

EFFECT OF CORPORATE TAX SHIELD ON EARNINGS MANAGEMENT IN NIGERIAN COMMERCIAL BANKS

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Abstract

This study assessed the effect of Tax shield on Earnings Management in Nigerian Commercial Banks from 2010 to 2019. The specific objective is to evaluate whether Charity Donations affect Earnings Management of Commercial Banks in Nigeria. Ex Post Facto research design was used for the study. Using purposive sampling, thirteen (13) commercial banks constitute the sample size of the study. The hypothesis was tested with Ordinary Least Square with aid of E-view 9.0. The study revealed that Charity Donations has not significantly affected Earnings Management of Commercial Banks in Nigeria. The tax authority should ensure that banks use itemized deductions on his tax return and as it must be given to an approved organization.

Keywords: Tax shield, Charity Donations and Earnings Management

Introduction

Not only in Nigeria, but also globally, there has been a growing interest in the declining movement of economic trends over the years. Various economic units have put in place a number of steps to adjust to the unfavorable climate on the one hand, while also helping to improve the economy on the other. In this pool of economic units, commercial banks are not left out. Managers of businesses should ideally use internal data to generate external data that provides an accurate and fair picture of the company's financial status and performance. In essence, this means that enterprises should provide outsiders with both relevant and credible accounting data.

The banking industry plays a critical role in resource allocation and the growth process, hence taxation of banks is of major relevance (Albertazzi & Gembacorta, 2006). Banking activity is subject to general taxation in most nations, including Nigeria (personal and corporate income taxes). Bank taxation is of particular interest for a variety of reasons: banks are financial intermediaries that perform unique and critical functions, despite increased competition from investment funds and security markets in many countries; they are heavily regulated and monitored, which reduces the administrative costs of some forms of taxation; and they are subsidized through low-cost deposit insurance and bailouts of insolvent banks. Furthermore, especially in the family and small company sectors, banks frequently have a monopoly of power. Banks have been characterized as intermediaries that are able to perform three main functions: asset transformation, provision of transaction services and monitoring. Banks can monitor entrepreneurs, which reduces agency costs in the credit market; they provide transaction services to investors (routine payments, check writing); and they offer investors liquidity insurance (Caminal & Xavier 2004).

Studies linking earnings management and corporate tax shelter have relied mainly on the agency hypothesis to explain the relationship (Desai & Dharmaphala, 2008, 2009b). They believe that, because of the conflict of interest between managers and shareholders, opportunistic managers trying to maximize their own self-interest resort to tax avoidance tactics in order to divert rent to themselves via profits management. Managers alter earnings opportunistically to expropriate wealth from shareholders to themselves, which has a detrimental impact on equity value (Hunt, Moyer & Shevlin, 2000). The research conducted by Setiawati and Na'im (2001) in detecting Earnings Management with discretionary accrual approach failed to prove the existence of Earnings Management by the company in response to tax rate reduction. On the other hand, the research done by Subagyo and Oktavia (2010) has successfully verified that Earnings Management performed by firm is influenced by tax incentive and non-tax incentive in response to the tax rate changes, while Earnings Management conducted by unhealthy firm was influenced by non-tax incentive. Wijaya and Martani (2011) result also indicated that Earnings Management conducted by healthy firm was affected by tax incentive such as tax planning, net deferred tax liability, as well as non-tax incentive (earnings pressure). Furthermore, the Earnings Management performed by unhealthy firm was influenced by tax incentive (net deferred tax liability) and non-tax incentive (earnings pressure). The main objective of the study is to assess the effect of Corporate Tax Shield on Earnings Management in Nigerian Commercial Banks. The specific objectives are to: Evaluate whether Charity Donations affects Earnings Management of Commercial Banks in Nigeria.

Review of related Literature

Earnings Management

The concept of earnings management stems from the trade-off between relevance and reliability in financial reporting. Sundvik (2017) reported that highly reliable financial reports solely include realized cash flows, whereas highly relevant reports are concerned with the current value of expected future cash flows. Since accounting rules and legislation demand both relevance and reliability in proportion, financial reporting is therefore associated with certain elements of discretion and managerial judgment. Academic accounting literature provides many definitions of the term earnings management. Derived from the opportunistic use of discretion in financial reporting, early literature defined the notion of earnings management as “a purposeful intervention in the external financial reporting process, with the intent of obtaining some private gain” (Schipper, 1989). Here, earnings management is viewed through an opportunistic lens.

In line with Beneish (2001), Walker (2013) takes two views on earnings management by noting the opportunistic behavior perspective as well as an information perspective. From the information viewpoint, earnings management occurs when the management wants to communicate or signal their private expectations about future cash flows to external parties. The goal of informative earnings management is to improve the relevance of the financial reporting and enhance the usefulness of the financial statement information. This is something that would increase value, in contrast to the opportunistic standpoint whereby managers act out of self-interest and thus, decrease value through their actions. Earnings management is frequently also used as an indicator for financial reporting quality or earnings quality in the financial accounting literature, where more absolute earnings management is equal to lower quality earnings and where higher quality is preferred (Dechow, Ge & Schrand 2010).

Empirical accounting research has commonly relied on various proxies to measure earnings management. Here, the so-called aggregate accruals approach has been the dominant strategy. This approach relies on the fact that accounting earnings consist of cash flows (actual cash receipts and payments) and accruals (accounts receivable and depreciation). The latter component is influenced by business operations but also by certain managerial decisions and subjective assessments of different assets and liabilities, which can be a breeding ground for earnings management (Sundvik, 2017).

According to Scott (2012), earnings management is a management action to choose the accounting policy of a certain standard to manage profit. Earnings management is the management intervention in the financial reporting process in order to give benefit to Managers. In addition, Belkaoui (2006) defined earnings management as an ability to manipulate the available options and to make the appropriate choices in order to achieve the expected profit. Earnings management is accomplished through managerial discretion over accounting choices and operating cash flow (Healy & Wahlen, 1999). The underlying assumption in preparing Financial Statements is that Managers exercise discretion to manage the book income upward without increasing the taxable income (Mills & Newberry, 2001). Discretionary Accrual (DA), which is an accrual component chosen by Managers as policy in preparing Financial Statement, can be used to detect the existence of earnings management in a company. Sanjaya (2011) mentioned that the high or positive discretionary accrual measurement result indicates the income increasing done by the manager. On the contrary, the low or negative positive discretionary accrual measurement result indicates the income

decreasing done by the manager. If the discretionary accrual measurement result is zero, then the manager does not perform earnings management.

Tax Shields for Charitable Giving

Similar to the tax shield offered in compensation for medical expenses, charitable giving can also lower a taxpayer's obligations. In order to qualify, the taxpayer must use itemized deductions on his tax return. The deductible amount may be as high as 60 percent of the taxpayer's adjusted gross income, depending on the specific circumstances. For donations to qualify, they must be given to an approved organization. In general, you can deduct up to 60% of your adjusted gross income via charitable donations (100% if the gifts are in cash), but you may be limited to 20%, 30% or 50% depending on the type of contribution and the organization (contributions to certain private foundations, veterans organizations, fraternal societies).

Itemizing can take more time than if you just take the standard deduction, and it may require more expensive tax software or create a higher bill from your tax preparer. Plus, if your standard deduction is more than the sum of your itemized deductions, it might be worth it to abandon itemizing and take the standard deduction instead. If you abandon itemizing, however, you abandon taking the deduction for what you donated.

Here are the standard deduction amounts by filing status. Again, if your standard deduction is more than the sum of your itemized deductions, it might be worth it to skip itemizing (and thus skip claiming those tax deductible donations) and take the standard deduction instead.

Filing status	2020 tax year	2021 tax year
Single	¥12,400	¥12,550
Married, filing jointly	¥24,800	¥25,100
Married, filing separately	¥12,400	¥12,550
Head of household	¥18,650	¥18,800

How to know when to itemize or take the standard deduction

Things to remember about tax deductible donations

Tax deductible donations must meet certain guidelines, or you would not get the extra cash to accompany your good deed. Here's how to make your tax year a little sweeter.

Donate to a qualifying organization

The charitable giving will qualify for a tax deduction only if it goes to a tax-exempt organization, as defined by section 501(c)(3) of the Internal Revenue Code. Examples of qualified institutions include religious organizations, the Red Cross, nonprofit educational agencies, museums, volunteer fire companies and organizations that maintain public parks.

An organization can be nonprofit without section 501(c)(3) status, which can make it tricky to ensure your charity of choice counts.

You can verify an organization's status with the IRS Exempt Organizations Select Check tool. Before one donate, ask the charity how much of your contribution will be tax deductible. Keep track of all of your tax-deductible donations, no matter how big or small they are. A bank statement, a credit card statement, and a receipt from the charity (containing the date, amount, and name of the organization) or a cancelled check are all acceptable forms of qualifying paperwork if you made a monetary contribution. Keep copies of your W-2 or pay

stubs documenting the amount and date of your donation if it was made as an automatic deduction from your paycheck through your company.

Donations of more than \$250 in cash or property: The IRS demands that you obtain a formal acknowledgment letter from the charity. It must contain the amount of money you donated, if you received anything in return for your donation from the charity, and an estimate of the worth of those goods and services. By the deadline for filing your taxes (see the tax calendar), you must have received the letter of acknowledgement.

Previous Studies

Masri and Martani (2014) studied Tax avoidance behaviour towards the cost of debt. The aim of the research was to analyze tax avoidance behaviour to cost of debt (COD) moderated by tax rate changes and family ownership structure. The research used the 420 manufacturing firms listed in Indonesia Stock Exchange for the period 2008–2010. The study found that tax avoidance has positive influence on COD. Tax avoidance creates a risk thereby increasing the COD. In the period before tax rate reduction, the influence of tax avoidance on COD is smaller compared with the period after tax reduction; this indicates the presence of earnings management conducted by the company before tax rate reduction. Family ownership structure causes greater influence over tax avoidance on COD; this shows that family ownership increases tax aggressive behaviour. The impact of short-term debt on accruals-based earnings management – evidence from Vietnam was studied by Trung, Liem and Thuy (2020). The study sought to examine the relationship between short-term debt maturity and accruals-based earnings management using a sample of listed firms in Vietnam from 2010–2017. Sample covered all non-financial firms listed on the Vietnam Stock Exchange over the period from 2010–2017. The findings provide evidence suggesting that short-term debt maturity is likely to exert a desirable impact in lowering earnings management at low levels of short-term debt. Oraka, Okegbe, and Ezejiofor (2017) investigate how the Nigerian economy has been influenced by the value added tax. This study utilized an ex post facto research design. Simple regression analysis was used to assess the collected data. According to the findings, the value added tax has had little impact on the Nigerian economy's Gross Domestic Product. It was also revealed that VAT and per capital income have a negative association. Finally, we discovered that the value added tax (VAT) has a positive association with the federal government of Nigeria's total revenue generation. These data imply that, despite the fact that VAT has a favorable impact on revenue generation; the Nigerian economy would continue to grow slowly. The effect of CEO duality on the effective tax rate of listed food and beverage firms is studied by Ezejiofor and Ezenwafor (2021). The study used an ex-post facto research design. During the data gathering procedure, a purposive sample strategy was used to pick nine (9) organizations. Data was gathered from the sampled companies' annual reports and accounts from 2013 to 2019. The study's data was examined using descriptive statistics, and regression was employed with the use of the e-view, which had a 95 percent confidence level at five degrees of freedom (df). The findings suggest that CEO duality was significant and had a positive coefficient on food and beverage company tax planning in Nigeria. The influence of tax preparation on company value in listed consumer products manufacturing firms in Nigeria was investigated by Umeh, Okegbe, and Ezejiofor (2020). The study employed an ex-post facto research design. The financial statements of the selected firms were available from the population of all non-financial quoted on the Nigerian Stock Exchange, hence a sample size of 21 firms was chosen. The study's data will come from annual published financial and non-financial reports from 2009 to 2018. With the use of E-View 9.0, the three hypotheses were tested using ordinary least square regression. The effective tax rate (ETR) was found to have a negative impact on business value in this study,

however the effect was statistically significant. Prabowo, Winarna, Aryani, Falikhathun and Gantowati (2020) studied Debt and earnings management in Indonesia: An issue of free cash-flow or covenant? This paper investigated the effect of corporate debt on the pattern of earnings management in Indonesia. Analysis was based on a sample set consisting of 497 firms engaging in manufacturing operations listed in Indonesia Stock Exchange during the period of 2009 to 2014. The results revealed that corporate debt is an important determinant of earnings management statistically and economically. Further tests revealed that the interaction between liquidity and specification of corporate debt shapes different pattern of the directions of earnings management. Atu, Atu, Enegebe and Atu (2016) carried out a study on determinants of earnings management in Nigerian quoted companies. The objective of this study was to examine the determinants of earnings management using selected quoted companies in Nigeria. The simple random sampling technique was employed in selecting the 30 companies for 2007-2014 financial years. The study made use of Ordinary Least Squares (OLS) regression analysis as the data analysis method. In the study they adopted OLS regression techniques to examine how the explanatory variables (Corporate governance, firm size, audit firm type and financial performance) impact on earnings management using discretionary accruals measure. The study finding indicates the existence of negative significant relationship between board size, audit firm type and earnings management. This study on the comparison of earnings management practices in Indonesia's Islamic banks and conventional banks was undertaken by Hatane, Octoavia and Florentina (2018) with the aim to compare earnings management practices and their components between Islamic banks and conventional banks. It was conducted using a sample of 11 Islamic banks and 40 conventional banks in Indonesia during a period that ranges from 2011 to 2017. The comparison model was estimated using independent sample T-test. This study found that the earnings management's practices are estimated significantly different between Islamic banks and conventional banks. This significant difference is probably caused by differences in organizational goals, in which Islamic banks are not fully profit oriented. The high level of loan loss provisions in Islamic banks indicates a high level of prudence in this type of bank. Ezejiofor, Adigwe, and Echekeoba (2015) investigate whether taxation as a fiscal policy tool has an impact on the performance of selected Nigerian manufacturing firms. Using the Statistical Program for Social Sciences (SPSS) version 20.0 software package, the study's hypothesis was tested using ANOVA. Taxation, as a fiscal policy tool, has a considerable impact on the performance of Nigerian manufacturing firms, according to the study. The study implies that the amount of tax to be paid is determined by the companies' performance. The influence of tax revenue on Nigerian per capita income was studied by Ezejiofor, Oranefo, and Ndum (2021). The study used an ex-post facto research design. The Nigerian economy was made up of the population, and data for this study came from the Statistical Bulletin of the Central Bank of Nigeria (CBN) and the Federal Inland Revenue Service (FIRS). Per Capita Income (PCI), as well as customs and excise charges, were retrieved as variables. This study's data analysis was based on information gathered from CBN, FIRS, and NBS publications and statistical bulletins. The hypothesis was tested using correlation and Ordinary Least Square (OLS) regressions. Customs and excise fees have a non-significant positive influence on Nigeria's per capita income, according to data analysis.

Methodology

Research Design

Due to the nature of the study, ex-post facto research design was adopted for the study. According to Isangedighi, Joshua, Asim and Ekuri in Anokye and Okri (2015), ex-post facto research design is a systematic empirical inquiry in which the researcher does not have direct control of independent variables because their manifestation have already occurred or

manipulated. This design is considered appropriate because the study aims at measuring the relationship between one variable and another in which the variables cannot be manipulated. This involves the use of published financial accounts of organizations to generate the financial analysis that will determine the extent of difference.

To obtain reliable information that will help the researcher to ensure the effectiveness of the study in question, data were collected from only secondary source. This data were obtained from the annual reports and audited accounts of the commercial Banks from 2010 to 2019. The choice of this period range is based on the fact that 2010 was year marked with unprecedented banking reforms that not only affected the size of quoted banks in Nigeria, but also changed the face of banking industry in the country.

Population and Sampling Technique

Purposive sampling used to select thirteen (13) banks out of the twenty two banks as sample. The thirteen banks chosen are; Access bank PLC, Ecobank PLC, Fidelity bank PLC, First Bank of Nigeria PLC, Stanbic IBTC, Sterling bank PLC, United Bank for Africa, Union Bank PLC, First City Monument Bank PLC, Guaranty Trust Bank PLC, Unity Bank PLC, Wema bank PLC and Zenith Bank PLC. The thirteen banks were purposively selected because of their consistency within the period under study as they have not undergone any form of changes as a result of merger/acquisition. Also the researcher was able to have access to the audited accounts of these banks.

Method of Data Analysis

To achieve the objectives of this study, the data required were those of the discriminating variables that include: Medical Expenses, Charity Donations, Amortization, and Depreciation of the selected commercial Banks listed on Nigerian Stock Exchange from 2010 to 2019. Hypotheses formulated for the study were tested with the Regression analysis and Person Correlation statistical tools analysis to establish the effect of and the relationship between the independent and dependent variables with the aid of E-view 9.0.

Model Specification

The researcher prediction in tax sheltering will be computed as follows:

$$EAMGT = \beta_2 CHD_{it} \dots\dots\dots ii$$

Where:

EAMGT = Earning management

CHD = Charity Donations of the bank in year t

Measuring Dependent Variable (Earnings Management)

This study used the modified Jones's model (Dechow et al., 1995) to measure the level of earnings management or discretionary accruals (DTAC). This model used total accruals (TAC) that are classified as discretionary components (DTAC) and non-discretionary components (NDTAC). Thus, defined as follows:

$$TAC = NDTAC + DTAC$$

Where:

TAC = Total accrual period t

NDTAC = Value of non-discretionary accruals

DTAC = Discretionary accrual

Under the cash flow approach, total accruals are measured as follows:

$$TACC_{it} = EBXT_{it} - OCF_{it} \quad (1)$$

Where:

EBXT_{it} = Earnings before extraordinary items and discontinued operations period t

OCFit = Operating cash flow for period t

3.7 Decision rule:

Using SPSS, 5% is considered a normal significance level. The accept/reject criterion was based on the p-value, alternative hypothesis will be accepted. If p-value > 0.05 otherwise reject and accept the null hypothesis.

Data Analysis

Table 1: Descriptive Statistics

	TACC	CHD
Mean	-1.36E+09	315031.5
Median	-1.08E+09	355270.5
Maximum	3.04E+09	480183.0
Minimum	-5.50E+09	107895.0
Std. Dev.	2.44E+09	112303.2
Skewness	0.107520	-0.490323
Kurtosis	2.564141	2.304977
Jarque-Bera	0.098423	0.601968
Probability	0.951980	0.740089
Sum	-1.36E+10	3150315.
Sum Sq. Dev.	5.35E+19	1.14E+11
Observations	10	10

Source: Researcher's computation (2021)

Table 1 shows the mean (average) for each of the variables, their maximum values, minimum values, standard deviation and Jarque-Bera (JB) statistics (normality test). The result in Table 1 provided some insight into the nature of the selected Nigeria quoted banks that were used in this study.

It was observed that on the average over the ten (10) year period (2010-2019), the sampled quoted banks in Nigeria were characterized by negative average TACC (-1.36). In Table 1, the Jarque-Bera (JB) which test for normality or the existence of outlier or extreme values among the variables shows that all our variables are normally distributed and significant at 5% level and the result could be generalized. This also implies that a least square regression can be used to estimate the pooled regression models.

Test of Hypothesis

Ho₁: Charity Donations has no significant relationship with Earnings Management of Commercial Banks in Nigeria.

H₁₁: Charity Donations has significant relationship with Earnings Management of Commercial Banks in Nigeria.

Table 2: Panel Least Regression analysis showing the relationship between TACC, and CHD

Dependent Variable: TACC

Method: Least Squares

Date: 10/18/21 Time: 13:10

Sample: 2010 2019

Included observations: 10

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-4.50E+09	2.27E+09	-1.983075	0.0827
CHD	9954.219	6821.292	1.459286	0.1826
R-squared	0.210229	Mean dependent var	-1.36E+09	
Adjusted R-squared	0.111507	S.D. dependent var	2.44E+09	
S.E. of regression	2.30E+09	Akaike info criterion	46.12548	
Sum squared resid	4.23E+19	Schwarz criterion	46.18600	
Log likelihood	-228.6274	Hannan-Quinn criter.	46.05909	
F-statistic	2.129517	Durbin-Watson stat	1.921613	
Prob(F-statistic)	0.182606			

Interpretation of Regression Result

In table 2, a panel least square regression analysis was conducted to test the relationship between charity donations and earnings management. Adjusted R squared is coefficient of determination which tells us the variation in the dependent variable due to changes in the independent variable. From the findings in the table 2, the value of adjusted R squared was 0.111, an indication that there was variation of 11% on charity donations due to changes in earnings management. This implies that only 11% changes in earnings management of banks could be accounted for by charity donations, while 89% was explained by unknown variables that were not included in the model. The probability of the slope coefficients indicate that; P-value = 0.182 > 0.05). The co-efficient value of; $\beta_1 = -9954.219$; $t = 1.459286$ for TACC implies that charity donations is positively related to earnings management, though not statistically significant at 5%.

The implication is that, for there to be a unit/one naira increase in CHD there will be 9954.219 multiplying effect increase of TACC.

The Durbin-Watson Statistic of 1.921613 suggests that the model does not contain serial correlation. The F-statistic of the CHD regression is equal to 2.129517 and the associated F-statistical probability is equal to 0.182606, so the null hypothesis was accepted and the alternative hypothesis was rejected.

Decision

Since the Prob (F-statistic) of 0.182606 is greater than the critical value of 5% (0.05), then, it would be upheld that charity donations has not significantly affect Earnings Management of Commercial Banks in Nigeria at 5% level of significance, thus, H_1 is preferred over H_0 .

Table 3: Pairwise Granger Causality Tests

Date: 10/18/21 Time: 13:20

Sample: 2010 2019

Lags: 2

Null Hypothesis:	Obs	F-Statistic	Prob.
CHD does not Granger Cause TACC	8	8.33413	0.0596
TACC does not Granger Cause CHD		0.42995	0.6852

Source: E-Views 10 Causality Output, 2021

Interpretation of Diagnostic Test

Table 3 indicates that there is a uni-directional causality between TACC and CHD, since the causality only runs from the independent variable to the dependent variable (TACC) at two (2) lags at p-values less than 5%; CHD = 0.05 < 0.05, thereby establishing the fact that charity donations affects significantly the earnings management of Nigerian banks.

Discussion

The results of hypothesis revealed that 0.112 of the total variation in dependent variable is explained by independent variable to the determination of earnings management (TACC) while the remaining 11% is caused by other explanatory factors outside this model and this is captured by the error term. The coefficient result shows that TACC ($\beta_1 = -9954.219$) is positively related with charity donations (CHD), the probability value of the slope coefficients indicate that $P(=0.182 > 0.05)$. This implies that CHD has insignificant positive relationship with TACC. The overall performance of the model is satisfactory as shown by Prob (F-statistics) = 0.182606. From the above factual information it is clearly obvious that there is a positive insignificant relationship between CHD and TACC.

The tax authority should ensure that banks use itemized deductions on his tax return and that as it must be given to an approved organization.

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