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The Effect of Tax Compliance on Economic Growth and Development in Nigeria, West-Africa

Akintoye, I.R
College of Management & Social Sciences
Osun State University, Osogbo, Osun State, Nigeria

Tashie, G.A
Department of Business Education(Accounting)
Federal College of Education, Akoka, Lagos, Nigeria
irakintoye@yahoo.com

Abstract

The study examined the effect of Tax compliance on economic growth and development in Nigeria. Tax compliance here is proxied in willingness of the citizens to pay tax. This is because tax revenue is an important instrument for economic growth and development in many developing economies like Nigeria, since the internal revenue generated through taxes go a long way in providing funds for the provision of public goods. It also gave an insight into the factors that influence the willingness of citizens to comply. A comparative analysis of the willingness to pay tax by citizens in two(2) large States of the Federation, Lagos and Oyo State was presented. Primary data was collected through the administering of questionnaires to self employed in each senatorial district in Oyo and Lagos States. Frequencies and percentages were used to measure the demographic variables of the respondents, and also the factors that affect the willingness to pay tax, while the Chi-square technique was used to measure the difference between willingness to pay tax of citizens in Lagos and Oyo States.

It was discovered that many Nigerians are complying with tax payment and that the willingness of citizens to pay tax in Lagos State is significantly higher than that of Oyo State. From the list of factors that were tested for, Trustworthiness of government, Provision of Infrastructural Amenities, Tax Accountability by Government, Level of government delivery, Income, Morale Ethics, Tax Knowledge, Tax Rate, and The System of Tax Payment were found to influence the willingness to pay tax. The conclusion is that compliance through the willingness of citizens to pay tax is very important and cannot be ignored. It is suggested that government should pay attention to the factors that influence the willingness of citizens to pay tax and improve on them, thereby improving peoples' willingness to pay tax, government revenue and economic growth and development of the nation generally.

***Keywords**:* Tax Compliance, Economic Growth, Tax knowledge, Accountability, Tax Rate.

Introduction

The importance of taxation in the activities of any government cannot be overemphasized. The world over, taxes is one major source of government revenue, however, not every national government have been able to effectively exploit this great opportunity of revenue generation. This can be attributed to a number reasons including the system of taxation; tax legislation; tax administration and policy issues; over reliance on other sources of revenue (such as foreign aid and grants); corrupt practices in the system – especially as it relates to the system of tax collection and behaviour of citizens towards tax payment; and ease of tax payment.

The willingness to pay tax, which may depend on the other aforementioned issues in tax-revenue generation, remains a key taxation-challenge in Nigeria. In the ease of tax payment, evidence from the World Bank Doing Business Report 2011 and 2012, show that Nigeria ranked 109 and 138, respectively, out of 183 countries; in Sub-Saharan Africa (SSA), it ranked 27 out of 46 countries. This result is, despite some improvements the government has made to the tax system in the recent past.

The Federal Inland Revenue Service (FIRS), for instance, which was first established as an operational arm of the Federal Board of Inland Revenue (FBIR) in 1993 but autonomous in 2007, was saddled with the responsibility of controlling and administering different taxes as well as accounting for all taxes collected. Another innovation by the government is the Tax Identification Number (TIN) programme, which has objective of carrying out a successful roll-out and implementation of TIN for Nigeria. The system developed a relational data base linked to all relevant stake holders in Nigerian tax administration. There is also the Joint Tax Board (JTB), amongst others, which are set up to address problems of the tax policies and its implementation, tax collection, and the tax payers' compliance in the country.

Thus, an integral part of the tax system is the people's attitude towards tax payment. Further evidences that affect willingness will include multiplicity of taxes that is, paying similar taxes on the same or substantially similar tax base, ineffective and inefficient tax collection structure, poor tax awareness, tax transparency and tax accountability. The issues raised have implications on the willingness to pay tax in Nigeria, with the indirect effects on actual revenue generated from taxation. The end-point implication of strong unwillingness to pay tax is a crippled government that is unable to implement its growth and development objectives.

The significance of the willingness to pay is also better related in the case of the informal sector, where the government is limited in terms of monitoring their affairs. The willingness of the people is what will speak for the government concerning tax payment. The peoples' willingness is greatly influenced by their perception of the governments' delivery.

Theoretical consideration on Compliance

According to Azubike (2009), tax is a major player in every society of the world. The tax system is an opportunity for government to collect additional revenue needed in discharging its pressing obligations. A tax system offers itself as one of the most effective means of mobilizing a nation's internal resources and it lends itself to creating an environment conducive to the promotion of economic growth. Tax is a compulsory levy imposed on a subject or upon his property by the government to provide security, social amenities and create conditions for the economic wellbeing of the society (Appah, 2004; Appah and Oyandonghan, 2011). Anyanwu (1997) defined taxation as the compulsory transfer or payment (or occasionally of goods and services) from private individuals, institutions or groups to the government. Anyanfo (1996) and Anyanwu (1997) stated that tax are imposed to regulate the production of certain goods and services, protection of infant industries, control business and curb inflation, reduce income inequalities etc. The main purpose of purpose of tax is to raise revenue to meet government expenditure and to redistribute wealth and management of the economy (Ola, 2001; Jhingan, 2004; Bhartia, 2009).

Nzotta (2007) presented four key issues to be understood for taxation to play its functions in the society. First, tax is a compulsory contribution made by the citizens to the government and for the general common use. Secondly, a tax imposes a general obligation on the tax payer. Thirdly, there is a presumption that the contribution to the public revenue made by the tax payer may not be equivalent to the benefits received. Finally, a tax is not imposed on a citizen by the government because it has rendered specific services to him or his family. Thus, it is evident that a good tax structure plays a multiple role in the process of economic development of any nation which Nigeria is not an exception (Appah, 2010a). Musgrave and Musgrave (2006) note that these roles include: the level of taxation affects the level of public savings and thus the volume of resources available for capital formation; both the level and the structure of taxation affect the level private saving. A system of tax incentives and penalties may be designed to influence the efficiency of resource utilization; the distribution of the tax burdens plays a large part in promoting an equitable distribution of the fruit of economic development; the tax treatment of investment from abroad may affect the volume of capital inflow and rate of reinvestment of earnings there from; and the pattern of taxation on imports relative to that of domestic producers affect the foreign trade balance.

Nwezeaku (2005) argues that the scope of these functions depends, inter alia, on the political and economic orientation of the people, their needs and aspirations as well as their willingness to pay tax. Thus, the extents to which a government can perform its functions depend largely on the ability to design tax plans and administration as well as the willingness and patriotism of the governed.

In a study carried out by Torgler (2011), examining the impact of tax morale on tax compliance, he states that over the last several decades, there has been a growing interest in theoretical, empirical, and experimental work on all aspects of tax compliance and tax evasion. A common theme in much of these works is that the traditional economics-of-crime approach to compliance, while containing many insights, is simply inadequate as a framework for more fully understanding why people pay taxes. Rather, the basic model of individual choice must be expanded by introducing some aspects of behaviour or motivation considered explicitly by other social sciences. Many of these aspects can be discussed under the general rubric of behavioural economics, broadly defined as an approach that uses methods and evidence from other social sciences to inform the analysis of individual and group decision making. The question of why so many people pay their taxes, despite low fine and audit probabilities, has become a central issue in the tax compliance literature. Erard and Feinstein (1994) stress the relevance of integrating moral sentiments into the models to provide a reasonable explanation of actual compliance behaviour.

Trend Analysis of Government Revenue

Nigeria is governed by a federal system; hence its fiscal operations also adhere to the same principles. This has serious implications on how the tax system is managed in the country. In Nigeria, the government fiscal power is based on a three tiered tax structure divided between the Federal, State and Local government, each of which has different tax jurisdictions, as discussed above. As of 2002, about 40 different tax and levies is shared by all three levels of government.

The Nigerian tax revenue is lopsided - dominated by oil revenue. The most veritable tax handles are under the control of the federal government, while the lower tiers are responsible for the less buoyant ones- the federal government taxes corporate bodies while state and local government tax individuals. While the federal government on average accounts for 90% of the overall revenue annually, it only accounts for 70% of total government expenditure. In 1995, the breakdown of total tax and levy collection of the three tiers of government was 96.4% for the federal government, 3.2% for the state and 0.4% for the local government (Phillips 1997). A major element contributing to this development was the prolonged military rule that had ignored constitutional provision.

Over the past four decades, the country's revenues were largely derived from primary products. Between 1960 and the early 1970s, revenue from agricultural products dominated, while revenue from other sources was considered as residual. Since the oil boom of 1973/4 to date, however, oil has dominated Nigeria's' revenue structure, and its share in federally collected revenue rose from 26.3% in 1970, to 81.8%, 72.6%, and 76.3% in 1979, 1989 and 1999 respectively. Over the past two decades, oil has accounted for at least 70% of the revenue, thus indicating that traditional tax revenue has never assumed a strong role in the country's management of fiscal policy. Instead of transforming or diversifying the existing revenue base, fiscal management has merely transited from one primary product based revenue to another, making the economy susceptible to fluctuations of the international oil market. (Odusola, 2006).

Tax Policy Reforms and Institutional Development

The need to address the problem of low tax returns motivated the Federal government to embark on a number of reforms to existing tax laws. According to Alli (2009), the objectives of tax reforms in Nigeria include: to bridge the gap between the national development needs and the funding of the needs; to ensure taxation, as a fiscal policy instrument, to achieving improved service delivery to the public; to improve on the level of tax derivable from non-oil activities, vis-à-vis revenue from oil activities; efforts at constantly reviewing the tax laws to reduce/manage tax evasion and avoidance; and to improve the tax administration to make it more responsive, reliable, skilful and taxpayers friendly and to achieve other fiscal objectives.

The Nigerian tax system has experienced series of reforms since 1904 to date. The effects of the various reforms in the country are as follows:

1. The introduction of income tax in Nigeria between 1904 and 1926.
2. The grant of autonomy to the Nigerian Inland Revenue in 1945.
3. The Raisman Fiscal Commission of 1957.
4. The formation of the Inland Revenue Board in 1958.
5. The promulgation of the Petroleum Profit Tax Ordinance No. 15 of 1959.
6. The promulgation of Income Tax Management Act 1961.
7. The establishment of the Lagos State Inland Revenue Department.
8. The promulgation of the Companies Income Tax Act (CITA) 1979.
9. The establishment of the Federal Board of Inland Revenue under CITA 1979.
10. The establishment of the Federal Inland Revenue Service between 1991 and 1992.

11. The tax policy and administration reforms amendment 2001 and 2004. And also the most current amendment of the Personal Income Tax Act, 2011.

Another reform embarked upon by the Nigerian government was instituting the Study Group on the Nigerian Tax System. This group was inaugurated on the 6th of August, 2002, to examine the tax system and make appropriate recommendations towards entrenching a better tax policy and improved tax administration in the country. This group consists of individuals from business, academia, and the government.

There is also the Chartered Institute of Taxation of Nigeria (CITN), established in 1982 and Chartered by Act No. 76 of 1992 to regulate tax practice and administration in the country, and to this extent a major stakeholder in the Nigerian tax system.

To understand the importance of tax policy reforms, one needs to appreciate the urgency for such reforms. First, there is a compelling need to diversify the revenue portfolio for the country in order to safeguard against the volatility of crude oil prices and to promote fiscal sustainability and economic viability at lower tiers of government. Second, Nigeria operates on a cash budget system, where proposals for expenditure are always anchored to revenue projections. This facilitates determining the optimal tax rate for a given level of expenditure. Thus accuracy in revenue projection is vital for devising an appropriate framework for sustainable fiscal management, and this can be realized only if reforms are undertaken on existing tax policies in order to achieve some improvement.

Third, Nigerian tax system is concentrated on petroleum and trade taxes while direct and broad-based indirect taxes like the value-added (VAT) are neglected. This is a structural problem for the country’s tax system. Although direct taxes and VAT have the potential for expansion, their impact is limited because of the dominance of the informal sector in the country. Furthermore, the limited formal sector is supported with strong unions that act as pressure groups to deter any appreciable tax increment from gross income. Fourth, the widening fiscal deficit that over the years has threatened macroeconomic stability and prospects for economic growth makes the prospect of tax reform very appealing.

Nigeria’s fiscal policy measures have been largely driven by the need to promote certain macroeconomic objectives as promoting rapid growth of the economy, generating employment, maintaining price levels and improving the balance-of-payment conditions of the country. Although policy measures change frequently, these objectives have remained relatively constant. Until the mid 1980s, tax policies, for instance, were geared to achieving such specific objectives as:

i) Ensuring effective protection for local industries;

ii) Encouraging greater use of local raw materials;

iii) Enhancing the value added of locally manufactured and primary products;

iv) Promoting greater geographical dispersion of domestic manufacturing activities; and

v) Generating increased government revenue.

As regards institutions relevant to the tax system, it is noted that the efficiency of a country’s institution has significant bearing on its operations. For instance, between 1999 and 2002, FIRS accounted for 74.5 per cent of federal revenue while the NCS collected the balance. For efficient operations, the federal tax organizations should comprise the following (Study Group on Tax Reform, 2003):

(i) Federal Inland Revenue Services (FIRS) with responsibility for income and other inland taxes, VAT excluded;

(ii) Value-added tax services, responsible for VAT;

(iii) NCS (Nigeria Custom Services) for custom and excise duties; and,

(iv) JTB (Joint Tax Board) for harmonizing income tax at the three tiers of government; managing the national database, and serving as a clearinghouse for inter-state tax flows.

Two models that have been applied in analyzing the benefit approach are: the Lindahl and Bowen models.

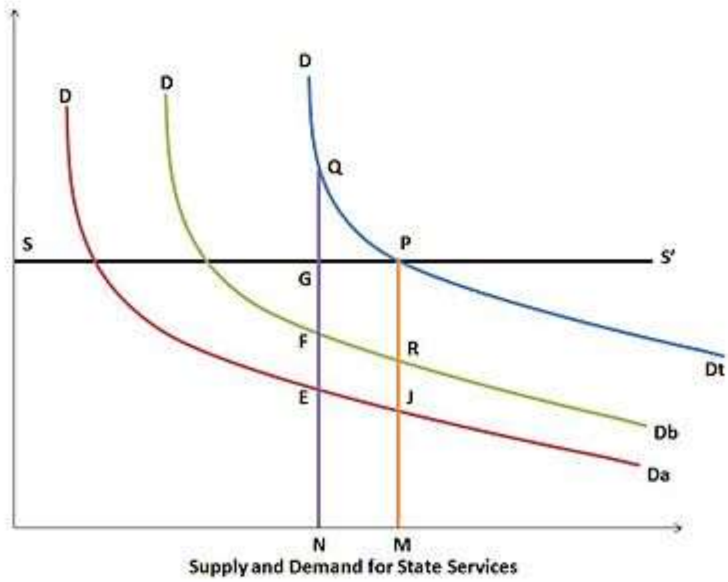
(1) Lindahl's model

This theory is discussed in the context of two tax payers who are free to reveal their preferences for state services against corresponding tax liability. It is a kind of voluntary exchange between the taxes paid and state services received. Lindahl tries to find out a solution for the following three problems:

i. the decision regarding the extent of state activity
ii. allocation of the total expenditure amongst various goods and services
iii. allocation of tax burden among tax payers

The model is explained using the geometry below:

Figure 3: Lindahl's Model

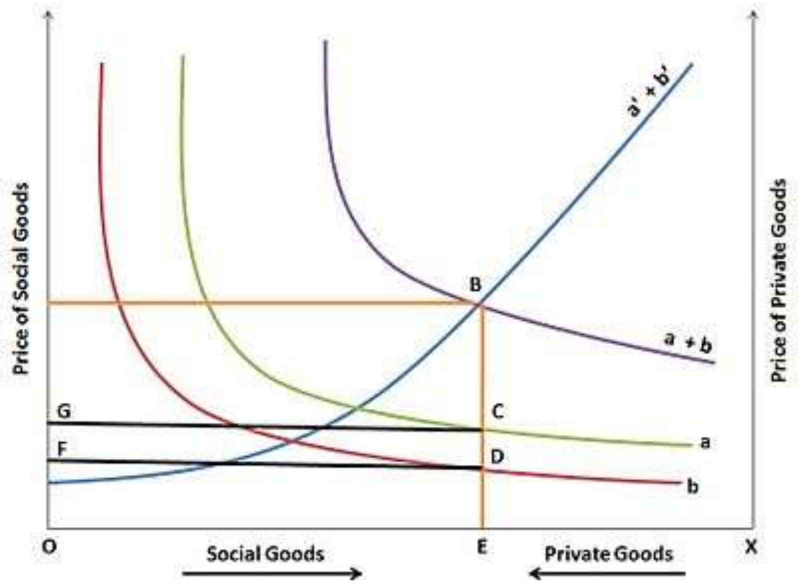


SS is the supply curve of the state services. Lindahl assumes production of social goods as linear and homogenous. DDa is the demand curve of A, and DDb is the demand curve of B. By vertical summation of two demand curves we get the community's demand schedule for state services. Both A and B pay different proportions of the cost of the good. When ON amount of the state services is produced, A contributes NE and B contributes NF. Now, the cost of supply is NG. Since the state is not a profit maker, it increases its supply up to OM. At this level, A contributes MJ and B contributes MR which when combined, equals the cost of supply. So equilibrium is obtained at point P on a voluntary exchange basis. The Lindahl model gives simultaneous determination of the extent of the provision of social goods and the tax shares of the individuals.

(2) Bowen's model

Bowen's approach is favoured for having the most operational significance. It has the virtue of easy adaptation to show what happens social goods are produced under conditions of increasing costs, the opportunity cost of private goods foregone. This is captured in the geometry below.

Figure 4: Bowen;s Model



We have one social good and two tax-payers A and B. The demand of A and B for social goods are represented by 'a' and 'b' and a+b is the total demand for social goods. The supply curve is shown by a'+b' indicating that these goods are produced under the conditions of increasing cost. But the cost of producing of social goods is the value of private goods foregone. This means, a'+b' is also the demand curve of private goods. The intersection of the cost and demand curves at B gives us the determination of how a given national income should, according to tax-payers desire be divided between social and private goods. Hence there should be OE social goods and EX private goods. Simultaneously, the tax shares of A and B are also determined through their individual demand schedules. Total tax requirement is area (ABEO) out of which A is willing to pay GCEO and B is willing to pay FDEO.

Data Presentation, Analysis and Interpretation

From the 300 questionnaires administered, 112 respondents, with a mean score of 60.0625, are less willing to pay tax, while 188 with a mean score of 76.6649, are more willing to pay tax and complying. Hence, it could be implied that more of Citizens in Nigeria are willing to pay tax and complying, drawing from the Lagos and Oyo State study.

The result reveals this glaring difference in the Willingness to pay Tax by Citizens of Lagos and Oyo States. Citizens in Lagos State with a mean score of 73.0400 are more willing to pay tax than Citizens in Oyo State with a mean score of 67.8933.

Our findings reveals Tax Knowledge as an influencing factor on Willingness to pay Tax: 75% (42% + 33%) of the respondents agreed to their perception of the importance and essence of tax affects my willingness, 73% (44% + 29%) of the respondents agreed to their knowledge of what tax is being an influencing factor on willingness to pay tax, while, 70.4%

(43.7% + 26.7%) of the respondents agreed to how much they know about how to go about paying their tax being an influencing factor on their willingness to pay tax. This then implies that majority of the respondents agreed to tax knowledge as an influencing factor on willingness to pay tax.

Among factors discovered to affect compliance and willingness to pay, Taxpayer's perception of the essence of tax has a mean value of 3.8, knowledge of various taxes 3.79 and understanding the payment system 3.75.

120(40.0%) of the respondents disagreed, 31(10.3%) were undecided while 149(49.6%) agreed to the system of tax payment operated in Nigeria being an influencing factor on willingness to pay tax. 59(19.7%) of the respondents disagreed, 19(6.3%) were undecided while 222(74.0%) agreed that morale ethics is an influencing factor on willingness to pay tax. 49(16.4%) of the respondents disagreed, 21(7.0%) were undecided while 230(76.7%) agreed that income is an influencing factor on willingness to pay tax.

75(25.0%) of the respondents disagreed, 23(7.7%) were undecided while 202(67.3%) agreed to tax rate as an influencing factor on willingness to pay tax. 26(8.6%) of the respondents disagreed, 14(4.7%) were undecided while 260(86.6%) agreed with provision of infrastructural facilities as factoring influencing tax compliance. 20(6.7%) of the respondents disagreed, 21(7.0%) were undecided while 259(86.4%) agreed to tax while 86% (31.7% + 54.3%) agreed that their willingness to pay tax is influenced by how well government is able to meet their expectations, 5.7% were undecided, while 8.3% disagreed. 83% (38% + 45%) agreed that the low level of government delivery on promises made influences their willingness to pay tax. 76.7% (44.7% + 32%) agreed that government being wasteful with tax proceeds influence their willingness to pay tax influencing on willingness to pay tax.

Summary of Findings and Recommendation.

It was discovered that many Nigerians are complying with tax payment and that the willingness of citizens to pay tax in Lagos State is significantly higher than that of Oyo State. From the list of factors that were tested for, Trustworthiness of government, Provision of Infrastructural Amenities, Tax Accountability by Government, Level of government delivery, Income, Morale Ethics, Tax Knowledge, Tax Rate, and The System of Tax Payment were found to influence the willingness to pay tax.

The conclusion is that compliance through the willingness of citizens to pay tax is very important and cannot be ignored. It is suggested that government should pay attention to the factors that influence the willingness of citizens to pay tax and improve on them, thereby improving peoples' willingness to pay tax, government revenue and economic growth and development of the nation generally, lending credence to the Lindahl and Bowen models showing relationship between tax revenue and economic growth and development. These factors can be summarized as

- Trustworthiness. Hence the government should pay attention to encouraging the citizens to build trust in them. And to do this, Tax Accountability by government is very crucial, and so also, a high level of delivery on the promises made by the government. The system of taxation should be transparent, and the government should be honest with the use of tax proceeds.
- Provision of infrastructural and social amenities. Because the idea is that, if individuals have to provide their electricity and water themselves, suffer bad roads and live from the fear of accidents, and more, why will they be willing to pay tax. In order to encourage voluntary tax compliance, government needs to be more responsible to the needs of the citizens and
- Tax awareness.

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