

## Tax Incentives and the Growth of Manufacturing Firms in Nigeria

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**Abstract:** This study examined the effect of tax incentives on the overall performance of manufacturing industries in Nigeria. The study aimed at identifying the effect tax incentives would have on the performance of manufacturing firms. A total of 100 structured copies of questionnaire were distributed to the staff of the selected manufacturing industries. The hypotheses were tested using regression analysis. The results of the empirical findings showed that tax incentives would affect the funds available for investment in the manufacturing industries. The findings also show that companies that are privileged to enjoy tax incentives from the government are willing to pay their taxes as at when due and that tax incentives would significantly increase the number of manufacturing industries in Nigeria. The study therefore, recommends that there should be more awareness among manufacturing companies in Nigeria on the tax incentives available to them. They should also be encouraged to take advantage of the tax incentives in order to increase the number of manufacturing industries in Nigeria.

**Key words:** Tax incentives, manufacturing, performance, empirical, industries

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### INTRODUCTION

**Tax incentives and firms' growth in Nigeria:** Taxation is a worldwide phenomenon that cuts across every organization and individual. The history of taxation in Nigeria began in 1914 after the amalgamation of the Southern and Northern Nigeria. The North had a very effective system of taxation because of their system of government. In the South, it was a different story especially with the Igbos who even rioted in protestation that they should not be taxed. With the famous crises that took place in 1930s, many countries' government, Nigeria inclusive were more aware of why taxes should be collected for the purpose of increasing their revenue (Ohaka and Agundu, 2012).

The necessity of tax triumphs because, it provides income for government. If this income is not available, government might not be able to execute key projects that cannot be implemented by individuals on their own (some of which includes road provision and health infrastructures). Consequently, individuals and organizations that generate more revenue are required to have increased tax and those with no income should also enjoy the application of tax revenues via the provision of benefits made available to everyone (Fakile and Uwuigbe, 2013).

In Nigeria, there are various forms of tax such as personal income tax, companies income tax, capital gains tax, value added tax and petroleum profit tax to mention but a few. In view of promoting indigenous investment in Nigeria, tax incentives are put in place to encourage the growth of local manufacturing industries which will in turn reduce the amount of imported goods. Tax incentives include tax holidays, tax reduction, capital allowances, the right of tax payers to election and incentives on processing zone.

Fiscal tax incentives in Nigeria have been in existence since, 1949 and they are still very much in existence in modern day governance (Fowowe, 2013). This is evident from the fact that from 2005 to date, there have been different technical institutions formed by the finance ministry to oversee and assess the tax incentives/structure in the country and make recommendation that will attract investments and promote development and growth in the country.

These tax incentives are anticipated to bring about investments which would eventually bring about higher future production in the economy. The Kwara State Governor, Abdulfatah Ahmed during his visit to Ilorin in September 2013, on a delegation by the Manufacturing Association of Nigeria (MAN) suggested the granting of tax holidays to the manufacturing sector as part of

strategies to reactivate the nation's ailing industries. According to the governor "granting tax holidays to genuine manufacturers would not only bring ailing industries back to life but also, provide employment to millions of idle hands which have become devil's workshop".

However, despite the efforts made by the government, there are still a lot of ailing industries in Nigeria and this has caused a lot of concern to the government. According to Adekoya, some of the problems faced by manufacturing industries include difficult and unfavorable operating environment due to infrastructural deficiency and high cost of fund and unavailability of fund to finance capital projects like expansion. Another major problem facing the manufacturing industries thereby impeding its development is the problem of excessive taxation in the form of high tax rate, double and multiple-taxation. Although, taxation forms one of the major sources of revenue to government apart from oil, it may affect manufacturing firms negatively if not properly applied and administered. Thus, higher tax rates serve as disincentive to firms for investment and expansion as, it leaves firms with less money to reinvest. This eventually discourages productivity, investment and also, the level of output by the manufacturing industry.

In light of the above, this study examined the extent to which tax incentives affect the funds available for investment in manufacturing industries in Nigeria. It further looked into how tax incentives affect the productivity level and growth of manufacturing industries in Nigeria.

**The scope of study:** This study covered 20 selected small and medium scale manufacturing industries in the South-West region of Nigeria. The South Western part of Nigeria is selected for this research with particular emphasis on Ogun State. This state was selected because it is one of the major industrial areas in the country.

**Research hypotheses:** To achieve the objectives of the study, the following hypotheses stated in their null forms were formulated and tested.

- $H_1; H_0$ : Tax incentives do not significantly affect the funds available for investment in manufacturing industries in Nigeria
- $H_2; H_0$ : Tax incentives do not significantly impact on the productivity of manufacturing industries in Nigeria
- $H_3; H_0$ : Tax incentives do not significantly affect the growth of manufacturing industries in Nigeria

**Literature review:** In Nigeria, the Institute of Chartered Accountants (2006) and the Chartered Institute of Taxation (2002) described tax as an imposed contribution of money to government pursuant to a defined authorized legislation. In other words, it is a compulsory payment (tax) that is guided by law.

Tax is, therefore, a major source of income to the government and the government uses these tax payments to cater for the needs of the society. Tax could be described as giving to the government and then the government is giving back to the community the same way the community gave it to them. So, it is a two way; thing the community or tax individuals give a particular or specified amount or rate of amount to the government and then the government provides individuals and operating firms with the necessary amenities.

However, operating companies are always interested in the relief or incentives that government is willing to offer to reduce the amount of tax to be paid by them in order to provide them with more funds to invest in capital projects. This relief offered by the government reduces the tax burden on the company and goes a long way in encouraging them to pay their taxes.

**Tax incentives:** Incentives in tax remains very popular and it is still evolving in the world. This study, therefore, defines tax incentive as all actions that offer additional satisfactory tax treatment of some particular actions or segments in relation to what is allowed for general industry. In relation to this description, a general reduction in the rate of tax or depreciation scheme for all firms will not be seen as a tax motivation (Klemm, 2009).

Okauru noted further that the truth about tax incentives in Nigeria is that not many people truly take advantage of the incentives that exist. Where this advantage is taken, past trends have suggested an individual corporate approach rather than an industry-wide approach.

**Forms of tax incentives:** Ohaka and Agundu (2012) identified the following forms of tax incentives.

**Tax holidays:** Temporary exemption of a new firm or investment from certain specified taxes, typically at least corporate income tax. Sometimes, administrative requirements are also waived, notably the need to file tax returns. Partial tax holidays offer reduced obligations rather than full exemption.

**Special zones:** These are special areas that are geographically located to enjoy tax exemptions of varying scope, since they are basically targeted for exporters.

**Investment tax credit:** Incentive here are received when qualified assets are acquired for use (production).

**Investment allowance:** This is the subtraction of a portion of an investment from the profit that is taxable (in addition to depreciation). The worth of an allowance is the product of the allowance and the tax rate. Contrary to a tax credit, its value varies across firms unless, there is a single tax rate. Besides, this value is affected by changes to the tax rate with a tax cut bringing about a reduction.

**Re-investment allowance:** It is an allowance that is added to existing firms that incur large expenditure.

**Accelerated depreciation:** This is calculating depreciation at a quicker schedule than available for the rest of the economy.

**Exemptions from various taxes:** Industries can be exempted from taxes on imported goods. Such taxes includes tariffs, excises duties and VATs.

**Financing incentives:** Reductions in tax rates which apply to those that provide funds.

The Nigerian Government has put in place a number of investment incentives for the stimulation of private sector investment from within and outside the country. While some of these incentives cover all sectors, others are limited to some specific sectors. The nature and application of these incentives have been considerably simplified (Akinyomi and Tasié, 2011; Oriakhi and Osemwengie, 2013).

**Prior studies:** Klemm (2009) opined that tax competition may likely serve as a motivation for countries tax reforms. This is also in line with other arguments. In a related study, Amira *et al.* (2011) observed that an increase in tax will negatively affect the two financial criteria of the performance.

Ohaka and Agundu (2012) in a related study established the fact that enhancing of firm's Return On Equity (ROE) is a direct consequence of reduction of corporate tax liability through tax incentives. They were of the opinion that firms which receive tax incentives pay less tax and therefore recorded a higher ROE as well as Return On Assets (ROA).

Further studies carried out by Akinyomi and Tasié (2011) examined the impact of the tax incentives on the overall performance of registered small scale industries in Rivers State, Nigeria. Eleven, out of the twenty two registered small scale food and beverages manufacturing industries in Rivers State were selected randomly for the study. Questionnaires were

administered to 260 respondents in the selected companies. The chi-square was used in the analysis of data and hypotheses testing respectively. The findings revealed that there are various tax incentives available to small scale industries and the operators in these industries are very familiar with them. It was also discovered that tax incentives do significantly affect the profitability, staff strength and the growth and development of small scale industries positively. Their conclusion was that tax incentives do have significant effect on the economic performance of small scale industries. Specifically, tax incentives help in improving the after tax profit and capital employed of small scale industries in Nigeria.

Olabisi (2009) observed that tax incentive has a positive impact on investment decision and tax incentives coupled with political stability stimulate the economic growth. Also, it leads to a decline in revenue generated by the government. However, this decline is compensated for with economic development. They concluded that to bring about sustainable working capital for companies the tax regime must not be outrageous. However, most of all these studies, focused on the effects of tax incentives on incorporated firms and not SMEs. To this end, therefore, this study focused on selected SMEs that operate in Ogun state (one of the most industrial states in Nigeria).

## MATERIALS AND METHODS

The focus of this research is on the impact of tax incentives on corporate financial performance in Nigeria. For the purpose of this study, the population consisted of all the small and medium scale manufacturing firms in Nigeria. Using the judgmental sampling technique, a sample of twenty small and medium manufacturing companies was selected in Ogun State.

In eliciting data from the selected samples, five copies of questionnaire were administered to five accountants and tax officers in the selected firms (making a total of 100 copies). Data retrieved from respondents was analyzed using the regression analysis. Regression was employed in testing the hypotheses because it is a statistical forecasting model that is concerned with describing and evaluating the relationship between a given variable (usually called the dependent variable) and one or more other variables (usually known as the independent variables).

## RESULTS AND DISCUSSION

**Data analysis:** The presentation of data was done through frequency tables and percentages. Analysis of

response from respondents was presented in Table 1-8 using Statistical Package for Social Sciences (SPSS) to ensure accuracy.

Table 1 shows the alpha coefficient. Alpha coefficient ranges from 0-1 and may be used to describe the reliability of factors extracted from likert scale (SA: Strongly Agree, A: Agree, U: Undecided, D: Disagree, SD: Strongly Disagree). The higher the score, the more reliable the generated scale is. With the above reliability of 66.9%, we can reasonably conclude that the instrument is reliable.

**Hypothesis testing:** Regression analysis was employed in testing the three hypotheses in this research work.

Table 1: Reliability statistics

Reliability statistics	Values
Cronbach's alpha	No. of Items
0.669	10

Table 2: Analysis of respondents

Response	No. of respondents	Percentage
Returned	93	93
Not returned	7	7
Wrongly filled	3	3
Total distributed	100	100

Field survey (2014)

Table 3: Analysis of ANOVA<sup>a</sup> of different model

Model	Sum of squares	df	Mean square	F	Sig.
Regression	4.224	1	4.224	4.683	0.033 <sup>b</sup>
Residual	79.376	88	0.902	-	-
Total	83.600	89	-	-	-

<sup>a</sup>Dependent variable: Tax incentives will increase the availability of funds to finance capital projects; <sup>b</sup>Predictors: (constant) is your company privileged to enjoy certain tax incentives from the govt?

Table 4: Analysis of standardized and unstandardized coefficients<sup>a</sup>

Model	Unstandardized coefficients		Standardized coefficients		Sig.
	$\beta$	SE	$\beta$	t	
Constant	2.624		0.335	7.844	0.000
Is your company privilege to enjoy certain tax incentives from the govt?	-0.598	0.276	-0.225	-2.164	0.033

<sup>a</sup>Dependent variable: Tax incentives will increase the availability of funds to finance capital projects; field survey (2014)

Table 5: Discription of ANOVA<sup>a</sup>

Model	Sum of squares	df	Mean square	F	Sig.
Regression	5.559	1	5.559	2.94	0.090 <sup>b</sup>
Residual	166.397	88	1.891		
Total	171.956	89			

<sup>a</sup>Dependent variable: productivity; <sup>b</sup>Predictors: (constant), tax incentives

Table 6: Description of coefficients<sup>a</sup>

Model	Unstandardized coefficients		Standardized coefficients		Sig.
	$\beta$	SE	$\beta$	t	
Constant	3.316	0.413		8.037	0.000
Tax incentives	0.163	0.095	0.18	1.715	0.090

Dependent variable: productivity; Field survey (2014)

- $H_1; H_0$ : Tax incentives do not significantly affect the funds available for investment in manufacturing industries in Nigeria

Linear regression was used to assess whether tax incentives can increase the availability of funds to finance capital projects. The model was statistically significant at 0.033, level of significance.

The hypothesis was tested using regression analysis the dependent variable used was the availability of funds while the independent variable was tax incentives. The results show that the significance level is 0.03 and the calculated value of 4.683>3.95. This means that the alternate Hypothesis ( $H_1$ ) is accepted. The implication is that if manufacturing industries are granted more tax incentives, they will have more funds at their disposal to finance their capital projects and other investments. This is in line with the study of Akinyomi and Tasie (2011):

- $H_2; H_0$ : Tax incentives do not significantly impact on the productivity of manufacturing industries in Nigeria

From the result, the model was not statistically significant as level of significance was 0.09. The result showed a significance of 0.09 and the tabulated value of 3.95 which is higher than the calculated value of 2.940. This means that the null hypothesis is to be accepted. The implication is that whether or not manufacturing industries are granted tax incentives it has no significant impact on their productivity. This is contrary to the study carried out by Ohaka and Agundu (2012) stating that tax incentives will increase productivity in manufacturing industries:

- $H_3; H_0$ : Tax incentives do not significantly affect the growth of manufacturing industries in Nigeria

Table 7: Analysis of ANOVA<sup>a</sup>

Model	Sum of squares	df	Mean square	F	Sig.
Regression	120.413	1	120.413	110.33	0.000 <sup>b</sup>
Residual	96.042	88	1.091		
Total	216.456	89			

<sup>a</sup>Dependent variable: growth; <sup>b</sup>Predictors: (constant), tax incentives; level of significance: 0.05

Table 8: Analysis of coefficients<sup>a</sup>

Model	Unstandardized coefficients		Standardized coefficients		Sig.
	$\beta$	SE	$\beta$	t	
Constant	1.44	0.313		4.594	0.000
Tax incentives	0.758	0.072	0.746	10.5040	0.000

<sup>a</sup>Dependent variable: growth; field survey (2014)

The result of the test shows a level of significance 0.000 and using a significance level of 0.05. The tabulated value of  $3.95 < 110.330$ . Hence, the alternate Hypothesis ( $H_1$ ) is accepted. This means that an increase in tax incentives granted to manufacturing industries will go a long way in ensuring the growth of small and medium scale manufacturing industries in Nigeria. This is in line with the research carried out by Akinyomi and Tasié (2011) that tax incentives significantly affects the growth of small scale industries.

### CONCLUSION

This study concludes that companies in Nigeria are privileged to enjoy certain tax incentives from the government. This, therefore, increases the financial performance of manufacturing firms. Furthermore, tax incentives increase the availability of funds to finance capital projects among manufacturing firms in Nigeria. This therefore increases the firms' growth and invariable the economy as a whole. Also, in conclusion as evident in the selected samples, tax incentive does not necessarily increase the productivity level of firms in Nigeria.

This study, therefore, recommends that the method of providing tax incentives should to be clear without discrimination about the owner of the firms. The public should also know the comprehensive information on procedures and criteria for obtaining tax incentives under each existing programs. Furthermore, the government should increase the awareness on the tax incentives available to manufacturing industries so that companies

take advantage of them. Finally, the exemption from tax of the dividend of small scale industries for the first 5 year of operations should be extended to 10 year. This will further encourage more investments in the small scale industries.

The implication of tax incentives on manufacturing firms is that there will be more funds to invest in capital projects and this will lead to expansion of the manufacturing firms in Nigeria. This in the long run will increase the revenue of the government.

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