

Tax Planning, Firm Performance and the Moderated role of Dividend Policy: Evidence from East African Countries

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Abstract: - This study aims to explore the impact of tax planning on the firm's value with the moderated effect of dividend policy. The study has drawn a unique and limited explored sample of non-financial listed firms in East African Countries' stock exchanges. It covers a period of eleven years (2009 – 2019). The tax planning proxy was determined using the book tax difference, while firm performance was measured using return on assets (ROA) and Tobin Q. The Dynamic panel system (GMM) was employed to establish the causal relationship between variables. The robustness check on GMM results was also conducted using OLS and FEM. The results of the study showcase that tax planning positively affects a firm's values. The findings indicate that tax planning activities in EAC partner state aim to achieve corporate goals, not opportunistic managerial ones. However, the study's findings reveal a significant moderated role of the dividend policy on the linkage between tax planning and firm performance of the EAC-listed firms. This study contributes to the existing literature by providing additional insights into taxation and corporate governance perspectives. The findings also have practical implications for tax administrators, policymakers, and shareholders

Key-Words: - Tax planning, tax avoidance, dividend policy, firm value, developing countries

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1 Introduction

Managing tax avoidance practices is increasingly challenging for both local tax administrations and international organizations. East African Countries (EAC), like any other developing countries, are explicitly vulnerable to aggressive tax planning due to deficiencies in their legal tax framework, inadequate resources, and expertise to monitor the

underlying behaviors, [1]. Although EAC experiences different patterns and histories of tax aggressiveness, its member states share common approaches and characteristics in dealing with the problem. The most common anti-avoidance measure undertaken by them is tax policy reforms and the development of anti-avoidance regulations, [2]. Despite those different measures being undertaken by

tax administrations in EAC and other developing countries, their success in addressing tax avoidance problems remains questionable. Firms are still reported to engage in tax minimization strategies commonly known as tax planning, [3]

The relationship between firms' performance and tax planning is currently the subject of extensive research, [4], [5], [6]. One of the crucial goals of many firms is to increase firm value with the aim of meeting owners' and other stakeholders' expectations. Therefore, with the help of experts, firms use several techniques to cut down tax liabilities to achieve firm value enhancement. They usually take advantage of the existing loopholes in tax regulations to accomplish their goal. For instance, managers can use variations in effective tax rates, book-tax differences, deferred tax liability, and debt at an optimal level to minimize their tax liability and maximize profit after Tax, [7], [8]. According to positive accounting theory, managers are also deemed to use accounting methods to reduce their earnings to reduce the tax burden, [9], [10].

The strand of literature indicates that tax planning when performed legally has a positive impact on firm performance, [11], [12]. It can be used to increase profit after tax without incurring unnecessary costs, which might arise if the firm practices illegal tax planning, [11], [13]. Besides reporting high performance, managers can also use tax planning to signal to their shareholders and attract market reaction, [5]. In contrast, when it is done opportunistically, tax planning adversely impacts shareholders and other stakeholders of the firms. In the same context, [6], highlighted that aggressive tax planning arising from agency problems creates not only personal benefits to managers but also accumulates non-tax costs such as penalties that directly affect the firms and shareholders. Tax planning creates opportunities for managers to manage earnings in their interest and reduce the firm value due to information asymmetry between managers and shareholders, [14], [15].

Despite the stated benefits of tax planning, its adverse still outweigh the benefits. Aggressive tax planning increases the company's likelihood of incurring high costs; thus, it is suggested to be controlled. On this note, a dividend can be used as a control mechanism for aggressive tax planning because it requires a firm to have quality earnings to pay dividends, [16]. Thus, managers of the firms that plan the payment of cash dividends must concentrate

on the quality of their earnings and avoid engaging in harmful tax planning, [17]. Additionally, the payment of cash dividends constrains opportunities for managers to have excess cash for their interest, [16]. Therefore, in this context, the link between tax planning, firm performance, and dividend policy is one of the most important factors to be examined. Nevertheless, despite the significant implication of dividend policy to monitor aggressive tax planning and reduce agency problems, prior researchers have given little attention to exploring its impact.

The impact of aggressive tax planning on firm performance has been less investigated in EAC. Innumerable research has been conducted in developed countries, and few were done in the rest of Africa, such as Ghana, Nigeria, and Tunisia, [5], [18]. Despite giving little attention, EAC has been highly affected by firms' tax avoidance practices. According to, [19], East African countries, such as Kenya and Tanzania, have been losing billions of US dollars in tax revenue from large companies in various sectors, including energy, resource, and tourism sectors. Therefore, having this study conducted in EAC becomes vital in filling the gap by ascertaining the significant tax planning impact on firms' performance and the moderating effect of dividend policy in a new setting.

This study also contributes to the literature in various ways. Firstly, to the agency and signalling theories, the study complements the literature with an understanding of the implications of tax planning in influencing agency problems and information asymmetry. This study explores the contribution of dividends policy in monitoring agency problems. Secondly, since EAC is losing considerable revenue through tax avoidance and evasion, the study plays an integral part to the policymakers and tax administrators in designing appropriate measures that will close loopholes for aggressive tax planning. Finally, the study contributes to the methodology by conducting a study in a previously unexplored setting.

2 Literature Review and Development of Hypotheses

2.1 Theoretical Review

Previous studies have divided tax planning into two categories known as tax avoidance and tax, [5], [20].

Tax planning is referred to as tax avoidance when it is performed legally. Usually, it occurs when it is arranged in a way that reduces the tax burden without adversely impacting the firm performance, [20]. However, when tax planning is set illegally, it is known as tax evasion, and most of the time, it negatively affects firm performance, [5]. Tax evasion can also be referred to as aggressive tax planning, and it goes in parallel with the practices of firms to manipulate tax payments, [21]. Typically, tax evasion exposes firms to a greater risk of heavy penalties and has negative implications on the firms' reputations. Hence to distinguish tax avoidance from tax evasion, one should figure out what is acceptable avoidance and what is unacceptable avoidance, [22].

Prior studies have focused on investigating the connection between firm value and tax planning mainly by using the agency, stakeholders' agency, and signaling theories, [23], [24]. Regarding the agency theory, an extensive body of literature has documented a piece of Evidence that self-interest managers have used tax planning to pursue their objectives, [5], [25]. Normally tax planning is considered value enhancement by shareholders when it is used to improve the firm's value, [26]. In this manner, managers receive great support from their shareholders, who inspire them to use their best effort to reduce the tax burden, [23]. However, tax planning allows opportunistic managers to capitalize on the advantage arising in their favor, [14], [23]. Therefore, instead of resolving the agency problem, tax planning increases the magnitude of the problem.

Following the agency problem arising from tax planning, the stakeholders' agency theory comes with propositions that try to resolve the existing situation. The stakeholders' agency theory proposes aligning the interest of shareholders and managers to avoid agency problems, [27]. Thus, the theory postulates that managers should have an obligation to balance and defend the interest of all stakeholders, [28]. That means firms must engage in legal tax planning, which increases firm value without harming other stakeholders. This proposition was supported by, [24], who found that tax planning positively relates to firm performance in different data sets and periods. In contrast to this proposition, firms are still engaged in harmful tax planning that aims to replicate managers' interests. Using data from Ghana-listed, [5], indicates an opposite relationship between tax planning and firm performance. In building justification for their finding, [5] reveal that

managers avoid tax to pursue their self-interests due to the presence of agency problems.

The linkage between tax planning and firm value is also explained by signalling theory. According to the signalling theory, managers are deemed to use tax planning to signal the firms' favorable or unfavorable performance to shareholders to attract their attention, [29]. Aggressive tax planning could signal bad information to investors that would cause them to lose their investment interest, especially when firms have court cases related to illegal tax practices, [30]. On the other hand, tax planning can also signal valuable information about the firm's good future performance, which would attract investors' interest to buy shares and subsequently increase share prices and firms' values, [30]. Furthermore, firms choose to disclose tax planning information based on their motivation. The effect caused by disclosed information varies depending on the types of firms and countries concerned, [22]. This means that the impact of tax planning tends to differ based on motivations, types of firms, and countries in which firms originated.

On the other side, the moderating role of dividend policy on the relation between tax planning and firm performance continues to be an open question. Most studies on corporate governance have explored the direct relationship between dividend policy and tax planning but not the moderating effect, [31], [32]. However, dividend policy can play an essential role in moderating the effect of tax planning on firm value because it monitors the relationship between shareholders and managers. [32], asserted that the dividend policy reduces the agency problem because cash dividend payments improve the association between shareholders and managers. Most importantly, the Dividend policy limits managers from being involved in aggressive tax planning; instead, they will minimize tax payments to have the excess cash flow for dividends payments, [23], [33], argue that with the obligations of paying dividends, managers will not be involved with aggressive tax planning because it is ineffective in increasing their benefits. Dividend policy is also highly linked with investor protection, [34]. Furthermore, an active dividend policy is favored by investors whose dividends are charged at a lower effective tax rate, [35], [36].

2.2 Hypotheses Development

Studies on the linkage between firm performance and tax planning have yielded mixed results. Tax planning is reported to have both beneficial and adverse impacts on firms. [37], indicated that tax planning performed in the tightened tax system is highly related to the positive performance of the firms. In the same context, [38], found that tax planning improves performance for well-governed companies. Similarly, [14], assert a significant relationship between firm performance and tax planning positively. Their results indicate that firms that adopt tax planning need assistance from corporate governance to have good performance. On the contrary, [39], using the effective tax rate as a proxy, reveals an adverse impact of tax planning on firm performance caused by high agency costs. [40], also produces identical results by indicating that tax planning increases agency costs and reduces firm value. With the above findings, it is presumed that tax planning affects firm performance. Hence the following hypothesis is developed.

H1: Tax planning has a significant relationship with firm performance.

Literature has reported contradictory results about the interaction of the dividends policy on the relation between tax planning and the value of the firm. Accordingly, while investigating the effect of tax planning on the firm performance of the Bursa Malaysia listed firms, [30] found that tax planning proxied by effective tax rate increased firm value. However, with the introduction of dividend policy, their study reveals a negative relationship between dividends and firm performance. Meanwhile, [41], explored the association between tax avoidance, dividend policy, and firm value of the manufactured listed firms on the Indonesia stock exchange. Their results reveal a significant positive relationship between dividend policy and firm value. At the same time, [42], indicates that an effective dividend policy manages to maximize shareholders' wealth by reducing tax liability. Therefore, the above findings lead to the generation of the following hypothesis

H2: The relationship between tax planning and firm performance is moderated by dividend policy.

3 Research Methodology

Empirical studies examining the effects of tax planning on firm performance were conducted in different economic contexts using different techniques. This study draws its sample from EAC-listed non-financial firms. It employs panel data from 48 firms from 2009 to 2019 with a total of 468 firm-year observations. Since the study utilized tax planning as one of the key variables, the study has excluded non-listed firms because tax planning incentives for non-listed firms differ from listed firms. Non-listed firms are reported to engage in tax planning only to avoid tax, while listed firms, apart from avoiding tax, also aim to attract market reaction, [43]. Also, the study has excluded financial institutions due to their complexity in meeting the financial reporting standards, [44].

Most of the studies which have used cross-sectional and time-series data have been affected by individual heterogeneity, [45], [46], [47]. To resolve this problem, several studies propose using panel data estimation [48], [49], [50], [51]. Panel data estimation was noted to provide convincing results because it not only exploits the advantage of cross-sectional and time series analysis but also corrects their weakness, [25]. The panel data estimation, apart from supporting the construction and testing of complicated models, is also more informative, while constructs are less collinear than in cross-sectional and time series, [52]. Therefore, based on the above findings, this study uses panel data estimations.

3.1 Measurement Variables

Firm performance in corporate governance studies has been divided into two groups: accounting performance and market performance, [53]. Market performance measures indicate long-term financial performance and growth opportunities while accounting measures reflect short-term financial performance, [6], [54]. This study measures firm performance from both perspectives, market and accounting performance, to improve the robustness and check the sensitivity of the results. Market performance is measured by using Tobin Q. Tobin Q is considered a better proxy for the study related to tax planning because it minimizes distortion arising from tax laws and accounting policies, [6]. Therefore, in line with, [5], [6], [55], Tobin Q is measured as the annual market capitalization of the firm divided by the annual book value of total assets.

On the other hand, accounting performance is measured by using return on assets. As one of the widely used accounting measures of performance, return on assets is considered an appropriate ratio in analyzing a firm's economic health and investment portfolio proficiency, [56], [57]. It is also considered to link a company's operations and investment activities, [58]. About the above findings, the study, therefore, measures return on assets (ROA) following, [59], [60], as net income per total assets.

Tax planning as an independent variable of the study has been measured by using various methods, including book-tax difference (BTD), the effective tax rate (ETR), and tax saving (TS). The utilization of BTD as a tax planning proxy has become much more popular due to the perceived difference between the reported level of accounting profit associated with taxable income and the corporate income tax payable to the tax authorities, [61]. On the other hand, ETR also was widely applied by prior studies, [5], [6], [39], as the reflection of a decrease in tax liability without affecting accounting income. This study uses BTD as the main measure of tax planning and ETR to check the robustness of the result. Using more than one method in estimating tax planning helps to increase the explanation of the results and make an appropriate statistical inference, [12]. Therefore, BTD is measured in line with, [61], [62], [63], using disaggregate BTD by first measuring total BTD and then estimating Permanent Difference out of total BTD. Accordingly, PD is estimated as follows

$$PD_{it} = BTD_{it} - TD_{it} \quad (1)$$

Where PD_{it} is the Permanent Book Tax Difference.

BTD_{it} denotes the Total Book Tax Difference which is calculated as *the difference between profit before tax and estimated taxable profit*.

TD_{it} denotes the Temporary Book Tax Difference which is calculated as *the ratio of deferred tax expenses over by the statutory tax rate*.

Furthermore, *ETR* as the tax planning proxy for checking the results' robustness in this study, is measured similarly to, [5], [64], as a ratio of total

corporate tax expense minus differed tax divided by pre-tax income. Since tax planning practices are argued to influence firms to incur losses, [23], loss-making firms are not excluded in this study.

Dividend policy has been widely measured by most studies as the dividend payout ratio, [65], [66]. Other studies also have examined the impact of dividends by using the dummy variables set as follows; a value of one (1) for the firm that paid dividends and a value of zero (0) for the firms that do not pay dividends in a particular year, [16]. This study employs the widely used dividend payout ratio, calculated as dividends over net income.

Firm size, as one of the control variables in this study, is the size of the firms that arguably influences tax planning decisions. Large firms are less involved in aggressive tax planning than small firms because of their reputations and transparency, [5]. Meanwhile, large firms are also reported to have higher information asymmetry and political influence that they can efficiently utilize to plan taxes, [25]. Firm size in this study is measured in line with, [39], [48], by taking the natural logarithm of total assets.

Financial leverage, as another control variable, is related to firm performance through the argument that firms with higher financial leverage are more efficient in minimizing tax liability and increasing firm performance, [39]. [67], finds that firms with higher debt-to-equity ratios have low effective tax rates because they use debt deduction to reduce corporate tax liability. The study measures financial leverage similarly to, [48], [68], by taking total debt and dividing it by total assets.

Firm growth opportunities as the final control variable in this study is an essential tool in examining the relationship between tax planning and firm performance. Low-growth firms are reported to engage more in aggressive tax planning than high-growth firms. This is because low growth faces more financial distress than high-growth firms that enforce them to reduce tax liabilities, [68]. Following [69], [70], firm growth opportunity in this study is measured by using the sales growth rate. The definition of the variables is presented in Table 1.

Table 1. Definition of Variables

VARIABLE	SYMBOL	DEFINITION	SOURCE
Firm Value	ROA	Net income over total assets.	Financial Reports
	Tobin Q	The market capitalization of the firm over the book value of total assets at the year-end	Financial Reports
Book-Tax Difference	BTD	Measure by tax effect book-tax difference	Financial Reports, Tax Authority website of the Partner State
Effective Tax Rate	ETR	Total corporate tax expense minus differed tax divided by pre-tax income	Financial Reports
Dividend Policy	DP	Dividend over Net Income	Financial Reports
Moderated Variable	BTD_DP	Book-Tax Difference times dividend policy	Financial Reports
Firm Size	SIZE	Natural logarithm of total assets	Financial Reports
Financial Leverage	LEV	Total debt over total assets	Financial Reports
Firm Growth Opportunity	GROWTH	Sales growth rate	Financial Reports

Source: Owners' compilation

3.2 Model Specification

The ordinary least squares (OLS) are highly criticized for being the best method for panel data. Instead, it is proposed to work with Panel data by considering individual effects, [71]. Studies under OLS suffered from endogeneity and simultaneity problems, [72]. According to, [73], [74], OLS could be appropriately used under restrictive assumptions of autocorrelation, homoscedasticity, normality, and Multicollinearity. However, these restrictive assumptions of OLS result in biased and inconsistent estimates, which create room for the possibility of reporting spurious results, [75]. Consequently, as a remedy for the observed shortcomings, it is proposed to use a dynamic panel system with two steps (GMM) to run regression estimations. The dynamic GMM is effectively designed to overcome the endogeneity bias arising from unbalanced panel data, resulting in inconsistent estimates, [76]. The model is also capable of handling heteroskedasticity and autocorrelation issues. Thus, this study estimates the dynamic two steps system GMM as follows;

$$Y_{it} = \alpha + k_p y_{it-1} + \beta_i X_{it} + \gamma_i Z_{it} + \lambda_i + \varepsilon_{it} \quad (2)$$

Where: Y_{it} presents firm performance for the firm t the time t , y_{it-1} denotes the lagged firm performance, represents independent variables and moderated variables (Tax planning and dividend policy), Z_{it} denotes control variables (financial leverage, Firm size, and growth opportunity), β_i and presents vector coefficients for explanatory and control variables respectively, λ_i firm-level fixed effect and the error term.

Accordingly, we estimate the relationship between firm performance and book-tax difference by using the panel data regression model as follows;

$$FV_{it} = \alpha_0 + \alpha_1 BTD_{it} + \alpha_2 SIZE_{it} + \alpha_3 LEV_{it} + \alpha_4 GROWTH_{it} + \varepsilon_{it} \quad (3)$$

Where; FV_{it} denotes Firm Value, BTD_{it} is the book-tax difference (BTD), $SIZE_{it}$ is Firm Size,

LEV_{it} is Financial Leverage and $GROWTH_{it}$ is Growth Opportunity.

Furthermore, the moderate role of dividend policy is estimated by using the following regression model:

$$FV_{it} = \alpha_0 + \alpha_1 BTD_{it} + \alpha_2 DP_{it} + \alpha_3 DP * BTD_{it} + \alpha_4 SIZE_{it} + \alpha_5 LEV_{it} + \alpha_6 GROWTH_{it} + \varepsilon_{it} \quad (4)$$

Where; DP_{it} denotes Dividend Policy.

4 Empirical Results

4.1 Descriptive Statistics

Firstly, the data were winsorized at the 2nd and 98th percentiles before analysis to control for outliers. The summary of descriptive statistics of the final sample of 516 firm-year observations is provided in Table 2 for dependent variables (ROA and Tobin Q) and explanatory variables (BTD, DP, LEV, GROWTH, and SIZE). The summary covers the mean, standard deviation, and minimum and maximum values of the variables used in this study.

The descriptive statistics results in Table 2 above indicate an average book-tax difference of -0.017, equivalent to -1.7%. It implies that many firms in EAC are under due tax by the government, and the statutory tax rate imposed by the governments of the

partner states does not reflect the real amount of tax paid by firms. Some firms in EAC reported a maximum and a minimum book-tax difference of -11.7% and 4.1%, implying that accounting income exceeds taxable income for some firms and vice versa for others. The descriptive statistics also report a standard deviation of 4.1% for book-tax differences, indicating considerably low variation across EAC-listed firms.

On the other hand, the EAC listed firms report a positive average return on assets (ROA) of 0.175 (17.5%) and Tobin Q 1.7 (170%), with maximum and minimum ROA of -41.4% & 67.6% and Tobin Q 40% & 659% respectively for some firms. This implies that EAC-listed firms efficiently utilize assets to generate more income, which is also evidenced by high market capitalization. The descriptive statistics further report positive averages for the following variables; dividend policy at 31.3%, financial leverage at 50.4%, growth rate at 0.6%, and firm size of the natural logarithm of 7.94. The average growth rate of 0.6% indicates that firms in EAC have poor sales growth even though a certain firm has recorded a maximum growth rate of 34.7%. Also, a standard deviation of 142.7% for Tobin Q and 69.7% for firm size indicates a high disparity between Tobin Q and firm size. Conclusive results of the descriptive statistics between book-tax difference and firm performance indicate the presence of tax planning activities that increase the firm's value.

Table 2. Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
ROA	516	.175	.286	-.414	.676
Tobin Q	516	1.709	1.427	.4	6.59
BTD	516	-.017	.041	-0.117	.033
DP	516	.313	.378	-.007	1.244
LEV	516	.504	.239	.196	1.04
GROWTH	516	.006	.182	-.389	.347
SIZE	516	7.942	.697	6.041	9.595

The notation: ROA = Return on Asset (ratio) ETR = Tax planning measure by Effective Tax Rate (ratio), AQI = DPI = Dividend Policy measure by dividend pay-out (ratio) SIZE = Firm size (ln), LEV = Leverage (ratio), GROWTH = Firm growth opportunity (ratio).

Table 3. Pearson Correlation Matrix

Variables	-1	-2	-3	-4	-5	-6	-7
(1) ROA	1						
(2) TobinQ	0.330***	1					
(3) BTD	0.647***	-0.011	1				
(4) DP	0.240***	0.312***	0.165***	1			
(5) LEV	-0.429***	0.015	-0.323***	-0.291***	1		
(6) GROWTH	0.183***	-0.001	0.157***	0.015	-0.036	1	
(7) SIZE	0.029	-0.024	-0.021	0.028	0.180***	0.149***	1

Notes: The asterisks ***, ** and * represent significance at 1%, 5%, and 10% levels respectively

4.2 Correlations Results

Table 3 provides the correlation matrix result between all variables used in this study. The correlation matrix also serves as the collinearity test among variables. The results indicate that some variables are significantly correlated with each other. Specifically, the results reveal that ROA is significantly positively correlated with the book-tax difference. This implies that more tax planning activities result in high firm value. The results also indicate a correlation among explanatory variables. Notably, the result showed a positive correlation between dividend policy and book-tax difference. Results also revealed that financial leverage negatively correlates with a book-tax difference and dividend policy. However, despite having a significant correlation among explanatory variables, Multicollinearity is observed to be not a problem. First, the magnitude of the correlation values is observed to be the minimum set threshold of 0.8, [74]. Also, as further evidenced in the results of variance inflation factors reported in Table 4, none of the reported VIF exceeds 10. The average VIF reported is 1.08, with the highest VIF at 1.142 and the lowest VIF standing at 1.03.

4.3 Other Diagnostic Tests

The study followed other researchers, [52] and ran other diagnostic tests to ensure the findings matched the different metrics. The study ran Breusch Pagan/ Cook-Weisberg Test to detect heteroscedasticity in the estimated regression models. As shown in Table 5, the estimated results indicate a p-value (probability > chi2) to be more than 0.1 ROA, showing no heteroscedasticity problem when ROA measures firm performance. Conversely, the results indicate significant heteroscedasticity in the Tobin Q models. This means the regression must be run robustly to overcome heteroscedasticity in the Tobin Q model. However, since the main regression is estimated using GMM, the heteroscedasticity problem is resolved automatically.

Table 4. Variance inflation factor

	V.I.F.	1/VIF
LEV	1.141	.876
SIZE	1.106	.904
DP	1.104	.906
ETR	1.042	.96
GROWTH	1.027	.973
Mean VIF	1.084	.

Table 5. Heteroskedasticity Test by Breusch Pagan/Cook-Weisberg

ROA		TOBIN Q	
Chi-Square	P-value	Chi-Square	P-value
2.22	0.1366	9.24	0.002***

Table 6. Unit Root Test- Im-Pesaran-Shin

Variables	Statistic	P-value	1st Difference
ROA	-1.9183	0.0275**	
TOBIN Q	0.5415	0.7059	0.0000***
BTD	-1.0942	0.0261**	
ETR	-2.8745	0.002**	
AQ	-2.7806	0.0027**	
LEV	0.6292	0.7354	0.0000***
GROWTH	-2.8369	0.0020**	
F_Size	-0.6328	0.0000***	

Table 7. Cointegration Test - Pedroni

	ROA	TOBIN Q
Variables	P-value	P-value
Modified Phillips-Perron t	0.0000***	0.0000***
Phillips-Perron t	0.0000***	0.0000***
Augmented Dickey-Fuller t	0.0006***	0.0000***

In line with, [52], [79], the study also conducts a unit root test to check for data stationarity using Im-Pesaran- Shin (IPS). IPS has been chosen over other tests because it fits well with both balanced and unbalanced panel data. Also, it has large power and size than others, [88]. The panel unit root test results in Table 6 indicate all variables to be stationaries except Tobin Q and Financial leverage. However, after performing the first difference, Tobin Q and Financial Leverage become stationary. The presence of stationarity implies that data is predictable on permanent or temporary shocks, and they can hold up for future projections.

The presence of data stationarity postulates the importance of assessing the long-run relationship between variables. Thus the study conducted panel cointegration using the Pedroni test to confirm whether data stationarity indicates a long-run relationship between dependent and independent variables. As shown in Table 7, the results reject the null hypothesis of no cointegration at less than a 1% significant level and accept the alternative hypothesis for all Pedroni tests. This means there is a solid long-run relationship between variables.

4.4 Regression Results

Relationship between Tax Planning and Firm Performance

Before GMM estimation, the model was pre-estimated by using the Ordinal Least Square (OLS) and Fixed Effect Model (FEM) to assess the sensitivity of the results. The initial results shown in Table 4 are robust in both OLS and FEM. Consistent with GMM, both OLS, and FEM reveal a positive relationship between book-tax difference and ROA at a 1% significant level and an insignificant relationship between book-tax difference and Tobin Q. Generally, the evidence of having a similar pattern of results in all estimation models implies the existence of strong persistency of the results that can not be affected by the change of models. Therefore, the results are appropriate for making statistical inferences.

The GMM results presented in columns 6 and 7 of Table 8 show that the lagged dependent variables are positively significant for both ROA and Tobin Q at 1%. The results confirm the condition of the lagged variable, which require it to be significant to

justify the instrument's validity, [77], [78], [79]. Specifically, the results show that tax planning positively relates to ROA at a 1% significant level (Coef 3.663), suggesting a large difference between the EAC-listed firms' accounting and taxable incomes. The coefficients of 3.663 indicate that every increase in 1 unit of tax planning increases firm accounting performance by 3.663. The result support hypothesis H1 by confirming that tax planning is related to firm performance. However, we find no evidence to support the relationship between tax planning and Tobin Q. This could be explained by the fact that book-tax difference arises from variation in the computation of accounting tax and taxable income. Thus, as a market measure of firm performance that reflects investors' valuation, Tobin Q could not be directly impacted by BTD. Also, complex tax avoidance is more likely to attract investors' attention and increase supervision costs, [14].

Furthermore, since ROA measures the firm's accounting performance, the results reveal that EAC firms engage in tax planning activities to meet earnings targets. They reduce earnings for tax purposes. However, this practice has a negative effect on the reliability and accountability of financial statements. It may create unnecessary contradictions for users of financial statements. Consequently, the significant magnitude between tax planning and ROA suggests that firms in EAC involve more in tax planning for the short-run causality than the long-run. Also, the positive relationship between tax planning and the firm's value confirmed the assertion by prior studies that proper tax planning favours shareholders as they consider it a value enhancement, [5], [26]. The result is identical to the existing empirical finding by, [6], [55], who documented that firms use tax planning to increase their value. On the contrary, the results oppose the finding by, [18], who documented a negative relationship between tax planning and firm value.

Similar results are also found in the association between leverage and Tobin Q, which confirms the positive relationship. This result suggests that high leverage is positively linked with the long-run performance of the firms, but in the short-run, high leverage has no impact on the firm performance. The result is also justified because firms usually acquire debt finance for projects that will yield positive returns in the future. Results also indicate a negative, statistically insignificant relationship between firm

size and firm performance, which stands to reason that large firms use their status and political influence to avoid tax, [80]. The negative relation between firm size and the value of the firm can also be explained as large firms experiencing more serious agency problems than small firms, which influence managers to pursue their opportunistic goals, [6]. The regression results for tax planning and firm value are presented in Table 8.

Table 8. Regression results for Tax Planning and Firm Value

	OLS		FEM		GMM sys	
	ROA	TOBIN Q	ROA	TOBIN Q	ROA	TOBIN Q
L.ROA/ L.TOBIN					0.228***	0.747***
					[0.082]	[0.219]
BTD	3.835***	-0.237	3.822***	-1.875*	3.663***	-0.91
	[0.235]	[1.635]	[0.188]	[1.107]	[0.458]	[0.711]
LEV	-0.314**	0.107	-0.216***	-0.032	-0.117	0.841***
	[0.041]	[0.284]	[0.054]	[0.316]	[0.086]	[0.303]
GROWTH	0.119**	0.035	0.103**	-0.244	0.08	-0.111
	[0.051]	[0.355]	[0.04]	[0.236]	[0.044]	[0.178]
SIZE	0.031**	-0.057	-0.15***	-1.851***	0.022	-0.194*
	[0.013]	[0.093]	[0.045]	[0.265]	[0.032]	[0.106]
Constant	0.148	2.103***	1.536***	16.4***	0.051	1.464*
	[0.105]	[0.729]	[0.358]	[2.111]	[0.237]	[0.851]
Number of Obs	516	516	516	516	516	516
AR (1) (p-value)					0.044	0
AR (2) (p-value)					0.74	0.533
Sargan					0.031	0
Hansen					0.296	0.264

Notes: The Table reports regression coefficients and Standard error (in brackets). The asterisks ***, ** and * indicate significant levels at 1%, 5%, and 10%, respectively. Dynamic panel data are reported with AR (1) and AR (2), which are first-order and second-order serial correlations in the first differenced residuals. Also, it reports the Sargan and Hansen Test in p-value. The notation: L.ROA and L. TOBIN = lagged performance, BTD = Book Tax Difference, LEV = Financial Leverage, GROWTH= Firm Growth Opportunity, SIZE= Firm Size

4.4.1 Robustness Check

To increase the reliability of the above-presented results, the robustness check has been performed using the effective tax rate as an alternative tax planning measure. The results, as shown in Table 9 below, indicate that the coefficients of the lagged firm performance variable still produce a positive correlation with a firm performance at a 1% significant level. This implies that the past effect of firm performance continues to control unobserved historical factors in the relationship between tax planning and firm performance. More specifically, the results reveal a quite similar pattern of the relationship between tax planning and firm performance. Exclusively, the results indicate a positive correlation between tax planning and Tobin Q at a 1% (Coef 0.105) significant level and a positive correlation between tax planning and ROA at a 10% significant level (Coef 0.043). Generally, the evidence obtained from the robustness check supports the study's finding that EAC-listed firms engage in tax planning to increase firm value. It

further reveals that the magnitude of tax planning on the firm performance depends on how it is measured. Book tax difference has a positive relationship with ROA, while effective tax rate has a positive relationship with Tobin Q. The robustness results for tax planning and firm value are presented in Table 9.

4.4.2 Moderated Effect of Dividend Policy

The moderated effects of the dividend policy on the relation between tax planning and the firm's value are presented in Table 10. The moderated variable is measured by calculating the product of dividend policy and book-tax difference. Similar to the previous section, the study conducted a robustness check of the GMM results using OLS and FEM. The robustness check on the moderated effect of dividend policy produces identical results for all models.

Table 9. Robustness Results for Tax Planning and Firm Value

	OLS		FEM		GMM sys	
	ROA	TOBIN Q	ROA	TOBIN Q	ROA	TOBIN Q
L.ROA/ L.TOBIN					0.422***	0.754***
					[0.121]	[0.211]
ETR	0.066***	0.517***	0	0.104	0.043*	0.105***
	[0.021]	[0.115]	[0.02]	[0.086]	[0.025]	[0.292]
LEV	-0.521***	0.161	-0.502***	0.1	-0.273***	0.875***
	[0.047]	[0.264]	[0.071]	[0.306]	[0.092]	[.281]
GROWTH	0.246***	0.052	0.225***	-0.297	0.163**	-0.141
	[0.062]	[0.344]	[0.054]	[0.234]	[0.065]	[0.187]
SIZE	0.025	-0.137	-0.086	-1.871***	0.009*	-0.212**
	[0.017]	[0.093]	[0.062]	[0.265]	[0.028]	[0.104]
Constant	0.244*	2.74***	1.109**	16.524***	0.146	1.599*
	[0.131]	[0.729]	[0.492]	[2.112]	[0.201]	[0.823]
Number of Obs	516	516	516	516	516	516
AR (1) (p-value)					0.001	0.041
AR (2) (p-value)					0.846	0.68
Sargan					0	0.032
Hansen					0.169	0.332

Notes: The notation: L.ROA and L. TOBIN = lagged performance, ETR = Effective Tax Rate, LEV = Financial Leverage, GROWTH= Firm Growth Opportunity, SIZE= Firm Size

On the other hand, the GMM model treats book-tax difference, dividend policy, the interaction of dividend policy and book-tax difference, firm size, financial leverage, and firm growth opportunity as exogenous and the lagged firm performance as endogenous.

The GMM results, as presented in Table 10, show the moderated effect of dividend policy to have a significant negative influence on the relationship between tax planning and firm performance. More specifically, the results indicate the moderated role of dividend policy has a negative relationship with ROA at a 1% significant level (Coef -4.323). This implies that the association between firm performance and tax planning in EAC-listed firms is successfully moderated by dividend policy. Therefore, the results accept hypothesis H2, which suggests that the relationship between tax planning and firm performance is moderated by dividend policy.

The plausible explanation for the results is that since the dividend is paid out of quality earnings, it

manages to monitor managers' self-interest activities which might deteriorate the firm's value. According to, [81], Tax planning is one of the high-risk investment opportunities available to managers that involve future cash flow. So, managers must avoid aggressive tax planning and effectively plan it to create a positive response from all shareholders. Accordingly, these findings suggest that EAC-listed firms are involved in effective tax planning to satisfy their shareholders through reported good firm performance. Also, with the help of a stable dividend policy, shareholders can foresee and monitor their firms' aggressive tax planning activities. The results affirmed the finding by, [82], that tax planning, besides increasing firm value, brings other benefits to the firms, including increasing firm liquidity, which can be used to facilitate the company's other activities, such as dividend payments. The regression results for the

moderated effect of dividend policy are presented in Table 9.

Table 10. Regression results for the moderated effect of dividend policy

	OLS		FEM		GMM sys	
	ROA	TOBIN Q	ROA	TOBIN Q	ROA	TOBIN Q
L.ROA/ L.TOBIN					0.231*** [0.077]	0.758*** [0.201]
BTD	4.269*** [0.253]	-0.997 [1.697]	4.271*** [0.199]	-1.553 [1.211]	4.227*** [0.39]	-0.681 [0.575]
DP	0.012 [0.027]	1.313*** [0.179]	-0.105*** [0.024]	0.185 [0.149]	-0.056* [0.03]	0.151 [0.109]
BTD_DP	-3.483*** [0.759]	-1.487 [5.093]	-3.167*** [0.602]	-3.151 [3.67]	-4.323*** [1.043]	-1.347 [3.755]
LEV	-0.277*** [0.042]	0.705** [0.279]	-0.233*** [0.052]	0.042 [0.319]	-0.1 [0.078]	0.934*** [0.283]
GROWTH	0.095* [0.05]	0.08 [0.337]	0.074* [0.039]	-0.238 [0.237]	0.041 [0.043]	-0.199 [0.197]
SIZE	0.026** [0.013]	-0.118 [0.088]	-0.16*** [0.043]	-1.86*** [0.265]	0.02 [0.03]	-0.213** [0.102]
Constant	0.164 [0.103]	1.861*** [0.69]	1.659*** [0.346]	16.366*** [2.112]	0.076 [0.228]	1.511* [0.819]
Number of Obs	516	516	516	516	516	516
AR (1) (p-value)					0	0.036
AR (2) (p-value)					0.331	0.729
Sargan					0	0.03
Hansen					0.289	0.301

Notes: The notation: L.ROA and L. TOBIN = lagged performance, BTD= Book Tax Difference, DP= Dividend Policy, BTD_DP = Moderated Variable

5 Conclusion

The study explores the effect of tax planning on firm performance with moderated effect of dividend policy in EAC-listed firms. Although tax literature emphasizes on tax planning activities of the listed firms, its impact has been under-investigated in emerging markets, [83], [84], [85]. Therefore, this study exploits this void by drawing a sample of 48 listed non-financial firms from EAC partner states. The study adopts a panel approach whereby the regression estimations were done using the Dynamic Panel System's two steps (GMM). The study first examines the relationship between tax planning and firm performance and then extends its investigation by analyzing the moderated impact of dividend policy on the relations between tax planning and the value of the firm.

The finding suggests a significant positive relationship between tax planning and firm performance. It implies that EAC context, listed firms consider tax planning as an effective strategy to reduce tax liability and increase the value of the firm. The finding is in line with the stakeholder agency theory that managers balance their interests to achieve the overall goals of the other stakeholders. Also, the finding supports the signalling theory by suggesting that, through effective tax planning, managers in EAC-listed firms can increase the disclosure of tax information and alleviate information asymmetry problems, [84]. More so, the results reveal that dividend policy has moderated impact on the relations between firm performance and tax planning. This finding also supports the agency theory proponents that shareholders can use a

control mechanism as a dividend policy to monitor managers' self-interest activities.

The study adds to the existence of several policy implications and contributions. First, it contributes to the literature on the implication of tax planning on firm performance in EAC. This contribution can be helpful to shareholders to have actual estimates of firm value. Also, the study discloses the implication of dividend policy as the moderated variable of corporate governance studies. Secondly, the study provides insight into the understanding of EAC's tax planning practices to policymakers and tax administrators that can be used to design effective anti-avoidance strategies.

Furthermore, the current study adds new insight into the literature by exploring the differences between the present and prior studies. These differences are the environment in which the study has been undertaken (East African Countries) and the uses of the moderated role of dividend policy. Dividend policy is the relevant moderated role in ensuring firms report high-quality earnings and avoid aggressive tax planning. The previous studies that have examined the relationship between book-tax difference and earnings quality have ignored the impact of dividend policy, [86], [87].

On the other hand, due to time constraints, the study has been limited to one component of tax planning: tax avoidance. Based on this limitation, the study identified some interesting parties that can open further research opportunities. Future researchers can extend their studies by including other tax planning components, such as transfer pricing. In addition, Future studies can use audit quality instead of dividend policy as the moderated variable. Furthermore, future studies can extend their sample period to capture the impact of COVID-19.

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