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EFFECT OF CORPORATE TAX AVOIDANCE ON FINANCING CASHFLOW OF MANUFACTURING FIRMS IN NIGERIA

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Abstract
The main objective of the study is to ascertain the effect of corporate tax avoidance on financing cash flow performance of quoted manufacturing firms in Nigerian. The research design adopted for the study was Ex-Post Facto research design. The study was limited to sixty-two (62) company's selected using purposive sampling technique; the decision was premised on the classification of the firms as manufacturing (based on the nature and description of activities). The multiple regressions were used to validate the hypotheses. The analysis was done via E-Views statistical software. The study revealed that book tax difference and effective tax rate have a statistically significant effect on financing cash flows of quoted manufacturing firm. Based on the result, the study recommended among other things that Managers can strengthen the rating of a firm among her investors and attract further investors by utilising tax savings for financing policies, such as dividend payments.

Keywords: Corporate tax avoidance, Book tax difference, Effective tax rate and Financing cash flow performance

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Introduction

Companies employ several tax avoidance strategies, for instance paying money into pension schemes, buying second-hand goods (Mayer, 2010); shifting income to tax havens (Dyreng & Lindsey, 2009); or engaging in other tax shelters (Lisowsky, 2010; Wilson, 2009). Generally, it entails taking advantage of the flexibilities and loopholes in the tax laws to reduce tax liability (Chen, Cheok, & Raziah, 2016). Corporate tax avoidance has several implications for businesses, the society and the government. To the government it suffocates 'the state's ability to provide essential services' (Bird & Davis-Nozemack, 2018); to businesses a higher after tax cash position (Chen, Cheok, & Raziah, 2016); while, to the society, it obstructs the financing of projects which are essential for the society and a neglect of CSR (Slemrod, 2004).

However, the negative consequences of corporate tax avoidance includes a damage to corporate reputation (Fisher, 2014), future profitability (Katz, Khan, & Schmidt, 2013), firm value (Chang, Hsiao, & Tsai, 2013), stock prices (Hanlon & Slemrod, 2009) and the cost of capital (Cook, Moser, & Omer, 2017). Similarly, studies have also shown evidence that corporate tax avoidance reduces the transparency of a firm's information environment (Hope, Ma, & Thomas, 2013).

Studies have been conducted both globally and locally on corporate tax avoidance behaviour. However, the vast majority of studies are limited due to their focus on income statement or the statement of financial position (Rui, 2019). Cash flow analysis is very effective in examining a firm's competitiveness in the market because it is a more dynamic examination of actual return on assets and equity (Amuzu, 2010). Thus, increasingly researchers are paying greater attention cash flow information (Aktaş & Karğın, 2012). Previous studies focus on relationship between cash flows firm valuation, stock price changes, earnings, and prediction of future cash flows (Aktaş & Karğın, 2012), and financial distress (Sayari & Mugan, 2013). The current study therefore is set out to tackle the following issues, which are four folds. Studies have shown evidence of the predictive ability of cash flow information when compared to earnings (Aktaş & Karğın, 2012; Arthur & Chuang, 2006; Barth, Cram, & Nelson, 2001). Researches also support disaggregating cash flow into its components to enhance predictive ability (Cheng & Hollie, 2005a, b; Krishnan & Largay, 2000).

The main objective of the study is to ascertain the effect of corporate tax avoidance on financing cashflow performance of quoted manufacturing firms in Nigerian. The specific objectives of the study are as follows:

1. To ascertain the effect of effective tax rate on financing cash flows of quoted manufacturing firms.
2. To examine the effect of book tax difference on financing cash flows of quoted manufacturing firms.

Literature Review

Corporate Tax Avoidance

Tax avoidance is distinct from tax evasion, which is the wilful and illegal circumvention or violation of tax laws in order to minimize tax liability (Bird & Davis-Nozemack, 2018). Tax avoidance is also different from tax mitigation, which arises from actions taken to reduce tax liability that are clearly and expressly stated or encouraged by legal rules (Prebble & Prebble,

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2010). Hanlon and Heitzman (2010) described tax avoidance strategies on a continuum, "where something like municipal bond investments are at one end (lower explicit tax, perfectly legal), then terms such as "noncompliance", "evasion", "aggressiveness", and "sheltering" are closer to the other end of the continuum.

Tax planning activity or strategy may appear anywhere along the continuum depending upon how aggressive the activity is in reducing taxes". Since the boundary between legal and illegal acts is not clear, the legality of a firm's tax position is determined by the authoritative bodies after the fact. Thus, there is no clear *ex ante* distinction between legal tax avoidance and illegal tax evasion (Lee, Dobiyanski, & Minton, 2015). Darussalam, Hutagaol, and Septiriadi (2007) define aggressive tax avoidance as an 'unacceptable method of reducing income taxes from the point of view of tax authority, although it is legal to conduct it'. Minnick and Noga (2010) used the term "tax management", which they define as "the ability to pay a low amount of taxes over a long period of time". Ftouhi, Ayed, and Zemzem (2015) considered tax planning as steps taken by taxpayers to reduce tax liability in order to obtain tax saving benefits.

> Scholes, Wolfson, Erickson, Hanlon, Maydew, and Shevlin (2014, p. 133) state:
>
> "Aggressive tax planning and tax shelters are structured so as to obfuscate the underlying transaction … Such complex transaction structuring could also obfuscate management's actions and obscure underlying firm performance in the financial statements, thus facilitating opportunism or even rent extraction by management".

A higher level of tax avoidance could exacerbate information risk by reducing the quality of information (Desai & Dharmapala 2006); because managers engaging in tax avoidance are hesitant to provide detailed disclosures on their avoidance activities for fear of providing a roadmap to the tax authorities (Hasan, Hoi, Wu, & Zhang, 2014).

Broadly, the measures of tax avoidance may be subdivided into three groups used in prior literature (Annuar, Salihu, & Obid, 2014). The first group includes measures that consider the multitude of the gap between book and taxable income. These comprise of total book-tax gap; residual book-tax gap and tax-effect book-tax gap. The second group includes ratios that measure the amount of taxes to business income. These comprise effective tax rates (with variants such as; Effective Tax Rate (ETR); current ETR; cash ETR; long-run cash ETR; ETR differential; ratio of income tax expense to operating cash flow; and ratio of cash taxes paid to operating cash flow). The third group includes measures such as discretionary permanent differences (PERMIDIFF)/DTAX; unrecognized tax benefits (UTB); and tax shelter estimates.

The statement of cash flows is crucial in assessing the ability of an entity to generate cash and cash equivalents and enables users to develop models to assess and compare the present value of the future cash flows of different entities. The information lays emphasis on the difference between operating profit and the apparent increase or decrease in bank/cash balance over the accounting period (Amuzu, 2010). As such, it enhances the comparability of the reporting of operating performance by different entities because it eliminates the effects of using different accounting treatments for the same transactions and events. A positive cash flow indicates that a company's liquid assets are enabling it to settle debt, pay dividends to shareholders, pay for expenses and provide a buffer against future financial distress. A negative cash flow

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indicates that a company's liquid assets are decreasing over time (Ogbonnaya, Ekwe, & Uzoma, 2016).

CTA and Financing Cash Flow

Studies have shown that firms with a financial deficit engage more often in tax avoidance to generate cash (Kweon, Kang, & Kim, 2009). Using a large sample of U.S. firms covering the 1993-2010 periods, Goh, Lee, Lim, and Shevlin (2016) document no relation between tax-sheltering activities and a firm's cost of equity. Similarly, the longitudinal study by Kroes and Manikas (2014) in the USA, evaluated the association between cash flow and financial performance on a sample of 1,233 manufacturing firms from 2008 to 2011. They employed Generalized Estimating Equations methodology and the results revealed that a significant association between cash flows from financing activities and the financial performance.

Previous studies

Stom and Wepukhulu (2019) conducted a study titled 'Effect of cash flow management on financial performance of listed companies at Nairobi Securities Exchange; Kenya'. The study adopts the casual and correlational research designs. The sample comprised of 54 firms listed at the Nairobi Securities Exchange. The study relied on secondary data obtained from the financial statements of the companies from 2013 to 2017. The data were analyzed using multiple linear regression technique. The results showed a positive significant relationship between cash flow from financing activities and financial performance. Erhirhie, Oraka and Ezejiofor (2018) examined the effect of corporate tax on financing decisions of manufacturing firms, using selected manufacturing firms listed on the Nigerian Stock Exchange (NSE). Ex post facto research design was employed and data were extracted from the annual reports and accounts of three selected manufacturing firms and data were analyzed using the linear regression model. The results of our findings showed that there is no significant relationship between corporate tax and dividend paid by Nigerian Breweries Plc, Dangote Cement Plc and PZ Cussons Plc and issuance of new ordinary shares, retained earnings and long term debt. Alslehat and Al-Nimer (2017) conducted a study titled 'Empirical study of the relationship between cash flow management and financial performance of the Jordanian insurance companies'. The study adopts the descriptive analytic approach. The sample comprised of 23 insurance companies. The study relied on secondary data obtained from annual reports and accounts from 2009 to 2013. The data were analysed using multiple regression technique. The results showed that net cash flows from financing activities had a non-significant negative effect on ROA. Ogbeide and Akanji (2017) conducted a study on 'Relationship between cash-flow and financial performance of insurance companies: Evidence from a developing economy'. The sample comprised of 27 listed insurance firms. The study used secondary data; specifically time series data for the period 2009-2014 obtained from annual reports and accounts. The researchers employed the panel estimates generalized least squares (EGLS) technique to analyse the data. The results showed a non-significant positive effect of financing cash flow on financial performance proxied as ROTE. Nwaiwu and Oluka (2017) conducted a study titled 'IFRS: Cashflow accounting and financial performance of quoted companies in Nigeria'. The sample comprised of 24 non-financial firms listed on the Nigerian Stock Exchange (NSE). The study relied on secondary data; obtained from annual reports and accounts from 2004 to 2008. The data were analysed using multiple linear regression. The results showed a negative significant effect of financing cash flow on operating profit and profit before tax. Oraka, Ogbodo and Ezejiofor (2017) determine the effect of Tertiary Education Tax Fund (TETFUND) on management in Nigerian tertiary education. Specifically, the study sought to determine whether ETF fund allocations to Nigerian Tertiary Institutions significantly affect the enrollment ratio to Nigerian Tertiary Institutions in Nigeria. The hypothesis was formulated

in line with the objectives of the study. Survey and Time series research design were adopted. Data were obtained from National Bureau of Statistics by use of financial ratios and tested using regression analysis with aid of SPSS statistical package version 20.0. Based on the analysis, the study found that ETF fund allocations to Nigerian Tertiary Institutions have no correlation the enrollment ratio of Nigerian Tertiary Institutions. Amah, Micheal, and Ihendinihu (2016) undertook a study titled 'Relationship of cash flow and financial performance of listed Banks in Nigeria'. The study adopted the ex post facto research design. The sample comprised of four banks listed in the Nigerian Stock Exchange (NSE) for the period of 9 years (2005 - 2013). The study utilised secondary data obtained from annual reports and accounts. The data were analysed using correlation. The results showed that financing cashflow had a weak negative relationship with performance. Duru, Okpe, and Ifunanya (2015) evaluated the 'Effect of cashflow statement on company's performance of food and beverages companies in Nigeria'. The study adopts the ex post facto research design. The sample comprised of 6 food and beverages companies quoted in the Nigerian Stock Exchange. The study relied on secondary data obtained from annual reports and accounts from 2007 to 2011. The data were analyzed using multiple regression technique. The results showed that financing cash flows have a significant positive effect on corporate performance. Ezejiofor, Adigwe and Nwolisa (2015) assess whether tax as a fiscal policy tool affect the performance of the selected manufacturing companies in Nigeria. To achieve the aims of the study, descriptive method was adopted and data were collected through the use of six years financial accounts of the selected companies. The hypothesis formulated for the study was tested with the ANOVA, using the Statistical Package for Social Sciences (SPSS) version 20.0 software package. The study found that Taxation as a fiscal policy instrument has a significant effect on the performance of Nigerian manufacturing companies. The implication of the finding is that the amount of tax to be paid depends on the companies' performances. Bingilar and Oyadenghan (2014) explored 'Cash flow and corporate performance: A study of selected food and beverage companies in Nigeria'. The sample comprised of 6 food and beverage companies quoted in the Nigerian Stock Exchange. The study relied on secondary data obtained from annual report and accounts of the selected companies. The data were analysed using multiple regression technique. The results showed that financing cash flow have a significant positive relationship with corporate performance. Sayari and Mugan (2013) evaluated 'Cash flow statement as an evidence for financial distress'. The sample comprised of 124 companies listed on the Istanbul Stock Exchange (ISE). The study relied on secondary data obtained from annual reports and accounts from 2005 to 2009. The data were analysed using multiple regression technique. The results showed that financing cash flows had a positive relationship with financial distress. Darabi, Adeli, and Torkamani (2012) examined the effect of cash flow shocks on capital and asset structure: Evidence from Tehran Stock Exchange'. The study adopted the descriptive research methodology. The sample comprised of 57 listed companies. The study relied on secondary data obtained from annual reports and accounts of the sample firms for the years 2005 to 2010. The data were analysed using Pearson correlation and simple linear regression. The results showed presence of a relationship among operating cash flows, investment and dividends. However, financial constraints do not affect sensitivity of cash flow.

Methodology

Ex-post facto research design was adopted for the study. The choice of *ex-post facto* research design is based on the fact that the study relies on historical accounting data obtained from annual reports and accounts.

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The study was limited to sixty-two (62) companies selected using purposive sampling technique; the decision was premised on the classification of the firms as manufacturing (based on the nature and description of activities) as shown on the Nigerian Stock Exchange (NSE) website. The sample selection criteria are shown in the table below.

Table 3.1: Sample selection

Sector/criteria	Number of firms
No of firms	164
Less: Construction/Real Estate	9
Less: Financial services	52
Less: Natural resources	4
Less: Oil & Gas	12
Less: Services	25
Total sample size	**62**

Source: The Nigerian Stock Exchange Website (2020)

The exclusion of the sectors was consistent with prior studies; firms from the financial sector are mainly excluded because of different regulatory environment (Tsipouridou & Spathis, 2012). In addition, during the data analysis any company whose required data are incomplete or unavailable will be eliminated from the sample. The final sample percentage with respect to the population is approximately 38% of the entire quoted companies on the Nigerian Stock Exchange.

Data collection is a crucial stage of dissertation that entails gathering all the necessary and required information from essential sources to be used for the analysis (Kumar, 2011, p. 24). The data for this study obtained from secondary sources.

Methods of Data Analysis

The multiple regression was used to validate the hypotheses. The analysis was done via E-Views statistical software. In view of the dependent, independent and control variables of the study, the following model was used to examine the relationship between corporate tax avoidance and cashflow performance of quoted manufacturing firms:

$$FCF = f(etr, fsize, flev, sgrow, roa, fira) \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots i$$

$$FCF = f(btd, fsize, flev, sgrow, roa, fira) \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots ii$$

Equations 1-2 can be written econometrically as presented in equations 7-12 as follows:

$$FCF_{it} = \eta_0 + \eta_1 etr_{it} + \eta_2 fsize_{it} + \eta_3 flev_{it} + \eta_4 sgrow_{it} + \eta_5 roa_{it} + \eta_6 fira_{it} + \sum_t \ldots\ldots \quad iii$$

$$FCF_{it} = \eta_0 + \eta_1 btd_{it} + \eta_2 fsize_{it} + \eta_3 flev_{it} + \eta_4 sgrow_{it} + \eta_5 roa_{it} + \eta_6 fira_{it} + \sum_t \ldots\ldots \quad iv$$

Where:

FCF	=	Financing cash flow
etr	=	Effective tax rate
btd	=	Book tax differences
fsize	=	Firm size
flev	=	Firm leverage
sgrow	=	Sales growth
roa	=	Return on assets
fira	=	Firm Age

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t	=	Time dimension of the variables
η_0	=	Constant or Intercept.
η_{1-2}	=	Coefficients to be estimated or the Coefficients of slope parameters.

The expected signs of the coefficients (a priori expectations) are such that η_2 η_4 and $\eta_5 > 0$; while, η_1 and $\eta_5 < 0$

Data Analysis and Interpretation

Hypothesis One

H_{01}: There is no statistically significant effect of effective tax rate on financing cash flows of quoted manufacturing firms.

Table 1: Random-effects GLS regression output for hypothesis one

```
Random-effects GLS regression                   Number of obs     =       733
Group variable: Panel_ID                        Number of groups  =        75

R-sq:                                           Obs per group:
     within  = 0.1366                                         min =         7
     between = 0.3502                                         avg =       9.8
     overall = 0.1793                                         max =        10

                                                Wald chi2(6)      =    141.00
corr(u_i, X)   = 0 (assumed)                    Prob > chi2       =    0.0000
```

CFFA	Coef.	Std. Err.	z	P>|z|	[95% Conf.	Interval]
EFFT	-.0000677	.0000209	-3.24	0.001	-.0001087	-.0000267
FSIZ	.007687	.007311	1.05	0.293	-.0066423	.0220162
DETA	-.0007854	.0001796	-4.37	0.000	-.0011373	-.0004334
REVG	.0001759	.000066	2.67	0.008	.0000466	.0003053
RETA	-.0034849	.0003187	-10.93	0.000	-.0041095	-.0028602
FIRA	-.0010762	.000441	-2.44	0.015	-.0019407	-.0002118
_cons	-.0077365	.0526461	-0.15	0.883	-.1109209	.0954479
sigma_u	.03270625					
sigma_e	.11820921					
rho	.07110887	(fraction of variance due to u_i)				

Source: Stata ver. 15

Interpretation

The regression model shown above with one IV and five CVs, as follows: log of total asset, debt to asset ratio, revenue growth, return on asset, and firm listing age. In model validation, the following are considered: Wald chi2 (6) which is equivalent to the F-statistics in Fixed and Pooled OLS, and the overall R^2 are used. The overall R-squared is 0.1793 and the between R-squared 0.3502. The *p*-value of the Wald chi2 statistic is less than .05 (i.e., margin of error), which confirms the statistical significance of the model.

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Decision rule

The *coefficient* of the variable of interest: EFFT was (-0.0000677) and *z-statistic* (-3.24) is negative and statistically significant (*p*-value <.05). Therefore, the alternate hypothesis is accepted and null rejected; there 'is a statistically significant effect of effective tax rate on financing cashflows of quoted manufacturing firms'.

Hypothesis Two

H_{02}: Book tax difference has no statistically significant effect on financing cash flows of quoted manufacturing firms.

Table 2: Random-effects GLS regression output for hypothesis two

```
Random-effects GLS regression                   Number of obs     =       733
Group variable: Panel_ID                        Number of groups  =        75

R-sq:                                           Obs per group:
     within  = 0.1666                                         min =         7
     between = 0.3597                                         avg =       9.8
     overall = 0.2045                                         max =        10

                                                Wald chi2(6)      =    170.40
corr(u_i, X)   = 0 (assumed)                    Prob > chi2       =    0.0000
```

CFFA	Coef.	Std. Err.	z	P>|z|	[95% Conf.	Interval]
DTAX	-.0081123	.0013619	-5.96	0.000	-.0107817	-.0054429
FSIZ	.0111212	.0072114	1.54	0.123	-.0030128	.0252552
DETA	-.0003791	.0001889	-2.01	0.045	-.0007493	-8.81e-06
REVG	.0001668	.0000649	2.57	0.010	.0000395	.000294
RETA	-.0039773	.0003246	-12.25	0.000	-.0046135	-.003341
FIRA	-.0009937	.0004339	-2.29	0.022	-.0018442	-.0001431
_cons	-.0310572	.0519107	-0.60	0.550	-.1328004	.0706859
sigma_u	.0321566					
sigma_e	.11609437					
rho	.07125486	(fraction of variance due to u_i)				

Source: Stata ver. 15

Interpretation:

The regression model shown above with one IV and five CVs, as follows: log of total asset, debt to asset ratio, revenue growth, return on asset, and firm listing age. In model validation, the following are considered: Wald chi2 (6) which is equivalent to the F-statistics in Fixed and Pooled OLS, and the overall R^2 are used. The overall R-squared is 0.2045 and the between R-squared 0.3597. The *p*-value of the Wald chi2 statistic is less than .05 (i.e., margin of error), which confirms the statistical significance of the model.

Decision rule:

The *coefficient* of the variable of interest: DTAX was (-.0081123) and *z-statistic* (-5.96) is negative and statistically significant (*p*-value <.05). Therefore, the alternate hypothesis is

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accepted and null rejected; thus, 'book tax difference has a statistically significant effect on financing cash flows of quoted manufacturing firms'.

Discussion of Result and Recommendations

The hypothesis one showed a significant negative effect of effective tax rate on financing cash flows of quoted manufacturing firms. The control variables showed that firm size had a non-significant positive effect, debt to total assets had a significant negative effect, revenue growth had a positive significant effect, return on total assets had a negative significant effect and firm age had a significant negative effect. However, the study by Alslehat and Al-Nimer (2017) in Jordan, using a sample of insurance companies found that financing activities net cash flows had a non-significant negative effect on ROA. Nwaiwu and Oluka (2017) using a sample of non-financial firms found a significant negative effect of financing cash flow on operating profit and profit before tax. Amah, Micheal, and Ihendinihu (2016) showed a weak negative relationship between financing cashflow and performance on a sample of banks in Nigeria.

Contrary to this, the study by Stom and Wepukhulu (2019) in Kenya found a positive significant relationship between financing cash flow from and financial performance. Studies by Duru, Okpe, and Ifunanya (2015) and Bingilar and Oyadenghan (2014) utilising a sample of firms from the food and beverage sector found that a significant positive effect of financing cash flows on corporate performance.

The hypothesis two showed a significant negative effect of book tax difference on financing cash flows of quoted manufacturing firms. The control variables showed that firm size had a positive non-significant effect, debt to total assets, return on total assets, and firm age had significant negative effects, firm revenue growth had a significant positive effect. This is somewhat consistent with the study by Alslehat and Al-Nimer (2017) using a sample of Jordanian insurance companies found that financing net cash flows had a non-significant negative effect on ROA. In Nigeria, studies by Nwaiwu and Oluka (2017) and Amah, Micheal, and Ihendinihu (2016) found a negative significant effect of financing cash flow on operating profit and profit before tax.

This is contrary to the study by Stom and Wepukhulu (2019) in Kenya which adopted the casual and correlational research designs showed a positive significant relationship between financing cash flow and financial performance. However, Ogbeide and Akanji (2017) using a sample of insurance companies showed a non-significant positive effect of financing cash flow on financial performance proxied as ROTE. And studies by Duru, Okpe, and Ifunanya (2015) and Bingilar and Oyadenghan (2014) using a sample of food and beverages companies firms reported a significant positive effect of financing cash flows on corporate performance. The control variable, debt to total assets had a significant positive effect on financing cash flows. This is inconsistent with the study by Darabi, Adeli, and Torkamani (2012) in Iran that documented evidence to support that financial constraints do not affect sensitivity of cash flow.

The study makes the following recommendations for policy, business managers, and shareholders:

1. Managers can strengthen the rating of a firm among her investors and attract further investors by utilising tax savings for financing policies, such as dividend payments.

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2. Policy makers, accounting standards developers and industry regulators can utilise the study findings to develop an insight on industry effect of corporate tax avoidance for ease of bankruptcy prediction.

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