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Tax Incentives for Industry Synergy in Nigeria: A Pragmatic Proprietary System Advocacy

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Abstract
Tax incentives are quintessential fiscal provisions designed by core industry-driven governmental authorities to attract and empower investors in strategic sectors of the economy. In Nigeria, several booster reliefs are obtainable, but many industrialists show soft spot for investment tax credit (ITC) and re-investment allowance (RIA). This study, thus, examined the potency of these specifications in redefining corporate financial performance, particularly in terms of return on equity (ROE). Using financial (secondary) data obtained from a net sample of 58 firms quoted on the Nigerian Stock Exchange (NSE); the correlation, regression and Z-test analytical results were vividly in the affirmative. Leveraging on the outcomes, therefore, a Tax Incentive – Corporate Profitability Impact Model (TICPIM) is conceptualized and presented herein, to accord meaningful impetus to a pragmatic proprietary system advocacy (PPSA), which is expedient for the Nigerian economy. It is expected that these tax appeals and ideals would conscientiously grow critical industries in nation to greater productive and competitive heights.

Key Words: Industrial investment, Nigerian economy, Tax incentives

Introduction

Intense advocacy for better tax incentives in many countries is a clear indication of growing concern for economic growth and sustainable development. These tax incentives generally include tax holiday, capital allowance, tax-payers' right of election, re-investment allowance, investment tax credit, accelerated depreciation, interest subsidy, and export processing zone (EPZ) incentives. They are expected to attract more investments, which would ultimately translate to higher future production in the economy. Much as the impact of tax incentives on productivity, employment, and economic growth has been examined extensively; evaluation of the impact of tax incentives on corporate financial performance is still relatively limited in literature.

Empirical submissions credited to Harris and Skuras (2004), Ola (1991), Bondolino and Greenbaum (2007), Lent (2004), and Klemm (2004) mainly relate to impact of investment subsidies and application of tax incentives on productivity and employment. Their criterion variables were mainly non-financial measures, except the work of Kaldor and Hume (2004) which considered the application of tax incentives on investment in industrial innovations. Besides widely canvassed use of policy instruments such as reduction in cost of raw materials, and interest rates to boost industrial growth, research endeavour in this regard had concentrated on the use of investment subsidies (Zee, Stotsky and Ley, 2002). Investment subsidies are expediently justified by the need to check widespread failures of financial markets, which make many firms not to have sufficient access to credit for strategic investments.

Analysts, however, have some reservations, as investment subsidies tend to cause allocation inefficiencies as a result of firms' over-investment in capital goods. Also, selective structure subsidies are often entangled with circumstantial bias and distorted market competition. These notwithstanding, several stakeholders, believe that tax incentives encourage business investment/development and protection of home industries from foreign dominance (Adedotun, 2001; Philips, 2004; Botman, Klemm, and Baquir, 2008). This study considers it quite timely and apt to analytically substantiate the impact of tax incentives on corporate financial performance in Nigeria. The specific research targets are:

i. To determine the extent to which investment tax credit impacts on return on equity of quoted manufacturing companies in Nigeria; and

ii. To ascertain the influence of re-investment allowance on return on equity of quoted manufacturing companies in Nigeria.

The ensuing research questions are:

i. To what extent does investment tax credit impact on return on equity of quoted manufacturing companies in Nigeria? and

ii. To what extent does re-investment allowance influence return on equity of quoted manufacturing companies in Nigeria?

The elicited hypotheses are:

H_{o1}: Investment tax credit does not significantly impact on return on equity of quoted manufacturing companies in Nigeria; and

H_{o2}: Re-investment allowance does not significantly influence return on equity of quoted manufacturing companies in Nigeria.

Taxation and tax incentives in Nigeria

Basically, taxation is designed to support government in the payment for goods and services provided for the overall socio-economic well being of the citizenry, as well as vital amenities in various communities where people live and do business. Conceptually, therefore, tax represents:

i. Compulsory payment made by individual and firms in a society to the government (Kaldor and Hume, 2004);

ii. Policy of collecting fees and revenue from individuals and bodies such as the private and public firms, which is closely linked with budget, the fiscal instrument that embodies political social and economic philosophy of government (Longe, 1997);

iii. Levy imposed by government against income, profit or wealth of individuals, partnerships, and corporate organizations (Due, 1980); and

iv. Transfer of resources from private sector to the public sector in order to accomplish a nation's economic and social goals, which will primarily increase the rate of economic growth and per capita income for higher standard of living (Agyel, 1990).

Taxation in most countries dates back to primitive society, when members of different societies organized themselves to render free services to their communities, such as cleaning of the environment, clearing of bushes, digging of wells, building barns for the storage of farm produce or the village centre and standing guard at night. These services constituted a form of tax required from every member of the society, and it was compulsory that everyone participated. Property of those who failed to participate were seized and only returned to the owners (defaulters) on payment of agreed fine. Income tax was first introduced in Nigeria in 1904, and this was charged on the income of individuals, not on incomes of incorporated and unincorporated bodies. Until the early 1930s, income tax was a fixed (flat) rate of 2% on wages, salaries or other remuneration of all individuals resident within the colony; while persons involved in trade or other business activities were to pay 2% of their profit as tax. This extended to every other profit yielding activity (Ola, 1991).

With the widespread crises of the 1930s, governments of most nations, including Nigeria, became more conscious of the need for taxes to be collected in order to finance defence. This marked the beginning of the broadening of the tax base. Tax was then extended to companies and the first real tax legislation was enacted in 1936. By the 1940s, gray areas of the ordinance were detected, including the fact that it addressed only company tax, leaving individuals out of it. As remedy, the Nigerian Income Tax Ordinance (NITO) was enacted. The two broad divides of the instrument are direct tax and indirect tax. The former is charged directly on income of individuals, groups of individuals, corporate bodies and institutions, while the latter is based on consumption of goods and services. Furthermore, the former is subdivided into personal income tax (PIT), by which individuals are assessed and collected where the individual resides; and company income tax (CIT), which is charged on corporate bodies by the appropriate tax authority.

The vitality and necessity of tax prevail in the reality that it provides income for government. Without such income, government will be powerless to carry out important ventures that cannot be shouldered by individuals on their own; such as provision of roads, infrastructure, and territorial defence. Accordingly, persons and bodies generating more income are expected to pay more tax, and those without income, should also benefit from the utilization of tax revenues through the provision of utilities which are made available to all. Functionally, tax administration describes the process of enforcement of

tax and ensuring that every payer under a particular tax regime pays his due at the right time and place. It is the responsibility of the Revenue Department to plan and manage the process in such a way that it will be operationally enabled to collect taxes efficiently and effectively. The Revenue Department, therefore, dutifully assesses tax liability, collects the taxes due, and keeps track of the target population of eligible tax payers, which varies from time to time.

Granting of tax incentives is also of the essence of sustainable macroeconomic management and administration. These are usually in form of tax holiday, tax credit, accelerated depreciation, or interest subsidy. In whatever form they are granted, they ultimately attract more investment towards higher future production in an economy. Consequently the least discriminatory form of tax incentive is the one that is so designed to increase the rate of return on investment (ROI) by reducing corporate and personal tax rates. In some cases, an incentive programme may be restricted to a few selected firms in the same industry (sector), usually those with highly desirable corporate goals (like generation of more value–added through domestic processing, and employment; as well as boosting exports and technology transfer).

In considering various forms of incentive programmes, it is imperative to highlight the relative merits and demerits of tax incentives. In this regard, equity and efficiency considerations are paramount, as analysts underscore precaution against possible distortion of allocation of capital (Kuewumi, 1996). This submission becomes clearer when it is realized that tax incentives affect capital spending by reducing the firm's capital stock on the one hand, and increasing the rate of adjustment of the existing capital stock to the desired level on the other hand. The growing concern of economy watchers in recent times is about the auspiciousness of tax incentives such as investment tax credit and re-investment allowance in boosting corporate financial performance, measured by return on equity, especially in the manufacturing sector.

Investment tax credit, re-investment allowance and business performance

Investment tax credit (ITC) is usually earned when qualified buildings or equipments are purchased for use in a firm (Shah, 2005). It may be applied against federal income tax and permits companies or individuals to deduct a specified percentage of certain investment costs from their tax liability in

addition to the normal allowances for depreciation. Though, ITC is similar to investment allowance, they differ from accelerated depreciation. They had all been adopted by various governments since the 1960s in order to protect domestic business from foreign competition. They are now better applied towards supporting strategic sectors and promoting sustainable economic development.

According to Zee, Stotsky and Ley (2002), ITC pertains to new manufacturing plant and equipment purchased for first-time use in manufacturing or processing. Consequently, corporations earn 10% non-refundable tax credit which can be applied against CIT in the year earned, with unused credits usually available for a 10-year carry forward and a 3-year carry – back. In manufacturing firms, ITC permits extension of the definition of qualified property to include used building and plant, as well as new equipments. Despite this argument, many countries, including Nigeria, restrict ITC to new equipments and buildings. Gugl and Zodrow (2006) also contend that ITC is only earned in the year that the property was actually acquired, and only applies to new properties. The affected property is eligible to attract a rate of 10% of capital cost of the property (although capital cost of an item must be reduced by any grants received on that purchase). The ITC earned in any particular year is then used to reduce federal income tax due in that year. Bloom, Griffith and Van Reenen (2002) posit that failure to use tax credits within 10 years of earning them will result in the loss of the incentive. Auerbach and Hines (1988) equally submit that 40% of unused ITC generated in a tax year may be claimed in the year that it was actually earned, and this grant is for the purpose of enhancing performance of the firm and boosting overall national economic growth.

Re-investment allowance (RIA) is another industrially reckoned plausible tax incentive. It is usually provided for already existing manufacturing companies that incur capital expenditure. The strategic purposes relate to approved expansion of production capacity, modernization of production facilities and diversification into related products. RIA is often made available to firms which have been in operation for not less than 12 months and had incurred capital expenditure on a factory, plant, or machinery for the purpose of a qualifying project. Fundamentally, it seeks to encourage re-investment of profits. Procedurally derived as a percentage of the expenditure incurred on qualifying projects, RIA deduction is usually restricted to a percentage of statutory income. The quantum of the deduction varies depending on pre-conditions, such as activity engaged, geographical location

where the expenditure is incurred, and achievement of a certain level of production process efficiency (Bird, 2000).

Conventionally, RIA is estimated at 60% of qualifying capital expenditure (QCE) incurred by firms for several years. This may be utilized to offset 70% of the statutory income in the year of the assessments. In the promoted areas, 100% of statutory income may be offset, while in non-promoted areas, 100% of statutory income may be offset if the company attains a productivity level exceeding the government bar. Furthermore, unabsorbed allowance may be carried forward to the following years until it is fully utilized (Olatundun, 2008; Toaze, 2001). In the light of the fore-going professional contributions, the importance of RIA as a dimension of tax incentive hinges on the strategic intent of government to encourage manufacturing firms to expand industrial infrastructure and contribute more to macroeconomic growth and development. It goes a long way to synergistically complement ITC in boosting overall industrial productivity and competitive corporate sustainability. Profit is the bottom-line of managerial efficiency. It remains a major indicator of an organization's going concern capacity. To harness more meaningful profit-based measures of corporate financial performance, profit may be better compared to shareholders' capital contributions, especially in terms of return on equity (ROE). This is a dominant criterion variable in this study, analytically pitched against ITC and RIA as predictor variables. ROE fundamentally measures how shareholders funds have fared in the course of the business year. Characteristically:

i. ROE is a measure of profit on investment in equity (Rouse, 2003);

ii. ROE manifest as return on net worth; where it is used for measuring the return on the owners investment (Helfert, 1991); and

iii. ROE also prevails as ratio of net profit after tax to equity, when weighing the rate of return on the shareholders investment (Pandey, 1980).

Essentially, ROE serves as critical test of corporate profitability, illuminating the quality of income made from investments and efficacy of financing strategies (Libby, Libby and Short, 2001). For firms with more robust structure, the ratio may be mathematically determined thus:

$$\text{ROE} = \frac{\textit{Net profit after tax} - \textit{Preferred dividend}}{\textit{Shareholders equity}}$$

This fairly assesses the earning power on shareholders' book investments, permitting meaningful comparison of two or more firms' financial performance in an industry. The earning of satisfactory return is the most desirable objective of business and ROE reflects the extent to which this objective is accomplished. This is of great interest to substantive/prospective shareholders, and *ipso facto*, of critical concern to management, which has the responsibility of maximizing the owners' welfare (Pandey, 2000; Agundu, 2010). Quoted manufacturing firms in Nigeria are equally ROE–driven and are logically appreciative of fiscal policy frameworks such as ITC, RIA, and allied tax incentives, as they are designed to significantly boost their corporate financial fortunes in the economy.

Methods

After due consideration of the circumstantial relevance and triangulating possibilities of various research designs, including case study, exploratory, experimental and descriptive typologies; the survey approach was deemed most appropriate for adoption in this study. The survey approach involves collection and examination of data set with features that could be reasonably generalized (Cooper and Schindler, 2001). It is facilitated by use of questionnaire, preferably in non-contrived settings, for the social/managerial sciences. The study population comprised all the 100 quoted manufacturing companies in Nigeria, listed in the Nigerian Stock Exchange (NSE) Fact Book (2008), which was the latest at the time of research visit. For objectivity and mathematical precision, the sample size was derived thus:

$$n = \frac{N}{1 + N(e)^2} = \frac{100}{1+100(0.05)^2} = 80$$

Where: n = Sample size,

N = Study population, and

e = Level of significance.

The firms' annual reports contained secondary data for the study, added to tax-related submissions from the Federal Inland Revenue Service (FIRS). The questionnaire format adopted was a blend of structured and unstructured questions, using modified 5-point Likert-scale, such as: 0 = Undecided; 1 = Strongly Disagree; 2 = Disagree; 3 = Agree and 4 = Strongly Agree. In determining the relationship between tax incentives (represented by ITC and RIA) and corporate financial performance (measured by ROE), the statistical

apparatus included correlation and regression analyses as well as Z-test. Regression analysis particularly facilitated the identification of empirical referents of the predictor variables (ITC and RIA) which most statistically explained changes in the criterion variable (ROE). This epitomized the impact of tax incentives on corporate financial performance. The secondary data on ROE covered a period of five years (2004-2008) as contained in the Annual Accounts of the net sample of quoted manufacturing companies, as substantiated in Table 1:

Table 1: Outcome of Questionnaire Administration

Industrial Bracket	Copies Administered	Copies Returned	Copies Rejected	Copies for Analysis
Automobile and Tyre	5	5	0	5
Breweries	10	10	1	9
Building Materials	5	5	0	5
Chemical paints	5	5	0	5
Conglomerates	5	5	1	4
Emerging market	5	5	0	5
Food/Beverages/Tobacco	10	10	1	9
Healthcare	5	5	1	4
Industrial/Domestic Product	5	5	0	5
Petroleum Products Agriculture	5	5	2	3
Agriculture/Agro Allied	5	5	2	3
Total	**80**	**65**	**7**	**58**
%	**100%**	**81.25%**	**8.75%**	**73%**

Source: Research Data (2011)

Furthermore, reliability confirmatory test, aided by Statistical Package for Social Sciences (SPSS), indicated coefficients of 0.85 and 0.73 (Crombach Alpha) for predictor and criterion variables respectively. The acceptable minimum benchmark for social/managerial science research is stipulated as 0.70 (Trochim, 2006; Ahiauzu, 2006).

Results

The results of test of hypotheses, based on the specified analytical methodologies are presented in Tables 2, 3, and 4; and these culminated in determining the extent to which tax incentives impact on corporate financial performance of quoted manufacturing companies in Nigeria.

Table 2: Hypothesis 1 Test Results (ITC and ROE)

Statistics	Value
Intercept (∝)	16.290 (5.034)
Partial regression coefficient	1.021 (36.970)
Coefficient of correlation (r)	.980
Coefficient of determination (r^2)	.961
F. Ratio	1.367

Source: Research Data, 2011 (SPSS–aided Computations)

NB: Z-values are shown in parenthesis.

The analytical results in Table 2 clearly indicate a strong positive relationship between ITC and ROE, as coefficient of correlation (r) is 0.980. This firmly establishes that ITC is significantly associated with ROE. The coefficient of determination ($r^{2)}$ is 0.961, implying that ITC accounts for 96.1% of the variation in ROE. This indeed is a very high explanatory potency, characteristic of ITC in boosting manufacturing industry investments in the Nigerian economy.

Table 3: Hypothesis 2 Test Results (RIA and ROE)

Statistics	Value
Intercept (∝)	11.08 (6.289)
Partial regression coefficient	1.239 (70.003)
Coefficient of correlation (r)	.994
Coefficient of determination (r^2)	.989
T. statistics	4.900

Source: Research Data, 2011 (SPSS–aided Computations)

NB: Z-values are shown in parenthesis.

The analytical results in Table 3 clearly indicate a strong positive relationship between ITC and ROE, as coefficient of correlation (r) is 0.994. This firmly establishes that RIA is significantly associated with ROE. The coefficient of determination ($r^{2)}$ is 0.989, implying that ITC accounts for 98.9% of the variation in ROE. This is also a very high explanatory potency, characteristic of RIA in boosting manufacturing industry investments in the Nigerian economy.

Details of secondary and parametric (mean) build up for the focal quoted manufacturing companies are presented in Table 4:

Table 4: ROE Mean Statistics (with and without Tax Incentives)

S/N	Company	Mean of ROE With Tax Incentives	Mean of ROE Without Tax Incentives
1	Adswitch PLC	0.08	13.47
2	Smart Products Nig. PLC	0.88	20.49
3	Uac of Nig. PLC	1.21	22.08
4	Stokvis Nigeria PLC	2.08	19.76
5	Premier Paints PLC	2.73	13.10
6	Utc Nigeria PLC	3.60	37.56
7	Incar Nig. PLC	4.38	12.82
8	Poly Products Nig. PLC	4.58	15.18
9	First Aluminium Nig. PLC	5.06	22.82
10	Grief Nig. PLC	6.06	15.79
11	Morrison Ind. PLC	6.31	19.28
12	Okitipupa Oil Palm PLC	6.68	8.21
13.	Nigerian Ropes PLC	6.79	22.50
14	Enamelware Nig. PLC	7.34	19.85
15	Aluminium Ext.Ind. PLC	7.41	10.23
16	Thomas Watts Nig. PLC	7.58	11.69
17	African Paints Nig. PLC	7.81	13.87
18	IPWA PLC	8.25	15.79
19	Northern Nig. Flour Mills PLC	8.47	13.55
20	Afprint Nig. PLC	9.07	14.40
22	Dunlop Nig. PLC	9.10	5.14
23	Cutix Nig. PLC	9.55	37.27
24	Berger Paints Nig.PLC	9.82	25.76
25	Neimeth Int'l Pharma PLC	10.07	11.90
26	Grommac Industries PLC	11.07	32.68
27	Phamer-Deko Nig. PLC	11.28	14.78
28	Big Treat PLC	11.42	79.85
29	Boc Gas Nig. PLC	11.80	32.77
30	Avon Nig. PLC	11.93	23.16
31	Vono Product PLC	11.98	19.76
32	International Breweries PLC	12.21	15.08
33	May & Baker Nig.PLC	12.21	20.80
34	Fidson Nig. PLC	12.93	24.09
35	Chemicals & Allied Products PLC	13.42	37.27
36	Vita Foam Nig. PLC	13.79	56.34
37	Nampak Nig. PLC	14.47	18.99
38	Nigerian Bag Man.PLC	14.73	67.92
39	Cement Coy. of Northern Nig. PLC	16.35	29.40
40	Cadbury Nig.PLC	17.36	21.29
41	Beta Glass PLC	17.97	21.95
42	Okomu Oil Palm PLC	18.53	27.69

43	Chevron Oil Nig.PLC	18.92	43.47
44	7-Up Bottling PLC	20.20	40.08
45	Glaxo-Smithkline PLC	20.84	35.82
46	Unilever Nig.PLC	23.29	29.78
47	Mobil Oil Nig. PLC	25.43	54.30
48	Nigeria Bottling PLC	26.94	29.40
49	Benue Cement PLC	26.97	35.37
50	Conoil PLC	27.62	37.38
51	Ashaka Cement PLC	33.44	217.53
52	PZ Cussons Nig. PLC	34.93	37.71
53	Nestle Nig. PLC	54.61	59.21
54	Guinness Nig. PLC	84.45	88.18
55	Lafarge Cement PLC	143.26	148.43
56	Nigeria Breweries PLC	216.16	231.45
57	Tantalizers Nig. PLC	584.41	39.42
58	Portland Paints & Processing Nig. PLC	704.52	68.63

SOURCE: Research Data, 2011 (SPSS – aided; with data input from Annual Reports of the Selected Companies).

Discussion

Two components of tax incentives (ITC and RIA) which were diagnosed in this study showed causally potent relationship with corporate financial performance (indicated by ROE). ITC is earned when qualified buildings or equipments are purchased for use in a firm. It is then applied against income tax so that firms can deduct a specified percentage of investment cost from tax liability in addition to normal allowances for depreciation. The analytical outcomes of this study are, therefore, in concordance with the submissions of many contemporary researchers in the field of financial/taxation accounting. Asiodu (2003), in particular, contends that ITC meaningfully promotes business performance, although the magnitude varies among countries, industries, and firm types. It helps to increase profit prospects of new ventures and enables firms to recover capital costs more quickly. These costs, when recovered eventually lead to reduced investment risks, thus consolidating firms' assets and working capital for strategic re-investments. In the same vein, Auerbach and Hines (1988) affirmed that tax incentives (especially ITC) critically redefine the financial performance of firms.

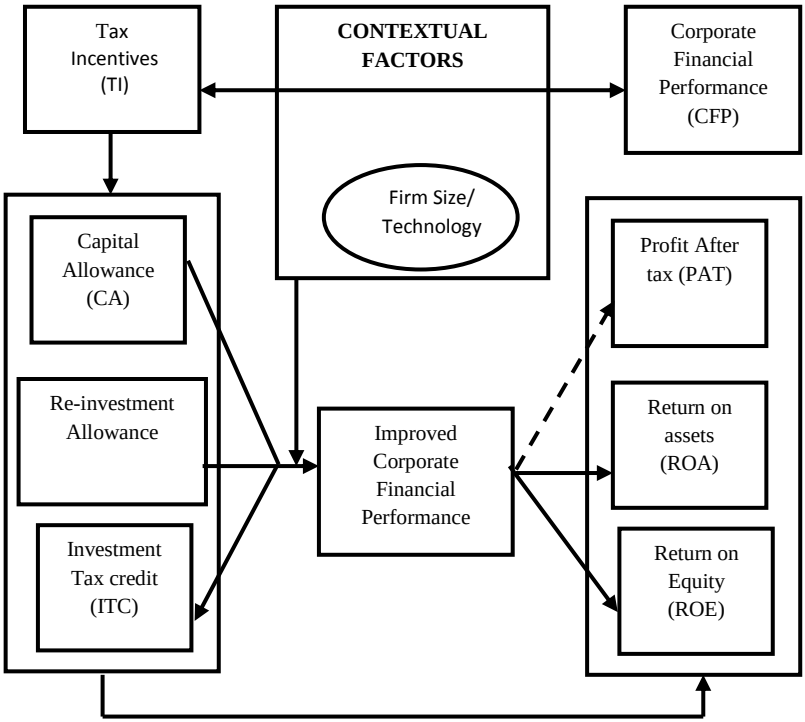
RIA comes handy to complement ITC in encouraging capital investments as firms are further enabled to plough back more profits for growth and expansion. As a tax relief, RIA is intended to boost corporate financial performance as well as macroeconomic growth and development in

progressively industrializing nations. The Nigerian government has proactively and constructively domesticated the concept in the manufacturing and allied sectors of the economy. The works of Klemm (2004), Ronald (2003), Keen (2002), Toaze (2001), and Wilson (1999) clearly demonstrate the imperativeness of such fiscal industrial attractions. More specifically, Toaze (2001) established that RIA enhances corporate financial performance by helping to boost productivity of firms and upgrade their financial status. Harris and Skuras (2004) sued for restraint in re-investment policy implementation to avoid a boomerang of indiscretion and maladministration, which often manifest in detrimental allocation inefficiencies in going and growing industrial concerns. Altogether, these contributions and the emerging revelations lend credence to the justifications for a *Pragmatic Proprietary System Advocacy (PPSA).*

Conclusion

Enhancing of firms' ROE, as established in this study, is a direct consequence of reduction of corporate tax liability through tax incentives. Fundamentally, firms which receive tax incentives pay less tax and *ipso facto* record higher ROE as well as return on assets (ROA), all of which derive from profit after tax (PAT). Contextually, firm's size and technology tend to moderate relationship between predictor variables (ITC and RIA) and the criterion variable (ROE). Technology, measured by the degree of automation in the production process, bears on corporate turnover and magnitude of ROE. Taking the focal variables of the study (ITC, RIA and ROE) together with other complementary conventional variables such as capital allowance (CA), ROA and PAT; a comprehensive framework is conceptually captured herein as *Tax Incentive – Corporate Profitability Impact Model (TICPIM)*, represented by Figure 1:

Figure 1: Composite Perspective of Tax Incentive – Corporate Profitability Impact Model (TICPIM)



The TICPIM conceptually symbolizes an array of opportunities beckoning on quoted manufacturing companies in Nigeria to harness prevailing tax incentives in order to redefine their corporate financial fortunes in the ever-challenging industrial world (Ohaka, 2011). Corporate executive and operative officers who are poised to advance this strategic course, in line with the PPSA, are expected to:

i. Invest in infrastructure modernization and expansion in order to upgrade critical technology, for the much-desired productive/competitive cutting-edge;

ii. Invest in training/retraining of critical human resources for more creative/innovative competencies; and

iii. Process and appropriate due benefits from tax incentives in accordance with relevant legislations, for utmost timeliness/effectiveness in auspicious utilization;

These ideals should be promoted in concert, to drive a robust governmental disposition towards implementation of more investor-appealing and compelling tax incentive regimes. This is a sure way to advance the Nigerian economy industrially, on a sustainable basis.

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