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An Evaluation of Capital Structure and the Profitability of Companies

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Introduction- For development and growth of any society, the provision of basic infrastructure is quite necessary. This perhaps explains why the government shows great concern for a medium through which fund can be made available to achieve their set goals for the society. Government needs money (fund) to be able to execute its social obligations to the public. These social obligations are not limited to the provision of infrastructure and social services. According to Murkur (2001), meeting the needs of the society call, for huge funds which an individual or society could not contribute alone. It becomes the responsibility of the government to source for the funds to enable her provide these basic amenities to the citizen who are the beneficiaries.

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AN EVALUATION OF CAPITAL STRUCTURE AND THE PROFITABILITY OF COMPANIES

Strictly as per the compliance and regulations of:



An Evaluation of Capital Structure and the Profitability of Companies

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1. INTRODUCTION

For development and growth of any society, the provision of basic infrastructure is quite necessary. This perhaps explains why the government shows great concern for a medium through which fund can be made available to achieve their set goals for the society. Government needs money (fund) to be able to execute its social obligations to the public. These social obligations are not limited to the provision of infrastructure and social services. According to Murkur (2001), meeting the needs of the society call, for huge funds which an individual or society could not contribute alone. It becomes the responsibility of the government to source for the funds to enable her provide these basic amenities to the citizen who are the beneficiaries. One of the medium through which fund is derived is through taxation. Therefore, the citizens are expected to discharge their civic responsibility by paying their taxes as these contribute to the development and administration of the society at large.

In the light of the importance of taxation as a source of revenue to the government, Hammer, Jager and Norddlow (2005) argued that unless people pay the taxes they are obliged to pay, government may not function properly. However, it is well known and accepted that some people do not like paying taxes and because of this reason, it is difficult for tax authority to levy and collect taxes anywhere and time. Therefore, the amount of tax revenue generated by government for its expenditure programmed depends among other things, on the willingness of the taxpayers to comply with tax laws of a country (Eshang, 1983). Not complying with tax obligations suggests that a taxpayer may be committing an act of non-compliance and the resulting tax revenue loss from such act may cause serious damage to the proper functioning of the public sector, thereby threatening its capacity to finance its expenditure programmed (Franzoni, 2000).

No one likes to pay taxes, even though tax payment is inevitable for the provision of social welfare, hence individual and companies want to reduce their tax liabilities and they try to do this either legally, by tax avoidance or illegally by tax evasion. However, one of

the greatest problems facing Nigeria tax system is the problem of tax evasion and avoidance. Tax evasion and avoidance has been an important subject of inquiry in developing countries over a long period of time. All form of taxes in Nigeria is to some extent avoided or evaded largely because the administrative machinery to ensure effectiveness is weak. Because of diversity and complexity in human nature and activities, no tax law can capture everything. Loophole will exist and can only be reduced and not completely eliminated.

Ogundele (1999) defines taxation as the process or machinery by which communities or groups of persons are made to contribute in some agreed quantum and method for the purpose of the administration and development of the society. It can be inferred that the payment of tax will in turn be beneficial to the entire citizen. This view is also similar to the definition of Sayode and Kajola (2006) who defined tax as a compulsory exaction of money by a public authority for public purposes. Nightingale (1997) describes tax as a compulsory contribution (contribution imposed by the government). These various authors concluded that it is possible for tax payers not to receive anything identifiable for their contribution but that they have the benefit of living in a relatively educated, healthy and safe society. However, the infrastructure which tax payers are supposed to enjoy is in a deplorable condition (Fafunwa, 2005), educational system in disarray (Obaji, 2005). Hence, there has been a clamor by leaders that a huge sum of the resources which they are to use, find their way out the Nation's income through tax evasion and tax avoidance.

Soyode and Kajola (2006) distinguished between tax evasion and tax avoidance. They defined tax evasion as a deliberate and willful practice of not disclosing full taxable income so as to pay less tax and as a contravention of tax laws whereby a taxable person neglect to pay tax due or reduces tax liability by making fraudulent or untrue claims on the income tax form. While tax avoidance can be defined as the arrangement of tax payers affairs using tax shelters in the tax laws. Abdulrazaq (2001) gave this example to differentiate between tax evasion and tax avoidance. If two people marry in order to reduce their tax liabilities, they are involved in tax avoidance, but when they tell the tax authority that they are married when they are not, they are quit of tax evasion, and would be prosecuted as such. Tax evasion is an attempt to escape tax liability

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(wholly or partially) by breaking the tax law and it is a criminal act since it is achieved principally by making false declaration such as underreporting income or over reporting relieves and allowances. While, tax avoidance is an attempt to escape tax liability by circumventing that is finding a way to bend the avoider have a similar end (that is reducing tax liability) their means to that end differ (Ayua, 1996). The tax evaded is a criminal while the tax avoided is just a smart taxpayer who exploits loopholes in tax laws (and related laws) to reduce tax liability.

One is the functioning of accounting is to provide adequate information decision making of which guiding the government on revenue generated through taxation is not an exception. Tax avoidance and evasion makes it difficult to keep accurate records for proper accounting and also causes poor budget planning which negatively affect the carrying out of the required social responsibility. According to Braide (1984:5), Accounting responds to the need of the society. It changes as society or culture changes. As the society grows economically, accounting also develops to meet up with the requirements of which adequate accounting for taxation is no exception.

Tax evasion in most developing countries like Nigeria is so rampant, and the scenario is much worsened by the fact that not many of these governments have made an effort to measure the ethical reasons that tax payers give, the extent of this problem and at the same time analyze its impact. Hence, when required revenue for smooth operation cannot be raised, these countries often times resort to increase tax rates or borrowings which may not only crowd out the rates or borrowings which may not only crowd out the private sector of their economies but also lead them to debt traps (Chiumya, 2006). On the other hand, tax evasion has the effect of distorting the principle of perfect market resource allocation and income redistribution. This can lead to economic growth stagnation and far much reaching socio- economic repercussions that is having indirect effect on the National income. Thus, there is the need to understand the behavior of tax payers and the reason that cause such specific behavior.

Tax evasion and tax avoidance are practices that have eaten deeply into the revenue that ought to be generated by the government, and hence affect the economic life of the country as a whole as well as affecting the Nation's income. In view of this, this research seeks to examine these practices in Nigeria and finding out the accounting and social implication of tax avoidance and evasion on the National income of the country by evaluating the reasons why people evade and avoid taxes, the methods used by people to achieve these and thereby proffer solution to the practices.

II. STATEMENT OF THE PROBLEM

Tax avoidance and tax evasion are problems that face every tax system, but the Nigeria situation is unique when view against the level and scale of corrupt practices prevalent in Nigeria economy. Tax is one of the major sources of revenue in Nigeria and is a factor to be reckoned with. The tax collected comes back to the tax payer in form of social amenities. Tax has encouraged or discouraged some activities in the private sector, depending upon whether the policy of the government is towards encouraging or discouraging such companies. Although tax revenue has shown remarkable increases, available evidence shows that fiscal viability of the government would have been higher if better structures are in place to enhance tax planning, tax administration, collection of taxes and the reduction of the level of tax evasion and tax avoidance.

In this study, therefore, it is set out to examine the various problems both internal and external problems confronting the revenue department in the collection of taxes and levies under their jurisdiction which hindered most proper accounting and carrying out adequate social responsibilities with a view to finding solution to them.

The accounting and social implication of tax avoidance and tax evasion on National income of Nigeria is a serious problem which this study is out to analyze and tackle.

III. OBJECTIVES OF THE STUDY

The broad objective of this study is to find out why people evade and avoid tax and suggest ways of minimizing the practices in Nigeria. The broad objective is broken down to the following specific objectives:

- i. To determine the effect of tax evasion and tax avoidance on the National income of Nigeria.
- ii. To examine the major accounting and social implication of tax evasion and tax avoidance.
- iii. To proffer solution to the problems of tax evasion and tax avoidance.
- iv. To examine the effect of perceived corruption in government on tax evasion and avoidance.

IV. RESEARCH QUESTIONS

This research attempted to provide answers to the following questions in other to achieve the objectives stated above:

- i. Is there any effect of tax evasion and tax avoidance on the National income of Nigeria?
- ii. Is there any accounting and social implication of tax evasion and tax avoidance?
- iii. What are the possible solution to the problem of tax evasion and tax avoidance?

- iv. What is the attitude of tax payers when government is perceived to be corrupt?

V. RESEARCH HYPOTHESES

The following alternative hypotheses (HO and Hi) will be statistically tested in the course of this study:

- i. HO: There is no significant effect of tax evasion and tax avoidance on the National income.
- ii. Hi: There is a significant effect of tax evasion and tax avoidance on the National income.
- iii. HO: There is no significant relationship between the accounting and social implication of tax avoidance and tax evasion.
- iv. Hi: There is significant relationship between the accounting and social implication of tax avoidance and tax evasion.
- v. HO: Company income tax has no positive impact on the economic growth.
- vi. Hi: Company income tax has positive impact on the economic growth.
- vii. HO: Tax revenue has no significant relationship with tax administration in Nigeria.
- viii. Hi: Tax revenue has significant relationship with tax administration in Nigeria.

VI. SCOPE OF THE STUDY

This research is premised on obtaining evidence on the accounting and social implication of tax avoidance and tax evasion on the National income of the country (Nigeria). Thus, the study will be restricted to cover the performance of tax revenue in Nigeria for a period of fifteen years (15 years) that is from 1996 to 2010. Primary data will be sorted from Federal Inland Revenue office, Asaba and Delta State Board of Internal Revenue, Asaba while secondary data will be obtained from Central Bank of Nigeria Annual Bulletin.

a) *Significant of the Study*

From the finding of the research work, the following are the significance itemize below:

- i. This research is expected to be a benefit to revenue officials who are saddled with the responsibility of ensuring that taxpayers are not negligent in paying their taxes.
- ii. It will also assist to knowing why taxes are avoided and evaded.
- iii. This research is also expected to be of benefit to researchers and students of accounting since it is an important aspect of taxation. Hence, it serves as a reference point for future researchers and a blue point for the policy makers.
- iv. The research is also aim at studying the social and accounting implication and tax evasion on the National income.

b) *Limitation of the Study*

It is not unusual for researchers to encounter some problems during studies of this nature. The constraints of this study include:

i. *Time*

The time allocation for the completion of the study is not sufficient enough to carry out adequate research, considered with other engagements of the researcher. Due to the time constraint, the researcher will not be able to get adequate information about the research topic.

ii. *Lack of Data*

The availability of data is usually a problem in study of this nature. There are some data or information, which will be needed but is termed confidential for office use only. In this situation, the study will be limited to only those data available.

iii. *Lack of Co -Operation*

Persons in position to help researcher gather information are usually hostile because of the fact that some of them believe that the researcher has the intention of knowing the secret about their job which the researcher would exposed to the tax authority. This attitude makes them raise a strong opposition to researcher and these in turn hinder the research work.

iv. *Finance*

Finance has been a constraint to research work done in this country and likely to affect this work too.

v. *Error*

Some of the data when obtained are usually subject to error and changes due to their sources. This would also limit this study.

However, it is believed that the researcher would take adequate steps to maintain the validity and reliability required in this study.

VII. DEFINITION OF MAJOR TERMS

The following terms are defined to assist in proper understanding of this work by its users:

i. *Tax*

This could be defined as revenue which government derived from its citizen for carrying out its social responsibilities and for the development of the Nation.

ii. *Tax Liability*

This is the amount of money that is borne by the taxpayer.

iii. *Tax Evasion*

This is described as intentional illegal behavior, or as behavior involving a direct violation of tax law to escape the payment of tax.

iv. *Tax Avoidance*

Is a term used to describe tax payer behavior aimed at reducing taxpayer tax liability without infringing the tax laws.

v. *Social Responsibility*

It is an obligation to protect and improve the welfare of the society as a whole along with one's own interest.

vi. *Corporation Tax*

This is the amount of money paid by company as tax.

vii. *Property Tax*

This is the tax paid on the property of the taxpayer.

viii. *Capital Gain Tax*

This is a type of tax paid based on the gain realized on the sales of capital goods.

ix. *Accounting*

Is the process of recording, classifying, selecting, measuring, interpreting and communicating financial data of an organization to enable user make assessments and decision. Accounting records monetary terms the flow of economic values within or between economic entities.

x. *Revenue*

Amount of money which is being realized by an individual, group or government.

xi. *State Board Of Internal Revenue*

The body is responsible for collection of taxes for the state.

xii. *Federal Inland Revenue*

The body is responsible for collection of federal taxes.

VIII. THEORETICAL STUDY

The theoretical study reviews some theories in taxation.

a) *Optimal Taxation of Labour Income*i. *The Mirrlees Model*

In the canonical model of optimal income taxation set up by Mirrlees (1971) consumers are assumed to maximize a utility function of the general form

$$U = U(C, L), \quad (1)$$

Subject to the budget constraint

$$C = wL - T(wL), \quad (2)$$

C = Consumption

L = Labour Supply

W = Real wage

T(wL) = a non - linear tax transfer schedule.

The solution to the consumer's problem yields his indirect utility function V(w). In the Mirrlees model the pre — tax real wage rates are treated as and taken to reflect the different non - observable ability levels of individual taxpayers. With wage rates being distributed over the interval (w, w), $0 \leq w \leq +\infty$ Mirrlees assumed that the benevolent policy maker wishes to maximize an individualistic Bergson on welfare function of the form

$$W = \int_w^w \psi \{v(w)\} f(w) dw, \psi' > 0, \psi'' \leq 0, \quad (3)$$

Here f(w)^w indicates the density of taxpayers earning the wage rate w, and the (numerical) magnitude of the second derivation ψ reflects strength of the policy maker's preference for equity. The maximization of (3) takes place subject to the constraint that the government must raise an exogenous amount of revenue R: T

$$\int_w^w T \{wL(w)\} f(w) dw = R.$$

The solution to the above optimal tax problem is technically demanding and does not yield very clear — cut results regarding the shape of the optimal income tax schedule. Mirrlees carried out simulations assuming Cobb — Douglas utility functions, a classical utilitarian social welfare function (with $\psi = 1$ and $\psi = 0$) and a log — normal wage distribution. On these assumptions he found that optimal tax schedule was approximately linear, with an exemption level below which positive net transfers are payable.

Had this early result been robust, it would have had great practical policy relevance, since a linear labour income tax is fairly simple to administer.

In practical, because a linear income tax features a constant marginal tax rate, it does not require information on individual income, since it can be implemented as a proportional payroll tax combined with a flat transfer to all taxpayers. However, subsequent work by Tuomola (1984) and other revealed that the near — optimality of a linear income tax is not a robust result once one allow for plausible respecifications of utility function and of the shape of the wage distribution. Atkinson and Stiglitz (1980, ch. 13) also found that the optimal tax schedule deviates substantially from linearity when the social planner has more egalitarian preferences than those implied by classical utilitarianism.

IX. EMPIRICAL STUDY

a) *Comparision of Tax Evasion and Tax Avoidance*

Tax evasion has been defined by researchers in a number of ways, one of which is in contrast to tax

avoidance. Sayode and Kajola (2006) defined tax evasion as a deliberate and willful practice of not disclosing full taxable income in order to pay less tax. It is a violation of tax laws whereby the tax due by a taxable person is unpaid after the minimum specified period. Likewise, tax evasion is evident in situations where tax liability is fraudulently reduced or false claims are filled on the revenue tax form. On the other hand, Kay, (1980) opined that tax avoidance takes place when facts of the transaction are admitted but they have been arranged or presented in such a way that the resulting tax treatment differs from that intended by the relevant legislation. In essence, tax evasion is illegal while tax avoidance is not illegal under the ambience of the law.

Eboziegbe (2007) noted that this unlawful practice of tax evasion remains a serious threat to revenue generation effort of government. According to Nwachukwu (2006) tax evasion is the general term of efforts by individuals, firms, trust and other entities to evade taxes by illegal means. Tax evasion usually entails taxpayers deliberately misrepresenting or concealing the true state of their affairs to the tax authorities to reduce their tax liability. It also includes, in particular, dishonest tax reporting such as declaring less income, profits or gains than actually earned; or overstating deductions. Conversely, tax avoidance as defined by Aim and Martinez (2001), is the legal reduction in tax liabilities by practiced that take full advantage of the tax code, such as income splitting, postponement of taxes and tax arbitrage across incomes that face different treatments.

From the comparison of various definitions given in the literature, it can be seen that paying less tax or not at all than what one is legally obliged to is described as tax evasion while tax avoidance is an act of doing everything possible within the confines of the tax law to reduce the tax paid. Therefore, the main difference between them is the legality of the taxpayer's action. This study also takes the position of the researchers as it is in conformity with the structure of Nigeria tax system.

b) Empirical Investigation of Tax Evasion

Tax evasion can be traced back to the study of Allingham and Sandmo (1972) the study observed a positive correlation between tax rates and evasion. This finding is also consistent with the findings of Chipeta (2002) which identified causes of tax evasion. Firstly, he noted that the rates at which taxpayers are being taxed impacts on tax evasion. He observed that the higher the rate, the higher will be the likelihood for the taxpayers to evade, as this increases their tax burden and hence lowers their disposable income. Secondly, the probability of being detected after evading taxes also influences the decision of a taxpayer as whether to evade or not. This is directly linked to the level of how street tax laws are being enforced.

Literature also provides a link between tax evasion and corruption. Acconnia et al, (2003) noted that the level of corruption depends on such factors as the wealth of a tax payer and the wage of the tax officer.

Maclearn (1996) further worked on a model, which tried to identify the optimal wage at which tax officers should be remunerated. He argued that government face the dilemma of identify, a salary level which will ensure that its tax officers are not enticed to bribery, as there is a link between tax evasion and the salary level of a tax officer though corruption.

According to Pashev, (2005) the failures of the government to provide basic infrastructures which are supposed to be funded by the tax being collected may aggravate tax evasion. Lack of transparency and accountability in the use of public fund has the effect of building public distrust both in the tax system as well as the government. Hence, this is believed to increase the level of tax evasion.

Some of the studies, Armstrong and Robison (1998), Olivia (1998), McGee (1998b; 1999b), Sratrakalev (1998) and McGee and An (2006) have taken different opinions on tax evasion. All these studies have one or more opinion portrayed in their studies. These opinions include philosophical opinion, practitioner's opinion and religious opinion. Some studies also have two opinions combined together. In the study of Morale (1998). Tax evasion was discussed from a philosophical point of view by gathering evidence from Mexican workers. His study concluded that Mexican workers have a more important duty to their family than to the state. This point of view is also believed to have a religious underlining as it has a bearing with the Catholic theological literature as identified by Crowe in 1944.

c) Three Opinions on the Ethics of Tax Evasion

All the opinions found on tax evasion in the literature can be grouped into three broad areas. These are the unethical opinion, the anarchist opinion and the circumstance opinion.

With these discouraging findings, it seemed for a while that optimal tax theory could offer little guidance on income tax design. But building on earlier contributions by Revesz (1989), piketty (1997), Diamond (1998), and Roberts (2000), Saez (2001, 2002 a) showed how a formula for the optimal marginal tax rate at every income level can be derived in terms of the relevant elasticity's of taxable income and the properties of the wage distribution. Since these parameters can in principles be observed or estimated empirically, the work of Saez has greatly enhanced the practical application of optimal income tax theory. Another important contribution by Saez (2002 a) was the explicit allowance for tax



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