

## Analysis of the Effect of High Corporate Tax Rate on the Profitability of Corporate Organisations in Nigeria – A Study of Some Selected Corporate Organisations

Ezugwu C.I. (Ph.D)

lykrydz2001@yahoo.com and ezugwuchrisiyke@yahoo.com

Akubo D.

daniel.ak2001@yahoo.com

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### Abstract

The study was carried-out to analyse the effect of high corporate tax rate on the profitability of corporate organizations in Nigeria. The related literatures were reviewed. The population of study comprises the selected corporate organizations while the sample size of the study is forty one (41). Taro Yamane sampling technique was adopted because it ensures a satisfactory degree of representativeness and un-biasness. A number of statistical tools including tables and Regression were used to analysed the data and test the hypothesis formulated. Our analysis of data revealed that, the study depicts a direct positive relationship between corporate tax rate and realised profit. It is therefore, recommended that, the Nigeria corporate tax rate of 30% should be reduce below OECD average corporate tax rate of 25.32% to avert the negative economic effects of high corporate tax rate on the long-run and also the Nigerian tax system should be change from classical system to imputation system to avoid economic double taxation.

**Keywords:** Effect; High; Corporate; Tax; Rate; Profitability and organisations

## 1. Introduction

### 1.1 Background to the Study

One of the Acts regulating the taxation practice relating to Companies Income in Nigeria is the Companies Income Tax Amendment Act 2007. Company Income Tax is charged on the chargeable profits of all companies operating in the country except those specifically exempted under the Act. The administration of the Companies Income Act and the tax is under the care and management of the Federal Board of Inland Revenue (the Board). The operational arm of the Federal Board of Inland Revenue is called the Federal Inland Revenue Service (the Service) and the Act that governed it, is called the Federal Inland Revenue Service Establishment Act (FIRSEA) 2007.

Historically, the formation of accountability and effective States has been closely associated with the emergence of taxation systems (Moore, 2007). Taxes underwrite the capacity of the States to carry out their goals; form one of the central arenas for the conduct of the State-Society relations and shape the balance between accumulation and re-distribution that give States their social character. Without the ability to raise revenue effectively, States are limited in the extent to which they can provide security, meet basic needs or foster economic development. A general analysis of the tax policy was considered. The emphasis is on the trade-off of encouraging the development of resources versus extracting the maximum tax revenue. This constrained the ability of the State tax policy makers to achieve goals of maximum resource development and the tax yields simultaneously; and hence, affects the profitability of Corporate Organisations.

There is no doubt that revenue is necessary for the State to meet the basic needs of citizenry in fulfilment of social contract. While this objective is been pursued there is need for a focus on the bases or core fundamental for understanding the impediments to industrial development and jobs generation and also serve as a mean for formulating and implementing dynamic industrial and employment policies. This is because special achievement that is unidirectional in terms of generating revenue for the State alone can fuel unemployment and de-industrialization due to its short run optimism in financing State fiscal policy. In addition, it can leads local and foreign investors' disenchantment, a situation where international investors quickly rebalance off their international investments in Nigeria, and flee to those countries where the tax systems provide for industrial growth and its consequent high investment returns.

Nigeria tax system, as it is today, is skewed towards raising fund to meet the State expenditures (recurrent and capital). Laudable as this is, it has however, obscured the need for tax system that can be used as a veritable tool for establishing and developing industries in Nigeria, particularly in the rural areas with its subsequent multiplier effects. Taking the forgoing into cognisance, the Nigeria tax architecture will need to be focused on the objective of industrial development, economic growth and employment generation. Therefore, it should look at the role of tax in promoting sound industrial performance and scale down unemployment.

A tax system is not merely aimed at raising a certain amount of revenue, but the aim is to raise it from those sections of the people who can best bear the tax. The aim in short, is to secure a just distribution of the tax burden. This obviously cannot be done unless; an effort is made to trace the incidence of each tax. We must know who pays it ultimately in order to find out whether it is just to ask him to pay it or whether the burden imposed on him is according to the ability of the taxpayers or not. If the tax system is to conform to Adams Smiths first cannon of taxation via, the cannon of equity, it becomes imperative to make a careful study of the reactions and repercussions of each tax and find out its final resting place.

The system has, from time to time, involved a number of different tax allowances and relief aimed at encouraging investment by differing or permanently reducing tax for those businesses which purchase capital equipments. In addition to this economic role of shifting the allocation of resources towards investments, the capital allowances system has been used to try to allocate resources to designated development areas by making allowances more generous for companies operating in those areas. It is necessary to understand how taxes affect the firm and resource markets in order to be able to judge the desirability of various taxes. The primary conclusion to be drawn from the literature is that a tax policy goal should be neutrality. This position has been taken by virtually all economists specializing in the field, including Harberger (1955), Agria (1969), Steiner (1963), Peterson (1975a). Only in cases where there are reasons to believe that the allocation of resources determine by private markets has been inefficient or pareto suboptimal should a tax policy be purposely designed to create distortions. In those cases, policies other than the taxes reviewed here may be better designed to achieve those ends.

However, complete exemption of profits from taxation is not desirable, yet a high tax rate is highly undesirable as is seen in Nigeria because the corporate tax rate of 30% charged in Nigeria is above the average Organisation of Economic Corporation and Development (OECD) corporate tax rate of 25.32% (Applicable Federal Rate, 2014). It will put a brake on invention and enterprise and it will cut down revenue and thus hinder modernisation of plant.

In the words of Mrs. Hicks cited in Dewett, Navalur & Janmejy (2005:784-785):

*The effect of an additional tax on profits on a curve of expected returns is to shift the curve bodily to the left, but without altering its shape or chance of loss. The chance of very high gains which formally balanced the big chance of loss in the risky investment curve is thus cut-off and the scales are consequently tipped against it; while the safe investment, being relatively unaffected, will become the more attractive. The discrimination of high profits tax against 'venture capital' is serious for any country that means to keep abreast of modern development; it is perhaps especially serious in established industrial equipment and where, consequently, new enterprise needs to be especially on the alert. This tax has also important cyclical relevance; in depression, curves of expected returns flatten out; many safe investments pass into the risky class.*

How the tax authority treats different segments of the formal and informal economy shapes the business tax culture, at the same time, the attitudes of entrepreneurs in the different sectors of the economy to the legitimacy of the State, the extent of corruption, voice and accountability are critical to trust in the State on which economic growth depends. Tax effort and tax collection depend not just on income base, but also on the political and institutional bases, especially the extent to which taxpayers trust their governments (Bird, Martinez-Vazquez & Torgler, 2006).

The elaboration of a general typology of tax non-compliance appears to both legal and economic approaches. The more complex the tax law is, the more it leaves open possibilities for tax non-compliance. Privileged taxpayers construct tax schemes which they depend as a category of tax avoidance (legal) while the tax administration may consider such schemes to be cases of tax evasion (fraud). Legal and illegal tax schemes (avoidance and evasion) may have similar economic effects, but different sociological effects. Tax evasion may be generally perceived rather negatively, tax flight neutrally, and tax avoidance positively (Kirchler, et'al 2003 cited in Fakile, 2009).

## 1.2 Statement of the Problem

The corporate income tax rate is placed directly on the accounting profits of incorporated enterprises. Utilizing this tax base creates two problems, a practical one of administration and a theoretical one of being able to determine how the

firm responds to the tax and who bears its final burden and incidence. The tax is difficult to administer and enforce because Lawyers and Accountants manipulate businesses and accounts so as to minimise tax payments. The Revenue Service (RS) and State tax-agency Lawyers and Accountants employed their energies in ferreting out evasion and being on guard to see that avoidance techniques are legal and permissible. The tax code is complex when applied to some industries. The complexity arises because economists define profits differently from accountants and the taxing authorities. Consequently, the corporate income tax falls partly on the expected return to equity capital, since this is not a deductible item and partly on economic rent and unanticipated economic profits.

The consensus among economists who have analyzed the effect of high corporate income tax rate on enterprises as a whole is that in the short-run as human-made capital is held constant, the tax has little or no effect on the behaviour of the firm; capital bears the tax burden. However, as capital depreciates, management must decide how to invest. Since the tax falls initially on equity capital, owners will divert their capital to activities or countries with tax preferences because the after-tax return in these will be higher. If the capital is shifted to other countries, the tax will equally shift and ultimately affect Gross Domestic Product (GDP).

### 1.3 Research Question

The following constitute the research question:

- (i) What is the effect of high corporate tax rate on corporate profitability?

### 1.4 Objectives of the Study

The broad objective of the study is to analyse the effect of high corporate tax rate on the profitability of some selected corporate organisations in Nigeria.

The specific objective of the study includes the following:

- (i) To determine the effect of high corporate tax rate on corporate profitability.

### 1.5 Statement of Hypothesis

In the course of this research work, the following hypothesis was formulated for test.

**Hypothesis:**

- Ho: High corporate tax rate does not have significant effect on corporate profitability.

### 1.6 Scope of the Study

This research was concerned with some selected corporate organisations in Nigeria. The study covers the period of 2009-2013. The study focused on the data generated i.e. the chargeable profits and tax rates of the selected corporate organisations which are all located in Lagos-Nigeria and the effect of high corporate tax rate on the profitability of these organisations. Also the problems encountered and their possible solutions will be considered. This research work will cover a fiscal year of 2014.

### 1.7 Significance of the Study

The important of taxation as an instrument of revenue generation by the government cannot be over-emphasized. The researcher aimed at providing recommendations on the effects of high corporate tax rate on the profitability of corporate organisations.

It is hoped that, if the recommendations are fully implemented, it would go a long way towards government adequate planning, industrial development and investors' motivation in the areas of investment and re-investment and hence bring positive multiplier effects on the economy.

### 1.8 Limitations of the Study

Like every other research undertaken, the study has its own limitations which were encountered at the course of carrying-out this research study and these include the followings:

- (i) The difficult means of generating data from the Federal Inland Revenue Service office as a result of

confidentiality;

- (ii) The high degree of secrecy in Nigeria public service which makes it difficult to officially have access to data for research purpose and even the enactment of Freedom of Information Act (FIA) does not helped matter;
- (iii) The difficult means of generating data from the selected corporate organisations.

## **2. Literature Review and Theoretical Framework**

### *2.1 Companies Income Tax Act*

One of the Acts regulating the taxation practice relating to Companies Income in Nigeria is the Companies Income Tax Act 1979 (CITA 1979). The Act is contained in Chapter 60 Laws of the Federation of Nigeria (LFN) 1990. It is a consolidation of the provisions of the former principal Act (The Companies Income Tax Act 1961) and the various amendments thereto. It became operative with effect from the year of assessment commencing on 1<sup>st</sup> April 1977. Subsequent amendments to the Act were done in 2004 and now the principal legislation is the Companies Income Tax Amendment Act 2007. The Federal Inland Revenue Service Establishment Act (FIRSEA) 2007 is also another legislation that governed taxation in Nigeria.

### *2.2 Corporate Taxation (Empirical Review)*

The link between taxation and governance is not immediately apparent, but in fact one is vital for the other. It has the potential to shape relationship between state and society in significant and distinctive ways. The history of state revenue production 'is the history of the state'. Taxes underwrite the capacity of the states to carry out their goals; they form one of the central arenas for the conduct of state-society relation and they shape the balance between accumulation and distribution that gives states their social character (Moore, 2007). There are several remarkable pointers to the universal importance of taxation to state-building: First, the state's capacity to raise taxes is closely linked to its ability to deliver good policies and it is suggested that tax-raising is a good proxy indicator of overall governance capacity (Arbetman et al (2007), secondly, tax levels remain surprising static in countries over long period of time, despite frequent tax policy reform. Thirdly, differences in the treatment of taxpayers by tax authorities may be explained by differences in citizens' right to political participation (Feld & Frey, 2002). Tax levels; in general usually rise with increases in the gross domestic product (GDP). This implies that better governed people are more willing to pay more taxes, but more heavily taxed states are not necessarily more legitimate. As taxation increases as a share of national economic output, conflict becomes less likely (Hendrix, 2007).

Political governance, economic growth and taxation create mutually reinforcing processes of State building. The 'fiscal social contract' is a key factor in delivering both political legitimacy and sustainable economic growth. A stable transparent, even-handed tax system is perceived by investors as a sign of established 'rule of law'. In other words, tax is a key indicator of an industrialised framework of political stability and fairness (Bird et al, 2006). As Levi has noted, a society's 'public spiritedness or normative conviction' can be motivating factors in the general willingness to pay taxes. People with a strong believe in a welfare state might thus be more willing to pay high rates of taxes (Levi, 1988). Religious tradition of 'Zakat' or 'tithing' might form a sense of moral obligation to hand over a percentage of one's income to the community (Hull, 2000). This attitude is intrinsic and not conditioned by actions by the government, although they might well have been conditioned by state-society relations in the past (Cummings et al, 2004 cited in Fakile (2009).

It is suggested that the level of compliance with taxation requirements is affected by perceptions of the government's legitimacy and the fairness of the tax system, as well as taxpayers' expectation that their tax moneys will be spent on valued public services (Slemrod, 1992).

Recognising the economic structure, some research has suggested that countries with sizeable shadow economies or informal sector can more easily observe large numbers of other escaping the tax net (Alm & Torgler, 2004). The business tax culture and morale of the private sector are more complex. The complex relationship between tax authorities and taxpayers reflect a country tax culture (Torgler, 2007). Therefore, how the tax authority treats different segments of the formal and informal economy shapes the business tax culture, at the same time, the attitudes of entrepreneurs in the different sectors of the economy to the legitimacy of the state, the extent of corruption, voice and accountability are critical to trust in the state on which economic growth depends. Tax effort and tax collection depend not just on the income base, but also on the political and institutional bases, especially the extent to which taxpayers trust their governments (Bird et al, 2006).

The elaboration of a general typology of tax deviance appears to include both legal and economic approaches. The

more complex the tax law is, the more it leaves open possibilities for tax non-compliance. Privileged taxpayers construct tax schemes which they depend as a category of tax avoidance (legal) while the tax authority may consider such schemes to be cases of tax evasion (fraud). Legal and illegal tax schemes (avoidance and evasion) may have similar economic effects, but different sociological effects. Tax evasion may be generally perceived rather negatively, tax flight neutrally, and tax avoidance positively (Kirchler et al, 2003 cited in Fakile, 2009).

The chargeable profits of the organisations under studied are hereby presented in the table 2.1 below.

**Table 2.1**

Chargeable Profits of Some Selected Corporate Organisations						
	Name of Company	2009 (N)	2010 (N)	2011 (N)	2012 (N)	2013 (N)
1	Ariosh LTD	951,978,000.00	2,265,802,000.00	2,265,802,000.00	15,730,638.00	72,288,557.00
2	Arkleen Oil & GAS LTD	23,611,156.00	3,721,479,122.00	3,721,479,122.00	2,361,116.00	9,268,698.00
3	Armada Offshore OSV LTD		11,827,173.00	11,827,173.00		709,630.38
4	Bell Oil & Gas LTD	4,247,324,000.00	5,637,577,000.00	5,637,577,000.00	29,456,000.00	13,184,000.00
5	Bendoriks Int'l LTD	1,201,339.00	1,552,892.00	1,552,892.00	33,046.00	35,015.00
6	Diesel Power Nigeria Limited	NIL	810,047,093.86	810,047,093.86	1,800,000.00	1,172,689.44
7	Dormanlong Engineering LTD	5,663,997,000.00	6,759,870,000.00	6,759,870,000.00	14,322,551.25	14,068,252.50
8	Dowell Schlumberger NIG. LTD	824,219,000.00	943,820,000.00	943,820,000.00	15,013,421.00	15,183,872.00
9	Dowell Schlumberger Western S.A.	4,686,686.25	192,726.93	192,726.93	281,201.18	11,563.62
10	Dredging INT'L Services(Cyprus) LTD	83,205,422.00	158,606,594.00	158,606,594.00	4,992,325.00	9,516,396.00
11	Dredging Int'l Services NIG. LTD	1,987,038,000.00	1,613,345,342.00	1,613,345,342.00	108,921,447.00	35,393,311.00
12	Dresser Rand Nig LTD	2,818,219,366.00	2,611,613,904.00	2,611,613,904.00	230,763,832.00	150,843,509.00
13	Exterran Nigeria Limited (Formerly Hanover Nigeria Energy Services LTD)	49,108,095.00	26,948,103.00	26,948,103.00	NIL	NIL
14	Falck Prime Atlantic LTD	1,270,432,938.00	1,814,361,136.00	1,814,361,136.00	47,471,595.00	48,750,511.00
15	FMC Technologies LTD	91,797,371.00	179,745,631.00	179,745,631.00	2,496,222.00	7,025,073.00
16	Frank's Int'l Oilfield Services (NIG.) LTD	929,739,192.00	1,148,257,599.00	1,148,257,599.00	29,424,186.00	25,020,335.00
17	Frank's Int'l West Africa (BVI) LTD	108,390,183,000.00	42,817,106.00	42,817,106.00	801,036,172.00	2,131,595.00
18	Global Santafe Int'l Drilling Corp	58,901,902.00	61,554,401.00	61,554,401.00	3,534,114.00	3,693,264.00
19	Globe Shipping Lines NIG LTD	412,917,740.00	454,209,510.00	454,209,510.00	840,430.00	1,431,100.00
20	Globestar Engineering NIG LTD	108,390,183,000.00	130,454,064,000.00	130,454,064,000.00	801,036,172.18	8,040,188,616.69
21	Granite Services International LTD		1,107,114,851.00	1,107,114,851.00		128,010,142.00
22	Halliburton Energy Services NIG LTD	9,447,237,037.00	11,604,592,805.00	11,604,592,805.00	227,541,237.00	280,069,280.00
23	Halliburton Operation NIG. Limited	6,109,823,411.00	8,782,256,759.00	8,782,256,759.00	992,650,454.00	1,396,750,531.00
24	Oildata Wireline Services NIG. LTD	576,056,601.00	740,167,763.00	3,530,371,037.00	8,955,738.00	9,381,989.56
25	Richardson Oil & Gas NIG. LTD	265,325,702.00	552,022,011.00	583,803,722.00	875,344.00	5,880,134.00
26	Rolls-Royce Industrial Power Engineering (Overseas) LTD	1,129,859.91	902,948.50	902,948.50	67,791.59	54,176.91
27	RTD Quality Services NIG LTD	371,804,000.00	465,606,000.00	465,606,000.00	1,946,300.00	1,446,003.00
28	SBM Marine LTD (UK).	7,388,186.41	NIL	NIL	443,291.28	NIL
29	SBM Marine NIG. LTD	549,134,022.00	95,599,343.00	95,599,343.00	22,755,836.93	5,541,743.73
30	Saipem NIG LTD	3,002,658,000.00	2,431,413,000.00	2,431,413,000.00	NIL	NIL
31	Stenar Tay (Hungary) Kft	70,650,415.59	NIL	NIL	4,239,024.94	NIL
32	SBM Services NIG. LTD	43,398,924.00	31,070,381.00	31,070,381.00	1,692,496.20	1,214,109.30
33	Stratos Offshore Service Co.	17,635.00	59,340.00	59,340.00	1,008.00	3,418.97
34	Scon NIG LTD.	32,675,000.00	131,755,000.00	131,755,000.00	590,302.50	3,786,900.00
35	Southern Gas Constructors LTD.	158,846,643,119.00	131,273,289,026.00	131,273,289,026.00	39,795,060.00	0.00
36	Sedco Forex International INC.	256,468,790.00	286,054,695.00	286,054,695.00	15,388,127.00	17,163,282.00
37	Vigeo LTD	805,527,203.00	6,639,807,855.00	878,844,299.00	31,041,080.00	49,377,554.00
38	Wellodynamics NIG. LTD	1,298,552,000.00	1,762,479,799.00	1,762,479,799.00	224,003,553.00	307,383,307.00
49	West Africa Catering NIG.LTD	7,757,348,000.00	10,496,482,000.00	10,496,482,000.00	39,731,000.00	55,482,000.00
40	West African Oilfields Services LTD	1,777,019,181.00	4,350,157,000.00	4,350,157,000.00	42,940,612.00	9,096,000.00
41	West African Ventures C.I LTD	149,634,247.66	204,798,281.06	204,798,281.06	8,978,054.53	12,287,896.86

Source: FIRS, (2014)

### 2.3 Incidence of Corporation Tax

It is a tax on companies. It is imposed on the net profit of the corporations or joint stock companies. By reducing the fund available for re-investment, the corporation tax militates against expansion and development. Also, the amount available to be distributed as dividends is reduced. This also serves as a disincentive to the investing public. Capital formation is

checked thereby. Thus, flow of equity capital is checked. The prices of goods manufacture by such a corporation's rise which may give a place to cheaper substitutes resulting in a shift of resources in their favour.

Further, since corporation taxes discourage investment, the level of national income and employment is reduced. If, however, the corporation which is taxed, maintains the dividend rate by paying dividend out of the undistributed profits, then neither is consumption reduced nor the flow of equity capital checked. A corporation tax, by reducing the earning of the existing firms, discourages the entry of new firms into the industry which may result in a monopoly or a semi-monopoly for the existing firms with all the attendant evils. This disincentive effect may lower efficiency. A part of the corporation tax may be shifted to the buyers through a price rise.

#### 2.4 Incidence of Tax on Profits

The problem of incidence of tax on profits is complicated by the fact that there is difference of opinion among the economists about the definition of profits and the elements that compose it. Some economists, like Walker, regard profits as analogous to rent. In this sense, profit is a surplus earned by the entrepreneur. The price in the market is determined by the marginal producer. Hence, profits, like rent, do not enter into price. It cannot, therefore, be shifted to the consumer. It will be borne by the businessman who pays it. This is Walker's view.

But, the marginal entrepreneur must have profit in the long run. Normal profit is, therefore, not a surplus but a part of the necessary cost. This, however, does not lead us to the conclusion that a tax on profit will be shifted to the consumer; unless the entrepreneur is able to influence the price which he rarely can. For an individual entrepreneur, price in the market is fixed. He believed that a tax on his profit must come out of his own pocket. A general tax on profit, as a rule, is not shifted unless the prices are rising rapidly and the consumers are anxious to buy. This, however, is very rare. Nevertheless, if the tax is on a special one on profits from the particular trade and industry, there will be a tendency on the part of the entrepreneurs to withdraw themselves from such lines. If this happens, the incidence will ultimately be shifted to the consumers of the commodity or the users of the service supplied by the entrepreneurs. A great deal depends on the elasticity of demand and the mobility of capital.

However, complete exemption of profits from taxation is not desirable, yet a high tax is highly undesirable. It will put a brake on invention and enterprise and it will cut down revenue and thus hinder modernisation of plant.

#### 2.5 Tax Shifting

Because individuals alter their behaviour in an effort to minimise tax payments, resources are reallocated and these reallocations are reflected in prices. This process is called tax shifting. Taxes which do not affect resource allocation cannot be shifted and fall on economic rent and the price of the service or commodity which is taxed. All other taxes are shifted, at least to some degree. Price changes of the taxed commodity and all other commodities affected by resource reallocation measure the final burden of a tax. The burden is borne by those who are adversely affected by changes in relative prices. Prices include the effects on income sources, consumption for labour or property, and income uses, consumption and savings. Albert (1981) opined that all price changes are traced to the people who are affected, for only people can bear taxes. To the extent that wages fall, labour bears the tax burden; to the extent that the price of mineral right falls, land owners bears the tax burden; to the extent that profits fall, owners of the capital bear the tax burden; and to the extent that prices of output increase, consumers bear the burden.

#### 2.6 Laffer Curve

In economics, the **Laffer curve** is a representation of the relationship between possible rates of taxation and the resulting levels of government revenue. It illustrates the concept of taxable income elasticity—i.e., taxable income will change in response to changes in the rate of taxation. It postulates that no tax revenue will be raised at the extreme tax rates of 0% and 100% and that there must be at least one rate where tax revenue would be a non-zero maximum.

The Laffer curve is typically represented as a graph which starts at 0% tax with zero revenue, rises to a maximum rate of revenue at an intermediate rate of taxation, and then falls again to zero revenue at a 100% tax rate. The actual existence and shape of the curve is uncertain and disputed.

One potential result of the Laffer curve is that increasing tax rates beyond a certain point will be counter-productive for raising further tax revenue. A hypothetical Laffer curve for any given economy can only be estimated and such estimates are controversial.

The basic idea behind the relationship between tax rates and tax revenues is that changes in tax rates have two

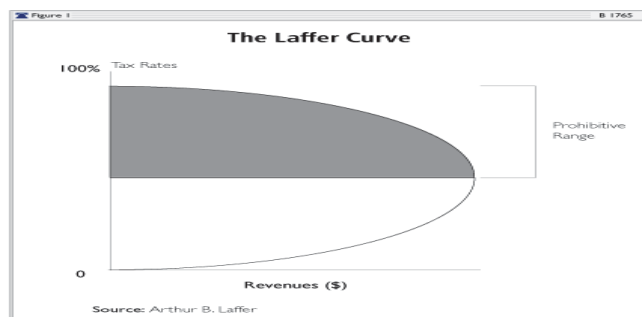
effects on revenues: the arithmetic effect and the economic effect. The arithmetic effect is simply that if tax rates are lowered, tax revenues (per dollar of tax base) will be lowered by the amount of the decrease in the rate. The reverse is true for an increase in tax rates. The economic effect, however, recognizes the positive impact that lower tax rates have on work, output, and employment--and thereby the tax base--by providing incentives to increase these activities. Raising tax rates have the opposite economic effect by penalizing participation in the taxed activities. The arithmetic effect always works in the opposite direction from the economic effect. Therefore, when the economic and the arithmetic effects of tax-rate changes are combined, the consequences of the change in tax rates on total tax revenues are no longer quite so obvious.

Figure 2.1 is a graphic illustration of the concept of the Laffer curve--not the exact levels of taxation corresponding to specific levels of revenues. At a tax rate of 0 percent, the government would collect no tax revenues, no matter how large the tax base. Likewise, at a tax rate of 100 percent, the government would also collect no tax revenues because no one would be willing to work for an after-tax wage of zero (i.e., there would be no tax base). Between these two extremes there are two tax rates that will collect the same amount of revenue: a high tax rate on a small tax base and a low tax rate on a large tax base.

The Laffer curve itself does not say whether a tax cut will raise or lower revenues. Revenue responses to a tax rate change will depend upon the tax system in place, the time period being considered, the ease of movement into underground activities, the level of tax rates already in place, the prevalence of legal and accounting-driven tax loopholes, and the proclivities of the productive factors. If the existing tax rate is too high--in the "prohibitive range" shown above--then a tax-rate cut would result in increased tax revenues. The economic effect of the tax cut would outweigh the arithmetic effect of the tax cut.

Moving from total tax revenues to budgets, there is one expenditure effect in addition to the two effects that tax-rate changes have on revenues. Because tax cuts create an incentive to increase output, employment, and production, they also help balance the budget by reducing means-tested government expenditures. A faster-growing economy means lower unemployment and higher incomes, resulting in reduced unemployment benefits and other social welfare programmes.

Figure 2.1



## 2.7 Theoretical Framework

The issue of taxation has generated a lot of controversy and severe political conflicts over time. According to its importance, several economic theories have been proposed to operate an effective system. Taxation is classified under two different theories as stated below: Benefit or 'Quid Pro Quo' Theory and 'Ability-to-Pay' or Faculty Theory. Therefore, this study is guided by the 'Ability-to-Pay' or Faculty Theory.

### 2.7.1 'Ability-to-Pay' or Faculty Theory

The most popular and the plausible theory of justice in taxation is that every taxpayer should be made to contribute according to his ability or faculty to pay. The tax is to be based on his taxable capacity. Nothing would appear to be more just. But the acceptance of the principle does not mean the end of our difficulties; rather the difficulties begin. The question which we then face is: 'What is the measure of a man's ability to pay?' (Dewett et'al, 2005)

In the search for a proper criterion of a person's ability to contribute to the State Coffer, we can proceed on two

lines, subjective and objective:

**Subjective Approach:** If we examine the position of the taxpayer in its subjective aspects, we shall consider the inconvenience, the pinch or the sacrifice involved. On this point, three distinct views have been advanced: (a) The Principle of Equal Sacrifice; (b) The Principle of Proportional Sacrifice; and (c) The Principle of Minimum Sacrifice.

In the words of J.S. Mill cited in Dewett et'al (2005) "**Equality of taxation**, as a maxim of politics, means equality of sacrifice. It means apportioning the contribution of each person towards the expenses of government, so that he shall feel neither more nor less inconvenience from his share of the payment than every other person experiences from his. According to this principle, the money burden of taxation is to be so distributed as to impose equal real burden on the individual taxpayers". This will mean proportional taxation.

According to the principle of **Proportional Sacrifice**, the real burden on the individual taxpayer is not to be equal but proportional either to their income or the economic welfare they derive. This will be more just than if the sacrifices involved were equal. Those who can make a greater sacrifice should be asked to do so. This will mean progressive taxation.

The **Minimum Sacrifice Principle** considers the body of taxpayers in the aggregate and not individually. According to this principle, the total real burden on the community should be as small as possible.

**Objective Approach:** We must, therefore, take our second line of approach to measure a man's faculty to pay that is, proceed objectively. Here we are on surer grounds, but here again; we find that several criteria have been suggested. A man's faculty to pay may be measured according to: (a) consumption; (b) property; and (c) income.

**Consumption**, as a criterion of ability to pay, is not a sound criterion, because consumption or utilisation of the services of the State by the poor is considered to be out of all proportion to their means, and as such, it cannot be taken as a practical principle of taxation.

**Property** also cannot be a fair basis of taxation, for properties of the same size and description may not yield the same amount of income; and some persons having no property to show may have large incomes, whereas men of large property may be getting small incomes. Thus, to tax according to property will not be taxation according to ability.

**Income**, however, remains the single best test of a man's ability to pay. But even in the case of income, the tax will be in proportion to faculty, if there is a minimum exemption to allow for a reasonable subsistence, if there is an allowance made for the number of dependants, and finally, if the principle of progression is applied by taxing the rich at a higher rate.

Besides, we have to consider 'the ability to pay' not merely of the individual taxpayer but of the community as a whole. In this light, it is necessary that the tax system as a whole is not oppressive. It should not discourage saving or retard accumulation of capital. Also, it should not, in any manner, impair the productive capacity of the community by hampering the development of trade and industry in the country (Dewett et'al, 2005).

### 3. Research Methodology

#### 3.1 Research Design

The study entails causal research in which the historical method was used in collecting the data. The method concerned with the quantitative data and this study used it to determine the effect of high corporate tax rate on the profitability of corporate organisations.

#### 3.2 The Population of the Study

The population of the study is the entire aggregate of individuals or items relevant to a phenomenon under investigation (Ugwu, 2003). The targeted population for this study consists of 45 corporate organisations in Lagos State of Nigeria as at April 2014. The above population shows that, all the corporate organisations in the population have about 45 Chief Accountants.

#### 3.3 Sampling technique and sampling size

The sample size is usually a compromise between what is desirable and what is feasible. For the purpose of this study, the researcher used mainly down stream oil sector of the economy as the population comprises forty five (45) corporate organisations, that pay their corporate taxes, as obtained from Federal Inland Revenue Service, Lagos office. The use of purposive sampling was based on the fact that, all the corporate organisations in Nigeria differ in sizes and profits and



therefore, may serve as a good representative of the whole corporate organisations in Nigeria. Hence, the researcher used random sampling technique on the forty five (45) corporate organisations.

Based on the above population, the sample size for the study is determined using Taro Yamane formula. This formula is used where the population parameter for the study is known. Thus it is stated:

$$n = N/1+N (e)^2$$

Where: n = Sample size

N = Population size

e = Degree of tolerance error

With a confidence level of 95%, the degree of tolerance error is 5% (0.05).

$$\text{Therefore: } n = 45/1+45(0.05)^2$$

$$n = 45/1+45(0.0025)$$

$$n = 45/1+0.1$$

$$n = 45/1.1$$

$$n = 40.9$$

$$n = \underline{41}$$

### 3.4 Sources of Data

Data were gathered from secondary sources. The secondary data were collected from the Federal Inland Revenue Service (FIRS) with specific focus on corporate tax rate and the chargeable profits of the organisations under study. The review of several publications that were relevant to the study was carried-out. These were FIRS bulletin and journals.

### 3.5 Method of Data Analysis

Data were sourced from forty one (41) corporate organisations in Lagos. The hypothesis formulated was tested using Regression analysis.

Statistical Package for Social Scientist (SPSS 17.0 version) was employed to analyze the data. Correlation test was also conducted to examine the effect of high corporate tax rate on corporate profitability.

### 3.6 Model Specification

The model built for the purpose of this study is influenced by Hasseldine & Hite (2010) as follows including all control variables in order to limit the influence on those variables. This model is used to test the null hypothesis one formulated for this study.

$$CP = f(CTR)$$

$$CP = bo + b1X1 + \mu_i$$

Where:

CP = an indicator representing Corporate profitability; (the Dependant Variable)

bo = Constant;

b1X1 = Co efficient of the Independent Variable;

X1 = a predictor representing Independent Variable (high Corporate Tax Rates); and

$\mu_i$  = Stochastic error term.

The error term is captured because there are other factors that affect corporate profitability than the high corporate tax rates which are not included in the model.

## 4. Data Presentation, Analysis and Discussion of Findings

### 4.1 Data Presentation and Analysis

Data were sourced from forty one (41) corporate organisations in Lagos. The data collected were regressed on SPSS 17.0 version; the following results were obtained as indicated below:

Model	Co-efficient	Standard Error
Constant	1.31	0.00
CTR	3.33	0.00

R	R <sup>2</sup>	Durbin Watson
1.00	1.00	1.46

**4.1.1.1 Model Presentation**

$CP = 1.31 + [(3.33) (X_i)] + \mu_i$   
 $CP = 1.31 + 3.33(X_i) + \mu_i$  Where:  $X_i$  = High Corporate Tax Rate  
(0.00) (0.00)

The figures in parenthesis are the respective Standard Errors values for the parameter estimates  $b_0$  and  $b_1$  respectively.

**4.1.1.2 Interpretation of Result**

The R values are correlation coefficient that helps to detect the strength of relationship between the corporate profitability (dependent variable) and the high corporate tax rate (independent variable). Thus; R=1.00 translates to 100%. This affirms that the dependent variable CP is linearly positive correlated with the independent variable. The coefficient of determination being  $R^2 = 1.00$  That is, 100 % of the change in the dependent variable is caused by change in the independent variables. To evaluate the effect of high corporate tax rate on profitability of corporate organisations in Nigeria, the following hypothesis was examined using standard error test and Durbin Watson (DW) test:

- H<sub>0</sub>:** High corporate tax rate does not have significant effect on corporate profitability.
- H<sub>1</sub>:** High corporate tax rate has significant effect on corporate profitability.

**4.1.1.3 Standard Error Test**

It is used to test whether the estimated parameter is statistically different from zero.  
 If  $S.e.(b_0) < \frac{1}{2}(b_0)$  : reject the null hypothesis ( Koutsoyiannis, 2001).  
 Since  $S.e. (b_0) < \frac{1}{2}(b_0)$ :  $0.00 < \frac{1}{2}(1.311)$ , the null hypothesis that high corporate tax rate does not have significant effect on corporate profitability is rejected.

**4.1.1.4 Durbin Watson (DW) Test**

To test for the presence or otherwise of autocorrelation, the theoretical lower and upper limits of the Durbin Watson statistic  $d_l$  and  $4-d_l$  respectively are compared with the observed DW statistic.  
 According to Gujarati & Porter (2009), if  $DW < (4-d_l)$ , there is no serious problem of autocorrelation, but if  $DW > (4-d_l)$ , there is presence of autocorrelation of the first order. The tabulated below are parameters needed to test for autocorrelation in the work

dL	du	4- dL	DW	Sig.	Conclusiveness	Result
1.35	1.49	2.65	1.46	5%	Conclusive	No Autocorrelation

Since  $DW < 4- d_L$ :  $d_i < DW$  i.e.  $1.46 < 2.65$ :  $1.35 < 1.46$ , there is no autocorrelation in the model. Also, the lower limit of the Durbin Watson is conclusive.

**4.2 Discussion of Findings**

Based on the analysis, the following findings were arrived at:  
 The high corporate tax rate has both arithmetic and economic effects on the economy. It increases the revenue of the government, which is used by the government to finance both the Capital and Recurrent Expenditure in its annual budget. However, there are negative effects; it discourages invention and entrepreneurship, it causes tax flight, it reduces savings, investments, employment opportunities etc.

There have been many arguments for the reform of corporation tax. Despite, many tinkering with the system, to take some criticisms into account, it has been argued that the system is in total disarray (Kay & King, 1990).

The Meade Committee (Meade, 1978) devoted some attention to the major problem in corporate taxation which imputation is designed to solve, that is, the different taxation of retained and distributed profits. On the one hand, it might be argued that any economic double taxation of income (on the company and on the shareholder), is inequitable when comparisons are made with unincorporated businesses. This argument is used to justify imputation of corporation tax to the shareholders.

## **5. Summary, Conclusion and Recommendations**

### *5.1 Summary*

This work examines the analysis of the effect of high corporate tax rate on the profitability of corporate organisations in Nigeria.

It appeals to rational thinking that high Corporate Tax Rate will impact negatively on realized profit. However, the study depicts a direct positive relationship between Corporate Tax Rate and Realised Profit. A contradiction to rational expectation portends that the companies under observation must have envisaged and factor in the implications of Corporate Tax Rate while transacting in goods and services. This will invariably transcend in increment in accounting figures presented by these companies.

However, for the companies under study, the prices of their goods and services are determined by market forces of demand and supply, any increase in price will reduce the demand for their products and services. The high corporate tax rate impinged on the decisions of the investors as it discourages invention and entrepreneurship, it causes tax flight, it affects capital formation, it reduces savings, investments and causes unemployment in the country.

### *5.2 Conclusion*

Nigeria as one of the countries of the world that charges high corporate tax rate stands a chance of under developing her economy. The multiplier effects of this on the economy are enormous; ranging from: low savings, low investments, high rate of unemployment, capital flight, tax flight, high cost of living, low standard of living, social unrest, decrease in honesty, corruption etc.

Taxation as an instrument of fiscal policy to regulate, control and manage the economy should be neutral to encourage the corporate organisations to save, invest, and create employment opportunities in the country.

### *5.3 Recommendations*

For Nigeria to achieve its fiscal policy through optimal corporate tax rate for economic growth and development, based on the findings, the following recommendations have been provided.

- (i) The Nigeria corporate tax rate of 30% should be reduce below OECD average corporate tax rate of 25.32% to avert the negative economic effects of high corporate tax rate on the long-run.
- (ii) The corporate tax which is classified as a direct tax is inappropriate and hence it should be classify as an indirect tax because the incidence is on the customers and suppliers through forward and backward shifting of prices.
- (iii) The Nigerian tax system should be change from classical system to imputation system to avoid economic double taxation.
- (iv) We recommended that government should do more to close the infrastructural gap to stimulate industrial development in Nigeria. Though, government encouraged corporate organisations in Nigeria through capital allowances.
- (v) The government should ensure revenue generated from taxation especially corporate tax should be utilize in the development of the general economy and not just a segment of it as this will go a long way to improve the standard of living of her citizenry and hence lead to a growth in Gross Domestic Product (GDP).

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