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Assessing the Productivity of Personal Income Tax System in Nigeria.

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ABSTRACT

This study involves an assessment of the personal income tax system in Nigeria. To generate the data for the study, the ex-post factor research design was adopted. Hence, the data on personal income tax (PIT), total tax revenue (TTR), and Gross Domestic Product (GDP) for the study were collected from secondary sources such as the Central Bank of Nigeria (CBN) Statistical Bulletin and Annual Reports for 14 years. The time series data covered the periods 2000 – 2013. In this study, we adopted Oloidi and Oluwalana (2014) model of assessing tax productivity with little modification. In the model tax productivity is measured by applying somewhat cross elasticity between some economic indexes such as GDP and TTR. Our findings showed that personal income tax in Nigeria is unproductive. It generate serious economic burden on the tax payer to be able to yield maximum revenue for the government. However, we believe that the new legislation (the Federal Capital Territory Internal Revenue Act 2015), which establishes a new tax authority for the Federal Capital Territory (FCT) to administer and collect taxes from residents of the FCT will improve personal income tax particularly from high net-worth individuals. Based on the above, it is therefore recommended that the Nigerian Government should intensify effort to further improve revenue generation through personal income tax. The government should ensure that all self –employed individuals and traders register their businesses, and appropriate monitoring system should be put in place to ensure maximum compliance with personal income tax to promote its productivity.

KEYWORDS: ***Personal income tax, assessment, productivity.***

1.0 Introduction

Over the past decades, the country's revenues were largely derived from primary products. Between 1960 and the early 1970s, revenue from agricultural products dominated, while revenue from other sources was considered as residual.

Since the oil boom of 1973 to date, oil has dominated Nigeria's revenue structure and its share in federally collected revenue rose from 26.3% in 1970 to 81.8%, 72.6%, and 76.3% in 1979, 1989 and 1999 respectively. Over the past two decades, oil has accounted for at least 70% of the revenue, thus indicating that traditional tax revenue has never assumed a strong role in the country's management of fiscal policy. Instead of transforming or diversifying the existing revenue base, fiscal management has merely transited from one primary product based revenue to another, making the economy susceptible to fluctuations of the international oil market (Odusola, 2006).

The fall in oil revenue in recent times has redirected the attention of Nigerian Government to seek alternative sources of revenue in financing its numerous projects. Public finance experts, economists and other stakeholders have argued that taxation is a veritable instrument for this purpose. Taxation as a veritable tool for economic growth and development largely depends on a proper tax system which has the capacity to generate revenue. Since tax is a major source of government's revenue in meeting its expenditure, the extent to which the Nigerian tax system generates the needed revenue to meet up with this ever-increasing government expenditure burden calls for concern. This implies that the tax system must be productive. The productivity of a tax system is the ability of the system to yield maximum revenue for the government with a given tax base without placing a difficult economic burden on the tax payer.

Realizing the importance of taxation in meeting expenditure requirements, the Nigerian government undertook various types of tax reforms. Osoro (1991) confirmed that most of the reforms focused on tax structure rather than on tax administration geared towards generating more revenue from existing tax sources. If a tax system is efficient and effective, the revenue generated as a proportion of national income should be close to or more than 100 percent of the standard rate of that tax (Ngerebo & Masa, 2012). For instance, if the effectiveness of personal income tax system were to be judged, then the tax revenue accruing from the rate of personal income to the national income should be divided by the average personal income tax rate subsisting (Ebrill, Bodin, & Summers, 2001). The idea is that, since tax is paid out of the total income, the amount of tax generated should be equal to the tax rate multiplied by the national income. Where the proportion is less than the standard rate, it follows that the tax system is not productive and hence ineffective. On the other hand, if the proportion is less than the standard tax rate where the revenue generated is divided by the total consumption expenditure, then the tax system can be said to be unproductive and inefficient because it has not been able to influence consumption as it would have been originally intended.

Prior studies have examined the productivity of the Nigerian tax system generally but little or no studies have been conducted on the productivity of a particular tax system such as personal income tax. Therefore, an attempt to evaluate the productivity of personal income tax system in Nigeria is the purpose of this study.

2.0 Literature Review

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 collecting effective personal income tax from this group. In fact, income from the self-employed or informal sector activities is grossly untapped. 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), population (30 per cent), landmass and terrain (10 per cent), social development needs (10 per cent) and internal revenue efforts (10 per cent). The

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approach, discouraging a proactive revenue drive, particularly for internally generated revenue, makes all government tiers heavily reliant on unstable oil revenue which is 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 personal income tax efforts within the provisions on taxation ratified in the 1999 Constitution. Although, some state governments have initiated measures to enhance their personal income tax generation attempts, the outcome has not reflected any level of serious effort.

Personal income tax is the oldest tax in Nigeria as a nation. It was first introduced as a community tax in northern Nigeria in 1904, before the unification of the country in 1914 (Ola 2001) and was later implemented through the native revenue ordinances to the western and eastern regions in 1917 and 1918 respectively. Among other amendments in the 1930's, it was later incorporated into Direct Taxation Ordinance No. 4 of 1940. The need to tax personal incomes throughout the country prompted the income tax management Act (ITMA) of 1961. In Nigeria, personal income tax for salaried employment is based on 'pay as you earn' (PAYE) system and several amendments have been made to the 1961 ITMA. For instance, in 1985 personal income tax (PIT) was increased from ₦600 or 10 percent of earned income to ₦2,000 plus 12.5 percent of income exceeding ₦6,000. In 1989, a 15 percent withholding tax was applied to savings deposits valued at ₦50,000 or more, while tax on rental income was extended to cover chartered vessels, ships or aircrafts. In addition, tax on the fees of directors was fixed at 15 percent.

In 1990, further amendments were made to PIT: apart from providing additional individual tax allowances, minimum taxation was reduced from 1 percent to 0.5 percent, so that individuals with incomes of ₦3,000 or less were exempted from submitting tax returns. Non-residents were exempted from withholding tax on interest accruing in deposit accounts. Personal allowances were further extended in 1992 to reduce the tax burden of individuals while the monetization and taxation of fringe benefits were introduced.

The application of ITMA varied across Regions/States, causing the burden of multiple taxes on individuals. Two study groups were subsequently set up in 1991 to review the situation and improve tax collection. The 1961 ITMA was amended and the amended Act was replaced in 1993 by PITA No. 104. It was applicable with nationwide coverage. Its administration, however, was assigned to the States, which were empowered to tax individuals, or corporate or bodies of individuals residing in its territory in a particular year. Rates were also increased, the PITA coordinated the subsidiary legislations for the PAYE system, withholding taxes, among others, as stipulated by the Ministry of Finance. The PITA empowered the Joint Tax Board (JTB) to administer the tax throughout the country and to coordinate its administration, while the State Board of Internal Revenue (SBIR) became responsible for the administration of the revenue. There have been some amendments since its implementation. For instance in 1994, to achieve progressive taxation, the withholding tax was increased from 5 to 10 per cent. Directors' fees payable by property and investment companies were raised from ₦3,000 to ₦10,000 when a 30 per cent ceiling was set for PIT. Child allowance was first increased to ₦1000 and then, in 1996, to ₦1,500 per child payable up to four children. In 1998, this became ₦2,500 per child. In addition, tax relief to low-income earners was increased to ₦2,500.

A recurring problem with PIT is the non-compliance of employers to register their employees and to remit such taxes to relevant

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authorities. To address this, in 2002 the government amended the 1993 PIT Act to make non-compliant employers liable to penalties up to ₦25,000, as well as liable for the payment of all tax arrears. Employers failing to keep proper records would also face a penalty of ₦5,000. A fine that is small tends to encourage tax evasion since the penalty for being caught is lower than the cost for non-compliance. The issues of unremitted funds from the PAYE system and withholding taxes particularly among government ministries and agencies as well as non adherence by all three levels of government to the approved list for tax collection, as stipulated by the 1998 Taxes and Levies Act 21, have over the past few years attracted the attention of JTB.

The JTB deplored the use of tax contractors/consultants for assessment and collection of taxes by some States and local governments and urged various States' Executive Governors to ensure that the tax administration structures as provided for by law are put in place for effective, efficient and enduring tax administration in the country.

PIT failed in Nigeria for lack of equitability. In spite of the fact that the self-employed out-number paid workers and earn as much as four times than that of formal sector employees, the bulk of PIT is paid by employees whose salaries are deducted at source (Adekanola 1997). Inadequate monitoring by tax authorities, the dominance of informal sector activities and the fact that many Nigerians live in rural areas make the coverage of self-workers difficult. Although regulations were stipulated in PIT Act No. 104 of 1993, amendments are still being made on a yearly basis. In addition to the fact that amendments are not adequately informed to the public nor incorporated in the relevant legislation, the legal language is also ambiguous, confusing and unprofessional (CITN 2002). There is very little tax education in Nigeria; taxpayers are ignorant of the laws regulating their taxation and this makes disclosure difficult. The absence of communication between the government and the people make most citizens view taxes as a mere legal hindrance rather than their civic responsibility. As regards institutions relevant to the tax system, it is noted that the efficiency of a country's institution has significant bearing on its operations. For instance, between 1999 and 2002, the Federal Inland Revenue Service (FIRS) accounted for 74.5 per cent of federal tax revenue while the NCS collected the balance. For efficient operations, the federal tax organizations should comprise the following (Study Group on Tax Reform, 2003). CITN (2002:15) summarizes the problem confronting the PIT administration as follows:

"We must admit that tax administration is particularly hard here
because literacy level is low and record keeping is not yet a popular
culture. There are not enough tax officials to cover the field. Most
of the officials are little trained, ill equipped, badly remunerated
and corrupt. Governments in Nigeria are perceived as a corrupt and
selfish lot, to whom money should not ever be voluntarily given. Taxes
paid are expected to end up in private pockets, not in public utilities".

The foregoing not only makes compliance difficult, but also enforcement problematic.

Various reforms have been made to Personal Income tax in Nigeria since its inception to enhance its productivity. The most recent is the personal income tax amendment Act No. 20 of 2011 which was signed by President GoodLuck Ebele Jonathan on 14th June, 2011. Highlights of the amendment to the Act include:

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(i) Itinerant Worker – Those workers that move from one State to the other, other than members of the Armed Forces. These categories of workers who work for a minimum of 20 days in at least 3 months of every assessment year would be liable to pay tax in those States.

(ii) Minimum tax is now 1% of Gross earnings instead of 0.5%.

(iii) An expatriate would be liable to tax in Nigeria if his employment costs are charged to a Nigerian company or borne by a fixed base in Nigeria e.g. Apportioned remuneration cost of Head Office charged to fixed base would be taxable in Nigeria.

(iv) In calculating 183 days stay rule in Nigeria, annual leave or temporary period of absence from Nigeria would be considered.

(v) Exemption of employment income from tax on the basis that the income has been taxed elsewhere is now limited to countries with whom Nigeria has Double Taxation Agreement (DTA).

(vi) Every employer is now required to file with relevant tax authority all emoluments paid to its employees in the preceding year, not later than 31st January every year. Failure to comply attracts a penalty on conviction of ₦50,000 for corporate and ₦50,000 in the case of individuals.

(vii) It is now mandatory for Banks, Ministries, Departments and Agencies (MDAs) to verify all tax clearance certificates (TCCs) submitted to them. Failure attracts fine of ₦5m or imprisonment of 3 years or both.

(viii) Consolidated Relief Allowance: A flat rate of ₦20,000 plus 20% of Gross Income. This allowance replaces the former reliefs and allowances claimable by employees or taxpayers.

(ix) The 1st schedule on determination of residence was amended to expand the definition of principal place of residence to include place of work, terminals, oil platforms, etc.

(x) The 3rd schedule of the PITA was amended to make it now mandatory for Mr. President, Governors and Deputies to be liable to personal income tax on their official emoluments.

(xi) The 6th schedule of the PITA was amended to reflect new tax table as follows:

	₦
a) 1st ₦300,000 at 7%	21,000
Next ₦300,000 at 11%	33,000
Next ₦500,000 at 15%	75,000
Next ₦500,000 at 19%	95,000
Next ₦1,600,000 at 21%	336,00
Above ₦3,200,000 at 24%	768,000

(b) Exempted Deductions
- National Health Insurance
- National Housing Fund Contribution
- Life Assurance Premium
- National Pension Scheme
- Gratuities

The importance of tax policy reforms, one needs to appreciate the urgency for such reforms. First, there is a compelling need to diversify the revenue portfolio for the country in order to safeguard against the volatility of crude oil prices and to promote fiscal sustainability and economic viability at lower tiers of government. Second, Nigeria operates on a cash budget system, where proposals for expenditure are always anchored to

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revenue projections. This facilitates determining the optimal tax rate for a given level of expenditure. Thus, accuracy in revenue projection is vital for devising an appropriate framework for sustainable fiscal management and this can be realized only if reforms are undertaken on existing tax policies in order to achieve some improvement. Third, Nigerian tax system is concentrated on petroleum and trade taxes while direct and broad-based indirect taxes like the value-added tax (VAT) are neglected. This is a structural problem for the country's tax system. Although direct taxes and VAT have the Potential for expansion, their impact is limited because of the dominance of the informal sector in the country (Ngerebo & Masa, 2012). Furthermore, the limited formal sector is supported with strong unions that act as pressure groups to deter any appreciable tax increment from gross income. Fourth, the widening fiscal deficit that over the years has threatened macroeconomic stability and prospects for economic growth makes the prospect of tax reform very appealing.

2.1 Productivity of a Tax System

In evaluating the productivity of a tax system, two measures are normally considered. These are the (income) elasticity and the buoyancy of tax revenue (Asher, 1989; Osoro, 1991). The former measures the change in tax revenue attributable to changes in income while the latter measures change in tax revenue due to changes not only in income but also changes in tax policy. The various methods for deriving these measurers and the required modifications to the underlying data have been elaborated upon by Pest (1962) and Singer (1968). They have also been adapted by several researchers, including Mansfied (1972), Rao (1979) and Osoro (1991).

Another measure of productivity of the tax system is the analogy of Amadi (1991) resulting in three different measures:

- Total output/total input which is identical
- Total results achieved/total resources consumed or
- Effectiveness/efficiency.

In effect, productivity becomes the attainment of the highest level of performance with the lowest possible expenditure of resources. The application of effectiveness and efficiency at macro level is the achievement of a desired result and the degree of effectiveness with which macro-economic policy is implemented. While effectiveness measures the extent to which set targets at the national economic level are actually achieved. Oshisanmi (1991) describes it as the determination of the achievement of "the objectives established by law and other authorizing bodies". This will involve an inquiry into the results or benefits achieved and the programme or activities to determine the achievements of established objectives. On efficiency, Ene (2000) noted that the efficiency of operations is the relationship between the level of service provided and the resources used to achieve that level. In other words, increasing efficiency will reduce cost and hence increase productivity. Efficiency measures the degree of effectiveness with which government and other economic services are implemented. The achievement of efficiency and effectiveness, depend upon the existence of some arrangement for the planning, appraisal, authorization and control of its use of resources (Chandler, 1985).

Nigeria's fiscal policy measures have been largely driven by the need to promote certain macroeconomic objectives as promoting rapid growth of the economy, generating employment, maintaining price levels and improving the balance-of-payment conditions of the country. Although policy measures change frequently, these objectives have remained relatively constant. Until the mid 1980s, tax policies, for instance, were geared to achieving such specific objectives as:

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i) Ensuring effective protection for local industries;
ii) Encouraging greater use of local raw materials;
iii) Enhancing the value added of locally manufactured and primary products;
iv) Promoting greater geographical dispersion of domestic manufacturing activities; and
v) Generating increased government revenue.

In spite of the fact that the federal government is responsible for tax legislation, there are departures from the statutory provisions in the method of assessment and collection at the State and local government levels, as for example, the use of tax consultants since the late 1980s. The option of using consultants was triggered by the desperate need of the sub-national governments to enhance their internally generated revenue. Tax consultants, apart from operating illegally counter to regulations in Section 2 of Decree 21 of 1998, have been considered unprofessional, crude and violent in their methods, thus minimizing the prospects for good tax administration (Okpara, 2010; Onaolapo, Aworemi & Ajala, 2013).

Generally, there are certain conditions against which personal income tax is judged to be efficient or effective. These conditions are referred to as the canons or principles of taxation and include fairness, equality, equity, convenience, certainty, economy, flexibility and productivity. There is, however, no yardstick for each of these conditions mentioned. It is expected that where the majority of the tax-paying public suffer the same relative amount of pain in paying their taxes, or where the majority of the population do not feel that they are cheated by way of tax, then the tax is taken to be good, effective and/or efficient. However, it is very difficult to apply these parameters especially in a country like Nigeria because of the size of the population and the cost of conducting such survey. Alternatively, the efficiency of tax system can be measured on the basis of the goals of the tax system.

According to Gbosi (2002) there are several objectives for the imposition of any tax. These objectives are called economic and social goals of taxation. Therefore, a tax system's efficiency could be judged against these goals, i.e. whether the goals are achieved and the extent of accomplishing these goals. These goals include revenue generation, ability to influence and control economic behaviour, transferability of resources from private to public sector, ability to distribute cost of governance and ability to promote economic growth. Comparing the two measurement approaches mentioned above, it would be seen that generation of revenue and productivity are very similar and form the nucleus of any tax administration and by far the most tangible assessor of the efficiency of any tax system. This is because policy-makers would want to enact tax laws with the purpose of being an unfailing source of funding public activities as well as achieving other socio-economic motives as specified. It therefore behoves on the policy-makers to employ control by comparing the outcome of the imposition of tax against expectation. And the two most prominent assessment could therefore be to examine the revenue generated against budgeted and the impact of the tax on consumption, production and disposable income.

Another way of measuring the efficacy of the system is to evaluate any of the approaches of assessing the tax burden. The approaches include the Expedience approach, the Socio-Political approach, the Benefits-Received approach, the Cost of Service approach and the Ability to Pay approach (Handley & Maheswaran, 2008; Laily & VanZijl. 2003; Bhatia, 2006). In most third world countries (Nigeria inclusive), measuring the effectiveness and the efficiencies of tax especially with regards to the economic and social goals or

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using the socio-political and benefits- received approaches has been difficult.

3.0 Methodology

The research design adopted in this study is the ex-post facto design. Hence, the data on PIT, TTR and GDP for the study were collected from secondary sources such as the CBN Statistical Bulletin and Annual Reports of various years. The time series data covered the periods 2000 – 2013.

In this study, we adopted Oloidi and Oluwalana (2014) model of assessing tax productivity with little modification. In the model, tax productivity is measured by applying somewhat cross elasticity between some economic indexes such as GDP and TTR. This is computed as:

Tax Effectiveness = TAXt/GDPt x STRt ----- (1)
Tax Efficiency = TAXt/TTRt x STRt ---------- (2)

Since we are concerned with PIT, the equation becomes:

PIT Productivity = PITt/GDPt x STRt --------- (3)
PIT Productivity = PITt/TTRt x STRt -------- (4)

Where:
GDPt = Total GDP for the period
STRt = Standard tax rate in operation for the period
TTRt = Total tax revenue for the period
PITt = Total personal income tax collected for the period
We assume the STRt to be 16% (i.e the average of personal income tax graduated rate)
There is productivity if:
Effectiveness / Efficiency > 1

If productivity is less than unity, the cost of resources or input is higher than the financial benefit in form of output. If productivity is at unity, there is no productivity since the cost of resources equals the output value. This shows that the tax system has managed to break even.

4.0 Analysis and Results

Data are collected from CBN statistical bulletin as presented in the Table.

Table on PIT, GDP and TTR for Years 2000 – 2013.

Years	PIT N, B	GDP N, B	TTR N, B
2000	357	4582	455
2001	443	4725	587
2002	491	4912	434
2003	589	8487	703
2004	845	11411	1195
2005	1084	14572	1742
2006	1462	18565	1847
2007	1688	20657	1847
2008	1902	24296	2972
2009	1596	24794	2198
2010	1983	33985	2839
2011	2196	47330	4629
2012	2258	51020	5008
2013	1438	57286	4806
Total	18332	233846	31262

Source: CBN Statistical Bulletin of Various Years

The effectiveness of PIT as per GDP is that the total PIT for the period is compared to the expected PIT from GDP. Total PIT should be at least 16 percent of Total GDP for the period. Therefore, if the total PIT for the period is less than the expected, then PIT is not effective as per GDP.

GDP Effectiveness rate = PIT/(GDP 0.16)
= (N18332) / (N233846 x 0.16) = 0.49

Efficiency Rate-This is when PIT is compared with TTR.
TTR on Efficiency rate = PIT/(TTR x 0.16)
=N18332/N 31262 x 0.16
= 3.66

Productivity on GDP effectiveness and TTR efficiency is: (Pr1) = Effectiveness/Efficiency
= 0.49÷3.66 = 0.13%
This implies that personal income tax in Nigeria is not productive.

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5.0 Conclusion and Recommendations

The productivity of a tax system is the ability of the system to yield maximum revenue for the government with a given tax base without placing a difficult economic burden on the tax payer. This study has shown that personal income tax (PIT) in Nigeria is not productive. Its failure in Nigeria is due to lack of equitability. In spite of the fact that the self-employed out number paid workers and that they earn as much as four times than that of formal sector employees, the bulk of PIT is paid by employees whose salaries are deducted at source. Inadequate monitoring by tax authorities, the dominance of informal sector activities and the fact that many Nigerians live in rural areas make the coverage of self-employed workers difficult.

However, we believe that the new legislation (the Federal Capital Territory Internal Revenue Act 2015), which establishes a new tax authority for the Federal Capital Territory (FCT) to administer and collect taxes from residents of the FCT will improve PIT particularly from high net-worth individuals. Based on the above, it is therefore recommended that the Nigerian Government should intensify effort to further improve revenue generation through PIT. The government should ensure that all self –employed individuals and traders register their businesses and appropriate monitoring system should be put in place to ensure maximum compliance with personal income tax to promote its productivity.

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