AN ASSESSMENT OF SHAREHOLDERS PROFITABILITY AS A STRATEGY FOR TAX AVOIDANCE.

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Abstract
Tax avoidance is a common problem among many nations all over the world, especially the developing and third world countries. Most citizens see tax payment as very offensive and seek all means to avoid tax liabilities. Kenya is not exempted from this economic menace. Despite the several tax holidays enjoyed by firms in Kenya, most firms have resorted to creatively avoid tax under the disguise of shareholders wealth maximization. This act is seen by the researchers as a corporate governance factor because the provision of bonus schemes by shareholders for managers for abnormal wealth maximization had justified the act of tax avoidance in the Kenyan corporate world.

Keywords: *Corporate Governance, Shareholders, Wealth Maximization, Tax, Avoidance.*

INTRODUCTION.

In the work of Kiabel and Nwikpasi (2012) it was feared that the social tax incentives provided by the Kenyan government for corporate bodies has not made any positive impact on the economy as to bringing in more foreign investors. Instead companies had continued to creatively design means of avoiding and evading tax payment through many schemes. The issue of tax evasion or avoidance is a governance problem. Managers who promulgate management policies also ensure the implementation of such policies. (Nwachukwu 2007). When the policies are anti-tax compliance, the result will be tax avoidance or evasion. (Desai and Dharmapala 2007). What basically create room for such malfeasance is the common conflict that occurs between investors and managers or the Principal- Agency conflict. Most shareholders in an attempt to motivate managers to improve on their wealth introduce bonus schemes for managers that are often defined by the accounting profit. Chesoli, J. W. (2017) When such schemes are introduced, managers are prone to facilitate earnings manipulation (by creating vehicles that can manufacture earning without real income) (Desai and Dharmmapala 2007), by way of accounting policies through green accounting. Appah & Oyadonghan (2011), Oseko, M.V., Maobe, A., Wafula, J. (2022).

According to Jain (2012) "with taxes being cost of business, tax minimization is as old as tax itself. The availability of advice for maneuvering complex corporate structures to dodge the consequences a literal reading of tax laws poses interesting choices to the corporate managers against the backdrop of `fierce competition in the industry. He further said, "some adopt a conservative outlook and rather err in paying the tax than taking the tax-administration head-on, some succumb to the attractive option of avoiding paying taxes by adopting creative means, (while) some take calculated risk considering the strength of the advice received and stakes involve, so forth and so on".

The implication is that corporations easily resort to tax avoidance or even outright evasion instead of following the tax administration procedures for a re-dress if not satisfied with the tax liability. Where this happens, management which is saddled with the responsibility of effective governance of the corporation is involved, a situation caused by poor corporate governance.

The existence of corporate governance is for efficiency, effectiveness, and proper and adequate disclosure of financial transactions by managers/directors for the good of the providers of fund, the society as an act of social responsibility and the government for compliance with the legal entrancements as required. (Jain 2012).

Theoretical and Literature Review

Expediency and Social Political theories of Taxation

Bhartia (2004) says that a taxation theory may be derived based on the assumption that there need not to be any relationship between tax paid and the benefits derived from state activities founded by tax revenue. The non-commensuration between tax cost to a payer and services enjoyed by the payer make it a compulsory levy not depended on any form of motivation. According to Jhingan (2004), a taxation theory is often linked to the tax liability and state activities; and tax liability should be apportioned on the basis of comparative ability to pay of the taxpayers; providing that although tax payment is a necessity but is based on the ability of the taxpayer. (Appah and Oyadonghan 2011).

The expediency theory: states that every tax proposal of the government must pass the test of practicability. It must be the only consideration weighing with the authorities in choosing a tax proposal. (Bhartia 2004, Jhingan 2004, Musgrave, and Musgrave 2004).

The Kenyan system of taxation had stood the test of time with reliable evidence of perpetual acts of tax evasion and avoidance by corporate beings (Appah and Oyadonghan, 2011). The practice is so prominent to the extent that most firms' reasons for hiring a tax consultant is to avoid or minimize tax liabilities (Appah 2010). This has raised questions in the theory of expediency on the Kenyan tax system.

The social political theory of taxation is designed to solve social political objectives of the society. A tax system should not be designed to serve individuals of the society but should be used to solve the problems of society (Bhartia 2004, Appah & Oyadonghan 2011). Since a tax system is designed to solve social-political needs of a state, then, the state is to take deliberate steps to ensure that its political/social objectives are achieved through a good tax system. (Jain 2012). This theory informed the reasons for the several tax laws initiated and implemented by different governments with relevant tax agencies. The existence of corporate governance guidelines in the global economy is another dimension employed by governments and private sector providers of fund to ensure honest and best practice governance for corporations for shareholders wealth maximization and off course the government as corporations provides a higher source of tax revenue for the state such as the petroleum profit tax in Kenya. (Appah & Oyadonghan 2011, Jain 2012, Ojaide 2005, Kefela 2009)`

Nature of Taxation and Tax Administration in Kenya.

Taxation provides a major source of revenue to all sovereign states in the world. All governments impose tax on its citizens including body corporates. This makes it a burden on everyone to support the government to achieve its social-political objectives. (Appah & Oyadonghan 2011). On the part of government tax revenue is used to perform social functions. Hence Nzatta (2007) Chesoli, J. W.(2018), defined tax as "a compulsory levy contribution made by the citizens to the

state or even an alien, subject to the jurisdiction of the government for reasons of residence or property and this contribution is for general common use. Secondly, a tax imposes a general obligation on the taxpayer. This means the taxpayer has duty to pay the tax, if he is liable and should not in any circumstance evade it. Thirdly, there is the presumption that the contribution to the public revenue made by the taxpayers may not be equivalent to the benefit received from the public sector. Finally, a tax is not levied on a citizen by government because it has rendered specific services to him or his family.

Taxes have allocation, distributional and stabilization functions (Appah & Oyadonghan 2011). The allocation function is concerned with the provision of social goods (Musgrave & Musgrave 2006). It ensures that public sector determines the pattern of production and creates a social balance between the public and private sectors in the use of economic resources. (Nzotta 2007). The distribution function relates to the manner in which the effective demand over economic goods is divided among various individuals in the society, while the stabilization function of taxation assist the economy attain high level of employment, stable prices, balance of payment equilibrium, exchange rate stability and non-inflationary growth output. (Jhingan 2004, Bhartia 2004), Chesoli, J. W. (2017)

Tax administration according to Kiabel and Nwokah (2009) is "carried out by the relevant tax authorities as established under the relevant tax laws." Tax collection as defined in section 100 of the personal income tax Act cap 8 LFN 2004 is done by the Federal Board of Inland Revenue, state board of Inland Revenue and the Local Government Revenue Committee. It also includes the Joint Tax board and the Body of Appeal Commission all together constitutes the organs of tax administration in Kenya. (Ola, 2001, Adebisi, 2004; Azubike 2009 and Appah 2010).

These bodies, adjudicate, regulate, assess, collect, and account for all tax revenues on behalf of the Kenyan taxes that falls within their jurisdictions as stipulated by the relevant tax legislations. (Nwokah 2009).

The management of the different taxes in Kenya is governed by the following tax laws.

1. Personal income tax Act Cap 8 LFN 2004 which governs the assessment, collection, and accounting of personal income tax in Nigeria. (Ali 2009, Azubike, 2009).
2. Company's income Tax Act cap 21 LFN 2004 regulates all companies on collection of taxes on profit made from operations in Kenya excluding those that deals with petroleum explorations. (Chesoli, J. W. 2017)
3. Petroleum profit tax Act cap 13 LFN 2004. This Act is the law that regulates all companies engaged in petroleum exploration activities in Kenya. (Appah and Oyadonghan, 2011).
4. Capital Gain Tax Act cap l LFM 2004. It regulates the collection of taxes due on the disposal of changeable assets.
5. Value Added Tax Act cap vi LFN 2004. Regulates the collection of tax due to "vatable" goods and services. It repealed the sales tax. (Appah & Oyadonghan 2011 and Talibong, A., Chesoli, W., Mogwambo, 2019).
6. Education Tax Act Cap E4 LFN 2004. This law was promulgated in 1993 with the sole aim of enabling the Government to use revenue collected for the rehabilitation, restoration, and consolidation of education in Kenya as amended.
7. Industrial Development (Income Tax Relief) Act Cap. P7 LFN 2004. This is the enabling law that grants tax holidays to certain categories of companies designed as pioneer companies in Kenya.

Corporate Governance and Tax Avoidance

According to Desai and Dharmapala (2007) "The basic intuition for how corporate governance and taxation interact is that tax avoidance demands complexity and obfuscation to prevent detection". Tax avoidance schemes are building around special purpose entities to create a shield for tax havens. These entities are rationalized as providing the means for reduction in tax liabilities. The details of such structures and transactions are not explicated fully or widely explained by management due to the likelihood of being detected by the tax system and the revocation of any tax relief or benefit enjoyed arising from the scheme. (Desai & Dharmapala; 2007).

When such structures and secrecies exist, they allow managers the ability to engage in various activities that may be harmful to shareholders and the Government. These activities facilitate earnings manipulation, (by creating vehicles that can manufacture earnings without enabling investors to understand their services), the concealment of obligations (by taking on debts that are not fully consolidated) or outright diversion (by allowing for insider trading that are not reported widely). The secrecy laws of tax havens also assist managers in obscuring these actions, all of which are rationalized as tax avoidance undertaken for the shareholders benefits. (Ofunya, J. K., Wafula, J. C., Ngacho C. (2020)

More formally, the technologies of tax avoidance and managerial diversion can be thought to be complementary (Desai & Dharmapala 2007). Meaning that undertaking tax avoidance can reduce the cost of managerial diversion or, alternatively reducing the likelihood of detection, whereby creating an interaction between resources diverted by managers and the amount of tax savings created by shelters. Another form of complementarity is as modeled by Chesoli, J. W.(2017), Desai and Dharmapala (2007) is the creating of interaction between the ability to reduce taxable income and inflated book income in a setting of dual reporting.

This view can be thought to be an agency perspective on tax avoidance or as corporate governance perspective of taxation. Economists view tax avoidance as an agency-conflict perspective where the taste to maximize shareholders returns and

increase managerial incentives, seeing tax liabilities as manageable cost. Studies revealed that tax shelter benefits accrue to shareholders in well-governed firms (Zain 2012).

Tax-avoidance activities appear to be increasingly central to corporate financial decision- making as financial innovations, the integration of capital tax code provide opportunities for forms to capitalize in differences in tax rates, tax preferences and tax laws in more and more elaborate ways. Thus creating a reason for corporate managers to engage and constructing their actions with intent to use tax-shelters where possible. Other than the intent to maximize shareholders return as being the impetus to engage in aggressive tax- strategies, there is an alternative view on the justification for such actions by corporate managers. It is suggested that tax-avoidance demands obfuscator actions that can be bundled with diversionary activities, including earning manipulation, to advance the interest of managers rather than shareholders, (Zain 2012). Individual executives play a significant role in determining the level of tax avoidance that firms undertake. So even if shareholders provide general guidance with regard to the corporation's tax attitude toward risk, managers will make the practical tax choice (Appah & Oyadonghan 2011). Studies have revealed that

(a) The higher the level of corporate social responsibility activities of a firm, the lower the level of corporate tax aggressiveness (Jain 2012, Desai & Dharmapola, 2007, Langat, G. K., Nyangau, A.S., Chesoli, W. (2019). Therefore more socially responsible corporations appear to deter tax aggressive activities.

(b) Outside director membership has a positive impact on debt policy and strengthens the negative association between tax aggressiveness and debt by reducing the agency cost between controlling shareholders and bondholders, decreasing opportunities for managerial rent division related to tax aggressiveness. Jain(2012), Chesoli, J. W. (2018) Added that individual political preference and beliefs influences their decisions on tax avoidance behaviour.

There arguments provide overwhelming evidence of corporate governance having a bearing on tax-aggressiveness of corporations. It is not surprising therefore that tax authorities are continually concerned with the ever-dealing ebb of corporate governance and look forward to encouraging top management and audit committees of large enterprises to take greater interest in and responsibility for their tax strategies where it is internationally accepted that bonds responsibility includes overseeing systems designed to ensure that the corporations obey applicable tax laws. (Leung, Lanis & Richadson 2012), Chesoli, J. W.(2017)

Conclusion

The problem of tax avoidance through creative accounting have a negative effect on revenue generation. To avoid this, it is expected that corporations and their respective regulating agencies should discourage all forms of managers bonus schemes that are based on income generated and net profit. Also managers should encourage on the basis of their fiduciary responsibility of utmost good faith and not on financial benefits. In addition, tax liability is not a manageable cost for manipulations the tax laws have sufficient provisions for appropriate redress if not satisfied with any assessment.

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