

## The Effect of Tax Audit on Tax Compliance in Nigeria (A Study of Bauchi State Board of Internal Revenue)

MU'AZU SAIDU BADARA

DEPARTMENT OF ACCOUNTING ABUBAKAR TATARI ALI POLYTECHNIC BAUCHI

### Abstract

This paper assesses the effect of Tax audit on tax compliance in Nigeria a case of Bauchi State Board of Internal Revenue. The methodology employed for data collection is only primary source, which involved the use of questionnaires, in which 48 questionnaire were administered to the staff of Bauchi State Board of Internal Revenue, some selected individuals tax payers and corporate bodies within Bauchi State out of which only 42 questionnaires were completed and returned. The data generated for the study were interpreted using simple percentage. The main finding of the study include among other; the Relevant Tax Authority (RTA) employed tax audit towards achieving target revenue, that tax audit reduce the problems of tax evasion, that tax payers do not usually cooperated with tax audit personnel during the exercise. etc The paper recommends that; the RTA at all levels should improve the standard of tax audit employed for effectiveness and efficiency, tax audit should aim at reducing the level of tax evasion and RTA should provide a policy that would allow the tax payers to cooperate during the period of tax audit..

**Key words:** Relevant Tax Authority (RTA), Tax payers, Tax audit, Tax compliance, Bauchi State Board of Internal Revenue

### INTRODUCTION

A tax is a compulsory levy by government through its agencies on the income, consumption and capital of its subjects. These levies are made on personal income such as salaries, business profit, interest, dividend, discount or royalties to obtain revenue. It is levied against company profit, petroleum profit, capital gains and capital transfer (Bello, 2001). Therefore, taxation is a compulsory payment or transfer of resources from private to public sector levied on the basis of the determined criterion and without reference to specific benefits received in order to accomplish some of the nation's economic and social objectives. Taxation is primarily aimed at generating revenue for government in order to cater for its expenditure (Al Zakari, 1995). Auditing is an independent examination and expression of opinion on the financial statement of an enterprise by an appointed auditor in accordance with his terms of engagement and compliance with statutory regulation and professional requirements (Daniel, 1999). It is important to note that any individual or organization that falls within the scope of the above income groups, is obliged to pay tax, this can be voluntarily or otherwise. It is within this process that the issues of returns and assessment arose. Every individual or organization liable to income tax for a year of assessment is required to submit returns of his income and other relevant matters to the tax authority having power to assess him to tax. And this is subject to satisfaction of the returns by the Tax Authority (Oyebanji, 2006). Slemrod, (2000) is of the view that Tax audit is one of the most effective policies to prevent tax evasion behaviour. The level of tax audit can be determined by two elements: one is how many tax payers are selected for audit and the other is how much intensive the audit is. The first element is easily measured by the number of audited tax payers divided by the total number of tax payers. However, the latter is so difficult to measure due to non-published information about tax audit progress. It is commonly measured by the first element to indicate the level of tax audit for practical comparison. The problems to be investigated in this paper are the increases in the degree of non compliance of tax rule and regulation by individuals and corporate bodies. The objectives of this paper are to find out the effect of tax audit over the tax compliance; to assess the degree of compliance by the tax payers over the relevant tax laws; to also determine whether tax audit limits the degree of non-tax compliance. Finally, the paper also makes recommendations towards improving tax compliance.

### LITERATURE REVIEW

Tax audit can be defined as "an examination of an individual or organisation's tax report by the relevant tax authorities in order to ascertain compliance with applicable tax laws and regulations of state". He further said that tax audit is a process where the internal revenue service tries to confirm the numbers that you have put on your tax return (Kircher 2008). Tax compliance can be defined as "an ability of a tax liable body to submit accurate, complete and satisfactory returns in conformity with tax laws and regulations of the state to the authority for the purpose of tax

assessment” (Kircher 2008). Frank (2010) concludes that the designed tax authorities audit policy can have important effects on production decision by firms. The nature of such effects depends on whether firms compete or collude. Accordingly, an appropriate designed audit policy may not only achieve greater compliance and higher net revenue for given output and resources spend on audit but may also have other effects that would be normally considered desirable in a wider economic context. By a smart design of audit policy, the authorities can create information externalities that partially offset the informational advantages of industry insider. Since decision in the product market is in the light of the eventual outcome of net after tax expected profits, the audit policy can create a linkage to

Output decisions. Specifically, it may be possible to nudge firms in the direction of greater efficiency. Yongzhi (2005) concluded that this study does find a positive relationship between the audit and the voluntary competence. The finding suggests that the audit productivity may be under estimated in many studies in the literature. It reminds us that when considering the productivity of the audit work. Besides the direct audit collections, we should also take the audit impact on the voluntary compliance into consideration. For this reason, the finding may provide tax professionals and tax authorities with incentives to strengthen the audit power and to better structure their audit organization to generate more revenue for the state. Jin Kwon (2004) concluded that Korea needs more rigorous analysis to evaluate the determinant of tax culture for the study of tax compliance tax audit. Luigi (1999) concluded that better integration of the research on tax evasion the “law and economics” analysis of legal rule, is definitely desirable. As theoretical analysis proceeds, additional empirical work will be needed together with more extensive study of comparative tax enforcement law and procedure.

#### **Reasons for Tax Audit**

Erard (1994) mentioned some reasons for tax audit which include, among others:

To assist the government in collecting appropriate tax revenue necessary for budget, maintaining economic and financial order and stability, to ensure that satisfactory returns are submitted by the tax payers, to minimise the degree of tax avoidance and tax evasion, to ensure strict compliance with tax laws by tax payers, to improve the degree of voluntary compliance by tax payers and to ensure that the amount due is collected and remitted to government.

#### **Objective of Tax Audit**

James (1993) identified a priority list of tax audit mission as follows:

To establish a viable and effective tax administration in order to deal with constantly changing economy, to put strategies in place in order to resolve tax dispute between the tax authority and the liable tax payers, to maintain a strong mechanism to deal with tax avoidance techniques which are available to various organisations, but are susceptible to tax abuse, to bring defaulting tax payers to the net of tax authorities, to prove the completeness, accuracy and timely filing of tax returns submitted by the tax payers.

#### **Tax Audit from an International Perspective**

Cremer (1990) concluded that “International tax laws have their domicile in their domestic tax laws of respective states (countries)”. Countries enact laws in order to enable their tax authorities to collect tax funds for public welfare and stimulation of domestic investment and business. From the explanation, it can be seen that the international taxation system has taken an important role in many countries of the world. The tax system is so important that world bodies were organised to deal with administration, collection and prevention of tax avoidance, tax evasion and double taxation of multinational corporations (MNCs). Therefore, an international tax audit is the examination of MNCs tax reports to ascertain compliance with applicable tax laws and regulations, domestic and foreign.

#### **Types of Audit Scheme**

Beck (1998) concluded that the audit scheme found in the tax compliance literature might be classified as: Random Tax Audit Scheme, Cut-Off Tax Audit Scheme and Conditional Tax Audit Scheme. The random tax audit scheme simply provides each self report of income an equal chance of being chosen for verification by an audit. No information is used to select the report to be audited. Under the cut-off audit scheme, audit resources are employed to verify reports of the tax payers reporting the lowest income levels. In contrast, the conditional audit scheme requires in addition to the reported income, sources of information representing a noisy signal of tax payers’ thorough income earning potentials. The cut-off and conditional audit schemes incorporated the preliminary information transmitted when tax payers self reports income and the corresponding tax liability.

#### **Theories of Tax Compliance**

Any strategy to prevent tax evasion should begin with the theory of why people cheat on their taxes. Naturally, much of it is unconvincing and ambiguous. Nevertheless, to give an indication of the full range of variables that social scientists have studied in an attempt to answer this question. The Forum on Tax Administration (2004) “identified some of the basic theories of tax compliance” which include, among others:

Economic theories, Psychological theories and Sociological theories

- i. **Economic Theories:** Economists approaching the question of why people fail to comply with the law began by constructing a theory based upon the assumption about human behaviour that underlies all economics; namely that individuals generally act rationally in evaluating the cost and benefit of any chosen activity. Consequently, in modelling the choice confronting individuals who are deciding whether to engage in tax evasion, their basic model assumes that people would commit evasion when the expected utility of their criminal act exceeds its expected disutility (Slemrod, 2000)
- ii. **Psychological Theories:** Many analysts have suggested that the economic model of human behaviour reflects a too simplistic view of human beings and, in the real world of everyday life, is without any predictive value. Like economists, psychologists also tend to explain human behaviour in terms of variables that relate to individuals. However, they tend to model human behaviour in much more complex terms than economists. Unlike economists, they would not think of modelling tax payers, in this context, as perfectly amoral, risk averse utility maximizers. Instead, they might be interested, as key independent variables, in tax evasion decision in factors such as: the individuals are moral beings with ideas and values of their own and that commands and their own impulses filter through and are affected by this moral screen (Slemrod, 2000)
- iii. **Sociological Theories:** Sociologists tend to see the cause of variation in human behaviour in the structure of the social system. Thus they explain people’s actions by examining the forces that impinge on the position that they occupy within the system. Among other things, this means that they extend the basic economic model of crime control by making the point that law is not the only source of punishment and rewards. Tax payers live and work in society. They have families, friends and co-workers who are sources of reward or punishment. These social forces shape behaviour just as effectively as the reward and punishments administered by the state. Given their basic assumptions about human behaviour, sociologists are also likely to look to attitudes towards government views relating to the enforcement of tax laws, views about the fairness of the tax system, contact with the tax department and demographic characteristics as independent variables (Slemrod, 2000). Beron (2002) is of the view that Social scientists from almost every discipline have turned their attention to tax evasion as social phenomena. What have we learned from their efforts? In a perfect world, by now we would have a theory about why people comply with the tax laws from which an interested tax administration department could deduce a comprehensive compliance strategy. However, compliance with the tax law typically means:  
True reporting of the tax base, Timely filing of the tax return, and Timely payment of the amount due (Slemrod, 2000).

### Monitoring Compliance

Erard (1994), (Besley, 1995) and (Andreoni, 1996), identified the following as a basis for monitoring compliance:

- i The primary goal of a revenue authority is to collect the taxes and due payable in accordance with the laws and to do this in such manner that will sustain confidence in the tax system and its administration. The action of tax payers – whether due to ignorance, carelessness, recklessness, or deliberate evasion – as well as weaknesses in tax administration – means that instances of failure to comply with the law are inevitable. Therefore, tax administration should have in place strategies and structures to ensure that non-compliance with tax law is kept to a minimum.
- ii Revenue authorities have a central role (and vested interest) in ensuring that tax payers and other parties understand their obligations under the revenue laws. For their part, taxpayers and others have an important role to play in meeting their obligations as in many situations.
- iii While the exact obligation placed on a tax payer is going to vary from one taxation role to another and from one jurisdiction to the next. Four broad categories of obligation are likely to exist for almost all tax payers, irrespective of jurisdiction. “Compliance” will essentially relate to the extent to which a taxpayer meets these obligations.

- iv These broad categories of taxpayer obligation are:
  - a. Registration in the system.
  - b. Timely filing or lodgement of requisite taxation information.
  - c. Reporting of complete and accurate information (incorporating good record keeping), and
  - d. Payment of taxation obligation on time.
- v If a tax payer fails to meet any of the above obligations, then he/she may be considered to be non-compliant. However, there are clearly different degrees of non-compliance.
- vi Giving tax payers incentives may have a positive effect on compliance behaviour (i.e. tax payers becoming more compliant), though this needs further explanation.
- vii Also, to ensure that tax payers understand their taxation obligation and find it easy to comply;
- viii Acting at all times with integrity and in a manner perceived to be fair and reasonable will encourage voluntary compliance;
- ix Enhanced capacity to influence tax payer’s compliance behaviour often comes through strategic alliances and partnerships with other agencies, industry bodies and tax advisers.
- x Strategies need to be applied in a way that demonstrates effective and efficient use of resources.
- xi Sustainable improvement in compliance can only be achieved by influencing and changing social and personal norms (Al Zakari, 1995).

**Reasons for Non Tax Compliance in Nigeria**

Usman (2008), mentioned some of the reasons behind non-tax compliance in Nigeria as follows: Lack of sufficient tax facilities for the relevant tax authorities, Influential tax dodgers are honoured and respected, Accident of history and cultural agencies, numerous taxes and levies, Extended family and tax system and Tax rates. Bello (2001), Beck (1998) same view but they argue on point number ii,

**METHODOLOGY**

The methodology adopted for this research work is the survey method and collected the data for the study through primary source only. The researcher administered 48 questionnaires to the staff of Bauchi State Board of Internal Revenue; some selected individuals tax payers and corporate bodies. The population of the study is the entire staff of Bauchi State Board of Internal Revenue; some selected individuals tax payers and corporate bodies within Bauchi State. However, the sampling technique adopted was the cluster sampling technique in which the respondents were divided into group. In this regard, the 48 questionnaires were distributed to the staff of Bauchi State Board of Internal Revenue; some selected individuals tax payers and corporate bodies on equal basis i.e.16 to each of them.

**RESULT AND DISCUSSION**

**RESULT OF THE QUESTIOONAIRES**

As explained above that the 48 questionnaires were distributed to the staff of Bauchi State Board of Internal Revenue; some selected individuals tax payers and corporate bodies, out of which 42 questionnaire were completed and returned.15, 13 and 14. The analysis is based on the 42 questionnaires received through the use of simple percentage with the option of “Agree or Disagree”

**Table 1: Responses of the questions**

QUESTIONS	Agree	Disagree	TOTAL
1. Tax audit is employed by Relevant Tax Authority (RTA) to achieved Target Revenue.	32	10	42
2. Tax audit solves the problems of tax evasion, avoidance and other irregularities.	34	8	42
3. Tax audit ensures the submission of accurate and current returns	42	-	42
4. The awareness of tax audit makes the tax payers to render a satisfactory returns	38	4	42
5. Suspicious about returns is what brings		12	42

about tax audit	30		
6. Tax payers co-operate during the audit exercise	10	32	42
7. Tax audit improves the level of compliance	29	13	42
8. Effective sanction on non-compliance with the tax rules and regulation	11	31	42
9. Skills of personnel conducting the tax audit	40	2	42
10. Equipment and adequacy of personnel conducting the tax audit	19	23	42

Source: Field Survey (2012)

**Table 2: Percentages of the Responses**

QUESTIONS	Agree %	Disagree %	TOTAL %
1. Tax audit is employed by Relevant Tax Authority (RTA) to achieved Target Revenue.	76	24	100
2. Tax audit solves the problems of tax evasion, avoidance and other irregularities.	81	19	100
3. Tax audit ensures the submission of accurate and current returns	100	-	100
4. The awareness of tax audit makes the tax payers to render a satisfactory returns	90	10	100
5. Suspicious about returns is what brings about tax audit	71	29	100
6. Tax payers co-operate during the audit exercise	24	76	100
7. Tax audit improves the level of compliance	69	31	100
8. Effective sanction on non-compliance with the tax rules and regulation	26	74	100
9. Skills of personnel conducting the tax audit	95	5	100
10. Equipment and adequacy of personnel conducting the tax audit	45	55	100

Source: Field Survey (2012)

**ANALYSIS ON THE RESPONSES**

On confirming whether or not the tax audit is employed by the Relevant Tax Authority (RTA) to achieved target revenue, 76% of the respondents agreed that the RTA employed the tax audit toward achieving targeted revenue, while only 24% of the respondents are on the position of disagree. Tax audit can be effective if its design in such away to eliminate the problems of tax evasion, tax avoidance and other tax irregularities. The study reveals that 81% of the respondents agreed that the tax audit reduce the problems of tax evasion, avoidance and irregularities in tax matters, while 19% of the respondents disagreed. For tax audit to take place effectively, tax payers most performed their duties toward the submission of accurate and currents returns of their operations. In this study, all the respondents agreed that tax audit ensure the submission of accurate and currents returns for proper computation of tax liability. Awareness on tax audit makes the tax payers to render proper and satisfactory returns to the RTA. The study also reveals that 90% of the respondents agreed that awareness on the tax audit is the main way that would make the tax payers to comply with the tax rules and regulation, while 10% of the respondents disagree. One of the reasons behind the conducting of a tax audit is the suspicious over the returns being submitted by the tax payers. In this regard, 71% of the respondents agreed that suspicious over the tax payers returns is another reason behind the tax audit, while 29% of the respondents disagree with the issue of suspicious of returns. Tax audit can also be effective if the tax payers are fully co-operated in the exercise. The study reveals that 76% of the respondents disagreed that the tax payers are not co- operating with the tax audit exercise and this can equally affect the objective

of the tax audit, while 24% of the respondents agreed that the tax payers co-operate. To some extent, the tax audit improves the level of compliance and at the same time reduces the level of non-compliance tax payers. It can be seen from the table that 69% of the respondents agreed that the tax audit improves the level of compliance of tax payers with the tax rules and regulation, while 31% of the respondents are of the position of disagree. Effective sanctions over the non-compliance with the tax rules and regulation will make them to comply. The research reveals that 74% of the respondents disagreed that there are no effective sanction on non-compliance of the tax rules and regulation, while only 26% of the respondents agreed that there are effective sanctions on non-compliance. Other things that will show the effectiveness of tax audit, is the issue of the skilled possessed by the personnel conducting the audit. The study also indicates that 95% of the respondents agreed that the personnel conducting the audit are skillful in the area of tax audit, while only 5% of the respondents are of different viewed. On confirming whether the personnel conducting the tax audit are adequate and well equip with necessary working materials. It reveals that 55% of the respondents disagreed that the personnel are not adequate and not equip, this can affect their efficiency on the work, while 45% of the respondents agreed that they are adequate and well equipped.

### **CONCLUSION AND RECOMMENDATION**

Based on the above data presentation and analysis, the following are the major findings of the research work:

1. The Relevant Tax Authority (RTA) employed tax audit towards achieving target revenue.
2. That the tax audit reduces the problems of tax evasion, tax avoidance and other tax irregularities.
3. That tax audit aimed at ensuring the submission of accurate and current returns for proper computation.
4. Awareness on tax rules and regulation increase compliance and reduce non-compliance tax payers.
5. That one of the reason behind the tax audit is the suspicious over the returns submitted by the tax payers.
6. Tax payers do not usually co-operate with the tax audit personnel during the exercise.
7. Tax audit improves the level of tax compliance by the tax payers.
8. No effective sanctions over the non-compliance tax payers with the tax rules and regulations.
9. That the personnel conducting the tax audit are skilful in the area of tax audit
10. That the tax audit personnel are not adequate and equipped with necessary working materials.

Based on the findings enumerated above, the following are some of the recommendations:

1. The RTA at all levels (Federal, State and Local Government) should improve the standard of tax audit employed for effectiveness and efficiency.
2. Tax audit should aim at reducing more problems of tax evasion, tax avoidance and other tax irregularities for standardisation.
3. The scope of tax audit should be wider in such a way that will ensure proper submission of accurate and current returns for proper computation.
4. The RTA should provide a policy to the public on the awareness of the importance of tax payment and the effect of non-tax payment, so that the level of compliance would be high and non-compliance will be low or even none.
5. The tax payers should have God fearing and submit the accurate returns of their operation.
6. RTA should also provide a policy that would allow the tax payers to co-operate during the period of tax audit and at the same time the tax payers should do their best toward cooperating with the tax audit personnel during the period of the exercise
7. RTA should also improve the standard of tax audit personnel so that they can highly improve the level of tax compliance by the tax payers.
8. There should be effective sanctions by RTA over the non-compliance tax payers with the tax rules and regulation.
9. RTA should provide a regular seminar and symposium to the tax audit personnel for improving their efficiency and effectiveness.
10. The RTA should employ more qualify tax audit personnel and equipped them with necessary working materials, so that they can improve their efficiency.

### **REFERENCES**

Al Zakari, I. A. (1995), Corporate Tax Compliance: A Case Study of Saudi Arabia, University of New Mexico, Ph.D.

Andreoni, T.H. (1996), Tax Compliance, University of Wisconsin Working Paper, No.

9610.

- Beck, P. (1998). "Tax Payers Compliance Under Uncertainty". *Journal of Accounting and Public Policy*. 8(1): 1-27.
- Bello, T. (2001). *The role of taxation in Nigerian Economy (a case of Kano State Board of Internal Revenue)*, MBA unpublished project, Department of Accounting BUK Kano, Nigeria.
- Beron, K.T. (2002), 'The Effect of Audits and Socioeconomic Variables on Compliance', in Slemrod, Joel (ed.), *Why People Pay Taxes: Tax Compliance and Enforcement*, Ann Arbor, University of Michigan Press, 67-89.
- Besley, T. M. (1995), *Fiscal Anarchy in the U.K. Modelling Poll Tax Noncompliance*, National Bureau of Economic Research Working Paper, No. 4498
- Daniel, G. J. (1999), *Public Sector Accounting*. Zaria: ABU Press Ltd.
- Cremer, H. M. (1990), *Evading, Auditing and Taxing*. *Journal of Public Economics*, 43: 67 – 92.
- Erard, B. (1994). "Honesty and Evasion in the Compliance Game". *The RAND Journal of Economics* 25(1): 1-19
- Forum on Tax Payers Administration (2004). *Managing and Improving Tax Compliance*. New York, USA.
- Frank, C. (2010), *Tax Compliance by Firms and Audit Policy*. University of Adelaide, London.
- James, A. (1993), *Tax Compliance and Administration*. Andrew Young School of Policy Studies, Georgia State University.
- Jin Kwan, A. (2004), *Tax Compliance in Korea*. Ajun University, South Korea.
- Kircher, E. E. (2008). "Enforced versus Voluntary Tax Compliance: The Slippery Framework". *Journal of Economic Psychology*. 29(2): 210 – 225.
- Luigi, A. (1999), *Tax Evasion and Compliance*. University of Bologna, Italy.
- Oyebanji, J.O. (2006), *Principles And Practice of Taxation in Nigeria*. Frontline Publishers Adesola Ibadan, Nigeria 3<sup>rd</sup> Edition.
- Usman, S. (2008), *Tax Compliance in Nigeria*. Federal Polytechnic Jigawa, *Accounting Journal*, 21-28.
- Slemrod, J. (2000), 'Why People Pay Taxes: Introduction', in Slemrod, Joel (ed.), *Why People Pay Taxes: Tax Compliance and Enforcement*, Ann Arbor, University of Michigan Press, 1-8.

Yongzhi, N. (2005), *Tax Audit Impact on Voluntary Compliance*. *Economics Journal*, 93 – 107.

#### **ABOUT THE AUTHOR**

Mu'azu Saidu Badara is a lecturer with the Department of Accounting, Abubakar Tatari Ali Polytechnic Bauchi State. An a Member of Association of National Accountant of Nigeria (ANAN), Member of National Institute of Management (NIM).

This academic article was published by The International Institute for Science, Technology and Education (IISTE). The IISTE is a pioneer in the Open Access Publishing service based in the U.S. and Europe. The aim of the institute is Accelerating Global Knowledge Sharing.

More information about the publisher can be found in the IISTE's homepage:

<http://www.iiste.org>

The IISTE is currently hosting more than 30 peer-reviewed academic journals and collaborating with academic institutions around the world. **Prospective authors of IISTE journals can find the submission instruction on the following page:**

<http://www.iiste.org/Journals/>

The IISTE editorial team promises to review and publish all the qualified submissions in a fast manner. All the journals articles are available online to the readers all over the world without financial, legal, or technical barriers other than those inseparable from gaining access to the internet itself. Printed version of the journals is also available upon request of readers and authors.

### **IISTE Knowledge Sharing Partners**

EBSCO, Index Copernicus, Ulrich's Periodicals Directory, JournalTOCS, PKP Open Archives Harvester, Bielefeld Academic Search Engine, Elektronische Zeitschriftenbibliothek EZB, Open J-Gate, OCLC WorldCat, Universe Digital Library, NewJour, Google Scholar

