Tax Planning: The Mediating Effect of Profitability, Return on Assets and Firm Value

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A B S T R A C T

This study investigated the role profitability, Return on Assets and Firm Value plays in the preparation of tax for businesses. The study utilized a causal research approach to investigate the cause-and-effect relationship between tax planning and the value of businesses. This study specifically aims to evaluate the effect of profitability on the firms' value and the relationship between Return on Assets and its influence on firm value. The research population consisted of 64 out of 76 listed non-financial firms on the Nigeria Stock Exchange and within the period of 2011 to 2020. Using STATA 13 to analyze data retrieved from the annual financial statements of chosen firms, we recommend that, management should examine their tax savings activities in order to enable them maintain a stable performance; and also to improve the value of the firms' income flow from extra income generation from the reduction of expenses.

INTRODUCTION

Tax may be defined as a "compulsory levy" obligatory on a business by the government in order to provide amenities and create conditions for the well-being of the society. Several tax strategies could be used by the government to boost development in various segments of the economy conditional on the government's purposes. High company taxes constitute major concern to firms as it results in effective tax rate exceeding the statutory income tax rate. Corporate bodies continually implement methods to postpone, reduce or evade tax payment. These activities by corporate bodies could be considered legal or illegal. It is called tax planning when it is legal and tax evasion when considered illegal (Izevbekhai & Odion, 2021).Consequently, "tax planning" is the arranging of a business's financial affairs in a manner that decreases its tax burden without breaching any legal rule. This may be a deliberate and astute strategy for an organization's activities in order to profit from tax exemptions, grants, and reliefs.

A tax planning approach is awfully important in describing and interconnecting the role of the tax purpose within and outside the business and ought to be in related to the general company. The company tax arrangement motivations as enclosed in the Petroleum Profit Tax Act (PPTA), the Company Income Tax Act (CITA) and other Tax laws which include pioneer status incentive, commencing rule, ending rule, investment allowance, and roll-over loss relief. The concept of tax planning, over time, has become more critical to financial decisions.

On the other hand, the expected value of a firm is an economic measure of all the stake of shareholders and debt securities. "Firm value can be seen as the value of the company's assets which can be arrived at on the basis of either book value or market value. The Firm's value can be seen as the price an investor is willing to pay for the ownership of the corporation (Bhabra, 2020). Niepelt, (2005) mentioned some firm value concept to include the nominal value, the Market value, intrinsic value, book value and liquidation value. Nominal value or par value is described as the face value of a stock. This is the value of a share or bond at the time of public issue rather than current market value. For a bond, this is the redemption price or the amount of money that a bondholder will get at maturity while the book value is seen as the total net assets of a firm computed as total asset minus intangible assets (goodwill, patents) and liability, it is the carrying value on the face of a firm's statement of financial position (Roni, Richard, William, & Shlomo, 2021). Intrinsic value is the fundamental analysis of the value of the firm's stock, product or currency without reference to market value. However, liquidation value is the likely price of an asset when it is not allowed sufficient time to sell on the open market as a result of involuntary liquidation or orderly liquidation". This value is most times typically lower than the market value. In light of the above, the general question this study seeks to address is; how does profitability and Return on Assets affect firms' value?

LITERATURE REVIEW

Concept of Firm Value

Firm's value is a degree of the achievable performance of executives who act as managers, administrators, business's representative in the optimum exploiting of the firm's value, which is the major goal of every set up. Investors and intending investors appraise a business's healthiness founded on its worth which has a relationship to its normal value, meaning that, the higher the stock value, the higher the value of a firm (Ftouhi, Ayed & Zemzem, 2010; Rajhans & Kaur, 2013). Experiential investigation conducted on firm assessment used the "after-tax contributions of the firms", thereby not recognizing the result of company's taxing arrangement open firm worth (Felthamet & Ohlson, (1995); Dechow, Hutton & Sloan (1998). Though , a few authors have different opinion on "the estimate of

firm's value", this study classifies two opinions on firm's estimate which are Tobin's Q and market capitalization, which could be denoted to as "enterprise value" [(Izevbekhai et al, (2021); Olfa, Ines & Oumaima, (2020)].

"Tobin's Q" is used, here, as a substitution for firm's value, since it deals more with real enterprise's properties than just a perceived value by market participants. It is the proportion of the market value of enterprise's asset and replacement cost of the company's asset book value (Desai & Dharmapala, 2009). A variation of conditions has seen Tobin's Q being used in literature to scrutinize various financial and investment decisions. High "Tobin's Q" means that the managers of a firm have produced greater market value from assets. Rajhans et al (2013) documented that companies who effectively utilized scarce resources were companies whose Tobin's Q was greater than one while, Q values less than one indicated a waste in an organization's resources. Fu, Rajeeve and Pakash (2016) established a correlation between the Tobin's Q ratio and future performance; this is also useful for studies relating to tax avoidance (Desai & Dharmapala 2009).

Taxation is a non-exhaustible and salient source of revenue to the government. Taxation is defined as the process through which communities contribute some agreed amount for the aim of the administration and development of the society (Ayers, Laplante, & Schwab 2011). This is an avenue of transfer of resources from private to the government. Government runs by exacting financial commitments on the public (individuals and corporate bodies) or as a contribution by virtue of its sovereignty (Desai et al, 2009). Tax policy has expanded well beyond its conventional focus on revenue generation to include an evaluation of the impacts of taxes on efficiency, incentives and competitiveness, as well as compliance and administrative costs. The difficulties for tax policy are increasingly related to establishing consistency throughout the tax system, utilizing tax to assist the Government's broader social, economic, and environmental objectives, and ensuring policy is founded on evidence and makes optimal use of information.

"Tax planning" is defined as the conscious effort to reduce tax burden within the confines of provisions in the law (Lakhotia & Lakhotia, 1998). It involves a disposition of an organization's business affairs to benefit from all deductions, exemptions, allowance, and rebates to reduce tax liability legitimately (Dyreng, Hanlon & Maydew, 2010). Payne and Raiborn (2018) described tax planning as "a generally conscious and legal activity undertaken by managers to reduce tax liability". Nevertheless, tax planning is a strategic decision which may extend beyond an accounting period thus causing a timing bias (Dyreng, Hanlon, & Maydew, 2008).

Cash ETR, according to Ayers, Jiang and Laplante (2009), is a reasonable indication of tax aggressiveness since it defines business years with a relatively high degree of a company's ability to sustain a reasonably low rate of tax payment. Salihu, Annuar and Obid (2015) found cash ETR to measure more of very aggressive tax avoidance because it is subject to partial accrual effect. Current ETR captures the company's tax deferral policy as it makes use of the existing income tax rather than the overall tax as this gives it a slight advantage over the GAAP ETR (Salihu et al., 2015). However, the major limitation of the current ETR is its inability to measure long term tax planning activities of corporate entities and also subject to yearly volatilities (Gebhart, 2017).

Long-term cash effective tax rates account for the tax benefits of employee stock options, which ETR does not provide, and in addition to this benefit, long-term cash ETR uses tax data from multiple years (Minnick & Noga, 2010). Salihu et al., (2014), opined that the obscurity in the measurement of tax planning is due to inconsistencies in the timing between the classification of such items in tax and financial accounting. Dyreng et al. (2008) argue "that this uncertainty will fade with time, and that tax

evasion should be evaluated using multiannual data rather than annual data, allowing for the elimination of yearly volatility".

Tax Planning profitability and Firm Value

Some prior research on "tax planning" has been viewed from two points; and the outcome demonstrated a two-way reaction of firm value to tax planning. Tax planning may either increase or decrease the value of a firm. Assessing tax planning reveals, however, that shareholders may not promote tax preparation activities due to the potential costs; in contrast, shareholders may react adversely if tax planning is perceived as a risk-related activity (Desai et al, 2009). The traditional perspective (tax avoidance) sees as "tax planning activities" which increases after tax earnings, which ultimately favors shareholders (Sinebe, 2021).

Generally, tax planning efforts that decrease the transfer of shareholder resources to the government should increase shareholder wealth and firm value (Johannesen, (2014); Fagbemi , Olaniyi & Ogundipe (2019)). The second approach, agency theory, views tax planning as difficult and ambiguous, which can lead to managerial opportunism (Desai et al, 2009; Ilaboya, et al, 2016). According to this concept, tax planning can affect firm's value when managers are induced to reduce corporate tax obligations (Abdul-Wahab & Holland, 2012). In this vein, Hanlon and Heitzman (2010) carried out a study on business tax planning behavior and organizational financial performance; the effect of tighter tax regimes on company market value was investigated. The study's sample was purposefully chosen from among the 850 businesses listed in the United States in order to represent the study's intended features. The design of correlative description was used. The conclusion shows that extensive tax preparation is connected with higher corporate value.

The issue of cash savings is one of the most benefits derivable from taxes avoidance. This cash savings leads to an increase in the cash flow of the firm and this often provide the firm the opportunities for investments which will crystallize to increased firm value. The wealth of the shareholders will also be enhanced in terms of more dividends and high sharer value. This is because; "cost of tax" preparations do not outweigh the advantages of "tax planning". Kim, Li, and Ziang (2011) revealed a positive correlation between tax savings and stock prices, since investors may perceive proactive tax planning as a value-enhancing practice. As a result of the liability reserve for unknown tax benefits, share prices will rise.

Effective Tax Rate (ETR) and Return on Assets

According to Umeh, Okegbe and Asika (2020), Actual tax rate also known as effective tax rate anchors on the tax burden or liabilities of the organization. Managers have more concern with post-tax results as taxation has negative relationship on cash flows and profits. The "effective tax rate" is a metric that assists the reduction in a company's tax burden without a commensurate reduction in its accounting revenue (Dzhumashev & Gahramanov, 2009). It evaluates businesses' tax performance. When compared to the book-tax gap metric. "ETR appears to be more suitable". The use of ETR for tax planning is important for shareholders because it represents tax planning actions, which are publicly available for shareholders to assess (Feren & Mukhlasin, 2020). Sinebe, (2021) suggested that low tax paying firms are regarded as being better in cost control. This conclusion is consistent with Mintz's (1990) suggestions that a penny saved in taxes might have a rippling effect on company value because of the mix nature of outcomes. Martins (2022) recommended that shareholders weight "tax planning" related information in valuing businesses, that is, only "valid information" regarding tax planning, actions should be considered.

Previous researches conducted by Kim et al (2011) discovered a "negative relationship between ETR and return on assets". The consequence is that profit making businesses are more likely to have lesser tax burden since they may take advantage of tax breaks and provisions to reduce their taxation income and therefore lesser ETR. The measurement of a firm's profitability using its profit before tax will invariably have an effect on its ETR as high earning firms pay a more tax as demonstrated by various authors in the study. According to Taylor and Richardson (2012), more profitable businesses have a lower cost in terms of tax planning owing to their investment capacity, which may easily lead to lower effective tax rates as this depicts a positive relationship between ETR and firm worth.

Theoretical framework

This section examined the theory that explains the impact of tax planning and firm value; which is the Keynesian theory which was developed by John Keynes (1936). Keynes used the analogy of the contest which features in a newspaper picture of a number of young women. Readers are expected to vote their favorite contestant as it will be won on popularity or number of votes. Probationers are asked to select a set of six faces from the photographs of the women "that are most beautiful" and those who pick the most popular face are qualified for the accolade. Probationers are supposed to rely on their judgment of beauty, but will rather rely on the judgment of other probationers for the most popular face to win the prize. Similarly, Keynes argued that investors behavior was similar to that of the probationers in pricing, shares not based on basic values, but on what everyone else thinks" is the true value. In the context of this study, this theory is a critique to the market capitalization as a measure of a firm's value.

METHODOLOGY

Research Question

(i) Does tax planning affect profitability and ultimately the firm value?

(ii) Does Return on Assets have any significant effect on firm value?

This study investigated the "the mediating effect of profitability, return on assets and firm on tax planning". The causal research design was chosen for this investigation and using a filtering sample technique of 64 listed firms. Descriptive statistics was used in describing the data, while correlation analysis was conducted to ascertain the level and magnitude of relationships amongst the variables. Regression was run in order to make interference from the outcome of the results as to their impact, direction and the significance level of their impact to the dependent variable. The study applied the following model:

$$TOBN_{it} = a_0 + a_1 ETR_{it} + a_2 ROA_{it} + a_3 ETRROA_{it} + \mu_t \qquad - \qquad - \qquad - \qquad - \qquad (1)$$

Where;

TOBN = firm value; (Measured as Mkt Cap + Total Loss less Cash Divided by Total Assets)

ETR = Effective Tax Rate; (Measured as Income Tax Paid to Profit before Tax %)

ROA = Profitability; (measured as earnings before Interest & Tax divided by Total Assets)

i = Firm;

t = Firm Time;

a_0 = intercept;

$a_1 a_2 a_3$ = coefficients;

$μ_{it}$ = Error term

Result Of Analysis

Statistical Analyses

Table 1: Results of Descriptive statistics

Source: Researcher's Computation, 2022.

Variables	Obs	Mean	Std. Dev.	Minimum	Maximum
TOBINS'Q	640	1.493531	1.408435	-.31	11.3
EPS	640	1.691328	5.838975	-18.08	57.63
ROA	640	2.631281	17.88764	-179.92	176.27
ETR	640	26.80659	99.89619	-370	1229.79

The descriptive data for all factors of importance to this inquiry are summarized in Table 1 above. "Firm Value (FV)" measured by Tobins'Q and Earnings per share (EPS) is the dependent variable, while "Tax Planning" measured by effective tax rate (ETR) is the independent variable. Table 1 also includes the moderating variable profitability measured by return on assets (ROA).

We have gathered a total of 640 observations from the data of 64 listed firms over the period of ten years, as indicated in the table. Mean and standard deviation for ETR were determined to be 26.80659 and 99.89619, respectively. Note that while the mean shows the average number of values gathered for each variable, the standard deviation (std. Dev) indicates the degree of data variability. Regarding the dependent variables, Table 1 indicates that measurements of firm value (TOBINS'Q and EPS) had the respective mean and standard deviations of 1.493531, 1.691328 and 1.408435, 5.838975 respectively. The minimum and maximum values recorded for the dependent variables (TOBINS'Q and EPS) stood at -31, -18.08 and 11.3, 57.63 respectively. While, the independent variable (ETR) recorded a negative minimum and positive maximum value of -370 and 1229.79 respectively. Mean and standard deviation values for the moderating variable (ROA) were reported to be around 2.631281 and 17.88764 respectively. The minimum and maximum value recorded for ROA was approximately -179.92 and 176.27, respectively.

Correlation Results

The coefficients for each pair of variables in a study are shown in the correlation analysis findings. These coefficients, which researchers employ to characterize the direction of relationship between pairs of variables under a given study, are typically expressed as integers with designated signs.

Table 2: Result of Correlation Analysis

Source: Researcher's Computation, 2022.

	TOBINS'Q	EPS	ROA	ETR
TOBINS'Q	1.0000			
EPS	0.4257	1.0000		
ROA	0.1175	0.3490	1.0000	
ETR	-0.0534	-0.0118	0.0323	1.0000

Table 2 displays the correlation results for the whole collection of variables. As indicated earlier, the dependent variable firm value measured by (TOBINS'Q and EPS) and mediating variable profitability measured by return on assets (ROA) demonstrated positive correlation coefficients with the exception of ETR. The correlation coefficient may also be used to demonstrate if there is a positive or negative relationship between independent variable pairs.

There were no indications of multicollinearity in independent variables, according to a rapid evaluation of the information in Table 2. This is shown by the Pearson Correlation (Pearson R) between independent variable pairs, which was establish to have varied from -0.0118 to 0.4257. While the Pearson R between TOBINS'Q and EPS had the highest Pearson R, it had the lowest Pearson R between EPS and ETR, at -0.0118. Because no pair of independent variables had a Pearson R close to or around 0.80 and higher, we draw the conclusion that the independent variables included in this research do not provide any indication of multicollinearity. To substantiate this assertion, further diagnostic test was conducted on the variables; the results are shown in section 4.2.1.

Other Diagnostic Tests

In order to ascertain the fitness of the models specified in this study, the data obtained for the entire variables were further subjected to a diagnostic test for multicollinearity. The results of the necessary diagnostic tests carried out in this study are displayed in the following sections and tables.

Result of Multicolinearity Test Using Variance Inflation Factor (VIF)

In this section, the results for the multicollinearity test for the independent variables were presented. In order to test for multicollinearity, the Variance Inflation Factor (VIF) test was conducted and the result is hereunder presented.

Table 3: Variance Inflator Factor Results for Independent Variables

Source: Researcher's Computation, 2022.

Variable	ETR	ROA	Mean VIF
VIF	1.00	1.00	1.00
1/VIF	0.998959	0.998959	

From Table 3, the range of VIF for the independent and mediating variable did not exceed the standardized VIF level (1.00:1.00<10.00). Overall, the mean VIF obtained is 1.10 which suggests the absence of multicollinearity among the independent and mediating variables.

DISCUSSIONS

The outcomes of the tests of hypotheses are presented in this section. The researcher tried to account for the effect of heterogeneity typical of panel datasets because this was a panel study.

Hypothesis One

Ho_1: Return on assets does not have significant effect on the relationship between tax planning and Tobins'Q of listed firms in Nigeria.

INTERNATIONAL JOURNAL ON ECONOMICS, FINANCE AND SUSTAINABLE DEVELOPMENT ISSN (electronic): 2620-6269/ ISSN (printed): 2615-4021

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Table 4: Results of Model I and Test of Hypothesis I (ETR, ROA and TOBINS'Q)

Source: Researcher's Computation via STATA 13.0

Dependent Variable: TOBINS'Q No. of Obs. = 640					
Variables	**Symbol**	**Coefficient**	**Std. Err**	**t-Statistics**	**Sign.**
Constant	_CONS	1.269718	.0622549	20.40	0.000
EFFECTIVE TAX RATE	ETR	-.0012001	.0005328	-2.25	0.025
RETURN ON ASSETS	ROA	.0038291	.0030488	1.26	0.210
PROFITABILITY	ETRROA	.0019197	.0002491	7.71	0.000
$F_{(3, 636)}$ (p-value)				23.82 (0.0000)	
R-Squared				0.1010	
R-Squared Adj.				0.0968	
Root MSE				1.3386	

The results of this study's test of hypothesis one is shown in Table 4. The table displays the findings of the Ordinary Least Square (OLS) analysis of the whole panel data. Careful examination of the data suggests that ETR achieved negative coefficients of around -0.0012. This implies a negative relationship between the explanatory variables ETR and business value. But ETR's t-stat. of -2.25 ($P>|t| = 0.025$) further shows that tax planning has a negative insignificant influence on the value of listed firms in Nigeria on a per-entity basis. ROA recorded a positive coefficient and standard error of .0038291 and .0030488 respectively. Additionally, ROA recorded t-stat of 1.26 ($P>|t| = 0.210$) which means that ROA has a positive insignificant relationship on firm value of listed firms in Nigeria on an individual basis. Furthermore, the outcome showed that the moderating variable had a positive coefficient of roughly 0.0019, suggesting that the moderating variable has a positive association with firm value. Low standard errors were obtained for the explanatory variables as a consequence of this finding (ETR = 0.0005328; ROA = 0.0030488). In regression analysis, the degrees of standard errors serve as indicators of the degree of accuracy and dependability of the defined models. Low standard errors are thus a sign of high levels of accuracy in the model estimates. It is sufficient to state that the predictions and estimates made by the variables in the test of hypothesis one attained a precision level of about 99.998% and 99.997%.

However, we found that the p-value for TOBINS'Q is 0.0000 when the mediating function of profitability (ROA) is taken into account. When ETR is mediated with ROA, they together account for around 10.1% to 9.68% of changes in the value of listed firms in Nigeria, according to the R-squared obtained, which is 0.1010, and the Adj R-squared obtained, which is 0.0968.

According to the findings in Table 4, the null hypothesis that return on assets does not have significant effect on the relationship between tax planning and Tobins'Q of listed firms in Nigeria is rejected. The p-value obtained, which is (0.0000), is less than 0.05 and significant at the 5% level of significance. Accordingly, we draw the conclusion that the profitability significantly affects the relationship between tax planning and firm value of listed firms in Nigeria.

Hypothesis Two

Ho$_2$: Return on assets does not have significant effect on the relationship between tax planning and earnings per share of listed firms in Nigeria.

Table 5: Results of Model II and Test of Hypothesis II (ETR, ROA and EPS)

Source: Researcher's Computation via STATA 13.0

Dependent Variable: EPS No. of Obs. = 640					
Variables	**Symbol**	**Coefficient**	**Std. Err**	**t-Statistics**	**Sign.**
Constant	_CONS	1.100569	.2534562	4.34	0.000
EFFECTIVE TAX RATE	ETR	-.0019296	.0021692	-0.89	0.374
RETURN ON ASSETS	ROA	.1059202	.0124124	8.53	0.000
PROFITABILITY	ETRROA	.0028399	.0010143	2.80	0.005
F(3, 636) (p-value)				32.52 (0.0000)	
R-Squared				0.1330	
R-Squared Adj.				0.1289	
Root MSE				5.4496	

The results of this study's test of hypothesis one is shown in Table 5. The table displays the findings of the Ordinary Least Square (OLS) analysis of the whole panel data. Careful examination of the data suggests that ETR achieved negative coefficients of around -0.0019. This implies a negative relationship between the explanatory variables ETR and firm value. But ETR's t-stat. of -0.89 (P>|t| = 0.374) further shows that tax planning has a negative insignificant influence on the value of listed firms in Nigeria on a per-entity basis. ROA recorded a positive coefficient of .1059. Additionally, ROA recorded t-stat of 1.26 (P>|t| = 0.210) which means that ROA has a positive insignificant relationship on firm value of listed firms in Nigeria on an individual basis. Furthermore, the outcome showed that the moderating variable had a positive coefficient of roughly 0.0028, suggesting that the moderating variable has a positive association with firm value.

However, we found that the p-value for EPS is 0.0000 when the mediating function of profitability (ROA) is taken into account. When ETR is mediated with ROA, they together account for around 13.3% to 12.89% of changes in the value of listed firms in Nigeria, according to the R-squared obtained, which is 0.1330, and the Adj R-squared obtained, which is 0.1289.

According to the findings in Table 5, the null hypothesis that return on assets does not have significant effect on the relationship between tax planning and earnings per share of listed firms in Nigeria is rejected. The p-value obtained, which is (0.0000), is less than 0.05 and significant at the 5% level of significance. Accordingly, we draw the conclusion that the profitability significantly affects the relationship between tax planning and firm value of listed firms in Nigeria.

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATION

The summary of the findings are as follows:

1. It was discovered that profitability significantly affects the relationship between Tax planning and Firm Value of listed firms in Nigeria.

2. It was discovered that return on Assets significantly affects the relationship between Tax planning and Firm Value of listed firms in Nigeria.

Conclusion

The firm at all-time should ensure to maximize its value through appropriate capital structure decision. As the representative of the company's shareholders, the manager is accountable for the optimal

maximisation of the firm's value, which is the fundamental purpose of any organisation. Shareholders and prospective investors evaluate a company's health based on its value, which is tied to the stock price. The decision made by any managers will either create or destroys the firm's value of shareholders. Generally, the shareholders and the managers who always have conflicts of interest will have the profitability and Return on Assets affected by the value of the firm. Also, it has been observed that the implementation of tax planning techniques could facilitate capital formation which could help in providing finance for repairs and replacement of obsolete plant and equipment and other necessary operational expenses.

Recommendations

Our recommendations are as follows;

1. It is therefore that management should examine their tax planning activities so as to ensure that it does not affect the performance of the firm negatively.

2. It is advised that tax savings activities be improved; these are the difference between the statutory tax rate and the effective tax rate, increase the value of a company owing to the fact that excess money is saved after tax costs have been lowered.

3. The study recommends that though Return on Assets could be a major determinant of the value of a firm, debt performance can be used as tool to monitor management operations and actions.

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