

# Net Tax Returns on Equity Investment of Businesses in Nigeria: A Comparative Evaluation Using Equations

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## Abstract

For effective tax planning for the purpose of tax burden shedding, it is imperative for equity investors to understand the tax implications and intricacies of their investments so as to minimize the incidence of tax thereby maximizing net tax returns on investment and the aggregate wealth accumulation of the business. The study therefore seeks to compare the net tax returns on equity investment in unincorporated and incorporated businesses in Nigeria. The essence is to determine the form of business organization that has the highest tax return (lesser tax burden). Scholes & Wolfson (1992) model, which was also applied by Okafor & Akwu (2015), was adopted with little modification for the purpose of this study to determine the maximum net tax returns of investments in both forms of businesses. Findings from the computations in Table 5.1 below clearly indicate that individual businesses is the best form of investment for the purpose of gaining net tax advantage and net tax wealth aggregation in Nigeria (2.38 for 5 years, 5.69 for 10 years & 13.59 for 15 years). This is followed by incorporated companies (2.24 for 5 years, 5.02 for 10 years & 11.23 for 15 years) and the third is upstream companies (domestic sales of crude) (1.51 for 5 years, 2.27 for 10 years & 3.34 for 15 years). Upstream companies (exported crude) occupied the last position in the ladder of investment for after-tax wealth accumulation (1.20 for 5 years, 1.44 for 10 years & 1.74 for 15 years). Chains of factors and conditions may be responsible for this result including the issue of double taxation, which may not be applicable to individual business but much visible with incorporated companies. Besides, the applicable tax rates varies and the computation is based on various tax rates regime of which individual businesses has upper band of 24%, a single rate of 30% for incorporated companies, 85% petroleum profit tax rates for exported crude for upstream firms and 65.75% for domestic sales for upstream firms. Also, there is a stringent regulation of incorporated companies more than unincorporated individual businesses and a more stringent regulation of companies operating in the upstream petroleum sector. The study therefore recommends that equity investors should carefully consider tax and non-tax factors while evaluating the net tax burden or the relative tax advantages of what forms of business to choose. This consideration would enable investors to get net tax wealth accumulation in both short and long gestation period of investments.

**Keywords:** Net tax returns, equity investment, tax burden, net tax wealth aggregation

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## 1. INTRODUCTION

Largely the type of economic system adopted and operated by a country determines the form of business organization that will be in operation in such a country. The dominant form of business and investment adventures in less advanced countries like Nigeria are sole proprietorship, partnership and incorporated companies. Each of these forms of business organizations has their peculiarities and characteristics features in respect to accounting, tax regulations and control requirements. The three forms of business organizations to be investigated in the course of this study are the individual businesses, which consist of sole proprietorships and partnership business and incorporated companies. The incorporated companies are classified into normal incorporated companies and incorporated upstream petroleum companies. The disaggregation becomes imperatives because the Nigerian tax legislation have specific and separate tax provisions for normal incorporated companies, companies operating in the upstream petroleum sector and individual businesses. Basically, there are three tax authorities in Nigeria that are responsible for tax administration, assessment and collection: they are The Federal Inland Revenue Service (FIRS), The State Internal Revenue Service (SIRS) and the Local Government Revenue Committee (LGRC). FIRS handles company income taxes and other related assigned tax obligations while SIRS takes charge of tax matters that are connected to individuals and body of individuals. The Local Government Revenue Committee handles residual tax matters especially of the local community fees, levies, charges, rates and other taxes. Therefore, our discussion on the burden of tax to incorporated companies fall within the purview of FIRS. The one of Sole Proprietorship business is within The State Internal Revenue Service (SIRS)/Local Government Revenue Committee.

Any wise investor needs to place in the front burner the tax exposure or benefits associated with intended investment before undertaking such investment. According to Okafor (2012), investors consider a low income tax rates as a motivation to invest in a particular form of business, while high income tax rates may constitute a disincentive to invest. In a world of multiplicity of taxes< income tax issues may also affect foreign direct

investment decisions (Dessai, Foley & Hines, 2004). Hulse & Pope (1996) observed that high income tax rate may attract high tax burden and low net income accumulation while a fair or low income tax rate may attract low tax burden and low after tax income accumulation. Therefore, investors are very much interested in their after-tax yield to be generated from their investments.

Tax matters matter most to government as well as investors and business owners. In many less developed economies, taxation serves as a socioeconomic tool that could be used to redirect the economy on the part of growth and economic sustainability. It serves as a fiscal means of mobilizing revenues to meet government-anticipated objectives. Depending on the socioeconomic policies a country wishes to pursue, it may introduce a low tax or a high tax regime on businesses. The bottom line is the enforcement of a stable and healthy tax regime at every level that will enable business and the economy to thrive. For business to flourish in Nigeria, it is necessary to streamline the tax system in order to make it flexible, neutral and non-distortionary. The experiences in some reforming countries of Easter Europe and emerging economies in Africa and Asia, where the tax system is rigid, surrounded with distortions and inefficient paint a discouraging and gloomy picture that should not be repeated in Nigeria. Investment in businesses has been affected because of these inefficiencies and poor management of tax.

In some of these countries, tax laws are imprecisely drafted, tax terminologies are ill defined, tax provisions are either undocumented or not publicly available, and tax laws unevenly applied. Tax burden are considered to be excessive and as a result voluntary compliance is very low and there is prevalence of tax evasion and practiced with reckless abandon” (Ezejelue, 2008) .

All these factors breed distortions and facilitate unethical and fraudulent practices of tax evasion by some small businesses, sole traders and falsification of returns by companies and other investors.

The pervasive impact of taxation as one of the key determinants of investment choice extends to across the border business decisions and business locations. The desires of most of the partners in partnership business, the sole proprietors and incorporated companies including multinationals entities is to obtain some forms of tax shelter and optimal tax advantages in their investment and business activities. This according to Ezejelue (2008: 483) calls for a conscious and methodical tax planning, tax strategies and tax accounting. Evaluating net tax returns and burden with respect to investment choice in individual business or incorporated entities is imperative as the effective tax burden on investment could affect the net tax returns/earnings capacity value of the sole trader or incorporated company. This result is valid only under several restrictive assumptions, the most important of which is the existence of a perfect capital market under certainty.

The only aim of imposing taxes on chargeable units according to classical economists was to mobilize public revenue to meet government plans and programmes. Currently there is a paradigm shift due to change in ideologies, political and socio-economic conditions as recent study has indicated that taxes level influence business decisions as well as production and consumption of goods and services. It also affects employees' morale, shareholders value and other stakeholders' interests.

The Nigeria tax system is defective and inefficient. This has led to rampant tax infraction by the taxpaying public. The issue of tax multiplicity dots the Nigeria tax space. While multiple taxation increases the tax burden of incorporated companies and individuals, it also increases, production cost of businesses thus reduces the international competitiveness of homemade items. In addition, high corporate income tax reduces the cash flow of business enterprises, hence stiffens their capacity to invest. To this end, tax policies and reforms geared towards elimination of multiple and double taxation and optimum tax will improve investment capacity of investors and the nation's investment environment. Thus, tax reforms are generally designed to serve amendatory/corrective, innovative and revenue roles. As the name implies, amendatory function of tax seeks to correct weakness in the tax system; the innovative role seeks to bring into practice something new in the tax regime and the revenue function seeks to widen the tax net and introduce mechanism that attempts to mobilize sufficient public revenue for programmes and project execution.

Entrepreneurs seek to maximize returns on investment and to achieve these noble objective questions about tax implications of a particular investment becomes very imperative. Taxes can redirect the flow of resources and the choice of investors to other sectors that may have lower productivity. Most investors have a perception that the tax burden of investing in incorporated companies is higher than that of individual outfit (sole proprietorship & partners in partnership). This is based on the assumption that the current Nigeria tax legislations accord more favourable tax reliefs to sole trading business than incorporated business entities. The one and key problem to be tackled in this study is the after tax burden of the Nigerian tax system on investors especially, sole proprietorship and incorporated businesses. The work therefore intends to investigate the effect of net tax returns on equity investment of businesses in Nigeria.

## 2.1 CONCEPTUAL REVIEW

### **Tax Implication of Individual Businesses in Nigeria**

In the context of Nigerian tax legislations, the term individual business include both the sole trader commonly

referred to as sole proprietorship and partnership business. “ A sole proprietor is an individual such as a chartered accountant who runs an unincorporated business on his or her own. As a business entity, a sole proprietorship does not pay income tax. It is the owner of the business that is chargeable to tax (Osirim , 2016). This form of business is established, owned, managed and financed by one person though he could get financial assistance from other persons and/or institutions. It is the simplest form of business and it is not a legal entity. It simply refers to a one-man business and the owner of the business is personally/solely responsible for all the risk (losses) and rewards (accrued profits) incidental in the running of the business.

The sole proprietor is required to report all business income or losses and other personal income on his self-assessment personal income tax return. The business itself is not charged to tax separately. It is described as a “pathway or pass-through” taxation, because business income and profits pass through the business to be taxed on the sole trader personal income tax return. Unlike in a limited liability company, there is no separation between you and your sole trading business as the liability of your business is your liability.

Personal Income Tax Act (PITA) 2011 as amended made a distinction between employment tax and self-employment tax. The employment tax is known as Pay As You Earn (PAYE) and is deducted at source from the salaries and wages of employees (additional income received by the employee like royalties and rent to be included at the yearly summary of the tax returns) and remitted by the employer to the relevant tax authority on monthly basis. Self-employment tax like the one of partners in partnership and sole traders is paid annually on preceding year basis unlike the PAYE system that is determined on actual year basis (Osirim, 2016). On the other hand, section 1 of the Partnership Act 1890 defines partnership as the “relationship which subsists between persons carrying on a business in common with a view of profit”. It is an advanced form of a sole proprietorship and a group of sole traders can pool resources together to form a partnership business. Under the partnership arrangement, the risk and return associated with this business is jointly shared among the partners but they are liable to tax individually. For tax purposes, a partnership business is not a separate legal entity and thus not liable to tax as a unit/entity. It is only recognized as a source of income for the partners. It is the individual persons that form the partnership that are chargeable to tax (Osirim, 2016). The preceding year basis of taxation is applicable to both the sole proprietorship and partnership business and they are regulated or governed by the Personal Income Tax Act 2011 as amended. Unlike incorporated companies, income generated from a sole trader business is liable to single and not double taxation. According to Okafor (2008), the sole proprietor is not liable to further tax but he is charged to tax on the aggregate income arising from all his business undertakings. This is because the income of the business is deemed to be inseparable from the proprietor. The sole trader business tax liability is his personal tax liability.

The income of individuals or body of individuals such as employees, sole proprietors, partners in partnership, trustees or executors, communities or families and other body of individuals such as societies and organizations, are covered in the Personal Income Tax Act (PITA 2011) as amended (Osirim, 2016). The Consolidated Relief Allowance (CRA) was incorporated into PITA 2011 to reduce the tax burden on the taxpayer. Under PITA 2011, the CRA consists of: The sum of N200,000 or 1% of the gross income whichever is higher, plus 20% of the gross income. In the end, the sum of the CRA is deducted from the gross income or profit of the taxpayer to arrive at the taxable income. The graduating personal income tax rates in Nigeria for various years are given in the table below:

Table 1.1 Schedule of Graduating Personal Income Tax

From 1995 to 1997	From 1998 to 2000	From 2001 to 2011 (June 14)	From 2011 to date
First N10,000 @ 5%	First N20,000 @ 5%	First N30,000 @ 5%	First N300,000 @ 7%
Next N10,000 @ 10%	Next N20,000 @ 10%	Next N30,000 @ 10%	Next N300,000 @ 11%
Next N20,000 @ 15%	Next N40,000 @ 15%	Next N50,000 @ 15%	Next N500,000 @ 15%
Next N20,000 @ 20%	Next N40,000 @ 20%	Next N50,000 @ 20%	Next N500,000 @ 20%
Above N60,000 @ 25%	Above N120,000 @ 25%	Above N160,000 @ 25%	Next N1,600,000 @ 21%
			Above N3,200,000 @ 24%

As the above table depicts, the maximum tax rate from 2011 to date is 24% as against 25% from 1995 to June 2011. This mean that no matter what other income you earn after N3,200,000, 24% tax rate (1% lower than previous maximum rates) is applicable. PITA 2011 provides that where annual income of the individual is less than N300,000 as against N30,000 previously, the minimum personal income tax rates to be applied on the total income is 1% as against 0.5% previously (Osirim, 2016)

The advantage of the sole proprietorship is that it is not considered tax entities separate from their owners,

therefore the issue of double taxation of income as obtains in limited liability company does not arise. In determining the tax liability of the sole proprietor and partners in partnership, all business expenses that are wholly, reasonably, necessarily and exclusively incurred are to be written off. There are windows provided under the PITA 2011 that could be exploited by the self-employed (sole proprietor/partners in partnership) to reduce their tax liabilities. Contribution of at least 8% of income to the National Pension Fund; contribution to the National Health Insurance Scheme (NHIS, 5%), and contribution to the National Housing fund (NHF, 2.5%) could be made. These are treated as statutory deductions. Life assurance policy could also be taken and the premium paid is tax exempt. Dividends and interests from quoted companies (franked investment) can give a relief. Claims could be made for capital allowances, business expenses and consolidated relief allowance (1% of Gross income or ₦200,000 + 20% of earned income). Profits on sale of fixed assets and investments that are under another tax Act is excluded. Besides, any reversal of an already disallowed expense like some depreciation provisions and general provision for doubtful debts could form reliefs.

## 2.2 THEORETICAL REVIEW

### Taxable Capacity Theory

The theory expresses the limit to which individuals and entities can be charged to tax, and government obligations to the taxpayers in forms of service and welfare provisions that may be funded from the mobilized tax revenue. A country or state can levy taxes on the people up to a certain level. This limit is described as the taxable capacity or the taxpayers' ability to pay taxes. The limit of taxable capacity has been deduced to be a saturation point where the services and welfare benefits provided by government from additional tax burden on the people leads to disincentive to work and invest with multiplier effects of poor economic performance in terms of decrease in gross domestic product and other economic indices. However, Hanson (1974) asserts that it is quite cumbersome to determine the tax ability (taxable capacity) of the taxpayers. Nonetheless, the taxpaying public should not be stretched beyond their capacity to bear the tax burden, as this will have far-reaching consequence on the economy. Dalton (1964) expanded the theory to include "absolute taxable capacity of a single community" and the relative taxable capacity of two or more communities".

### The Classical Theory of Tax

The classical theory is referred to as the classical system or the separate corporation tax system. The system shares similarities with the business entity theory of taxation. Loosely speaking, it could also be referred to as business entity theory as it views companies as separate entities different from their owners and thus imposes taxes separately on the company's income and the dividends income distributed to shareholders. According to Sijbren (1993), the proponents of the classical system argue that the separate personality of a company justifies a separate imposition of tax. This theory has been faulted and criticized on the ground that it leads to double taxation. The systematic over taxation of profits shared to shareholders may lead to various degrees of economic distortions. To mitigate matters arising from the classical system, the full integrated tax system is being proposed for adoption and implementation. Under this system, companies income tax is 100% integrated with the income tax of shareholders. In other words, the same treatment is accorded to corporation profit and profits distributed to business owners as the two profits are integrated and fully charged to tax using the appropriate prevailing tax rates.

### The Classical System and Companies Income Tax in Nigeria

Companies' income tax occupies a prominent place in the fiscal policies and discussion of most countries because of its immense contribution to economic growth and development. The case of Nigeria is not different as the tax plays key roles in the fiscal policies of the country. On the flip side, Adegbite and Fakile (2011) argue that company income tax has not measured up to expectation because of perceived weak tax enforcements in the areas of assessment and rapid collection of the assessed tax. The non-compliant attitude of most companies in Nigeria with regard to tax payment has been attributed to multifarious factors. Adegbite and Fakile (2011) attributed high tax evasion and poor behaviour of companies to tax payment to inefficient tax administration and the existence of loopholes in the Nigerian tax legislations. They were of the view that the prevailing widespread misunderstanding, poor tax knowledge and misrepresentation of tax purposes contributes to noncompliance problem and poor growth in tax yields. In the same vein, Usman (2014) blamed it on weak penalty system, ineffectual enforcement procedures, and poor comprehension of the tax statutes and procedures. Idebi (2013) blamed the noncompliance issues on lack of awareness by taxpayers of the contents of the various tax laws in operation. He therefore suggest the consideration of tax education as a key element in tax administration.

The classical system of tax promotes over taxation of companies worldwide. The first level tax is where the income earned is charged to tax at source at the current Nigerian company income tax rates of 30%. The second level is where the part of income distributed to shareholders as dividends is charged to tax again in the form of withholding tax at the rate of 10%. However, the second tier tax on company income will only arise when dividends are distributed and credited to the accounts of shareholders. However, dividend is waived on dividend income received from companies having a pioneer status in Nigeria during their pioneering periods. Add to this

list is dividend income received from small companies that are into the fabrication of local machines and equipment, agro-allied, manufacturing and export oriented businesses ( Soyede & Kajola, 2006). Such concessions may induce investors to invest in these companies when compared with other companies that do not enjoy the same concessions. Equity investors could erase the adverse effect of subjecting dividend income to withholding tax (second level tax) by disposing of part or all of their equity holdings (shares or stocks) to realize capital gains (exempted from capital gains tax since 1 January 1998) in lieu of dividend income (Aguolu, 2010).

### 2.3 EMPIRICAL REVIEW

The effect of tax on investment is well documented in the extant literature both in advanced and in the less advanced countries of the world. However, the effect of tax burden on investment made by individuals and an incorporated company is scarce hence, this study is undertaken to close the identified gap. Arthur Laffer asserts that higher tax rate above the optimal tax rate could have disincentive and discouraging effect on savings, investment and labour supply (Rosen, 2009). Indeed several studies indicate that tax can strongly influence investment and the tax system in a nation has a strong impact and a systematic relationship with other macroeconomic variables like inflation, levels of savings, money and labour supply and other macroeconomic indicators. Tax policy measures and reforms directed towards encouraging investment through minimization of tax burden on the taxpayers command widespread support. Investment incentives of taxation can be effected by reducing the tax rates and granting investment tax credit, accelerated depreciation and other forms of incentives to chargeable units.

In their study on fiscal policy, taxes and investments, Abizadeh and Tosun (2005) assert that taxes are popularly used as proxy for fiscal policy and it can restrain investment growth through such taxes as companies' income taxes, individual taxes and capital gain taxes. They also observe that taxes can retard labour supply growth rate by disposing labour-leisure choice in favour of leisure. Finally, they opine that high taxes on labour supply can distort the efficient use of human capital, bring about high tax burden even though they have high social productivity.

In a cross-country study, using fourteen (14) OECD countries, Cummins, Hasset and Hubbard (1996) investigated the impact of tax reforms on investment. The study reveals that 12 out of the 14 countries investigated had investments that are significantly responsive to changes in the tax rate. This portends that if the tax reforms in these countries reduces the tax rate, it will stimulate investment in those countries. Rodrigo (2004) empirically investigated the nexus between tax reforms and private investment using Chile data from 1975 to 2005. The study confirmed the findings of Cummins et al. (1996) which indicated that tax reforms stimulate investment by freeing up investible resources. Mika, Andrew and Shiv (2012) explored the impact of the tax system on small and medium scale enterprises (SMEs) in Shinyanga Municipality, Tanzania adopting the use of primary data and descriptive statistics. The results indicate that the nation tax system has a negative influence on SMEs performance thereby opening up a window for tax policies reform.

Rockley (1863) study the impact of corporate tax rate on capital spending and found that reductions in the rate of taxation did not appear to have very powerful impact on corporate investment. He however, attributed this to a large number of firms who evaluated investments proposals on a pretax basis. Other similar investigations show that company's income tax rate has a strong relationship with capital spending. Therefore, government manipulates the tax rates to stimulate investment.

Hall and Jorgenson (1971) investigate tax policy and investment behavior. They estimated a one percent increase in cost of capital as a result of a variation in corporate tax rate from 52 to 48 percent in 1964. Krausz (1987) study on tax policy and investment behaviour show that for certain assets classification, a cut in the tax rates from 46% to 33% may actually reduce the NPI of projects for companies whose tax rate is below 35%.

Moore, Swenson and Steece (1982) investigated the impact of corporate income tax rates on foreign manufacturers investments and found the existence of a weak relationship between the variables. Fortunate (1977) undertook a survey on US executives choice of business investment and locations and found that 20% of the respondents were of the view that states and/or local taxes on business and industry are one of the three to five most important factors in the choice of investment/business location. Mary (1965) found in her survey that only six out of twenty-six British companies operating in Nigeria give much premium to the generous tax incentive available in Nigeria.

The result of the survey carried out by Hakem (1966) indicated that only 16% respondents selected tax incentive as a factor that influenced their decisions to set up a pioneer industry. In a similar vein, the empirical study of Philip (1969) shows that out of 51 companies investigated, 33, which represent 64.7% ranked import duty reliefs & concessions the highest amongst tax incentives available to them. Tax holiday was ranked next. 35% of the respondents agreed to the fact that tax incentives are imperative while 7% disagreed. Other incentives include accelerated depreciation. Hall and Jorgenson (1969) investigated the effect of accelerated depreciation as a form of tax incentives on investments and found that depreciation has a 9% reduction in the cost of capital and

17.5% increase in net investment in manufacturing equipments over the period 1854-70.

Broadway (1978) proved in his model accelerated depreciation discriminate against non-current assets (long lived capital investment) for which the social rate is higher than the square root of tax depreciation rate multiply by the depreciation rate multiply by the depreciation exponent.

In a comparative study of investment incentives in relation to the durability of projects, Brown (1962) argued that accelerated depreciation favours long-live investments as compared with investment tax credit and vice-versa for short-lived investment. Black (1959) showed initial allowance, which is a form of accelerated depreciation, as favouring long-live investment relatives to investment allowances and vice-versa for short-lived ones. On the other hands, Sandomos (1974) analysis suggested accelerated depreciation favoured short-lived capital. The Accelerated cost recovery system (ACRS) which is another way of expressing accelerated depreciation was been criticized as generating adequate allowance for depreciation relative to economic depreciation (Tax Reform Act 1985) because it is used on cost rather than on current cost. In addition, it has been criticized for failure to consider the issues of fluctuating inflation.

Muhammed, *et al.* (2012) empirically investigated the impact of Pakistan taxes on investment and economic growth using the Ordinary Least Square method. Findings show that taxes influence investment indirectly but they do not directly influence economic growth. Thus, higher income taxes inhibit growth and result in dis-investment due to the savings channel.

### 3.1 METHODOLOGY

The Scholes & Wolfson (1992) model specification, which was also applied by Okafor & Akwu (2015) was adopted in the course of this work with modifications. The model mirrors the net tax yields from an investment in individual businesses, incorporated companies and oil and gas businesses. Basically, three different tax regimes are applicable in Nigeria, viz: taxation of individual businesses (unincorporated), taxation of incorporated companies and taxation of companies operating in the upstream (oil and gas) sector. The current maximum rate of tax for individual business is 24%, for corporation it is 30% while for upstream (oil & gas) companies = 85%. For local sales of crude, the rate is 65.75%. The evaluation will attempt to determine the potential tax differentials/incidence for the three forms of businesses. The objective function is to maximize net tax returns of the investor at the investment gestation of 5 years (short-term investments), 10 years (medium term investments) and 15years (long-term investments). To ascertain the real worth of the investment, the differentials shall be converted to present value equivalents. Any form of business that has the capacity to produce the highest rate of present value of return at the end of the investment gestation is deemed to have a lower tax incidence and considered a better investment for tax purposes.

The study rides on the wing of the following assumptions:

- ✓ the conjectural assets invested in unincorporated, incorporated and oil and gas businesses are indistinguishable and have the same characteristics;
- ✓ the assets of these businesses have the same earnings potential and risk exposure;
- ✓ one-fourth (25%) rate of returns is applicable after deducting allowable and chargeable expenses;
- ✓ investment returns and yields are ploughed back into the business.

The following symbols are therefore applied in the model:

R	=	Rate of returns anticipated before tax in each investment	=	25% (1/4)
IBtr	=	Individual business tax rate	=	24%
Ctr	=	Corporate tax rate	=	30%
N	=	Gestation period of the investment	=	5,10 & 15 yrs

### 3.2 Wealth Aggregation under Individual Business Tax Provisions

The following equation is assumed under the individual business for net tax return after the deduction of chargeable and allowable expenses:

$$NTR_i = R - Ib_i R \dots \dots \dots \text{equation (i)}$$

Where:

NTR	=	Net tax return from individuals (sole traders/partners in partnership)
R	=	Rate of return forecasted before tax in each investment
Ib <sub>i</sub> R	=	Individual business tax rate

The yearly incremental rate of earnings on the basis of the assumption that investment yields are ploughed back into the business is :

$$YIR_{it} = R (1 - Ib_t R) \dots \dots \dots \text{equation (ii)}$$

where:

YIR<sub>it</sub> = Yearly incremental rate of investment in individual business  
 T = tax

At the close of the first year of investment, the aggregate value of investment in individual business after

investing N1 would be:

$$AV_{ibt1} = 1 + YIR_{it}$$

Substituting  $YIR_{it}$  for  $R(1-Ib_t)$ ;

$$AV_{ibt1} = 1 + R(1-Ib_t)$$

Thus the aggregated value of the investment at the end of 'n' years would appear as:

$$AV_{ibtn} = \left\{ 1 + R(1-Ib_t) \right\}^n \dots \dots \dots \text{equation (iii)}$$

where:

$AV_{ibtn}$  = Aggregate value of investment in individual business tax at the close of 'n' years.

R = rate of investment

$Ib_t$  = Individual business tax rate

N = number of years

The given numerical value of 25% investment rates, 24% marginal tax rate for personal income tax and the investment durations (5, 10 & 15 years respectively) shall be substituted into equation 3 in the course of computation to arrive at the aggregate value of investment at the close of 'N' years.

### 3.3 Wealth Aggregation under Incorporated Companies Income Tax Provisions

Under the incorporated companies business, the net tax return after deductions of chargeable and allowable expenses would be:

$$NTRc = R - CtR \dots \dots \dots \text{(iv)}$$

where:

NTRc = Net tax return from incorporated companies business profit

R = Rate of returns before tax on each investment (anticipated)

CtR = Company income tax rate

Since it is assumed that investments yields will be ploughed back, yearly incremental of returns from such investment would be:

$$YIRc = R(1 - CtR) \dots \dots \dots \text{(v)}$$

Where:

YIRc = Yearly Incremental rate of investment in an incorporated company

Therefore, at the close of first year of investment in incorporated company, the aggregated value of investment after investing N1 would appear as follows:

$$Avc_1 = 1 + YIRc$$

Substituting  $YIRc$  for  $R(1 - CtR)$

$$Avc_1 = 1 + R(1 - CtR)$$

Where:

$Avc_1$  = Aggregated value of investment at the close of the first year.

When the investment lapses at year 'n', aggregated value would appear as:

$$Avc_n = \left\{ 1 + R(1 - CtR) \right\}^n \dots \dots \dots \text{(vi)}$$

Where:

$Avc_n$  = Aggregated value of investment in company tax provisions at the close of 'n' years. This equation shall be utilized in determining wealth accumulation from investing in incorporated company.

**TABLE 2.1:** Wealth Aggregation under Individual business Tax rule (sole traders & partners in partnership business)

Short-term investment of five (5) years	Medium-term investment of ten (10) years	Long-term investments of fifteen (15) years
$Avibt_n = \{ 1 + 0.25(1 - 0.24) \}^5$	$Avibt_n = \{ 1 + 0.25(1 - 0.24) \}^{10}$	$Avibt_n = \{ 1 + 0.25(1 - 0.24) \}^{15}$
$= \{ 1 + 0.25(0.76) \}^5$	$= \{ 1 + 0.25(0.76) \}^{10}$	$= \{ 1 + 0.25(0.76) \}^{15}$
$= (1 + 0.19)^5$	$= (1 + 0.19)^{10}$	$= (1 + 0.19)^{15}$
$= (1.19)^5$	$= (1.19)^{10}$	$= (1.19)^{15}$
$= 2.38635365$	$= 5.69468379$	$= 13.58953$
$Avibt_n = 2.38$	$Avibt_n = 5.69$	$Avibt_n = 13.59$

**TABLE 3.1 :** Wealth Aggregation under Incorporated Businesses (Companies) Tax Rule ( sole traders & partners in partnership business)

Short-term investment of 5 years	Medium term investment of 10 years	Long-term investments of 15 years
$Avct_n = \{1 + 0.25(1 - 0.30)\}^5$	$Avct_n = \{1 + 0.25(1 - 0.30)\}^{10}$	$Avct_n = \{1 + 0.25(1 - 0.30)\}^{15}$
$= \{1 + 0.25(0.70)\}^5$	$= \{1 + 0.25(0.70)\}^{10}$	$= \{1 + 0.25(0.70)\}^{15}$
$= (1 + 0.175)^5$	$= (1 + 0.175)^{10}$	$= (1 + 0.175)^{15}$
$= (1.175)^5$	$= (1.175)^{10}$	$= (1.175)^{15}$
$= 2.23969733$	$= 5.016244147$	$= 11.23487$
$Avct_n = 2.24$	$Avct_n = 5.02$	$Avct_n = 11.23$

**TABLE 4.1:** Wealth Aggregation under Incorporated Businesses (Upstream Petroleum operation- Exported Sales) Tax Provisions

Short-term investment of 5 years	Medium term investment of 10 years	Long-term investments of 15 years
$Avpt_n = \{1 + 0.25(1 - 0.85)\}^5$	$Avpt_n = \{1 + 0.25(1 - 0.85)\}^{10}$	$Avpt_n = \{1 + 0.25(1 - 0.85)\}^{15}$
$= \{1 + 0.25(0.15)\}^5$	$= \{1 + 0.25(0.15)\}^{10}$	$= \{1 + 0.25(0.15)\}^{15}$
$= (1 + 0.0375)^5$	$= (1 + 0.0375)^{10}$	$= (1 + 0.0375)^{15}$
$= (1.0375)^5$	$= (1.0375)^{10}$	$= (1.0375)^{15}$
$= 1.20209980$	$= 1.44504394$	$= 1.737087$
$Avpt_n = 1.20$	$Avpt_n = 1.44$	$Avpt_n = 1.74$

**TABLE 5.1:** Wealth Aggregation under Incorporated Businesses (Upstream Petroleum Operation –Local Sales) Tax Regime

Short-term investment of 5 years	Medium term investment of 10 years	Long-term investments of 15 years
$Avlpt_n = \{1 + 0.25(1 - 0.6575)\}^5$	$Avlpt_n = \{1 + 0.25(1 - 0.6575)\}^{10}$	$Avlpt_n = \{1 + 0.25(1 - 0.6575)\}^{15}$
$= \{1 + 0.25(0.3425)\}^5$	$= \{1 + 0.25(0.3425)\}^{10}$	$= \{1 + 0.25(0.3425)\}^{15}$
$= (1 + 0.085625)^5$	$= (1 + 0.085625)^{10}$	$= (1 + 0.085625)^{15}$
$= (1.085625)^5$	$= (1.085625)^{10}$	$= (1.085625)^{15}$
$= 1.5079924909$	$= 2.27404135$	$= 3.429237$
$Avlpt_n = 1.51$	$Avlpt_n = 2.27$	$Avlpt_n = 3.43$

#### 4.1 Interpretation and Discussion of Results

The critical values utilized in the comparison are aggregate values derived from the various equations from individual business (sole traders & partners in partnership), incorporated companies and upstream oil and gas firms. Table 2.1 indicates that the net tax return (aggregate value) for individual businesses for 5 years investment period is 2.38, for 10 years = 5.69 and 15 years = 13.59. This result shows that the longer the gestation period of the investment for the sole proprietors and partners in partnership, the better their net tax wealth accumulation. Under Table 3.1, the net tax returns (wealth accumulation) for investment of 5 years, 10 years and 15 years are 2.24, 5.02 and 11.23 respectively. Similar to net tax return for individual business, the results indicate that the longer the duration of the investment the higher the net tax wealth accumulation other factors held constant. The results on Table 4.1 for upstream oil and gas businesses shows no deviation as the net tax returns (wealth aggregation) for investments of 5 years = 1.20, 10 years = 1.44 while 15 years is 1.74. For domestic sales of petroleum products, the net tax return for investment of 5 years = 1.51, 10 years investment = 2.27 while 15 years = 3.43.

**Table 5.1: Comparison of After-tax (Net tax) Wealth Aggregation**

Forms of Business	Net tax wealth accumulation 5 Yrs of inv.	Net tax wealth accumulation 10 years of inv.	Net tax wealth accumulation 15 years of inv.
Individual Businesses	$Avibt_n = 2.38$	$Avibt_n = 5.69$	$Avibt_n = 13.59$
Incorporated Companies	$Avct_n = 2.24$	$Avct_n = 5.02$	$Avct_n = 11.23$
Upstream Coys (Export)	$Avpt_n = 1.20$	$Avpt_n = 1.44$	$Avpt_n = 1.74$
Upstream Coys (Local)	$Avlpt_n = 1.51$	$Avlpt_n = 2.27$	$Avlpt_n = 3.43$

The computation on Table 5.1 above clearly indicate that individual businesses (sole traders and partners in partnership) denotes the best net tax wealth aggregation with a rank of 1 notwithstanding the gestation of the investment. The second best business option with a rank of two (2) is incorporated companies. The third is upstream petroleum companies that sell their products in the local Nigerian market with a rank of 3 while the fourth is upstream petroleum firms that export their products to other countries.



## 5.1 Conclusion

For effective tax planning for the purpose of tax burden shedding, it is imperative for equity investors to understand tax implications and intricacies of their investment so as to minimize the incidence of tax thereby maximizing net tax returns on investment and the aggregate wealth accumulation of the business. Table 5.1 above clearly indicates that individual businesses are the best form of investment for the purpose of gaining net tax advantage in Nigeria as it produces the highest after tax values for all the various investment duration (2.38 for 5 years, 5.69 for 10 years & 13.59 for 15 years). This is followed by incorporated companies (2.24 for 5 years, 5.02 for 10 years & 11.23 for 15 years) and the third is upstream companies (domestic sales of crude) (1.51 for 5 years, 2.27 for 10 years & 3.34 for 15 years). Upstream companies (exported crude) occupied the last position in the ladder of investment for after-tax wealth accumulation (1.20 for 5 years, 1.44 for 10 years & 1.74 for 15 years). Chains of factors and conditions may be responsible for this result including the issue of double taxation, which may not be applicable to individual business but applicable to incorporated companies. Besides, the applicable tax rates varies and the computation is based on various tax rates regime of which individual businesses has upper band of 24%, a single rate of 30% for incorporated companies, 85% petroleum profit tax rates for exported crude for upstream firms and 65.75% for domestic sales for upstream firms. In addition, there is a stringent regulation of incorporated companies more than unincorporated individual businesses and a more stringent regulation of companies operating in the upstream petroleum sector. Complying with the regulations has a huge cost implication on companies.

The comparison of the relative net tax advantage of the studied forms of business is based on tax rates and assumed investment gestations. This is one of the limitations of the study as factors outside tax rates and other non-tax issue should also be considered by the investors. Comparison based on only tax rates may not tell the whole story as government may alter tax rates from time to time, as conditions permit. It may choose also to accord a preference to a particular form of business by encouraging investment in such a preferred sector. Also, while determining after-tax burden, aggregate tax liability and other non tax factors should be considered in conjunction with tax rates.

## 5.2 Recommendations

Business investors should carefully consider tax and non-tax factors while evaluating the net tax burden or the relative tax advantages of what forms of business to choose. This recommendation agrees with the position of Trando & Omer (1993) and Guenther (1992). They submitted in their empirical investigations, that businesses consider tax and non-tax factors in measuring the after tax incidence. This consideration would enable investors to get net tax wealth accumulation in both the short and long gestation period of investments.

Equity investors in incorporated companies may need to consider non-tax factors such as ease of transfer of shares, limited exposure to risk of default and limited life of individual businesses. Corporate entities have limited liabilities, which give them an edge over individual and unincorporated businesses and may make up for the higher tax burden of incorporated organizations. Business investor in individual businesses has a greater risk exposure that the superficial tax shelter may not completely satisfy.

For a higher after-tax return, other constraints arising and enveloping the local and global business environment such as regular alterations in fiscal policies, market volatility and other business matters should be evaluated. In a nutshell, business investors should carefully evaluate tax factors as well as non-tax factors in making investment decision on what form of business to chose. At any given time, equity investors should seek to commit their resources to that business template that has the tendency to gain the best net tax yield and has the highest tax attraction.

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