Tax System in Nigeria – Challenges and the Way Forward

Leyira Christian Micah (Ph.D), Chukwuma Ebere, Asian Asian Umobong
Department of Accounting, Faculty of Management Sciences
University of Port Harcourt, Nigeria
Tel: 234-803-354-2244.

ABSTRACT
This paper discusses the challenging issues affecting the tax system in Nigeria. It is characterized by lack of statistical data, poor tax administration, and inability to prioritize tax effort, multiplicity of taxes and increase in underground economy. It also proffer challenges so as to engender an efficient and effective tax regime in Nigeria
Keywords: Tax system, challenges, administration.

1. Introduction

Before a country considers how best to administer its tax system it must possess a clear picture of the scope of its tax system. The quantity and quality of resources required by tax administrators are to a large extent determined by the type of tax system which is introduced.

A nation's tax goals are not achieved by designing a tax system which is fair. Any fair system which is not administered as planned becomes inequitable. Thus, a good tax system is capable of financing the necessary level of public spending in the most efficient and equitable way possible. It should also (1) raise enough revenue to finance essential expenditures without recourses to excessive public sector borrowing, (2) raise the revenue in ways that are equitable that minimized its disincentive effects on economic activities, (3) do so in ways that do not deviate substantially from international norms. (Tanzi and Zee, 2000).

The Nigerian Tax system is lopsided and dominated by oil revenue and therefore the establishment of effective and efficient tax systems faces some formidable challenges. The first of these challenges is non availability of tax statistics.

The second is the inability to prioritize tax effort. The third is poor tax administration. The fourth is the multiplicity of taxes. The fifth is the structural problems in the economy that affects the maximization of VAT. Finally, the challenge of underground economy. It would take too much space to enumerate all the challenges so a few comments on some of them will have to suffice. The main objective of this paper is to examine these challenges affecting the proper implementation of a good tax system in Nigeria and proffer strategies for an efficient tax regime.

The rest of the paper is divided as follows: section 2 provides an overview the relevant tax regulations in Nigeria; section 3 examines the challenges that inhibit an efficient tax system in the country. Probably strategies for the way forward are provided in section 4 and section 5 gives the conclusion.

2. Overview of Taxation System in Nigeria

The Nigeria tax system is basically structured as a tool for revenue generation. This is a legacy from the pre-independence government based on 1948 British tax laws and have been mainly static since enhancement. The need to tax personal incomes throughout the country prompted the income tax management act (ITMA) of 1961. In Nigeria, personal income tax (PIT) for salaried employment is based on a pay as you earn (PAYE) system, several amendments have been to the 1961 ITIMA Act. For instance, in 1985 PIT was increased from N600 or 10 percent of earned income to N2000 plus 12.5 percent of income exceeding N6000. In 1989, a 15 percent withholding tax was applied to savings deposits valued at N50000 or more while tax on rental income was extended to cover charted vessels, ships or air craft. In additions, tax on the fees of directors was fixed at 15 percent, these policies were geared to achieving effective protection for local industrial, greater use of raw materials, generating increased government revenue among other (Mamud, 2008) consequently, and attention has been focused on promoting exports for manufactures and reducing the tax burned of individual and companies. In line with this change in policy focus, many measures were undertaken. These involved, among others, reviewing custom exemption and rebats introduction capital allowanced, expending the duty drawback scheme and manufacturing-in-blood scheme, abolisng excise duty. Implementation VAT, monetizing firings benefits and increased tax relief to low income earners.

3. Relevant tax Regulations in Nigeria

Taxation in Nigeria is enforced by the three (3) tiers of government, i.e. federal, state, and local government with each having its sphere clearly spelt out in the levies (approved list to investors both foreign and local.

The major tax laws in existence as of September 2003, and various related amendment include the following

i) Personal Income Tax act of 1993
ii) Companies profits Tax of 1990
iii) Petroleum profits tax act of 1990
iv) The Petroleum tax act of 1990;
v) Value –added tax act of 1990;
vi) Education Tax Act of 1993
vii) Capital gain act of 1990
viii) Customs and Excise management Act of 1990;
ix) Minerals and mining act of 1999;
x) Stamp duties act of 1990
xii) 1999 constitution of the federal republic of Nigeria.

All laws currently in effect date the military regime. The civilian regime, which has ruled the country since 1999 is yet to enact tax laws despite critical pending issues. With the exception of the 1999 constitution, the laws have been amended on a yearly basis in conjunction with the annual budget to correct loopholes and to promote their use as macroeconomic management instruments. Appendix tables 1 summarize some of the annual adjustments. In line with fiscal federalism, court jurisdiction over tax matters reflects the three tiers of government. The federal high courts have jurisdiction over company income tax, petroleum profit tax, custom and excise duties as well as stamp duties and corporate capital gains tax, and education tax. Personal income tax (PIT) and capital gains tax and stamp duties payable by individuals are legislated by the federal government, but collected by state authorities. Since the federal government is not a party to these taxes, their adjudication should fall on the state. The fact that any appeal to the VAT tribunal is handled by the court of appeal confirms that VAT adjudication jurisdiction of the magistrate courts. (Odusola, 2006).

4. Challenges Facing Tax System, in Nigeria

The Nigeria tax system is beset by a myriad of challenges, some of which are highlighted below (FRN i1997, 2002; Ariyo 1997; Ola 2001; Odusola 2002, 2003; study group on tax reform 2003);

4.1 Non availability of Tax Statistics: Taxation has been the oldest governmental activity since the country's unification is 1914, so one would expect tax statistics to be readily available. This expectation, however, is misplaced. With the exception of the states of Delta, Lagos, Kaduna and Katsina and the Nigeria Customs Services, other agencies of the states and relevant federal tax offices have serious failures in data management. Moreover, there are no efforts to have the limited data that are available collated or analyzed on a routine basis, not to mention, having it stored, or made more easily assessable or retrievable. This situation does not provide much input to policy process.

4.2 Inability to Prioritize Tax Effort: The political economy of revenue allocation in Nigeria does not prioritize tax efforts. It is, instead, anchored on such factors as equality of states (40 percent), pollution (30percent) landmass and terrain (10percent), social development needs (10 percent), and internal revenue effort (10percent). The approach, discourages a proactive revenue drive, particularly for internally generated revenue, makes all government tiers heavily reliant on unstable oil revenues which are affected by the volatility of the international oil markets. Aside from the national syndrome of 'cake sharing', the instability and volatility of oil revenue should have created an opportunity for improved tax efforts within the provisions on taxation ratified in the 1999 constitution. Although some state governments have initiated measured to enhance their tax generation attempts, the outcome has not reflected any level of serious effort.

4.3 Poor Tax Administration: Tax administration and individual agencies suffer from limitations in manpower, money, tools and machinery to meet to meet the ever increasing challenges and difficulties. In fact, the negative attitude of most tax collectors toward taxpayers can be linked to poor remuneration and motivation. Philips (1997) consider the paucity of administrative capacity as a major impediment to the government in its attempts to raise revenue in Nigeria. As of March 2003, the federal inland revenue service (FIRS) had 7,643 staff members throughout the country; of these a mere 12.6 percent, or 645 employees, were tax professionals/officers. The predominance of support staff in a professionally inclined agency like the FIRS does not augur well for the country. The situation at the local government level is more precarious. Anecdotal evidence shows that staffs are not provided with regular training to keep them abreast of developments in tax-related matters. This makes the administration of taxes in terms of total coverage and accurate assessment very weak.

4.4 Multiplicity of Tax: A major problem facing the country is the multiplicity of taxes. Individuals and corporate bodies complain about the ripple effects associated with the duplication of tax, this problem arose from the states' complaints about the mismatch between their fiscal responsibilities and fiscal powers or jurisdiction. To compensate, some states took the initiative of levying certain taxes, which has led to arbitrariness, harassment and even closure of businesses. To rectify this embarrassing situation, the taxes and Levies Act of 1998 was enacted. Lagos state is a good example of efforts to offset the inequitable distribution of VAT proceeds: it imposed certain taxes and proposed a re-introduction of the sales tax. To control multiple taxation, the join tax board started to publish a list of approved taxes and levies and to declare an other unspecified taxes illegal. This has created a degree of harmony, and checked the hitherto rampant taxation that had made the business environment in Nigeria so harsh.

4.5 **Regulatory Challenges:** Political risk and exchange controls pose by far one of the greatest business and regulatory challenges for companies during business in Nigeria. Also company law, protection of intellectual property are challenging areas for companies. Protecting your investment and workforce, being able to extract profits and freely move the workface are often taken for granted when investing in first world countries. Not so in Africa and Nigeria in particular, where the possibility of forfeiture of the business, or ability to remit profits could overnight as political regime come and go.

4.6 Structural Problems in the Economy:

Since the early 1990s, Nigeria has been moving away from direct to the indirect tax considered to be less distortionary. VAT, for instance, is less distortionary because it is applicable to the value-added contents of imports and of domestically produced goods. The potential for maximizing the benefits of this taxation from however, is constrained by structural problems in the economy. The predominance of the informal sector, constituting more than 50 percent of the country's economy, enables most domestic production to circumvent VAT. Income tax also faces the same risk. Since operations in the informal sector are rudimentary without adequate recordkeeping tax assessments are difficult to make. Often tax administration resorts to estimates that are prone to a wide margin of error, or open up tax evasion opportunities. Ariyo (1997) points out that the proportion of self-employed relative to the total working population is substantial, yet tax authorities have not devised appropriate means of collection effective personal income tax from this group. In fact, income from the self-employed or informal sector activities is grossly untapped. This situation applies equally to excise tax and VAT-retail trade in Nigeria is incredibly large but substantially informal. VAT collection at this stage is bound to be a logistical nightmare, particularly where a large depends largely on the extent of economic administration. The coverage of these forms of taxes depends largely on the extent of economic progress.

4.7 Underground Economy: The hidden or underground is usually taken to mean any undeclared economic activity. The major issue is how inland revenue authorities would tackle hidden economy covering these groups:

(a) Business that should be registered to pay tax, such VAT, but are not;

(b) People who work in the hidden economy such as the rural areas with difficult terrain and pay no tax at all on their earnings.

(c) People who pay tax on some earnings but fail to declare other additional sources of income

There are a number of serious policy issues that may results from the growth of the underground economy in Nigeria.

Tax evasion caused by higher tax rates will siphon off revenue, forcing even higher tax rates in the areas where evasion is tax policy must depend on the type of enforcement that accompanies it.

The opportunity to participate in the underground economy represent a "subsidy" to certain types of economic activity where evasion is easier. These are often relatively low productivity areas of the economy. The underground economy makes official statistics on economic growth less reliable, and this faculty information may lead to incorrect economic policy decision.

The underground economy is just one of many concerns that affects the tax system. Whenever there are taxes, there will be tax evasion, and its consequences, alters the way in which taxes impact on economic efficiency and income distribution. Therefore, the underground economy needs to be taken into account in predicting the impacts of tax changes. In particular, it can reasonably be argued, following Palda (1998), that anything which drives more activity into the underground economy reduces productivity.

5. CORRUPTION

Many countries have also had committees of enquiry, which have dealt with tax reform issues, include corrupt tax practices. The outcome of these efforts have also, at best, been mixed. It has become increasingly understood that without the imposition of fundamental complementary changes, tax reforms in and of themselves do not have a long lasting impact. Has noted.

"In many cases political corruption is at least as serious as corruption of the tax bureaucracy. Low salaries for tax officials, political protection of prominent tax evaders, poor monitoring of junior officials, high tax rates, high levels of discretion for the tax official, and poor information, generally are some of the Africa, Asia and Latin America". (1988, p.82) (Bowles 1988: 82).

At what point are the policymakers, bureaucracies, and taxpayers ready to make fundamental changes towards reducing corrupt practices is a question to which there is no prior or easy answer. As noted earlier, globalization has increased the urgency for such fundamental changes, but it is the internal dynamics of each society that will determine whether the needed changes will be made.

Measures to reduce corrupt practices are needed on a variety of fronts, and they need to be applied on an on-going basis over a long period of time. (the world bank, 1997, p. 105). It is essential that as with reform, addressing corrupt tax practices come to be regarded as an on-going process and not as one-off event. Basic institutional reforms are needed. However, the knowledge about how to bring appropriate institutions is still at an early stage (Rodrik,, 1999). All parties, including the multilateral agencies need to develop a sense of humility in this area.

It is also essential to distinguish between an ideal tax system and tax reform. The latter involves improving the exiting trade-offs between revenue generation equity, efficiency, and tax administration and compliance. This assumes the existence of a robust tax system and entrenched practices. Thus, strategies that address difficulties embedded in the political economy of the country, and that address economic literacy and political and leadership skill deficits (?) (delete the question mark) in particular, are essential in fundamentally tackling the causes of corrupt tax practices. This task is particularly challenging in the economics in transition where radical changes in the relations between the state, taxpayers and tax officials are contemplated when shifting from a centrally planned economy to a market economy. In the transition economics, ensuring that government officials and others do not misappropriate state assets is also a hugely challenging task because of the unclear nature of property rights and enforcement problems (Tanzi and Davoodi, 2001).

In any explanation of the phenomenon of corruption, in general, as well as in the specific case of corrupt tax practices, the principal-agent model (or agency theory) is frequently used (Jain, 1998; Rose-Ackerman, 1999). The principal is usually a person or organization on whose behalf the agent undertakes various tasks. To avoid corruption, the key then is to design incentive structures in such a way that the agent acts in the interest reducing the opportunities for corruption, and strengthening the mechanisms for monitoring and punishment (The World Bank, 105-107).

Corruption is prevalent in the administration of taxes and duties. Until very recently, it was commonplace to collect tax payments partly on behalf of one's self and partly for the government. Evaders prefer to bribe officials rather than pay taxes. Tax assessors collude with taxpayers, particularly with regard to the PIT, or in some cases, in connection with the assessment. The multiple processes of clearing imports is not only a source of administrative delay, but also an avenue for entrenching corruption. This is further compounded by the pilferage of goods at Port As CITN notes, 'governments in Nigeria are perceived as a corrupt and selfish lot, to whom money should not ever be voluntarily given, taxes paid are expect to end in private pocket, not in public utilities' (CITN 2002:15). This attitude has eroded tax consciousness on the part of Nigerians. Although some progress has been made by the present administration, there is still room for improvement.

It is important to note that in Nigeria the administration of VAT has been beset with problems, namely:

(i) Tax evasion and avoidance;
(ii) Inadequate finding for the revenue services
(iii) Limited or lack of independence of revenue services;
(iv) The lack of the VAT tribunal, as recommended under VAT Act Decree No. 102 of 1993
(v) Proposals by some state governments (e.g. Lagos) to re-introduce sale tax;
(vi) Practical problems related to the implementation of VAT's dual elements (input and output). Experts consider this to be a major challenge.

The failure of the three tiers of government to provide social amenities affects tax compliance. Apart from the problem of mismanagement of resources, more than 70 per cent of the revenue is spent on recurrent operations. For instance, recurrent expenditures in the total ranged between 71,9-78.5 percent during 1998 -200 (Odusola 2003) some local government are having difficulties in paying salaries, not to mention funding development projects. To many taxpayers, the fundamental principle of government has been defeated and the moral obligation to pay taxes for the salaries of government officials no longer exists.

6. Complexity of Tax Laws

Tax laws in Nigeria are complex and difficult for the common taxpayer to understand, and some cases are problematic even for literate officials. In addition to lack of understanding, many taxpayers are unaware of the existence of certain taxes. This coupled with the lack of information, laziness of the tax officials, uncooperative taxpayers and the habit of quick fix; solutions –encourages the use of 'the best judgement' approach. This may be a manifestation of the poor tax education and weak fulfillment by tax authorities of their responsibilities with regard to public awareness.

7. THE WAY FORWARD

7.1 Autonomy. What Nigeria tax system needs is the issue of autonomy which should be granted to boards of internal revenue. The operation we have now, as far as the federal Inland revenue service (FIRS) is concerned, is an old system. Until independence is allowed in the system there wouldn't be any way for the process to be impactful. With autonomy, the revenue boards will be responsible and responsible to what they are supposed to do, and we can be talking about professionally tax administration in Nigeria.

7.2 Efficient and effective Tax Administration: What the government has been trying to do now is to enforce the law. But you cannot enforce the law where you want to collect money and people are not aware of which law. There is need to educate staff of some government and private organizations. Also included on this tax education are staff of FIRS, economic and financial crime commission and Joint Tax Force on taxation.

Tax education may engender the citizens to carry out their obligations voluntarily. Tax administration can achieve good results only if the following conditions are met: simple tax rules and procedures, low tax burden, convenience to taxpayers, minimal compliance costs, easy access to information, and mutual thrust and fairness. Reforms that ignore these issues may not.

7.3 The use of computer technology. Computer technology must be combined with the political will to enforce tax collection if it to yield potential for greater revenue. Technology without accompanying enforcement procedures will not help in increasing revenue. Computer technology can help in developing a master file system. The system assigns a unique number to each tax payer. This unique number directly aids in identifying assessing and collecting direct taxes, such as personal income tax, company income tax, and the property tax. In this way, the master file can become an important instrument for audit. If the tax payer identification number is tied to other means of identification, such as drivers licenses or passport, it can be a potentially powerful means for tax enforcement.

7.4 Strengthening Auditing. Auditing is a vital but neglected function. Tax administrators often employ resources for checking refunds from withholding schemes rather than going after the more difficult but higher revenue yields that would come from aggressive auditing of self-employed, professional and business firms. If significant number of tax payers have stopped filling returns, and if large numbers of firms show suspiciously small profits, there is a need for more audit. Measures to strengthen auditing capacity include hiring and training new auditors, cross-checking information from large taxpayers on income tax and VAT returns, and for those who voluntarily accept auditor's should be established whereby finds and penalties are reduced if tax payers immediately accept auditor's preliminary assessments, penalties are progressively increased for those taxpayers who appeal and fail.

7.5 Tax Rates and Use of Tax Money. Legislatures and tax administrators must recognize that tax systems will be effective in the long term only if they have the cooperation of the vast bulk of tax payers. There are a number of things which a legislature can do. For instance, it can start by keeping demands on tax payer funds to a minimum. Perceptions that tax rates are too high can have a significant effect on compliance. Related to this is the tax payers' perception of how wisely a government spends taxpayers money. Compliance will be significantly better if tax-payers perceive that the government is wasting taxpayer money compliance is likely to decline. Governments must not only aim to eliminate waste, they must also convince tax payers that taxpayer money is being spent wisely.

7.6 Public Enlighment. Explore ways of using the mass media to publicize such things as new tax laws, taxpayers' annual return obligations, the penalties for evasion, the enforcement activities which are conducted, the type of people who are caught trying to avoid their taxapaying responsibilities, etc.

A corrupt-free and efficient administrative machinery with personnel who are adequately trained, well-equipped and motivated would enable Nigeria to make appreciable progress in revenue diversification. Tax administration machinery should have an effective redress and refund system so that disputes can be settled easily and corruption checked.

To avoid the present situation where states impose illegal taxes and levies, there should be a unified, effective and unbiased tax administration with full representation from the three tiers of government. This should not, however, compromise the diversified revenue efforts and the uniqueness at each level of government. To complement this effort, specialized tax judges are needed in the courts to adjudicate on tax matters promptly and efficiently and to foster tax compliance and respect.

Funding for tax authorities and custom services should be increased to 3-5 percent of the targeted revenue to ensure efficient administration. Officials employed within these services must adopt a client friendly attitude for assisting taxpayers/importers as the need arises.

Nigeria has numerous tax incentive structures, but these need to be made internationally competitive. While acknowledging the efforts of the present democratic regime to put the country's ports into shape, they are still below international standards, and should be improved to ensure competitiveness.

The current situation in which the buoyant tax handles are controlled by the federal government is an issue for concern. Thus, there is need to align tax responsibilities with tax power. The authority to issue taxes should be devolved to lower tiers of government: this could have positive implications for the fiscal coordination and macroeconomic management of the country.

JTB's new stance that tax consultants should not be involved in primary taxation functions is a step in the right direction because it upholds the tenets of the taxes and levies act of 1998. Consultants contravening the law should be prosecuted by the Attorney General, and relevant professional associations should take disciplinary steps against erring tax consultants. To tap income from the self-employed or informal sector activities, a broad-based comprehensive scheme should be designed so as to fully harness the potential from this revenue source. Tax incentives have not had much impact in Nigeria. Total rejection of the present approach is not warranted, but its use should be restricted to such important sectors as oil and gas, export-oriented industries located in rural areas and solid minerals development, etc.

In addition to addressing the problem of corruption and entrenching real for money in public service delivery, there is need for continuous dialogue between the government and citizen on taxation matters. This does not, however, repalce the need for tax education and information campaigns on critical issues relating to tax administration. The government must be honest and more transparent with regard to the way public funds are dispensed. Defaulters must be prosecuted for tax evasion, or the general public will not take taxation seriously. Nigerian tax laws are noted for their complex structure. Tax laws must be understandable to all: they should be expressed simply, clearly and intelligibly. The annual amendments that are incorporated into the yearly budgets should be aligned with the principal legislation to avoid confusion.

8. CONCLUSION

The foregoing offers a theoretical framework for improving some silent issue in Nigeria's tax system, suggesting challenges and possible remedies. As must be clear by now, tax is a complex phenomenon that affects both the government and the citizenry.

We consider the remedies raised as crucial to overcoming the challenges inherent in the entire tax system with a view to enabling Nigeria desire the potential benefits of fiscal policy re-engineering.

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Table 1 Nigeria's tax system (taxes and levies approved for collection)

Decree No. 21 of 1998

Federal government	Statement government	Local government
• Company income tax	• Persona income tax (applies to residents of the state)	• Tenancy rate
• Petroleum profit tax	• Withholding tax (individuals only)	• Shops and kiosk rates
• Value – added tax (applies to companies, residents of the federal capital territory and non-resident individuals)	• Capital gains tax (individuals only • Stamp duties (applies to instrument executed by individuals only)	• Fees for on-off liquor license • Fees for butcher slabs • Fees for marriage, birth and death registrations
• Capital gains tax (applies to corporate gains tax (applies to corporate bodies and Abuja residents)	• Road taxes (e.g. vehicle license) • Taxes on pool bets, lottery and casino wins	• Fees for street name registration (except those of federal and state governments)
• Stamps duties (applies to corporate bodies)	• Business premises and registration fees in urban and rural areas: Urban area as defined by each state, maximum of;	• Cattle tax, applies to cattle farmers only
• Withholding tax (applies to companies	(i) N 10, 00 for registration, and • (ii) N5, 000 per annum for renewal of registration;	• Entertainment and road closure levy
• Personal income tax (applies to personnel of the armed forces, police, external affairs ministry, and residents of Abuja	Rural area (i) N2, 000 for registration, and (ii) N1,000 per annum for renewal of registration	• Fees for radio and television license • Vehicle parking and radio licenses fees
	• Development levy (max. of 100 per annum applies to taxable individuals only)	• Charges for wrongful parking fees for public convenience, sewage and effuse disposal
	• Street name registration fees (state capital only)	• Customary ground permit fees
	• Fees for right of occupancy on urban land owned the state government	• Fees for permits for religious establishments
	• Market taxes and levies where sate finance is involved	• Fees for permits for signboards, bill boards and advertisements
	• Miscellaneous revenue (e.g. rent on property)	

Note: Other major taxes authorized under different tax includes; (i) mining, rents and royalties; (ii) customs and excise duties (i.e., import and export duties), and (iii) miscellaneous revenue (e.g. earning from oil sales, rents on property, etc.