

Is Tax an Expense or Appropriation of Profit? – A review of The Impact of Taxation and Tax Savings on the Financial Performance of Companies

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ABSTRACT

This study reviews the notion of tax as a controllable expense that can affect the financial performance of companies. This study investigates the impact of taxation and tax savings on the financial performance of commercial entities by examining both the theoretical and empirical frameworks and operational data of the firms examined. The study employed an ex-post facto research design to collect data from 111 firms listed on the Nigerian Exchange (NGX) and analyzed the data using one-way analysis of variance (ANOVA), while the interviews were transcribed and thematically analyzed. The results affirmed earlier findings that tax savings do indeed impact companies' financial performance but suggest that there is no significant difference between the expected tax due to profits and the actual tax paid by firms, thereby faulting the view that tax is a controllable expense.

Keywords: Taxation, Tax Savings, Financial Performance, Appropriation of Profit, Controllable Expense.

INTRODUCTION

Commercial enterprises operate in a highly competitive environment, in which financial performance is crucial for survival and growth. Taxation is viewed primarily as a significant expense for all commercial companies, because it affects profit margins and investment capabilities. Understanding the impact of taxation and exploring tax-saving strategies can provide valuable insights for enhancing firms' financial performance.

This study seeks to establish whether corporate taxation is truly an expense or dividend accruing to the government in which the entity operates. As a recipient of tax, the government can be considered a major stakeholder in any company within its jurisdiction. It not only provides the legal framework for the company's establishment but also the necessary infrastructure such as roads, energy, water, public telecommunications, and security, which ordinarily could have cost fortunes, were they left for individual businesses to provide. It would have been chaotic, if not impossible, for every business to provide its own amenities.

In other words, while fund providers are viewed as active investors or shareholders of a business, the government should also be viewed as a passive investor or shareholder who, like active shareholders, is entitled to dividends from their investments.

Given this context, it is appropriate to regard corporate taxation as a controllable expense, thereby assessing the managerial competence of organizational leadership based on this criterion.

Problem Statement

Despite the importance of taxation in financial decision making, there is a lack of comprehensive studies examining how taxation and tax savings specifically affect manufacturing companies' financial performance. Although there has been significant global attention on how tax savings have influenced firm profitability over the years, the concept of tax as a controllable expense warrants further investigation. This study attempts to address this gap by reviewing the relevant literature and analyzing empirical data to examine the true effects of taxation and tax savings on the financial performance of selected companies. It also explores how well the notion of tax as a controllable expense fits the broader tax equation.

Research Objectives

This study aims to establish whether corporate tax is an expense or an appropriation of profit by analyzing the relationship between taxation and financial performance in listed Nigerian companies. It also aims to identify effective tax saving strategies employed by companies, evaluate the impact of tax savings on their profitability and overall financial health, and determine whether tax planning is a good measure of operational efficiency with which managerial performance can be evaluated.

Research Hypothesis

To ascertain whether tax is an expense or an appropriation of profit, we test the following hypotheses:

H₀₁: There is no significant difference between the taxes paid by companies and the taxes paid due to their profits.

H₀₂: Corporate tax is not an Expense but an appropriation of profit.

Hypothesis H₀₁ is designed to test statistically whether tax savings can significantly affect a company's profits as would controllable expenses, while hypothesis H₀₂ uses the opinion of finance managers to determine whether corporate tax is viewed by them as an expense or as an appropriation of profit.

LITERATURE REVIEW

The need for Taxation

Taxation is a critical aspect of any economy that influences both individual and corporate behavior. Taxation serves several key economic purposes. For most countries, taxes are the primary source of government revenue, funding public services such as infrastructure, education, healthcare, and defense (Musgrave & Musgrave, 1989) and as argued by many classical economists. Progressive tax systems aim to reduce income inequality by taxing higher incomes at higher rates (Piketty, 2014). Taxes can also be used to control inflation, manage economic cycles, and stabilize the economy (Keynes, 1936). However, many countries are yet to prove the latter assertion positively, owing to the divergent socio-economic and religious practices prevalent in many climates. It is also strongly posited that taxes can incentivize or disincentivize certain behaviors such as taxing tobacco to reduce smoking or offering tax credits for renewable energy investments (Slemrod, 1990).

Process of Taxation

The taxation process involves several steps including legislation, assessment, collection, and enforcement. Governments enact laws defining tax types, rates, and procedures while instituting the tax collection authorities. Tax authorities determine the tax liability of individuals and corporations based on income, profits, or transactions, as dictated by enabling tax laws. Taxes are collected through various means, such as payroll deductions, corporate tax filings, value-added, or sales taxes. Governments take responsibility for ensuring compliance through audits, penalties, and legal actions (Bird & Zolt, 2008).

Taxation and Corporate Performance

Taxation significantly impacts corporate performance, both positively and negatively. One negative effect of taxation is that it reduces corporate profits, thereby affecting a company's ability to reinvest or distribute dividends (Desai & Dharmapala, 2006). In some industries, such as tobacco and alcoholic beverage manufacturing, the

usually high tax rates imposed on them may discourage investment. On the other hand, tax incentives (as depreciation and capital allowances) can encourage capital expenditure (Hassett & Hubbard, 2002). Additionally, tax rates can be used to temporarily reduce the effect of loan interest, which is useful in investment appraisal. It is worth noting that taxes affect cash flow, which is critical for operational liquidity and growth (Graham, 1996). The argument that firms can engage in tax planning to minimize their tax liabilities to the government is one of the focus of this study. As suggested by Hanlon and Heitzman (2010), companies may engage in tax planning to avoid tax evasion and minimize liabilities, which can lead to legal risks and reputational damage (Hanlon & Heitzman, 2010). Finally, it was posited that corporate tax rates influence a country's attractiveness to foreign direct investment (FDI) and the competitiveness of domestic firms (Devereux & Griffith, 1998).

Taxation and Financial Performance: Taxation is a compulsory financial charge imposed by the government on individuals and corporations. For commercial entities, taxes can significantly reduce net income, thereby affecting their ability to reinvest in operations, pay dividends, and expand. Various studies highlight the adverse effects of high tax rates on corporate financial performance, suggesting that effective tax management can mitigate these adverse impacts (Smith, 2019; Johnson, 2020). In addition, a recent Nigerian study affirms earlier findings that taxation and tax strategies affect manufacturing companies' financial performance by reducing corporate tax burdens and improving profitability (Onwuka & Akoma, 2022).

Expense Perspective: From financial accounting perspective, corporate taxation is typically viewed as an expense. It reduces a company's net income, affecting its ability to reinvest in operations, pay dividends, and expand (Smith, 2019; Johnson, 2020).

Dividend Perspective: As posited earlier, this study argues that corporate taxation should be seen as a dividend to the government rather than an expense. As a recipient of taxes, the government is indeed a major stakeholder in any company within its jurisdiction because it not only provides the legal framework for the company's establishment but also the necessary infrastructure such as roads, energy, water, public telecommunications, and security. Given this context, corporate taxation is a return on the government's investment in creating a conducive environment for businesses to operate.

Tax as a Corporate Managerial Performance Evaluation Tool: The notion of tax as a controllable expense led to the idea of using tax management as a tool for evaluating corporate managerial performance. This perspective is grounded in agency and trade-off theories taken from the works of Jensen and Meckling (1976) and Modigliani and Miller (1963) discussed under the theoretical framework.

Tax Savings Strategies

Firms employ various strategies to minimize their tax liabilities, including income shifting, tax credit, and deductions. These strategies can lead to substantial tax savings and enhance cash flows and profitability. According to Brown (2021), companies that effectively implement tax-savings strategies report higher profit margins and better financial stability. Some common tax-saving strategies used by manufacturing companies include net operating loss carrybacks, cost segregation, income deferral, expense acceleration, research and development tax credits, qualified business deduction (pioneer status companies), accelerated depreciation (capital allowances), passthrough entity tax (where applicable), energy-efficient commercial property deduction, and selling off unproductive assets (Smith Schafer, 2022).

THEORETICAL FRAMEWORK

The theoretical framework for this study is based on agency theory and trade-off theory. Agency theory posits that managers, as agents of shareholders, are responsible for optimizing company resources including tax management. Trade-off theory suggests that companies balance the benefits of tax savings against the potential costs of tax planning, such as compliance risks and reputational damage (Jensen & Meckling, 1976; Modigliani & Miller, 1963).

METHODOLOGY

Research Design

This study adopts a mixed-methods approach combining qualitative and quantitative data to provide a comprehensive analysis of the impact of taxation and tax savings on companies' financial performance.

Data Collection

Data were collected from financial statements, tax records, and interviews with financial managers of 111 companies listed on the Nigerian Exchange Group (NGX). The number of financial years examined for each company ranged from one to ten and averaged six. Other empirical data were sourced from academic journals, industry reports, and government publications. The consent of the finance managers interviewed was obtained through telephone calls before the dates scheduled for the interview.

Data Analysis

Quantitative data were analyzed using ValuStats (VSP 2.0) statistical software to identify correlations between taxation, tax savings, and the main financial performance metric, profit after tax (PAT). Data were preprocessed for analysis by computing the expected tax due to companies' profits with the prevailing Nigerian corporation tax rate and using the same to derive the tax savings from the actual tax paid by firms. Qualitative data from the interviews were thematically analyzed to gain insights into tax management practices and their perceived effectiveness.

FINDINGS

Impact of Taxation

Preliminary findings from empirical reviews indicate that higher tax rates negatively impact companies' financial performance, reducing their net income and limiting their capacity for investment and growth. An analysis of how different types of taxes (e.g., corporate income tax and capital gains tax) affect the financial performance of manufacturing companies corroborates earlier findings on the impact of tax on firms' profitability (Eneisik et al., 2023).

The Effect of Tax on Profit

Empirical reviews also reveal a significant inverse relationship between tax rates and profit margins. Companies facing higher tax burdens tend to report lower profitability, underscoring the importance of effective tax management.

Evaluation of the effectiveness of various tax-saving strategies, such as R&D tax credits, capital allowances, and energy-efficient upgrades on companies' finances tends to suggest a good relationship (Direct Point Accountant, 2023). However, the outcome of the one-way analysis of variances presented as follows tends to be different.

One-way ANOVA results:

F-statistic: 9.831130668857067

p-value: 0.0000566

Table 1: Posthoc Tukey HSD results

Multiple Comparison of Means - Tukey HSD, FWER=0.05

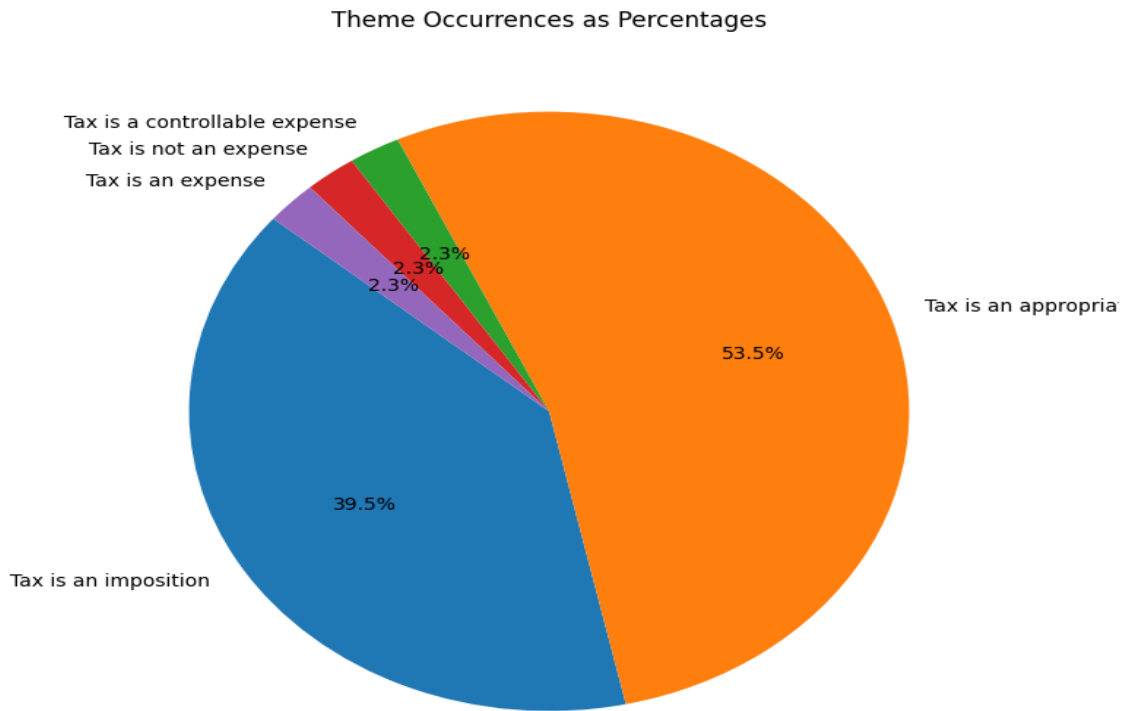
| group1 | group2 | mean-diff | p-adj | lower | upper | reject |
|----------|-----------|------------|--------|------------|------------|--------|
| Tax-Due | Tax-Paid | -944256.9 | 0.5021 | -2922614.9 | 1034101.2 | False |
| Tax-Due | Tax-Saved | -3606119.7 | 0.0001 | -5584477.8 | -1627761.7 | True |
| Tax-Paid | Tax-Saved | -2661862.8 | 0.0046 | -4640220.9 | -683504.7 | True |

Thematic Analysis Summary

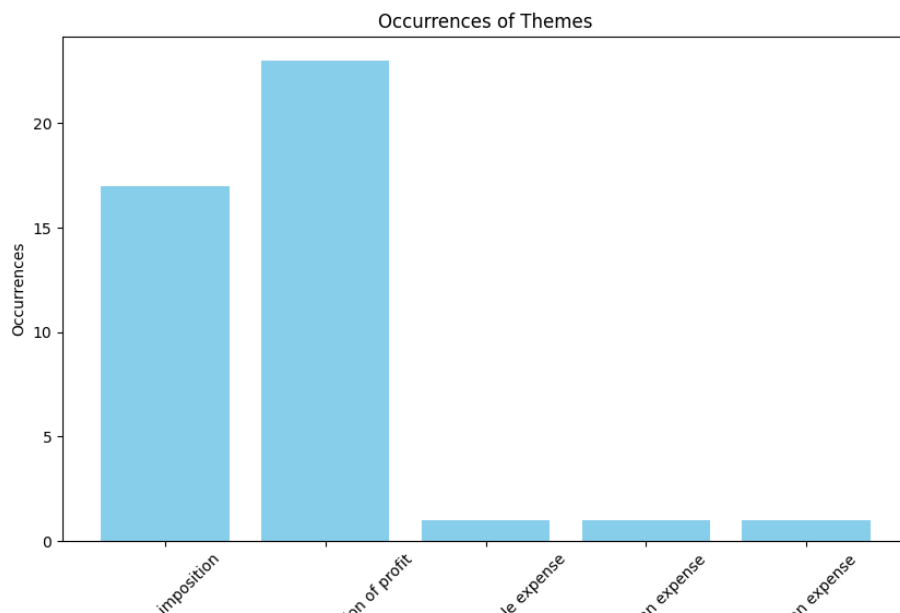
- Tax is an imposition: 17 occurrences (39.53%)
- Tax is an appropriation of profit: 23 occurrences (53.49%)
- Tax is a controllable expense: 1 occurrence (2.33%)
- Tax is not an expense: 1 occurrence (2.33%)
- Tax is an expense: 1 occurrence (2.33%)

The results of the thematic analysis of the interviews conducted on consenting finance managers showed that 53.49 percent of the respondents believed that tax should be seen as an appropriation of profit rather than as a controllable expense. The results further revealed that 39.53% of the respondents believed that tax is an imposition, 2.33 percent opined that tax is not an expense, and only 4.66 percent believed that tax is an expense. See figures 1 and 2.

Figure 1: Pie Chart of Occurrences of Research Themes



Source: ValuStats (VSP 2.0) 2026

Figure 2: Bar Chart of Occurrences of Research Themes

Source: ValuStats (VSP 2.0) 2026

DISCUSSION

Interpretation of Results

The literature review suggests that taxation is a critical factor that influences the financial performance of manufacturing companies. Effective tax saving strategies can mitigate the adverse effects of high tax rates and improve profitability and financial stability.

Comparison with Previous Studies

The literature review findings align with those of Smith (2019) and Johnson (2020), who also highlight the negative impact of high tax rates on corporate financial performance. However, this study provides additional insights into specific tax savings strategies and their effectiveness in the manufacturing and other productive sectors.

How Effective is Taxation as a Catalyst in Company Performance Improvement?

This study demonstrates that, while taxation can impose significant financial burdens, effective tax management can serve as a catalyst for performance improvement. Companies that proactively engage in tax planning and leverage the available tax incentives can enhance their financial outcomes.

Is Tax an Expense or a Dividend?

Although no known literature has specifically attempted to pose or answer this question in the past, the answer seems to have been provided by the results of the analysis of variances (ANOVA) test in Table 1 in the previous section and those of the thematic analysis. Table 1 shows that the post-hoc Tukey HSD results indicate that there is **no significant difference** between Tax-Due and Tax-Paid by company, with a *mean-difference* of -944256.9, $p = 0.5021$. On the other hand, there were significant differences between Tax-Due and Tax-Saved and between Tax-Paid and Tax-Saved (*mean-difference* = -3606119.7, $p = 0.0001$, *mean-difference* = -2661862.8, $p = 0.0046$). This implies that we **do not reject** hypothesis H_01 .

These results implicitly indicate that the difference between the tax due and tax paid is not significant enough to warrant the conclusion that tax savings can significantly impact a firm's profit by increasing or decreasing it. An expense in the true sense of it is one that can be avoided or negotiated.

From the results of the thematic analysis, more than 53.49 percent of respondents believed that tax, although an imposition by government is effectively an appropriation of profit, it cannot be avoided that it cannot be negotiated outside the provisions or ambit of the law that imposed it. In the opinion of this paper, and as can be

deduced from the empirical and thematic analyses, tax is an appropriation of profit and not a controllable expense. This implies that the acceptance of H₀₂.

Practical Implications

These findings have several practical implications for various companies. By adopting effective tax saving strategies, companies can improve their profitability and financial health, but cannot do so beyond the limits allowed by the tax law. Policymakers should also consider the impact of tax policies on corporate performance and provide incentives to encourage investment and growth.

CONCLUSION

Summary of Findings

This study underscores the profound impact of taxation on companies' financial performance. Effective tax savings strategies, when applied according to the law, can mitigate the adverse effects of high tax rates and improve profitability and financial stability. Nevertheless, company boards should bear in mind that tax is **not a controllable expense** contrary to common misconceptions; it is an imposition far beyond the influence or decisions of managers. Tax planning is an effective tool to control the aspect of the organization's profit that accrues to the government; it cannot increase profit beyond the level generated after accounting for interest costs. Therefore, it should not be considered as a reliable metric for evaluating managerial performance.

Future Research

Future research should focus on longitudinal studies to assess the long-term impact of tax savings on financial performance. Additionally, comparative studies across industries can provide a broader understanding of tax management practices and their effectiveness.

Declarations

Ethical Approval and Consent to Participate

This study exclusively utilized publicly available financial statements of companies listed on the Nigerian stock exchange (NGX), which does not require specific permission for use. The consent of the finance managers interviewed was obtained through unrecorded telephone calls to schedule interview dates, and no personal details of the respondents were collected or published in accordance with the Babcock University Health, Research and Ethics Committee (BUHREC) guidelines.

Consent for Publication

No personalized details, images, or videos of any individual were used in the preparation of this document; thus, no consent for publication was required.

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Data Availability

The data used for the analysis in this study are available from the corresponding author upon request.

Authors' Contributions

The first author (EPE) wrote the manuscript, the second author (EON) supplied the literature and performed the statistical analysis, the third author (AO) supplied the financial statements from which data were extracted, while the fourth and last author (OMD) was particularly helpful in scheduling interview dates with the respondent

finance managers, offsetting some of the expenses incurred during data collection, proofreading the manuscripts and effecting the suggested corrections.

Conflict of Interest

The authors have no conflict of interest to declare.

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