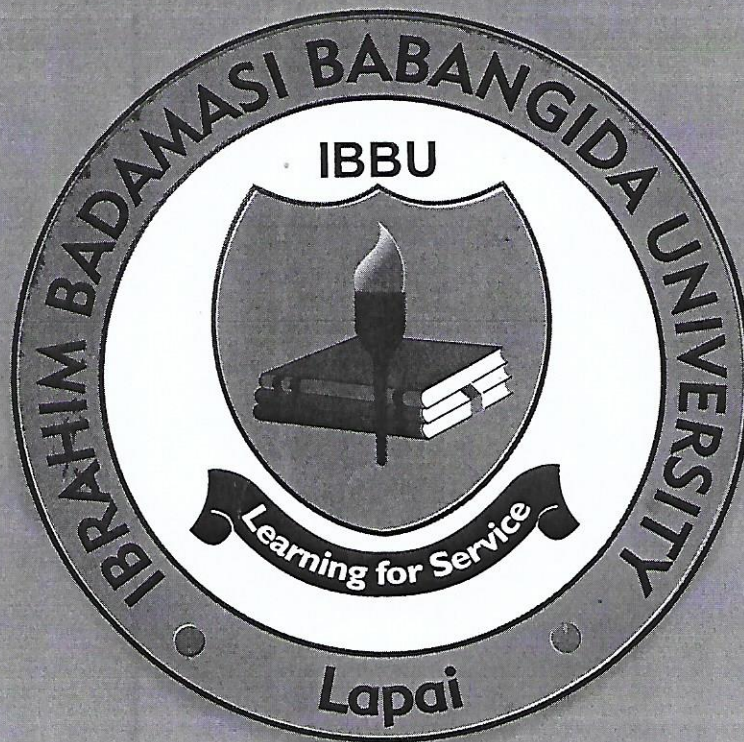


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EFFECT OF TAX RATE, TAX AVOIDANCE AND TAX EVASION ON REVENUE GENERATION IN NIGERIA

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ABSTRACT

The shift from dependence on oil revenue to internally generated revenue (IGR) of which tax constitutes a huge proportion to finance developmental functions in Nigeria has not yielded the required results due to draw down on the country's revenue base by tax rate, tax avoidance and tax evasion practices. This study, therefore, evaluates the effect of these dominant factors (tax rate, tax avoidance and tax evasion) on company income tax revenue in Nigeria, using survey method via the instrument of questionnaire on a sample of 396 employees of Federal Inland Revenue Service in Nigeria. The reliability confirmatory test yielded 0.81 and 0.78 coefficients (Cronbach Alpha) for dependent and independent variables respectively while hypotheses of significant relationships between and among the dominants factors and companies income tax revenue were tested using analysis of variance (ANOVA) model. The study finds a significant tax evasion and tax avoidance practices among Nigerian companies while the prevailing tax rate has been adjudged fairly high which has resulted into negative significant impact on tax revenue. The study also reveals lack of transparency on the use of tax revenue which fuels more tax evasion and tax avoidance practices. It was, therefore, recommended that tax rate should be lowered while Nigerian government should demonstrate accountability and transparency in the utilization of company income tax revenues on developmental functions with a view to discourage tax avoidance, tax evasion and boost government revenue base as well.

Key words: Company Income Tax, Tax Revenue, Tax Evasion, Tax Avoidance.

1.0 INTRODUCTION

In Nigeria, as well as other countries of the world, governments at all levels need substantial amount of revenue to finance their statutory and conventional responsibilities to the governed (the citizen). These needs become more demanding on the governments of developing countries particularly Nigeria as a result of ever increasing population. Since its independence in 1960; the

country has been running a mono-product economy and thus was guilty of depending too much on crude oil revenue for the performance of its civic responsibilities. However, the dwindling price of crude oil in the world market had compelled the government to redirect its attention to internally generated revenue in the form of company income tax revenue (Sanni, 2013).

A number of studies including Allingham and Sandmo (1972); Syndelle (2009); Muhammed and Muhammed (2012) as well as Adebisi and Gbegi (2013) have agreed that the major determinants of the size of income tax revenue include the tax rate, tax avoidance, tax evasion, the size of income or profit before tax, the diligence and prudence of tax authority, the transparency and accountability of government as well as the tax law and the legal system.

Although, tax is expected to be deployed as an instrument of social engineering, to stimulate general and/or sectoral economic growth (Sanni, 2007), improper tax administration, assessment and collection has been responsible for tax inability to achieve these objectives (Adegbite 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.

Also, as pointed out by Olabisi (2010), actual tax revenue generated in most years fell below the level expected due to dysfunctionalities in the income tax system, loopholes in tax laws and inefficient tax administration giving ways to tax evasion and tax avoidance. Despite the government efforts in Nigeria to improve this revenue generation drive, not much has been recorded due to the devastating effect of tax evasion and tax avoidance and seemingly unfavourable tax rate applicable in the country. Adebisi and Gbegi (2013) conclude that companies avoid tax because every form of tax represents a burden (cost) which the rational tax payer would like to minimize or completely avoid.

Tax evasion is the wilful and deliberate violation of the relevant law in order to escape payment of tax while tax avoidance is the active means by which the taxpayer seeks to reduce or remove altogether his liability to tax without actually breaking the law (Onyeukwu, 2010); both of which led to a gap between actual and potential tax revenue. Adebisi and Gbegi (2013) argue that tax evasion and tax avoidance often lead to the loss of theoretical equity of the tax (a very germane principle of taxation) since the two allow tax payers to escape by legal or illegal means the tax to which they should generally be subjected to under the general scope of the tax.

The opposing developments of unstable crude oil revenue and the civic responsibility to develop the economy, the government had to contend with the increasing needs of its ever growing population in terms of security, infrastructure, and creation of employment opportunities and enhanced standard of living. The government had to resort to internally generated revenue with a view to expand the revenue base through company income tax. Hence, the government is being restrained from increasing company income tax rate beyond the conservative rate so as not to discourage investment in the productive real sectors of the economy. These innovations come in terms of tax incentives ranging from tax holidays, minimum tax and pioneer legislation all designed to encourage infant industries to enhance productive activities which indirectly reduce tax revenue.

Apart from the above dilemma, the increasing incidence or preponderance of tax evasion and tax avoidance among the various companies has culminated in a significant reduction in internally

generated revenues. Notwithstanding these sharp practices, many of the existing companies are packing up while others migrate to neighbouring countries such as Ghana, Algeria, Senegal, Niger and Guinea Bissau partly due to their low tax rate of 25%, 25%, 25%, 2%, 25% respectively for production purposes and partly due to infrastructural decay in Nigeria.

Thus, the incidence of tax evasion, tax avoidance as well as unpleasant tax rate has been drastic on growth level recorded in the country. This is because the impact of these variables on revenue generation exerts significant multiplier effect on economic growth (performing civic responsibilities of the government).

The above analogy led to the following research questions:

- (i) What is the impact of company income tax rate on Internally Generated Revenue of Nigerian Government?
- (ii) What is the impact of tax evasion and tax avoidance on Internally Generated Revenue of Nigerian Government?
- (iii) What is the relationship between income tax rate, tax evasion and tax avoidance?

1.1 Research objectives

The primary aim of this study is to evaluate the effect of tax rate, tax evasion and tax avoidance on company income tax revenue generation. The specific objectives are to:

- (i) evaluate the impact of company income tax rate on revenue generation in Nigeria,
- (ii) evaluate the impact of tax avoidance and tax evasion on revenue generation in Nigeria,
- (iii) examine the relationship between income tax rate, tax evasion and tax avoidance.

1.2 Research Hypotheses

This study hypothesized in null form as follows:

- H_{01} : The impact of company income tax rate on tax revenue generation in Nigeria is insignificant.
- H_{02} : The impact of tax avoidance and tax evasion on tax revenue generation is not significant.
- H_{03} : There are no significant relationships between tax rate, tax evasion and tax avoidance.

1.3 Justification for the study

A proper review of studies on tax evasion, tax avoidance, tax rate and revenue generation reveals that none of the studies has addressed the combined effects of all these variables at once. For instance, Adebisi and Gbegi (2013) evaluated the effects of tax avoidance and tax evasion on personal income tax administration, Olabisi (2012) examined tax evasion and tax avoidance in Lagos state, Nigeria while Okafor (2012) considered the relationship between tax revenue generation and economic development in Nigeria.

Despite the fact that in principle, all the aforementioned factors among others are known to influence the direction of government revenue and thus its propensity to meet its obligations, an assessment of the combined effect of tax rate, tax evasion and tax avoidance on revenue generation in Nigeria seems to have lacked adequate treatment. Hence, a worthwhile academic exercise, this study has decided to handle. The study covers company income tax which has the highest level of tax evasion and tax avoidance compared to capital gain tax, personal income tax, petroleum profit tax and value added tax.

2.0. LITERATURE REVIEW

2.1 Conceptual Issues

A critical look at the concept of tax in the literature shows a universal meaning. For instance, Dalton (1954) cited in Jhingan (2005) saw tax as a compulsory contribution imposed by a public authority irrespective of the exact amount of service rendered to the taxpayer in return. Similarly, The Institute of Chartered Accountants of Nigeria (ICAN, 2006) 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.

Tax can be mistaken for such similar concepts as special assessments, fees, fines, gifts and grants but Dalton (1954) clarified the difference by maintaining that special assessment resembles a tax in that it was a compulsory payment but differs from it in that the payer received a definite and direct *quid pro quo* (equivalent benefit). However, a special assessment differed from a price in that it is not voluntary. A fee is a payment to defray the cost of each recurring service undertaken by the government, primarily in the public interest, but conferring a measurable advantage on the fee payer (Seligman, 2004). Like prices, there is an element of *quid pro quo* in the payment of fees but if the cost of performing a service is less than the fee charged, the excess is in the nature of a tax.

Fines and penalties, according to Jhingan (2005), are not imposed to collect revenue but to punish the people for the infringement of state laws. Fines and penalties, therefore, resemble taxes only in that they are compulsory payments without any *quid pro quo*. Gifts are voluntary contributions made by individuals and societies to the government for relief work in the event of an earthquake, flood, famine, war. Thus, gifts are significantly different by nature from tax. All grants are voluntary gifts and are thus very uncertain source of revenue for the government. Conceptually therefore, tax connotes compulsory payments made by individuals and firms in a society to the government (Kaldor and Hume, 2004). It represents "transfer of resources from private sector to the public sector in order to accomplish a nation's economic and social goals, which will primarily increase the rate of economic growth and per capita income for higher standard of living" (Agyel, 1990).

Tax, as a fiscal policy instrument has two components: direct tax and indirect tax. Direct tax is charged directly on income of individuals, corporate bodies and institutions, while indirect tax is based on consumption of goods and services (Ohaka and Agundu, 2012). Direct tax is a form of tax assessable directly on the taxpayer who is required to pay tax on his property, income or profit,

etc; while indirect taxes are those imposed on commodities before they reach the consumers, and are paid by those upon whom they ultimately fall, not as taxes, but as part of the selling prices of the commodities (ICAN, 2006). Examples of direct taxes include personal income tax; company income tax, capital gain tax, and education tax; while those of indirect taxes are value added tax, stamp duties, excise duties, customs duties and sales tax.

Tax avoidance and tax evasion have been variously conceptualised by scholars in the literature. According to Kiabel (2001), tax avoidance occurs in a situation where the tax payer conducts his finances in a way that will make him pay the least possible amount of tax without contravening the sovereign rules and regulations. In short, it is a term connoting various devices which have been adopted as a package with the sole aim of saving tax and thus sheltering the taxpayers' income from greater liability which would have been otherwise incurred.

Thus, it is clear that tax avoidance is legal or at least not illegal since the taxpayer is mostly probably using the tax laws to limit his tax liability under the same laws. Examples of tax avoidance practices include: (i) seeking professional advice; (ii) reducing one's income by submitting claims for tax deductible expenses incurred in earning the income; (iii) taking additional life assurance policies. Tax avoidance is thus considered to be a matter of being sensible.

Tax evasion on the other hand, according to Adebisi and Gbegi (2013) is the fraudulent, dishonest, intentional distortion or concealment of facts and figures with the intention of avoiding the payment of or reducing the amount of tax otherwise payable. However, Faseun (2001) pointed out that tax evasion is accomplished by deliberate act of omission or commission which in them constitutes criminal acts under the tax laws. These acts of omission or commission as enumerated by Ishola (2011) among others include: (i) failure to pay tax such as education tax or withholding tax; (ii) failure to submit returns; (iii) omission or misstatement of items from returns; (iv) claiming reliefs falsely; (v) understating income; (vi) claims for fictitious expenses in order to reduce taxable income; (vii) concealment of information about income and assets held outside the country; (viii) falsification of accounts, records and other documents; (ix) documenting fictitious transactions; (x) overstating expenses; (xi) failure to answer queries.

While the causes of tax evasion and tax avoidance seem not to differ from one country to the other (Adebisi and Gbegi, (2013), Lefebvre, Pestleau, Riedl and Villeval,(2011) identified some of these causes as: (i) the absence of a *quid pro quo*, that is, something of value given in return by government; (ii) inequitable distribution of amenities; (iii) misuse or mismanagement of collections made; (iv) remoteness of taxpayers from the government; (v) absence of spirit of civic responsibility.

2.2 Theoretical Background

The related theories to the concept of taxation, its evasion and avoidance are theories of taxable capacity, theory of Laffer Curve and Ibn Khaldun's theory. Taxable capacity refers to the extent of tax burden which the people can bear in a country; it is a level to which taxes can be imposed without jeopardizing the interest of individuals in a community (Jhingan, 2005). Taxable capacity is of two types: absolute and relative taxable capacity. Relative taxable capacity is a reality while absolute taxable capacity is a myth (Dalton, 1954).

The theory of Laffer curve connotes a theoretical representation of the relationship between government tax revenue raised and all possible rates of taxation. It considers the amount of tax revenue raised at and between the extreme tax rates of 0% and 100%. Laffer (2004) maintained that a 100% tax rate raised no revenue in the same way that a 0% raised no revenue. At 100% tax rate, there was no longer incentive for a rational taxpayer to earn any income. It followed, therefore, that there must be at least one rate in between where tax revenue would be at maximum.

Ibn Khaldun's theory had two effects: arithmetic effect and economic effect. With respect to arithmetical effect, the higher the tax rate, the higher the tax revenue, that should be generated and vice versa. However, the economic effect recognised the positive impact that lower tax rate had on work, output and employment by providing incentives to increase these activities whereas raising tax rate had the opposite economic effect by penalizing participation in the taxed activities. At a very high tax rate, the negative economic effect dominated positive arithmetic effect, thereby the tax revenue declined (Ishlahi, 2006).

The theoretical foundation of this study is based on the two theories of Laffer Curve theory and Ibn Khaldun's theory.

2.3. Empirical Studies

The relationship among tax rate, tax evasion and tax avoidance, revenue generation has been variously investigated in the literature by different scholars such as Onaolapo, Aworemi and Ajala (2013), Ekeocha, Ekeocha, Malaolu and Moses (2012) and Adebisi and Gbogi (2013).

For instance, Onaolapo, Aworemi and Ajala (2013) used stepwise regression analysis to evaluate the effects of value added tax (VAT) on revenue generation in Nigeria. Their findings showed that value added tax had statistically significant effects on revenue generation in Nigeria. The study recommended an improved dedication and apparent honesty on the parts of all agents of VAT with respect to its collection and payment.

However, Ekeocha, Ekeocha, Malaolu and Moses (2012) employed the econometric technique of Ordinary Least Square (OLS) to estimate the sensitivity, volatility and persistence of the Nigerian tax system. The study reveals that while the bases of the company income tax and personal income tax were more sensitive to cyclical swings (current state of the economy over time) that of the value added tax was not. Company income tax and personal income tax create distortion while high tax rate distort the demand and supply, thus impairing productivity. The study's policy implications supported the recent government tax policy reform of a shift in focus in the tax system from direct taxation to indirect taxation: with the tax base of Value Added Tax being insensitive to the current state of the economy, the revenue there from would not drop sharply when the economy slowed down, thus shielding the government from budgetary shortfalls.

Some countries structure their tax systems purely towards revenue generation, thus negatively impacting the various economies. Very low taxes may impact on education as larger population will prefer to work than school but very high taxes may reduce productivity as people will prefer longer leisure hours, thereby discouraging economic development (Gordon, 2010). Laffer (2009)

cautioned that a government simply cannot tax a country into prosperity, thus, as important as tax revenue is to a nation, many people still find it difficult to comply with their tax obligations. According to Nightingale (2002), *"No one really likes paying taxes yet they are inevitable for the provision of social welfare"*.

Adebisi and Gbegi (2013) examined the effect of tax avoidance and tax evasion on personal income tax administration in Nigeria. The study utilized primary and secondary data, employing tables, percentages, and analysis of variance (ANOVA) to test relevant hypotheses. The study reveals that enlightenment and adequate utilization of tax revenue on public goods will discourage tax avoidance and tax evasion. He concludes that there was a direct and positive relationship between tax avoidance, tax evasion and personal income tax administration in Nigeria and recommends constant training and retraining of tax officials. The study specifically recommended that tax officials should be constantly trained and retrained on the job.

Okafor (2012) evaluated the relationship between government revenue generation and economic growth in Lagos and discovered no significant relationship between the two claiming that tax administration is very inefficient and ineffective in Lagos state.

Summarily, the conspicuous lack in the literature of studies which address impact of tax avoidance, tax evasion and tax rate simultaneously on revenue generation informs this study.

3.0 RESEARCH METHODOLOGY

3.1. Research Design

This study adopts the survey design method as it involves collection and examination of data set that could be reasonably generalised. The study made use of questionnaire to obtain primary data used. This option considered was in line with (Sekaran and Bougie, 2010) who pointed out that *"Questionnaires are most useful as a data collection method, especially when large numbers of people are to be reached...."* The type of questionnaire used is the closed ended type with strongly agreed, agreed, undecided, disagreed and strongly disagreed responses.

The sample frame of this study was an enhancement / improvement over Adebisi and Gbegi (2013) sample of three hundred and five respondents selected from one thousand two hundred and ninety eight (1,298) population frame of the Federal Inland Revenue Service (FIRS) in Nigeria. The 305 sample size Adebisi and Gbegi's study was considered inadequate and was enhanced by 30% increment which is the impact the tax rate has on the payers. Thus, the sample size of this study became $305 + (305 \times 30\%) = 396$

Hence, the questionnaire was administered on three hundred and ninety six (396) employees of Federal Inland Revenue Service (The Service) of Nigeria. This data was subjected to Cronbach Alpha confirmatory test which yielded 0.81 and 0.78 for dependent and independent variables, respectively. This data can be said to be reliable for analysis without fear of spurious results since 0.81 and 0.78 Cronbach Alpha coefficient exceeds 0.70 acceptable minimum benchmark for social/management sciences' research (Ahiauzu, 2006).

3.2. Method of Analysis

The formulated hypotheses were tested using the analysis of variance (ANOVA) model (Adapted from Adebisi and Gbegi, 2013) with the following specification:

$$SSB = r \sum (X_{ij} - \bar{X})^2$$

$$SSW = \sum \sum (X_{ij} - \bar{X}_{.j})^2$$

Where: SSB = between treatment sum of squares

SSW = within treatment sum of squares

X_{ij} = individual observation around their column mean

$\bar{X}$ = grand mean column

df = degree of freedom = $(c - 1)(n - 1)$

c = number of columns

n = number of observations

r = number of rows

Σ = summation

Level of significance = 0.05

4.0. DATA ANALYSIS AND DISCUSSION OF RESULTS

The entire 396 questionnaires administered were returned due to close supervision and serving and replacement and were all used in the analysis. The study presented the summary of the responses as follows noting that:

Strongly agreed = A; Agreed = B; Undecided = C; Disagree = D; Strongly Disagree = E; F = Frequency; T = Total.

Table 1: Frequency and Percentage Distribution of Responses

Core Questions	A		B		C		D		E		T	
	F	%	F	%	F	%	F	%	F	%	F	%
Adequate accountability and transparency in usage tax revenue by infrastructure will discourage tax avoidance and tax evasion	301	76	49	12	10	3	19	5	17	4	396	100
High company income tax rate encourages tax avoidance and tax evasion through such tactics as transfer pricing.	244	62	81	20	4	1	12	3	54	14	396	100
Company income tax revenue generation has not been encouraging in Nigeria	147	37	73	18	7	2	110	28	59	15	396	100
Company income tax rate is abnormally high in Nigeria.	80	20	151	38	11	3	91	23	64	16	396	100

Core Questions	A		B		C		D		E		T	
	F	%	F	%	F	%	F	%	F	%	F	%
Tax evasion and tax avoidance had led to drastic reduction in government revenue in Nigeria.	167	42	140	36	45	11	24	6	20	5	396	100
The impact of tax revenue generated by government in terms of infrastructural growth (electricity power, water and good roads) has not been felt by Nigerian companies	205	52	129	33	36	9	18	4	8	2	396	100

Source: Author's Computation (2014)

The results in Table 1 reveal the following findings:

- (i) Accountability and transparency in the spending of company income tax revenue will discourage tax evasion and tax avoidance thus boosting revenue generation. This proposition was supported by 88% of the respondents who strongly agreed while 3% were undecided but 9% disagreed.
- (ii) High company income tax rate encourages tax evasion and tax avoidance, thereby leading to reduction in revenue generation as pointed out by 82% of the respondents while only 17% has opposite views. This result is in conformity with the propositions of Ibn Khaldun's theory of taxation and the theory of Laffer Curve);
- (iii) Revenue generation from company income tax has been moderate and average in nature. This is evidenced by 220 respondents representing 55% in total support of the view while 169 respondents amounting to 43% subscribing to the fact that income tax revenue has not been encouraging in Nigeria and only 2% of the respondents remained undecided.
- (iv) 58% of the respondents are of the opinion that company income tax rate is abnormally high in Nigeria while 39% oppose the view. By inference therefore, this might mean that tax rate is relatively high in the country compared to operational rates in the neighbouring countries. This high tax rates and its associated burden on the tax payers might account for high incidence of tax avoidance and tax evasion experienced in the country. There is thus the need for Nigerian tax authority to keep company income tax rate at a bearable rate (possibly a little below 30%) considering the economic and political situation of the country. If the tax rates is lowered, it is believed that companies that transferred their production activities to the Neighbouring countries will prefer Nigeria economic system and as such employment levels will improve.
- (v) It can be inferred that tax evasion and tax avoidance activities had resulted into drastic reduction in government revenue in Nigeria. This was the view of 78% of the respondents while only 11% of them each held opposing view and remain neutral respectively.

- (vi) That the usage of revenue from taxes generated by Nigerian government has not been felt in terms of infrastructural development. No wonder why 85% of the respondents lend their support to the fact that tax revenue has not been judiciously used for infrastructural development. This might account for the reasons behind tax evasion and avoidance by the companies.

4.2. Hypotheses Testing

Table 2: ANOVA test statistics for hypotheses I and II

Source	Ss	df	ms	F-ratio
Hypotheses I and II				
Between treatment	54988	1	54988	145.3
Within treatment	3212	8	398.734	
Total	58200	9		
Hypothesis III				
Between treatment	38678	1	38678	52.5
Within treatment	6354	8	776.512	
Total	45032			

Source: Author's Computation, 2014

(a) Hypotheses I and II

From table 2, the study rejected the null hypotheses I and II while the alternatives were accepted since F_{cal} (145.3) is greater than F_{tab} (5.32) at 0.05 level of significance, for the two hypotheses. This implies that tax rate, tax avoidance and tax evasion all have significant impact on income tax revenue generation in Nigeria. It can, therefore, be inferred that the higher the tax rate, tax avoidance and tax evasion the less will be the revenue accruable to the government and vice versa.

(b) Hypothesis III

The same table 2, shows the acceptance of alternative hypothesis having rejected the null hypothesis because F_{tab} (5.32) is lower than F_{cal} (52.5) at 0.05 level of significance. This means that significant relationships exist between company income tax rate, tax avoidance and tax evasion such that the higher the tax rate signifying more tax liabilities on the part of the companies, the higher the magnitude of tax evasion and tax avoidance expected. These conclusions were in term with those of Adebisi and Gbegi, 2013) except that they concentrated on personal income tax. Also, this inference conforms to theory and the cash flow concept such that companies try as much as possible to increase their cash inflow and keep cash outflows (tax liability) to the barest minimum (ICAN, 2010). This is otherwise called prudent financial management control necessary for the survival of business organisations.

5.0. CONCLUSIONS AND POLICY RECOMMENDATIONS

The study discovered strong and significant relationships between company income tax, tax avoidance, tax evasion and revenue generation in Nigeria. There was also a significant positive

relationship between company income tax rate, tax avoidance and tax evasion while the impact of revenue derived from company income tax in terms of social and structural growth have not been felt by Nigerian companies. There is thus the tendency to avoid and evade tax the more since electricity power, water and good roads are not in place to reduce cost of production by these companies. The infrastructure decay may partly be because revenue generation by government from company income tax has been on the average (not encouraging) and that the tax rate has been adjudged to be high leading to insufficient revenue to meet government needs contrary to its citizen's expectations.

It is, therefore, recommended that government should demonstrate accountability and transparency in the utilization of company income tax revenues on infrastructure provision to discourage tax avoidance and tax evasion while little reduction in tax rate (in comparison with neighbouring West African countries might also mitigate tendencies to avoid or evade tax.

It is believed that if government can show transparency in the usage of tax revenue, while basic infrastructural facilities (electricity, water and good roads) are made available, these companies will be willing to pay tax and all (the companies, the government and the populace) will benefit tremendously in terms of more manufacturing, merchandising and service industries that will power economic growth indices: employment, per capital income and poverty eradication. All these will translate into a better by far Nigeria.

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