Tax Planning for Organization Survival: How Relevant is Accounting Theory

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Abstract: Tax planning is a contentious issue because of its importance to the governments in raising funds for their activities and its importance to the business organizations in managing, monitoring, and controlling their cash flows. The governments want to collect as much taxes as they can and the business organizations want to pay as little taxes as possible. The difference between what the business organizations want to pay as taxes and the taxes that the government expects from the business organizations made the governments and the business organizations to be on the opposite sides. This study reviewed relevant literature on the usefulness of the tax planning in the survival of the organization and the relevant of the accounting theories. This study employed exploratory research design by reviewing pertinent journal publications and textbooks and traced the usefulness of the tax planning in managing the organizational cash flows. The review of the literature indicated that tax planning, if properly implemented; is a good strategic plan in managing, monitoring, and controlling the cash flows of the business organization. It also discovered tax-favored investments to be a good tool for tax planning as this would attract less government attention. The study concluded that tax planning is a strategic plan that management can use to control the outflows of cash from their business organizations. The study recommended that the business organizations should take advantage of tax planning in controlling their cash flows. It also recommended development of more accounting theories to enhance research in the area of tax planning.

Keywords: Tax planning, organizational survival, tax avoidance, accounting theories.

I. INTRODUCTION

In the present competitive business environment where the costs of running business organization continue to be on the rise, the managements are looking for the ways to reduce costs in order to increase the performance of their organization. Though there are many strategic methods that the organizations are using for the improvement of their organizational performance. But tax planning is one of the effective strategic methods the managements have been using to reduce the outflows of the resources from their organizations. The management employs tax planning in order to pay lowest taxes as possible and the governments want to collect as much taxes as possible. This dilemma makes the tax issue to be a contentious one (Hilling, Sandell, & Vilhelmsson, 2017; Xynas, 2011; Ogundajo & Onakoya, 2016; Vrijburg, 2014; Encyclopedia, n. d.).

The effective tax planning would reduce the outflows of cash from the organization as this would reduce the organizational tax liability. Tax planning involves the combination of various strategies resulting in the minimization of the tax liability of the organization for the accounting period under consideration. The implication of the reduction in the organizational tax liability is that the organization would have more cash in its possession which could have otherwise been paid to the government as tax (PricewaterhouseCoopers, 2013; Aganyo, 2014). The cash saved through the tax planning can be used for other activities in the organization such as paying for other expenses, undertaking expansion of the business as a growth strategy or other usage that would benefit the organization and its stakeholders. This would improve the organizational performance and therefore increased the long term survival of such organization. In the present economic condition where it is difficult to raise funds at a reasonable cost, the managements are looking inwards to see how they can improve the economic condition of their organizations. And managing the outflows of the resources from the organizations such as effective tax planning is a means of reducing organizational expenses. Putting together effective tax planning that would positively impact the organizational performance demands carefully and well planning strategy (Borek, Frattarelli, & Hart, 2014; Avi-Yonah, 2014; Booner, Davis, & Jackson, 1992).

If the tax planning is not well coordinated, the outcome of such plan can hurt the same organization that it supposed to help. Some organizations have employed tax planning that had resulted in negative consequences on their organizations due to the lack of proper tax planning. Some organizations are found to be buying things they actually do not need because of tax deduction. There is nothing bad in buying what the organization needs but buying things that the organization
does not need for the sake of tax deductions has not been proven to be good strategic planning. This has been seen as a bad strategic practice because at the end of the day this type of practice would create more liabilities to the existing ones (Hilling, Sandell, & Vilhelmsson, 2017; Chen & Lin, 2017; Pfeifer & Yoon, 2016; Graham, Hanlon, Shevlin, & Shroff, 2014; PricewaterhouseCoopers, 2013; Encyclopedia, n. d.).

Though, some people equate the tax planning to the tax avoidance and tax evasion which connotes negative impression. The meaning many people associated with the tax planning is that the organizations that are employing tax planning are just running away from their responsibility. This is not so as there are legitimate methods for the organizations to plan their tax in a way to reduce their tax liability. It is not illegal to use the legal means of reducing tax liability. The tax avoidance and tax evasion are both parts of tax planning. But how the organizations make use of them makes difference in the accounting rules and regulation. Conventionally, some people believe that tax avoidance is acceptable to the tax evasion. But the tax authorities have their own definition of acceptable tax avoidance and non-acceptable tax avoidance. As long as the organizations stay within the legal limit of the acceptable tax avoidance, all efforts to reduce tax liability will worth it. The accounting standards give the organizations choices of the accounting methods they can use when preparing their financial reports and they have the legal right to use the ones that would give them minimum tax liability and maximum tax deduction (PricewaterhouseCoopers, 2013; Aganyo, 2014).

It is not illegal to choose the one that would minimize the tax liability of the organization. The accounting standards around the world have created opportunity for the organizations to manage their tax liabilities to the benefits of their shareholders and other stakeholders. The present business environment has seen corporate tax increasing progressively and as a result forming significant parts of the organizational costs. The organizations are taking advantages of the tax planning within the accounting rules and regulations to make use of tax planning as a means of competitive advantage as well as a survival method. Though, the aggressive tax planning may become illegal when the organizations used illegal means of reducing their tax liability. The organizations must be careful to know when they are within the prescribed accounting rules and regulations and when they are about to cross the boundary. The overstatement of the expenses and understatement of the income for the sake of tax liability are signs of problem for the organization as this has become illegal activities that may cause serious negative repercussion for the organization (Mgammala & Ismail, 2015; Aganyo, 2014; Encyclopedia, n. d.).

II. THE OBJECTIVE AND METHODOLOGY OF THE STUDY

The objectives of the tax planning are twofold. The first one aims at reducing the existing tax liability from previous operations or business activities. The other one is to help the organization to come up with financial planning that would result in minimum tax payment. While one is looking at what has happened in the past and the other one is looking towards the future, they are both working towards achieving one goal. Both of these objectives are working towards minimizing the outflows of the resources from the organization which would result in increment in the after tax performance of the organization. That is, the two objectives are aiming at reducing tax burden which will be beneficiary to the management and the employees as well as other organizational stakeholders. The objective of tax planning is not to refuse the payment of the tax or to evade tax as some people are made to believe. But the objective of tax planning is to use the legal means within the established accounting rules and regulations to minimize the amount of tax the organization pays in any given accounting period. It is the duty of the management to hire knowledgeable tax practitioners to advice management on the transactions that are legally qualified to reduce the tax liability (PricewaterhouseCoopers, 2013; Aganyo, 2014; Cao, Xu, & Ao, 2009; Encyclopedia, n. d.).

Measuring the achievement of the tax planning objectives has been a difficult task in the academic. The essence of tax planning is to reduce tax burden and the tax burden data are kept by the organization with little or no access to such data. The difficulty in getting these data has been problematic in reliable measurement of the objectives of the tax planning. Book-tax gap and effective tax rates are two major variables used in measuring the achievability of the objectives of the tax planning. The objective of this study is to review the literature pertinent to the usefulness of the tax planning in organizational survival and the relevant accounting theory.

Exploratory research design was used for this study. The pertinent journal publications and textbooks were reviewed for this study. This research design is useful when the secondary sources are going to be used in a research. It helps the researcher to gather the necessary information needed for a study through the review of available literature. Since this study used the review of the relevant literature, the researcher believes that exploratory research design is appropriate for this study.

III. THEORETICAL FOUNDATION OF THE STUDY

This section covers the theories that address the motive behind the employment of the tax planning for the improvement of the performance of the organization that will ensure its survival. The activities of the management supposed to be focused on how the shareholders and other stakeholders will benefit from the organizational activities. The theories that address the issues surrounding the separation of the ownership of the business organization from its control are also relevant in the tax planning and organizational survival.
The theories reviewed are agency theory, stewardship theory, accountability theory, and stakeholder theory.

The tax planning theories introduced principles that needed for effective tax planning. The tax planning is a continuous process and the process needs to be flexible in order to have working tax planning that would reduce the tax liability of the organization. The tax liability varies from organizations to organizations and from industries to industries. As a result, the tax planning cannot be uniform for all organizations thus necessitates the need to be personalized tax planning in a coordinated way that will meet the needs of the organization in question. Honesty, moral responsibility, and good faith are required in developing a successful tax planning. The organization needs to be honest, morally responsible, and acting in good faith during the tax planning process in order not to cross the line from what is believed to be legal tax planning to the illegal tax planning. Scholes-Wolfson tax planning framework proposed three principles for tax planning namely, all parties approach, all taxes approach, and all costs approach. This tax framework believes that the best tax planning can be achieved when all the parties involved such as employers and employees are taking into consideration during the tax planning period. Developing tax planning from the organizational point of view without taken the employees into consideration may not provide the tax planning that would help the organization. Both the employers and employees must be taken into consideration during the tax planning. It is believed that there is existence of the implicit tax and explicit tax in the organization which some people called known tax and unknown taxes. This framework believes that having effective tax planning required the full knowledge of all taxes and these should be considered during the tax planning process. Tax cost is just one of the costs incurred in the organization. Therefore the inclusion of all other costs that are not tax cost is crucial in developing working tax planning. These principles can also be linked with the requirements of honesty, moral responsibility, and acting in good faith discussed earlier in this section. It is when the management is honest, morally responsible, and acting in good faith that it can disclose everything that needed to be disclosed in order to have workable tax planning (Heitzman & Ogneva, 2015).

A. Agency Theory

Agency Theory deals with the conflict of interest that arises from the divergent of the goals of the agents from that of the owners of the business as well as divergent in the level of dislikeness of risk between the owners of the business and the managers. The theory postulates that the agents would look out for his or her self interest at the expense of the principals that hired him or her to manage the business. This self interest is a consequence of the asymmetry of information that favors the managers who have access to the information about the business that the owners do not have. The owners of the business are expected to put in place a mechanism that would align the managers’ interest with that of the owners of the business (Clarke, 2007).

B. Stewardship Theory

Stewardship Theory, unlike agency theory proposes that the agent would align his or her interest with that of the owners of the business. In other words, this theory is saying that the agent is a rational human being who would utilize the resources entrusted with him or her judiciously. This theory believes that the interests of the agents and the owners of the business can be taken care of by the agent without taken advantage of the owner of the business due to the asymmetry of information. This theory is contrary to what the agent theory proposes in dealing with principal-agent relationship (Clarke, 2007).

C. Accountability Theory

Accountability Theory addresses the explanation of rationality of the agent behaviors to the principal. This theory proposes that the agent would give justification about how he or she manages the resources entrusted in his or her hand. The agent has obligations that must be fulfilled in the agency contract and how these obligations were carried out in terms of decision-making process that would maximize shareholders’ wealth must be clearly explained. The principals who are the shareholders would then be in position to make and pass judgment about how the managers have discharged their obligations. The explanation of the agent would then play a determinant factor on whether the principal is satisfied with the performance of the agent or not. The renewal of the agency contract signified the acceptance of the agent explanation of how he or she has discharge his or her responsibilities in the accounting period under consideration while refusal to renew the agency contract is an indication of unsatisfactory performance of the agent (Lindberg, 2009; Borrero, Martens, & Borrero, 1979).

D. Stakeholders Theory

Stakeholders Theory addresses the issues of managing business organization ethically and morally as well as infusing values into the organization. This theory believes that the organization is not operating in isolation but within the communities. As a result, the needs of those who would be affected in the communities where the organization is operating must be taken into consideration during the decision making process. That is, this theory does not limit the issues arising in managing the organization to the principals and agents alone. It addresses the issues that concern all participants in the organization, both internally and externally (Clarke, 2007).

Among the theories reviewed for this study, this study would be anchored on the agency theory. The rationale for choosing agency theory is based on the fact that the principal-agent relationship is the first contract established before other participants joined the process. Also, the theory that addresses the issues arising from conflict of interest and attitude to risk is very crucial to the successful running of the business organization. The ability and capability of the agent in running the business organization would be reflected in the type of tax planning employed. The efficient and effective tax
planning would increase the cash inflow and reduce cash outflow for the organization thus resulted in organizational survival and sustainability. On the other hand, ineffective and inefficient tax planning would reduce the possibility of the survival of the organization.

IV. LITERATURE REVIEW

Tax planning has been a contentious issue and continues to be a controversial one especially during this economic downturn in various countries. The present economic hardship has necessitated the governments in various countries to broaden their tax bases and this has also negatively affected the business organizations who are the major taxpayers. The management has been focusing on the loopholes in the rules and regulations by effectively and efficiently plans their tax in order to reduce their tax liability. This section reviewed literature on the tax planning and organizational survival. Mucai, Kinya, Noor, and James (2014) examined the influence of the tax planning on the financial performance of the Small Scale Enterprises in Kenya. They used survey research design and employed questionnaire to collect data from the participants in the study. The findings of the study indicated that there is no significant relationship between tax planning in investment in capital asset and performance of small scale enterprises; there is no significant relationship between tax planning by capital structure and performance of small scale enterprises; there is no significant relationship between tax planning through advertisement expenditure and performance of small scale enterprises; there is no significant relationship between legal forms of enterprise tax planning and performance of small scale enterprises. The study concluded that there is no significant relationship between the tax planning and financial performance of small scale enterprises in Kenya. The study recommended that the small scale enterprises should seek and take the advantage of the tax advisor in order to improve their performance.

Ilaboya, Izevbekhai, and Ohiokha (2016) examined the relationship between the tax planning and firm value through extant review of the pertinent literature. The findings of the study indicated constant inconsistent in the results of studies of the firms that used tax planning to improve their firm value; the generally accepted parameter to measure the tax planning is another concern found in the research. The lack of theories to address the tax planning issues is another concern found in the study. They argue that some researchers used agency theory to explain the tax planning, but they believe it is not enough. The study also found that it is hard to see the empirical researches on the tax planning and firm value in developing countries. The study concluded that tax planning is an interesting research topic that needs the attention of the academic. The study recommended that empirical researches on tax planning and firm value should be carried out as the authors claimed that they found it difficult to see empirical studies on tax planning and firm value in Nigeria.

Alduneibat, Altawalbeh, and Hashem (2017) examined the impact of tax planning in the industrial public stock companies on the performance of the industrial companies listed in the Amman stock exchange market. The study employed the analytical descriptive approach and the population of the study is the total financial managers who are presently working in the sixty six (66) Jordanian industrial public joint stock companies. There is one financial manager in each of the company and the total enumeration sampling technique was employed. That is, the population figure is the same as the sample size. The questionnaire was used to collect data from the study’s participants. The finding of the research indicated the existence of tax planning in industrial public joint stock companies and it has impact on the performance of the industrial companies listed in the Amman stock exchange market. The study concluded that tax planning is essential in the organizational performance. The study recommended that there should be awareness education among the financial managers and the employees of the organization regarding the consequence of tax avoidance.

Tax planning changes the timing, amounts, and the variance of the cash flows of the organization. The tax planning if properly developed has substantial influence on the activities of the organization; both reported and unreported, in order to get the tax liability that would be beneficiary to the organization and its stakeholders. It is generally believed that the efficient and effective tax planning has the tendency of changing the value of the organization if such tax planning can deliver after-tax income increment. That is, if the tax planning is able to produce an after-tax income that is normally higher than what the organization could have gotten without the tax planning. This can be clearly established when the after-tax income without tax planning is compared with the after-tax income with the tax planning. The difference between the two after-tax incomes would determine if the tax planning contributed to the value of the organization. Based on this premise, Heitzman and Ogneva (2015) examined the influence of corporate tax planning on the stock returns in United States of America (U.S.). The ex post facto research design was used for the study. The researchers collected secondary data from the U.S. firms traded on New York Stock Exchange (NYSE), American Stock Exchange (AMEX) or National Association of Securities Dealers Automated Quotations (NASDAQ). The population and sample size are the U.S. firms listed and traded on NYSE, AMEX or NASDAQ with not less than two years of Compustat – a database of financial, statistical, and marketing on global companies - coverage and monthly returns available from Centre for Research in Security Prices (CRSP) from July of 1988 to December of 2013. The findings of the study indicated the existence of the tax planning-based risk premium that depend on the size of the organization, the incumbent President’s affiliated political party, and the thinking characteristics or ideology of the U.S. Tax Court judges. The results of the study further indicated that firms with effective tax rates – high tax planning – have significantly higher rates of settlements with the tax authority.
The firms with high cash tax rates – low tax planning – also have the highest rates of settlements after controlling for size and profitability. The result of the book-tax differences was similar to the cash tax rates. The study concluded that tax planning is vital in the organizational strategic planning for the corporate decision makers, monitor, and regulators. The study recommended that the boards of directors and the managers should pay close attention to the relevance of the tax planning in the increment in their cash flows. The study also recommended that the management should take into consideration the impact of tax planning on the discount rate.

Yuan and Xu (2015) studied tax planning through review of literature on the researches that have been done on tax planning published in both China and international journals. The result of the study found that the researchers are concentrated on three areas namely motivation of tax planning, economic consequence of the tax planning, and the measurement of the tax planning. The study concluded that the organizations can benefit economically from tax planning. The study also concluded that the motivation of the managers is mostly studied and the characteristics of the executives were totally neglected in both China and International journals. They argue that since the executives play central role in the development and implementation of the tax planning, their personal traits must be studied. The study therefore recommended that the personal traits of the executives need to be studied.

V. CONCLUSION AND RECOMMENDATION

This study reviewed pertinent literature on tax planning, organizational survival and relevant theory. The review of the literature indicated that many business organizations are using tax planning to reduce their tax liability. This has led to the improvement in their performance and the improvement in their performance has led to their survival and sustainability. The governments around the world depend on the taxes collected from the business organizations and citizens of individual countries for the implementation of their activities. As a result, the governments are very serious when it comes to the payment of the taxes by the business organizations. It is true that among the indications in this study is that the business organizations are using tax planning as strategic plan to reduce their cash outflows and increase the cash inflow. However, those who are using tax planning as strategic plan are doing so with a serious caution because this study also found that there is a thin line between using tax planning as a strategic plan to reduce tax liability legally and the employment of tax planning as strategic plan to reduce the tax liability illegally. The management must be knowledgeable in order to stay within the limit provided by the rules and regulations guiding the payment of taxes by the business organizations.

This review of the literature found that not all business organizations are using tax planning to reduce their tax liability. The size of the business organization plays important role in determining whether to use tax planning as a strategic plan to control its cash flows or not. The business organizations with bigger sizes use tax plan as a strategic plan to control their cash flows than the business organizations with smaller sizes. The rationale behind this is that the bigger business organizations have more resources to develop and implement tax planning that would help them in controlling their cash flows than the smaller organizations. The bigger business organizations also have the resources to resolve any charges or litigations the government may have against them regarding the disputes in the payment of the taxes than the smaller ones. The development and the implementation of tax planning are associated with costs. The business organizations that want to make use of tax planning as strategic plan to improve the organizational performance must do the cost and benefit analysis and decide whether the benefits that will be derived from such plan are more than the costs that would be incurred. Even when the benefits outweigh the costs, the availability of the resources needed to develop and implement the tax planning will be a deciding factor.

The study found little or no differences in tax settlements between the business organizations who are using aggressive tax planning and those who are not using aggressive tax planning. The business organizations that are using aggressive tax planning as a strategic plan to control their cash flows are the big size organizations because of the availability of the resources and those business organizations that are using little or no aggressive tax planning are small size organizations. The review of the literature also found that the political party of the President in power makes a difference in the interpretation and implementation of the tax rules and regulations. It is gathered in the study that the business organizations have favorable tax rules, interpretation, and implementation under the President whose political party has more pro business agenda than the President whose political party has less pro business agenda. The ideology of the tax court judges is very crucial to the interpretation and implementation of the tax laws and these decisions would have both direct and indirect effects on the management’s using of the tax planning as strategic plan in controlling, monitoring, and managing the survival of the business organization.

The review of literature indicated the relevance of the accounting theory in the employment of the tax planning as strategic plan for organizational survival. Whatever the management is doing is for the benefit of the organizational stakeholders. The improvement of the performance of the organization that will ensure its survival is for the benefit of the shareholders and other stakeholders. The management and the stakeholders are the beneficiaries of the effective and efficient organizational performance. Therefore the theories guiding and addressing the issues arising from the separation of the ownership from the control of their business are relevant in the usefulness of tax planning as a strategic plan for the organizational survival. The management activities must be planned and implemented to the benefit of the
stakeholders rather than the activities that would be for the self serving of the management. The theories that separate the ownership from the control of the business address the issues that may arise between the management and the organizational stakeholder. As a result, these accounting theories are relevant in the tax planning and the survival of the organization.

The study found that lack of the right measurement of the tax planning to be a serious issue. The effective tax rates, cash tax rates, and book-tax differences are three measures of tax planning that the organizations are currently using for measuring the tax planning. The study also found that people are associating negative connotation to the tax planning. Despite the legal usage of tax planning to manage the cash flows of the business organizations, some people believe that those who are using tax planning are trying to avoid paying taxes. It is also found that the common names used for tax planning are tax avoidance, aggressive tax planning, tax sheltering, and tax evasion. Some people believe that tax avoidance is a legal means of managing and controlling tax liabilities and cash flows while tax evasion is illegal means of managing and controlling tax liabilities and cash flow. The review of literature found tax-favored investments as good tools for tax planning because governments normally give tax exemptions and tax credits to encourage organizations to invest in certain types of investments. Investing in these types of investments would prevent the outflow of resources from the organization thus helps in managing and controlling the cash flows of the organizations. The study also revealed that the study of personal traits of the business executives who play crucial role in the development and implementation of the tax planning is lacking in the tax planning researches. The business executives are at the helm of the organization and they direct all activities of the organization. Their inputs in the research would help in throwing more light to the ongoing discourse in tax planning.

This study concluded that tax planning is a legal strategic plan of managing, monitoring, and controlling cash flows of the business organization. Cash is a very scarce resource for every organizations and the ability of the management to effectively and efficiently manage it would prevent the organization from run out of cash when it is needed for the running of the operations of the organization. The payment of taxes is the outflow of the scarce cash resource from the organization. The less cash resource that goes out from the organization, the more cash the organization would have in its possession to carry out the business activities. Development and implementation of the proper tax planning would ensure the availability of cash that could have otherwise gone to the government. This study also concluded that payment of the taxes is a legal obligation of the business organizations. The governments in various countries levy taxes on business organization as well as individual citizens in order to raise funds needed to carry out their activities. But the business organizations can use tax planning as a means of controlling their cash flows if done within the frame of tax rules and regulations.

This study recommended that the business organizations should take the advantage of the tax planning in managing, monitoring, and controlling their cash flows. The organizations should seek the service of tax experts who are knowledgeable in tax planning because of the complexity nature of the tax planning. It is important for the organizations to know what expenses can be deducted before taxable income and which ones do not meet the deduction before the taxable income. This is very important as tax planning that runs contrary to the rules and regulations of the tax can cause serious damage, both financially and in reputation; to the organization. And this could end up hurting the organization that the tax planning is trying to protect. This study also recommended the employment of tax-favored investments in order to get the exemptions and tax credit that would result in limiting the amount of cash that would be leaving the organization. This would help the organization as this type of tax planning would not attract government attention that would require the auditing of the taxes paid by the organization that may lead to litigation. The study also recommended the development of the more accounting theories in the area of tax planning. This would enhance the research in the area of tax planning.

Tax planning is contentious issue that has been around for many years to the present and it would continue for foreseeable future because of the importance of taxes to the government on one hand, and the business organizations on the other. The governments in various countries impose taxes on business organizations in order to raise funds for their activities. The government would do everything possible to ensure the collection of the taxes due to them and sometimes broadening or expanding the tax bases. The business organizations would also use every means within the limit of the tax rules and regulations to pay minimum taxes.

This study has contributed to the discourse on tax planning, organizational survival, and accounting theories relevant to the tax planning and organizational survival by shed more lights to the discourse. The study is in the position to help the readers to understand better the issues surrounding tax planning, organizational survival, and relevant accounting theories to the tax planning and organizational survival.

REFERENCES


