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FINANCIAL DISTRESS AS A DETERMINANT OF CORPORATE TAX PLANNING STRATEGIES OF LISTED MANUFACTURING COMPANIES IN NIGERIA

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Abstract

Apparently, the persistence increase in tax rate, inadequacy of tax incentives and poor capital allowance across developing countries, particular Nigeria manufacturing companies which has consequently resulted into corporate tax planning strategies. As a result of this void, this study investigates financial distress as a determinant of corporate tax planning strategies of listed manufacturing companies in Nigeria. .. This study employed an ex-post facto research strategy; on the study date, 39 manufacturers of consumer and industrial goods were listed on the Nigerian Stock Exchange floor (Nigerian Stock Exchange Fact book, 2020). The study focused on 29 manufacturing enterprises between 2013 to 2020, a span of twelve years. Consequently, after eight years and 29 manufacturing companies, a total of two hundred and thirty-two (232) observations were made. In the light of result and findings of this study, it was discovered that financial distress has negative effect on corporate tax planning strategy. Therefore, this study recommends that Managers responsible for overseeing businesses in severe financial trouble need to consider the best strategy for preserving the business, which may be accomplished by lowering the obstacles the companies, must overcome in order to boost sales for manufacturing enterprises.

Keyword: Financial Distress; Corporate Tax Planning; Data Envelopment Analysis (DEA)

1. Introduction

Corporate tax planning has become issue across developed countries particular developing countries; this was as a result of high rate of taxes, denied companies to claim allowances and other tax incentives. 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). However, the high tax rates have served as a deterrent for companies; leading many of them especially Manufacturing Companies (MCs) to constantly look for ways to lower their corporate income tax obligations. Any MC that wants to successfully lower their tax liability needs to have management who has a strategic grasp of the many tax benefits found in each country's tax legislation. Pioneer status incentive, initiation rule, cessation rule, investment allowance, and roll-over loss relief are a few examples of these incentives.

For instance, the anti-avoidance group of Her Majesty's income and Customs estimates that tax evasions cost the British government billions of

pounds in lost income annually (UK HMRC, 2016). When a result, the government incurs more costs when the authorities use risk classification evaluations to carry out tax investigations. This means that tax planning techniques raise the expense of tax compliance while also having a detrimental effect on 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, 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. The action caused the companies to perform poorly on the Nigerian Stock Exchange floor, which resulted in 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. In a similar spirit, another current cause of concern is the corporation managers' lack of strategic knowledge of the different tax incentives found in Nigerian tax laws and the implications for the ongoing operations of publicly traded corporations. Due to the implications, both skilled and unskilled laborers who receive daily earnings from the corporation have lost their job, which has decreased the nation's GDP.

This issue has been address in literature with different factors that influence or determinant corporate tax planning. However, it was argued or cleared in literature on either or not financial distress of companies can resulted into corporate tax planning. In the light of this, Manufacturing companies have also experienced financial difficulties, often known as bankruptcy risk, which has made it difficult for them to make their debt payments. Sadly, the majority of manufacturing companies constantly make an effort to handle financial hardship, particularly when it is brought on by external factors like rising interest rates and depreciating local currencies and internal factors like paying off debt.

Consequently, manufacturing companies employ debt stock to finance their operations for the importation of raw materials during financial crises of this kind, and the depreciated currency may raise the amount of loan stock that needs to be returned. The company's product sales may tend to drop as a result of the decreasing economic conditions. In the end, this can make the company more vulnerable to bankruptcy. Manufacturing companies that experience significant financial hardship would require additional funding to settle debt and stay in operation. Therefore, a corporation may choose to cause trouble for itself by taking out a loan to finance its operations in order to benefit from interest that is payable in the form of tax savings that are deducted from taxes. As a result, one option worth taking into consideration is the reduction of the tax burden. This is the rationale for businesses using corporate tax planning strategies, such as tax minimization.

In the light of these problems, to the best of this study, studies on financial distress and corporate tax planning strategy have not yet been fully resolved. In summary, there has been a dearth of study expressly addressing the companies' characteristics, corporate tax planning, financial difficulty, and managerial ability of Nigerian listed manufacturing enterprises. Similar to this, research on tax planning in Nigeria has mostly concentrated on one of the following topics: corporate governance and tax planning (Salawu, 2017); tax planning and firm value (Nwaobia, 2016); tax planning and financial performance Olamide, et al (2019).; Ogundajo & Onakoya, 2016); or corporate effective tax rate and firm performance (Inua, 2018). Sequel to this address, this study examined financial distress as a determinant of corporate tax planning strategies of listed manufacturing companies in Nigeria.

2. Literature Review

2.1 Conceptual Issues

Corporate Tax Planning

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. However, the arguments of Izevbekhai, et al (2018) and Nwaobia, et al (2016) was superseded, however, this definitions can be remodel and for the purpose of this study, it can be redefined as a as series of strategies put in a place by to ensure the tax burden is at minimum. This action is necessary as a result of financial distress within or outside the organization.

Corporate Tax Planning

On the other hand, empirical definitions of this is scanty, however, according to chartered financial analyst (2020) defined financial distress as a legally declared inability or impairment of an individual or companies to pay its creditors often refer to as bankruptcy risk. There are two types of financial distress: involuntary and voluntary distress. When creditors attempt to recoup a portion of their debt or start a restructuring, they file a petition for involuntary bankruptcy against the debtor. Voluntary bankruptcy on the other hand is usually filed by the insolvent individual or company. Bankruptcy risk is defined as the inability of a company to redeem maturity debt (Amri, 2018). According to Fauzan, et al (2021), in a situation where companies have high financial distress, creditors and other stakeholders will provide tighter supervision to reduce manager's opportunity for tax avoidance. The effect of financial distress on tax planning was proved by Richardson, et al (2016) on the studies carried out in the United State during the period 1986 – 2012. Companies typically attempt to handle bankruptcy when pressured by both external and internal reasons, such as rising interest rates, declining local currencies, and internal debt.

2.2 Theoretical Review

Many theories have been reviewed in literature particular theories that are related to corporate tax planning for instance, Agency theory which was first propounded by Mitnick in 1973 and the author studies the agency relationship and issues that arise particularly between the principal and the agent. Jensen and Meckling (1976) further buttressed this that agency relationship are a contract whereby one or more person (the principal) engage another person (the agent) to do a job in the interest of the principal through delegation of authority to the agent in decision making authority. Primarily, each party in this relationship has its own economic interest. Consequently, if the relationship between the two parties is utility maximize, the agent does not always act in the best interest of the principal. This is exactly what lies behind the agency problem in a company. As a result, Filatotchev et al, (2011) argue that agency issues affect corporate functions such as investments, operations and financial policies.

In the view of all these arguments, this study anchored on this theory. The best course of action for managers of manufacturing companies in financial difficulties is to minimize the amount of taxes that the company must pay in order to preserve its viability. Therefore, one burden that does not directly benefit the company is the tax load, which makes it a desirable alternative to pursue. This is essential as uncertain economic conditions usually increase a company's risk of insolvency. As a result, minimizing tax savings helps the companies save the money it requires for operating expenses and has a favorable effect on cash flow and the after-tax rate of returns. Furthermore, profitable industries and market penetration allow efficient businesses to capture a significant portion of the market and generate economic gains.

2.3 Empirical Review

As a result of financial distress in the economic Richardson, Lanis and Taylor (2015) investigated economic distress on tax avoidance. 203 manufacturing enterprises that are listed on the Australian Stock Exchange comprise the study's sample size. Panel regression was used to evaluate data that came from the audited reports of non-financial listed firms in Sydney from 2008 to 2014. The study's findings showed that businesses experiencing financial difficulties engage in more tax evasion. As a result, their precarious financial situation pushes them to manage their revenues by raising income in order to conceal their declining status.

In spite of foregoing issue relating to corporate tax aggressiveness in USA Jalan *et al.,* (2016) elucidated bankruptcy risk on tax aggressiveness in USA. Panel regression analysis was used to evaluate data taken from the 1986–2012 financial reports of S&P 500 companies. The results showed that tax aggression is negatively impacted by bankruptcy risks. The author came to the conclusion that because investors and other linked parties would be closely monitoring companies.

In addition, Charalambakis and Garret (2016) examine whether market-driven factors and accounting have a good predictive power for financial hardship in a developed market of enterprises (the USA), as well as in another developed market economy (the UK) and an emerging country (India). The study found that a model that incorporates market capitalization, book leverage, excess returns, and returns volatility enhances the prediction of financial crisis for the UK. The study discovered that when paired with accounting data, market-based variables had no effect on the likelihood of financial trouble for the Indian enterprises.

The impact of the global financial crisis on the tax revenue of Tehran-listed manufacturing companies was ascertained by Zayer and Shafi (2009). Data from the financial statements of nineteen (19) listed manufacturing businesses chosen as a sample for the period 2002 to 2008 were analyzed using panel regression analysis. The study's findings demonstrated that corporate tax evasion is positively impacted by the global financial crisis, with Tehran's economy feeling the brunt of this influence in 2009.

Mehdi, Esmaeil, and Farzad (2016) investigated the connection between tax evasion and financial distress in Tehrani companies. The data for the 118 Iranian listed firms from 2008 to 2014 was obtained from the Tehran Stock Exchange and analyzed using Ordinary Least Square (OLS) regression analysis. According to the study, business tax evasion is positively and significantly impacted by financial difficulties. Stated differently, attempts to exacerbate financial distress will result in a rise in corporate tax evasion.

Amrie (2018) investigated how tax aggression in Indonesia is impacted by bankruptcy risk. Regression analysis was used to examine data that came from the 2011–2015 annual reports and accounts of thirty-six (36) manufacturing companies that were listed on the Indonesia Stock Exchange. According to the study, a company's tax aggression is positively impacted by the danger of bankruptcy. The investigation came to the conclusion that tax aggression increased with bankruptcy risk.

Using 154 firm year records from 2001 to 2014, Nwaobia and Jayeoba (2016) examine the connection between tax planning and firm liquidity across Nigerian manufacturing firms, adopting firm size as a control variable. Regressing analysis was used in the study, and the results showed that business size (Size) positively impacted firms' liquidity. Ogbeide (2017) investigated the relationship between tax aggressiveness of Nigerian listed firms and firm characteristics. OLS regression analysis was used to examine the information obtained from the annual reports of 85 non-financial companies listed on the Nigerian Stock Exchange between 2012 and 2016. The study's conclusions showed that tax aggression is positively and significantly impacted by firm size.

Obviously, it was cleared in literature that several issues have been resulted into several studies in corporate tax planning strategies. Most importantly, the area of financial distress has been address as a factor influence corporate tax planning in developed and developing countries. Unfortunately, little or view of this studies were addressed in Nigeria particular in manufacturing companies. On this note, this becomes the gap identified in this study.

3. Methodology

The study used ex-post facto research design, utilizing the already available annual reports of Nigerian listed manufacturing businesses as well as other relevant materials. As of December 31, 2020, all companies listed on the floor of the Nigerian Stock Exchange (NSE) that produce consumer and industrial goods are included in this study. 39 companies were listed on the floor of the Nigerian Stock Exchange as of that date (Nigerian Stock Exchange Fact book, 2020).The data availability, active trading, and continuing listing of the firms during the study period led to the adoption of the purposive sampling strategy, which was further refined by carefully excluding 10 companies with incomplete data. The study covered 29 manufacturing enterprises during a twelve-year period, from 2013 to 2020. There were a total of 232 observations made throughout this time. That is an eight-year multiplication of 29 manufacturing companies.

However, the goal of this study was analyzed using ordinary least square (OLS) regression approaches. Firm efficiency was determined before inferential statistics were performed, and a normality test was run to confirm the accuracy of the data collected using skewness, kurtosis, and Jaque-Bera. Further preliminary analysis was also performed, which included the multi-collinearity test using the variance inflation factor (VIF) and the heteroskedacity test utilizing the Breusch-Godfrey serial correlation, Breusch-Pagan Godfrey, and Ramsey Reset tests (Uddin, et al 2014). These tests were carried out to ensure that the data utilized in the multiple regression analysis did not violate any of the fundamental assumptions of the study. At a significance level of 5%, the Eviews and SPSS software packages were used to assess whether the hypotheses should be accepted or rejected.The model of Amrie (2018) was adapted in order to achieve the objectives of the study and it was modified as follows:

$$\mathbf{TaxP}_{it} = \boldsymbol{\beta}_0 + \boldsymbol{\beta}_2\mathbf{Fdis}_{it} + \boldsymbol{\varepsilon}_i \quad \text{.....(1)}$$

Where;

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

$\boldsymbol{Fdis}_{it}$= Financial distress 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
Dependent *CETRs*	Cash Effective Tax Rate	This is Measured as tax paid divided by pre-tax book income before in period *t*, proxy for Corporate Effective Tax Planning Strategy	Amrie (2018) Ruhs & Østerås (2019)
Independent FDST	Financial Distress	Classic data envelopment analysis (DEA) was adapted to measure Financial distress. The methodology proposed by Charnes et al. (1978)	Charnes *et al.*,(1978); Demerjian *et al.*, (2012)

Source: Author, 2020

4. Results and Discussion

Before testing the hypothesis, a preliminary test was conducted to confirm that the data collected was normal. Some of the preliminary tests that were carried out 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 instance, One of the fundamental tenets of regression is revealed by the correlation LM employing Breusch-Godfrey correlation analysis results. The aforementioned finding suggests a linear link between the study's independent and dependent variables. The variable's perfect correlation, or 1.00 coefficient of correlation with itself, lends evidence to this. Every variable showed both positive and negative associations. Take TAXP (-0.2157) and FDIS, for instance. In addition, the association was found to be moderate and within the suggested threshold of 0.8 in the Table (Aifuwa & Embele, 2019; Stundenmund, 2014). This result led to the suspicion that multicollinearity problems might exist in the model. The variance inflation factor test was performed to look into any concerns regarding multicollinearity in the model and variables under study.

Table 2: Inferential Statistics Result: Ordinary Least Square:

Variables	Predicted Sign	Model Coefficient (t-Statistics)	Prob.
Constant	Nil	0.2267 (1.6933)	0.0918
Financial Distress	+	-0.0039 (-0.4746)	0.6355

Source: Author's 2020

4.1 Discussion of Findings

The study's findings showed that listed Nigerian manufacturing companies' corporate tax planning strategies are insignificant by financial distress. This suggests that there are no incentives for industrial enterprises to participate in tax management programs. As so, the outcome deviates from the a-priori assumption. The findings of Jalan et al. (2016) and Mustafa et al. (2018), who discovered that financial duress had little detrimental effects on company tax planning aggressiveness, are congruent with our result. The results, however, are at odds with research by Richardson et al. (2014), Medi et al. (2016), Dhamara and Violita (2017), and Amri (2018), which employed the same financial distress construct and discovered a positive correlation between financial distress and corporate tax evasion. This study's conclusion that corporate tax planning approach among Nigeria's listed manufacturing companies is unaffected by financial crisis implies that manufacturing firms not under significant financial strain won't use tax management practices.

5. Conclusion and Recommendations

The study concludes that there is no relationship between financial distress and the corporate tax planning strategy of Nigeria's listed manufacturing companies; rather, there is a negative relationship between the two; the less financial distress, the lower the corporate tax planning strategy, and vice versa. Companies that are not experiencing financial distress will not be experiencing financial difficulties, and managers will not be making an effort to engage in corporate tax management. Based on the empirical results of the financial distress and corporate tax planning strategy, the study suggests that managers overseeing highly financially distressed companies consider the best course of action to save the business, which may be achieved by lowering the burdens the company bears in order to boost revenue for manufacturing companies. Because of these more advantageous qualities, saving taxes therefore becomes a desirable option.

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