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## **CORPORATE TAX SHIELD OF CHARITY DONATION ON EARNINGS MANAGEMENT OF DEPOSIT MONEY BANKS IN NIGERIA**

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**Abstract:** *This ascertained the effect of corporate tax shield of charity donations on earnings management of deposit money banks in Nigeria. Ex post Facto research design was adopted. Data were extracted from audited annual reports and accounts of the sampled banks in Nigeria spanning from 2014 to 2023. From the findings, the result revealed that the probability of the slope coefficients indicate that;  $P\text{-value} = 0.4724 > 0.05$ ). The co-efficient value of;  $\beta_1 = 1536.19$ ;  $t = 0.792$  for TAC implies that charity donations are positively affect earnings management, but not statistically significant at 5%. Based on the findings, the study recommended that since charitable donations can also lower a taxpayer's obligations. In order to qualify, the tax authority should ensure that banks use itemized deductions on his tax return and that the donations are qualify as it must be given to an approved organization.*

**Key word:** *Corporate tax shield, Donation and Earnings management.*

### **Introduction**

One of the motivations for earnings management is taxation, the phenomenon of effective tax rate increases the occurrence of earnings management and the quality of corporate profits (Martani & Persada, 2019). Studies such as Desai and Dharmaphala (2018, 2019b) have investigated the book-tax trade-off where firms must balance the incentive to minimize taxes and to maximize book income and studies linking earnings management and corporate tax shield have explained the relationship relying heavily on the agency theory. They argued that due to the conflict of interest between managers and shareholders, opportunistic managers, seeking to maximize their self-interest, resort to tax shield practices to divert wealth to them through earnings management. Managers opportunistically adjust earnings to expropriate wealth from shareholders to themselves (Hunt, Moyer, & Shevlin, 2017). Moreover, the literature suggests one incentive for managing earnings is corporate tax shield. Christensen and Murphy (2020) argued that the corporate tax shield is value accruing to shareholders hence managers is encouraged to employ their best effort to minimize taxes. A corporate tax shield is favoured by shareholders (Graham, Hanlon, Shelvin and Shroff (2017); it has been described as a

transfer of value from the government to the shareholders. However, tax shield techniques like, interest payment, debt payment and differed tax liability give room for opportunistic management to manage earnings in a way that is beneficial to managers instead of the owners (Desai & Dharmapala, 2018). Hence, managers, managing earnings are more likely to insulate themselves by avoiding more taxes, as avoidance offers them shield from shareholder scrutiny. This is possible because corporate tax shield techniques are require obfuscation of transactions to guarantee tax benefits whilst shielding such actions from tax authorities (Goncharov & Zimmermann, 2016a). Such mystification of transactions and its consequent shielding from the tax authorities reduce the ability of shareholders to monitor managers' behaviour.

Governments anywhere need tax revenues to provide socially mandated services and infrastructure. However, the drive to increase government revenue through effective corporate tax regime is often jeopardized by the competitive strategy of tax avoidance adopted by commercial banks. However, banks generally, under competitive market environment, are more motivated to avoid tax so as to boost their profit levels and have more capital to compete well in the market. They may not increase the charges for their services so as to retain their customers, but prefer to engage in activities leading to tax avoidance in order to remain in competition and declare reasonable profit. The study therefore, sought to assess corporate tax shield charity donations on earnings management of deposit money banks in Nigeria.

## **Conceptual Review**

The debt tax shield has stimulated decades of debate regarding firm valuation and the cost of capital. In 1963, Modigliani and Miller ~hereafter MM first hypothesized that the tax benefits of debt increase firm value and decrease the cost of using debt capital. In 1977, Miller countered that firms pass out the tax benefits of debt to Creditors through high interest rates to compensate them for the personal tax disadvantage of debt. Graham (2000) uses firm-level Financial Statement data to calculate the tax benefit of debt and estimates the mean corporate tax benefit of debt for a large sample of Compustat firms equals approximately 10 percent of total firm value. Although he does not provide direct market evidence of the debt tax shield, Graham demonstrated that firms derive substantial tax benefits from debt.

Few studies seek direct market evidence for the debt tax shield. For example, Engel, Erickson, and Maydew (1999) found out that firms derive substantial net tax benefits when they swap tax-deductible trust preferred stock for nondeductible regular preferred stock. On the other hand, Fama and French (1998) used cross sections to regress firm value on interest expense, which proxied for debt and various controls for profitability. They found a strong negative relation between debt and firm value, concluding that "imperfect controls for profitability probably drive the negative relations between debt and value and prevent the regressions from saying anything about the tax benefits of debt.

Tax shields according to Murray (2019) involved investments and purchases that are tax deductible. Some common examples include charitable deductions for individuals and businesses. Charitable giving is a deductible expense for both individuals and businesses. For an individual to take a tax deduction on charitable giving, they must itemize deduction. Corporations can include charitable donations with some limits and restrictions.

## **Charitable Donations**

Similar to the tax shield offered in compensation for medical expenses, charitable donation can also lower a taxpayer's obligations (Drummond, 2000). In order to qualify, the deductible amount may be as high as 60 percent of the taxpayer's adjusted gross income, depending on the specific circumstances. For donations to qualify, they must be given to an approved organization (Purnama & Nurdiniah, 2019).

For the 2020 tax year, there's a twist: you can deduct up to ₦300 of cash donations without having to itemize. This is called an "above the line" deduction. In 2021, the deduction rises to ₦300 per person rather than per tax return, meaning a married couple filing jointly could deduct up to ₦600 of donations without having to itemize.

## **Earnings management**

The first step in estimating a proxy for accruals-based earnings management is to calculate the total accruals of a firm. These accruals are assumed to include both discretionary and nondiscretionary components. The discretionary accruals are accruals that the management has control over whereas the non-discretionary accruals constitute the expected level of accruals or accruals that the management has no or little control over (accruals mandated by different accounting rules). The second step is to apply a linear regression approach to separate the two accrual forms from each other by modelling non-discretionary accruals as a function of change in sales, tangible assets and performance by industry. The residuals of the regressions are then considered to be the discretionary part and used as a proxy for earnings management. Other approaches in the literature incorporate studying specific accruals or distributions of earnings. The discretionary accrual calculation is done by applying Jones model (1991) which has been modified by Guenther (1994). Such model uses current accrual from total accrual to estimate the value of discretionary accrual and nondiscretionary accrual because current accrual influences taxable income (Wijaya & Martani, 2011).

## **Empirical Reviews**

Oranefo (2022) examined the effect of effective tax rate on cash flow of manufacturing firms in Nigeria and Ghana, using a sample of consumer manufacturing firms of both countries and Ordinary Least Square analysis. The study showed that the sampled firms in Nigeria have a favourable impact on cash flow while that of Ghanaian has no significant effect. Ndum (2022) ascertained the effect of tax avoidance on earnings management in Nigerian deposit money banks from 2010 to 2020; using nine deposit money banks with international authorization constitute the sample size of the study.

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Ordinary Least Square with the aid of E-View 9.0 used to arrive at a logical conclusion. The study showed that amortization has significant effect on Earnings Management of deposit money banks in Nigeria. Ofurum, Okoye, and Ezejiofor (2021) determined corporate tax shield and earnings management of commercial banks in Nigeria, using thirteen commercial banks with international authorization constituted the sample size of the study. Ordinary Least Square was used for the analysis. The study found that medical expenses and amortization have a positive relationship with and significant effect on earnings management of commercial banks in Nigeria. Elena, Lubos, Lucia, and Lucia (2021) assessed the influence of the tax shield and earnings management on a corporate capital structure, in 14 countries. The interest tax shield found to be statistically insignificant for deciding between debt and equity, while the non-debt tax shield is negatively correlated with debt. Prabowo, et al (2020) assessed debt and earnings management in Indonesia. Analysis was based on a sample set consisting of 497 firms engaging in manufacturing operations listed in Indonesia Stock Exchange during the period of 2009 to 2014. The results revealed that corporate debt is an important determinant of earnings management as it was statistically significant. Purnama and Nurdiniah (2019) examined profitability, firm size, and earnings management: The moderating effect of managerial ownership. The study sought to know: if a company size influence profit; whether managerial ownership can afford to strengthen or weaken the influence of the size of the company towards profit. Findings revealed that profitability has a positive relationship with and earnings management while firm size negatively affected earnings management. Managerial ownership is found not to be moderating variable on the profitability, firm size and earnings management. Inua (2018) in a similar study undertook to examine determinants of corporate effective tax rate: Empirical evidence from listed manufacturing companies in Nigeria. The objective of the study was to identify how some corporate governance attributes such as (board size and board independence); as well as firm characteristics such as firm size and leverage, determine the effective tax rate (ETR) of manufacturing firms in Nigeria. Out of the 170 listed firms in Nigeria, as at 31<sup>st</sup> Dec. 2016, 30 manufacturing firms with complete and consistent data were selected and the period under consideration was from 2011 – 2016. Linear regression was used to analyze the data. The analysis revealed that firm leverage, board independence and board size are negatively related to and significantly affect effective tax rate while firm size is negatively related to but insignificantly affect ETR. This implies that the higher the firm leverage, board independence and board size, the lower the effective tax rate paid by manufacturing firms in Nigeria. Zhu, Lu, Shan, and Zhang (2015) evaluated how Chinese reverse merger firms trade off and conduct income increasing earnings management. The study used both accruals-based and real activities-based methods over the period 1990-2011 using descriptive analysis. It was found that firms substitute the two methods. Norhayat, Rahayu, and Noor (2013) examined the association between leverage and real earnings management (REM) activities. This study used Abnormal Cash Flow from Operation, Abnormal Production Cost and

Abnormal Discretionary Expenses model by Roychowdhury, 2006, as a proxy for REM. Using a sample of 3,745 firm-year observations for the period of 2006-2011, the study found that there is a significant negative association between leverage and REM. The finding also revealed that leveraged firms have lower levels of REM. This supports the view that leverage limits the REM activities, which in turn, could affect the quality of accounting earnings. Llukani (2013) carried out a study on earnings management and firm size: An empirical analyze in Albanian market. This study aimed to bring evidence and analyze earnings management initiatives in Albanian context, and identify the relationship between earnings management and firm size. Empirical analysis was based on a valid sample of 75 firm-year observations. It considers historical data for a three-year period (2009-2011) from entities selected, mainly from the private sector. Log of total assets is used as proxy for firm size, and absolute value of discretionary accruals for earnings management. The results showed that firms in the Albanian market are engaged in earnings management initiatives and there are no significant differences concerning earnings management initiatives and practices, comparing large and small size companies.

## Methodology

The study adopted *ex-post facto* research design. This design is considered appropriate because the study aims at measuring the relationship between one variable and another in which the variables cannot be manipulated, hence the adoption of the design. The researchers used purposive sampling technique to select thirteen (13) quoted deposit money bank on the Nigeria Exchange Group out of the twenty one banks stated as population of this study. The choice of these banks was based on the availability of data that covered the period under study.

Data were collected from only secondary sources. The data were extracted from the annual reports and audited accounts of the banks under study from 2014 to 2023.

## Model Specification

The model for this study was adapted from the study of Ofurum, Okoye, and Ezejiofor (2021) which was modified to suit the variables under study. The adapted model is presented as thus:  $EAMGT = f(MDE, CHD, AMT, DEP)$ .

In the course of modifying the model a variable such as Effective Tax Rate (ETR) was added to make the model conformed to the earlier stated specific objectives. Thereafter the newly modified model of this study is presented in functional form as stated below.

$$EAMGT = f(ETR, MDE, CHD, AMT, DEP) \dots \dots \dots \text{Model 1}$$

The econometric form of the model is stated in the equation below.

$$EAMGT_{it} = \beta_1 ETR_{it} + \beta_2 MDE_{it} + \beta_3 CHD_{it} + \beta_4 AMT_{it} + \beta_5 DEP_{it} + \sum_{it} \dots \dots \dots \text{Eqn 1}$$

Where: EMT = Earnings Management

CHD = Charity Donation

$\beta_1$  = Constant/Intercepts

$\beta_1 - \beta_5$  = Regression Coefficient

$\Sigma$  = Error Term

i = Cross section

t = Time Period

## Measuring Dependent Variable (Earnings Management)

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

$$TAC = NDTAC + DTAC$$

Where:

TAC = Total accrual period t

NDTAC = Value of non-discretionary accruals

DTAC = Discretionary accrual

## Method of Data Analysis

In order to investigate corporate tax shield and earnings management, the study used descriptive statistics, correlation and simple regression analysis.

### Decision rule:

The study's hypotheses were tested at 5% level of significance. In view of that, when the p-statistics is less than 0.05, the null hypotheses is rejected and the alternate hypothesis is accepted. But when the P-statistics is higher than the critical level of 0.05, the null hypotheses is not rejected.

### Data Analysis

The data gathered were analyzed with the help of E-view 9.0. The results are presented in the relevant tables.

### Descriptive Statistics

The descriptive statistics provides evidence on the mean distribution, maximum, minimum, standard deviation, median and the count of the data collected which span from 2014 to 2023.

**Table 1: Descriptive Statistics**

	TACC	CHD
Mean	1.56E+04	950809.5
Median	3286E+04	382792.5
Maximum	4.25E+09	4059824.
Minimum	-3.41E+09	211568.0
Std. Dev.	3.09E+09	1302819.
Skewness	-0.145120	1.737266
Kurtosis	2.204286	4.370779

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Jarque-Bera	1.458353	5.813085
Probability	0.381188	0.054664
Sum	2.53E+05	9508095.
Sum Sq. Dev.	7.64E+28	1.53E+13
Observations	20	20

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Source: E-view 9 Output

Table above revealed the mean for each of the variables, their maximum values, minimum values; standard deviation and Jarque-Bera (JB) statistics (normality test). The result in table 1 provided some perception into the nature of the deposit money banks in Nigeria that used in this study. It was observed that on the average over the ten (10) year period (2014-2023), the sampled quoted banks in Nigeria were characterized by negative average TACC (2.560). It was also observed that Charity donation (CHD) mean stood at 950809.5 with maximum and minimum values of 4059824.0 and 211568.0 respectively.

From Table 1 above, the Jarque-Bera (JB) which test for normality or the existence of outlier or extreme values among the variables shows that all our variables are normally distributed and significant at 5% level and the result could be generalized. This also implies that a least square regression can be used to estimate the regression models.

### Correlation Analysis

In examining the association among the variables, we employed the Pearson correlation coefficient (correlation matrix) and the results are presented in table 2.

**Table 2: Pearson Correlation Matrix Result**

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	TACC	CHD
TACC	1	
CHD	0.66368	1

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Source: E-view 9 Output

The use of correlation matrix in most regression analysis is to check for multicollinearity strength and direction of the relationship between two variables. It evaluates the extent variations in one variable correspond to changes in another variable. The table 2 focused on the correlation between earnings management dependent variable and explanatory variable which consists of Charity Donations (CHD). The findings from the correlation matrix revealed that the independent variable was positively and strongly correlated with the dependent variable.

### Test of Hypothesis

**H<sub>01</sub>:** Charity donations have no significant relationship with earnings management of deposit money banks in Nigeria.

### Testing of Hypotheses

### Table 3 Regression Analysis Result

Dependent Variable: TACC

Method: Least Squares

Date: 12/12/24 Time: 17:04

Sample: 2014 2023

Included observations: 20

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-9.67E+09	2.50E+09	-3.865690	0.0181
CHD	1536.193	1938.448	0.792486	0.4724
R-squared	0.841769	Mean dependent var		-2.70E+08
Adjusted R-squared	0.764731	S.D. dependent var		3.09E+09
S.E. of regression	1.14E+08	Akaike info criterion		34.80861
Sum squared resid	4.08E+17	Schwarz criterion		34.99016
Log likelihood	-216.0431	Hannan-Quinn criter.		44.60945
F-statistic	11.50642	Durbin-Watson stat		1.657087
Prob(F-statistic)	0.056451			

In Table 3, the regression analysis was conducted to test the relationship between Tax shield and earnings management. The result revealed that charity donations have a positive and insignificant effect on earnings management of deposit money banks in Nigeria. From the findings in the Table 3, the value of adjusted R squared was 0.80. This implies that only 80% changes in earnings management of banks could be accounted for by independent variable CHD, while 20% was explained by unknown variables that were not included in the model.

The Durbin-Watson Statistic of 1.657087 suggests that the model does not contain serial correlation. The F-statistic of the regression is equal to 11.50642 and the associated F-statistical probability is equal to 0.056, so the alternative hypothesis was accepted and the null hypothesis was rejected.

The probability of the slope coefficients indicate that; P-value = 0.4724 > 0.05). The co-efficient value of;  $\beta_1 = 1536.19$ ;  $t = 0.792$  for TAC implies that charity donations are positively related to earnings management, but not statistically significant at 5%.

Since the P-value of 0.4724 is higher than the critical value of 5% (0.05), then, it would be upheld that charity and donation has a positive insignificantly effect on earnings management of deposit money banks in Nigeria at 5% level of significance, thus,  $H_0$  is preferred to  $H_1$ .

## Conclusion and Discussion

This ascertained the effect of corporate tax shield of charity/ donation on earnings management of deposit money banks in Nigeria. Data were extracted from audited annual reports and accounts of the

sampled banks in Nigeria spanning from 2014 to 2023. From the findings, the result revealed that the probability of the slope coefficients indicate that; P-value = 0.4724 > 0.05). The co-efficient value of;  $\beta_1 = 1536.19$ ;  $t = 0.792$  for TAC implies that charity donations are positively affect earnings management, but not statistically significant at 5%. The result from the findings are in congruence with Falikhatun and Gantowati (2020); Tjondro and Pemeta (2019); Ayunku and Uzochukwu (2020). However, the findings showed that tax shield has significant effect on earning management in Nigeria. Based on the findings, the study recommended that since charitable donations can also lower a taxpayer's obligations. In order to qualify, the tax authority should ensure that banks use itemized deductions on his tax return and that the donations are qualify as it must be given to an approved organization.

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