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Original Research Article

Tax Aggressiveness and Earnings Management: Evidence from Listed Commercial Banks in Nigeria

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Abstract: This study examined the extents to which tax aggressiveness affects earnings management of listed commercial banks in Nigeria. *Ex-post facto* research design and panel data was obtained for twelve (12) listed commercial banks from 2014-2023. Tax aggressiveness was measured using cash effective rate while two earnings management models were employed namely, Chang and Jones models. Data collected were analyzed through descriptive, post-estimation and inferential statistical techniques. The fixed and random effects regression models showed that tax aggressiveness significantly affects earnings management models. In view of the findings, it recommends the needs for management of listed commercial banks to dampen earnings management practices since it is negatively influenced by the level of tax aggressiveness. Furthermore, management of publicly listed commercial banks needs to engage in aggressive tax planning to enhance their performance; however such level of tax aggressive planning should be kept minimal as possible to further discourage tax fraud and evasion.

Keywords: Tax Aggressiveness, Earnings Management, Commercial Banks, Chang Model, Jones Model.
JEL Classification: M40, M49.

1. INTRODUCTION

Based on agency and stewardship theories, CEOs seem to exhibit opportunistic behavior, thereby disregarding shareholders' interests (Omamo, K'obonyo & Muindi, 2022). CEOs may exhibit dysfunctional behavior due to opportunistic tendencies when choosing accounting principles and standards (such as income measurements, depreciation expenses) and exercising discretion in financial statement preparation. Wang and Ooi (2023) found that this behavior could lead to earnings manipulation. Furthermore, the accounting structure seems to allow management to exercise personal judgment when creating financial statements, leading to a relatively high prevalence of earnings management practices among listed companies.

Earnings manipulation is worsened by several factors; initially, earnings are manipulated to surpass earnings targets (Abdullahi, Norfadzilah & Aliyu, 2020). Management manipulates earnings to avoid losses and present attractive profits in reports (Akhalumen & Monday, 2019; Canndice & Wang, 2018). Companies may engage in earnings management, a form of dysfunctional behavior, in order to avoid breaking debt agreements and paying high taxes (Eufrasia & Toto, 2019). In contrast to the agency and stewardship theories, research shows that there is a connection between performance and both earnings management and corporate tax aggressiveness (Bouteska & Mefteh-Wali, 2021; Hosam, 2019).

Corporate tax aggressiveness, or tax management, planning and sheltering, refers to a deliberate decrease in a company's official corporate tax obligations. The belief is that if a company is overly aggressive with taxes, investors may not benefit as the costs of avoiding taxes can harm both the company and investors (Akhmad & Novita, 2020). Nweze,

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Ogbodo and Ezejiofor (2021) suggested that corporate tax aggressiveness (CTA) involves a degree of obscurity and intricacy in order to avoid being discovered and its consequences can be significant.

2. LITERATURE REVIEW

2.1 Earnings Management

The idea of earnings management has received a lot of focus in academic research due to the ongoing financial accounting scandals at both domestic and global levels. As per the findings of Phillips, Pincus, and Rego (2023), earnings management involves using accounting knowledge and skills in accordance with generally accepted accounting principles (GAAP) to present annual reports in a more favorable light for firms' operational and financial performance, often for personal benefit. According to Abdullahi, Norfadzilah, and Aliyu (2020), earnings management involves intentionally manipulating external financial reports to achieve personal benefits.

Healy and Wahlen (1985) cited in Akhalumen and Monday (2019) argued that earnings management happens when management manipulates financial reports and restructuring transactions using subjective judgement to distort financial information for the purpose of deceiving or impacting the firm's economic performance or contractual results based on reported accounting figures. Different terms such as aggressive accounting, creative accounting, window-dressing accounting, and cosmetic accounting have been developed to characterize earnings management. It is important to mention that management may engage in inappropriate behavior to manipulate accounting numbers (taxes, profits, expenses, etc.) according to accounting rules in order to show higher profits and influence stakeholders.

Earnings manipulation is driven by several factors; primarily, it is often done to exceed earnings targets (Burgstahler & Dichev, 1997 as cited in Eufrasia & Toto, 2019); secondly, to prevent violation of debt agreements (De Fond & Jiambalvo, 2004 as cited in Hosam, 2019); and finally, for individual benefits like enhancing management's image. Canndice and Wang (2018) pointed out that businesses manipulate earnings to impact financial results and enhance their reputation in the financial markets.

2.2 Tax Aggressiveness

Tax aggressiveness is when companies lower their tax payments through aggressive tax planning methods and avoidance strategies (Adeyeye, 2019). Amrie and Reza (2019) suggested that aggressive tax involves the strategic actions undertaken by companies to reduce tax liabilities through tax planning which essentially amounts to tax management. Ezejiofor and Ezenwafor (2020) define aggressive tax as straightforward tax management technique used by corporate companies for tax planning, with the aim of lowering firms' tax liability. Therefore, aggressive tax outlines various methods of managing activities to reduce taxable income, which can be either legal (tax avoidance) or illegal (tax evasion).

In this research, the author views aggressive tax as a tactic used by corporate management to decrease tax obligations to the government and other tax authorities through various methods, procedures, and resources. The aim of implementing this strategy is to decrease the tax base in order to create opportunities for generating non-tax revenues with high potential (Onatuyeh & Odu, 2019). The main objective of aggressive tax, according to Ryandono *et al*., (2020), is to boost companies' profits in order to send a positive message to current investors.

Aggressive tax is synonymous with tax planning, as they adhere to the regulations set by tax authorities, but crossing the line results in tax avoidance. Therefore, aggressive tax is primarily known for the significant utilization of tax avoidance (Umeh, Okegbe & Ezejiofor, 2020). Previous research has used different techniques to calculate aggressive tax, such as dividing the company's tax liability by net income, or dividing current income tax expense (total income tax expense minus deferred tax expense) by pretax income. Tax aggressiveness is measured by effective tax rate (ETR), calculated by dividing tax burden by net income, commonly used in the analysis.

2.3 Theoretical Framework

This research was based on Kant's utilitarianism theory as referenced in Hlaing and Stapleton's (2022) work. The theory concentrated on maximizing the total value of benefits (utility) for the largest number of people possible. The foundation of utilitarianism, according to Omamo, K'obonyo, and Muindi (2022), can be achieved via consequentialist where outcomes ultimately validate the methods. There are two (2) types of utilitarianism: rule-utilitarianism focuses on maximizing happiness while act-utilitarianism looks at likely rule (Wang & Ooi, 2023; Prichard, Custers, Dom, Daveport & Roscitt, 2019).

In this study, the importance of utilitarianism theory lies in the fact that accountants need to adhere to a particular accounting method or choice when preparing reports to ensure maximum shareholder satisfaction, in accordance with generally accepted accounting standards (GAAP). Rule-utilitarianism provides accountants with a basis for selecting accounting methods when creating financial statements, which can lead to firms engaging in aggressive corporate tax strategies and earnings manipulation.

Rule-utilitarianism suggests that by adhering to certain accounting methods and choices, accountants will avoid participating in actions that harm shareholders. Rohaida, Kamarun, and Hasnah (2022) suggested that conflicting rules may exist in rule-utilitarianism, but management can potentially leverage these conflicts for their own benefit or that of their firms through practices like tax aggressiveness or earnings management.

3. METHODS

The design used was the *ex-post facto* and the study population comprised publicly listed commercial banks on the floor of Nigerian Exchange Group (NGX) as at 31st December, 2023. Given the population of study, twelve (12) publicly listed commercial banks were sampled out of the twenty-three (23) publicly listed commercial banks using purposive sampling technique. Secondary data comprising proxies of earnings management models (Chang and Jones) and tax aggressiveness measure (effective tax rate) were obtained from the annual reports and accounts of the publicly listed commercial banks from 2014-2023. The dependent variable is earnings management while the independent variable is tax aggressiveness. In view of the above, the following models were estimated:

ChangM = f(TAGG)Eq. 1

JonesM = f(TAGG)Eq. 2

Equations 1-2 were re-estimated to show the explicit regression models as follows:

$ChangM_{it} = \beta_0 + \beta_1 TAGG_{it} + \mu_{it}$ Eq. 3

$JonesM_{it} = \beta_0 + \beta_1 TAGG_{it} + \mu_{it}$ Eq. 4

Where:

ChangM represents Chang earnings management model; JonesM represents Jones earnings management model; TAGG is tax aggressiveness; μ_{it} represents error term; ί represents individual publicly listed commercial banks; *t* represents time-frame. Data obtained were analyzed using descriptive (mean, standard deviation, kurtosis, skewness and Pearson correlation); and inferential (fixed and random effects models) statistical tools

4. RESULTS

Table 1: Summary Statistics

Variables	Mean	Std. Dev.	Skewness	Kurtosis
Chang Model	9.4220	0.3484	3.4421	2.2019
Jones Model	11.088	0.2494	4.3939	2.1130
Tax Aggressiveness	3.3038	0.8302	3.3343	2.1177
Number of Observations	120	120	120	120

Source: Computed by the Researcher (2024)

Table 1 revealed that the mean earnings management models were 9.4220 (ChangM) and 11.088 (JonesM) respectively while tax aggressiveness variable had mean of 3.3038. The mean value for tax aggressiveness (effective tax rate) and earnings management (ChangM and JonesM) and the standard deviation values revealed significant variation. Also, ChangM, JonesM and tax aggressiveness variables skewed toward one direction (positive); indicating that the variables moved in one direction. Furthermore, the variables had normal distribution as shown by the kurtosis results, which were not above three.

Table 2: Pearson Correlation

	ChangM	JonesM	TAGG
ChangM	1.0000		
JonesM	0.0491	1.0000	
TAGG	0.0349	0.0247	1.0000
N	120	120	120

Source: Computed by the Researcher (2024)

Table 2 showed that the Pearson correlation for the dependent and independent variables were positive; this implies that there is positive relationship between tax aggressiveness and earnings management of the publicly listed commercial banks in Nigeria as shown in the values of Pearson coefficients.

Table 3: Fixed and Random Effects Model for Tax Aggressiveness (TAGG) and Chang Model (ChangM)

Estimator(s)	Fixed Effect		Random Effect	
Variable	**Coeff.**	**Prob.**	**Coeff.**	**Prob.**
TAGG	0.5511(8.04)	0.000	0.6028(9.77)	0.000
Constant	0.0226(11.44)	0.000	0.0328(12.01)	0.000

F-score	20.22			
F-Prob.	0.0000			
Overall R-Squared)	0.392		0.399	
Wald Ch2			28.34	
Prob. Ch2			0.000	
Hausman Test	Chi2 = 1.22		Prob>Chi2= 0.8371	

Source: Computed by the Researcher (2024)

Table 3 showed coefficient of 0.6028 (TAGG), indicating that publicly listed commercial banks' tax aggressiveness variable would result to approximately 60% changes in earnings management (ChangM). Tax aggressiveness is significant for fixed and random effects at 5% significance level; the t-score showed that tax aggressiveness is statistically significant in explaining earnings management (ChangM)

Furthermore, the aggregate R^2 is 0.399 for random effect; this implies that tax aggressiveness explained about 40% variation in earnings management model (ChangM). The Hausman specification result (Prob > Chi2 = 0.8371 > 5%) indicates that model of random effect is more efficient than model of fixed effect. Hence, using the Wald Ch2 result, we affirmed that tax aggressiveness has significant effect on earnings management model of Chang.

Table 4: Fixed and Random Effects Model for Tax Aggressiveness (TAGG) and Jones Model (JonesM)

Estimator(s)	**Fixed Effect (FE)**		**Random Effect (RE)**	
Variable	**Coeff.**	**Prob.**	**Coeff.**	**Prob.**
TAGG	0.3403(5.07)	0.000	0.3948(7.57)	0.000
Constant	0.4482(9.31)	0.000	0.4548(10.31)	0.000
F-value	8.66			
F-Probability	0.0000			
R-Squared (overall)	0.3100		0.3304	
Wald Ch2			12.88	
Prob. Ch2			0.000	
Hausman Test	Chi2 = 1.09		Prob>Chi2= 0.8018	

Source: Computed by the Researcher (2024)

Table 4 showed coefficient of 0.03948 (TAGG), indicating that publicly listed commercial banks' tax aggressiveness variable would result to approximately 39% changes in earnings management (JonesM). Tax aggressiveness is significant for fixed and random effects at 5% significance level; the t-score showed that tax aggressiveness is statistically significant in explaining earnings management (JonesM).

Furthermore, aggregate R^2 is 0.3304 for random effect; this implies that tax aggressiveness explained about 33% variation in earnings management model (JonesM). The Hausman specification result (Prob > Chi2 = 0.8018 > 5%) indicates that model of random effect is more efficient than model of fixed effect. Hence, using the Wald Ch2 result, we affirmed that tax aggressiveness has significant effect on earnings management model of Jones model.

5. CONCLUSION AND RECOMMENDATIONS

This study examined the extents to which tax aggressiveness affects earnings management of listed commercial banks in Nigeria. *Ex-post facto* research design and panel data was obtained for twelve (12) listed commercial banks from 2014-2023. Tax aggressiveness was measured using cash effective rate while two earnings management models were employed namely, Chang and Jones models. Data collected were analyzed through descriptive, post-estimation and inferential statistical techniques.

The fixed and random effects models showed that tax aggressiveness significantly affects earnings management models. In view of the findings, it recommends the needs for management of listed commercial banks to dampen earnings management practices since it is negatively influenced by the level of tax aggressiveness. Furthermore, management of publicly listed commercial banks needs to engage in aggressive tax planning to enhance their performance; however such level of tax aggressive planning should be kept minimal as possible to further discourage tax fraud and evasion.

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