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Income Tax Rate Regimes and Financing Decisions of Quoted Agricultural Companies in Nigeria

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Abstract

The purpose of the study was to examine income tax rate regimes and financing decisions of quoted agricultural companies in Nigeria. The specific objectives were as follows: to ascertain the extent to which company income tax rate regimes influence equity financing decision of the Nigerian quoted agricultural companies, to determine the extent to which company income tax rate regimes influence debt financing decision of the Nigerian quoted agricultural companies, and to investigate the extent to which company income tax rate regimes influence retained earnings financing decision of the Nigerian quoted agricultural companies. The study employed an ex-post facto research design in carrying out the study. Data for this study were gathered from secondary sources of data. The research data were obtained from various secondary sources which include Central Bank of Nigeria Statistical Bulletin, Central Bank of Nigeria Annual reports, Federal Inland Revenue Service (FIRS) revenue statistics as well as other researchers' journals and publications. The study employed regression models for the purpose of the study. The major findings of this study showed that CIT1 had a positive and insignificant effect on company financing decisions, CIT2 had a negative and insignificant effect on company financing decisions, and CIT3 had a positive and significant effect on company financing decisions. Arising from the results obtained, the study makes the following recommendations: Government should make it possible for companies to evade tax and penalize any registered company that evades tax.

Keywords: company income tax rate regimes, equity financing decision, debt financing decision, retained earnings financing decision

1. Introduction

Financial policy relates to two key choices that firms make namely: how much of their capital structure is supported by debt, rather than equity; and how much of their earnings to retain for use as internal equity finance, rather than distributing dividends and raising new equity in the market. In other words, financial policy decisions often amount to choosing the optimal trade-off between debt financing and equity financing (Sanusi, 2912). Capital structure is one of the most important decisions by finance managers. Capital structure relates to the various means of financing a firm; that is the proportionate relationship between debt and equity. Capital structure has been found to have impact on firm performance. Pandey (2011) maintained that capital is a significant managerial decision because it influences the shareholders' returns and risk as the market value of the share may be affected by the capital structure decisions.

It therefore goes to say that while making capital structure decisions, company managers are expected to seek answers to how the investment project be financed, the way in which the investment projects are financed, how financing affect the shareholders risk, return and value, the exist of an optimum financing mix in terms of the maximum value to the firm's shareholders, the determination of optimum financing mix in practice for a

company, and the factors in practice a company considers in designing its financing policy (Chang, 2019).

Tax considerations regarding location, organizational form, type and timing of transactions enhance the risk that financial decisions are guided by tax purposes rather than management objectives (Apampa, 2014). This is especially true for multinational companies. Although value maximization is the leading principle of financial management, the use of tax planning strategies has a distorting impact on a company's financing and investment decisions. A distortion of company financing and investment decisions is related to the different taxation of debt and equity, impacting the capital structure of companies. Most national tax systems favour the use of debt over equity thus, attributing a different tax treatment to the cost related to each of those financing modes (Titman & Wessels, 2018).

On the one hand, interest paid, that is the return to creditors, is a tax deductible expense, lowering the taxable base of the company. On the other hand, retained earnings or dividends paid, that is the return to shareholders are not tax deductible. As a result, companies could trade- off between sources of financing based on their tax differential. The study is supported by capital structure theories which states that debt in a firm's capital does not affect the firm's value (Diamond, 2014). This theory is normally referred to as irrelevant theory. Later in their second paper published in 1963, they modified the irrelevant theory by presenting proof that cost of capital affect capital structure and thus the value of the firm when the assumptions that there are no taxes or transaction cost were removed. This study is motivated by the need to add to the body of knowledge on capital structure as a means of making company financing decisions. The research will also enhance the study on the relationship where it exists between company income tax rate regimes (fiscal variable) and capital structure decisions in Nigeria.

2. Statement of the Problem

Most firms and company organizations exist as profit making organizations. In the quest to maximize profits, decisions on capital structure are usually applied. A firm's capital structure is primarily made up of two main components namely debt financing and equity financing. These components clearly indicate the firm's financing decision. Debt financing which comes with tax deductible expense also has a high probability of financial distress accompanied by the payment of a high interest alongside principal and despite the foregoing, business corporations and firms still use debt financing even when it is highly geared (Titman & Wessels, 2018).

The instrument of taxation has been recognized worldwide as a means of generating income for public authorities. Taxes are enforced proportional contributions from economic units such as persons, households, businesses as well as properties; levied by the state, by virtue of its sovereignty, for the support of government activities such as construction of public works (roads, bridges, dams, flyovers and railways); provision of education, healthcare, recreation and maintenance of law and order. The economic recession of 2016 with symptoms of stagflation was attributed to decline in demand of Nigeria's crude oil and eventual dip in government revenue.

Stagflation is an economic downturn characterized by stagnant economic growth in the face of rising inflation and unemployment. This process of economic recession is characterized by low aggregate demand occasioned by low level of disposable income, falling gross domestic product (GDP), business failure and massive loss of jobs. When a country experiences negative growth in manufacturing sector (Mohammad, 2012). According to Chang (2019), the economy started manifesting symptoms of recession with a negative GDP growth rate of -0.36 per cent in the first quarter of 2016, and eventually slumped into recession as a consequence of another negative -2.06 per cent in GDP. The revenue collection mechanism in Nigeria seems weak; lacking in transparency and accountability. This necessitated the researcher to carry out the study to determine the effect of company tax rate regime on company financing decision with a view to resolving the disparity created by other scholars in their related researches.

3. Objectives of the Study

The main objective of the study was to carry out an assessment of the company income tax rate regimes and financing decisions of quoted agricultural companies in Nigeria. The specific objectives were as follows:

i. To ascertain the extent to which company income tax rate regimes influence equity financing decision of the Nigerian quoted agricultural companies.

ii. To determine the extent to which company income tax rate regimes influence debt financing decision of the Nigerian quoted agricultural companies.

iii. To investigate the extent to which company income tax rate regimes influence retained earnings financing decision of the Nigerian quoted agricultural companies.

4. Theoretical Framework

The Pecking Order Theory

This theory was propounded by Myers and Majluf (1984) and it maintains that financing adapts to mitigate problems created by differences in information between insiders (managers) and outside investors. The firm turns first to the financing sources where differences in information matter least. It begins with a firm with assets-in-place and a growth opportunity requiring additional equity financing. The pecking order theory explains why the bulk of external financing comes from debt. It also explains why more profitable firms borrow less: Not because their target debt ratio is low — in the pecking order, they don't have a target — but because profitable firms have more internal financing available. Less profitable firms require more external financing, and consequently accumulate more debts.

Myers and Majluf (1984) assume perfect financial markets, except for asymmetric information. Investors do not know the true value of either the existing assets or the new opportunity, so they cannot exactly value the shares issued to finance the new investment. Announcement of the stock issue could be good news for investors if it reveals a growth opportunity with positive net present value and could also be bad news if managers are trying to issue overvalued shares. Some firms will have undervalued shares, however. Issuing shares at very low prices transfer value from existing shareholders to new investors. If managers act in the interest of existing shareholders, they will refuse to issue undervalued shares unless the transfer of value is more than offset by the growth opportunity's net present value.

Myers and Majluf (1984) derived an equilibrium position in which firms can issue shares, but only at a marked-down price. Share price falls not because investors' demand for equity securities is inelastic, but because of information inferred from the decision to issue. It turns out that the bad news (about the value of assets in place) always outweighs the good news (about the positive-NPV investment). However, the companies that decide to issue are, on average, worth less than the companies that hold back. Investors downgrade the prices of issuing firms accordingly. Shyam-Sunder (2021) confirms this prediction. Issuing debt minimizes the managers' information advantage.

5. Taxation

One of the simplest definitions of tax is the one offered by Obeten (2014), tax is a charge imposed by governmental authority upon property, individuals or transactions to raise money for public purposes. The Black's law Dictionary defines it as "Monetary charge imposed by the government on person's entities or property, levied to yield public revenue". Tucker and Zarowin (2016) in their text on taxation define tax as a 'compulsory exaction of money by a public authority for public purposes' and taxation as 'a system of raising money for the purposes of government by means of contributions from individual person or company body.' Ola also similarly defined taxation as the demand made by the government of a country for a compulsory payment of money by the citizens of the country. Taxes are used in modern times to generate revenue, in addition, they are applied to fund governance, generate employment, ensure resource redistribution, streamline consumption of certain goods, reduce inflation and stimulate growth in the economy (Gabrielson, 2012).

A tax may be direct or indirect. It is direct where it is levied on the person who is intended to pay it. Companies Income Tax and Personal Income Tax are examples of direct taxes. A tax is indirect if the levy is imposed on the person who pays with the expectation to pass the burden to third parties (Peterson & Rgen, 2014). Indirect taxes are borne by someone other than the person responsible for paying them. For example, excise tax, import duties and value added tax are often included in the prices of the items purchased, thus ultimately, the seller sends the payments to the government while the buyer remains the real payer. Taxes build capacity, legitimacy and consent. Thus, the imposition of tax is statutory to enable government meet its obligations.

The Constitution of the Federal Republic of Nigeria 1999 (as amended) under Section 24(f) stipulates that, "it shall be the duty of every citizen to declare his income honestly to appropriate and lawful agencies and pay his tax promptly". Companies also fall within the categories of persons that are taxable in Nigeria. Companies are taxed under the companies income tax introduced in 1961 with modification in 2007. The administration of the companies' income tax in Nigeria is vested on the Federal Inland Revenue Services. The tax is payable by all companies at the rate defined by the Companies Income Tax Act.

5.1 Companies Income Tax

Nigerian companies are taxed on their worldwide income, foreign companies are liable only as regards the portion of their profits, which is attributable to business operation carried out in Nigeria (Aryeetey, 2014). The current normal tax rate on companies is 30 per cent. In addition to the companies' income tax, all accompanied companies are required to pay 2 per cent of their assessable profit as tertiary education tax into an education tax fund.

5.2 Company Income Tax Rate Regime in Nigeria

The Nigerian tax regime policies can be divided into two (2) phases, namely, the pre- 1992 era and the post 1992 to date period. The pre-1992 era which represented the first phase was basically characterized with high tax rate

which was a burden to taxpayers and a disincentive to tax payers. This era negatively impacted on both savings and investment (Ola, 2019). As a result of this negative impact, it became very necessary for there to be tax reforms in the Nigerian tax system. Consequently, as a result of the aforementioned, tax reforms were introduced in November 1992 to cushion the effect of the distortion and burden on the tax payer. These reforms saw to the scrapping of some taxes like the capital transfer tax and the excess profits tax between 1991 and 1996 respectively. Company income tax rate was reduced from 45 per cent between 1970 and 1986 (Regime 1) to 40 per cent between 1987 and 1991 (Regime 2); the rate was further reduced to 35 per cent between 1992 and 1995 (Regime 3) and finally to 30 per cent which is the current rate still in existence and subsisting i.e., 1996 to date (Regime 4).

6. Empirical Review

Omole and Falokun (1999) investigated the impact of interest rate liberalization on the company financing strategies of quoted companies in Nigeria. These scholars aimed at ascertaining the extent to which interest rate liberalization impact on company financing decisions of companies quoted in the Nigerian stock exchange and the implications this will have for the effectiveness of interest rate policies. Their research was carried out using both descriptive and quantitative research techniques and their research indicated that the effects of liberalization on the financing strategies are significant. It was then concluded that interest rate liberalization had significant impact on company financing decision. It was then recommended that liberalizing the interest rates, though desirable for its influence on increased financial mobilization, would not be enough in itself and that effort is also required in the area of developing the capital market to absorb the likely increased demand for investible funds.

Arachi and Alworth (2000) examined the effect of taxes on company financing decisions: evidence from a panel of Italian firms. The aim of the research is to provide additional evidence on the relationship between company taxes and debt using panel data on Italian companies. The panel covers 1054 companies for the years 1982-1994 and the researchers tested whether taxes encourage the use of debt by analyzing incremental financing decisions and also whether personal taxes affect company financing decisions. Methodology used was to consider differences in the dividend-payout ratio across companies and several reforms in interest, dividend and capital gains taxation provide sufficient cross-section and time-series variations to identify the effect of personal taxes on debt usage. Data were taken from the Central Bank database and the data were restricted to manufacturing companies with sales greater than 10 billion lira that are “operative” in all years for the period 1982-1994. It was concluded that the role of taxes in encouraging the “excessive” indebtedness of firms has been among the principal motivations behind many tax reform proposals in recent years and that widespread consensus that company financial strategies are driven by tax considerations could not be supported by convincing empirical evidence.

Auerbach (2001) carried out a research on taxation and company financial policy in Nigeria. The research was aimed at reviewing the theory and evidence regarding the impact of taxation on company financial policy starting from a basic characterization of the classical company income tax and its effects. The analysis focuses on three areas of research: equity policy, debt-equity decisions, and choices regarding ownership structure and organizational form. Ex-post facto research design was adopted and data was analyzed using multiple regression analysis. The result indicated that company taxation significantly influences company financing policies.

Salawu (2007) researched on an empirical analysis of the capital structure of selected quoted companies in Nigeria. The aim was to determine empirically the impact of capital structure on the profitability of selected quoted companies in Nigeria using panel data pertaining to 50 non-financial firms. Static tests were conducted and panel data specifications were used. The results indicated that leverage was negatively correlated with profitability of the firms and tangibility was positively correlated with total debts and long term debts but negatively correlated with short term debts. It was therefore concluded that debt financing for listed companies in Nigeria corresponds only to short term debts nature with a mean value of 60 per cent. The researcher therefore recommended that Nigeria firms should therefore adopt appropriate steps to lengthen the maturity structure of company debt and government should endeavor to develop capital market to be able to absorb the increase in demand for funds.

7. Research Design

The study employed an ex-post facto research design in carrying out the study. This research was conducted in Ellah lakes Plc, FTN Cocoa processing Plc, Livestock feeds Plc, Omatek ventures Plc and Presco Plc, which are quoted organizations operating in Nigeria. Data for this study were gathered from secondary sources of data. The research data were obtained from various secondary sources which include Central Bank of Nigeria Statistical Bulletin, Central Bank of Nigeria Annual reports, Federal Inland Revenue Service (FIRS) revenue statistics as well as other researchers’ journals and publications. The study employed three multi-regression models for the purpose of the study.

The relationship between equity financing decision (EFD) and the company income tax for the three tax regimes (CIT1, CIT2 and CIT3) is expressed by the following equation:

EFD = f (CIT1, CIT2, CIT3)

The statistical model for model 1:

$EFD = \beta_0 + \beta_1 CIT1 + \beta_2 CIT2 + \beta_3 CIT3 + \varepsilon$

Where:

EFD = Equity financing decision

CIT1 = CIT for first tax regime

CIT2 = CIT for second tax regime

CIT3 = CIT for third tax regime

β_0=regression intercept; β_i=parameters to be estimated; and ε = the error term incorporating other factors that are not considered in the model. Multiple regression statistical tool was employed in the study. The study adopted panel data analysis to compare the relationship between the regimes.

8. Data Analysis

Table 1. (The panel fixed effect model result)

Dependent Variable: LEFD

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LCIT1	0.125294	0.123383	1.015494	0.3186
LCIT2	-0.038518	0.154949	-0.248588	0.8055
LCIT3	1.824240	0.155559	11.72697	0.0000
C	-10.48220	3.093743	-3.388193	0.0021
	Effects Specification			
			S.D.	Rho
Cross-section random			2.592843	0.9665
Idiosyncratic random			0.482879	0.0335
	Weighted Statistics			
R-squared	0.825103	Mean dependent var		1.537990
Adjusted R-squared	0.806364	S.D. dependent var		1.246091
S.E. of regression	0.543170	Sum squared resid		8.260940
F-statistic	44.03134	Durbin-Watson stat		1.113290
Prob(F-statistic)	0.000000			
	Unweighted Statistics			
R-squared	0.185153	Mean dependent var		13.35855
Sum squared resid	270.0889	Durbin-Watson stat		0.034051
Sourcez				

Source: Eviews.

The panel fixed effect model result.

The fixed effect model result in Table 1 is the regression of various expression of the company income on company financing in Nigeria. (-10.48) decrease when all other variables (CIT1, CIT2, CIT3) are held constant further analysis of the fixed effect model revealed that, the estimate coefficients which are CIT1 (0.125) shows that a percentage change in CIT1 will cause a corresponding per cent increase on company financing in Nigeria, and was found to be positive and insignificant. The implication was that, a percentage increase in CIT2 will lead to a corresponding decrease of about – 0.038 on company financing.

The relationship between CIT3 and company financing in Nigeria was positive and significant, the implication was that, a percentage increase in CIT3 will lead to a corresponding per cent increase of about 1.82 on company

financing. The R^2 (R-Squared) which measures the overall goodness of fit of the entire regression shows the value as 82.51 = 83 per cent approximately. This indicates that the independent variables (CIT1, CIT2, CIT3) accounts for about 83 per cent of the variation in the dependent variable (EFD). Hence, the study does have a goodness of fit. From the result, f-calculated (44.03) is greater than the f- tabulated (18.1), that is fcal > F-critical. Hence, we reject the null hypothesis (Ho) that the overall estimate has a good fit and a joint significance which implies that our independent variables are simultaneously significant. The test for the existence of autocorrelation was performed using Durbin-Watson statistic. The test result indicates the absence of positive autocorrelation in the model since the calculated DW is 1.11. This is judged as a good fit, as such, it will be safe to conclude the result as devoid from autocorrelation.

The Hausman Test

Having estimated both the panel fixed effect and the Cross-sectional random effect, it is then expected that one of the results would best approximately address the study, theoretically, this cannot be done using the rule-of-the-thumb or head — guess, thus, the study adopted the Hausman test as a basis for adopting the analysis that best address the study. The Hausman test is used to check whether the fixed effect or random effect is most suitable and appropriate. The Hausman test hypothesis holds that:

Ho: random effect model is appropriate.

Hi: fixed effect model is appropriate.

Decision rule: if there exist a statistically significant P-values, then the statistically significant P-values, then the fixed effect model should be used. Otherwise, the random effect model should be used, conclusively, if the P-value is less than equals to 0.05, the null hypothesis should be rejected. Given that the P-value of the Hausman test in Table 2 is 0.0257, the study accepted the alternative hypothesis (fixed effect is most appropriate) and rejected the null hypothesis that, random effect model is most appropriate. As such, the fixed effect model is considered appropriate and adopted for the study.

Table 2. (Hausman test)

Correlated Random Effects - Hausman Test

Equation: Untitled

Test cross-section random effects

Test Summary		Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random		9.291102	3	0.0257
Cross-section random effects test comparisons:				
Variable	Fixed	Random	Var(Diff.)	Prob.
LCIT1	0.270610	0.125294	0.002638	0.0047
LCIT2	0.019172	-0.038518	0.002310	0.2300
LCIT3	2.021989	1.824240	0.005504	0.0077
Dependent Variable: LEFD				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-14.84856	3.402723	-4.363728	0.0005
LCIT1	0.270610	0.133644	2.024852	0.0599
LCIT2	0.019172	0.162230	0.118178	0.9074
LCIT3	2.021989	0.172344	11.73229	0.0000
	Effects Specification			
Cross-section fixed (dummy variables)				
R-squared	0.988744	Mean dependent var		13.35855
Adjusted R-squared	0.978192	S.D. dependent var		3.269900
S.E. of regression	0.482879	Akaike info criterion		1.688751
Sum squared resid	3.730754	Schwarz criterion		2.421619
Log likelihood	-11.02002	Hannan-Quinn criter.		1.931676

F-statistic	93.70155	Durbin-Watson stat	2.253919
Prob(F-statistic)	0.000000		

Source: Eviews.

The primary aim of this study was to examine effect of company income tax on company financing in Nigeria. The study employed the panel ordinary least squares empirical test and with the following findings. The result of the panel fixed effect on Company income tax of model one revealed that, the value of the intercept (-10.48) revealed that the performance of agricultural companies in Nigeria will experience -10.48 per cent decrease as a result on interaction between CIT1, CIT2, and CIT3, all things being equal (ceteris paribus). The R^2 (R – squared) which measures the overall goodness of fit of the entire regression, shows its value as 82.51, implying that the independent variables (CIT1, CIT2, CIT3) account for 83 per cent of the variables in the dependent variable (EFD), hence, the study have a goodness of fit. Further analysis of the panel fixed effect positive effect of CIT1 on performance of companies, this finding is in line with the work of Ola (2019), who posit that company income affects company decision. The OLS regression analysis revealed that company income tax components has a negative effect on performance of companies, and was found to be significant. The major findings of this study showed that in model one.

1) CIT1 has a positive and insignificant effect on company financing decisions,

2) CIT2 has a negative and insignificant effect on company financing decisions,

3) CIT3 has a positive and significant effect on company financing decisions.

4) In model two, the result revealed that CIT1 has a positive and insignificant effect on company financing decisions.

9. Conclusion

This study was carried out to investigate empirically the effect of company income tax on company financing decisions in Nigeria. Specifically, this study sought to examine empirically the extent to which company income tax in different regimes impacted company financing decisions. Theoretically, a well-structured tax system offers government opportunity to generate needed revenue to meet its ever growing need and serve as a veritable and sustainable tool for fiscal policy and macro-economic management. Tax as a macro-economic policy tool determines the level of economic growth among nations of the world. The study concluded that tax has a positive and significant effect on company financing decisions. This could be true as taxes are not easily evaded as it is collected at source on the consumption of goods and services and salaries payment respectively. Majorly, the findings from this study can be traced to an intentional negligence from the tax officials and corrupt practices in tax administration which is prevalent in the economy.

10. Recommendations

Arising from the results obtained, the study makes the following recommendations.

1) Government should make it possible for companies to evade tax and penalize any registered company that evades tax.

2) Moreover, the study recommended that the government should increase the tax rate but not without sensitizing the public.

3) Government should harness the potentials of taxation and promote tax system in order to increase the prosperity of the Nigerian economy.

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