax payer’s future requirements” (Hoffman, 1961:280). The “Flexibility” view is aligned with the findings by Dyreng, Hanlon &Maydew (2008) in investigating firm’s ability to avoid tax over a long period of time using a data set of 2,077 U.S firms for the period from 1995 until 2004. The researchers find a significant fraction of firms that could avoid corporate taxes for the 10 years period. These findings are explained as long-term tax avoidance which might be triggered by management actions in avoiding tax and it may be caused by inherent variations in the characteristics of groups of firms, for example, different characteristics in different industries. This shows that there is a possibility for firms to become involved in tax planning for a long period of time but, as claimed by Hoffman, (1961), it may be limited if the motivation for such activities is based on tax law ambiguities.

In addition to the above-mentioned principles, Viaro (2007) tax planning framework suggests three important principles in tax planning; a multilateral approaches i.e. all contracting parties, the importance of hidden taxes, i.e. all taxes and the importance of non-tax costs, i.e all costs. The themes are further detailed as follows: “all contracting parties must be taken into account; and importance of non-tax costs – all costs of business must be considered, not just tax costs” (Sartorin, 2009). ShachelFord &Shevlin (2001), in tracing the development of income tax research in accounting, highlights tax. The Scholes – Wolfson framework adopts a positive approach in explaining the role of taxes in organizations.

Sartori (2009) provides examples of the three themes: “all parties” could refer to both employer’s and employee’s taxes in arranging the compensation; “all taxes” could refer to taxes comprehensive of explicit taxes (the tax paid to the authority) and implicit tax (tax-induced reduction in pre-tax rates of return; and finally, “all costs” could refer to management incentives and transaction costs, and the trade-offs between corporate financial accounting aims and tax aims.

In empirical tax researches, the Scholes – Wolfson framework is widely accepted and, up to the study, Wilson (2009) finds that no research paper challenges the validity of the framework. However, Slemod (2004) highlights a shortcoming of the framework from a research perspective. This is due to the difficulty in quantifying non-tax costs which leads to the possibility of portraying any results as consistent with the framework.

Tax Planning Strategies

Many researchers and taxation literature have averred various explanations on the subject of tax planning strategies (Nwaiwu, 2014). Tax planning strategies are available schemes of arrangements legally undertaken to reduce burdens of taxpayers while enhancing the realization of fiscal policy objectives of government. Some of the schemes as identified in previous studies (Ejele, 2001; ICAN, 2006; Ali, 2007; Aneke, 2007; Temetsy, 2007; Nwaiwu, 2015) include planning arrangements of tax factors in investment and business decision areas such as: choice of appropriate date of commencement of new business (Kiabel, 2008), Accounting period (Ihendinhih, 2009), and associated implications of capital allowances for effectiveness (Nwaiwu, 2015; NwaiwuElgw, 2015). Section 25(1) and (2) of CITAs 1990 as amended and section 23 of PITA 1993 as amended provide that an established and continuing business should be assessed to tax on preceding year basis. But special rules apply in the case of new business for the first three years of operation. Thus, by the provisions of section 25(3) (a)-(e) of profit/income of a new business shall be ascertained on the basis of the following rules:

“First year – the adjusted profit from the date of commencement to the end of government tax year; that is to 31st December of the same year). Second year – the income of the period from the date of commencement of business to the end of the first twelve months of operation. Third year – the income of the year immediately preceding the year of assessment, provided that this period is a normal accounting period; (that is, it is a 12 months account, it is the only accounting period ending in that particular year, and it must have commenced on the day after the last account ended or on the day business started.” (ICAN PACK, 2006:106).

The taxpayer may however make a claim to be assessed to tax for the second and third tax years taken conjunctively on the actual profits of those years, provided that such claims are made in writing within two years after end of the second tax year to the revenue, and provided also that such rights could be revoked by the taxpayers within 12 months after the end of the third year of assessment. The adjusted profit of the business for the first year largely forms the basis of assessment for the two tax years and it is strategic that the business reduces the taxable profit of this year to the barest minimum by absorbing as many expense items as are legally permissible. Additionally, the choice of a tax beneficial accounting date imports on the companies tax liability, and should be wisely made.
There are complicating issues relating to capital allowances for businesses which create the chance of granting initial allowance, balancing allowance more than once for the same asset (Braithraite, 2003). To prevent such double reliefs:

“Where two basis periods overlap, the period common to both shall be deemed, except for the purpose of making an annual allowance, to fall in the basis period ending at the earlier date, and in no other basis period. Where two basis periods coincide, they shall be treated as overlapping, and the basis period for the earlier year of assessment shall be treated as ending before the end of the basis period for the later year of assessment.”

Ezejelue (2006) uses a hypothetical anecdote to illustrate the tax implications of capital allowances in relation to the performance of a new business, including that the exercise of taxpayers option for the second and third tax years accelerates the claim for capital allowance will reduce both chargeable profits and tax liabilities during the early years of a new business. Expectedly, there will be enhanced liquidity and after tax profit figures during the first three years. The relationship of this strategy is however unlikely to be sustained in the long-run as it merely redistributes the tax burden to later periods when the business is expected to be more financially buoyant. Thus, capital allowance maneuvering does not favour a going concern.

ICAN (2006), equally identifies timing of fixed assets acquisition, disposals in view of balancing adjustments, and capital allowance claims, as

1. That planning point with potential test savings allowance claims,
2. Tax planning points with potential tax saving payoffs,
3. The taxes previously paid and refunded to the company by the revenue service (Nwaiwu, 2015).

Applying the carry-back of capital allowance on cessation provides liquidity through tax refunds at a time when cash is critically needed by the tax payer. However, any part of the capital allowances which remained unrelieved after the 5 years period is irredeemably lost.

Again, a company which sustains a loss from its trade is entitled to relieve such loss by carrying it forward for set against the assessable profits of the following four (4) tax years starting with the year following that in which the loss was incurred. Agro-allied businesses are however allowed to carry forward such losses without restriction. The loss relief provisions have the effect of reducing the total chargeable profit of the future years in which the losses are relieved, and by extension the tax liability. The resulting favourable impact on after tax profit and cash outflow enhances the financial strength of the company. It should however be noted that there is no provision under the Nigerian tax system for carry-back of terminal loss on cessation (Minnicls & Noga, 2010).

There have obvious implication in both the short-term liquidity and profitability of the firm. Increased amount of capital allowance reduces total (chargeable) profit and tax liability, which ultimately increases after tax profit. Also, a reduction in tax liability diminishes cash outflows and relates positively on liquidity.

Other tax planning strategies relate to claims on assessable profits of companies as provided under sections 27 and 28 of CITAA. In ascertaining the total profit of a company for any tax year, the assessable profit of the company is adjusted with the amount of capital allowances/charges as provided under the second schedule to CITAA and loses sustained in the business in the preceding year of assessment and other deductions as provided under section 28 of CITAA – The maximum capital allowance to be deducted from the assessable profits of future tax year of assessment in which a business permanently ceases operation, the taxpayer is allowed to carry back such unabsorbed capital allowance for relief against the remainder of profits of the penultimate tax year, and there after, the pre-penultimate year, and so on. The effect of the carry – back provision on corporate performance is well demonstrated in ICAN (2006: 74-78), to the effect.

Two Converging Issues: Tax Avoidance and Tax Evasion

Tax avoidance is commonly regarded as the legal utilization of the tax regime to one’s own advantage, (Williams, 2015) in order to reduce amount of tax that is payable by means that are within the law. But it is however more frequently used to denote reduction in tax liability by means of fictitious or artificial arrangements, designed to take advantage of loopholes, irregularities and anomalies in the law. As expressed by Ezejelue (2001), tax avoidance schemes are often fraught with fraud, deceit or culminating in the intentional perversion of truth in order to reduce tax liability.

Ihendinihu (2009) reckons that such schemes were mushroomed in many countries soon after the World War II to protect affluent taxpayers from the ravages of an expropriating tax regime of the time. By contrast, it widely differs from tax evasion which is the reduction of tax liability by illegal means, by tax payers deliberately misrepresenting or concealing the true state of their affairs to the tax authorities, including dishonest tax reporting, thereby breaking the law and attracting the imposition of criminal law sanctions. According to former British Chancellor of the Exchequer, Denis Healey (2011), the difference between tax avoidance and tax evasion is like the thickness of a prison wall.

Despite the general acceptance of the distinction between the two by tax payers and tax practitioners, latest trend in court decisions tend to narrow down the distinctions between the two terms against an earlier court attitudes, particularly, the decision by Lord Temin in IRC VS. Duke of Westminster (1936), 19 Tax cases, 490, which gave prominence to the concept of tax avoidance. The rule enunciated in the above case is to the effect that “Every man is entitled if he can to order his affairs so that the tax attaching 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 tax payers may be of his ingenuity, he cannot be compelled to pay an increased tax” (Ihendinihu, 2009:13).

This position accords with the dictum established by the Lord President Clyde in the case of Ayrshire Pullman Motors services and David M Ritchie vs. IRC (1929) 14 TC 754 which entitles the tax payer to be astute to prevent, so far as he honestly can, the depletion of his means by the revenue authority (Abdullah Wahab, etal 2008).

Board Size

Prior studies provide empirical evidence on the Board Size in enhancing the monitoring of management. Tsegba & Herbert (2012), Nwaiwuetal (2014), Ogbowu (2014) suggest that larger boards are able to commit more time and effort, and smaller boards are able to commit less time and effort, to overseeing management. Nwaiwu (2015) extends this argument by suggesting that board monitoring is positively associated with larger boards due to their ability to distribute the work load over a greater number of observers. The majority of the previous literature supports this argument by
finding that larger boards are strongly associated with lower levels of tax planning strategies.

On the other hand, Braithwaite (2003) argues that large boards exhibit poorer coordination and communication between members, and their results display a significant positive association between larger board size and tax planning strategies. However, the findings of this study were inconsistent and should not be generalized due to several limitations. Firstly, the study covers only one year. Secondly, their study sample used mixed data from ten different countries without controlling for different external factors and, consequently, their study may be biased. Abdul Rahman & Ali (2006) investigated the extent of the effectiveness of the board size in constraining tax planning strategies among 90 Malaysian listed companies over the period 2004-2005. Their study reveals that board size is positively related to the tax planning strategies. Kao & Chen (2004) examined the effect of board size on Tax planning strategies in Taiwan. They find that large board size is related to a higher extent of tax income. Their sample consists of 970 observations and they applied the cross sectional model as measure.

**Evidence of Relationship of Tax Planning activities and Corporate Governance**

The studies about the relationship of tax planning activities and corporate governance have yielded mixed results. For instance, Chinnararin & Kim (2001); Derashid & Zhany (2003), Philips (2003), Plesko (2003), Zimmerman (2005), Chan et al (2006), Desai & Sharrampala (2008) report no significant relationship between tax planning activities and corporate governance. Interestingly, Coase (1937), Derashid & Zhang (2003), Desai & Dharmapala (2008), Amir & Sougiannis (2009), found significant positive relationship. In similar development, investigations into the influence of tax planning activities on corporate governance have also yielded mixed results, (Altshuler & Grubert, 2005; Damman & Shaw, 2005). The influence of tax planning activities on corporate governance has also received scant attention in the literature, notable exception being Cha metal (2006), Tsegbha and Herbert (2013), Nwaiwu (2015).

Also, the authors observe that the effect of tax savings on board size has received sparse empirical investigation. The tax planning activities mirrors board size. The major distinguishing feature between tax planning strategies and corporate governance activities is that while the former is interested in tax collection, the later has the governance activities to create higher performance irrespective of the level of the members. The tax planning activities mode of tax savings is, however, a newly introduced concept and there appears to be no known specific study assessing its efficacy as a tax activities. It is nonetheless, desirable. To draw inferences from previous works that provide empirical knowledge of the tax planning strategies in Nigeria also resulted to differing corporate governance activities (Tsegbha & Herbert 2013), Nwaiwu, (2015).

These empirical and cum theoretical studies provide the pivot on which a more rigorous assessment of methods of tax planning strategies and corporate governance could be based. Empirical studies on tax planning strategies in Nigeria remain scanty. Exceptions include the works of Coase (1937), Chincararin & Kim (2001), Derashid & Zhang (2003), Desai, Dyck & Zingales (2007), Desai & Dharmapala (2008), Nwaiwu (2015), appraises the planning strategies of some quoted companies in Nigeria. This is against the backdrop of rising wave of quoted companies in developing and transition economies in the last two decades as a means of fostering economic growth. As Nasser (2007) observed, despite the increase in research, empirical knowledge in Africa is limited. Extant research has not provided insights into the peculiar circumstances of Africa, such as the embryonic financial sectors and week regulatory institutions and the manner in which these influence the pace and outcome of tax planning strategies efforts.

The main interests of this study, therefore, are to: (1) ascertain the tax planning strategies effort in Nigeria by examining the antecedent pattern, volume and status of tax planning strategies undertaken so far; (2) evaluate the financial and operating performance of these new areas in Nigeria; and (3) Identify technical efficiency in these enterprises before and after privatization. The concern of this review is, however on the second objective which emphasizes corporate governance evaluation of the quoted companies in Nigeria.

The specific corporate governance measures examined by Ogbowu (2014) are Board Size, and Audit Committee Independence. His empirical results, albeit mixed show significant increases in some of the indicators. Thus the study postulates that:

**Hypothesis**

The tax planning strategies do not significantly influence on board size.

**Research Methodology**

Based on the nature of the theoretical and empirical study, Ahiazu, (2006) examined research design from the dimensions of purpose of study, type of investigations, study setting, unit of analysis and time horizon. Interestingly, our study makes use of the survey approach and the causal comparative designs. The survey investigates the extent to which the application of tax planning strategies affects the board size using a set of well structured questionnaire designed on the modified 5-point Likert scale. The instrument was validated by experts in accounting, finance and banking. The reliability of the instrument was established through a test-retest method with the scores correlated using Coase (1937) and Nwaiwu (2014). The reliability of 0.91 was obtained and this indicates the stability of the instrument.

The well structured questionnaire instrument was then administered on a sample of 150 corporate managers and financial analysts in Rivers State, Lagos State, Delta State, and Federal capital, Abuja, Nigeria. The sample was selected from the target sample frame and their responses provided the primary data used in the study. Five years financial data were extracted from 24 quoted companies for the first five years of their commencement of business in Nigeria. The period was considered adequate for testing the corporate governance activities (Board size) of quoted companies in Nigeria (Ihendinhu, 2006).

The study employs multiple regression analysis which is one of the most widely used statistical tools in social sciences. The major advantage of regression model is the power to measure the degree of influence among variables and determine the extent and direction of their effectiveness.

**Model specification**

$$GM_t = \beta_0 + \beta_1BS_t + \beta_2CAD_t + \beta_3TI_t + e_t$$

Where

- $GM_t$ = Governance measures
- $BS_t$ = Board Size
- $CAD_t$ = Change of Accounting Data
- $TI_t$ = Tax Incentives
\[ \beta_{0_{it}} B1_{it} = \text{The correlation coefficient} \\
e = \text{Last period in the time series data} \\
\]

**Empirical Results**

This sub-section presents the empirical results with respect to the study hypothesis.

\[ H_{01}: \text{Tax planning strategies has no significant influence on board size companies in Nigeria.} \]

**Results of one**

### Table 1. Tax planning strategies on board size of companies in Nigeria

<table>
<thead>
<tr>
<th>Statistical variable</th>
<th>Values</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression constant (( \alpha ))</td>
<td>34351.001(0.03)*</td>
</tr>
<tr>
<td>Regression co-efficient (( \beta ))</td>
<td>-0.410</td>
</tr>
<tr>
<td>Correlation co-efficient (( R ))</td>
<td>-0.813</td>
</tr>
<tr>
<td>Co-efficient determination(( R^2 ))</td>
<td>0.463</td>
</tr>
<tr>
<td>r-value</td>
<td>0.034</td>
</tr>
<tr>
<td>F-ratio</td>
<td>18.243***</td>
</tr>
</tbody>
</table>

Note: *P \leq .03, **P \leq .01, ***P \leq .001.

Table 1 above shows the test of empirical results of the effect of tax planning strategies on board size of companies in Nigeria. Based on the number of significant factors and statistical values of co-efficient determination (\( R^2 \)) of 0.463, correlation co-efficient (\( R \)) of -0.813, P-value of 0.034 and f-ratio of 18.243 is found to be significant at 1% level and provides sufficient evidence that the model specification is appropriate. The empirical results indicate that tax planning strategies accounts for 81.3% of changes in Profit After Tax. The result indicates that improvements in company’s tax planning strategies are most likely to translate into growth in its profit after tax. The study therefore, rejects the null hypothesis and concludes that tax planning strategies have significant effect on profit after tax of companies in Nigeria. The finding of this study is consistent with previous studies by Chincarini & Kim (2001) and Desai & Dharmapala (2008) who found a positive causal link of tax planning strategies on profit before tax of companies in Nigeria and USA.

**Conclusion and Recommendations**

The results challenge dominant assumptions in the prior empirical literature on tax planning strategies and corporate governance mechanism. Interestingly, the study reveals that there exists a positive and significant influence of tax planning activities on board size of companies in Nigeria. More generally, the study recommends conducting a rigorous empirical research that examines the behavioural processes and dynamics that underlie tax planning activities and corporate governance mechanism.

**Managerial Implication**

The findings of this study appear to have important implications for the tax planning activities and corporate governance mechanism and may have important normative implications for corporate boards, institutional investors, management consultants, and the popular press has long advocated greater board independence from management. Directors with close ties to management are routinely characterized in cynical terms as “pals of the CEO” or hand-picked appointees,” and their relationship to CEOs are described as overly ‘Chummy’ (Williams, 2015).

Overall, this study contributes to the tax planning activities and corporate governance mechanism by providing empirical evidence on how CEOs and outside directors collaborate in the strategic planning decision making process and then demonstrating that such collaboration independently and positively contributes to tax planning strategies and corporate governance mechanism of companies. Further studies should examine the psychological mechanisms that mediate the relationship between tax planning strategies and corporate governance mechanism.

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