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The Analysis of the Effect of Corporate Income Tax (CIT) on Revenue Profile in Nigeria

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Abstract

The study empirically analyses the effect of corporate tax on revenue profile in Nigeria and also examines the impact of corporate tax revenue on economic growth in Nigeria. Secondary data were obtained from Central Bank of Nigeria Statistical Bulletin from 1993 to 2013. Multiple regressions analysis were employed to analyze the relationship between the dependent variable (Gross Domestic Product (GDP)) and independent variables (company income tax, value added tax, petroleum profit tax and inflation). It is therefore concluded that corporate income tax has positive significant impact on revenue profile in Nigeria with the Adjusted R^2 of 95.3% which directly enhanced growth in Nigeria. Government derives revenue from corporate tax in discharging their obligation by providing funding for infrastructure, education and public health this invariablely enhance economic growth in Nigeria. It is recommended that government should reduce corporate tax rate rather than eliminate corporate tax in Nigeria, lower corporation tax will increase the demand for labour which in turn raises wages and increases consumption. Therefore, a reduction in the corporation tax rate will reduce the incentives to shift profits out, protecting the Corporation Tax base. Tax reductions will also increase the level of investment in the country. Furthermore, other assistance should be provided for corporations by the government to cushion the effect of corporate tax rate on the payers in Nigeria.

Keywords

Company Income Tax, Exchange Rate, Economic Growth, Inflation, Revenue Profile

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1. Introduction

Background to the Study

Companies operate with profit motives, they enjoying essential services from the government. Government embarks on the construction of better road networks, effective and efficient telecommunication, electricity and water supply. Government also develops human resources by establishing universities and college of technology. It has become important for the company as they come under increased scrutiny over how much tax they pay and whether they are paying the right amount of tax to government, the amounts of the tax that they pay represent a key element of the contribution that they make to the economies as they operate. Taxes are a cost that has to be managed like any other cost, and the level of taxes paid is one of the factors that are taken into account when government making decisions on where, when and how to provide social amenities and infrastructural facilities. Company which benefitting from the government must directly contributing to the government purse, this is where corporate tax comes in. Corporation tax is a tax on the taxable profits of limited companies and some organisations including clubs, societies, associations, co-operatives, charities and other unincorporated bodies.

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Many countries impose corporate tax (corporation tax or company tax) on the income or capital of some types of legal entities. This corporate income tax generally only applies to corporations and treated as taxable entities separate from their shareholders. That is, corporate income is taxed once at the corporate level according to the corporate income tax system. When corporate dividend payments are made or capital gains are realized income is taxed again at the individual-shareholder level according to the individual tax system. The corporate tax system serves to ensure a comprehensive income tax system.

According Simeon et al (2009), the principal corporate income tax measure is the effective tax rate that company pays if it complies with its country's laws, defined as the actual corporate income tax owed by the company relative to pre-tax profits. Company's income taxes are chargeable on the income of all companies operating in Nigeria except those that are specifically exempted by the enabling act. Company taxation is administered by the Federal Inland Revenue Service using the Company's Income Tax Act (CITA). The relevant section of CITA provides that company income tax shall be levied and payable for each year of assessment at the rate of thirty kobo for every Naira in respect of a company's total profits. For the purpose of calculating the amount of tax payable by a company, the federal Inland Revenue board normally makes use of the audited accounts of the Company. The audited accounts will be adjusted to arrive at a taxable profit to which a tax rate of 30% will be applied for Income Tax and 2% will be applied for Education Tax (Olufunke 2012).

Firms maximize profits by optimizing on output and price. Taxes on pure profits or economic rents do not distort a firm's choice of output, and thus do induce distortions or efficiency losses. In practice, since pure profits and economic rents are difficult to measure, taxes are levied on accounting profits. Corporate tax as currently applied is not a tax on pure profits or economic rents. Consequently, the corporate tax in its current form does distort economic decision making, which can reduce overall economic output (Mark and Molly 2014). Corporate income tax rate applied to all corporate income with no write offs of any kind apart from economic depreciation

The amount of corporate income tax paid by companies has become increasingly important in recent years as government adapt their poliicies to encourage growth, while recognising the need to raise revenue to fund social investment progrmme and to repair public finance in the wake of the global economic downturn. It is important to recognise and understand the impact of corporate tax policies on the revenues received by government. The main objective of the study is to analyze the effect of corporate tax on revenue profile in Nigeria and to examine the impact of corporate tax revenue on economic growth in Nigeria.

2. Literature Review

2.1. The Effects of Corporation Tax

Corporate tax or company tax refers to a tax imposed on entities that are taxed at the entity level in a particular jurisdiction. Such taxes may include income or other taxes. The tax systems of most countries impose an income tax at the entity level on certain type(s) of entities (company or corporation). Many systems additionally tax owners or members of those entities on dividends or other distributions by the entity to the members. The tax generally is imposed on net taxable income. Net taxable income for corporate tax is generally financial statement income with modifications, and may be defined in great detail within the system. The rate of tax varies by jurisdiction. The tax may have an alternative base, such as assets, payroll, or income computed in an alternative manner (Wikipedia 2014).

Many countries impose corporate tax on the income or capital of some types of legal entities. A similar tax may be imposed at state or lower levels. The taxes may also be referred to as income tax or capital tax. Entities treated as partnerships are generally not taxed at the entity level. Most countries tax all corporations doing business in the country on income from that country. Many countries tax all income of corporations organized in the country. Company income subject to tax is often determined much like taxable income for individuals. Generally, the tax is imposed on net profits. In some jurisdictions, rules for taxing companies may differ significantly from rules for taxing individuals. Certain corporate acts, like reorganizations, may not be taxed. Some types of entities may be exempt from tax.

Most income tax systems provide that certain types of corporate events are not taxable transactions. These generally include events related to formation or reorganization of the corporation. In addition, most systems provide specific rules for taxation of the entity and/or its members upon winding up or dissolution of the entity. The corporate income tax generates a distortion by double taxing corporate income. In other words, corporations typically pay income tax on income earned at the corporate level and then shareholders pay personal income tax upon the income when it is distributed to them (Austan 2002). According to Stephen (2010), the effects of corporation tax are:

- Corporation tax increases the output prices in the corporate sector. It leads to reduced demand for corporate sector output and consumer substitution towards output of unincorporated sector. If prices rise, consumers bear some

of the burden of the corporation tax.

- Corporate-sector firms will change use of labour and capital. That is a reduction in output will absolutely reduce demand for all factors and they may also substitute labour for capital.
- Impact on wage rates will depend on the impact on overall labour market. That is wages may rise or fall, depending on substitutability of labour for capital, and relative labour intensity of corporate and unincorporated sectors.
- Overall demand for labour (and hence wages) may rise if corporations can easily substitute labour for capital, and the unincorporated sector is relatively labour intensive. If wages rise, burden of the corporation tax lies on consumers. But if wages fall, some part of corporation tax is incident on workers (in all sectors)

Corporate tax reforms and corporate tax systems designed to minimize economic distortions can help promote an efficient economy. Generally, tax systems that impose large tax rates on broad tax bases limit tax-induced distortions in economic activity. Broadly, the corporate tax system distorts the allocation of capital across economic sectors. The corporate tax may reduce economic efficiency to the extent that it causes a misallocation of capital between corporate and non corporate business forms (Mark and Molly 2014)

Corporate taxes might reduce investment in manufacturing because most manufacturing firms operate in the formal sector, but shift activity from the formal to the informal sector in services, where informality is more prevalent (Davis and Henrekson 2004).

Lower corporate tax rates increase returns on corporate investment but to date they have had no measurable impact on foreign direct investment.

Nevertheless, corporate tax rate reductions generate significant economic benefits for the economy as a result of their positive impact on after tax business profits.

According to Kimberly (2012) the corporate income tax raises sizable revenue, and it has important interactions with the personal income tax system. Corporate taxes fall on both domestic and multinational actors that can respond to taxation along a multitude of behavioral margins that frequently stretch across national borders. And the corporate tax has implications for the progressivity of the tax system, but these implications are anything but straightforward.

It can be derived that the corporate tax policy can affect consumption, investment activity and employment to some extent. An appropriate tax system can lead to the optimal resources allocation and to the increase of economic growth. Most studies which are interested in this area however employ only statutory tax rates which have only limited informative value about actual tax burden (Kotlán et al., 2011).

2.2. Taxation of Corporations

Corporations may be taxed on their incomes, property, or existence by various jurisdictions. Many jurisdictions impose a tax based on the existence or equity structure of the corporation. Nigeria imposes a tax on corporations organized in that state based on the number of shares of capital stock issued and outstanding. Nigeria imposes a tax based on stated or computed capital, often including retained profits. Generally, this tax is imposed at a specific rate or range of rates on taxable income as defined within the system. Some systems have a separate body of law or separate provisions relating to corporate taxation. In such cases, the law may apply only to entities and not to individuals operating a trade. Such laws may differentiate between broad types of income earned by corporations and tax such types of income differently. Generally, however, most such systems tax all income of a corporation in the same manner. Some systems like Canada and the United States tax corporations under the same framework of tax law as individuals. In such systems, there is normally taxation differences related to differences between the inherent natures of corporations and individuals or unincorporated entities. For example, individuals are not formed, amalgamated, or acquired, and corporations do not generally incur medical expenses except by way of compensating individuals.

Many systems allow tax credits for specific items. Such direct reductions of tax are commonly allowed for foreign taxes on the same income and for withholding tax. Often these credits are the same as those available to individuals or for members of flow through entities such as partnerships. Most systems tax both domestic and foreign corporations. Often, domestic corporations are taxed on worldwide income while foreign corporations are taxed only on income from sources within the jurisdiction. Many jurisdictions imposing an income tax impose such tax income from a permanent establishment within the jurisdiction.

Corporations are also subject to property tax, payroll tax, withholding tax, excise tax, customs duties, value added tax, and other common taxes, generally in the same manner as other taxpayers. These, however, are rarely referred to as “corporate tax.” Taxable profits for corporation tax also include:

- profits from taxable income such as trading profits and investment profits (except dividend income which is taxed differently)
- capital gains - known as 'chargeable gains' for Corporation Tax purposes.

2.3. Empirical Review of Corporate Tax

Becker, Fuest and Riedel (2012) measured the relative importance of quality and quantity effects of corporate taxation on foreign direct investment. They conclude that booth effects of corporate tax have a negative impact on foreign direct investment.

Buettner and Wamser (2006) showed that corporate taxes affect both the extent and location of international investment. Keuschnigg (2008) created a model of monopolistic competitive industry with extensive and intensive investments and show how marginal changes of these investments reacts to changes on average and marginal corporate tax rates.

Lanaspa, Pueyo and Sanz (2008) pointed to the possibility that governments can influence FDI location decisions of firms through capital tax rates. They confirm the general conclusion that countries with lower tax burdens are FDI net recipients.

Mutti and Grubert (2004) examined the impact of taxes on the horizontally integrated international organizations which are considering foreign investment. They conclude that foreign investment is sensitive to the host country tax rates and this sensitivity is greater in developing than in developed countries and increases over time. Tremblay (2010) brought out that the absence of a neutral relationship between corporate taxes and investment to the human capital. In his study he comments negative relationship after adhering employee and company investing to the human capital and positive relationship after adhering only company investment to the human capital.

Baranová and Janíčková (2012) studied taxation of corporations and their impact on economic growth, they made reference to EU Countries, Dependent variable is represented by the growth of gross real domestic product per capita (GDP / pc) expressed in purchasing power parity. The explanatory variables are capital accumulation (CAP), approximated by the share of investments creation to GDP expressed in purchasing power parity per capita, population (POP) which represents the rate of population growth in the given country and also human capital (HUM), this variable is represented by a share at least secondary educated population in the labor force. Corporation tax burden is approximated by tax quota separated for corporate income tax (TQC), the implicit tax rate on capital (ITRC) compiled, and the effective tax rate (EATR) and (EMTR) received by forward looking micro view. They concluded that reduction of the tax burden will have a greater effect in EU15 countries rather than in the EU new member countries.

3. Research Methodology

3.1. Method of Data Collection

Secondary data was used in this study. The relevant data for the study were obtained from Central Bank of Nigeria (CBN) Statistical Bulletins (various issues), National Bureau of Statistics. The data covered 20 years period from 1993-2013.

3.2. Method of Data Analysis

Regression analysis technique was used to measure the relationship between a dependent variable and independent variables.

3.3. Model Specification

Model 1

This Model evaluated the impact of corporate tax on economic growth in Nigeria. Economic growth (proxies by GDP) is dependent variable where company income tax, value added tax, petroleum profit tax and inflation are independent variables.

$$GDP = a_0 + a_1 CIT + a_2 PPT + a_3 VAT + a_4 INF + \mu$$

$$LOGGDP = a_0 + a_1 LOGCIT + a_2 LOGPPT + a_3 LOGVAT + a_4 LOGINF + \mu \quad 1$$

Model 2

This model also examined the impact of corporate tax on revenue profile in Nigeria. Revenue profile is a dependent variable where Company Income Tax, Value Added Tax, Petroleum Profit Tax and exchange rate are independent variables.

$$RP = a_0 + a_1 CIT + a_2 PPT + a_3 VAT + a_4 EXCH + a_4 INF + \mu$$

$$LOGRP = a_0 + a_1 LOGCIT + a_2 LOGPPT + a_3 LOGVAT + a_4 LOGEXCH + a_4 LOGINF + \mu \quad 2$$

Where:

$LOGGDP$-Log of Gross Domestic Product

$LOGCIT$-Log of Company Income Tax

$LOGPPT$-Log of Petroleum Profit Tax

$LOGVAT$-Log of Value Added Tax

$LOGINF$-Log of Inflation rate

$LOGEXCH$-Log of exchange rate

$LOGRP$-Revenue Profile

4. Presentation and Analysis of Data

4.1. The Effect of Company Income Tax on Economic Growth in Nigeria

The analysis of the effects of corporate income tax (CIT) on economy growth in Nigeria from the period of 1993 to 2013 are stated below

Table 1. The Effect of Company Income Tax on Economic Growth

Dependent variable	Independent variables	Coefficient	Standard error	t	P>/t/	95%Conf. Internal)	
	LOGCIT	1.375388	1.037994	3.33	0.010	-.8862076	3.636983
	LOGPPT	.0216908	.0396638	0.55	0.594	-.1081108	.0647293
LOGGDP	LOGVAT	1.218278	.2653982	4.59	0.001	.6400253	1.796531
	LOGINFL	.0069838	.102435	0.07	0.947	-.216203	.2301706
	CONSTANT	-1.325834	5.650476	-0.23	0.818	-13.63716	10.9855
R-squared = 0.9720	Adj R-squared = 0.9626			Prob > F = 0.0000		F(4, 12) = 103.98 Root MSE = .20531	

Source: Regression using STATA 11

The above table is represented by regression plots below:

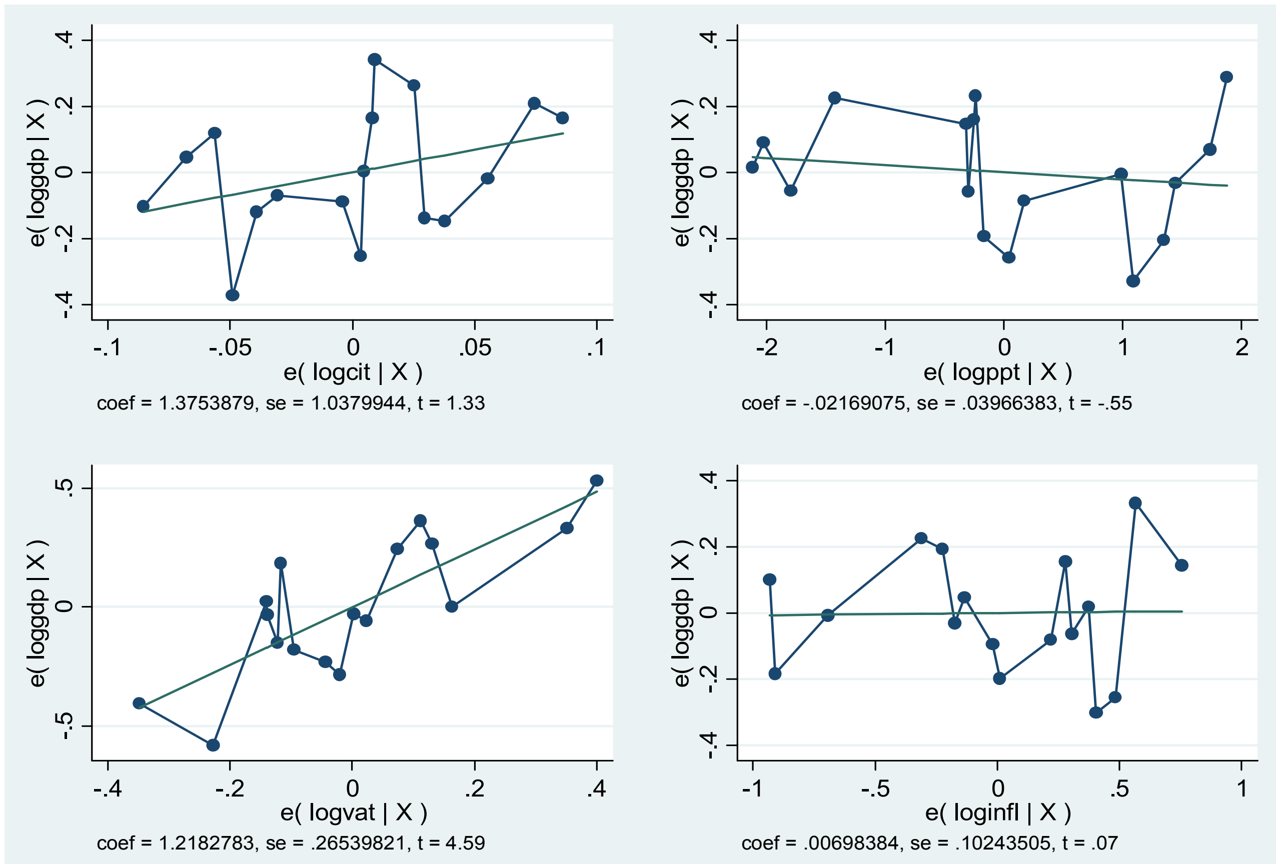

Fig 1. Regression plots of the Effect of Company Income Tax on Economic Growth. Source: Regression using STATA 11

Table 1 and Fig 1 above show the effect of Company Income Tax (CIT) on economic growth in Nigeria. 1% increase in CIT increases GDP by 1.3%; this shows that there is a positive relationship between CIT and GDP. As CIT increases GDP also increases. Also, 1% increase in PPT increases GDP by 0.2%; this shows that there is a positive relationship between PPT and GDP. AS PPT increases GDP also increases. Likewise 1% increase in VAT increases GDP by 1.2%; this shows that there is a positive relationship between VAT and GDP. As VAT increases GDP also increases. Lastly, 1% increase in INFL increases GDP by 0.6%; this shows that there is positive relationship between INFL and

GDP. As INFL increases GDP also increases.

Given the R^2 which is the coefficient of determination as 0.9720(Approximated 97%) with high value of Adj. R^2 which is 96%.It connotes that independent variables incorporated into this model were able to determine the effect of CIT on GDP to the tune of 97% confirmed by probability of F which is 0.0000

4.2. The Effect of Company Income Tax on Revenue Profile in Nigeria

The analysis of the effects of corporate income tax (CIT) on revenue profile in Nigeria from the period of 1993 to 2013 are stated below:

Table 2. The effects of Company Income Tax on Revenue Profile

Dependent variable	Independent variables	Coefficient	Standard error	t	P>/t	95%Conf. Internal)	
RP	CIT	1.727779	1.109898	4.56	0.048	-.7150889	4.170648
	PPT	.03839	.0588556	0.65	0.528	-.0911503	.1679303
	VAT	1.093772	.2857043	3.83	0.003	.4649413	1.722603
	EXCH	-.1380984	.1992828	-0.69	0.503	-.5767169	.30052
	INFL	-.1732558	.1095486	-1.58	0.142	-.4143707	.0678591
	CONSTANT	-3.146802	6.121323	-0.51	0.617	-16.61974	10.32614
R-squared = 0.9680	Adj R-squared = 0.9535		Prob > F = 0.0000			F(5, 11) = 66.58 Root MSE = .21672	

Source: Regression using STATA 11

The above table is represented by regression plots below:

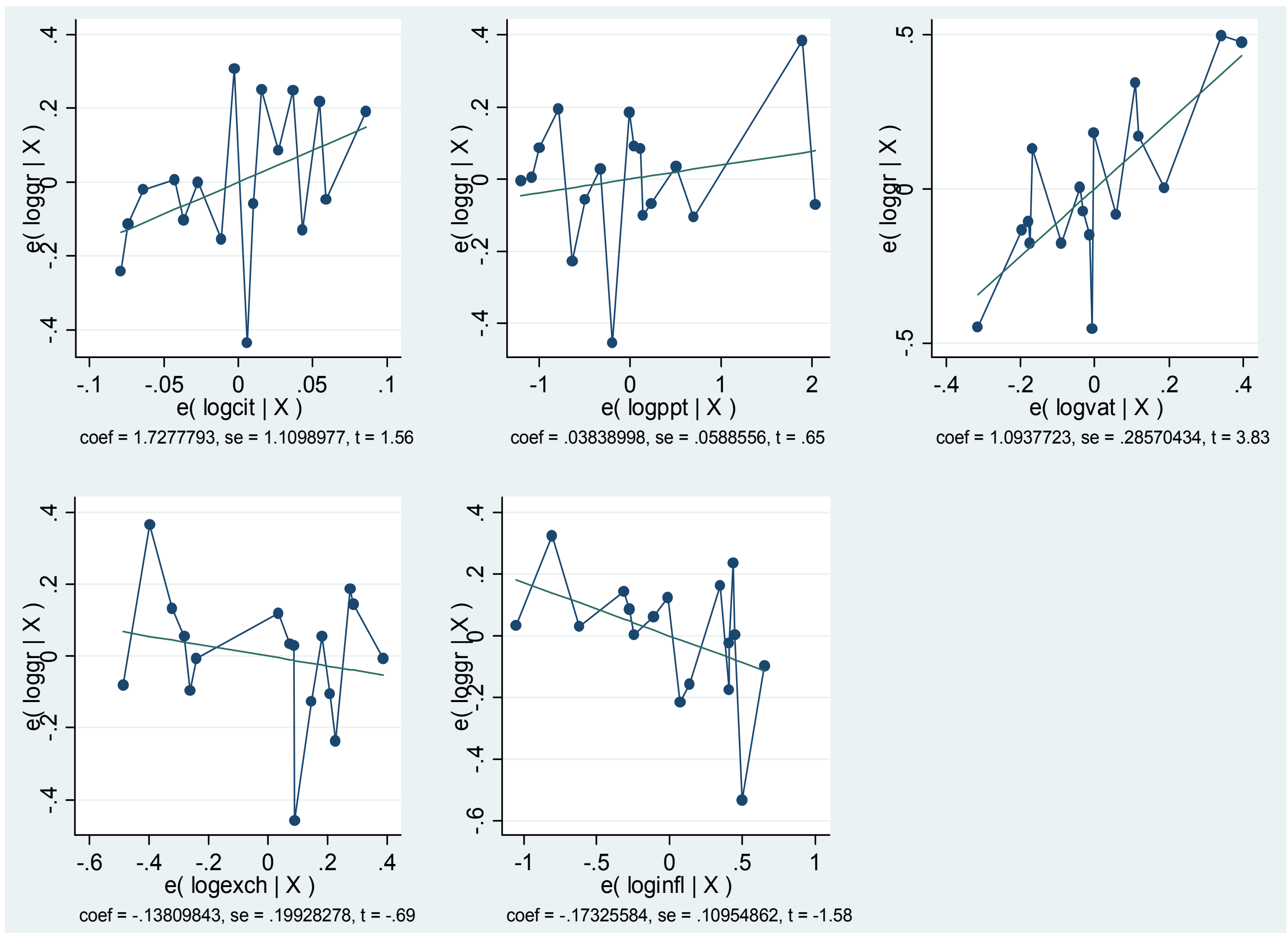

Fig 2. Regression plots of the effects of Company Income Tax on Revenue Profile. Source: Regression using STATA 11

Table 2 and Fig 2 above show the effects of CIT on RP in Nigeria. 1% increase in CIT increases RP of Nigeria by 1.7%; this shows that there is a positive relationship between CIT and RP that is as CIT increases RP. Also increases. Also, 1% increase in increases PPT increases RP by 0.3%; this shows that there is a positive relationship between PPT and RP in Nigeria that is as PPT increases RP also increases. More so, 1% increase in VAT increases RP 1.0%; this also shows that there is a positive relationship between VAT and RP in Nigeria that is as VAT increases RP in Nigeria also increases. Contrarily, 1% increase in EXCH reduces the RP of Nigeria by 0.1%; this shows that there is a negative relationship between EXCH and RP in Nigeria. As EXCH increases RP in Nigeria reduces. Lastly, 1% increase in INFL also reduces RP by 0.1%, this also shows that there is a negative relationship between INFL and RP in Nigeria. As INFL increases RP in Nigeria reduces.

Given the R^2 which is coefficient of determination as 0.9680(Approximated 96%) with high value of Adj.R^2 which is 95%. It connotes that independent variables incorporated into this model were able to determine the effect of CIT on RP to the tune of 96% confirmed by probability of F which is 0.0000.

5. Summary and Conclusions

This study examined the effects of corporate tax on revenue profile; it also determined the impact of corporate tax revenue on economic growth in Nigeria. The result of the study showed that there is a positive significant impact of corporate tax on revenue in Nigeria. Also, corporate tax enhanced growth positively in Nigeria as supported by Baranová and Janíčková (2012) and Kotlan et al (2011). Government derives revenue from corporate tax in discharging their obligation by providing funding for infrastructure, education and public health, these invariably enhance economic growth in Nigeria. The corporate income tax raises sizable revenue and it has important interactions with the personal income tax system. Corporate income tax provide effective hedge against inflation in Nigeria. This is explained by the significant and negative relationship between inflation and corporate income tax. The study also revealed that there is a negative relationship between exchange rate and revenue profile in Nigeria, an increases in exchange rate reduces the revenue in Nigeria. In the same vein, inflation also reduces the total revenue to Nigeria government. Conclusively, corporate income tax has positive significant on revenue profile in Nigeria.

It is therefore recommended that government should reduce corporate tax rate rather than eliminate corporate tax in Nigeria, lower corporation tax will increase the demand for labour which in turn raises wages, and increases consumption. Therefore, a reduction in the corporation tax rate will reduce the incentives to shift profits out, protecting the Corporation Tax base. Tax reductions will also increase the level of investment in the country. Furthermore, other assistance should be provided for corporations by the government to cushion the effect of corporate tax rate on the payers in Nigeria.

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