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Tax Reforms in Nigeria: Case for Value Added Tax (VAT)

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Abstract

This paper examined tax reforms in Nigeria with respect to value added tax (VAT). It highlighted the reasons for the replacement of sales tax with value added tax (VAT), yearly contributions of value added tax to the total revenue base of the nation and revealed that Value Added Tax (VAT) was designed to favour development at the

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lower tier level of government. The paper further revealed that Nigerian value added tax rate was the least in the world. Based on these revelations, the paper recommends that value added tax rate should be increased from five (5) percent to 10 percent in Nigeria. The paper also recommended that Value added tax (VAT) Act should be amended based on destination principle to impose VAT on imported services rendered outside Nigeria by a non-resident company.

Key words: Tax Reforms, Value added tax, Nigeria, sales tax.

Introduction

A major challenge facing Nigeria's economy is the diversification of its revenue on crude oil earnings base. This diversification has become necessary with the realization that dependency on crude oil earning cannot sustain public expenditure. The economy faces the danger of being grounded if proactive efforts are not made towards sustaining the diversification of the revenue base. The USA and other major oil consuming nations have consistently reduced their demand for Nigerian oil over the last few years. This is not a good signal for our fiscal operations which are oil revenue driven (Oriakhi & Ahuru, 2014). The policy of taxation in Nigeria is directed towards achieving some specific objectives which include amongst others revenue generation and upholding economic growth. Recently the Nigerian government introduced the National Tax Policy (NTP). This is a policy geared towards shifting from direct to indirect taxation in Nigeria. The choice has elicited some serious debate in terms of economic benefits and limitations that characterized each (Umoru & Anyiwe, 2013).

Nigeria is richly blessed with oil and gas among the mineral resources, but the over dependency on oil revenue for the economic development of the country has left much to be deserved. According to Ariyo (1997), Nigeria's over dependency on oil revenue to the total of other revenue sources was encouraged by the oil boom of 1973/74 (Abiola & Asiweh, 2012). This was unsustainable due to the fluctuation in the oil market which has in most cases plunged the nation into deficit budgets. It was the view of Popoola (2009) that Nigeria tax administration and practice be structured towards economic goal achievement since government budgets for the years centre on the oil centre.

However, tax has been mentioned in the works of Olukoshi (2005), Olabiyi (2005) but the ability of the tax to stimulate economic growth results from the deliberately designed regimes that encourage compliance by all who should pay. Harrison (2002) expoused that taxes as they are, will not achieved macro objective for the economic therefore requires a tax re-engineering and reforms approaches. Tax reform is simply the series of action taken by Nigeria's government to promote the tax system. It is not novel as Nigeria has embarked on series of tax reforms. The several tax reforms were designed to broaden the tax base, reduce the tax burden on tax payers,

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restore the confidence of the tax payer on the tax system, and promote voluntary compliance on the part of the tax payer. On the whole, the ultimate goal of tax reform is the enhancement of public generation (Oriakhi & Ahuru, 2014). The essence of tax reforms in both developing and developed countries of the world is the reduction or eradication of fiscal deficits through appropriate restructuring of the tax system to attract higher revenue or to improve the revenue elasticity or buoyancy of the tax structure. Tax reform is therefore a deliberate design to increase revenue, improve efficiency, and promote equity (World Bank, 1991).

Value added tax (VAT) is simply called the goods and services tax (GST), it is levied on the value added that results from each exchange. It is an indirect tax collected from someone other than the person who actually bears the cost of the tax. It was invented by a French economist, Maurice Leave in 1954 and was first introduced in France in April, 10, 1954.

The focus of this paper was to review value added tax in view of the global drop in the price of oil and the fact that it is the third major contributor to the total revenue base of Nigeria.

Conceptual Framework

Taxation is the life wire of every nation and the level of development of any nation most times depends on the amount of revenue generated through taxation. Taxation is therefore, one among other means of revenue generation of any government to meet the need of the both the government and citizens. According to Ifurueze & Ekezie (2014), tax is “a compulsory levy imposed on a subject or upon his property by the government to generate the needed revenue for the provision of basic amenities and create enabling condition or the economic wellbeing of the society”. To them, the enabling environment created by government encourages the establishment of new business, survival of existing business and infrastructures provided is a key determinant of political, economic and social well structured tax system which provides government the needed fund for capital (infrastructure) and current (administrative) expenditure. A good tax system comprises of the tax law, tax policy and tax administration. The Nigerian tax system is a good portfolio comprising of direct and indirect tax, status which regulate the various types of tax and their administration by both the Federal and Local Governments. Azubuike (2009) believes that the Nigerian system is still far from efficiency as it’s lopsided, dominated by oil revenue and pose a formidable challenges to its usage as a macroeconomic regulating tool.

Tax reform became imperative in Nigeria because of the nature of its tax structure, which according to Anyanwu (1997) was complex, inelastic, inefficient, inequitable and unfair. Moreover, the country depended on import and export duties, while there were no opportunities to generate revenue through consumption-based tax such as

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VAT. The dependency of the country on taxes relating to foreign trade activities had made the revenue base of the country to be very unstable. In addition, the Nigeria's tax base was very narrow while the tax rate was very high. Tax reform is the process of changing the way taxes are collected or managed by the government (en.wikipedia.org/wiki/taxreform). Tax reforms have different goals: some seek to reduce the level of taxation of all people by the government, some seek to make the tax system more progressive or less progressive. Others seek to simplify the tax system and make the system more understandable or more accountable (Wikipedia).

Value added tax (VAT) is a consumption tax payable on the goods and services consumed by any person, business organizations or individuals. VAT can also be defined as a tax on spending/consumption levied at every stage of transaction but eventually borne by the final consumer of such goods and services (Ugwa & Embuka, 2012). The concept of VAT in Nigeria can be traced to the Dr. Sylvester Ugoh led study group on indirect taxation in November, 1991. Thereafter, a committee was setup under the chairmanship of Mr. Emmanuel Ijewere to conduct extensive research and make recommendations. VAT was-finally introduced in Nigeria in 1993 by the VAT Act No. 102 of 1993 as a replacement of the sales tax which had been in operation under Federal government Legislated decree No.7 of 1986 but administered by the states and the Federal capital territory (Ugwa & Embuka, 2012).

Theoretical Framework

Bhatia (2009) enumerated the following as the theories of taxation: social political theory, the expediency theory, benefit received theory, cost of service theory and ability-to-pay theory. The theoretical foundation of tax reform is gotten from the Supply-siders. These are sets of economists who had their hay days between 1970 and early 1980s. The Supply-siders believed in the use of economic incentives to encourage production. They positioned that higher marginal tax rate will not only create disincentive to work, investment and saving but encourages tax avoidance and evasion,that reduces public generated revenue (Oriakhi & Ahuru, 2014). The leader of the group Arthur. Laffer, using what is today as the Laffer curve showed that there is an optimum tax rate that both encourages savings, investment and labour supply, and at the same time motivate tax payment obligation. Thus, tax rate in excess of the optimum rate will be harmful to economic activities.

Another dimension to theory of tax reforms is the optimal tax reform theory. Under this theory, it is required that the best way to raise revenue is through taxing goods or factors with inelastic demand or supply, and that taxation relating to distribution and externalists or market failures should concentrate on identifying the source or origin of the problem. Thus, for distribution, we should look for the sources of inequality (for example, land endowments or earned incomes) and taxation should be concentrated there (Oriakhi & Ahuru, 2014). Regarding externalities, an attempt

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should be made to tax or subsidize directly the good or activity that produces the externality (Stern, 1988). Employing the optimal tax reform theory, Newbery and Stern (1987) applied a normative framework to analyze the impact of tax reform and evaluate both its administrative costs and its effects on social welfare.

Empirical Literature Review

Globally, government is saddled with the responsibility of providing some basic infrastructures for her citizens. Among these are the provisions of schools, hospitals, construction of roads, bridges, dams, airports, seaports, railways, etc. More so is the security of the life and properties of the citizens in the country against foreign as well as local aggression. In the view of Abiola and Asiweh (2012), the stabilization of the economy, the redistribution of income and the provision of services in the form of public goods are among other functions or obligations government may owe her citizens. Miller and Oats (2009) note that due to the inefficiency of the private market, the provision of public goods such as security of life and property which the public is not prepared to pay for directly, are left in the hands of the government rather than the private market.

Okafor (2012) who empirically investigated the impact of tax reforms in Nigeria's economic growth found that all the income taxes have positive coefficients showing that tax reform can stimulate economic growth. Myles (2000) empirically ascertained that direct tax policy is a stimulant to economic growth. Barry & Jules (2008) found that direct taxation is harmful to growth in endogenous models. Ogbonna and Ebimobowei (2012) in their study of the impact of tax reforms on economic growth found that tax reforms is positively and significantly related to economic growth and that tax reforms granger cause economic growth. Jibrin, Blessing and Ifurueze (2012) in their study of the impact of petroleum profits tax on economic development of Nigeria found that petroleum profits tax impact positively on gross domestic product and was statistically significantly.

Ajakaiye (1999) found that value added tax (VAT) has a negative effect on economic growth in Nigeria. In a more broad study, Romer and Romer (2000) resolved that progressive taxation affords policy makers the opportunity to pursue counter-cyclical fiscal policies which drives economic growth. Specifically, they are of the view that VAT can only increase growth when enforcement and implementation procedures are effective. This position was strengthened by McCarton (2005). The study of Arisoy and Unlukaplan, (2010) on the effect of direct-indirect tax on economic growth of Kurkish within the period of 1968-2006. Their result shows that real output is positively related to indirect tax revenue while direct tax has no significant effect. Aniechebe (2013) study of the impact of tax on economic growth in Nigeria between 1986 and 2011, applied econometric model found a significant relationship between tax composition and economic growth. Decomposing the impact into direct and indirect

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tax and total tax revenue components found a significant positive relationship between direct, indirect tax and economic growth and a negative relationship between total tax revenue and economic growth. Efurueze and Ekezie (2014) in their study of the Nigerian tax system and economic growth: A times analysis found that indirect tax (VAT and CED) contribution to total revenue and economic growth glucoses more than direct tax. This implies that indirect tax shows future growth prospect rate than direct tax.

Value Added Tax (VAT) as a Replacement of Sales Tax.

VAT is a replacement of the sales tax, which was earlier promulgated into existence through decree No.7 of 1986. The rationale behind replacing sales Tax with VAT was informed by a number of factors and considerations (Ogunbesan, 2015 and Soyode & Kajola, 2006). Notable among these are: The base of the sales tax in Nigeria as operated under Decree No. 7 of 1986 was narrow. It covered only nine (9) categories of goods plus sales and services in registered hotels, motels and similar establishments. The narrow base of the tax negates the fundamental principle of consumption tax which by nature is expected to cut across all consumable goods and services expected. VAT base is broader and includes most professional services and banking transactions which are high profit-generating sectors.

Besides, the sales tax decree of 1986 targeted only locally manufactured goods, although this might not have been the intention of the law. In the case of VAT it is neutral in this regard. Under VAT, a considerable part of the tax to be realized is from imported goods. This means that under this new indirect tax, locally manufactured goods will not be placed at a disadvantage relative to imports.

Another reason was that VAT is a consumption tax and is based on the, general consumption behaviour of people; the expected high yield from it is boosting the revenue collected by governments with minimum resistance from the payers of the tax.

Case for Value Added Tax (VAT)

Tax reforms are changes that are made in the Nigerian Tax system to increase the revenue base of the company. No matter the angle from which VAT is viewed, the purpose is to generate more revenue to the government. A critical examination of the current formula: Federal Government 15%; State Governments 50% and Local Government 35%, shows clearly that VAT was designed to favour development at the lower-tier level of government. The introduction of VAT in 1993 and its actual implementation in 1994 has recorded a huge success in Nigeria. Details of VAT collected by Federal Inland Revenue Service since its introduction are as follows:

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Year	Amount (N billions)	Year	Amount (N billions)
1994	8.20		
1995	20.23	2005	192.70
1996	32.47	2006	232.70
1997	14.74	2007	312.60
1998	38.28	2008	401.70
1999	47.68	2009	481.40
2000	60.68	2010	564.89
2001	91.75	2011	659.15
2002	108.60	2012	710.50
2003	131.42	2013	795.60
2004	163.30	2014	616.90

Source: Nwachukwu (2013) and Obadan, (2015).

However, the problem is that VAT rate as remained at 5 percent since the introduction despite every attempt to increase it. It is important to note that it is one of the lowest in the world. Obadan (2015) notes that some European Union countries and non-European countries have VAT rates as follows: European countries: Austra 20 percent, Belgium 21 percent, Bulgaria 20 percent, Denmark 25 percent, France 20 percent, Hungary 27 percent, Lativa 21 percent, Finland 24 percent, and United Kingdom 20 percent. For non-European union countries, Albania has 20 percent rate, Australia 10 percent, Argentina 21 percent, Bangladesh 15 percent, Chile 19 percent, People's Republic of China 17 percent, Egypt 10 percent, Ethiopia 15 percent, South Africa 14 percent, Russia 18 percent, Norway 25 percent, and Nigeria 5 percent. Others are Ghana with 15 percent VAT rate, Guyana 16 percent, Indonesia 10 percent, Taiwan 18 percent, Tunisia 18 percent, Israel 18 percent, Japan 8 percent, India 5 percent, Malaysia 6 percent, Mexico 16 percent, Mauritius 15 percent, Nambia 15 percent, and Morocco 20 percent.

The revelation made from Obadan (2015) shows that many countries have standard VAT rates in the range of 10-25 percent. It also shows that only few countries have low VAT rates, e.g. Nigeria, India and Malaysia. It is also important to note that some are VAT-free. Such as; USA, Libya, Suadi Arabia and Hong Kong (Wikipedia). Yes, it is true that few countries have low VAT rates like Nigeria while few others are VAT free but the Nigeria's situation is different because its fiscal position is weak. This is basically because of the global drop in the price of oil which the country has

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depended heavily for so long as well as corruption. One basic problem facing Nigeria's economy is the diversification of its revenue base. This diversification has become expedient with the realization that dependency on crude oil proceeds cannot sustain public expenditure. The government must learn to rely on tax revenue from now because it is a most predictable and sustainable source of revenue for other well governed countries such Britain, USA, etc.

However, Value added tax (VAT) Act LFN 2004 (as amended) needs to be amended further to impose VAT on imported services rendered by a non-resident company outside Nigeria. This is because a meticulous examination of the Act shows that VAT is not applicable on imported services rendered by a foreign company outside Nigeria. The implication is that, where a non-resident/foreign company who is a provider of services is not carrying on business in Nigeria, such a company has no legal obligation to register for, or charge VAT in Nigeria.

Conclusion and Recommendations

The benefits of taxation cannot be over emphasized. Through taxation, government ensures that resources are channelled towards important projects in the society. Thus, the imposition of taxes is essential to economic and social development in any given economy. Tax reform is inevitable in every nation that wants to live up to the expectation of her citizens and wants to be people oriented. It is a strategic option for government to raise revenue to meet up its public expenditure and sustainable development. It is inevitable because taxes introduced some decades ago cannot always achieve macro objectives today except if reformed in line with the current economic realities; hence taxes need to be reformed from time to time.

Based on the revelations of this paper, the following recommendations are made.

1. Government should increase the VAT rate to at least 10 percent considering the fact that the Nigerian VAT rate is one of the lowest in the world and secondly, increase in VAT revenue will help to cushion the effect of global drop in the price of oil.
2. Government should intensify effort to devise an effective means of taxing the informal sector, as this strategy will bring more people into the tax net thereby increasing the revenue from taxation.
3. Tax reforms is found to be positively related to economic growth, therefore, it should be carried out after every two years.

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4. Companies' income tax rate should be lowered to encourage savings and investment in order to increase gross domestic products, which by extension increases total tax revenue.
5. Effort should be made by the government to fight corruption and if possible, introduce capital punishment depending on the degree of mismanagement of public funds or embezzlement of public funds.
6. Value added tax (VAT) Act should be amended further to impose VAT based on destination principle. This will enable VAT to be imposed on imported services rendered by a non-resident company outside Nigeria.

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