

## Complicated Tax Law as an Impediment to Domestic Resource Mobilization in Nigeria

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### ABSTRACT

*The following article examines how the convolution of the tax laws upon which the tax system depends can be an impediment to effective resource mobilisation in Nigeria. It focuses on the influences of the prevailing socio-economic conditions on the taxpayer's likelihood to comply with tax laws which they hardly understand. Taxpayers are portrayed as being more of victims of an opaque tax system than intentionally bent on defaulting and evading their civic responsibilities. A key contributor to the complexity of the tax system is the ambiguity emanating from a duplication of roles and the competing interests of agencies working at cross purposes to each other. These complications in the tax system eventually constitute loopholes for other losses such as capital flights and profit shifting. Initiatives aimed at demystifying the process of tax collection were lauded as viable future directions to stem the tide of suboptimal resource mobilisation in Nigeria.*

**Keywords:** Tax laws, Resource mobilisation, Tax system

### 1.0 Introduction

The system of taxes and tax laws in any country is bound to be predicated on the peculiarities of the nation's population especially with regard to its demographic and socioeconomic distribution. However, the challenge of complicated or complex tax laws which place demands on the understanding of the average taxpayer seems to be a recurrent trend in many nations of the world. Some experts have even suggested that the apparent complexity of the tax systems may be deliberate. This characteristic of tax systems is actually problematic even in informed societies with literacy levels of at least 99%. In Nigeria however, the level of enlightenment tends to cast doubt on the wisdom of implementing a system bordering on the abstruse. Furthermore, per capita income in Nigeria lies within the lower quartile globally (World Bank, 2018) and compliance to tax laws may be too expensive for start-ups who struggle to break even in their early years of business. If it becomes necessary to retain the services of a tax expert, the cost to such potential taxpayers could prove too prohibitive to maintain. It is thus obvious that when attempts to navigate a confusing landscape of the tax system prove difficult, compliance is bound to suffer.

Advocates of tax law complexity believe that a simple system will not be equitable because it will not take into account the differentials in income levels and the unique needs of different population segments. No matter how narrow a tax base may be or how homogeneous the population, the goals of individuals and businesses may not converge. An overarching quest for simplicity will result in a tax system known as the head tax in which everyone pays the same amount but this would only be appropriate if everyone earned exactly the same amount.

Taxes are also likely to increase in complexity by virtue of the politics surrounding their passage into law (Maag, 2011). There are usually a myriad of interest and pressure groups with a stake in certain taxes while some friends of the administration may be seeking some tax exemptions for their investments. Members of the legislature who owe their allegiance to their political parties are aware of the taxes which could help fund the initiatives that constitute a part of the campaign promises they made to their constituencies. If the Presidency also wishes to focus on a particular strategic direction for the nation, it may require more emphasis on some aspects of the tax system over others. Recent analyses for instance, have identified the large informal sector in Nigeria as an opportunity area for the augmentation of the tax base. The responsibility would then fall on the Tax Service to creatively induct this sector into the tax base. To do

this, additional bills will have to be passed into law to ensure compliance by enforcing these laws on a previously undocumented sector of the potential tax base. As new problems emerge with implementation, revisions and amendments would occur to the tax system. These additions could potentially increase the complexity of the laws guiding taxation in Nigeria.

A major thrust of the debate on tax law complexity is that it could impede the efforts to mobilise resources domestically in Nigeria. This argument certainly has some merit. It may however be necessary to examine the profile of the average Nigerian taxpayer in order to understand how the issue of tax law complexity impacts domestic resource mobilisation.

## **2.0 The Average Nigerian Taxpayer: Realities in the Nation**

Nigeria is the most populous nation in Africa with an estimated population of over 195 million people (UN, 2018) which constitutes almost 3% of the global population. There is also a preponderance of young people who cannot contribute significantly to the Gross Domestic Product (GDP) as the median age is 17.9 years. As such, the dependency ratio is currently 88% (CIA Factbook, 2018). Only about 60% of Nigerians above the age of 15 can read and write with a greater proportion of them being males. This invariably influences employment opportunities and the employability of youth as recent estimates put the unemployment rate at 13% of a labour force of approximately 77 million people (National Bureau of Statistics, 2016). The most worrisome of these figures is that about 70% of the population subsist below the threshold for extreme poverty of almost \$2 per day despite Nigeria having a per capita income of almost \$6,000 (CIA Factbook, 2018). The implication here is that a severe “Pareto principle” operates in which more than 80% of the resources reside in the control of less than 20 % of the population while the majority of the population struggles for scraps. Furthermore, the tax to GDP ratio in Nigeria is almost 3.5% which is the second lowest in the world after war torn Somalia (UN, 2018). This ratio is a reflection of the perceptions of the taxpayer about taxes in general and once more highlights the failure of the social contract between government and the populace.

From the foregoing, we can infer some of the following insights into the perspective of the Nigerian taxpayer.

- The Nigerian taxpayer is more preoccupied with survival in a harsh economic climate and challenging business environment than with payment of taxes.
- The Nigerian taxpayer does not trust that their taxes will be used for the public good. A collapse of the social contract can be blamed for this. In addition, the Finance Minister in the person of Kemi Adeosun recently lamented the poor compliance rates among individuals and business owners which was seen in the fact that only 8% of the businesses registered with the Corporate Affairs Commission (CAC) are also registered with the Federal Inland Revenue Service (FIRS) (The Guardian, March 2018). Thus business owners are likely to prefer spending extensively to provide their firms with essential services such as water, power and security as well as stopgaps for any aspect of infrastructure which concerns them instead of remitting any monies to government in form of taxes.
- Many Nigerian employees simply depend on their employer to deduct the appropriate amount of income tax and PAYE as at when due. Thus, the employees may have no idea how these computations are made. Based on the poor compliance rates among private businesses, it is obvious that some employers fail to remit the money to government after deducting it from their employees.
- Business owners who wish to file appropriate and accurate tax returns are frustrated by the difficulties inherent in the process. The expense in time and money on the part of the business owner, may not justify the amount eventually remitted to the Tax Service. Furthermore, they do not perceive any tangible benefit for their trouble neither do they discern any avoidance of punishment since it is quite fashionable to evade taxes in Nigeria (PwC, 2017).

A better grasp of the ramifications of a simplification of the tax system is possible if we examine the characteristics of the current system. It is not appropriate to blame the taxpayer for their inability to understand the nuances of meaning inherent in the tax laws. Rather, it is the system that must endeavour to carry them along if improved domestic resource mobilisation is to be achieved.

### **3.0 The Tax System: Challenges with Complexity**

Tax system complexity is an issue all nations grapple with but this is especially true of Nigeria. A recent survey by PwC revealed that the strongest reason for noncompliance and invariably, poor resource mobilisation in Nigeria, is because Nigerians claim that they do not see taxpayer money at work (PwC, 2017). The second most cited reason for noncompliance was that tax rules are difficult to understand and the process of compliance was riddled with too much complexity (PwC, 2017). It was also speculated that such unclear rules may incite suspicions of possible exploitation of the taxpayer by government. For example, if the taxpayer cannot understand the tax laws, he perceives himself at a disadvantage due to the failure of the social contract with regard to taxation. He also expects government to take advantage of his ignorance to increase his tax burden when he decides to pay his taxes. To avoid being exploited by a system he does not trust, he resorts to noncompliance.

The structure of the current system has also led experts to conclude that the tax laws contain many ambiguities and these sometimes degenerate into conflict and legal action between one tier of government and another or one agency of government and another. An example was the case of *Lagos State Waterways Authority & Others vs The Incorporated Trustees of Association of Tourist Boat Operators & Water Transportation in Nigeria & Others*. The summary of this case is quoted below:

For a long time, there was lack of clarity on who was the rightful regulator of the waterways within Lagos State. Whilst this ambiguity lingered, operators of boats and dredgers on the waterways were groaning under the heavy burden of double taxation, as they were licensed, regulated and taxed by the Lagos State Waterways Authority (LASWA), National Inland Waterways Authority (NIWA) and Nigeria Maritime and Safety Agency (NIMASA).

In May 2012, operators of boats and dredgers instituted action at the Federal High Court (FHC) to challenge the FG's power to assess cabotage fees and levies on vessels, boats and dredgers working in the intra-inland and inter-inland waterways.

The FHC decided that that the activities of the boat operators and dredgers fall under the purview of the power vested in the NIWA to regulate maritime and shipping in the country. Essentially, the FHC ruled that the FG and its agencies were the competent authorities to license, register and regulate transportation and tourist boat operators on the inland waters, waterways and waterfronts within Lagos State.

Dissatisfied with the FHC's ruling, the Lagos State Government appealed the case at the Court of Appeal (COA) in 2014. The main issue for determination in the case was whether the regulation and taxation of intrastate waterways fall under the Exclusive Legislative List over which the FG has jurisdiction, based on a correct interpretation of Part 1 of the Second Schedule to the Constitution.

The COA resolved the case in favour of Lagos State and set aside the earlier judgment of the FHC. In deciding the case, the COA agreed with Lagos State's position that the Constitution was silent on the classification of intra-waterways in the State; and that the matter consequently falls under the Residual Legislative List, which only the State's House of Assembly has legislative powers over. Thus, the Lagos State House of Assembly is competent to make laws in respect of the intra-inland waterways in Lagos State.

The appellate court also highlighted that no conflict was pointed out by the FG between the provisions of the National Inland Waterways Act and the LASWA Law as to render the latter void to the extent of its inconsistency with the former (KPMG Year in review, 2017).

The case cited above is an example of several other ambiguities which exist in the tax laws. These complicated laws are liable to result in multiple taxation which can adversely affect tax morale, compliance and eventually the mobilised domestic resource. Similar to the case cited above, multiple taxation occurs when the taxpayer is faced with demands for the same or similar tax from two or more different agencies of government (Sanni, 2012). The Fourth Schedule of the 1999 constitution lists over 120 types of local government taxes which have prompted experts to declare almost unanimously that the schedule should be amended; many of the taxes listed are obvious cases of multiple taxation. When multiple taxation exists,

the professionalism and integrity of tax authorities may be questioned by the taxpayer whose trust in the authority is known to be fragile. Compliance to tax laws is as much the duty of the tax authority as the taxpayer but complicated laws could impede the effectiveness of tax authorities.

Following from this issue of multiplicity of taxes is the low level of interagency cooperation with regard to the monitoring and enforcing of compliance. Since the tax laws do not always clearly specify the ambit of an agency's powers to demand or collect taxes, it fails to prevent an overlap of roles from similar agencies and this could degenerate into conflict. If the perception of the taxpayer is that the establishment of these agencies and the passage of the tax laws was carried out arbitrarily, they could hardly be blamed. Although this applies more to taxes at the local government and State level, these perceptions are likely to also affect taxes at the Federal level. The current administration has simplified payments into the government's coffers by the implementation of the Treasury Single Account (TSA) and this has plugged many loopholes through which Federal resources had dissipated in the past. Could this be an indication that simplification is possible in other domains including taxes and tax regulations? It remains to be seen what strategic direction the Service will adopt but it is obvious that complicated tax laws have not delivered on the intentions behind them.

Improved domestic resource mobilisation is considerably hampered by some of the exemptions granted to several firms as some of these provisions have not aided sustainable development. The process by which firms are granted pioneer status should be more stringent and the laws governing this exemption may need to be reviewed. Similarly, tax incentives which have been overstated as a driver for Foreign Direct Investment, have not proven as effective as hoped. Research suggests that investors do not make decisions in the hope of gaining tax breaks. Rather, they are more interested in economic and commercial factors such as the cost of doing business in an environment as well as the size of the markets they seek to enter. In fact, they may prefer lucrative environments even without the tax breaks because they are confident that they would make more than enough profit to defray any taxes (EPS Peaks, 2013). In addition, some multinationals already enjoy foreign tax credit in their home countries and any tax breaks they enjoy in Nigeria may have negligible impact on their bottom line and may only be of benefit to the developed home country.

Complicated tax laws have also been known to impede the smooth running and negotiation of tax treaties. According to the United Nations Conference on Trade and Development (UNCTAD, 2007), it is estimated that most of the domestic resource mobilised in Nigeria and the rest of Africa falls victim to capital flight every year. This tide can be stemmed with the achievement of more bilateral partnerships with mutually beneficial terms. However, clarity of local tax laws will enable smoother negotiations on the international front because differences in language, experience and politics could reduce mutual understanding in these negotiations which are usually fraught with complexity.

Complex tax legislation also poses a stumbling block to the Tax Services of many African Countries. Even among administrators and tax officials themselves, only a handful are fully experts with the clauses and provisions of the tax laws. If we use the current drive to induct the large informal sector into the tax base as an example, it is apparent that those who will engage the potential taxpayer in the field may not be as conversant with the tax laws as the experts at the Headquarters. Since many of these laws lack clarity and simplicity, they are sometimes difficult to enforce because a tax official may not be able to tell unambiguously when an undocumented potential taxpayer has actually broken the law. This is a fertile ground for corruption because unscrupulous and enterprising officials on the field are free to interpret the tax laws how they wish and the taxpayer is none the wiser. The tax official could then offer the taxpayer a cheaper alternative so that in the end, the taxpayer pays less than what the law stipulates and a significant fraction of such payments go the officials without being remitted to the coffers of the Tax Service.

#### **4.0 Conclusion: The Way Forward**

An attempt to simplify tax laws in Nigeria will signify government's intention to ease the burden of compliance on taxpayers and eliminate yet another obstacle in the path of optimal resource mobilisation. The Tax Service will thus be able to effectively deliver on its mandate. Many loopholes for exemptions and

exclusions must be plugged to allow the economy truly benefit from taxation as a driver of sustainable development. Even as government seeks for alternative sources of income to reduce the degree of borrowing from abroad, it has become necessary to fully exploit taxation in mobilising domestic resources for domestic growth and to obviate the need to increase the foreign debt. The following key actions required to turn the current tide in our favour include but are not limited to the following:

1. Reduce the cost to taxpayers of complying with the tax code: This reduction of cost entails reducing the cost in time, effort and expense of compliance. It also includes reducing the consequences of past ignorance and noncompliance especially for the teeming informal sector who are to be inducted into the tax base. Technology can be a veritable tool in boosting the efficiency of the system. This era of e-banking, e-payments and the fledgling e-governance in Nigeria has shown that it is possible to have online platforms for the payment of taxes. With the use of a computer or smartphone, a taxpayer should have access to a user-friendly and adaptive online platform. Global benchmarks suggest that an increase in the automation of repetitive tasks in any process could improve efficiency and eliminate human error in computations. Any capital expenditure incurred in setting up and maintaining such a platform will eventually be paid back many times over as the initiative gains momentum.

Current initiatives such as VAIDS (Voluntary Assets and Income Declaration Scheme) must be commended for the benefit it affords the Tax Service by bringing previously undocumented taxpayers into the tax base. Through similar schemes such as improved social media presence, government can ensure that tax related matters achieve increased visibility and top-of-mind awareness in the public consciousness. This could eventually drive domestic resource mobilisation to a critical mass that can translate to observable upswings versus previous years.

2. Improve the ability of the Tax Service to administer tax laws effectively: Inasmuch as the taxpayer benefits from a simplification of the laws guiding the process of tax collection, the Tax Service could also enjoy reduced difficulties in administration and will be better able to contribute to the global objectives of the Service and the nation at large.

3. Protect taxpayers from corrupt and opportunistic officials: There is no agency in the world that can claim to be entirely immune to corruption and the Tax Service in Nigeria is no exception to this assertion. When the laws are simple and straightforward, taxpayers are shielded from exploitation by unscrupulous officials who seek to portray the process as overly difficult in order to induce the taxpayer to pay a reduced sum to circumvent the hassle and thus the taxpayer parts with their money without documentation.

4. Easier capacity building: Officials of the Tax Service can be more amenable to training in global best practices when the laws are as simple as the process and can thus be clearly understood. A situation in which a brilliant process cannot be implemented because the laws are ambiguous on jurisdiction could negatively impact the morale of officials and reduce trainee readiness. This could also reduce costs associated with dependence on consultants for protracted periods of time by ensuring that consultants only come in occasionally as stopgaps during transitions to a new and improved business process.

The recommendations can further be distilled into the following points:

- A shift towards greater reliance on indirect taxes which are easier to collect and administer and more difficult to evade.
- Abolition of multiple taxation by various tiers of government.
- Classification of tax incentives by sector, and limiting of such incentives to economic activities that expedite national development.
- Periodic comprehensive review of the Nigerian Tax System (laws and administration).

It is hoped that with the implementation of the above, we can exponentially improve domestic resource mobilisation in Nigeria.

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