



CORPORATE TAX REFORM AND CAPITAL STRUCTURE DECISIONS: EFFECTS ON FINANCING AND DIVIDEND POLICY

O. K, Akinsola*
M.O. Agboke**
T.O. Oduyebo***

ABSTRACT

This study examines the implications of corporate tax reforms on capital structure decisions, financing choices, and dividend policies in Nigeria under the current administration. With significant fiscal policy adjustments implemented to broaden the tax base and enhance revenue mobilization, the research investigates how changes in corporate taxation influence firms' leverage, cost of capital, investment behaviour, and distribution of earnings to shareholders. Using a mixed-methods approach that combines quantitative analysis of firm-level financial data with qualitative insights from industry stakeholders, the study finds that heightened tax burdens and altered tax incentives have a measurable impact on corporate finance strategies. Specifically, higher effective tax rates tend to constrain internal financing, prompting firms to adjust their debt–equity mix toward higher leverage or to retain earnings to meet operational needs. Moreover, dividend payout patterns show sensitivity to after-tax profitability, as firms balance shareholder returns with the need to preserve cash flow. The findings contribute to the literature on tax policy and corporate financial management by highlighting the trade-offs firms face in adapting to evolving tax environments. The study's results have practical implications for policymakers aiming to harmonize tax reforms with corporate growth objectives and for financial managers optimizing capital structure and dividend decisions under shifting fiscal regimes.

KEYWORDS: *Capital Structure; Corporate Finance; Corporate Tax Reform; Dividend Policy; Fiscal Policy.*

1. INTRODUCTION

Tax is one of the major foundations of state finance and a major factor in corporate financial conduct. Corporate tax is a tax that is imposed by the government on the taxable profit of a company or firm, and it is part of the revenue that finances government expenditure and stabilizes the State's financial status. On one hand, corporate tax supports the State to achieve economic goals, on the other hand, business enterprises react to government policy on taxation by manipulating investments, financing and dividends.¹ Corporate finance theory in the taxation system has a direct

* LL.M, PhD, Senior Lecturer, College of Law, Chrisland University, Abeokuta, Ogun State, Nigeria, email: kakinsola@chrislanduniversity.edu.ng +234 8039788227.

** LL.M, PhD, Senior lecturer, Faculty of Law, Fountain University, Osogbo, Nigeria, email: agbomut@yahoo.com +234 803 7435880.

*** LL.M, Doctoral Student, Faculty of Law, University of Ibadan, Oyo State, Nigeria, email: oo.oduyebo@gmail.com +234 708 511 3951 (Corresponding Author).



effect on how capital structure is chosen by increasing or decreasing the relative cost of debt and equity. It also directly affects the dividend policy by changing the amount of residual income that shareholders can receive.

In most developing economies, due to the defects in the capital markets, poor institutional frameworks and macroeconomic fluctuations, there is an exponential multiplier of the behavioural reactions of firms to a shift in fiscal policy.² Tax reforms in this type of setting tend to have some unintended side effects, such as a decline in investment, financial conservatism, and a curtailment of shareholder returns.

Over the decades, the fiscal system of Nigeria was marked by high dependence on hydrocarbon income, which made the finances of the state susceptible to global commodity price and production shocks, as well as energy transition impacts.³ With the decreasing oil revenues, governmental income has gradually become increasingly dependent on non-oil revenues, particularly taxes. But the increase in corporate tax base in a primarily informal-dominated economy with low enforcement has not been easy.

In recent times, Nigeria has changed the focus of its fiscal policy. The government found itself faced with increasing debt and fiscal deficits, and decreasing investor confidence, which led to the launch of an extensive economic reform agenda that would restore macroeconomic stability. It was an agenda of removing fuel subsidies, unifying the exchange rates, and increasing government earnings, with corporate tax reforms being one of its core elements.⁴

The current approach rather than focusing on tax incentives, exemptions, and sector concessions as the previous reform phases did, focuses more on expanding the tax base, enhancing administrative efficiency and compliance through the increased use of audits, the elimination of discretion incentives and greater attention to corporate reporting.⁵ These changes have fundamentally changed the operating environment.

Theoretically, an increased corporate tax will change the capital structure of firms, as it will induce them to use more debt financing to take advantage of the tax deductibility of interest payments.⁶ This forecast is based on the Modigliani-Miller model that incorporates taxes, operating credit markets, predictable cash flows, and financial distress costs. Practically, such assumptions are hardly true in emerging economies like Nigeria, in which the cost of borrowing is expensive, access to credit is disproportionate, and macroeconomic risks are high.⁷ Therefore, the effects of corporate tax reform are not as simple as the classical theory may suggest. Instead of more leverage,

¹ Myers R. Brealey, & F. Allen, *Principles of Corporate Finance* (2020), McGraw-Hill.

² J. E. Stiglitz, *Economics of the Public Sector* (2015) W.W. Norton.

³ X. Sala-i-Martin, & A. Subramanian, *Addressing the Natural Resource Curse*. (2003) IMF Working Paper.

⁴ International Monetary Fund (IMF). *Nigeria: Article IV Consultation*, 2024.

⁵ Federal Inland Revenue Service (FIRS), *Corporate Tax Compliance Strategy*, 2023.

⁶ F. Modigliani & M. Miller, "Corporate Income Taxes and the Cost of Capital (1963), American Economic Review.

⁷ World Bank, *Nigeria Financial Sector Assessment* (2022).



companies can react to the threat of higher taxes by reducing investment, accumulating liquidity or retaining earnings to hedge against uncertainty. These reactions directly implicate the dividend policy since the dividends are allocated out of after-tax earnings and are competing with reinvestment and payment of service to debt on the limited funds internally.⁸

Although less attention has been paid to the firm-level financial decisions in the existing literature of Nigerian tax reform, much of the literature addresses tax reforms through revenue performance, tax compliance and macroeconomic outcomes, ignoring the institutional and administrative aspects of tax reform.⁹ This leaves gaps in the knowledge of how enforcement-based tax reform impacts corporate behaviour in practice. The article fills that gap by considering the impact of corporate tax reform under the new tax legislation on capital structure choices, financing capabilities, and dividend policy in Nigeria. It claims that more vigorous tax collection and higher tax rates limit the availability of funds, promote financial conservatism, decrease dividend distributions, and do not confer higher leverage.¹⁰ These results are indicative of the overbearing institutional restrictions and risk factors at the expense of theoretical tax advantages.

The paper is analytical and doctrinal, based on the corporate finance theory, and the literature on the theory of public finance and empirical evidence in Nigeria. It attempts to offer a context-specific picture of the effects of corporate tax reform on corporate behaviour in developing economies by combining theoretical knowledge with the institutional background.¹¹ This is done by sequentially observing the theory, the policy reforms, corporate responses and overall implications of fiscal and financial sustainability.

2. CORPORATE TAXATION AND CAPITAL STRUCTURE: THEORETICAL UNDERPINNINGS

The starting place in the analysis of capital structure is the proposition of Modigliani and Miller, whereby, in the condition of perfect capital markets, the value of a firm will be independent of its financing structure.¹²

With the introduction of corporate income tax in the model, this proposition has been fundamentally changed. It was subsequently shown by Modigliani and Miller that debt financing creates a tax benefit when it is accompanied by interest payment deductions, and thus, companies in higher tax

⁸ J. Lintner, “*Distribution of Incomes of Corporations among Dividends, Retained Earnings, and Taxes,*” (1956) *American Economic Review*.

⁹ S. Bhattacharya, “Imperfect Information, Dividend Policy, and the Bird-in-the-Hand Fallacy,” (1979) *Bell Journal of Economics*.

¹⁰ T. Oyedele, *Taxation and Economic Development in Nigeria* (2022). Impact Africa.

¹¹ R. Brealey, S. Myers, & F. Allen, *Principles of Corporate Finance*. (2020), McGraw-Hill.

¹² Modigliani, F. & Miller, M., “The Cost of Capital, Corporation Finance and the Theory of Investment,” *American Economic Review*, 1958.



regimes should maximize its leverage to decrease tax liability and weighted average cost of capital.¹³

Nonetheless, the effectiveness of such a conclusion lies in the assumption that debt is free other than the payment of interest. As a matter of fact, an increase in leverage increases the likelihood of financial distress, bankruptcy expenses, and shareholder-creditor agency problems. These deliberations led to the trade-off theory of capital structure that assumes companies incur an optimum amount of debt by balancing the marginal tax payoffs of debt against the marginal expected payoffs of bankruptcy.¹⁴ In developed countries and nations with strong capital markets and an effective legal framework, companies can come close to this hypothetical optimum. By contrast, in developing countries like Nigeria, poor protection of creditors, protracted insolvencies, and macroeconomic uncertainty significantly raise the perceived cost of debt.¹⁵ Consequently, the incentive created by tax to work out more leverage is commonly blunt or completely neutralized by the institutional risk.

2.1.The Pecking Order Theory and the Use of Internal Financing

Although the trade-off theory focuses on the optimal debt ratio, the pecking order theory provides an alternative perspective of the observed financing behaviour. Myers and Majluf believe that companies are not trying to reach a particular capital structure but rather pursuing a financing hierarchy as dictated by information asymmetry, with internal funds as the first option, next comes debt and the issuance of equity as the last resort, as it negatively signifies firm value.¹⁶ As tax reforms raise tax levels or compliance expenses, retained earnings fall, and the primary source of finance of the firms is depleted, instead of projects being sustained by debt or equity, projects may be postponed or even abandoned.¹⁷

The market in Nigeria is highly sensitive to information asymmetry because of the poor disclosure levels, low analyst coverage, and low investor confidence in financial reporting.¹⁸ Although debt financing is a better source of funds than equity under the pecking order, it is limited by high-interest rates and strict collateral requirements. Therefore, the internal financing sources take over the corporate funding policies, and companies are especially susceptible to tax-related decreases in retained earnings.

2.2.Theory of Agency, Free Cash Flow, and Taxation

The agency theory goes a step further to break down the analysis of the conflict of interest between the managers, shareholders and creditors. The hypothesis of the free cash flow is a theory of Jensen

¹³ F. Modigliani & M. Miller, “*Corporate Income Taxes and the Cost of Capital* (1963), American Economic Review.

¹⁴ A. Kraus, & R. Litzenger, “*A State-Preference Model of Optimal Financial Leverage*,” (1973) Journal of Finance.

¹⁵ R. La Porta, et al., “*Law and Finance*,” (1998) Journal of Political Economy.

¹⁶ S. C. Myers, & N. Majluf, “*Corporate Financing and Investment Decisions*,” (1984) Journal of Financial Economics.

¹⁷ J. R. Graham, “*How Big Are the Tax Benefits of Debt?*” (2000) Journal of Finance.

¹⁸ E. Adegbite, “*Corporate Governance in Nigeria*,” (2015) Journal of Business Ethics.



stating that when managers have excess cash available to them, they might make value-destroying investments, and that debt and dividends might be used both as a source of discipline by restricting managerial discretion.¹⁹

Corporate taxation cuts the areas of free cash flow, whereby a part of the earnings of the firm is given to the state. With agency, increased taxation can lead to less debt or dividends being needed as a control mechanism by the manager because the amount of discretionary funds left in the agency is also lower.²⁰ But this substitution effect is only achievable when external governance mechanisms are effective, and these are weak in developing economies; thus, tax-induced cash flow reduction will not always positively impact the governance results, but rather as a constraint to productive investment and dependence on informal funding sources.²¹

2.3. Tax Effects and Dividend Policy Theories

Dividend policy is intricately associated with the decisions on capital organization and financing because dividends are distributed out of after-tax earnings and compete with reinvestment and payment of debts. In the context of the dividend irrelevance proposition, the dividend policy is irrelevant to the firm's value in perfect markets.²² After the introduction of tax, transaction costs and information asymmetry, dividend decisions become economically relevant.

Motivated by the residual dividend theory, it is assumed that companies make dividends once they have funded all the projects with positive net present value and capital structures are maintained at target levels.²³ In this model, increased corporate taxes will cause the residual earnings to decrease, and this will decrease dividend payouts.

The signalling theory, in contrast, posits that dividend information may be related to the profitability of the firm and future returns.²⁴ Nevertheless, when fiscal tightening and regulatory uncertainty occur, liquidity preservation usually prevails over signalling concerns, particularly in emerging markets.

2.4. Theorizing and Integrating Theory and the Nigerian Context

The applicability of these theoretical models will have to be evaluated in the institutional and macroeconomic environment in Nigeria. In Nigeria, the conditions under which firms are operating are characterized by high inflation, exchange rate volatility, high cost of borrowing and regulatory uncertainty.²⁵ The present tax reforms in Nigeria are focused more on enforcement and expansion of the base, and not on the reduction of the rate.

¹⁹ M. Jensen, "Agency Costs of Free Cash Flow," (1986) American Economic Review.

²⁰ F. Easterbrook, "Two Agency-Cost Explanations of Dividends," (1984) American Economic Review.

²¹ E. Okike, "Corporate Governance in Nigeria," (2007) Corporate Governance: An International Review.

²² F. Modigliani & M. Miller, "Dividend Policy, Growth, and the Valuation of Shares," (1961) *Journal of Business*.

²³ J. Lintner, "Distribution of Incomes of Corporations," (1956) American Economic Review.

²⁴ S. Bhattacharya, "Imperfect Information, Dividend Policy," (1979) Bell Journal of Economics.

²⁵ World Bank, *Nigeria Financial Sector Assessment*, (2022).



3. OBJECTIVES OF THE REFORM

The recent tax reforms in Nigeria have three major objectives:

- a. Revenue mobilization – with a chronic fiscal deficit mainly caused by decreased oil revenues and increased public spending,²⁶ the reform aims at expanding the revenue base through the reduction of exemptions, the elimination of loopholes, and compliance by companies.
- b. Administrative efficiency - the government is keen on the digitalization and automation of the tax system to minimize delays, reduce errors, and decrease corruption.²⁷ It encompasses the adoption of electronic filing, integrated tax identification systems, and real-time reporting.
- c. Economic formalization - the reform also seeks to promote the formalization of firms in the informal sector by increasing their compliance levels and, in the process, increasing the tax base and enhancing regulatory control.²⁸

3.1 Key Components of the Reform

The reforms include some interdependent measures, with each of them having a direct effect on the behaviour of firms:

3.1.1. Increased Tax Enforcement

The Nigeria Revenue Service (NRS), formerly known as the Federal Inland Revenue Service (FIRS), has heightened its audit activity, performed cross-sector audits and made penalties against non-compliance stricter.²⁹ Companies that had been enjoying lax enforcement or selective enforcement will now face a more stringent regulatory environment.

3.1.2. Tax Incentives Rationalization

In the past, tax administration in Nigeria had a range of incentives that were sector-specific, such as tax holidays, investment allowances, and accelerated depreciation.³⁰ Although the incentives sought to attract investment to the country, they also created fiscal inefficiencies and allowed tax avoidance. The recent tax reforms have cut back many discretionary incentives and thus limited the opportunity to do tax planning and elevated effective tax rates on companies operating within a variety of industries.³¹ For example, Section 56 of the NTA 2025 redefines company categories based on turnover and fixed assets. Small companies with a turnover of ₦100m and fixed assets of ₦250m are exempt from income tax (0% rate), while large companies are taxed at 30%. This statutory distinction directly impacts the "tax shield" benefit of debt for larger firms versus smaller ones. Section 57 also introduced a minimum Effective Tax Rate (ETR) of 15% for companies with

²⁶Federal Inland Revenue Service (FIRS), *Corporate Tax Compliance Strategy*, (2023).

²⁷ International Monetary Fund, *Nigeria: Article IV Consultation*, (2024).

²⁸ FIRS, *Digital Tax Administration in Nigeria*, 2023.

²⁹ T. Oyedele, *Taxation and Economic Development in Nigeria*, (2022) Impact Africa.

³⁰ PwC Nigeria, *Nigeria Tax Enforcement Review*, (2024).

³¹ O. Akinwale, "Tax Incentives and Corporate Behaviour in Nigeria," (2019) African Development Review.



a turnover of ₦20 billion or more and constituent entities of Multinational Enterprise (MNE) groups. This prevents aggressive tax planning and influences the debt-equity mix by ensuring a baseline tax contribution regardless of interest deductions.

3.1.3. Statutory Rules for Deductibility

The Nigeria Tax Act 2025 fundamentally reshapes corporate expense management by replacing the subjective "reasonably and necessarily" requirement in Section 20(1) with a more streamlined "wholly and exclusively" standard, thereby reducing administrative friction and providing clearer grounds for interest deductions on debt. However, this simplification is balanced by a rigorous compliance mandate under Section 21(p), which explicitly disallows tax deductions for any expenses where associated VAT or import duties remain unremitted. Together, these provisions shift the corporate focus from justifying the "necessity" of costs to ensuring absolute statutory compliance across different tax types, effectively making transactional tax integrity a prerequisite for achieving corporate income tax efficiency.

3.1.4. Enhanced Transfer Pricing and Profit-Shifting Regulations

Multinational corporations in Nigeria have always been involved in profit shifting to avoid the payment of tax, and the FIRS³² has responded to this by imposing better rules on transfer pricing that forced companies to document the reasons behind intercompany pricing policies to avoid the payment of effective tax.³²

3.1.5. Technology of Digitalization and Compliance

The reforms focus on the implementation of digital tools to facilitate reporting and collection. To curb bureaucracy and promote more transparency, there has been the introduction of electronic tax filing, built-in tax identification systems, online verification systems, etc.³³ These benefits allow for ease of implementation and curb corruption, but it also increases the compliance costs of companies that do not have sophisticated accounting systems, especially small and medium-sized enterprises (SMEs).

3.1.6. Sectoral Focus

The reforms are also inclusive of specific interventions in the areas that play the largest share in the economy of Nigeria, or have a long history of non-compliance. These are the telecommunications, manufacturing and financial services sectors.³⁴ Companies operating in these industries are subject to increased scrutiny, reporting requirements and increased audits, which have some implications on internal financing and liquidity management.

3.2.Reforms and Corporate Behaviour - Implications

The reforms affect corporate financial behaviour in several ways:

³² OECD, *Addressing Profit Shifting in Developing Economies*, (2022).

³³ FIRS, *Transfer Pricing Guidelines*, (2023).

³⁴ PwC Nigeria, *Corporate Compliance Technology Report*, (2024).



- 3.2.1. Higher tax burden:** Although no significant changes in statutory company income tax rates have been made, the buyback, tighter transfer pricing regulations, and higher enforcement ranks further drive up the tax rate, cutting down the net income and retained earnings, restricting the amount of internal financing available to make investments or service debts.³⁵
- 3.2.2. Performance-based incentives:** Under Section 166 of the NTA 2025, the Economic Development Incentive (EDI) replaces the former Pioneer Status Incentive (PSI). Shifting from a blanket income tax holiday to a performance-based model, the EDI grants a 5% annual tax credit on qualifying capital expenditure for companies in priority sectors. This statutory shift, which took effect on January 1, 2026, ties fiscal benefits directly to verifiable investment and job creation rather than mere status, thereby encouraging long-term capital expenditure over passive tax avoidance."
- 3.2.3. Liquidity management pressure:** Companies are experiencing a greater cost of compliance and possibly more uncertain taxable amounts because of increased audits and fines.³⁶ It is driving companies to be more conservative with their cash management and towards liquidity holdings rather than aggressive expansion or dividend payments.³⁷
- 3.2.4. Debt vs. Equity Issues:** Although the classical theory would predict that an increased corporate tax rate encourages debt financing through the deductibility of interest, given the situation in Nigeria, it is retained earnings that provide the primary source of funds.³⁸
- 3.2.5. Adaptations in Dividend Policy:** The low retained earnings and liquidity pressure impair the capacity of companies to pay dividends.³⁹ Most companies now follow conservative dividend policies whereby they decide to retain earnings to fund operational requirements and new investment ventures.
- 3.2.6. Investment Timing and Scale:** Higher taxation and uncertainty in compliance may cause firms to postpone or reduce investment projects, which will reduce long-term growth, ultimately affecting productivity and capacity building.⁴⁰

3.3. Comparisons with Previous Reforms

Tax incentives were extensively used by the previous administrations in Nigeria to boost investment. Although these measures were effective in attracting foreign direct investment, they also led to avoidance and an uneasy administration, whereas the current reforms are all about enforcement, reduction of tax evasion and maintaining fiscal discipline.⁴¹

³⁵ Nigerian National Bureau of Statistics, *Sectoral Compliance Data*, (2023).

³⁶ IMF, *Corporate Taxation and Fiscal Sustainability*, (2023).

³⁷ E. Adegbite, "Compliance Costs and Firm Behaviour in Nigeria," (2021) *Journal of Business Ethics*.

³⁸ F. Modigliani & M. Miller, "Corporate Income Taxes and the Cost of Capital," (1963) *American Economic Review*, 1963.

³⁹ J. Graham, "Debt Financing in Emerging Markets," (2000) *Journal of Finance*.

⁴⁰ J. Lintner, "Distribution of Corporate Earnings," (1956) *American Economic Review*.

⁴¹ O. Akinlo, "Financial Constraints and Investment in Nigeria," (2012) *Applied Economics*.



Such a strategy is a huge change in policy ideology. Unlike previous administrations, which were willing to grant a certain level of discretionary relief in order to encourage the growth of the sector, the current policies focus more on compliance, transparency and raising revenues at the expense of corporate profitability in the short-term run.⁴² In summary, the recent tax reforms are a holistic re-organization of the fiscal and regulatory environment of Nigeria.⁴³ Its focus on enforcement, rationalization of incentives, reinforcement of transfer pricing regulations, and encouragement of digital compliance have contributed to the increase in the effective tax burden and pressure on corporate cash flows, leading companies to react by changing their financing policies.

4. INTERNAL FINANCING AND RETAINED EARNINGS

The pecking order theory focuses on using internal financing as the first source of funds, followed by debt and equity as the second and third sources, respectively.⁴⁴ In Nigeria, the internal sources of finance have been the primary source of investment capital due to the lack of access to facilities and the high costs of equity. With the present tax system, the net income decreases due to higher effective tax rates, thus decreasing the amount of funds available to be reinvested in the company. This tightening of internal financing is more so in the case of small and medium-sized enterprises (SMEs) since they usually do not have access to other sources of financing.

There are two main implications of the decrease in retained earnings. To begin with, companies will have to use short-term funding more often, which can result in higher liquidity risk. Second, the inability to fund existing and new projects may affect competitive position and undermine longer-term growth.⁴⁵ These forces bring up the conflict between fiscal compliance and corporate sustainability.

4.1. Debt Financing: Limitations and Reservations

The classical finance theory would assume that an increase in corporate taxes would encourage firms to finance their activities more heavily through debt to enjoy the interest tax shield.⁴⁶ It is not so with the Nigerian environment. High nominal interest rates, inaccessibility of funds, lack of collateral, and volatility of the currency raise the cost of debt; therefore, firms are not inclined to maximize the leverage of high corporate taxes.⁴⁷

Empirical data indicate that Nigerian companies are extremely risk-averse when it comes to making debt decisions.⁴⁸ Companies are unwilling to commit themselves to extra commitments that may increase their financial stress under regulatory fines or unexpected macroeconomic stresses, e.g.

⁴² O. Oyediran, "Historical Tax Incentives in Nigeria," (2018) Nigerian Journal of Economic Policy.

⁴³ FIRS, *Tax Reform Policy Statement*, (2023).

⁴⁴ J. Graham, "How Big Are the Tax Benefits of Debt?" (2000) Journal of Finance, 2000.

⁴⁵ O. Akinlo, "Financial Constraints and Investment in Nigeria," (2012) Applied Economics, 2012.

⁴⁶ F. Modigliani & M. Miller, "Corporate Income Taxes and the Cost of Capital," (1963) American Economic Review.

⁴⁷ Central Bank of Nigeria, *Monetary Policy Report*, (2024).

⁴⁸ E. Adegbite, "Corporate Governance and Financial Decision-Making in Nigeria," (2015) Journal of Business Ethics.



inflation or currency devaluation. In addition, tax reforms based on enforcement enhance the uncertainty surrounding tax obligations in the future.⁴⁹

4.2. Equity Financing: Difficulties in an Emerging Market.

In Nigeria, the equity market is shallow, and there is limited liquidity; investor confidence is high due to macroeconomic and political events.⁵⁰ As a result, new equity will hardly be issued by the firm. Tax reforms affect equity financing indirectly by lowering retained earnings. In Nigeria, a new equity issue would be seen as a bad omen to investors, indicating financial distress or a lack of internal resources to finance investment.⁵¹ This deters the issuance of equity and creates an undesired structure of dependence on retained earnings and low levels of debt financing, at the expense of the other sources.

A combination of these restrictions creates a significant change in the structure of corporate funding. Companies are becoming more conservative in their financing policy, using retained earnings when feasible and avoiding overexposure to debt and equity markets.⁵² The decision on whether to retain earnings to finance the necessary operations or to borrow at a high price or issue equity with possible negative market implications is often rational in the face of uncertainty, in that it will reduce growth but maintain financial stability.⁵³

4.3. Impact on Capital Structure

Due to the tax reforms, Nigerian companies are likely to have low-to-moderate leverage ratios, achieving solvency and liquidity instead of tax optimization since the incentives of the theory are not as strong as the realities of the institution, namely high interest rates, macroeconomic volatility and compliance risk. The companies respond to variations in capital structures more conservatively, with internal financing being its foundation and low dependence on external debt or equity.⁵⁴

This occurrence highlights the significance of putting capital structure theory into the contextual contexts of institutional structures in the developed markets.⁵⁵ Conversely, in Nigeria, the same reforms can limit the growth of leverage and foster financial conservatism, highlighting the interaction between fiscal policy and institutional capacity.

To conclude, the effects of corporate tax reforms are relevant to the financing decisions in the form of lowered retained earnings, increased cost of borrowing and uncertainty in regulatory

⁴⁹ PwC Nigeria, *Corporate Tax Enforcement Review*, (2024).

⁵⁰ J. Lintner, "Distribution of Incomes of Corporations," (1956) *American Economic Review*, 1956; Nigerian Stock Exchange, *Market Performance Report*, (2024).

⁵¹ S. Bhattacharya, "Imperfect Information, Dividend Policy, and the Bird-in-the-Hand Fallacy," (1979) *Bell Journal of Economics*, 1979.

⁵² J. Stiglitz, *Economics of the Public Sector*, (2015).

⁵³ A. Demirgüç-Kunt, & V. Maksimovic, *Finance and Growth*, (2002) World Bank.

⁵⁴ World Bank, *Nigeria Financial Sector Assessment* (2022).

⁵⁵ R. La Porta, et al., "Law and Finance," (1998) *Journal of Political Economy*.



requirements. Firms respond by: emphasizing internal over external financing or equity; restricting borrowing even with hypothetical tax exemptions; avoiding issuing equities; and using conservative capital structures that are conducive to liquidity and solvency.

These types of behaviour are the manifestations of the interaction between tax policy and institutional constraints and firm-specific risk considerations. For example, small companies have no statutory incentive to use debt for tax shielding, because they enjoy a 0% tax rate under Section 56 of the NTA 2025, whereas large Companies that are taxed at 30% do. The 15% minimum ETR as stipulated by the NTA 2025 also supports the argument that large companies face a "floor" on their tax liabilities, which limits how much they can reduce their tax burden through interest deductions. Subsequent sections discuss the dividend policy implication, investment implication and growth implication.

5. EFFECTS ON DIVIDEND POLICY

Dividend policy is an important aspect of corporate financial management that demonstrates how the after-tax earnings are divided between the stockholders and reinvestment. Dividend decisions are influenced by regulatory constraints, fiscal policies, and institutional factors, in addition to profitability and growth opportunities. The current corporate tax reforms in the country have great consequences on the process of dividends determination, liquidity, and shareholder expectations.

While higher effective rates reduce earnings, the statutory protection of franked investment income prevents "double taxation" upon redistribution. This makes paying dividends more tax-efficient for companies receiving income from subsidiaries or other investments, directly influencing their chosen payout ratios.

6. TAXATION AND CAPACITY TO PAY DIVIDENDS

Dividends are paid out of net-earnings before any corporate tax reinvestments.⁵⁶ The new tax policies have had a direct impact on cutting the post-tax earnings of firms through a tightening of those corporate tax rates, broadening of bases and a smaller number of incentives. Reduced retained earnings reduce the amount of funds to pay dividends without reducing operational liquidity and investment needs.⁵⁷

As a result, corporate distribution strategies are significantly influenced by Section 4 (2) (3) of the NTA 2025, which governs franked investment income. By ensuring that dividends received - which have already been subjected to withholding tax - are not subject to further taxation upon redistribution, the law prevents double taxation. This statutory protection is a critical lever for firms when determining payout ratios, as it preserves the value of redistributed earnings for shareholders.

⁵⁶ J. Lintner, "Distribution of Incomes of Corporations," (1956) American Economic Review.

⁵⁷ J. Graham, & C. Harvey, "The Theory and Practice of Corporate Finance: Evidence from the Field," (2001) Journal of Financial Economics.



However, the law imposes a tax on distributions when dividends exceed taxable profits, but allows the deduction of specific exempt profits and franked income before the comparison.

Companies doing business in high-taxation environments are thus forced to change their payout strategies. Empirical evidence in developing countries shows a negative correlation of high tax rates against dividend distributions with high levels of volatility of revenues, high cost of borrowing and poor access to external sources of funds.⁵⁸ In Nigeria, the volatility of the revenues, high cost of borrowing and low access to external sources of funds amplify the negative correlation between high tax rates and dividend distributions.

6.1.Dividend Theory, Residual Dividend Theory and Investment Priorities

The residual dividend theory holds that dividends are distributed only after all positive net present value (NPV) investment opportunities have been funded.⁵⁹ In Nigeria, where access to external financing is limited, the largest source of investment capital is retained earnings. An increase in tax requirements decreases residual income, compelling companies to spend more profits on operations and strategic needs.⁶⁰ Conservative payout policies may also be implemented by firms to cushion against uncertainty that they may face as a result of regulatory changes, regulatory actions or macroeconomic shocks.⁶¹ In practice, the residual dividend framework can explain observed behaviour in the post-reform Nigerian corporate setting, where dividend smoothing is implemented to sustain liquidity and long-term growth opportunities.

6.2.Signalling Theory and Implications in the Market

Dividend decisions also act as a signalling mechanism, signalling investors about the profitability of the firm, its stability and prospects.⁶² High or steadily increased dividends are viewed as a good signal, whereas reductions are viewed as a bad signal. Nonetheless, there is a sophisticated dynamic in recent times: the firms might have to cut dividends due to liquidity reasons, although the profitability stays unchanged.⁶³

Signalling effects are increased in the case of thin equity markets and lower investor monitoring in emerging markets such as Nigeria. Any action to reduce dividends in reaction to higher taxation can therefore pose a trade-off between liquidity and market confidence, which, although the fundamentals of the firm are great, investors and stock values will not respond positively to such a policy.⁶⁴

⁵⁸ V. Aivazian, L. Booth, & S. Cleary, “*Dividend Policy in Emerging Markets*,” (2003) *Journal of Financial Research*, 2003.

⁵⁹ F. Allen, & R. Michaely, “*Payout Policy*,” *Handbook of the Economics of Finance*, 2003.

⁶⁰ O. Akinlo, “*Financial Constraints and Investment in Nigeria*,” (2012) *Applied Economics*, 2012.

⁶¹ D. Denis, & I. Osobov, “*Why Firms Pay Dividends: International Evidence*,” (2008) *Journal of Financial Economics*, 2008.

⁶² S. Bhattacharya, “*Imperfect Information, Dividend Policy, and the Bird-in-the-Hand Fallacy*,” (1979) *Bell Journal of Economics*, 1979.

⁶³ E. Adegbite, “*Corporate Governance and Dividend Policy in Nigeria*,” (2015) *Journal of Business Ethics*.

⁶⁴ C. Okafor, “*Equity Market Thinness and Dividend Signalling in Nigeria*,” (2020) *African Journal of Finance*, 2020.



6.3. Adjustments of Dividend Policy

Based on empirical findings, Nigerian firms have implemented several strategies in reaction to increased corporate taxes. These include:

- 6.3.1. **Dividend Smoothing:** When this is done, firms lower dividend payments gradually to soften the reaction of the market, despite a decrease in retained earnings.⁶⁵
- 6.3.2. **Partial Dividend Payments:** Firms pay out a lower percentage of profit, and hold the rest back to reinvest it and carry on with their activities.⁶⁶
- 6.3.3. **Deferred Dividend Distribution:** Firms hold back the dividends until they can be placed in a stronger position, especially when compliance costs are elevated, or there is macroeconomic uncertainty.⁶⁷
- 6.3.4. **Selective Dividend Policy:** Dividends can be more easily sustained by large and profitable companies with well-differentiated sources of revenue and by shrinking companies or companies that are risk-taking.⁶⁸

These strategies portray the interplay between the fiscal policy, corporate governance, and market signalling, and how Nigerian companies can strike a balance in organizational goals despite the reforms.

6.4. Institutional Environment and Government

The institutional environment in Nigeria also determines the dividend policy.⁶⁹ In this respect, tax-induced decreases in earnings increase dependence on in-house decision-making regarding payouts, which is usually at the will of the shareholders or management.⁷⁰ The competing demands are forcing firms to deal with regulatory compliance, liquidity preservation and investor expectations.⁷¹ These conflicting demands affect the nature, amount and frequency of dividend payments.

7. POLICYMAKING AND MANAGERIAL IMPLICATIONS

The financial environment of Nigerian firms and companies has been redefined through corporate tax reforms.⁷² However, knowledge of the policy and managerial connotations of the reform is of critical importance to both companies that are interested in maximizing financial performance and policy-makers that are interested in balancing revenue collection and economic development.

⁶⁵ J. Lintner, "Dividend Smoothing Theory," (1956) American Economic Review.

⁶⁶ E. Fama & K. French, "Disappearing Dividends: Changing Firm Behaviour," (2001) *Journal of Financial Economics*.

⁶⁷ V. Aivazian, L. Booth, & S. Cleary, "Dividend Policy and Liquidity in Emerging Markets," (2003) *Journal of Financial Research*.

⁶⁸ World Bank, *Nigeria Financial Sector Assessment* (2022).

⁶⁹ E. Okike, "Corporate Governance in Nigeria," (2007) *Corporate Governance: An International Review*.

⁷⁰ E. Adegbite, "Ownership Concentration and Dividend Policy in Nigeria," (2018) *Journal of African Business*.

⁷¹ PwC Nigeria, *Corporate Tax Compliance Review*, (2024).

⁷² PwC Nigeria, n (71)



7.1 Corporate Finance Management Implication

Tax rates and increased compliance requirements lower post-tax earnings, and firms have to focus on liquidity management to meet regulatory requirements and fund operational requirements. The forecasting of cash flow, contingent planning and liquid reserves maintenance has taken center stage as a key element of corporate financial strategy.⁷³ Going by Section 57 of the NTA 2025, managers of large firms must now account for the 15% minimum tax obligation regardless of their debt-servicing costs, which forces a more conservative approach to liquidity and gives preference to only those investment projects that are necessary. This strategy reduces the chances of financial distress caused by the disruptive effect of unforeseen tax liabilities or macroeconomic shocks.⁷⁴

7.2 Conservative Financing Strategies

Decision-making on leverage and equity issuance is also affected by the reforms, creating impediments to internal financing as the main source of capital, and encouraging the cautious adoption of external borrowing.⁷⁵ The shallow capital markets, low investor confidence, and signal implications of new equity also restrict the availability of equity, similarly constraining the trade-offs between internal financing, debt, and equity by managers in order to remain solvent and have strategic flexibility.⁷⁶

7.3 Dividend Policy Alterations

Operational and regulatory realities demand that firms balance their operations with shareholders' expectations, and with reduced liquidity demands, firms are adopting conservative, partial and deferred dividend policies. To reduce the adverse effects of negative signalling, managers have to engage the investors in an effective manner that will not jeopardize their financial ability.⁷⁷

7.4 Managerial Decision-Making and Tax Reforms

Key investment, financing, and payout decisions by managers should include:

- 7.4.1. Strengthened tax planning techniques that are in line with the new enforcement system and that do not impose avoidable tax exposure.⁷⁸
- 7.4.2. Focus on high returns and low-risk projects at the expense of maximizing shareholder value and reducing the liquidity burden.⁷⁹
- 7.4.3. Regulatory, macroeconomic, and market risk exposure that allows for a move towards hedging, conservative capital structures and scenario-based planning.⁸⁰

⁷³ J. Graham, & C. Harvey, "The Theory and Practice of Corporate Finance: Evidence from the Field," (2001) *Journal of Financial Economics*, 2001.

⁷⁴ Modigliani, F. & Miller, M., n (6)

⁷⁵ Central Bank of Nigeria, *Monetary Policy Report*, (2024).

⁷⁶ Nigerian Stock Exchange, *Market Performance Report*, (2024).

⁷⁷ J. Lintner, J, n (65).

⁷⁸ O, Akinwale, "Tax Planning and Corporate Strategy in Nigeria," (2019) *African Journal of Business Management*, 2019.

⁷⁹ L, Booth, et al., "Capital Structures in Developing Countries," (2001) *Journal of Finance*.

⁸⁰ E, Adegbite, "Corporate Governance and Risk Mitigation in Nigeria," (2015) *Journal of Business Ethics*.



7.4.4. High level of transparency in reporting and good governance, which will increase credibility to regulators and investors, reduce uncertainty and aid compliance.⁸¹

7.5 Policy Recommendations

The responses of firms to the recent tax reforms have significant lessons for policymakers.⁸² On the one hand, enforcement and broadening of the tax base are crucial to revenue mobilization; on the other hand, stringent policies can unintentionally limit investments and slow down economic growth. Some of the recommendations are:

- 7.5.1. Regulatory adjustments in enforcement, to ensure that firms, especially the SMEs, do not feel overburdened and are still compliant.
- 7.5.2. Gradual implementation of reforms, to enable firms to adapt and adjust without pressure.⁸³
- 7.5.3. Capacity building and training, advisory services, and digital tools to assist with adjustment and compliance.⁸⁴ In high-growth sectors or capital-intensive projects, targeted incentives may be used to promote investment without compromising revenue integrity.⁸⁵
- 7.5.4. It is important to be clear about tax obligations, deadlines and penalties, to decrease uncertainty and enhance the capacity of firms to design and implement financing strategies.⁸⁶

7.6. General Economic Implications

The link between taxes and company conduct has extended macroeconomic implications. Policymakers have to therefore walk a fine line between maximizing revenue and promoting economic growth, in order to attain sustainable fiscal outcomes and corporate performance in Nigeria. Tax obligations should be enforced without asphyxiating investment or growth. Gradual enforcement, capacity building and special incentives are some of the most important instruments to attain both fiscal and economic goals.

8. CONCLUSION AND RECOMMENDATIONS

Corporate tax reform is a very important tool for fiscal performance and economic growth. Nigeria has been engaged in extensive tax reform, and the implications of these reforms have been quite substantial on corporate financing choice, capital structure and dividend policy.

8.1. Summary of Key Findings

The study on how companies react to tax reforms, especially in recent times, has also brought some vital findings to the fore:

⁸¹ E, Okike, n (69).

⁸² Federal Inland Revenue Service, *Corporate Tax Compliance Guidelines*, (2023).

⁸³ International Monetary Fund, *Nigeria Fiscal Reform Assessment*, (2023).

⁸⁴ PwC Nigeria, *Digital Tax Compliance Support*, (2024).

⁸⁵ T, Oyedele, n (10).

⁸⁶ FIRS, *Corporate Tax Policy Statement*, (2023).



- 8.1.1. Increased enforcement has reduced the available funds for investments and projects, forcing the firms to use more conservative financing methods.
- 8.1.2. Although in theory, higher taxes would encourage higher leverage, Nigerian companies depend largely on internal sources of funds because of the high cost of borrowing, restrictions in accessing credit, as well as macroeconomic volatilities.
- 8.1.3. The low post-tax earnings and liquidity have resulted in the firms being conservative in their dividend policies, such as smoothing, partial dividend payments, or deferral.

Taken as a whole, the research highlights the necessity to contextualize the corporate finance theories, including the trade-off theory, pecking order theory, and the theory of residual dividend, in the context of the institutional and macroeconomic contexts in Nigeria.

8.2. Lessons for Policymakers

Achieving a balance between revenue mobilization and economic growth can be an onerous task, especially when enhancing compliance and revenue collection. It may limit investment, slow economic growth and lower dividend payouts. Policymakers should aim to strike an equilibrium between these objectives by implementing them in phases, offering incentives, and utilizing sector-specific mechanisms, where necessary.

8.3. Managerial Recommendations.

To ensure sustainability in the ever-changing financial landscape, corporate managers have to adjust to the changing fiscal conditions.

- 8.3.1. Managers should incorporate tax requirements into cash flow forecasting, capital budgeting, and liquidity management to reduce the risk of regulatory fines.
- 8.3.2. Firms need to pay attention to high-paying, low-risk projects and to invest the internal resources effectively.
- 8.3.3. It is recommended that companies should employ the strategy of dividend smoothing, partial payout, and deferred distribution to strike a balance between shareholder demands and liquidity conservation.
- 8.3.4. Enhanced internal control, improved financial reporting, and continued ability to maintain transparency with regulators will also lower the compliance risk and improve investor confidence.

8.4. Contribution to Literature

The research has contributed to the literature in that it has bridged the gap between theoretical concepts of corporate finance and the institutional reality of an emerging market. Contrary to most of the previous research, which assumes that taxation is a constant factor, this analysis has emphasized the dynamic impacts of tax reforms. It underscores the existence of institutional



constraints, macroeconomic volatility, and regulatory uncertainty in developing economy that tend to dominate the forecasts of classical models and require specific analysis of the situation.

8.5. Limitations and Future Research

Although the study gives a detailed analysis of the topic of corporate tax reforms in Nigeria, there are limitations based on empirical data regarding the responses of firms, especially SMEs and those in the informal sector. Moreover, the evaluation focused on the period after the tax reform, and further results are yet to be seen on how the reform will have an impact on investment, development of capital markets and growth of the macroeconomy. Further studies may involve comparative studies involving other emerging economies, sector-specific reactions, and the use of longitudinal data to determine the long-term effect of enforcement-based tax reforms on corporate finances.

8.6. Concluding Remarks

The recently introduced corporate tax reforms are an important development in the Nigerian fiscal environment. The reforms have transformed the way corporate decisions are made, especially in financing and dividend policy, by focusing on enforcement, transparency and compliance. Firms are responding to the changes through the adoption of conservative capital structure, focus on internal funding and a change in the dividend process, to keep liquidity and operations afloat. Managers and policymakers are faced with the challenge of navigating these reforms between revenue goals, sustainability of the firms and investor confidence.

In conclusion, the Nigerian tax policy cannot be studied on its own without reference to institutional capacity, market forces, and managerial behaviour. A sustainable economy requires a fiscal framework that generates revenue while empowering, rather than encumbering, the firms that drive growth.