WIDENING THE TAX NET: LESSONS FROM LAGOS STATE, NIGERIA

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Abstract

Pressure is on governments all over the world to increase revenue through taxation in order to provide better services within their jurisdictions. This study attempts to access the Lagos state's revenue performance under the internally generated revenue scheme. Lagos state total revenue data was collected from 2009 to 2013 in addition to 65 copies of questionnaire applied on tax payers in Lagos state. The valid questionnaires (54) were analysed using chi-square statistics while the secondary data collected were analysed through error correction model regression. It was found that Lagos state internally generated revenue has increased substantially between 2009 and 2013. However, there are still rooms for improvements. Fines and fees, licences, earnings and sales, and rent on Government property are all revenue items that impacted greatly on the total internally generated revenue. It is recommended that the sources of revenue that are significant such as taxes, licences, fines and fees, grants, finance aids and loans should be reconstructed and re-engineered through public awareness, through keeping accurate data and methodical manner of collection.

Key words: Internally generated revenue: Revenue collection: Tax net, Tax avoidance, Tax evasion.

Introduction

Lagos state is one of the 36 states in Nigeria. It remains the commercial nerve centre of Nigeria even when the administrative seat of federal capital was moved to Abuja. It has unofficial population of over 18 million people out of which over 12 million are estimated taxable adults (Fashola, 2009). It is the only state that has substantially increased her internally generated revenue over time. Despite the results yielded from the efforts made so far to ensure increased revenue generated only 3 million of the 8 million taxable adult under self-assessment are said to be in the tax net (Fashola, 2009). It is therefore worthwhile to find out the level of efficiency of the existing tax administrative structure in Lagos state. While tax policy and tax law create the potentials for raising tax revenues, the actual amount of taxes flowing into the government treasury, to a large extent, depends on the efficiency and effectiveness of the revenue administration agencies. Weakness in revenue administration leads to inadequate tax collections. Financing of the resulting budget deficit through borrowing can cause unsustainable increases in the state public debt. In the alternative, revenue shortfalls shrink the budgetary resource envelope, thus, affecting the government's ability to implement its policies and programmes and provide public services. Unexpected dips in revenue collection also cause budget cuts that result in major inefficiencies in the public expenditure management. Successive administration of Lagos state in recognition of this developed improved revenue administration structure targeted at increasing internal revenue accruable to the government. The main administrative measures taken in the past ten years to improve revenue include:

- Accelerated revenue generation programme (ARGP) – 1994
- CITI Bank direct monitoring and reporting of internal revenue system – 1999
- Electronic banking system of revenue collection and monitoring (EBS-RCM) – 2000
- Granting full autonomy to Lagos Board of Internal Revenue – 2006.

This paper examines the efficiency of tax administration in Lagos state with respect to revenue collections and the possibility of widening the current tax net. Lagos state is chosen because of its position as the commercial nerve centre of Nigeria. In addition, it is the only state that has successfully increased the internally generated revenue much more than the income accruable from the federal statutory allocation.

Conceptual and Theoretical Framework

The objective of an effective tax administration is to bring more people into the tax net by making tax assessment and payment simple and easy to pay for the tax payers. One of the theories that set out to provide definition between attitudes, beliefs, intentions, norms and individual behaviours is theory of reasoned action (TRA). TRA focuses on the behavioural intentions and research concerning user's pre-adoption and post-adoption behaviour (Abiola, 2013). TRA is favoured for this study as the voluntary payment of taxes through self-assessment entirely depends on behavioural intentions of taxable individuals.

Review of Related Literature

According to Abiola and Asiweh (2012), an examination of some of the factors or reasons for the uncooperative attitude of people towards taxation reveals that the onus is on the complications and complexity of tax policies and administration in the country. Most times, the resistance to taxation is so fierce that it could lead to social unrest. In Nigeria the "Aba Women Riot of 1929" which constituted the historic first British challenge during the colonial era was prompted by the introduction of taxation by Lord Lugard, who was then the governor (Evans, 2009). The women who felt oppressed by the introduction of tax took to arms forcing the colonial master to withdraw the policy. However, apart from the South Eastern Nigeria, where this happened, there was women riot in Abeokuta, south western Nigeria which was led by Funmilayo Ransome-Kuti and also the post-independence Agbekoya riot of Akanran near Ibadan of 1968. All these riots and violent protests point to the fact that taxation is not an attractive pie that anyone enjoys and that introduction of new taxation regimes need supports and understanding of all stakeholders. The enactment of Income Tax Management Act of 1961 was a watershed that marked the beginning of taxation in the post-independence Nigeria (Abiola, 2003).

James and Nobes (2009) and Nightingale (2002), while citing (Adams Smith, 1776), posit that a good tax should have the qualities of Equitability, Efficiency, Neutrality, Flexibility, and Simplicity. These principles still hold today and even act as a guide for policy formulation. However, the ability to achieve all in a single tax policy is practically impossible; hence Nightingale (2003) stated that there is no good tax. This is because an efficient tax might be inequitable. According to Lamb et al (2005:40) "An efficient tax may not necessarily be considered fair, one that is considered equitable may not be efficient". Ordinarily, people abhor tax payment due to its effect on their income (Abiola and Asiweh, 2012). Owens (2006) noted that only a few people are enthusiastic about paying tax. Tax policy must be generally accepted by the people if it must gain compliance (Nightingale, 2002). It therefore means that a good tax system must be in compliance with Adam Smiths' (1776) canon of taxation cited in Nightingale (2002): Equitable, Neutrality, Efficiency, Flexibility and Simplicity.

James and Nobes (2008) noted the inability of tax policy to meet the efficiency and equity criteria against which it is being judged. It was further noted that tax policy is continually subjected to pressure and changes which most times does not guarantee outcome that are in line with the overall goal (James and Nobes, 2008). Taxation is the life-blood of the administration in Lagos state and the Lagos state government takes its life-blood very seriously indeed. Lagos generated N60 billion in Internally Generated Revenue (IGR) in 2006. Four years later, in 2010, IGR in Lagos had more than doubled to N168 billion. Tax revenues make up the lion's share of Lagos state's IGR at 65% of it in 2006 and as much as 83% in 2010. In 2015, the state government projects that it will generate around N316.6 billion internally, 80% of which will come from taxes on Lagosians. (Lagos State 5 Years Budget, 2010-2015)

The growth of the state's IGR is nothing short of phenomenal compared to the rest of the country. While Lagos currently generates about N20 billion every month, Kano state which has a similar population struggles at N2 billion while Bayelsa state generates a paltry N1 billion. Lagos state's impressive ability to squeeze billions in taxes, rates and charges out of the pockets of its 21 million citizens is born out of necessity. Lagos received N168 billion in 2012 from the federation account (excluding derivation and excess crude payments). Akwa Ibom state is the largest oil producing state in Nigeria, with as many as eight oil producing local governments and this attracts the largest share of oil revenue for the state. When it comes down to it, Lagosians are the only abundant natural resource available to Lagos state. (Nigeria Economic Outlook; Business Digest, August 2013).

Research Methodology

Three hypotheses were tested. Hypotheses 1 and 2 are tested with the primary data collected from questionnaire response using Chi-Square statistics while hypothesis 3 is tested with secondary data of 5 years (2009 – 2013) revenue data of Lagos state

collected from Central Bank of Nigeria Bulletin using error correction model. The three hypotheses formulated and tested are:
H01: Lagosians see tax levied on them and the tax system as not equitable, difficult and inefficient.

H02: The collection of revenue in Lagos state is not effective and efficient.

H03: There is need to widen tax in Lagos state to increase internally generated revenue.

H01: Lagosians see tax levied on them and the tax system as not equitable, difficult and inefficient.

Test statistics

	Q1	Q4	Q5
Chi-square	23.551[a]	80.286[b]	31.408[c]
Df	2	4	3
Asymp. Sig.	.000	.000	.000

a. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 16.3
b. 0 cells. (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 9.8.
c. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 12.3.

From the table, the three questions related to the hypotheses have all their chi-square values (23.551-0.000; 80.286-0.000; and31.408) significant at 0.000 which is lesser than the p-value of 0.05. The significance of this is that the efficiency and equitability of tax system is a determinant of amount of tax collected.

H02: The collection of revenue in Lagos state is not effective and efficient.

Test Statistics

	Q3	Q6	Q7	Q8
Chi-square	15.469[a]	48.449[b]	29.286[c]	19.980[c]
Df	2	4	3	3
Asymp. Sig.	.000	.000	.000	.000

a. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 16.3.
b. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 9.8.
c. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 12.3.

The asymptotic significances of the chi-square values in the table above are put at 0.000 which are measured on 5% level of significance. This establishes the independence of test that effectiveness and efficiency of tax administration have impacted on collection of revenue in Lagos state.

H03: There is need to widen tax net in Lagos state to increase internally generated revenue
Model Specification

The model adopted for this study is presented to address the research question and hypotheses formulated.
Model
$IGR = B_0 + B_1 FFE + B_2 LIC + B_3 EARS + B_4 RGP + e$…………… (1)
Where:
IGR = internally generated revenue.
FFE = Fines and Fees
LIC = Licences
EARS = Earnings and Sales
RGP = Rent on Govt. property
e = Stochastic variable (error term)
B_0 = intercept
B_1 B_2 B_3 B_4 = Slope
A priori Expectation

The apriori expectation would be that if the taxes, rates, licenses, rents, earnings are increased, the level of internally generated revenue will increase, implying there is a positive relationship between the variables.

Estimation of Model
The data for the models are presented in the appendix but the regression results are presented below.

Error Correction Model (ECM) Regression Output
Dependent variable: IGR
Method: Least Squares
Date: 10/30/14 Time: 02:22
Sample (adjusted): 2009/2013
Included observation s: 5 after adjustment

Variable	Coefficient	Std. Error	t-Statistics	Prob.
C	7.116519	1.246716	2.217690	0.0115
FFE	7.222108	0.326834	2.132998	0.0062
LIC	2.121292	0.225512	-0.327707	0.0217
EARS	4.307029	0.144723	-0.554493	0.0288
RGP	6.122966	0.312887	-0.290317	0.0435
ECM	-0.160216	0.164390	-1.017233	0.0227
R- squared	0.681276	Mean dependent var.		7.5438876
Adjusted R-squared	0.658732	S.D dependent var.		1.739810
S.E of registration	1.162928	Akaike infro criterion		2.541982
Sum squared resid	42.87642	Schwarz criterion		1.544872
Log likelihood	-44.98213	Hannan- Qunn criteria		3.442148
F – statistics	13.18767	Durbin-watson stat.		2.088119
Prob. (F-statistics)	0.000012			

Source: Computation using E-views statistical package. Version 7.0.

Interpretation

The results of chi-square analysis support the view that tax administration needs to be strengthened in order to put more tax payer in the tax net. The more efficient the tax administrative machinery, the more tax can be collected. This view is supported by Abiola and Asiweh (2012) who posited that tax administration must be efficient to reduce tax avoidance and evasion.

Result obtained further shows that the estimates of the variables confirm to apriori expectations. The estimated econometric model above reveals that the dependent variable, internally generated revenue (IGR), has an autonomous value of 7.116519 and a relationship with the explanatory/independent variables. The coefficient of fines and fees, licences, earnings and sales and rent on government property are 7.2, 2.1, 6.1 and 4.3 respectively and significant at 0.05 level of significance. This shows that Fines and Fees, Licences, Earnings and Sales and Rent on Government property are highly significant in enhancing Lagos state internal revenue. The finding shows that for every one percent increase in the explanatory variable will cause an increase in internally generated revenue (IGR). The coefficient of determination (R^2) is 0.68. This means that about 68% of systematic mean variation of the dependent variable is explained by the explanatory variable.

The remaining 32% variable is explained by other elements not included in the model, but are taken care of by the error term; hence, the regression model is a good fit. At 5% significant level, the level of regression passed the overall significant test (F-test), this is an indication that none of the estimated coefficient is equal to zero and that there is a linear relationship between the dependent variable and the explanatory variables. The Durbin-Watson statistic of 2.0 indicates the absence of auto-correction. This implies that the problem of serial auto-correction does not constitute a problem in the research analysis.

Discussion of Findings

The result indicates that each component of the explanatory variables had variant impact on the dependent variable in the long – run. The t-value obtained shows that all variable employed are statistically significant under 5 percent level of significance. That implies that the estimated model can be used for policy analysis as well as for economic inference. It is interesting to note that the regression equation is significant at 5 percent level of significance and shows a high degree of influences on the independent variable as shown by the co-efficient of determination R^2.

The bulk of income from tax comes from assessment under pay-as-you-earn. Majority of those who evade and avoid tax falls under those on self-assessment. Lack of accurate data of eligible tax payers still makes tax evasion and avoidance possible. Government should develop and constantly upgrade data base of all eligible tax payers under her jurisdiction. This can be linked with biometric registration of individual to make recognition of individual tax payers possible.

Lagos state has limited options if it wants to sustain and even expand its impressive year-on-year internal revenue growth. One way is to make the state's tax collection infrastructure more robust and effective by strengthening the tax net, eliminating waste, clamping down on tax evaders and capturing more of the 4 million eligible but untaxed workers in Lagos. Of the 8 million taxable individuals in the informal sector only 2.5 million were captured in the tax net last year. Lagos state Commissioner of Economic Planning and Budget, Mr Ben Akabueze described this when he told the press "the intension was not to impose any hardship on the residents as the administration would not introduce new taxes or increase the tax rates, but to make more people pay their taxes" (Akabueze, 2006).

A second option is to widen the tax net by identifying taxable but currently untaxed economic activity. Lagos is doing just that, which the merriment tax local governments in the state are now demanding. According to Commissioner for Local Government and Chieftaincy Affairs, Ademorin Kuye:

"Over ₦1 Million is spent monthly in Lagos state on entertainment and parties, we have the records to confirm this and these people, how many of them pay tax? The money goes into drinks, wine, food, *asoebi* and all of that and when they spend all this money; they do not want to pay anything to the government…. This justifies the reason why local governments demand that anyone organising event in the state must pay the merriment tax…. There is merriment tax in the constitution, it is part of the rate local government can collect. We have not fully utilised the benefit of the entertainment industry in the state" (Kuye, 2006).

Merriment tax is provided for in the taxes and levies (Approved list collection) Act of 1988, not in the constitution as erroneously stated by Mr. Kuye. The tax is already being collected by the local governments in the state and is proving to be deeply unpopular with Lagosian. It is probably not politically correct to say this but Lagosians have a serious partying addiction. We do not want to pay taxes although we are perfectly happy to spend N12 billion a year on parties, champagne and *asoebi*. Nigerians reportedly spent N9.4 billion in 2012 on imported champagne alone. God knows how much we spent on imported *aso ebi*, but I suspect it must be equal to scandalous amount. The 1 billion monthly spent on parties and entertainment in Lagos is equal to the monthly IGR of Bayelsa state. These days, Lagos is the venue of a massive arms race, with each wedding now trying to 'out-party', 'out-champagne' and 'out *aso ebi'* the next. If Lagosians have so much money to invest in *owambe* and *faaji* then they really shouldn't be upset when the state government comes for its share of the endless parting that seems to be going on. According to a recent report by Renaissance Capital (RenCap) 'Nigeria unveiled: Thirty six states of Nigeria', the rebasing of Nigeria's gross domestic product (GDP) has raised Lagos state to African's 13th biggest economy in 2014, equivalent to that of Ghana. As the state continues to grow it needs to mind its only available natural resource. That means more money out of the pocket of its teaming citizens. (RenCap, 2014)

The greatest obstacles to effective tax administration in Nigeria today are: tax avoidance and evasion. The twin evils have for years posed insurmountable obstacles to increase tax revenue. Revenue authorities have not been able to effectively tackle these obvious problems. This apathy is made worse by the fact that the people generally find it difficult to part with their hard earned income. Lagos state is perceived to be a state with the highest internally generated revenue (IGR) in Nigeria, but the incidence of tax evasion is still very high. In 2012, the average monthly IGR of N25 billion is far above annual generation of some states of the federation. Nevertheless, there are tax evasion especially among some foreigners and Nigerians who hide under the cloak of dubious tax officials and some appointed consultants. According to Olabisi (2010), tax evasion and tax avoidance have a relationship with the government revenue in Lagos state; hence, government revenue is seriously affected by tax irregularities. The overall evidence suggests that tax evasion and avoidance are significant in Nigeria and the degree of the significance depends on the extent the government relies on taxation as a means of government revenue (Temitope, Olayinka and Abdurafiu, 2010). Olabisi (2010), Nigeria tax system is not efficient and effective in its totality: there is no available database of all taxable individuals, the mechanism in place for the assessment and collection of taxes are not enough and there is no strict measure in place. The effect of tax evasion and tax avoidance on the Lagos state economy cannot be overemphasized. The revenue of government has been greatly affected. The correct tax system being used gives rooms for loopholes, the corrupt tax officials, the lack of adequate data and many more have worsened the situation. In addition, a reduction in tax rate is even not an optimum solution to the problem, simply because some people would still attempt to evade or avoid taxes no matter the rates of taxes. Therefore, there should be complete overhauling of the Nigeria tax system. The existence of substantial number of tax evaders in Lagos state should be a matter of concern to the policy makers and tax administrators. According to Nzotta (2007), tax avoidance can largely be checked by plugging the loopholes in the tax law and carefully drafting of all new tax legislation. From the above, problems of tax evasion and avoidance is imminent.

Recommendations

It is recommended that the state Government should embank on massive and purposeful training of workers for knowledge enhancement that could enhance the necessary motivation for the staff of the revenue board. Furthermore, the source of revenue that are significant such as taxes, licenses, fines and fees, grants, finance aids and loans should be reconstructed and re-engineered through public awareness, keeping of accurate data and methodical manner of collection. Lagos state government has great potential to become one of the most efficient and highest generated revenue government if efforts are made to improve collection and generation performance.

It is suggested that all the tax laws should be further codified and harmonized. Furthermore, tax enforcement machinery should be strengthened with computerisation. The level of punishment should also be stricter and the legal provisions for doing this should be clearly stated. Continuous education for citizenry has to be embarked upon and step has to be taken to convince the tax payers that the money collected in form of taxes are judiciously spent. The state Board of internal revenue and the revenue collecting officers at the state level should be exposed to further training and continuous education.

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