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European Journal of Business and Management
ISSN 2222-1905 (Paper) ISSN 2222-2839 (Online)
Vol 4, No.19, 2012
www.iiste.org

Tax Revenue Generation and Nigerian Economic Development

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Abstract
The objective of this paper is to explore the impact of income tax revenue on the economic growth of Nigeria as proxied by the gross domestic product (GDP). The ordinary least square (OLS) regression analysis was adopted to explore the relationship between the GDP (the dependent variable) and a set of federal government income tax revenue heads over the period 1981-2007. A simple hypothesis was formulated in the null form which states that there is no significant relationship between federally collected tax revenue and the GDP in Nigeria. The regression result indicated a very positive and significant relationship. However actual tax revenue generated in most years fell below the level expected. The anomaly was attributed to dysfunctionalities in the income tax system, loopholes in tax laws and inefficient tax administration. Suggestions were made as to strategies to be adopted to improve the system of tax administration to increase tax revenue generation.
Key Words: Income Taxes, GDP, Tax evasion and avoidance, Loopholes in tax laws and administration, Revenue generation.

1.0 Introduction

The Institute of Chartered Accountants of Nigeria (2006) and the Chartered Institute of Taxation of Nigeria (2002) defined tax as an enforced contribution of money to government pursuant to a defined authorized legislation. In other words, every tax must be based on a valid statute. Without a valid statute no legitimate tax can be imposed. The income tax is levied on incomes such as salaries, business profits, interest, dividends, commissions, royalties and rent. It may also be charged on capital gains and petroleum profits. Taxation yields very substantial revenue to government. Therefore, it has a bearing on the Gross Domestic Product (GDP} which is the standard indicator for measuring the economic wellbeing of a nation. The nature and level of taxes vary according to the economic policies adopted by the government of the day.

Sanni (2007) advocate the use of tax as an instrument of social engineering, to stimulate general and/or sectoral economic growth. In that regard, taxation could have a positive or negative effect on both the individual and on government. To the individual, low income tax rate constitutes an incentive to work or save, while high income tax rate represents a disincentive to work or save. To the government, high tax rates provides the most reliable, important and dominant source of government revenue, for promoting the economic development of the nation. The tax rate is often a major consideration in the choice of organizational form of business (Okafor, 2008), and may also be associated with varying levels of foreign direct investment (Desai et. al., 2004).

It has been observed over the years that income tax revenue has generally been grossly understated due to improper tax administration arising from under assessment and inefficient machinery for collection. In Nigeria revenue derived from income taxes has been grossly understated due to improper tax administration, assessment and collection (Ola, 2001; Oluba, 2008; Adegbie and Fakile, 2011). Persons and companies are known to routinely evade and avoid taxes due to corrupt practices and the existence of various loopholes in the tax laws. According to Naiyelu (1996), the success or failure of any tax system depends on the extent to which it is properly managed; the extent to which the tax law is properly interpreted and implemented.

Recently the Nigerian government undertook various tax law reforms to improve tax administration and to increase tax yield. The Value Added Tax (Amendment) Act, 2007; was for instance intended to widen the value added tax base and improve the machinery for its collection. Similarly the Company`s Income Tax (Amendment) Act. 2007; the Federal Inland Revenue Services (Establishment) Act, 2007 and The Personal Income tax (Amendment) Act, 2011, were all aimed at encouraging tax compliance and increasing tax yield (Aguolu, 2010).

The main objective of this paper is to examine the contributions of income taxes to the development of the Nigerian

economy, evaluate the adequacy of the relevant tax laws, identify loopholes in the tax system and make recommendations for improving the overall administration and yield of the tax system. The discussion is restricted to federally collectable taxes.

2.0 Federal Government Tax System

The federal tax system in Nigeria refers to the range of taxes over which the federal government has exclusive or shared jurisdiction. The system also covers the machinery put in place by government for the administration and collection of such taxes. The federally collectable taxes in Nigeria include the petroleum profit tax (PPT), the company's income tax (CIT), customs and exercise duty and the value added tax (VAT). Though VAT is managed by an agency of the federal government the bulk of the proceeds go to the state governments. The tax which has direct and immediate impact on the average individual is of course, the personal income tax (PIT). It is however not covered in the discussion because the bulk of PIT is derived from the states and accrues to the states of derivation. Each state has its independent machinery for PIT administration and collection. PIT revenue accruable to the federal government comprises PIT derived from residents of the Federal Capital Territory (FCT), armed forces personnel and staff of diplomatic missions.

The federal government agency responsible for the administration and collection of these taxes, (except customs/excise duties) was up to April 2007 known as the Federal Board of Inland Revenue (FBIR). In 2007, the FBIR was scrapped and replaced with the Federal Inland Revenue Services (FIRS). The collection of customs and excise duties is handled by the Customs and Excise Service.

3.0 Data Presentation and Analysis

The time series data on the dependent variable (GDP) as well as the explanatory variables namely petroleum profit tax, company income tax, customs and excise duty and value added tax, over a 27 year period (1981-2007) is presented in Table I. As explained earlier, VAT was introduced in 1994 hence its contribution was first captured in that year.

The first statistical analytical test conducted was the ordinary least square (OLS) multiple regression test to ascertain the explanatory power of total tax revenue over the GDP as well as the relative impact of each independent variable as reflected by their respective co-efficient. The traditional multiple regression formula was applied. In the functional form it is stated as:

GDP = f(PPT, CIT, CED, VAT) ----------(i)

In the linear (i) coverts to

$GDP = b_o + b_1(PPT) + b_2(CIT) + b_3(CED) + b_4(VAT) + e$

Where GDP = gross domestic product

PPT = Petroleum tax revenue

CIT = Company tax revenue

CRD = Customs and excise duty

VAT = Value added tax

To obviate the problems associated with the OLS tests, the relationship was further subjected to complementary statistical tests, the result of which is presented in Table 2, which shows the outcome of the linear regression using Statistical Package for social science SPSS.

Table 1: GDP and Federal Government Collected Tax Revenue

YEAR	GDP	PPT	CIT	CUS.&EXC. DUTY	VAT
	N`000000	N`000000	N`000000	N`000000	N`000000
1981	50,456	6,326	403	2,326	
1982	51,654	4,847	550	2,336	
1983	56,313	3,747	562	1,984	
1984	62,474	4,762	787	1,616	
1985	70,633	6,711	1,004	2,184	
1986	71,859	4,811	1,101	1,728	
1987	108,183	12,504	1,235	3,541	
1988	142,618	6,815	1,551	5,672	
1989	220,200	10,598	1,914	5,816	
1990	271,908	26,909	2,997	8,641	
1991	316,670	38,616	3,828	11,457	
1992	536,305	51,477	5,417	16,055	
1993	688,137	59,208	9,554	15,485	
1994	964,005	42,803	12,275	18,295	7,261
1995	1,934,831	42,858	21,878	37,364	20,761
1996	2,703,809	76,667	22,000	55,000	31,000
1997	2,801,973	68,574	26,000	63,000	34,000
1998	2,721,179	68,000	33,300	57,700	36,000
1999	3,313,563	164,300	46,200	87,900	47,100
2000	4,727,522	525,100	51,100	101,500	58,500
2001	5,374,339	639,200	68,700	170,600	91,800
2002	6,232,244	392,200	89,100	181,400	108,600
2003	6,061,700	683,500	114,800	195,500	136,400
2004	11,411,067	1,183,600	113,000	217,200	159,500
2005	15,610,882	1,904,900	140,300	232,800	178,100
2006	18,564,595	2,038,300	244,900	177,700	221,600
2007	23,280,715	1,600,600	275,300	241,400	289,600

Source: Central Bank of Nigeria Annual Statistical Bulletin (2007)
GDP = Gross Domestic Product
PPT = Petroleum Profit Tax
CIT = Companies Income Tax
CUS &EXC = Customs and Excise
VAT = Value Added Tax

Table 2: Results of Multiple Regression

VARIABLES	PEARSON CORRELATION	STANDARDIZED COEFFICIENT	STANDARD ERROR	T. STATISTICS	PROBABILITY
GDP	1	-	238302.32	2.350	.028
PPT	955	.276	.726	3.857	.001
CIT	.981	-.383	19.590	-0.895	.008
CUS & EXC	.879	-.208	8.330	-3.358	.003
VAT	-982	1.287	25.219	-3.973	.001
R. Squared	.986				
Adjusted R. Square	.984				
ANOVO	391.258				
F. Statistics	4				
Degree of freedom 1	22				
Degree of freedom 2					

Source: Author's Computations
GDP = GROSS DOMESTIC PRODUCT
PPT = PETROLEUM PROFIT TAX
CIT = COMPANY INCOME TAX
CUS & EXC = CUSTOMS AND EXCISE DUTIES
VAT = VALUE ADDED TAX

Gross Domestic Product (GDP) is the dependent variable with constant 1, the PPT = .955, CIT = .981, CED = .879 and VAT = .982. The R^2 unadjusted multiple correlation coefficient of .986 percent of the variables, is explained in the Gross Domestic Product (GDP).

Summary of the test result
R^2 = 0.986
R^2 adjusted = 0.984
SE = 238302.32
df = 4
F- cal = 391.258
F – sig: PPT = .001; CIT = .008; C&E = .003; VAT = .001

R^2 which is the unadjusted multiple correlation coefficient signifies the goodness of the equation and also denotes the coefficient of multiple determination. It also shows that 99% of changes in total GDP (dependent variable) were influenced by changes in the independent variables (PPT, CIT, C&E and VAT). The F - statistics test computed show a figure of 391.258 at the degree of freedom 4, is used to test the overall significance of the regression. The results of R^2 = 0.986; adjusted R square 0.984; F-cal 398.258; f – sig level of .008 CIT, .003 C&E .001 VAT and .003 PPT, they are all less than 0.05, which suggest that there is very strong evidence that Ho is not true. The null hypothesis is rejected which suggest that a strong significant relationship exists between GDP and federally tax revenue generation. Therefore all federally collected income taxes make positive contributions to the economic development of Nigeria and the composition of GDP which is a measure of economic development. With all these explanations and analysis the null hypothesis is rejected and the alternate hypothesis which states that federally tax revenue generation has a positive impact on the economic development of Nigeria is accepted.

4.0 Failure in Tax Revenue Generation

In his ageless book, *The Wealth of Nations,* Adam Smith propounded the four basic indices of a good tax system namely universality, certainty, convenience and economy. If weighed on the scale of these efficiency indicators, the

Nigerian tax system would be found to be poles away from the efficiency reference point. The system is marred by failures in tax compliance, failures in tax enforcement and failures in tax administration.
Poor Compliance

Every form of tax represents a burden (cost) which the rational tax payer would like to minimize or completely avoid. Compliance to any tax could either be self imposed (voluntary) or enforced. Voluntary compliance is the preferred option because it is more cost effective and therefore yield higher tax revenue. The level of voluntary compliance is directly related to the assessment of the taxpaying population as to whether or not the relevant tax is fair and equitable.

Tax is adjudged to be fair, by tax payer, if it could be justified by the level of services provided by the beneficiary ie the government. Similarly, it is deemed to be equitable if the entire population qualified to pay the tax is effectively brought into the tax net. The level and quality of infrastructural and social/welfare services provided by governments in Nigeria do not elicit voluntary tax compliance. As regards the issue of equity, the Nigerian tax system is considered to be inequitable, if not discriminatory because a very high percentage of the identified population for each type of tax tariff or levy is not captured by the relevant tax assessment and collection machinery.

Based on the above considerations, a huge population of tax payers in Nigeria comprising individual and corporate entities has no qualms in strategizing to minimize the tax liability either within the existing tax laws or in contravention of such laws. The two prominent strategies for tax liability minimization is tax avoidance and tax evasion.

Tax Avoidance

Tax avoidance refers to the strategy of exploiting loopholes in both tax laws and tax administration to reduce legitimate tax liability (Downes and Goodman, 1995). Tax avoidance does not involve criminality in the legal interpretation of that term. One major loophole often exploited in Nigeria is the broad interpretation of capital allowance and other tax deductible non-operating expenses. For instance, a company could invest in qualifying capital assets that it could ordinarily not have required for effective operations just to earn a tax deductible advantage. According to Sani (2005), the tax avoider seeks to comply with his tax obligation only to the extent of what is minimally feasible within the law. Nigeria corporate tax payers especially the large ones, both foreign owned and indigenous, seem to be engaged in a continuing smart game of trying to out-wit the tax authorities to maximize tax allowable deductions and minimize overall tax liability.

Tax Evasion

Tax evasion is an illegal act of intentionally reducing accrual taxes or completing skipping the payment of such taxes by under reporting income, overstating expenditures, deductions or exemptions (Downes and Goodman, 1995). Tax evasion is a serious problem in Nigeria which arises from many sources including outright ignorance of extent tax laws, lack of faith in the ability of government to utilize tax revenue well and high tax rates which make evasion very attractive and economical.

5.0 Failure in Tax Enforcement and Administration

Failures in tax law enforcement and administration are inter-related. Each of them originates from the ineffectiveness and/or lack of transparency of government agencies responsible for the management of each type of tax.

A failure in tax law enforcement arises when ever there is improper tax assessment. In theory, the problem could result from over assessment or under assessment. The more common case in practice is deliberate under assessment of tax triggered by fraudulent collaboration between tax enforcement officer(s) and the tax payer. It is fraudulent because the tax assessor is most often compromised to “co-operate” with the tax payer to reduce tax liability.

To improve tax enforcement, Nigerian tax payers (both individual and corporate entities) are now compelled to

produce three years` tax clearance certificates to access various types of public services. The strategy has, to some extent, improved tax collection, but has obviously not eliminated tax dodging because the range of services covered by the "show your tax clearance certificate" requirement is limited. Moreover taxes extracted under such conditions of duress are notorious for under assessment.

Another aspect of failure in tax administration is delayed assessment and late collection of taxes. Under the tax laws, the initiative to start the tax assessment and collection process rests with the tax payer who is expected to file the relevant tax returns within a stipulated period after the relevant fiscal year. There is a high incidence of late filing of returns as well as falsification of accounting information of such returns. For instance, many companies are known to prepare two sets of annual accounts for each year, one for the company and the other for the tax assessment authority. In each of such cases, the accounts for "tax purposes" clearly understate the tax assessable income.

Such malpractices are tax offences for which clearly detained penalties exist. Sec. 13(3) of the Companies Income Tax (Amendment) Act. 2007 has specifically increased (by ten fold) the fine for late filing of returns and by over five fold the penalty for falsified accounting information on tax returns.

6.0 Tax Revenue Enhancement Strategies

As indicated earlier, the best option strategy to expanding tax revenue from any type of tax is to take proactive measures to maximize voluntary compliance. Voluntary compliance ensures that the largest percentage of the taxable population is effectively brought into the tax net. It also minimizes the propensity to compromise tax officials to achieve under assessment. The most potent weapon for government to achieve high tax revenue is therefore to implement fiscal policy measures which encourage voluntary tax compliance.

The first step forward for government in that direction is to expand the socio-welfare benefits accruable to Nigeria tax payers. In the final analysis, ability to provide such services constitutes the primary legitimacy of the power of government to levy taxes. Government has a primary obligation to provide basic social welfare services like basic education, access to basic health services, safe drinking water, sanitation and security for the citizenry. The failure of any government to live up to that expectation erodes loyalty to the government and destroys the incentive to voluntarily pay taxes. In the current Nigerian situation the state of decay in social-welfare services is compounded by failure of basic infrastructural support services like electricity and transportation. Given that situation, there is a systemic luck-warm attitude to meeting tax payment obligations.

Some positive steps have been taken to overhaul the tax administration machinery especially with regards to taxes administered by the FIRS. The Federal Inland Revenue Services (Establishment) Act, 2007 has not only granted autonomy for the service but has completely reorganized it for more effective administration of the tax system. The introduction of Integrated Tax Offices (ITOs) in place of the former Area Tax Offices (ATOs) has resulted in a significant decentralization of tax management operations. Unlike the ATOs which were based only in major urban centres and state capitals, the ITOs are intended to be located in all identified centres that have a significant cluster of businesses. The decentralization will obviously improve the tax assessment background information about companies under their mandate and hopefully result in fairer assessments and more timely in tax returns. The system will also promote more frequent on-site inspections and investigations by tax officers because of the reduced spatial coverage of each ITO.

The external auditors of funds play a vital role in ensuring the veracity of tax returns filed by and on behalf of their clients. More often than not the external auditors in their capacity as tax consultants aid and abet the filing of accounting returns that are "creatively structured" to understate tax liability. There is need for the tax authorities to cultivate the co-operation of the professional bodies connected with tax matters namely external auditors and corporate tax consultants to minimize the current level of abuses in tax returns.

7.0 Conclusion

Tax revenue constitutes a major component of national income in a modern economy. It is the dominant source of

government recurrent revenue in most developed countries. The world`s largest economy which is the United States of America, is tax revenue driven. The impact of taxes may not be as significant in developing countries most of which are fueled by commodity export earnings.

The Nigerian economy is heavily dependent in crude oil export receipts. The immense potentials of taxes as a major engine room for fueling the economy have not been exploited. Oil is a wasting national asset and the major components of tax revenue in Nigeria. The positive danger of over-reliance on crude oil export receipts to drive the economy seems to have raised to the front burner of current economic policy discussions. The need to expand the tax yield through improved tax system administration has become a major economic policy issue.

This paper is an attempt to factually determine the impact of tax revenue on the economy thereby providing further insight into the need to improve and strengthen tax administration. The OLS multiple regression analysis was adopted to determine the relationship between Nigeria's economic growth (proxied by GDP) and the major components of tax revenue in Nigeria. The positive and significant relation between the GDP and the tax explanatory variables indicates that policy measures to expand tax revenue through more effective tax administration will impact positively in growing the economy.

Failures on the part of tax payers as well as on the part of tax system administrators which adversely affect tax yield were identified. A two pronged strategy for improving overall tax revenue yield was recommended. Firstly, specific socio-welfare interventions of government to encourage voluntary compliance to tax obligations by both individual and corporate Nigerians were highlighted. Secondly, suggestions for improving the effectiveness of tax administration by ensuring proper and equitable tax assessment and timely collection were made. It was also recommended that the tax execution agencies should forge good relationship with the professional associations involved in tax matters so as to elicit their support in reducing tax malpractices perpetrated by tax payers with the connivance and often active support of external auditors and tax consultants.

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