

TAX PLANNING LAW AND CORPORATE GOVERNANCE: IN WHOSE INTEREST IS CORPORATE TAX PLANNING?

BY

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Abstract

There is a general assumption that tax planning activities are mainly in the interest of the company and its shareholders. However, this may not always be so. Therefore, the pertinent question begging for an answer is: In whose interest is corporate tax planning: the Board of Directors (managers) or the shareholders (company owners)? In this article, the author answers this question by examining the purpose of tax planning law and the motivational factor behind every tax planning activity by company directors. While the author explains tax planning and finds out that tax planning activities may actually benefit the company and its shareholders in the long run, depending on the company's risk appetite, at times, directors deliberately embark on tax aggressiveness that will majorly favour them. This is part of the agency problem that has been in place since the time of Adams Smith. However, the promotion of the overall interest of the company should be the primary concern of directors. Thus, the author concludes that tax planning activities strategy must embrace an all-inclusive approach by ensuring that it is implemented in the interest of the company and all its stakeholders. He recommends an inclusive approach to the issue of tax planning for the benefit of all stakeholders without violating any tax law in place.

KEYWORDS: Tax Planning; Corporate Governance; Tax Law, Directors, Shareholders

1.0 Introduction: The Concept of Tax Avoidance

Tax planning in the form of tax avoidance is the lawful utilization of the tax law to one's own advantage in order to reduce the amount of tax payable by means that are within the law. To borrow from Wheatcraft's aphorism, it is the art of dodging tax without breaking the law, or alternatively, the right of every citizen to arrange one's affairs in a manner allowed by the law, or to pay no more than what is required.¹

In jurisdictions such as the United Kingdom and New Zealand, a distinction can be drawn between tax avoidance and tax mitigation. Tax avoidance is a set of business transactions designed to oppose or defeat the evident intention of the parliament. Tax mitigation, otherwise called tax planning, on the other hand, is conduct which reduces tax liabilities without avoidance. This conduct aligns with the intention of the legislature. Examples of such conduct are gifts to charity or investments in certain assets or industries which qualify for tax relief.

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¹ O. Oguntokun: 'Global Perspectives in Tax Evasion and Avoidance: The Legal Quagmire in Nigeria,' in *KWAREVE News*, a monthly publication of Kwara State Internal Revenue Service, Vol.3 Issue 21, August 2017, p.7.

The clear understanding of the distinction between the concept of an avoidance or mitigation goes back to the 1970s. It was an innovation drawn from the case of *IRC v Challenge Corp Ltd*,² a New Zealand case. In practice, there is a very thin line of distinction between them. The main factors to consider in deciding whether a particular conduct is avoidance or mitigation include whether there is a particular tax regime applicable, or whether transactions have economic consequences.

Other approaches in differentiating tax avoidance and tax mitigation seek to identify ‘the spirit of the Statute’ or ‘misusing’ a provision. But this is the same as the “evident intention of parliament” properly understood. Another approach is to seek ‘artificial’ transactions. However, a transaction cannot be described as ‘artificial’ if it has valid legal circumstances, unless some standards can be set up to establish what is ‘natural’ for the purpose.

In all, tax avoidance occurs when a person undertakes transactions that align with the letter of the law but violate the spirit and intent of the law. On the other hand, tax evasion is used to describe efforts by individuals, firms, trusts, and other entities to illegally reduce tax liabilities or fail to pay tax as and when due or refuse to pay tax at all. Tax evasion involves deliberate misrepresenting or concealing the true state of affairs by the taxpayers to the tax authorities to reduce tax liability. Such misrepresentation includes but not limited to dishonest tax reporting (such as declaring less income, profits, or gains than usually earned or overstating deductions). It may also extend to outright failure or refusal to pay tax or failure to tax as and when due.

Tax evasion is a crime in most countries, including Nigeria, and subjects the guilty party to fine or imprisonment, or both. Tax aggressiveness is a behaviour of manipulating taxable income that can lead to tax evasion.³ Tax aggressiveness can also be defined as a deliberate act by taxpayers who adopt aggressive or borderline positions to minimise their tax liabilities in breach of current tax regulations. Thus, it can be concluded that tax avoidance is an activity or action that reduces the amount of tax payments.

2.0 Corporate Tax Avoidance by Corporate Managers

Tax avoidance practices among firms are carried out by corporate managers, the Board of directors, who are agents of Shareholders and ought to act in the interest of the principals.⁴ For a

²[1986] NZPC 1; [1986] UKPC 45; [1987] AC 155; [1986] 2 NZLR 513; [1987] 2 WLR 24; (1986) 10 TRNZ 161 is a prominent case in New Zealand tax law regarding the issue of tax avoidance.

³M. M. Frank, et al., Tax Reporting Aggressiveness and Its Relation to Aggressive Financial Reporting, *The Accounting Review*, Vol. 84, No. 2 (MARCH 2009), pp. 467-496.

⁴M. Jensen, & W. Meckling, (1976). ‘*Theory of The Firm: Managerial Behaviour, Agency Costs & Ownership Structure*’, *Journal of Financial Economics*, Vol. 3 (4), pp. 305-360.

company, the burden of tax payment is eventually borne by shareholders since it brings about a reduction in the profit, which is the basis for dividend payment.⁵ The aftermath of management actions is usually reflected in the stock returns, which is the value gained or lost (whether realised or unrealised) on an investment in stock. The impulsive nature of stock returns calls for concerns and research.⁶

With the separation of ownership from management, corporate tax avoidance actions could provide a platform for managers' opportunistic behaviour,⁷ thereby pursuing self-interests at the expense of the principal.⁸ Desai and Dharmapala⁹ had submitted that the benefits accruing from tax avoidance activities in the form of tax saving are possibly rendered non-beneficial to shareholders by the potential managerial rent extraction¹⁰ for firms having poor governance structures.

Protecting the interests of the company's stakeholders arises due to the separation of corporate ownership from corporate management by many modern firms. Owners with no managerial role and administrators with no ownership stake in the company are prevalent in today's corporate world. Equity lenders are usually many, and the median stockholders' portion of influence is inherently negligible. The smallness of the average shareholders' control manifests in a loss of interest and close business monitoring. The managers (directors) are in charge of the business's day-to-day operations, and they may pursue an individual goal that differs from the overarching plan of the business owners or equity shareholders. Sound corporate governance is essential for increasing investors' confidence, protecting stakeholders such as lenders, borrowers, staff, and the government, and complying with supporting tax laws.¹¹

⁵D. Amiram., A. M. Bauer., & M. M. Frank, (2013). *Corporate Tax Avoidance and Managerial Incentives Generated by Shareholder Dividend Tax Policy*. Paper presented at the CAAA Annual Conference and the European Accounting Association.

⁶ S. Ogege, (2016). *Gauging the Volatility Level of Stock Returns in the Nigerian Stock Market*. *The Pacific Journal of Science and Technology*. Vol. 17 (1), pp. 120-128.

⁷ Opportunistic behaviour of the leader can be defined as behaviour that consists of seeking his or her personal interest through cunning and various forms of cheating and fraud. Opportunism is based on incomplete, distorted or falsified disclosure of information by an agent, including information about his or her abilities, preferences or intentions, and thus on the existence of information asymmetries between agents.

⁸ M. Desai, & D. Dharmapala, (2006). *Corporate Tax Avoidance and High-Powered Incentives*. *Journal of Financial Economics*, Vol. 79, pp. 145-179.

⁹ M. A. Desai, & D. Dharmapala, (2009b). *Corporate Tax Avoidance and Firm Value*. *Review of Economics and Statistics*, Vol. 91(3): pp. 537-546.

¹⁰ Managerial rent extraction is the compensation paid to company managers so as to ensure that the insider information at their disposal is always used for the benefits of the company and not their own personal benefits.

¹¹ K. F. N. Muka, (2010). *The Relationship between Corporate Governance and Ownership Structure of Firms Listed at the Nairobi Stock Exchange*, pp. 1-18.

As a result, the upper management team needs to carry on the responsibility of ensuring that the incident of tax does not “encourage conduct that is” detrimental to the “interest of the entity or its stockholders.”¹²The OECD guidelines on taxation emphasise compliance with tax law through discernment and implementation of the legal intent of the law. The ‘tone of the board’ should reflect an ongoing effort to keep itself abreast of issues affecting its tax strategy, tax planning, tax compliance, and reputation risks that may arise from tax evasion. A company whose Board is generally uninterested in tax affairs may run the risk of financial scandals. Tax managers must effectively plan corporate tax obligations to maximise profit. Nigeria’s corporate governance codes aim to ensure corporate transparency, responsibility, and equity to stockholders through the management board. The Code aims to ensure top management acts transparently and is accountable to the company’s stakeholders, such as investors and governments.

For several years, literary works treated taxation and corporate governance as separate entities or fields of inquiry. However, the latest evidence has shown that organizational governance and taxation are related topics because specific corporate governance processes significantly affect companies’ tax conduct. Nevertheless, there was little theoretical effort.¹³ There is yet an empirical investigation of the extent to which tax compliance is related to corporate governance. It is so, despite the existence of researches with interest in evaluating tax evasion,¹⁴ tax avoidance,¹⁵ tax aggressiveness,¹⁶ tax management,¹⁷ and tax planning.¹⁸ In light of this, this paper analyses the impact of good corporate governance on tax compliance by discussing the main beneficiaries of corporate tax planning.

3.0 Profit Maximisation and Tax Planning

Due to their profit maximization objective, companies are concerned about the amount they pay

¹²A. Friese., S. Link., & S. Mayer, (2008). Taxation and Corporate Governance –The State of the Art., p.365.

¹³S. M. Shamsudin, & R. M. Noor, (2012). Corporate Governance and Tax Compliance: A Study on Small Medium Enterprises (SMEs) in Malaysia, Faculty of Accountancy and Accounting Research Institute Universiti Teknologi MARA, Malaysia retrieved at <https://www.researchgate.net/publication/261195862>; Sartori, N. (2009). Corporate governance dynamics and tax compliance, *International Trade and Business Law Review*. J. Andreoni., B. Erard, & J. Feinstein, (1998). Tax compliance. *Journal of Economic Literature*, Vol. 36, pp. 818-860.

¹⁴L. Franzoni, (1999). Tax evasion and tax compliance, University of Bologna, Italy.

¹⁵H. A. Annuar, I. A. Salihu, & S. N. Obid, (2014). Corporate ownership, governance and tax avoidance: An interactive effect. *International Conference on Accounting Studies, ICAS (2014)*, pp. 18-19, Kuala Lumpur, Malaysia.

¹⁶Boussaidi, A., & Hamed, M. (2015). The Impact of governance mechanisms on tax aggressiveness: Empirical evidence from Tunisian context. *Journal of Asian Business Strategy*, 5(1), 1-12; Zemzem, A. & Ftouhi, K. (2013). The effects of board of directors’ characteristics on tax aggressiveness, *Research Journal of Finance and Accounting*, (4) 4.

¹⁷K. Minnick., & T. Noga, (2010). Do corporate governance characteristics influence tax management? *Journal of Corporate Finance*, Vol. 16(5), pp. 703-718.

¹⁸B. Kiabel., & C. Akenbor, (2014). Tax Planning and Corporate Governance in Nigerian Banks. *European Journal of Business and Management*, Vol. 6, p. 19.

as corporate tax to the government. Taxes remain an essential aspect of many managerial decisions.¹⁹ Therefore, corporate tax planning in the form of tax avoidance is an outcome of policies and decisions taken by the leaders (directors) of a company.²⁰ Generally speaking, tax is a cost to companies and their shareholders and, therefore, a reduction in cash flow available to them as profit. Thus, shareholders prefer tax planning activities in an effort to increase both the profit after tax and the cash available to shareholders.²¹

Tax avoidance practices among firms,²² the directors, who, as agents of shareholders, ought to act in the interest of the principals.²³ For a company, the burden of tax payment is eventually borne by shareholders since it brings about a reduction in the profit, which is the basis for dividend payment.²⁴ The aftermaths of management actions are usually reflected in the stock returns, which is the value gained or lost (whether realised or unrealised) on an investment in stock.

Due to the different preferences between the company's directors and its shareholders on corporate tax avoidance, it is believed that corporate governance influences managerial tax avoidance decisions,²⁵ as the policies and decisions taken by the company's directors are a reflection of the attributes of corporate governance, such as board size and composition, board independence, frequency of board meetings, board diligence, CEO duality, and audit committee diligence.²⁶ For instance, directors can conceal rent extractions²⁷ through tax aggressiveness.²⁸ In that case, one may ask: in whose interests are the directors concealing rent extractions, their

¹⁹R. Lanis, and G. Richardson, (2011). The effect of the board of director composition on corporate tax aggressiveness. *Journal of Accounting and Public Policy*, Vol. 30(1), pp. 50–70.

²⁰V. A. Tandean., and W. Winnie, (2016). *The effect of good corporate governance on tax avoidance: An empirical study on manufacturing companies listed in IDX period 2010-2013*. *Asian Journal of Accounting Research*, Vol. 1(1), pp. 28–38.

²¹I. K. Khurana., and W. J. Moser, (2013). *Institutional Shareholders' Investment Horizons and Tax Avoidance*. *Journal of the American Taxation Association*, Vol. 35, pp. 111-134. <https://doi.org/10.2308/atax-50315>.

²²Managers and Directors and at times, the Board are interchangeably used in this article.

²³M. Jensen, & W. Meckling, (1976). 'Theory of The Firm: Managerial Behavior, Agency Costs and Ownership Structure', *Journal of Financial Economics*, 3 (4), pp. 305-360 quoted from Ikponmwo Michael Igbinovia and Chizoba Marcella Ekwueme: *Corporate Tax Avoidance and Shareholders Returns: Moderating Effects of Monitoring*, *Sriwijaya International Journal of Dynamic Economics and Business*, Vol. 2(3), 2018, pp. 255-268 p-ISSN: 2581-2904, e-ISSN: 2581-2912.

²⁴D. Amiram., A. M. Bauer., & M. M. Frank, (2013). *Corporate Tax Avoidance and Managerial Incentives Generated by Shareholder Dividend Tax Policy*. Paper presented at the CAAA Annual Conference and the European Accounting Association.

²⁵C. S. Armstrong., J. L. Blouin., A. D. Jagolinzer., and D. F. Larcker, (2015). *Corporate governance, incentives, and tax avoidance*. *Journal of Accounting and Economics*, Vol. 60(1), pp. 1–17.

²⁶N. V. D. Pilos, (2017). *Tax Avoidance and Corporate Governance - Does the Board of Directors influence tax avoidance?* (Unpublished Master's Thesis). Erasmus School of Economics, Erasmus University.

²⁷'Rent extraction' means the ability of lawmakers to squeeze payments (i.e., "rents") in some form in exchange for favourable legislation. The term presents a conscious, welfare maximization strategy by individual statespersons. It emerges when political decision-makers derive benefits from the rents they generate.

²⁸M. A. Desai., and D. Dharmapala, (2006). *Corporate tax avoidance and high-powered incentives*. *Journal of Financial Economics*, Vol. 79(1), pp. 145–179.

interests or that of the shareholders? Apart from this, because of the prevalence of information asymmetry²⁹ between directors and shareholders, the former can manipulate tax gains through corporate tax planning to their own advantage against the latter.

4.0 Chief Executive Officer (CEO) Compensation

Scholes et al.³⁰ submit that it is necessary to consider the employer's and employee's tax implications to understand the compensation policy. They show that the variation of the corporate tax rates produces arbitrations between salaries, bonuses, differed profits, and compensation in the form of options. The debate on the alignment of interests between managers and shareholders was in the middle of the research of the specialists in corporate finance who were interested in agency problems. The tax laws influence the nature of the optimal contract between managers and shareholders by changing the nature of the incentives (differed or current compensation). Crocker and Slemrod³¹ developed an ideal model explaining the contractual relationship between the shareholders and the tax directors. The authors emphasized on the effect of the compensation policies on tax planning. They suggest that the remuneration of the tax-responsible persons will have to be proportional to the effective tax rate. The differences related to the tax deductions, the temporal effect, and the different tax treatments of the incentive plans imply that the corporatefiscal policy influences the managers' compensation.³² The mode of compensation of administrators and managers could be a central factor that encourages them to act according to their own interests, which may diverge from those of the company. Compensation based on the performance after imposition of the company encourages administrators and managers to choose aggressive tax strategies.

Thus, the manager is motivated to cooperate with the tax professionals in order to identify, develop, and carry out tax planning strategies. The expected advantages of the manager's responsibility should be more important than the additional salaries that must be paid to compensate the manager for the additional risk and the provided effort. Consequently, the measurement of the performance after imposition should be used as a variable in the contract of remuneration. This measurement is advantageous only for the manager if his participation in the

²⁹Information asymmetry is an imbalance between two negotiating parties in their knowledge of relevant factors and details. Typically, that imbalance means that the side with more information enjoys a competitive advantage over the other party.

³⁰ M. Scholes., P. Wilson, and M. Wolfson, (1992) *Firms' responses to anticipated reductions in tax rates: The Tax Reform Act of 1986*, Journal of Accounting Research, Vol. 30, pp. 161-191.

³¹K. Crocker, and J. Slemrod, (2005) *Corporate tax evasion with Agency Costs*, Journal of Public Economics, Vol. 89, pp. 1593-1610.

³²M. Scholes., P. Wilson, and M. Wolfson, (1992) Op cit.

efforts of tax optimization will lead to a difference between the accounting incomes before and after tax. Prior research related to the measurement of the performance after imposition concentrated only on the determinants of the CEO compensation by using the income after imposition³³ and did not provide any proof concerning the effectiveness of compensation after imposition in the reduction of corporate tax burdens. Linn and Park³⁴ show that CEO compensation is aligned with investment opportunities. Their conclusions are based on two elements: firstly, the companies supporting the control costs attract the qualified directors by suggesting an important compensation. Secondly, these companies try to reduce agency conflicts through incentive compensation. While protection can be limited, the tax law ensures that stock-based compensation plays an incentive factor for the managers.

5.0 Board Structure

Desai et al.³⁵ proposed a situation where self-interested managers structure the firm in a complex manner to facilitate transactions that mitigate corporate taxes and divert company resources for private use. They do this through the manner by which their boards are structured because board members influence the companies' financial decisions. Therefore, corporate tax avoidance can be seen as an opportunistic behaviour of company's managers. Most of the directors might be persuaded to use any tax avoidance techniques to boost company's profits and dividends paid to shareholders. This may be the result of the variety of business board members, who may have diverse opinions. The concepts of gender balance and Chief Executive Officer (CEO) duality are perhaps the most significant aspects of board diversity that influence tax avoidance decisions in corporate boards of listed consumer goods manufacturing companies in Nigeria.³⁶ An expression of company's value is the corporate strategies planned by the Board of Directors.³⁷

Section 2 of the Nigerian Code of Corporate Governance (NCCG) 2018 ("the Code") empowers companies that will use it to determine the size and composition of their boards by taking into account, the complexity and volume of their operations, the need for enough members to serve on its committees; the need to secure quorum at meetings; together with the need to ensure diversity on the Board.

³³T. J. Atwood., T. Omer, and M. Shelley, (1998). *Before versus after-tax earnings as performance measures in compensation contracts.*, Managerial Finance, Vol. 11, pp. 30-44.

³⁴S. Linn, and D. Park, (2005) *Outside director compensation policy and investment opportunity set*, Journal of Corporate Finance, Vol. 11, pp. 680–715.

³⁵M.A. Desai., and D. Dharmapala, (2008). *Tax and Corporate Governance: An Economic Approach*. MPI Studies on Intellectual Property, Competition and Tax Law, Vol. 3, pp. 13-30.

³⁶ See <https://www.amsoshi.com/2022/12/a-study-on-tax-avoidance-decisions-of.html>, accessed 5th January, 2024.

³⁷A. Vacca., A. Lazizi., D. Vrontis., and M. Faith, (2020). *The role of Gender Diversity on Tax Aggressiveness and Corporate Social Responsibility: Evidence from Italian Listed Companies*. MDPI Journal of Sustainability.

The Code also recommends an appropriate mixture of executive directors (EDs), non-executive directors (NEDs), and independent non-executive directors (INEDs), with most of them being non-executive directors (NEDs). However, the Code fails to provide for the number of INEDs required on boards but recommends that the majority of the NEDs be INEDs. This provision implies that companies are now granted the freedom to determine the composition and size of their Boards within the limits of the requirements set out by their sectoral regulators.³⁸ This flexibility enables the users of the Code to have significant control over their cost of governance.

Generally, Board structure and tax planning have been said to be related, given the fact that aggressive tax strategies represent a company's value-maximizing activity because they involve the transfer of wealth from the government to shareholders of a firm.³⁹ Thus, shareholders' value will increase with efficient corporate tax strategies as long as the expected marginal benefit exceeds the marginal cost.⁴⁰ In this regard, therefore, tax-aggressive activity will be allowed by the Board since it will result in shareholders' wealth maximization. On the other hand, however, corporate tax aggressiveness can worsen the already existing agency problems because shareholders' and managers' interests may differ with regard to risks associated with tax.

6.0 In Whose Interest Is Corporate Tax Planning?

Shareholders mostly believe that directors will act on their behalf so as to maximise their profit, which includes a reduction in tax liabilities. However, based on an agency theory perspective, the severance of ownership and control can lead to corporate tax decisions that reflect directors' private interests as opposed to the shareholders' interests. Hence, self-interest directors would structure a company in a manner to facilitate transactions that divert corporate resources for their private use.⁴¹ Therefore, the pertinent question arising from this is: in whose interest is corporate tax planning, the shareholders' or the Board of Directors'? This question will be engaged with the aim of finding a solution to it as it is very central to this article.

In trying to answer the question, this author looks at the issue from two key theoretical positions. Firstly, given the presence of agency cost problems, the shareholders will be averse to the management's tax-aggressive activities because they are purported to reflect the private interests

³⁸ Examples of the sectoral regulators in Nigeria are the Central Bank of Nigeria for banks and other financial institutions, NAICOM for the insurance sector, PENCOS for the Pension industry, NERC for the electricity sector, and SEC for public companies, among others.

³⁹ I. Khurana & W. Moser, (2013). *Institutional Shareholders' Investment Horizons and Tax Avoidance*. The Journal of the American Taxation Association. 35(10) .21-39

⁴⁰ M. A. Desai., & D. Dharmapala, (2009b). *Earnings management, corporate tax shelters, and book-tax alignment*. National Tax Journal, Vol.62, pp. 169–186.

⁴¹ I. Khurana & W. Moser, (2013). Op.cit.

of the directors instead of the shareholders. It can be used to achieve opportunistic management behaviour exemplified by earnings manipulations, related party transactions, and other resource-diverting actions.⁴² Secondly, without agency cost problems, tax aggressiveness practices will not only be allowed by corporate boards but will be aggressively pursued because it results in the maximization of shareholders' wealth.

By finding out how corporate governance is related to tax-aggressive behaviour, this author gives insight into the potency of board structure arrangements in the short and long terms within the context of the maximisation of shareholders' wealth on the one hand, and the likelihood of managerial opportunism⁴³ on the other.

Some commentators have also argued that managers, that is, the Board of Directors, have a fiduciary (trust) duty to shareholders to reduce corporate tax liability.⁴⁴ This argument is questionable as a matter of positive law. This is because there is no law that mandates managers to engage in corporate tax planning, and there is no court that has interpreted the law to find such a duty.⁴⁵ What the law requires the directors to do is to act in the overall interest of the company.⁴⁶ It is the duty of directors to prepare annual accounts,⁴⁷ and it is from this document that explanations will be offered regarding the tax strategy adopted before arriving at profit chargeable to the company's tax. It is also the duty of the directors to lay and deliver

⁴² M. A. Desai., & D. Dharmapala, (2009b), op.cit.

⁴³ Managerial opportunism is a situation in which the directors act in their own interests as against the interest of their principal, the shareholders.

⁴⁴ J. Nocera, Opinion, *Who Could Blame G.E.?* N.Y. TIMES, Apr. 4, 2011, A23. ("The executives who run America's corporations have a fiduciary duty to maximize profit for their shareholders... One way to maximize profits is to minimize taxes"); F. Cramer: *Apple's Tim Cook 'Patriotic' on Taxes*, CNBC (Dec. 21, 2022, 11:08 AM), <http://www.cnbc.com/2015/12/1/cramer-apples-tim-cook-patriotic-on-taxes.html> (Jim Cramer's response to criticism of Apple Inc.'s tax planning stated that "[t]he main thing you learn is that tax avoidance is everybody's duty. You're supposed to try to avoid."); B. Johnson, *We All Want Apple to Pay More Tax*, TELEGRAPH, <http://www.telegraph.co.uk/news/worldnews/europe/eu/12118898/We-all-want-Apple-to-pay-more-tax.html> accessed 24 January 2023. ("It is the fiduciary duty of [corporate] finance directors to minimize tax exposure. They have a legal obligation to their shareholders.")

⁴⁵ R. Avi-Yonah explored this question at length from both practical and theoretical point of view, considering the duty of managers to reduce corporate taxes under different corporate theories. See, e.g., Reuven S. Avi-Yonah, *Corporate Taxation and Corporate Social Responsibility*, 11 N.Y.U. J.L. & BUS. 1, 13 (2014) [hereinafter *Corporate Social Responsibility*] (stating that under the nexus-of-contracts view of the corporation, which is the dominant view among corporate scholars, "management arguably has a responsibility to maximize shareholder profits by minimizing corporate taxes as much as possible"); M. Hanlon & J. Slemrod, *What Does Tax Aggressiveness Signal? Evidence from Stock Price Reactions to News about Tax Shelter Involvement*, 93 J. PUB. ECON. (2009) Vol. 126, p. 126. ("Of course, in order to maximize the value of the firm, shareholders would like to minimize corporate tax payments net of the private costs of doing so."); W. Schön, *Tax and Corporate Governance: A Legal Approach*, in TAX AND CORPORATE GOVERNANCE Vol. 31, p. 46 (W. Schön ed., 2008) ("The basic goal which offers guidance for the actions of the management under the 'corporate contract' is wealth maximization for investors. This makes the minimization of the corporate tax burden an integral part of the managers' duty of care.")

⁴⁶ CAMA 2020, section 377.

⁴⁷ CAMA 2020, section 377.

financial statements⁴⁸ during a company's AGM. It is equally the right of the shareholders to obtain copies of the financial statements.⁴⁹ All of these are the rendering of stewardship by directors to their principal, the shareholders, on how the business is being run on their behalf in a particular financial year.

It is, however, worth considering the rationale of such arguments⁵⁰ in the context of this paper. Those who suggest that the Board has a fiduciary duty to increase shareholders' wealth by reducing corporate taxes make an explicit normative choice to adopt the shareholder primacy⁵¹ view of the company.⁵² Under this view, normative assessment of company laws (and board actions) is based on whether they enhance shareholders' value.⁵³ Shareholder primacy offers the Board a means of evaluating decisions within a single-valued objective function: shareholders' welfare.

The shareholder primacy view is prevalent in academic discourse.⁵⁴ The shareholder primacy approach has been criticised, among others, because it contains an implicit assumption that all shareholders share homogenous interests.⁵⁵ In reality, however, shareholders have diverse investment tastes, which implies different preferences for corporate behaviour. For instance, some shareholders invest in companies majorly for the purpose of getting their annual dividend. Such shareholders are not happy if, for any reason, a company does not declare dividend in a particular financial year. On the other hand, some shareholders are not particularly bothered if a company declares dividend in a particular year or not as long as there is a consistent growth in the value of their shares. Still, some other shareholders are

⁴⁸CAMA 2020, section 388.

⁴⁹CAMA 2020, section 392.

⁵⁰ The argument that managers, that is, the board of directors, have a fiduciary duty to shareholders to reduce corporate tax liability.

⁵¹ Shareholder primacy is a shareholder-centric form of corporate governance that focuses on maximizing the value of shareholders before considering the interests of other corporate stakeholders, such as society, the community, consumers, directors and other employees.

⁵² "Shareholder primacy" imposes a duty upon boards of directors to put the interests of their shareholders above all others. Traditionally, management has been seen as an "agent" for the "principals" who are the owners.

⁵³ J. E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 637-38 (2006) (describing shareholder primacy as a normative linchpin to assess corporate law); O. Hart & L. Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2017 J.L. FIN. & ACCT. 247 (2017) (arguing that companies should operate to increase shareholders' welfare).

⁵⁴ L. STOUT, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, And the Public* 33 (2012) ("[M]any legal scholars today passionately embrace shareholder value as a normative goal. The perceived superiority of the shareholder-oriented model has inspired a generation of would-be reformers to work tirelessly to 'improve' corporate governance so that managers will focus more on shareholder value.").

⁵⁵ ("The standard shareholder-oriented model assumes a hypothetical, homogeneous, abstract shareholder who does not and cannot exist."); Fisch, *supra* note 13, at 661 ("To the extent that the interests of different stakeholders conflict, the stakeholder model offers no principled basis for choosing among them.... Within the shareholder class, the investors vary considerably among such dimensions as the time frame over which they invest, the extent to which they trade versus passively holding the corporation's stock, their degree of diversification, the extent to which they hold non-equity interests in the issuer, any option or other hedging position that they hold, and so forth.").

more interested in both. “Recognisingthesedifferences showsthatthe notion of a single measurable ‘shareholder value’ is not onlyquixoticbutintellectuallyincoherent.”⁵⁶

Theargumentthatmanagersengagein corporate-leveltaxplanningtobenefit the shareholdersimplicitlyassumes that shareholders’ tax interests are the same. Thisassumptioncannotbealignedwithhowtaxlawoperatesinpractice.Such a practicemayincreasevalueforsomeshareholdersbut, at the same time, reduceitfor others.⁵⁷ This position exposes the logical incoherence of the argumentthat the Board must engage in corporate tax planning. If a corporatetax-reducingschemeresults inan increasedtax burdenonshareholders, how then can one argue that the Board has a duty to engageinsuchbehaviourunderashareholdervalue-maximizationtheory?

Assuming thatoneadoptsstheviewthatboardsmusttrytomaximize shareholders’ value, there is a real practical difficulty witharticulating the Board’s duties in the context of tax planning. Boards donot know (and cannot know) what the personal tax consequences areto each shareholder stemming from a particular transaction. Boards donothaveaccesstoshareholders’ personaltaxinformation.⁵⁸As a result, managers can never tell in advance whether a tax-aggressive strategy willincreaseordecreaseshareholdervalueintheaggregate. To see why this observation is important, explaining some of the components of managers’ fiduciary duties and exploring them is helpful. In broad terms, the fiduciary duties of the Board includethedutyofloyalty,otherwise known as thedutyoffair dealing,as well asthedutyofcare. Under the duty of loyalty, a director “commits allegiance to theenterprise (or company) and acknowledges that the best interest of the companyand its shareholders must take precedence over any individual interest.”⁵⁹Company officers⁶⁰ “can neither appear on both sides of atransaction nor be expected to derive any personal financial benefit from it, such as when there is self-dealing,⁶¹ contrary to a benefit which

⁵⁶ STOUT,*supra*,at60.

⁵⁷ O. Marian, *IsAllCorporateTaxPlanningGood forShareholders?*UniversityofCalifornia,Vol.52, pp 905- 979.

⁵⁸ O. Marian, *ReconcilingTax Law and Securities Regulations*, 48 J.L. MICH. REFORM 1, 10-13 (2014) [hereinafter*Taxand SecuritiesRegulation*]. at 42-43 (“From a legalstandpoint, privacy safeguards protect most taxpayer information, which makes itimpossibletoacquiresuchinformationwithoutawaiverfrominvestors.”).

⁵⁹Principles of Corporate Governance:Analysis and Recommendations§4Intro.NoteAt137(Am. Law Inst.1994).

⁶⁰ See CAMA 2020, section 868 (1) which defines company officers to include directors, company secretary and auditors.

⁶¹Self-dealing is when a fiduciary or people in a position of trust, such as company directors, act in their own best interest in a transaction, rather than in the best interest of their principal, for instance, the shareholders. It represents a conflict of interest and an illegal act that can lead to litigation, penalties, and termination of employment for those who commit it.

devolves upon the company or all shareholders generally.”⁶²

Due to shareholders’ tax heterogeneity, that is, differences in shareholders’ tax preference or position, corporate tax planning benefits do not necessarily flow to “all stockholders generally”⁶³ or in equal proportion.

Although tax planning can increase earnings, there are actual and potential costs that restrain firms from maximizing profits through tax planning. In addition to the direct costs such as salaries and fees, indirect costs can also arise, for instance, when company restructuring (such as merger, acquisition, demerger, obtaining controlling shares, and so on) is a condition precedent for obtaining the desired tax benefits. Also, there is the possibility of potential costs to the extent that tax planning activities can be challenged by tax authorities, which might lead to reputational costs.⁶⁴ Tax planning only benefits shareholders through increased after-tax earnings. However, because of the existence of information asymmetry⁶⁵ between directors and shareholders with respect to tax planning, it facilitates directors to act in their own interests, and that will result in a negative association between tax planning and the company’s value.⁶⁶

The Courts have indeed recognised the duty of directors and majority shareholders to ‘deal fairly with their company and minority shareholders.’⁶⁷ If directors had not approved the transaction without the tax gross-up, this could imply that directors preferred their own interests to the interests of shareholders and the company. Whether this is the case is a transaction-specific question that requires a fact-intensive inquiry. The questionnaire administered by this author contains a question that directly bothers on whether aggressive tax planning is in the interest of the directors or shareholders. The outcome is that more than 80% of the respondents answered that it is in the interest of the shareholders. However, the respondents in this category might assume that all shareholders’ tax preferences are

⁶² *Aronson v Lewis*, 473 A.2d 805, 812 (Del. 1984), overruled on other grounds by *Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000). See also <https://unicourt.github.io/cic-code-ga/transforms/ga/ocga/r83/gov.ga.ocga.title.14.html> accessed 12 June 2023.

⁶³ *Aronson v Lewis*, 473 A.2d 805, 812 (Del. 1984), *ibid.*

⁶⁴ Reputation Costs means the reasonable fees, costs and expenses charged by any public relations firm, crisis management firm or law firm retained by or on behalf of an Insured Person, to mitigate the adverse effects to such Insured Person’s reputation as a result of a negative public statement made about him or her by a regulator. In this context, reputational costs can occur when a company loses its good corporate citizenship status for being known as a company that is always avoiding tax.

⁶⁵ Information asymmetry is an imbalance between two negotiating parties in their knowledge of relevant factors and details. Typically, that imbalance means that the side with more information enjoys a competitive advantage over the other party.

⁶⁶ A. Wahab, & K. Holland (2012). Tax planning, corporate governance and equity value. *British Accounting Review*, Vol. 44(2), pp. 111–124.

⁶⁷ Principles of Corporate Governance § 5.01, At 207 (Am. Law Inst. 1994), and cases cited therein.

homogenous, that is, the same. But from the view explained by this researcher, this may not always be the correct position as there are instances where the tax planning strategy adopted by the company will, in the long run, be in the interest of the directors. This is because the directors may deliberately invest in businesses with high corporate tax and, at the same time, with more remuneration or compensation for directors where such remunerations or compensations are tied to the profitability of the project or business.

The other major component of directors' fiduciary duties is the duty of care. This duty is meant "to perform the director's functions in good faith, in a way that there reasonably believe to be in the company's best interests, and with the care which an ordinarily prudent person would reasonably be expected to exercise"⁶⁸ in the circumstance. Directors' duties are as provided in section 305 of CAMA 2020. The section provides, *inter alia*, that "a director of a company stands in a fiduciary relationship towards the company and shall observe utmost good faith towards the company in any transaction with it or on its behalf."⁶⁹

While corporate tax planning may reduce corporate-level taxes, there is no legal obligation or requirement that the Board must engage in corporate tax planning. Instead, most corporate-level tax plans will likely fall under the "business judgement rule." Under this rule, directors are not likely to breach their duty of care as long as they make a business judgement in good faith, and there is no conflict of interest; that is, they are not self-interested in the transaction, they make the decision on an informed basis, and they rationally believe that the judgement is in the best interest of the company.⁷⁰ The business judgement rule "sharply reduces managers' exposure to liability."⁷¹ The courts are unwilling to intervene in the management's business decisions and generally presume that management's action is proper.⁷² Under such a situation, it is inexpedient to imagine that the directors' duty of care includes a duty to either engage or not engage in corporate tax planning, especially

⁶⁸ CAMA 2020, section 305. See also https://www.law.cornell.edu/wex/duty_of_care and <https://thenigerialawyer.com/checks-and-balances-of-directors-under-the-provisions-of-cama-2020/> accessed 6 April 2023.

⁶⁹ See 'Board Dynamics: Managing Conflict of Interests' in <https://firstfiduciary.ng/board-dynamics-managing-conflict-of-interest/> accessed 12 June 2023.

⁷⁰ O. Marian, *Is All Corporate Tax Planning Good for Shareholders?* University of California, Vol. 52:967.

⁷¹ *Ibid.*

⁷² *Kamin v. American Exp. Co.*, 86 Misc. 2d 809, 813-14 (N.Y. Sup. Ct. 1976) (finding no actionable claim when managers were aware that certain transaction structure would "result in the realization of a substantial income tax saving," but chose a different structure due to "countervailing considerations"); *Principles of Corporate Governance* § 4.01, at 144 ("Courts, when applying the business judgement rule, have often stated that a 'presumption' exists in favour of the propriety or regularity of the actions of directors and officers. This correctly signifies that no inference of dereliction of duty can or should be drawn, for example, from the fact that a corporation has suffered a business reversal.")

because tax outcomes are rarely certain.⁷³

7.0 The Ideal Position

The mutual suspicion between managers and shareholders on how companies are managed has been an age-long problem since the time of Adams Smith. The problem, even in the 21st century, remains evergreen, as seen in different cases of corporate collapse, of which the Enron case appears to be the landmark. Board diversity in terms of having different skills, such as financial literacy, the component of which is tax planning, is expedient in today's board composition. Such skills are required in analysing financial and investment decisions, with their tax consequences or implications. So many factors determine a company's tax policy. The risk appetite of the company, the sectoral risk of the company, the investment portfolio of the company, the nature of the company's business or undertaking, and the way government policies and regulations affect the company, among others. The combination of these factors will invariably determine the tax planning strategies of the company in question.

In the course of pursuing the business objective of the company, directors take the above factors into consideration. They know they will give an account of their stewardship to their principals (the shareholders), and there will be no excuse for failure. These are what engage the attention of directors at their periodic meetings. Every investment opportunity has its tax implications. Based on the concept of cost-benefit analysis, if a particular project is lucrative but has high tax implications, as long as it will increase corporate profit either in the short or long run, the managers might want to embark on such. However, such projects may appear to the shareholders as too risky and may call to question the transparency of the directors in such instances. This is one of the suspicions in the principal/agency relationship.

Should the directors avoid high taxes but lucrative projects so as not to be seen as self-dealing? Should the directors prioritize the tax implication of company's investment above the overall company's profitability? Should low-tax but low-profit projects be the priority of directors in order to be seen as transparent and acting in the overall interest of the company? This author does not agree with these questions and answers them negatively. If the project is lucrative, meaning it will improve the company's profit and, by extension, its shareholders, payment of high tax should not be the reason to abandon such a project. Instead, it should be seen as

⁷³See, e.g., *Seinfeld v Slager*, No. CIV. A. 6462-VCG, 2012 WL 2501105, at 3 (Del. Ch. June 29, 2012).

benefitting all. The government, the company, the shareholders, and the directors or managers benefit in the long run.

8.0 Conclusion

Payment of corporate tax is inevitable as tax is part of the cost of doing business. From simple economic principles, the lower the costs, the higher the profits. Therefore, tax planning is expected to be a *sine qua non* as it reduces tax burden, thereby increasing corporate profit. Directors are the managers of the company's business. They have been saddled with the responsibility of managing the affairs of the company, not in the interest of a few or some shareholders but in the overall interest of the company. The implication is that while some managerial decisions may favour some shareholders, they may adversely affect the expectations of other shareholders. Also, while it might be true that some managerial decisions might seem to have favoured the managers, the tax planning strategies of a company should enhance corporate objectives in the long run. The question of whether a particular tax planning activity is in favour of managers or directors should be a secondary consideration. This position does not, however, erode the statutory obligation of the directors to act in the company's overall interest at all times, even where their personal interests are at stake. This is the underlying principle of ensuring that directors do not put themselves in a position where their personal interests conflict with those of the company.

9.0 Recommendations

Although a value-enhancing practice, we suggest that corporate tax avoidance be done with caution so that it does not become aggressive. Although cash savings are usually made from such practices, which improve the company's liquidity, profitability, expected growth, and tangibility, caution must be taken to ensure it does not get out of proportion. Unlike a company with atomistic shareholdings,⁷⁴ institutional shareholders can assert monitoring powers over their agents (management). However, institutional shareholding should be practiced within a sound corporate governance policy framework. Such monitoring should ensure managers channel tax savings to value-enhancing areas. Therefore, shareholders must monitor and ensure that managers can channel tax savings to value-enhancing activities. They should also discourage management from tax-aggressive actions as they may not benefit them or improve their value if litigation issues arise. Aggressive tax practices may necessitate litigation costs, which further deplete

⁷⁴ Atomistic shareholding occurs when majority of the shares of a company are owned by or concentrated in the hands of few individuals. This is otherwise called concentrated ownership.

shareholders' returns.

To achieve effective and reliable tax planning, the following should be borne in mind. First, the appointment committee should screen and meticulously follow all the procedures while appointing directors. The requirements for the appointment of directors, as stated in the Companies and Allied Matters Act (CAMA) 2020, must be complied with. There should be no conflict of interest, and directors must not place themselves in any compromising positions either with the company, contractors, or creditors. Secondly, directors must be given the freedom to carry out their statutory duties once appointed. Thirdly, in acting in the company's overall interest, the directors' tax planning strategies must not be in anybody's interest but in the company's overall interest. Any director who violates this should be sanctioned appropriately.

Furthermore, directors should be as transparent as possible to enhance good corporate governance. Timely dissemination of useful information from the directors to the shareholders is recommended as this will drastically reduce instances of information asymmetry, which is the basis of the mutual suspicion of the agency's problem. Also, there should be appropriate induction for company managers to acquaint them with the company's business strategies. One or two tax experts can be appointed to the Board to render professional advice regarding tax matters, including the ideal tax planning in appropriate circumstances.

There should also be an appropriate mix of EDs, NEDs, and INEDs on the Board of companies to enhance oversight functions, monitoring, and effective supervision, as well as independent and non-sentimental advice. As long as a project will be profitable to a company, the tax implications become immaterial. After all, the company is incorporated primarily for profit maximization. Tax planning is just a cost-saving mechanism to achieve the profit maximization objective. Also, directors should not embark on tax aggressiveness that negatively affects the company's corporate image. Reputational risk should be avoided by all means. Prompt payment of corporate tax enhances corporate image and makes the company a socially responsible corporate citizen. In summary, tax planning activities should be in the interests of all the stakeholders of a company, as this is the hallmark of good corporate governance.