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Tax Incentives Influence on Corporate Earnings: Evidence From Quoted Manufacturing Companies In Nigeria

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ABSTRACT

This study examines the influence of tax incentives on corporate earnings of quoted manufacturing companies in Nigeria. The operational dimension of tax incentives adopted are annual allowance, investment allowance, and tax holiday; while the proxy for corporate earnings is earnings per share (EPS), with share capital as a moderating variable. Secondary data for this study are sourced from financial reports of 69 manufacturing firms quoted on the Nigerian Stock Exchange out of a population of 81 in agriculture, conglomerates, consumer goods, healthcare, industrial goods, natural resources, oil and gas operations. Results from data analysis using descriptive statistics and multiple regression, showed that EPS is influenced by the specified operational dimensions, adjusted R^2 = 0.62, $p < 0.05$. Thus, tax incentives influence corporate earnings in quoted manufacturing companies in Nigeria. It is, therefore, recommended that tax incentives should be sustained by the government to enhance corporate revenue and improve investment. Also, investment booster agencies should do more to coordinate activities, disseminate information on available incentives, and assist investors towards optimum capacity utilization to efficiently drive the Nigerian economy to higher heights.

Keywords: *corporate earnings, tax incentive, manufacturing companies, Nigerian economy.*

INTRODUCTION

Taxation is a fiscal tool applied by government in the creation of wealth. It is usually levied on the income, property, transactions and consumptions, from which government transfers back to the public by providing social benefits, facilities, security, management and development of infrastructure, among others. The Nigerian tax system seeks to facilitate achievement of economic goals, as a mechanism for obtaining income for the government. The various types of taxes obtainable in Nigeria include personal income tax, corporate income tax, value added tax, petroleum profits tax, capital transfer tax, capital gains tax, education tax, customs duties, excise duties, and stamp duties [1]. In spite of conscious effort to encourage the payment of taxes, the system allows tax breaks and reductions for the benefit of manufacturing companies. Tanzi [2]

contends that when people face high tax rates, they may opt to move to a friendlier environment, transfer their financial assets abroad, or stay in the environment, but resort to tax avoidance or become more tax aggressive. Under the Nigerian tax system, the tax incentives available include tax exemptions, investment allowances, investment reliefs in rural areas, tax-free interest, tax deductible, research and development, tax-free dividends, tax breaks, and capital allowances.

The grants relate to pioneer companies (in the form of tax exemption), export-free zone, mining of solid minerals, hotel revenues, spare parts production, locally produced installation, replacement of an out-dated factory, investment relief, rural investment relief, tax-free interest relief, deductible investment relief, research and development, tax-free dividends, tax agreements with other countries, incentives for the gas industry and rate for small businesses [3,4]. However, it is worrisome that the Nigerian economy still attracts low investments needed to boost employment, productive gains, improved foreign direct investment, increased private fixed assets, etc. Tax incentives may bring mixed results, so countries and multilateral organizations are cautious in their implementation, especially relative to capital flows [5]. This study examines the influence of tax incentives on corporate earnings in quoted manufacturing companies in Nigeria. It specifically seeks to:

i. Ascertain the influence of annual allowance on earnings per share of quoted manufacturing companies in Nigeria;
ii. Determine the influence of investment allowance on earnings per share of quoted manufacturing companies in Nigeria; and
iii. Examine the influence of tax holiday on earnings per share of quoted manufacturing companies in Nigeria.

To address these objectives, the research hypotheses are as follows:

HO_1: Annual allowance has no influence on earnings per share,
HO_2: Investment allowance has no influence on earnings per share, and
HO_3: Tax holiday has no influence on earnings per share.

LITERATURE REVIEW

Tax Incentives

Tax is a levy in order to create revenue for the general purpose and benefit of the society. It is a framework for the provision of revenue, which government uses in extending social welfare, goods and services, and infrastructure to the citizenry. Consequently, it is the desire to derive revenue from corporate organizations, individuals, and other legitimate outlets to fulfil constitutional obligations of government, that advances the concept and practice of taxation [1,3,6]. Taxation, being a process of administering and receiving money, places obligation on the government to ensure that accrued revenues are utilized for the purpose of carrying out developmental projects. It is geared towards financing government expenditure and optimizing the redistribution of wealth, in the process of expending public fund and financing developmental projects. These attractions notwithstanding, investors clamour for tax incentives to enable them mobilize more funds for capital expenditure [7,8,9]. The packages are outlined in various forms including the following:

(a) Direct incentives such as:

Goods and materials (e.g. seedlings, fertilizers etc.);
Specific provision of local infrastructure;
Grants;
Tax assuagement or concessions;
Differential fees and access to resources;
Subsidized loans; and
Cost-sharing arrangements and price guarantees.

***Variable incentives* such as:**

(i) Sectorial facilities comprising:

Input and output prices
Specific taxes, and
Trade restrictions (e.g. tariffs)

(ii) Macro-economic facilities comprising:

Exchange rates,
General taxes,
Interest rates, as well as
Fiscal and monetary measures

(iii) Enabling incentives relating to:

Land tenure and resource security,
Accessibility and availability of basic infrastructure (ports, roads, electricity etc),
Producer support services,
Market development,
Credit facilities,
Political and macro-economic stability,
National security,
Research and development, and
Extension services.

Furthermore, direct incentives may entail cash payments and payments-in-kind (in form of provision of land or any other infrastructural favour to enhance productivity, for the specific companies granted).

(b) Indirect incentives such as:

(i) Direct tax cuts (tax holiday, expedited depreciation allowances, investment tax credits, investment tax allowances or deduction of qualifying expenses);
(ii) Indirect tax cuts (minimization in import tariffs or value integrated tax); and
(iii) Special protection granted to specific firms against competition emanating from rival firms, which can be increases in tariffs payable by the competing firms.

(c) Non-fiscal incentives such as:

(i) Special arrangement arising from input prices emanating from agencies, like Electric Power Agency, Oil & Gas Agency, Transportation Agency, etc;
(ii) Exemption for Export Processing Zones (EPZ) that offer both fiscal and non-fiscal incentives; and
(iii) Subsidized financing from government.

(d) Financial incentives such as:

(i) Subsidized credits and credit guarantees: subsidized loans/loan guarantees/ensured export credits; and
(ii) Government insurance at preferential rates/publicly funded venture capital participating in investments involving high commercial jeopardies.

(e) Fiscal incentives such as:

a. Profit-predicated: minimization of the standard corporate income tax rate/profit tax rate/tax holiday;
b. Capital-investment-predicated: expedited depreciation/investment and reinvestment allowance;
c. Labour-predicated: reduction in social security contribution/deductions from taxable earnings predicated on the number of employees or on other labour related expenditure;
d. Sales-predicated: corporate income tax reductions predicated on total sales;
e. Import-predicated: duty exemptions on capital goods, equipment or raw materials, components and inputs related to the production process; tax credits for duties paid on imported materials or supplies;
f. Export-predicated: export tax exemptions; duty drawback; preferential tax treatment of income from exports, income-tax reduction for special foreign exchange earning activities or for manufactured exports; tax credits on domestic sales in reciprocation for export performance; income-tax credits on net local content of exports; deduction of overseas expenditures and capital allowance for export industries;
g. Predicated on other particular expenses: corporate income tax deduction predicated on, for example, expenditures relating to marketing and promotional activities;
h. Value integrated-predicated: corporate income tax reductions or credits based on the net local content of outputs; granting income tax credits based on net value earned; and
i. Minimization of taxes for expatriates.

(f) Regulatory Incentives such as:

(i) Lowering of environmental, health, safety or labour standards;
(ii) Ephemeral or perpetual exemption from compliance with applicable standards; and
(iii) Stabilization clauses assuring that subsisting regulations will not be amended to the detriment of investors.

(g) Subsidized incentives such as:

a. Subsidized dedicated infrastructure: electricity, water, telecommunication, transport/related infrastructure at less than commercial price; and

b. Subsidized services, including assistance in identifying sources of finance, implementing and managing projects, carrying out pre-investment studies, information on markets, availability of raw materials and supply of infrastructure, advice on production processes and marketing techniques, assistance with training and retraining, technical facilities for developing know-how or ameliorating quality control.

Other packages include *market privileges* (including preferential government contracts, and closing the market to further ingression or the granting of monopoly rights; aegis from import competition), as well as *foreign exchange privileges* (including special treatment with reverence to foreign exchange, especially special exchange rates, special foreign debt-to-equity conversion rates, elimination of exchange risks on foreign loans, concessions of foreign exchange credits for export earnings, and special concessions on the repatriation of earnings and capital [10,11].

Nonetheless, there are grey areas associated with tax incentive practices, which border on:

(i) *Discrimination*, as selected few organizations with political connection, are favoured to receive the grants. This situation does not encourage fair play and propitious competition among companies, to drive the economy. With tax discrimination, outsiders are differently subjected to taxation from insiders; the insiders being the nationals while the foreign individuals are the outsiders.

(ii) *Increased burden on tax administration*, as the grants often lead to increased cost on administration of taxation by the tax authority; and they could spring increase in tax effort and establish additional burden on tax administration.

(iii) *Corruption*, as there is possibility of widening the scope of unwholesome practices with the grants. The grants may backfire and cause a widening of the scope for corruption in the system; and may empower some bureaucrats to perpetrate corrupt tendencies. In such circumstances, tax incentives give the regulating tax agency discretion to determine which projects qualify for incentives or not. Corruption may be high with tax incentives, due to direct links between investors and government authority which exercise discretion in implementing the grants.

(iv) *Loss of tax revenue to government*, as the grant denies government of income required to finance major infrastructural needs of the economy. This tends to erode the statutory tax base. Two ways in which revenue losses arise from granting of tax incentives include daunting other investments in favour of the incentive-receiving projects, as against the foregone projects; and loss of revenue in the event where businesses claim incentives and, in some instances, shift income from taxable activities to the exempted ones.

(v) *Sign of firms' inefficiency*, as the grants could be a channel for intrinsic inefficiency and non-productivity of the companies longing for such incentives.

(vi) *Loophole for tax avoidance*, as there is tendency to utilize legal methods to lower the magnitude of income tax liability, generally accomplished by claiming the permissible deductions and credits. This practice differs from tax evasion which uses illicit methods, such as under-reporting income to evade paying taxes.

(vii) *Distortion in resource allocation, as* any departure from perfect competition interferes with economic agents towards maximizing social welfare. Small and medium enterprises may have difficulties accessing credit and suffer from higher interest rates because of information asymmetry, weak reputation because of their small size, and possible differences in their obligations compared to sizably voluminous companies with regards to passing on information to investors, including accounting practices.

(viii) *Impairs transparency and accountability*, as it tends to abuse the principle of transparency and accountability when rules are bent in the process of implementation. The concept of accountability relates to legal and reporting framework, organizational structure, strategy, procedures and actions that will produce acceptable outcome for the public good. Transparency emphasizes integrity, rectitude, decorum and leadership by example; while accountability is linked to the concept of stewardship.

(ix) *Enforcement and compliance challenges*, as it comes with difficulties in terms of administration and enforcement, which often trigger astronomical loss of revenue to government.

These exceptions subsist especially in relation to the tax environment of developing countries [2,12,13].

Corporate Performance

Concerning corporate performance, the focus is on a yardstick for measuring within a given period, as a company seeks to grow in size and have competitive edge over competitors. Analysts generally submit that a positive relationship subsists between size and performance, in line with economies of scale; justified by efficient pooling of resources (finance, human, material, technology, etc). One of the measures of financial performance is Earnings per Share (EPS), which is the profit attributable to each equity share of a company predicated on the consolidated after-tax profit, after subtracting non-controlling interest and preference dividend but before considering extra-ordinary items, relative to total number of equity shares in issue. It is an index that facilitates strategic decisions regarding share valuation, management performance, as well as merger and acquisition negotiations. It is a yardstick for promoting managerial efficiency in organizations [14,15].

Financial performance of manufacturing firms in Nigeria varies widely, ranging from long term poor performance to long term favourable financial performance. Chukwu and Wadike [16] found this pattern and classified brewing firms in Nigeria based on the consistency of their financial performance. It is therefore probable that a number of factors affect the financial performance of manufacturing firms in Nigeria. The focus of this study is to determine whether tax incentives influence the financial performance of firms drawn from different sectors of the manufacturing industry in Nigeria. Studies conducted over the years justify the submission that higher EPS is associated with higher market price per share, and greater level of investment in the economy. This study, therefore, examines the influence of tax incentives on corporate earnings of quoted manufacturing companies in Nigeria, using earnings per share as the measure of corporate earnings.

METHODOLOGY

This study utilizes secondary data from published the financial reports of manufacturing firms in the period (2006-2015). The study population is 81 manufacturing firms quoted on the Nigerian Stock Exchange (NSE); out of which an enhanced sample of 69 quoted manufacturing firms is drawn based on the framework of Yameni [17]. The companies are listed under sub-sectors, such as conglomerates, consumer goods, healthcare, industrial goods, as well as oil and gas. Analysis of data involves tabulation and enumeration, beginning with descriptive statistics. This is followed by computation of correlation, multiple regression and associated explanatory statistics (facilitated by E-Views software package), in order to establish the influence of tax incentives on corporate earnings (with EPS as proxy). The research model features the following functions:

EPS = f(AA, IA, TH, SC) … (1)

$$EPS = \gamma_0 + \gamma_1(AA) + \gamma_2(IA) + \gamma_3(TH) + \gamma_4(SC) + \mu_3 \quad \ldots \quad (2)$$

Where:

AA = Annual Allowance

IA = Investment Allowance

TH = Tax Holiday

SC = Share Capital (moderating variable)

This process is in line with the dispositions of Sekaran and Bougie [18], Kothari [19], Chinwe et al. [20], as well as Twesige and Gasheja [13].

DATA ANALYSIS AND RESULTS

The descriptive statistics and explanatory results obtained from data analysis are presented in Tables I and II.

Table I : Group Descriptive Statistics

	AA	IA	TH	SC	EPS
Mean	4889384.	2080095.	2742618.	29660157	4.856910
Median	266642.5	52490.07	43776.46	350000.0	1.100000
Maximum	4.39E+08	1.94E+08	1.80E+08	1.86E+09	458.0000
Minimum	72.00000	5.000000	1.140000	179.3900	-432.2800
Std. Dev.	34965678	14170348	16133086	2.03E+08	33.26889
Observations	690	690	690	690	690

Source: Timah (21).

Table II : Multiple Regression Results

Dependent Variable: EPS				
Method: Pooled Least Squares				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	13.41250	3.395670	3.949885	0.0001
LOG(AA)	0.784143	0.262597	2.986106	0.0028
LOG(IA)	0.697315	0.210799	3.307956	0.0009
LOG(TH)	0.453760	0.203682	2.227787	0.0259
LOG(SHARES)	-2.375849	0.247408	-9.602944	0.0000
R-squared	0.621242	Mean dependent var.		4.856910
Adjusted R-squared	0.620407	S.D. dependent var.		33.24760
S.E. of regression	32.90661	Akaike info criterion		9.826290
Sum squared resid.	5073130.	Schwarz criterion		9.833170
Log likelihood	-23037.65	Hannan-Quinn criter.		9.828709
F-statistic	25.42007	Durbin-Watson stat		2.110270
Prob(F-statistic)	0.000000	Variance inflation factor		1.944300

Source: Timah (21).

In Table I, the average annual allowance is 4889384, with standard deviation of 34965678, while the average EPS is 4.86, with a standard deviation of 33.26. Table II, relative to EPS, indicates VIF = 1.9443 (< 3), which imply that there is no multicollinearity between the variables. Also, in Table II, the adjusted coefficient of determination is 0.62, indicating that the tax incentive operational dimensions account for 62% of variations in EPS. The F-statistic of 25.42007 is significant at the specified level (p = 0.00), affirming overall fitness of the model in ascertaining the relationship between the variables. In all, the results establish that tax incentives have positive and significant influence on corporate earnings of quoted manufacturing companies in Nigeria.

DISCUSSION OF FINDINGS

Tax incentives are designed to attract investments and, by extension, enhance the financial performance of companies. This study focused on the influence of tax incentives on corporate earnings of quoted manufacturing firms in Nigeria. In terms of the operational dimensions of tax incentives, the results indicated that EPS is positively and significantly influenced by annual allowance, investment allowance, and tax holiday. The coefficient of determination revealed that 62% of variation in EPS is explained by the influence of the tax incentive operational dimensions. This justifies the favourable disposition of the Nigerian government relative to relevance of tax incentives [20,21,22]. Three institutional frameworks for actualizing tax incentives in Nigeria, amongst others, which bear on the industrial operations of quoted manufacturing companies, are National Office for Technology Acquisition and Promotion (NOTAP), Nigerian Investment Promotion Commission (NIPC), Nigeria Immigration Service (NIS), Nigeria Customs Service (NCS), Federal Inland Revenue Service (FIRS), and Nigerian Export Promotion Council (NEPC).

NOTAP is concerned with issues relating to transfer of technology in Nigeria, enabled by NOTAP Act, 2004. The principal function of NOTAP is to monitor the transfer of foreign technology to Nigeria; as the Act makes it mandatory to register all contracts/agreements for the transfer of foreign technology entered into by persons in Nigeria with NOTAP as well as registration of every contract/agreement entered into by any person in Nigeria with another person outside Nigeria within specified days from the execution/conclusion of the contract. The Act provides that every

contract is to be registered if its purpose/intent is in the opinion of NOTAP, is wholly/partially connected with the:

(i) Utilization of trademarks,
(ii) Right to utilize patented inventions,
(iii) Supply of technical expertise in the form of the preparation of plans, diagrams, operating manuals or any other form of technical assistance of any description whatsoever;
(iv) Supply of basic or detailed engineering;
(v) Supply of machinery and plant; and
(vi) Provision of operating staff or managerial assistance and the training of personnel.

With respect to NIPC, the main objective is to encourage, promote and coordinate investments in the Nigerian economy; and address for matters connected therewith; whilst the core functions include:

i. Coordinating and monitoring all investment promotion activities;
ii. Initiating and supporting measures which shall enhance the investment climate in Nigeria for both Nigerian and non-Nigerian investors;
iii. Promoting investments in and outside Nigeria through effective promotional means;
iv. Collecting, collating, analysing and disseminating information about investment opportunities and sources of investment capital, and advising on request, the availability, choice or suitability of partners in joint-venture projects;
v. Registering and keeping records of all enterprises;
vi. Identifying specific projects and inviting interested investors for participation in those projects;
vii. Initiating, organizing and participating in promotional activities, such as, exhibitions, conferences and seminars for the stimulation of investments;
viii. Maintaining liaison between investors and Ministries, Departments and Agencies (MDAs), institutional lenders and other authorities concerned with investments;
ix. Providing and disseminating up-to-date information on incentives available to investors;
x. Assisting incoming and existing investors by providing support services;
xi. Evaluating the impact of the NIPC in investments in Nigeria and making appropriate recommendations;
xii. Advising the Federal Government on policy matters, including fiscal measures designed to promote the industrialization of Nigeria or the general development of the economy; and
xiii. Performing such other functions as are supplementary or incidental to the attainment of the objectives of this NIPC Act.

The NIS is empowered by Section 2 of the Immigration Act, 2015, to:

i. Control of persons entering or leaving Nigeria;
ii. Issue peregrinate documents, including Nigerian passports, to *bonafide* Nigerians within and outside Nigeria;
iii. Issue residence permits to foreigners in Nigeria;
iv. Ensure border surveillance and patrol; and

v. Eenforce laws and regulations with which they are directly charged; and perform such para-military obligations within or outside Nigeria as may be required of them under the agency of this Act or any other enactment.

The NCS is responsible for:

I. Checking anti-smuggling activities;
II. Providing statistics for planning and budgetary purposes;
III. Monitoring foreign exchange utilization;
IV. Engaging in research, planning and enforcement of fiscal policies of government;
V. Carrying out security functions;
VI. Collecting revenue (import/excise obligations and other taxes /levies) and accounting for same;
VII. Carrying out manifest processing;
VIII. Registering and designation of collecting banks; and
IX. Working in collaboration with other government agencies in all approved ports and border stations involved in licensing and registration of Customs Agents.

The FIRS is a leading federal tax agency in Nigeria, responsible, amongst others, for:

i. Assessment, charging and collection of all relevant taxes and revenue for the government;
ii. Operating statutory tax legislation, forms and procedures for applying for tax clearance; and
iii. Managing the tax treaties between Nigeria and other countries, the tax assessment procedure and how to file tax returns.

The NEPC, established through its enabling Law, is responsible for:

I. Promoting non-oil exports as the key driver of the Nigerian economy and positioning the export market as the growth opportunity of choice for private sector earnings and sustainable economic development;
II. Promoting the development and diversification of Nigeria's export trade;
III. Helping in promoting the development of export related industries in Nigeria;
IV. Spearheading the creation of appropriate export incentives;
V. Actively articulating and promoting the implementation of export policies and programmes of the Nigerian Government;
VI. Co-ordinating and monitoring export promotion activities in Nigeria; accumulating and disseminating information on products available for export;
VII. Collecting and disseminating to local manufacturers and exporters information on foreign markets; provide technical assistance to local exporters in such areas as export procedures and documentation, transportation, financing, marketing techniques, quality control, export packaging, costing and pricing, publicity and in other homogeneous areas; maintain adequate and effective representation in other countries; provide directly or jointly, with training institutions, training for its staff and assist with the manpower development of the export community in Nigeria; organize and plan the participation of Nigeria in trade fairs and exhibitions;
VIII. Administering grants and other benefits related to export promotion and development;

IX. Undertaking studies of the current economic conditions, with special attention to the export sector, with the aim of advising government on obligatory policies and measures;
X. Establishing specific trade promotion facilities in Nigeria and in other countries including the establishment of perpetual showrooms at significant commercial centres in other countries;
XI. Engaging in export promotion publicity;
XII. Pursuing the simplification and streamlining of export procedures and documentation on perpetual substructure; assist in finding felicitous solutions to practical problems encountered by exporters in the process of exportation;
XIII. Planning and organizing outward trade missions and providing support from Nigeria; and
XIV. Performing such other functions as may be conducive to the achievement of the objective of the export law.

Findings of this study on the influence of tax incentives on corporate earnings agree with scholarly which indicate a positive relationship between tax incentives and financial performance. A study on the operations of multinational companies in developed countries also indicate a positive correlation between tax incentives and increase in investment activities; even as contemporary analysts generally admit that business-friendly tax incentives are proactive measures which attract and boost investments in industrializing nations [5,23].

CONCLUSION AND RECOMMENDATIONS

In developing economies, government seeks to address the problems of decrease in industrial productivity, capital flight, and gross domestic (national income) decline in the Nigerian economy, arising mainly from under-utilization of installed capacity. This informs the favourable disposition towards granting tax incentives to corporate investors. This study, therefore, examined the influence of tax incentives on corporate earnings of manufacturing companies quoted on the NSE. The framework featured EPS as proxy for corporate earnings in relation to the operational dimensions of tax incentives such as annual allowance, investment allowance, and tax holiday, with share capital as moderating variable. The results established that:

i. Annual allowance has significant influence on EPS,
ii. Investment allowance has significant influence on EPS, and
iii. Tax holiday has significant influence on EPS.

In the light of these findings, the study concludes that tax incentives influence corporate earnings of quoted manufacturing companies in Nigeria. Previous researchers who advanced this position include Akinyomi and Tasie [22], Oriakhi and Osemnwenge [3], as well as Twesige and Gasheja [13].

Based on the conclusion, it is recommended that:

I. Tax incentives should be sustained for industrialists in order to enhance real investment climate in the Nigerian economy; and
II. Firmer measures should be put in place to prevent beneficiaries from circumventing the grants to the disadvantage of government.

In this regard, greater responsiveness is expected of the investment booster agencies (NOTAP and NIPC in particular), in the task of coordinating and monitoring activities, providing and

disseminating up-to-date information on available incentives, and assisting incoming/existing investors with support services, towards optimum utilization of productive capacities for the production of quality goods in Nigeria. With time, this will efficiently drive the economy to higher heights.

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