

An Empirical Study of Tax Evasion and Tax Avoidance: A Critical Issue in Nigeria Economic Development

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ABSTRACT

The revenue generated by the government from taxation forms a major source of finance to the federal government capital expenditure which is crucial to sustainable economic development. A major challenge to the government in generating this revenue has been the increasing rate of tax evasion and tax avoidance. Therefore tax evasion and tax avoidance are important factors to be considered as they affect both the volume and nature of government finances which is the key to economic development. This paper considers the effects of tax avoidance and tax evasion on Nigeria economic development. This paper considers the effects of tax avoidance and tax evasion on Nigeria economic development. A survey research design was adopted and responses were obtained through the use of a well structured questionnaire administered to 150 Nigerians, out of which are tax payer and tax evader. Findings from the analysis using statistics techniques reveal that tax evasion and avoidance have adversely affected economic growth and development in Nigeria, and also, that lack of good governance and unpatriotic act of tax payer, is the basis for which tax evasion and tax avoidance activities is perpetrated. The study therefore recommends that the government should embrace and promote good governance so as to encourage voluntary compliance of tax liability by the tax payers.

Key words: Tax evasion, tax avoidance, economic development, tax hostility.

INTRODUCTION

The concept of taxation has been a concern of global significance as it affects every economy irrespective of national differences (Oboh et al., 2012). According to Omotoso (2001), in his definition of the modern taxes, defined tax as a compulsory charge imposed by a public authority on the income of individuals and companies as stipulated by the government decrees, acts or cases laws irrespective of the exact amount of services rendered to the payer in return.

A more recent and comprehensive definition was given by Dr. Ekenze Oliver of Buitas Consultancy to the effect that tax is:

“a compulsory levy imposed by an organization or Government on its member citizens, for the sole purpose of providing common goods and services for the benefit of all members”.

He continued:

“tax is designed to raise revenue required for the expenditure authorized in a government budget expectation. It is also a veritable instrument of promoting social and economic justice and equality amongst citizens of a state or members of an organization”.

As could be gleaned from the above definitions, a tax is not therefore a voluntary payment; it is a compulsory pecuniary burden placed upon the subjects of a given country to support the people.

Thus, taxes constitute the principal source of government revenue and the beauty of any government is for its citizen to voluntarily execute their tax obligations without much coercion and harassment.

The greatest puzzle facing the Nigerian tax system is the threat of tax evasion and tax avoidance. It is widely believed that there is a substantial difference between estimated revenue from taxation every year and what is actually collected.

Theoretical frame work.

Definition of Tax Evasion and Avoidance:

The Nigerian tax codes have neither defined nor drawn any distinction between tax evasion and tax avoidance.

Tax Avoidance

Tax avoidance may simply be defined as the reduction or minimization of a person’s tax liability by carefully arranging one’s affairs in such a way as to take advantage of loopholes in the tax law provisions. It is the intentional act of a tax payer to pay less than what he ought to pay to the tax authority. It is legal.

In the course of examining the attitude of the courts and the legislature towards tax avoidance, Professor Wheat craft observed that:

“... tax avoidance is an art of winning games without actually cheating; thereby beating the internal revenue and

the Government to their own game”.

Similarly in *Ire v. Duke of Westminster*, Lord Tomlin observed in respect of Tax Avoidance that:

“Everyman is entitled, if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then however in appropriate, the commissioner of Inland Revenue or his fellow tax payers may be of his ingenuity, he cannot be compelled to pay an increased tax”.

Tax avoidance as defined by Aim and Martinez (2001) is the legal reduction in tax liabilities by practices that take full advantage of the tax code, such as income splitting, postponement of taxes and tax arbitrage across incomes that face different treatments (Aim and Martinez, 2001; Eboziegbe, 2007).

Tax avoidance includes not only the use of strategies that allow for the legal minimization of taxes, but also for the search of strategies to exploit deficiencies or ambiguities in the law (known as aggressive tax planning strategies).

Therefore irrespective of the generally held opinion that tax avoidance is unpatriotic and anti-social, it is clear that it is not a moral or legal issue unless the legislature expressly prohibits it.

Tax Evasion

According to Nwachukwu (2006) tax evasion is the general term for efforts by individuals, firms, trusts and other entities to evade taxes by illegal means. Tax evasion usually entails taxpayers deliberately misrepresenting or concealing the true state of their affairs to the tax authorities to reduce their tax liability. It also includes, in particular, dishonest tax reporting such as declaring less income, profits or gains than actually earned; or overstating deductions. Tax Evasion apart from being a moral wrong also amounts to a breach of the tax laws.

According to Soyode and Kajola (2006), tax evasion is defined as a deliberate and willful practice of not disclosing full taxable income in order to pay less tax. It is a deliberate violation of tax laws and it is evident in situations where tax liability is fraudulently reduced or false claims are filled on the revenue tax form (Farayola, 1987; Ayua, 1999; Soyode and Kajola, 2006).

From the comparison of various definitions given in the literature, it can be seen that paying less tax or not at all than what one is legally obliged to is described as tax evasion while tax avoidance is an act of doing everything possible within the confines of the tax law to reduce the tax paid. Therefore, the main difference between them is the legality of the payer's action.

Causes of Tax Evasion and Tax Avoidance in Nigeria

Tax evasion according to Uadialeet al. (2010) is an outright dishonest action whereby the taxpayer endeavors to reduce his tax liability through the use of illegal means. Tax evasion is accomplished by a deliberate act of omission or commission which constitutes criminal acts under the tax laws these acts include: failure to pay tax e.g. withholding tax, failure to submit returns, omission of items from returns, claiming relief (in Personal Income Tax), for example, of children that do not exist, understating income, documenting fictitious transactions, overstating expenses, Failure to answer queries. (Farayola, 1987; Uadialeet., 2010).

Other causes of Tax evasion and Tax avoidance are: corruption in public office, inadequate tax education and awareness, misappropriation of taxes collected, ignorance of the tax authority, lack of adequate enforcement for default, proliferation of taxes, loopholes in the tax laws, inequitable distribution of income, absence of 'Quid Pro Quo' i.e. something of value given in return (by the government) for taxes paid, high level of illiteracy and high tax rates.

Effects of Tax Evasion and Avoidance

Tax evasion and tax avoidance has undoubtedly affected adversely the government revenue generation capability and the economy as a whole. However, despite the government efforts to bridle the practices of tax evasion and tax avoidance in Nigeria, the problem still persists. There is no doubt that the revenue due to the federal government of Nigeria will be reduced by the lack of good governance and unpatriotic act of tax evaders. and as observed by Toby (1983), the taxpayer indulges in evasion by resorting to various practices. These practices erode moral values and build up inflationary pressures.

Methodology

The study was based on one hundred and eighty respondents drawn from the staff of the Internal Revenue

Service of Oyo State and taxpayers (individuals) in these states.

Initially one hundred and eighty copies of the questionnaire were sent out: forty copies were administered on Internal Revenue Staff of the rank of Chief Inspectors, Principal Inspectors and Senior Inspectors of taxes of the Internal Revenue Service of Oyo State. In addition to this one hundred and forty copies of the questionnaire were administered randomly on various taxpayers both self-employed and salary earners in the state. Of the forty copies sent out to the Revenue Service thirty were properly completed and returned while a total of one hundred and twenty copies were duly completed and retrieved from the taxpayers. The study was eventually based on one hundred and fifty respondents. This number represents the sample size in this study.

The questionnaire was designed in such a manner as to solicit responses as to the causes (or reasons) of tax evasion and avoidance and the possible consequences of tax evasion and avoidance on Nigeria economic development.

Analysis, Findings and Discussions

Data collected were analyzed using percentages, the arithmetic mean and standard deviation. The standard deviation enables us to determine with a great deal of accuracy where the values of a frequency distribution are located in relation to the mean. The standard deviation and the mean of normal population density function help us to determine probabilities of events. As the sample size is sufficiently large (greater than 30) the central limit theorem was applied. According to the Central Limit theorem, even if the population is not normally distributed as the sample size increases, distribution of sample means approaches normality. Thus the application of this theorem enabled us to use the sample size in this study to draw inference about the population of study without knowing much of the population other than what we got from the sample. Also, the government will not have sufficient funds in executing its plans and agenda for the nation (Eboziegbe, 2007) since taxation is one of the major source of government revenue and which is being paralyzed by the menace of tax evasion and tax avoidance. Further more, tax evasion is one of the major social problems inhibiting development of the Nigeria economy and eroding the existing welfare state in Nigeria and other developing economies of the world.

Analysis of Tax Evasion and Tax Avoidance

S/No.	Particulars	No. of Samples that identified it (X)	Mean (M)	X-M	(X-M) ²	Percentage %
1	Corruption in public office	17	10	7	49	100
2	Inadequate tax education and awareness	7	10	-3	9	73
3	Misappropriation of taxes collected	15	10	5	25	90
4	Ignorance of the tax payer's of their civic responsibility	6	10	-4	16	45
5	Inadequate qualified personnel engaged by the tax authority	13	10	3	9	80
6	Lack of adequate enforcement for default	11	10	1	1	85
7	Proliferation of taxes	7	10	-3	9	55
8	Loopholes in the tax laws	8	10	-2	4	65
9	Inequitable distribution of income	11	10	1	1	77
10	Absence of 'Quid Pro Quo' i.e. something of Value given in return (by the government) for taxes paid	12	10	2	4	90
11	High level of illiteracy	8	10	-2	4	64
12	High tax rates	7	10	-3	9	33
13	Inadequate accounting records maintained by traders	9	10	-1	1	67
14	Non-existence of efficient and equitable tax system	8	10	-2	4	78
15	Poverty	11	10	1	1	82
	TOTAL	150			146	

Source: Author's Survey January 2012

$$\text{Variance } (s^2) = \frac{\sum_{n=1}^{15} (X - M)^2}{N-1}$$

$$= 146/14$$

$$= \underline{\underline{10.42}}$$

$$\text{Standard deviation } (s) = 10.42^{1/2}$$

$$= \underline{\underline{3.229}}$$

Applying the central limit theorem

$$Z = \frac{X - M}{O}$$

$$Z = \frac{17 - 10}{3.229} = \underline{\underline{2.167}}$$

$$\Pr(Z \geq 2.167) = 1 - \Pr(Z \leq 2.167)$$

$$= 1 - (0.5000 + 0.4784)$$

$$= \underline{\underline{0.0216}}$$

From the above computations the mean (M) = 10 the standard deviation (s) is 3.229 and the distribution is 0.0216. this shows that there are 0.0216 probabilities that the mean will lie outside the standard deviation. In other words, it means that there is about 98% probability that all the variables listed as causes of tax evasion and avoidance are correct. Since the probability of its correctness is by far greater than its non-acceptance we can conclude that these reasons are actually the causes of tax evasion and avoidance. As could also be observed in Table 1 there are four major causes of tax evasion and avoidance. These are corruption in public office, misappropriation of taxes collected, and absence of 'quid pro quo. i.e. something of value given in return for taxes paid and lack of adequate enforcement for default. All of these causes have a percentage of 85% and above.

Conclusion

Tax evasion and avoidance is a very serious social menace that is causing a major set back on Nigeria economic development. From all indications it is now clear that if government engages in overhauling the tax administrative machineries, the problems of tax evasion and avoidance will be reduced to the barest minimum. It is also important for the federal government to put in place stiff penalty for corrupt tax officials and made frantic efforts aimed at putting in place adequate enforcement for defaulters. Such penalties and enforcement will help generate more revenue to the coffers of the government. It is hoped that if the measures prescribed in this study are implemented, it will go some way in reducing the problem of tax evasion and avoidance to reasonable dimensions.

Recommendations

For the federal Governments to meet her revenue targets it would be appropriate to take a look at the factors responsible for the incidence of tax evasion and avoidance since a check on these factors will go a long way in reducing if not eradicating the problem. Base on this background, the following recommendations are made:

1. Government should embark upon other means of publicity such as radio messages, television advertisements, post bills as well as the use of town criers to inform taxpayers of changes in tax legislation and need for compliance.
2. The tax authorities should properly review and evaluate the assessment and collection procedures so as to encourage compliance by the taxpayers. The usual practice of reprinting parts of the tax laws and sending same to the taxpayers expecting that they would understand is not encouraging since these laws are written in legal jargons or terms that are not easily understood. Moreover, tax forms should be made easy to understand. Vast improvement can be made by improving the design of the forms.
3. Suitable personnel should be recruited and Revenue personnel generally trained and retrained to cope with the

demands of the job.

4. Staff should also be motivated through good salary package to insulate them from fraud and other corrupt practices.

5. The setting up of Revenue Courts should be embraced by the federal Government. These Courts should be made to impose heavy monetary penalties and criminal sanctions.

6. The handling of tax clearance certificates should be well decentralized such that neither the assessor nor the collector can issue tax clearance certificates.

7. The Audit Unit of the tax authority should be strengthened to always Audit tax remittance by collectors at all levels. This measure will go a long way to curb corrupt practices among tax officials.

8. A legislation compelling banks to inform the tax authorities, on request, of any income standing in the account of any taxable person (especially the self-employed taxpayers) should be put in place by the federal government.

9. Government should endeavor to provide social amenities to all nooks and crannies of the federation (not just the state capitals alone), provide employment opportunities to all by the judicious use of tax proceeds. In this way all will feel belong thereby encouraging voluntary compliance.

10. A census of the taxable population should be conducted throughout the various states. This will now update the tax register so that at any given point in time the tax authority can give details of taxable adults and businesses thus reducing the incidence of tax evasion.

11. Since majority of the people are poor tax evasion becomes inevitable. The federal government should therefore aggressively tackle the inflationary trend and also ensure that the poor pay very minimal tax.

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