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Much Ado About Nigeria's Taxes

INTRODUCTION

Why do governments impose taxes? The answer to this question at first glance seems obvious; it is a monetary charge imposed by the Government on persons, entities, transactions or properties to yield revenue.[1]

In other words, taxes are compulsory, unrequited payments to general government.[2]

It is however not that simple. There are different reasons why tax is imposed apart from enabling government raise revenue for financing public goods and infrastructure.

Tax is not a voluntary payment made by individuals to the government, it is enforced compulsorily pursuant to the government's legislative authority.

According to then Governor Fashola, the philosophy underpinning taxation is that the expenses of government, being for the general good, ought to be borne by the public generally.[3]

The objectives of a tax system are to encourage domestic and foreign investment and to create employment, among others.

A tax system should also be able to promote fiscal responsibility and accountability, address inequalities in income distribution, and correct market failures and imperfections,[4] as well as provide social security benefits.

Taxation is therefore a veritable tool for national development. Taxes do not only provide sustainable revenue for Government to carry out its activities and provide development to its citizens, it also puts citizens in the role of stakeholders, who are directly contributing to national development.[5]

Through its impact on investment and capital formation in the economy, taxation policies are not only a major source of revenue for Governments but can also help in the stimulation of economic growth and job creation.

Economist Adam Smith attempted to outline the rules that should govern a rational system of taxation in the book the Wealth of Nations;[6] first published in 1776. These canons remain relevant today.

These canons laid down by Adam Smith have been redefined today to translate to a number of broad tax policy considerations that have traditionally guided the development of taxation systems.[7] These include neutrality, efficiency, certainty and simplicity, effectiveness and fairness, as well as flexibility.

Tax systems should be fair and neutral across all forms of business activities; it should therefore seek to raise revenue without discriminating against particular economic choices. The business costs of complying to tax systems and government administrative costs should be at the minimum as far as possible.

In order for a taxpayer to make optimal business decisions in line with the tax regime of a jurisdiction, the rules should be as clear and as simple as possible. Tax systems should also ensure that the ability to evade or avoid paying taxes is reduced, in order for the system not to be viewed as being ineffective.

A tax system that sufficiently complies with these policy considerations will meet the conditions for a healthy public finance.

A country's right to tax individuals and corporations is founded on its sovereignty. The 1999 Constitution of the Federal Republic of Nigeria places the responsibility for legislating on taxation on Income, Capital Gains and Stamp duty on the Federal Government.[8]

The Nigerian Government generates revenue from proceeds of sale of crude oil, taxes, penalties, interests, fines, charges and other earnings received from Government investments (bonds, dividends etc.)

The over-reliance on revenue from the proceeds of sale of crude oil meant that the Nigerian Government more or less paid no attention to the effectiveness of its tax authorities in fulfilling its mandate.

Not only was taxation as a means of revenue ignored, the other areas of the economy suffered as a result also. The revenue generated from oil was not used to diversify the economic base.

The sale of crude oil accounted for over 60 per cent of the nation's Gross Domestic Product in 2016[9] as opposed to revenue from taxes that amounted to just 6 per cent of the Gross Domestic Product,[10] one of the lowest in the world – South Africa, in comparison had a tax to Gross Domestic Product ratio of 27.3 per cent in the same period.[11]

Nigeria, one of Africa's top oil producers,[12] derived 95 per cent of export earnings and 70 per cent of government revenue from the oil sector.[13]

This overdependence on oil revenue crumbled the economy. It was attributed as the reason for the economic recession the nation faced in late 2015 and all of 2016.[14]

When Nigeria's current government took office in 2015 it discovered it had a mountain to climb. Alleged systemic corruption under the previous administration had depleted the public finances. This meant that when the oil price plummeted, Nigeria was hit hard.[15]

Interestingly, this overdependence on a particular product is not new to Nigeria, as the Nigerian economy depended largely on agricultural products before oil was discovered in commercial quantities in the 1950s. It is this overdependence on a single commodity that the Government has tried to eliminate through diversification.

There is also a fear about how much longer world oil reserves would last, with there being unanimity that global demand is on the rise.

According to estimates from the International Energy Agency, consumption will rise from 85 million in 2007 to about 113 million barrels per day by 2030. It is only logical that the increase in demand will affect global reserves even in the most endowed countries.[16]

There was therefore a need to increase the non-oil revenues. The government in 2015 embarked on a diversification of the economy in order to generate revenue, with sectors like agriculture, mining and steel development and taxation being given more attention than in the past.

In present day Nigeria, as with almost everywhere else, there are two different categories of taxes; direct or indirect, and they are levied on individuals, corporations, assets and transactions depending on the type.

There are different types of taxes that fall into the categories listed above. The most important taxes in Nigeria are imposed on the following basis:

Personal Income Tax (PIT) imposed on citizens and residents who derive income inside and outside Nigeria. Corporate Income Tax (CIT) imposed on the profits of all corporate entities who derive income from Nigeria, except those that engage in petroleum operations. Petroleum Profits Tax (PPT) imposed on profits of all corporate entities that derive income from oil and gas operations. Education Tax imposed on all corporate entities registered in Nigeria. Value Added Tax (VAT), Capital Gains Tax (CGT), Stamp Duty, Excise Duty and Withholding Tax imposed on transactions.

Before the country came out of a recession in 2017, the FIRS was almost charged with the mandate of getting the country out of this recession by generating revenue through taxes.

Previous governments at all levels relied heavily on revenue from oil thereby neglecting revenue from tax in the process. With the fall in oil prices[17] and the economy of the country slipping into a recession, arguably due to this over reliance, it became clear that revenue from oil was not sustainable.

The Government needed to generate revenue from other sources, taxation became one of these sources. The Ministry of Finance hoped to increase tax to GDP ratio from 6 per cent in 2017 to 15 per cent by 2020.[18]

The benefits of taxation are enormous. Revenue from taxation is more reliable and predictable, once tax- to-GDP ratio in a country reaches 12.5 per cent, real GDP per-capita increases sharply.[19]

But it is not without its challenges, especially in a country where the rate of compliance has been historically very low.

According to the Joint Tax Board of Nigeria, which comprises all the chairmen of the tax authorities of the 36 States and chaired by the Executive Chairman of the FIRS, there were 10 million people registered for personal income tax purposes in the country in 2017. One state, Lagos, had 46 per cent of this number registered, with an average of 1.5 per cent per state for the other 35 states.[20]

The National Bureau of Statistics estimated the country's labour workforce at about 77 million, this means about 67 million people did not pay income taxes.[21]

Ironically even government, as the largest employer was not fully compliant in deducting and remitting taxes on the salaries of its workers. [22]

It was reported that 75 per cent of registered companies were not in the tax net while 65 per cent of those in the tax net do not pay taxes. [23]

The Minister of Finance disclosed that about 363,000 companies had been discovered as never paying taxes, thereby evading several billions of Naira in taxes.[24]

The situation is not any better in respect of VAT as there was only a 12 per cent compliance rate in 2016, and this figure only considers the registered entities filing returns and remitting VAT,[25] it is believed that the figure would be lower if unregistered entities are taken into account.

There is no doubt that Nigeria suffers from low tax rates as well as low tax compliance. VAT at 5 per cent until 2020 was one of the lowest in the world;[26] neighbouring Ghana is at 15 per cent.[27]

The FIRS, as far back as 2007, recommended an increase in the VAT rate to 7.5 per cent in order to shore up non-oil revenue and to ensure that Nigeria's tax policy was consistent with other countries in the region whose VAT rate was far higher than 5 per cent.[28]

Although increased to 10 per cent by a ministerial directive effective from 23rd May 2007, it was reversed by the government due to pressure from the organised private sector and members of the public, who questioned the authority of the Minister of Finance to perform such action by virtue of the VAT rate being provided for by a principal legislation.[29]

Following the implementation of the new Finance Act 2020, on February 1st 2020, however, the VAT rate was increased from 5 per cent to 7.5 per cent. This increase was executed to increase revenue for Nigeria.

The National Bureau of Statistics stated that Lagos State, the commercial capital of the country, accounted for 40 per cent of the total revenue collected by all the states in 2015. It collected N268 billion, more than 32 states combined, the nearest state in revenue generation only collected N82 billion. By June 2017, only 214 people in the entire nation paid taxes of more than N20 million, all of which are in in Lagos. [30]

South Africa, in comparison, which is a smaller country with less people, collected more revenue from tax than Nigeria did. [31]

There is massive room to improve tax receipts by improving compliance and broadening the tax base to include the informal sector, which is estimated at 58 per cent of GDP.[32]

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