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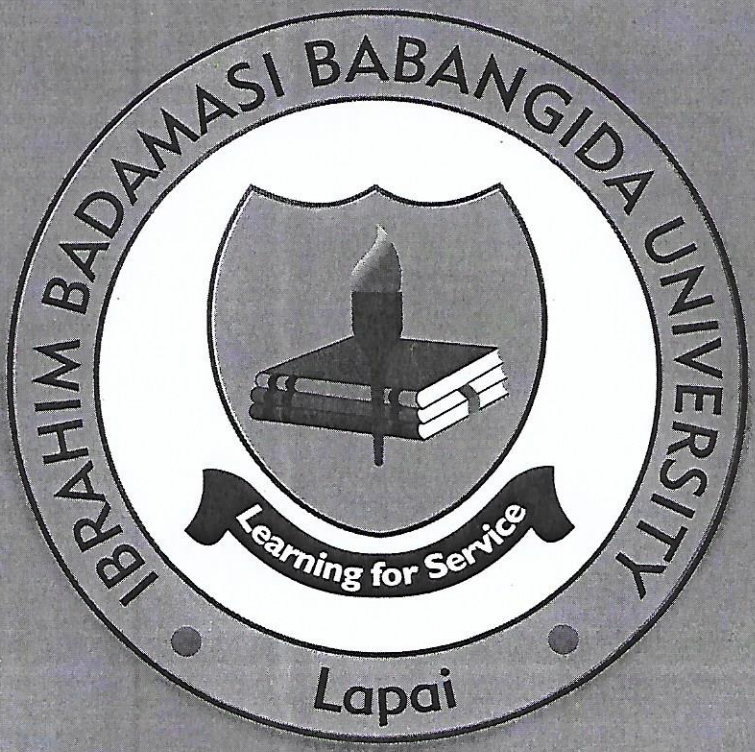

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VALUE ADDED TAX AND ECONOMIC GROWTH: EVIDENCE FROM NIGERIA

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ABSTRACT

The replacement of sales tax with Value Added Tax (VAT) in Nigeria was premised on the need to engender more transparency, ease of collection and widen the tax base of the Nigerian tax system. This is with a view to increase the revenue base of the government and brings forth more development programmes and economic growth. This study evaluates the impact of VAT after the introduction of Standard Integrated Government Tax Administration System (SIGITAS) on the country's economic growth using quarterly time series data generated from Office of the Accountant General of the Federation and Central Bank of Nigeria for forty-eight quarters (Quarter1 2001 – Quarter 4 2012); the data was analyzed using Ordinary Least Square (OLS) statistical tool after testing for normalcy using Phillips-Perron's Unit Root Test. The study reveals that VAT has negative relationship with GDP while Company Income Tax (CIT) and Total Federally Collected Revenue (TFR) have positive relationships with GDP. It is therefore recommended amongst others that the automation of the administration and collection procedure for VAT is germane to eliminate the loopholes therein in order to raise government revenue from VAT and promote economic growth in Nigeria.

Keywords: *Value Added Tax, Company Income Tax, Revenue.*

1.0 INTRODUCTION

The need for government to impose tax on taxpayers stems from the need to adequately generate funds that will be utilized in the defraying of government's both capital and recurrent expenditures. However, studies have shown that in spite of the attempts by government to

improve on its revenue generation drive through various tax reforms, little have been achieved in improving the top line (See: Odusola, 2006 and Taiwo, 2008). The inability of government to improve top line has led to the problem of multiplicity of taxes being imposed on taxpayers and its attendant inefficient collection machinery being put in place by the relevant tax authorities. This has led to drastic reduction in tax revenue as a result of revenue leakages (Ekeocha, Ekeocha, Malaolu and Oduh, 2012).

Value Added Tax (VAT) which was introduced in Nigeria in 1994 as a replacement for Sales Tax, is a veritable means of generating revenue for government especially in developing countries. VAT has become an important contributor to total government tax revenues (Ajakaiye, 2000), as it accounted for about 30% of total tax revenues in Cote d'Ivoire, Kenya and Senegal in1982 (Shalizi and Squire, (1988). The oil producing countries are not excluded from the list of countries introducing this tax hurdle. For instance, Tait (1989) showed that VAT has been in effect in Ecuador and Mexico since at least 1973 and by 1983, it accounted for 12.35% and 19.71% of total government revenues in these counties respectively. Indonesia introduced VAT in 1983 and by 1988, the ratio of VAT revenue to GDP had risen to 4.5% (Bogetic and Hassan, 1993). This impressive performance of VAT in virtually all countries where it has been introduced, according to Ajakaiye (2000), clearly influenced the decision to introduce VAT in Nigeria in January 1994.

VAT is a consumption tax that is relatively easy to administer and difficult to evade and it has been embraced by many countries worldwide (Federal Inland Revenue Service, 1993). Evidence so far supports the view that VAT revenue is already a significant source of revenue in Nigeria. For example, actual VAT revenue for 1994 was N8.189 billion, which is 36.5% higher than the projected N6 billion for the year. Similarly, actual VAT revenue for 1995 was N21 billion compared with the projected N12 billion. In terms of contributions to total federally collected revenue, VAT accounted for about 4.06% in 1994 and 5.93% in 1995. As much as N404.5 billion was collected on VAT (5.1% of total revenue) in 2008.

The collection process of Value Added Tax in Nigeria is characterized with inefficiencies that lead to shortfall in VAT revenue due to non-remittance of tax revenues to the coffers of the government. Thus, this has created a system that robs government of the much needed revenue compared to what obtains in advanced countries that depend heavily on tax revenue. This has led to little funds availability for defraying public expenditure. No wonder why development has been low in terms of infrastructure, employment and standard of living (World Bank, 2013).

Although Angus and David (2011) claim that VAT has significant impact on human development in Adamawa State while VAT revenue has partially grown in the country, indices of economic growth (poverty reduction, employment generation, improvement in literacy level as well as growth in infrastructural facilities); all of which are embedded in Gross Domestic Products (GDP) values are low. If agitations for the increasing VAT rate from 5% to 15% will hold water there is the need to establish the relationship between VAT and economic growth in Nigeria and while doing this a simultaneous effect of Company Income Tax.

From the scenario presented here, the following research questions become pertinent:

i) Is there any significant relationship between Value Added Tax and economic growth in Nigeria?

ii) Is there any significant relationship between Value Added Tax and Federally Collected Revenue in Nigeria?

1.2. Statement of Hypotheses

In view of the foregoing, the following hypotheses are postulated:

H_{01}: There is no significant relationship between Value Added Tax and economic growth in Nigeria.

H_{02}: There is no significant relationship between Value Added Tax and Federally Collected Revenue in Nigeria.

These hypotheses form the bedrock of the study objective.

2.0. LITERATURE REVIEW

Relevant literature were reviewed in this study under the conceptual framework, theoretical background and empirical studies.

2.1. Conceptual Framework

Economic growth has been defined by ABWA (2009) define as the expansion in a nation's real output (Gross Domestic Product, GDP) reflected in increased per capita income since a nation is said to experience economic growth if overtime, its real output (real GDP) increases as well as its real per capita income. It went further to classify the factors that affect economic growth to include competency of human resources, availability of natural resources, capital formation and application of science and technology.

Value Added Tax, according to Umeora (2013) was first advocated by Wilhelm Von Siemens in 1918 while Maurice Laure first introduced Value Added Tax in France in 1954. The reason attributed by the duo for the introduction of Value Added Tax is that it is better than Sales Tax because Sales Tax and tariffs encourage cheating and smuggling.

However, since the introduction of value added tax in France in 1954, most countries of the world have introduced Value Added Tax as part of their fiscal structures. For instance, Belgium introduced VAT in 1971, Denmark introduced VAT in 1967, Germany in 1968. Ireland, Italy, Luxembourg, Netherlands, Norway, Sweden and United Kingdom introduced VAT in 1972, 1973, 1970, 1969 and 1973 respectively. On the African continent, Value Added Tax was introduced in 1960 in Ivory Coast, Guinea, Kenya and Madagascar. Morocco, South Africa and Algeria introduced VAT in 1986, 1991 and 1992 respectively.

Adereti, Sanni and Adesina (2011) citing Oserogho and Associates (2008), defined Value Added Tax as a consumption tax levied at each stage of the consumption chain and borne by the final consumer of the product or service. They went further to say each seller is required to charge and collect VAT at a flat rate of 5% on all invoiced amounts on all goods and services not exempted from paying VAT under the Value Added Tax Act 1993 as amended. Where VAT collected on

behalf of the government (output VAT) in a particular month is more than VAT paid to other persons (input VAT) in the same month, the difference is required to be remitted to the government on a monthly basis.

Onaolapo, Aworemi and Ajala (2013) citing Jones (2003) also describe Value Added Tax as a tax levied at each stage in which supplies change hands. In the case of manufactured items, this could be the primary producer, manufacturer, wholesaler and retailer stages. It is ultimately borne by the consumer who being registered for VAT purposes is unable to reclaim it. This definition by Jones suggests that there are intermediaries through which goods must pass before they reach the final consumer. Each time goods are passed from one stage to the other, intermediary value is added to it. It is this value that is being taxed and borne by the final consumer.

VATable persons according to FIRS (1999) is one who trades in *VATable* goods and services for a consideration. Every *VATable* person has an obligation to register for VAT operation and the registration is to cover all the business activities of the *VATable* person. The person can be a sole proprietor, a professional, a partnership, a Limited Liability Company, a Club or Association or a Charity. Also a Nigerian resident who performs services outside Nigeria needs to register with the local VAT office while a non-resident who has a business, trade, profession or vocation in Nigeria still needs to register using the address of the person with whom it has subsisting contract as its local address.

Ewoma (2012) noted that all goods and services produced or rendered are to be charged to VAT except those goods or services that are exempted from VAT are called *VATable* goods. He went further to say zero rated goods are goods that are *VATable* but at zero percent, which means no VAT is collected from the buyer of the goods. However, the supplier of the goods will be entitled to a refund of any input VAT paid.

Ojo (2009) identified the classes of goods and services exempted from VAT. Goods exempted from VAT include: Medical and pharmaceutical products, basic food items, books and educational materials, baby products, commercial vehicles and their spare parts, agricultural equipment and products and veterinary medicine, fertilizers, farming machinery and farming transportation equipment. Others are all exports, plants and machinery used in export processing zone, plant and machinery and equipment purchased for utilization of gas in downstream petroleum operations as well as tractors, ploughs, agricultural equipment and implements purchased for agricultural purposes. Services exempted from VAT as pointed out by Ojo (2009) include services of Microfinance Banks (MFBs) and Primary Mortgage Institutions (PMIs), plays and performances conducted by educational institutions as part of learning, services related to education, medical services and all exported services.

ICAN (2009) defines Companies Income Tax (CIT) as tax payable on the profits of a company accruing in, derived from, brought into, earned in or received in Nigeria. Section 47 of Companies Income Tax ACT (CITA) stipulates that a company shall be chargeable to Companies Income Tax (CIT) in:

I) its own name;

ii) the name of its principal officers, attorney, factor, agent or representative in Nigeria or

iii) the name of a receiver or a liquidator, where a company is in receivership or liquidation, or its attorney, factor, agent or representative in Nigeria.

Ekeocha, *et al.* (2012) say Companies Income Tax (CIT) is the tax imposed on profit or gain of any company accruing in, derived from, brought into, earned in or received in Nigeria assessable to tax under Companies' Income Tax Act CAP C21 2004 LFN amended in 2007.

2.2. Theoretical Background

The identified theories in relation to the concept of taxation, VAT and economic growth are socio-political and benefit-received theories.

Socio-political theory of taxation states that social and political objectives should be the major factors in selecting taxes. The theory advocated that a tax system should not be designed to serve individuals, but should be used to cure the ills of society as a whole (Bhartia, 2009). Contrarily, the benefit-received theory proceeds on the assumption that there is basically an exchange relationship between tax-payers and the state. The state provides certain goods and services to the members of the society and they contribute to the cost of these supplies in proportion to the benefits received (Bhartia, 2009). However, from the two theories, the socio-political theory forms the theoretical foundation of this study.

2.3. Empirical Studies

Rostami, Nourbakhsh and Akbarian (2012) studied the impact of fiscal policy on economic growth in Iran with emphasis on the role of Value Added Tax. The study employed the use of auto regressive distributed lags (ARDL) to analyze the annual data spanning 1979- 2009. The study showed that value added tax has a significant effect on economic growth of Iran.

Gustavo, Jorge and Violeta (2013) evaluate taxation and economic growth in Latin America and conclude that greater reliance on consumption taxes (VAT) has significant positive effects on economic growth in Latin America in general while personal income tax does not have the expected negative effect on economic growth in the region. However, corporate income tax also, do not seem to have any significant effect on economic growth except if reduction in tax evasion and greater reliance on its collection is assured, it may boost economic growth in the area.

In Nigeria, the studies of Adereti, *et al.* (2011), Onaolapo, *et al* (2013) as well as Basila (2010) have immediate bearings on the concept of taxation and VAT. Adereti, *et al* (2011) in their study on Value Added Tax and economic growth in Nigeria, employed the simple regression analysis and descriptive statistical method. Data from 1994- 2008 were analyzed using the above mentioned methods. The study shows that a positive significant correlation exists between VAT revenue and GDP and no causality exists between GDP and VAT revenue.

Onaolapo, *et al.* (2013) carried out a study on assessment of Value Added Tax and its effect on revenue generation in Nigeria. The study employed stepwise regression analysis using data

covering 2001- 2010. Findings show that VAT has statistically significant effect on revenue generation in Nigeria. Basila, (2010) empirically investigated the relationship between Value Added Tax and gross domestic product in Nigeria. The study employed Pearson Product Moment Correlation to analyze the data obtained from 1994-2008. The result gave 96% strength of relationship between VAT and GDP. Umeora (2013) studied on the effect of value added tax on the economic growth of Nigeria utilizing the simple linear regression model to analyze the data. The data used was for the period 1994-2010 and the result reveals that Value Added Tax has significant effect on gross domestic product and on total tax revenue.

Angus and David (2011) evaluated the impact of VAT on economic development in Adamawa state but their conclusion was erroneous and contradictory (primary data analysis gave a minimal impact of VAT on human development while secondary data analysis gave a significant impact of VAT on human development). Worse still, determination of the portion of VAT that goes to human growth cannot be established anywhere either from secondary data or through unreliable primary data. The only option that seems feasible is to look at VAT and economic growth from national perspective and that singular objective informs this study.

Moreover, subsequent to these studies was a reform of Value Added Tax collection process specifically and other taxes in general through the automation of tax collection system in order to plug the loopholes in the collection system. This modernization was implemented through the introduction of Integrated Tax Administration System (ITAS) on a tailor made solution known as the Standard Integrated Government Tax Administration System (SIGITAS).

The primary goal of this modernization was to re-engineer the tax administration service delivery, eliminate gaps and redundancies in the current administrative assessment processes by leveraging technology in line with global best practices ultimately leading to simpler tax compliance. The objective is to transform the tax administrative system and optimize its contribution to national development. The most vital aspect of SIGITAS will be to widen the tax net, deepen compliance, create a friendlier environment for taxation as well as curb leakages in tax administration. The introduction of SIGITAS will also standardize processes which will facilitate reduced turnaround times for service offerings to taxpayers.

A major highlight of the deployment of SIGITAS is the automation of unified communications and enterprise collaboration, document management portal as well as automated VAT collection system. This system will thus enable taxpayers to view their entire tax history of filing and assessment with the Federal Inland Revenue Service. Thus, there is the need for a re-assessment for the VAT impact on economic growth in line with the new reform/ modernization. This is with a view to establish the effect of the reform compared to the oil system of VAT and this objective was pursued in this study.

3.0. METHODOLOGY

This study examines the relationship between Value Added Tax on economic growth in Nigeria. It also measures the relationship between VAT revenue and federally collected revenue in the country. The secondary data used in this study include GDP as the dependent variable, while the independent variables are Value Added Tax(VAT), Company Income Tax (CIT) and Federally

Collected Revenue(TFR). The dependent variable is sourced from CBN Statistical Bulletins while the independent variable is sourced from Office of the Accountant General of the Federation. These data span across 10 years (or 48 quarters), starting from 2001 to 2012. This period is seen to be most suitable in view of the mixed fortunes in respect of VAT collections.

3.1. Model Specification

Relationship among the variables identified is captured using multiple regression model stated as follows:

$GDP = f(VAT, CIT, TFR) + e$ ..... (i)

When expanded, the model becomes

$GDP = \alpha + \beta_1 VAT + \beta_2 CIT + \beta_3 TFR + e$ ..... (ii)

Where:
GDP = Gross Domestic Product (represents economic growth index)
VAT = Revenue from Value Added Tax (reflecting impact of SIGITAS)
CIT = Revenue from Companies Income Tax
TFR = Total Federally Collected Revenue
e = Stochastic error term

Based on the above model, the a priori expectation of the independent variables (VAT, CIT and TFR) on the dependent variable GDP in the model is that $\beta_1 > 0$; $\beta_2 > 0$; $\beta_3 > 0$. This implies that a positive relationship is expected between the dependent variable and the independent variables, VAT, CIT and TFR.

The estimated model becomes: $GDP = GDP = \alpha + \beta_1 VAT + \beta_2 CIT + \beta_3 TFR + e$

Where α, β_1, β_2 and β_3 are regression coefficients expected from the regression. Then a priori expectation is that all the predictive variables (VAT, CIT and TFR) must be positively related to the response variable (Economic Growth; GDP).

1.0. DISCUSSION OF RESULTS

Unit Root test was carried out in this study using Phillips-Perron's Test model in order to determine if the variables are stationery or not. This is otherwise called normalcy test and should always precede any analysis to avoid any spurious results. The result is shown in Table 4.1 revealing that all the variables were stationery at first difference.

Table 4.1: Phillips-Perron's Unit Root Test

Variables	t-statistics	Order of Integration
GDP	-9.004730***	I (1)
VAT	-6.411068***	I (1)
CIT	-13.64593***	I (1)
TFR	-5.366343***	I (1)

Source: Author's Computation
NB *** denotes significant at 1% level of significance.

Table 2: Result of Regression on Value Added Tax and Economic Growth in Nigeria

Variables	Coefficient	Std Error	t-statistics	Probability
VAT	-3.301342	1.124012	-2.937106	0.0053
CIT	24.98789	2.795935	8.937221	0.0000
TFR	1.806387	0.293777	6.148848	0.0000
C	733522.3	300961.7	2.437261	0.0189
R-squared	0.920769			
Adj R-squared	0.915367			
S.E. of Regression	861822.9			
F-statistics	170.4458			
Prob(F-stats)	0.000000			
Durbin-Watson statistics	1.630850			

Source: Author's Computation

The estimated equation from the regression analysis became:
GDP = 733522.3 -3.301342 VAT + 24.98789 CIT + 1.806387 TFR + e

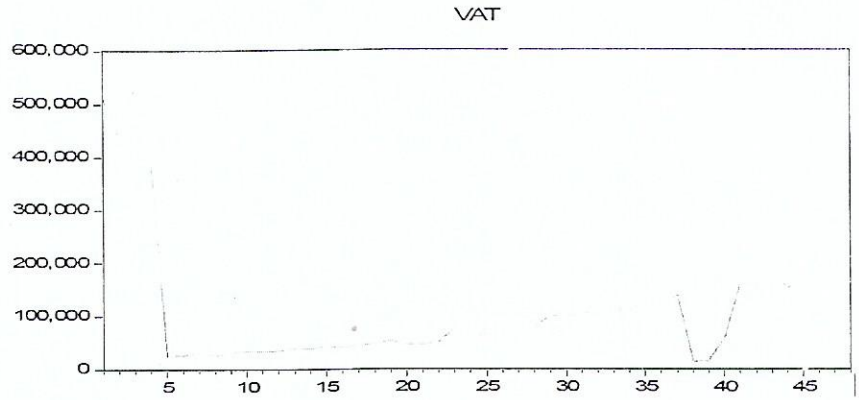
The regression results of Value Added Tax (VAT) and Economic Growth in Nigeria is presented in Table 4.2 while TFR and CIT serve as control variables. The result reveals that the overall coefficient of determination (R^2) shows that the equation has a good fit with 92.08 percent of GDP explained by the variables in the equation. As the adjusted (R^2) tends to purge the influence of the number of included explanatory variables, the adjusted (R^2) of 91.54% shows that having removed the influence of the explanatory variables, the model is still of good fit. Hence, in terms of the goodness of fit we can say that the test is good. This result means that (R^2) and the adjusted (R^2) are significant.

In terms of the signs and magnitude of the coefficients of the predicting variables on GDP, it can be seen that only CIT and TFR conform to the a priori theoretical expectation while VAT contradicts the theoretical expectations since it has a negative impact (-3.301342) on economic growth measured by GDP. Although all the predictive variables are significant, as Table 4.2 indicates that GDP has a negative relationship with VAT while it has a positive relationship with CIT and TFR. More precisely, the estimation equation translate to mean that over the period covered in this study, N1 increase in VAT will lead to N3.30 decrease in GDP; N1 increase in CIT will lead to N24.99 increase in GDP while N1 increase in TFR will lead to N1.81 increase in GDP. This negative relationship between VAT and GDP is more clearly seen in figures 1 and 2 where it can be seen that as VAT nosedives initially but later increases marginally, GDP increases throughout the period. This suggests that VAT has no useful impact on economic growth in Nigeria. Conversely, other variables might be responsible for the economic growth in Nigeria of which Companies Income Tax and Total Federally Collected Revenue are included.

The negative relationship between VAT and GDP emanating from this study is at variance with the findings of Adereti, *et al* (2011) which shows that a positive significant correlation exists between VAT revenue and GDP. However, this result is in conformity with the socio-political theory which states that social and political objective should be the major factors in selecting taxes and not a go-getter in terms of moving the economy in a desired direction as it might purport

to presume. The theory advocated that a tax system should not be designed to serve individuals, but should be used to cure the ills of the society as a whole. This might mean that VAT was aimed at achieving certain objectives rather than a direct connect with economic growth measured directly by GDP.

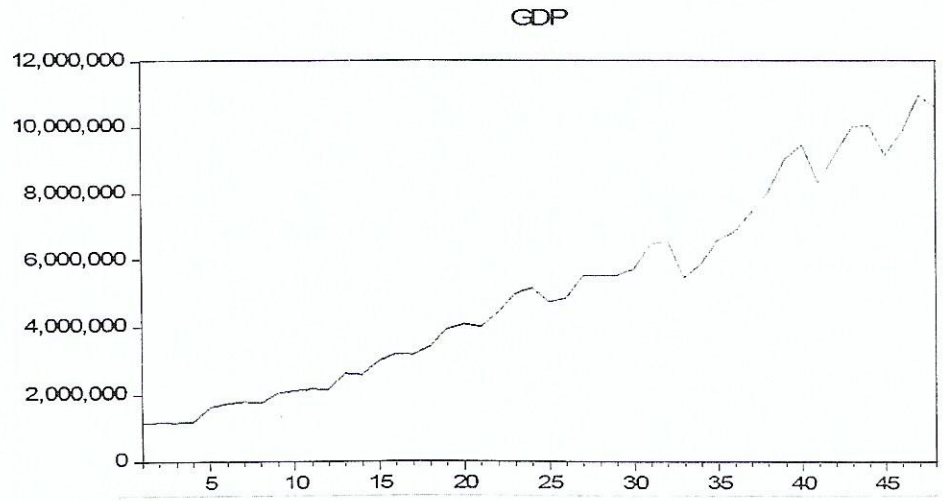
Figure 1: Graph showing VAT revenue over the period of consideration



Source: Authors' Analysis (2013)

The graph in Figure 1 shows the VAT revenue of government over the period under consideration which goes down from the first four quarters (2001 Q1-Q4) before it shows slight increase afterwards. This abysmal performance was recorded amidst the introduction of the new reform (SIGITAS). This might mean that the observed loopholes in VAT administration were yet to be adequately addressed by SIGITAS reform or that the products covered by VAT are not being consumed by the populace.

Figure 2: Graph showing GDP performance over the period of consideration



Source: Authors' Analysis (2013)

Conversely, figure 2 shows the performance of GDP which was consistently on the increase within the period under consideration. Thus, it can be said that other variables aside VAT are responsible for the forward movement in economic growth of Nigeria and it may also be due to insignificant amount of VAT compared to huge amount of GDP.

5.0. CONCLUSIONS AND RECOMMENDATIONS

Value Added Tax as a source of revenue to the government at inception exceeded its budgeted target but plummeted sharply in later periods. VAT thus has a negative impact on Nigeria's economic growth. This performance could be that the loopholes in the administration and collection procedures of the tax system have not been properly addressed by SIGITAS. In order to make VAT relevant and an inducing factor of economic growth in Nigeria without violating the benefit-received theory, the following recommendations are put forward which if religiously followed will improve the relationship between VAT and economic growth:

i) Automation of the administration and collection procedures of Value Added Tax to eliminate the loopholes;

ii) Extension of Value Added Tax net on other goods and services which are not covered under the Value Added Tax net by amendment of VAT Act; and

iii) VAT rate should be reduced to encourage voluntary compliance by registered VAT collection agents.

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APPENDIX I: EVIEW RESULT OF REGRESSION

Dependent Variable: GDP
Method: Least Squares
Date: 11/20/13 Time: 12:58
Sample: 1 48
Included observations: 48

Variable	Coefficient	Std. Error	t-Statistic	Prob.
VAT	-3.301342	1.124012	-2.937106	0.0053
CIT	24.98789	2.795935	8.937221	0.0000
TFR	1.806387	0.293777	6.148848	0.0000
C	733522.3	300961.7	2.437261	0.0189

R-squared	0.920769	Mean dependent var	5135266.
Adjusted R-squared	0.915367	S.D. dependent var	2962426.
S.E. of regression	861822.9	Akaike info criterion	30.25114
Sum squared resid	3.27E+13	Schwarz criterion	30.40708
Log likelihood	-722.0274	Hannan-Quinn criter.	30.31007
F-statistic	170.4458	Durbin-Watson stat	1.630850
Prob(F-statistic)	0.000000		