



POLAC INTERNATIONAL JOURNAL OF ECONS & MGT SCIENCE (PIJEMS)
DEPARTMENT OF ECONOMICS & MANAGEMENT SCIENCE
NIGERIA POLICE ACADEMY, WUDIL-KANO



MODERATING EFFECT OF MANAGEMENT COMPENSATION ON CORPORATE TAX PLANNING STRATEGIES: EVIDENCE FROM QUOTED MANUFACTURING COMPANIES IN NIGERIA

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Abstract

Corporate tax planning tactics appear to be the outcome of persistently rising tax rates, inadequate tax incentives, and limited capital allowances in emerging nations, particularly in Nigerian manufacturing enterprises. As a result of this void, this study investigates management compensation as a determinant of corporate tax planning strategies of listed manufacturing companies in Nigeria. 39 manufacturers of consumer and industrial goods were listed on the Nigerian Stock Exchange floor on the study date (Nigerian Stock Exchange Fact book, 2020). This study used an ex post facto research technique. Over the course of twelve years, from 2013 to 2020, 29 manufacturing businesses were the subject of the study. Thus, following a period of eight years and involving 29 manufacturing firms, a grand total of 232 observations were recorded. Therefore, As a result, managers in charge of companies facing severe competition should think about the best course of action for preserving the business, which could be achieved by reducing the challenges those companies face in order to increase sales for manufacturing companies.

Keyword: Management Compensation; Corporate Tax Planning; Data Envelopment Analysis (DEA)

Introduction

Due to high tax rates and restrictions on companies' ability to claim benefits and other tax incentives, corporate tax planning has grown problematic in developed, especially developing nations. However, corporate tax planning entails ways of exploiting loopholes in the tax law in order to reduce companies' tax liabilities or anything that reduces companies' cash effective tax rate over a long time period (Amrie, 2018). Nonetheless, companies have been discouraged by the high tax rates, which has caused many of them

particularly Manufacturing Companies (MCs) to be on the lookout for methods to reduce their corporate income tax liabilities. A management team with a strategic understanding of the various tax incentives present in each nation's tax laws is essential for any MC looking to successfully reduce their tax bill. Among these incentives are the pioneer status incentive, the initiation rule, the cessation rule, the investment allowance, and the roll-over loss relief. However, these incentives sometime are denies which are resulted into management manipulate figures in other to pay lesser tax.

For instance tax evasion is estimated by Her Majesty's income and Customs' anti-avoidance group to cost the British government billions of pounds in lost income each year (UK HMRC, 2016). As a result, the government bears additional costs when the authorities use risk classification evaluations to conduct tax investigations; in other words, tax planning strategies increase the cost of tax compliance while also negatively impacting government revenue. It has absurd effects on the economy and government treasury; it lowers the amount of public goods provided and addresses more broad social issues (Schultze, 2010).

In Nigeria, The Nigerian Stock Exchange floor saw the companies perform poorly, which led to the trading of two of the company's shares below the nominal value of fifty thousand dollars: Nigerian Sewing Machine traded at fifteen thousand dollars, Stokvis Nigeria Limited at fourteen thousand dollars, and Nigeria Wire and Cable traded flat at fifty thousand dollars. Proshare (2015) highlighted three (3) manufacturing companies (Nigeria Wire and Cable, Stokvis Nigeria Limited, and Nigerian Sewing Machine) who have been delisted because the company's management lacks higher managerial ability by failing to enhance their operations. In a similar vein, the lack of strategic understanding among corporation managers regarding the many tax incentives present in Nigerian tax laws and their implications for the continuous operations of publicly traded firms is another current source of worry. The consequences have resulted in employment losses for both skilled and unskilled laborers who receive daily wages from the firm, which has lowered the GDP of the country.

This issue has been discussed in the literature along with various determinants or influences on company tax planning. Nonetheless, the question of whether or not management compensation at corporations can lead to corporate tax planning has been debated or resolved in the literature. In the light of this, Nigerian companies, particularly those in the manufacturing sector, offer a range of remuneration packages to managers who can secure the company's continued existence by lowering operating expenses and tax obligations. These managers become increasingly adept at producing financial gains

from regular business operations by utilizing their expertise and technical know-how to successfully take advantage of all tax planning opportunities, including tax avoidance strategies. Conversely, when a manager lacks the necessary experience and certification in tax matters, he ends up creating a subpar tax planning strategy for the company, which has resulted in the bankruptcy of multiple national businesses.

In null shell, there has been a view of studies specifically addressing the characteristics, corporate tax planning, financial difficulty, and managerial ability of Nigerian listed manufacturing enterprises. In light of these issues, studies on management and corporate tax planning have not yet been fully resolved. Comparably, studies on tax planning in Nigeria have primarily focused on one of the following subjects: tax planning and firm value (Nwaobia, 2016); tax planning and corporate governance (Salawu, 2017); tax planning and financial performance (Ogundajo & Onakoya, 2016); or corporate effective tax rate and firm performance (Inua, 2018). This study looked at management compensation as a factor in listed manufacturing companies in Nigeria's corporate tax planning techniques as a follow-up to this study.

2. Literature Review

2.1 Conceptual Issues

Izevbekhai, et al (2018) defined corporate tax planning as strategies that maximize the firm's expected discounted after-tax cash flows. Nwaobia, et al (2016) argue that the reduction of tax burden in relation to optimization of after-tax returns is what is referred to as corporate tax planning or effective corporate tax planning in which the role of taxes and other contracting costs underlies the decision rules of maximizing after-tax returns or optimizing tax liability. Although the arguments made by Izevbekhai et al. (2018) and Nwaobia et al. (2016) were superseded, these definitions can be reinterpreted for the purposes of this study as a set of strategies implemented to guarantee that the tax burden is as low as possible. This action is required due to management compensation that exist either inside or outside the organization.

In the light of management compensation, Nielsen (2010) defined it as a process by which top senior executives have a crucial role in setting and implementing operation strategies for organizations, including investment decisions regarding short-term activities and long-term development. In another dimension, investment in long-term activities (such as research & development and innovation) may be reduced if the executive places a higher priority on short-term results (Scuotto et al., 2017). According to Bertone and Gomez-Mejia (2009), remuneration has thus been employed as a useful instrument to balance the interests of executives and organizations. Furthermore, studies have looked into how top-level management pay affects capital structure (John & John, 1993), shareholder return (Kerr & Bettis, 1987), and an organization's chance of surviving (Trinh & Seetaram, 2022). According to this research, there is a strong correlation between business performance and the remuneration package received by top management, which in turn affects an organization's risk of bankruptcy. This led to the conceptualization of management compensation in this study as the overall reward value that companies managers receive over the course of the year.

2.2 Theoretical Review

Numerous theories, especially those pertaining to corporate tax planning, have been reviewed in the literature. One such theory is the Agency theory, which Mitnick first proposed in 1973. The author examines the agency relationship and the problems that can arise, especially between the principal and the agent. The idea that an agency relationship is a contract in which one or more people (the principle) hire another person (the agent) to do a task in the principal's best interest by giving the agent decision-making authority was further supported by Jensen and Meckling (1976). The main interests of each participant in this relationship are their own finances. Therefore, the agent does not necessarily behave in the principal's best interest if the two parties have a utility-maximizing relationship. This is precisely the cause of an organization's agency issue. Consequently, Filatotchev et al. (2011) contend that agency concerns have an impact on companies operations, investments, and financial policies.

This study is grounded in this idea, according to all of these arguments. In terms of management compensation, the best course of action for managers of manufacturing companies is to reduce the taxes that the business must pay in order to maintain its profitability. Therefore, it is a favorable alternative to pursue because the tax load is one duty that does not directly benefit the company. This is crucial as a company's managerial pay typically rises in unpredictable economic times. Consequently, limiting tax savings has a positive impact on cash flow and the after-tax rate of returns while also assisting businesses in preserving the funds needed for operating expenses. Moreover, lucrative sectors and market penetration enable competent companies to seize a sizeable share of the market and make fund.

2.3 Empirical Review

Tax planning strategies have become techniques for improve financial performance, for instance, the age of operational managers and the age composition of employees are related to the survival of Swedish firms between 2004 and 2013, according to research by Backman and Karlsson (2020). The study's explorative analysis reveals that the relationship between manager age and firm exit changes functional shape when separated into different firm-size categories. Additionally, the age of operational managers tends to be more important for new firms compared to incumbent firms, and the share of older employees is positively associated with firm survival.

Rahman, Adeolu, and Ogundeko (2018) investigated how investors' confidence was affected by corporate tax planning schemes as a factor in determining share price in Nigeria. Panel regression analysis was used to evaluate data that came from the audited reports of ten (10) samplelisted money deposit institutions for the years 2010 to 2017. The study's findings showed that listed banks in Nigeria that consciously lower their taxes have a major and beneficial impact on the share prices of listed companies. Furthermore, the share price was positively influenced by tax avoidance and evasion schemes; only extreme tax planning had a negative impact on the firm's performance and undermined investor trust.

The impact of tax planning on the financial performance of manufacturing companies listed on the Nigerian Stock Exchange was studied by Ogundajo and Onakoya (2016). Twenty-eight (28) companies listed in the consumer goods sector made up the study's population. Ten of these companies were chosen as study samples using a judgmental sampling technique. This was done on the grounds that the sample companies represented approximately 40% of the study population, which is higher than the general threshold of 30% (Kawor & Kportorgbi, 2014; Ogundajo & Onakoya, 2016). The effective tax rate (ETR) was used as a proxy for tax planning instead of tax savings, as used by Kawor & Kportorgbi (2014), because of empirical evidence showing that both tax savings and ETR consistently produced the same results once the statutory tax rate was constant over the study's years. Leverage, size, and firm age were used as control variables. The study used the generalized least square method (GLS), which was based on the results of the Hausman's model estimation test by proxy financial performance with return on assets (ROA) as the dependent variable. The study found that Nigerian companies have not made full use of aggressive tax planning strategies such as thin capitalization, tax law incentives, and other advantages of loopholes in Nigerian tax legislation. The research suggested that manufacturers

In the same vein, the corporate financial performance and managerial effectiveness of listed Nigerian companies were investigated by Adegbe, Akintoye, and Alu (2019). Panel regression analysis was used to examine the information gathered from the audited reports of ninety (90) companies listed on the Nigerian Stock Exchange that were selected as a sample for the years 2008 to 2017. The study's findings indicate that managerial effectiveness raises ROA, however the coefficient of determination indicates that the primary model's ability to explain changes in ROA is less strong.

In another view but in developing nation, Aganyo (2014) looked at how 61 manufacturing companies listed on the Nairobi Securities Exchange (NSE) were valued in relation to their firm age. Regression analysis was used to examine data that was gathered from the 2009 to 2013

websites of African Financial and CMA. The findings demonstrated a strong positive correlation between the firm's age and value.

Nwaobia and Jayeoba (2016) use 154 firm year data from 2001 to 2014 to investigate the relationship between firm liquidity and tax planning in Nigerian manufacturing enterprises, using firm size as a control variable. The study employed regressing analysis, and the findings indicated that firms' liquidity was positively impacted by business size (Size). Ogbeide (2017) looked into the characteristics of the firms and the tax aggression of Nigerian listed companies. The data from the annual reports of 85 non-financial companies listed on the Nigerian Stock Exchange between 2012 and 2016 was examined using OLS regression analysis. The results of the study demonstrated that firm size has a favorable and significant impact on tax aggression.

It is evident from the literature that a number of problems have led to several studies on company tax planning techniques. Most significantly, research has examined how financial crisis affects company tax strategy in both industrialized and developing nations. Regrettably, few or no of these studies' findings were discussed in Nigeria, especially in manufacturing firms. In light of this, this becomes the study's identified gap.

3. Methodology

Using the already-available annual reports of Nigerian listed manufacturing companies as well as other pertinent resources, the study employed an ex-post facto research design. This study includes all companies that generate consumer and industrial goods that are listed on the floor of the Nigerian Stock Exchange (NSE) as of December 31, 2020. As of that day, the Nigerian Stock Exchange had 39 companies listed on its floor (Nigerian Stock Exchange Fact book, 2020). The technique of purposive sampling was adopted due to the availability of data, the firms' continuous listing, and their active trading during the study period. Ten companies with incomplete data were carefully excluded, further refining the strategy. From 2013 to 2020, spans of twelve years, 29 manufacturing companies were the subject of the study. During this period, 232 observations were made

in total. That is the equivalent of multiplying 29 manufacturing enterprises by 8 years.

Nonetheless, methods for ordinary least square (OLS) regression were used to examine the study's objective. Prior to using inferential statistics, company efficiency was ascertained, and skewness, kurtosis, and Jaque-Bera normalcy tests were used to verify the accuracy of the data acquired. Additional preliminary analysis was conducted using the Breusch-Godfrey serial correlation, Breusch-Pagan Godfrey, and Ramsey Reset tests (Uddin, et al. 2014), as well as the multi-collinearity test employing the variance inflation factor (VIF) and the heteroskedacity test. With a significance level of 5%, the Eviews and SPSS software packages were utilized to determine whether the hypotheses should be accepted or rejected. These tests were performed to make sure that

the data used in the multiple regression analysis did not violate any of the fundamental assumptions of the study. The model of Alabere. et al (2018) was adapted in order to achieve the objectives of the study and it was modified as follows:

$$TaxP_{it} = \beta_0 + \beta_2 MComp_{it} + \quad (1)$$

Where;

TaxP = Tax Planning Strategy proxy with Cash Effective Tax Rates (CETR);

MComp = Management in year *t*;

β_0 = Intercept or constant of the coefficient;

$\beta_1 - \beta_7$ = Coefficient of Explanatory Variables;

Table 1: Measure of Variables

Type of Variable	Variables Name	Measurement	Sources
<u>Dependent</u> <i>CETRs</i>	Cash Effective Tax Rate	This is Measured as tax paid divided by pre-tax book income before in period <i>t</i> , proxy for Corporate Effective Tax Planning Strategy	Amrie (2018) Ruhs & Østerås (2019)
<u>Independent</u> <i>MCOM</i>	Management Compesation	Binary options of 1 and 0. 1 if the manager receive reward 1 and 0 if otherwise	Adegbie <i>et al.</i> , (2019)

Source: Author, 2024

4. Results and Discussion

Prior to testing the hypothesis, an initial test was performed to verify that the data collected was normal. This preliminary test included the correlation matrix test, the variance inflation factors (VIF) test of multi-collinearity, the Breusch-Godfrey test for serial correlation LM, the Breusch-Pagan-Godfrey serial heteroskedacity test, and the Ramsey Reset test for misspecification. For example, the correlation LM using the results of Breusch-Godfrey correlation analysis reveals a linear relationship between the studies's

independent and dependent variables. This is supported by the variable's perfect correlation, or 1.00 coefficient of correlation with itself. Each variable displayed correlations that were both positive and negative. Consider TAXP (-0.2157) and MCOM as examples. Furthermore, the Table's suggested threshold of 0.8 for the connection was found to be moderate (Aifuwa & Embele, 2019; Stundenmund, 2014). This finding raised the possibility that the model has multicollinearity issues. The purpose of the variance inflation factor test was to investigate potential issues with multicollinearity in the model and the variables being examined.

Table 2: Inferential Statistics Result: Ordinary Least Square:

Variables	Predicted Sign	Model Coefficient (<i>t</i> -Statistics)	Prob.
Constant	Nil	0.2267 (1.6933)	0.0918
Management Compensation	+	-0.0112 (-0.4579)	0.6474

Source: Author's 2024

4.1 Discussion of Findings

In view foregoing result, the study discovered that among Nigerian listed manufacturing companies, managerial compensation negatively affects corporate tax planning approach. One of the tenets of corporate tax planning strategy is that business managers and tax advisors can be compensated and given bonuses in order to reduce corporate income tax liabilities. According to Armstrong et al. (2012), corporate managers' bonuses and salaries have an impact on the way the company handles its taxes. Additionally, managers who receive larger salary tend to be more aggressive with taxes. This merely indicates that the company compensates the manager for achieving cost efficiency by lowering the tax burden. Tax savings can be achieved through management strategies such as reducing tax burden. You can invest the cash inflows into other, more lucrative endeavors.

The study's findings imply that the tax managers' salary has a detrimental impact on the corporate tax planning strategies of Nigerian listed industrial companies. This suggests that managers will be incentivized to contemplate further company tax planning management due to their high salary. Aggressive taxation is a dangerous practice that, should tax authorities discover the unethical activity, could result in higher costs for the company in the form of penalties and fines. As a result, managers and tax directors are incentivized in other ways that do not put the company at greater risk, like extra pay and bonuses for exceeding sales targets. Paying employees is crucial to preserving positive working relationships between managers (agents) and shareholders

(principals). The agency theory states that bonding costs are used to ensure that managers act in the principals' best interests.

Therefore, the policy impact of this is that managers who receive higher salary will be less inclined to take aggressive steps in their corporation tax planning approach. Thus, in lieu of aggressive tax planning, higher compensation paid by the shareholders to the managers for improved operational efficiency will align the interests of agents and principal, deter information asymmetry, and ultimately improve the performance of Nigeria's listed manufacturing companies.

5. Conclusion and Recommendations

The study finds that the corporate tax planning of Nigerian listed manufacturing companies is unaffected by management compensation. The corporation tax planning strategy is negatively impacted by management compensation. The opposing relationship is also demonstrated by the negative direction of management compensation, which indicates that a corporation tax planning approach is less effective the greater the management compensation and vice versa. This implies that corporate tax planning strategy is lowered when corporation managers obtain more bonuses and compensation for improved operational efficiency rather than through aggressive tax schemes. Therefore, the study suggests that the company should keep encouraging managers to execute cost-efficiency, which can be accomplished in part by reducing the tax burden, based on the results of management remuneration. A tax burden plan is chosen as a management technique to produce immediate financial tax savings.

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