AN APPRAISAL OF PERSONAL INCOME TAX EVASION IN NIGERIA

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ABSTRACT
The objective of this study is to appraise the evasion of personal income tax in Nigeria. A total of 160 questionnaires were administered to some selected self-employed individuals in Edo State comprising businessmen, contractors, professional practitioners like lawyers, doctors, accountants, architects and traders in shops as well as staff of Federal Inland Revenue Service in Benin City, Edo State, Nigeria. The result revealed that the tax payers’ relationship with tax authority (TAXPAY_TAXAUTH) and weak penalties (PENALTIES) have a significant influence on tax evasion in Nigeria. Tax rate showed a positive relationship with tax evasion. This means that the higher the tax rate the higher the tendency of tax evasion. The Board should intensify tax payer education and maintain a harmonious relationship capable of fostering voluntary compliance. In addition, efforts should be made towards entrenching stiff penalties for evaders. Finally the prevailing tax rates should be reviewed optimally as not to serve as disincentives to compliance.

Keywords: Tax evasion, Penalties, Tax authorities, Tax rates, Compliance.

1. INTRODUCTION
Tax evasion is a major problem plaguing many emerging economics across the globe and Nigeria situation seems peculiar when viewed against the scale of corrupt practices prevalent in the country. Under the direct personal taxation as practiced in Nigeria, the major problem lies in the collection of the taxes especially from the self-employed such as the businessmen, contractors, professional practitioners like lawyers, doctors, accountants, architects and traders in shops among others (Kiabel and Nwokah, 2009). As observed by Ayua (1999) cited in Kiabel and Nwokah (2009) these persons blatantly refuse to pay tax by reporting losses every year. Ayua (1999) further asserts that many of these professionals live a lifestyle inconsistent with reported income, which is usually unrealistically low for the nature of their businesses. The only categories of individuals who fulfill their tax obligation in Nigeria are civil servants and other salaried workers. However, even among the salaried workers, many have the statutory personal allowance and relief into a
fertile ground for tax evasion (Ayua, 1999). This development is an indication of poor tax system in Nigeria. While it immediately presupposes that there are legal framework put in place to punish tax evaders it perhaps raises a poser in the efficiency and effectiveness of tax laws and tax administration in Nigeria.

Fagbemi et al. (2010), observe that, tax evasion in most developing countries is so rampant and the scenario is much worsened by the fact that not many of these governments have made an effort to measure the ethical reasons that tax payers give, the extent of this problem and at the same time analyze its impact. Hence when required revenue for smooth operation cannot be raided, these countries often times resort to increase tax rates or borrowings which may not only crowd out the private sector of their economies but also land them in debt traps.

On the other hand, tax evasion has the effect of destroying the principle of perfect market resource allocation and income redistribution. The implication of this abdication of civic responsibility ranges from economic growth stagnation with far reaching socio-economic repercussions. Thus, there is the need to understand the behavior of tax payers and the reasons that cause such specific behavior.

The broad objective of the study is to examine the causes and challenges of tax evasion in Nigeria. Specifically, the study seeks to satisfy the following objectives:
1. Determine if there is a significant relationship between high tax rates and tax evasion in Nigeria;
2. Ascertaining whether poor relationship between taxpayers and tax authority is responsible for tax evasion in Nigeria; and
3. Establish if a significant relationship exists between weak penalties and tax evasion in Nigeria.

The following hypotheses have been formulated to serve as basis for this research;

\( H_1: \) There is no significant relationship between high tax rates and tax evasion in Nigeria.

\( H_2: \) There is no significant relationship between taxpayer-tax authority-relationship and tax evasion in Nigeria.

\( H_3: \) There is no significant relationship between weak penalties and tax evasion in Nigeria.

2. CONCEPT OF TAX EVASION

Tax evasion is the failure to disclose the correct income that should be assessed either by misstatement of facts, falsification of figures, filing of incorrect returns or by misrepresentation of tax liabilities. Thus, through the employment of criminal or fraudulent means, the tax payer pays less tax than he ought to pay. Tax evasion is accomplished by deliberate act of omission or commission which themselves constitutes criminal acts under the tax laws. These acts of omission or commission might include failure to pay tax; failure to submit return; omission or misstatement of items from returns; claiming illegal reliefs; understating income; documenting fictitious transactions; overstating expenses; failure to answer queries and so on. Tax evasion involves willful default and is therefore a criminal offence.
The most common form of tax evasion in Nigeria is through failure to render tax returns to the relevant tax authority. A tax evader may be charged to court for criminal offences with the consequent fines, penalties and at times imprisonment being levied on him for evading tax (Faseun, 2001). As observed by Sosanya (1981), tax evasion has become the favourite crime of the Nigerians; so popular that it makes armed robbery seem like minority interest. It has become so widespread that there now exists a cash economy of vast proportions over which the taxman has no control and which is growing at several times the rate of the national economy. No doubt, tax evasion has robbed the Nigerian government of substantial tax revenue.

3. METHODOLOGY

The survey method was employed in order to elicit information from the sampled respondents selected for the study. The choice of this method stems from its high reliability engenderment of more honest response than other types of research methodology. A simple random sampling technique was adopted due to the largeness of the population under study. The total population for this study is 204, comprising of seventy (70) selected staff of Federal Inland Revenue Service and hundred and thirty-four (134) selected taxpayers in Benin City, Edo State. We employed the use of Yemane sample size determination technique to arrive at a sample size of one hundred and sixty (160), comprising of sixty (60) for staff of Federal Inland Revenue Service and one hundred (100) taxpayers (i.e. some selected self-employed in Edo State comprising businessmen, contractors, professional practitioners like lawyers, doctors, accountants, architects and traders in shops among others) in Benin City, Edo State.

The Yemane formula is:

\[ n = \frac{N}{1+N(e)^2} \]

Where

- \( N \) = Number of population size
- \( n \) = Appropriate sample size
- \( e \) = Margin of error
- \( i \) = Constant

i.e.: (for Staff of Federal Inland Revenue Service)

\[ \frac{70}{1 + 70(0.05)^2} \]

\[ \frac{70}{1 + 70(0.0025)} \]

\[ \frac{70}{1 +0.175} \]
In view of the need to utilize accurate data for this research, five-scale questionnaires were administered to the selected sample to elicit valid and reliable responses from the respondents meet the objective of this study. The data generated were analysed using the Spearman Rank Correlation and Ordered Probit Regression technique. The model for this study is specified thus:

\[
\text{TAXEVASION} = \beta_1 \text{TAXRATE} + \beta_2 \text{TAXPAY\_TAXAUTH} + \beta_3 \text{PENALTY} + \epsilon
\]

Where:
- \text{TAXEVASION} - Tax evasion
- \text{TAXRATE} - Tax rate
- \text{TAXPAY\_TAXAUTH} – Relationship between tax payers and tax relationship
- \text{PENALTIES} - weak penalties
- \epsilon - error term

\( \beta_1, \beta_2 \text{ and } \beta_3 \) are the parameters to be estimated

The a priori signs are \( \beta_1, \beta_2 \text{ and } \beta_3 \geq 0 \)
4. PRESENTATION AND ANALYSIS OF RESULTS

4.1. Correlation Analysis

The study used the spearman rank correlation due to the qualitative nature of the data. The result from the spearman rank correlation is presented below:

<table>
<thead>
<tr>
<th>Spearman’s rho</th>
<th>Taxevasion Correlation Coefficient</th>
<th>Evasion</th>
<th>Taxrate</th>
<th>Taxauthority</th>
<th>Penalties</th>
</tr>
</thead>
<tbody>
<tr>
<td>N</td>
<td>213</td>
<td>213</td>
<td>213</td>
<td>213</td>
<td>213</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.049</td>
<td>.002</td>
<td>.000</td>
<td>.319</td>
<td>.077</td>
</tr>
<tr>
<td>Taxrate</td>
<td>Correlation Coefficient</td>
<td>.153(*)</td>
<td>1.000</td>
<td>.214(**)</td>
<td>-.121</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.049</td>
<td>.</td>
<td>.002</td>
<td>.077</td>
<td>.</td>
</tr>
<tr>
<td>N</td>
<td>213</td>
<td>213</td>
<td>213</td>
<td>213</td>
<td>213</td>
</tr>
<tr>
<td>Taxpay_Taxauth</td>
<td>Correlation Coefficient</td>
<td>-.679(**)</td>
<td>.214(**)</td>
<td>1.000</td>
<td>.000</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.002</td>
<td>.</td>
<td>.999</td>
<td>.</td>
</tr>
<tr>
<td>N</td>
<td>213</td>
<td>213</td>
<td>213</td>
<td>213</td>
<td>213</td>
</tr>
<tr>
<td>Penalties</td>
<td>Correlation Coefficient</td>
<td>.096</td>
<td>-.121</td>
<td>.000</td>
<td>1.000</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.319</td>
<td>.077</td>
<td>.999</td>
<td>.</td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>160</td>
<td>160</td>
<td>160</td>
<td>160</td>
<td>160</td>
</tr>
</tbody>
</table>

* Correlation is significant at the 0.05 level (2-tailed).
** Correlation is significant at the 0.01 level (2-tailed).

The result shows that there exists a positive correlation between tax evasion and tax rate with a correlation coefficient of 0.153. This means the strength of relationship between tax evasion and tax rate is about 15.3% which shows a weak positive relationship. Relationship between tax authority and taxpayer with a correlation coefficient of -0.679 indicates that there exists a significant inverse relationship between tax authority-taxpayer’s relationship and tax evasion. Penalties with a correlation coefficient of 0.096 indicate a direct positive relationship between weak penalties and tax evasion in Nigeria.
The result shows that about 24% of the systematic variation in tax evasion could be explained by tax rate, tax payers’ relationship with tax authority and weak penalties. While about 76% of the variations in tax evasion could be explained by other exogenous factors. The LR stat. shows that the overall model is significant at 1% level. The result revealed that the tax payers’ relationship with tax authority (TAXPAY_TAXAUTH) and weak penalties (PENALTIES) have a significant influence on tax evasion in Nigeria, since their absolute calculated z-values of 8.9 and -3.61 respectively were greater than the critical z-value of 1.96 at 5% level of significance.

Tax rate showed a positive relationship with tax evasion. This means that the higher the tax rate the higher the tendency of tax evasion. This agrees with the findings of Allingham and Sandmo (1972). They observed that the higher the tax rate, the higher the likelihood of tax evasion; since increase in tax rate increases tax burden and as a consequence, disposable income is lowered.

The result showed that there exist a negative relationship between between tax-authorities-taxpayers relationship and tax evasion. This means that an increased cordial relationship between tax authorities and tax payers would lower the tendency for the tax payers to evade tax. Thus, tax officials should treat taxpayers with some respect and recognition, bearing in mind their immense contribution to the revenue pool of the government. By so doing taxpayers will be prepared to fulfill their tax obligation.

The result also showed that there exist a direct relationship between weak penalties and tax evasion. This implies that when tax payers observe that penalties are weak, the incentive to evade tax increases. This agrees with the findings of (Allingham and Sandmo, 1972). It therefore presupposes that weak penalties engender weak tax compliance, as no taxpayer will be willing to pay taxes if such action is not met with stiff penalties.

4.2. Diagnostics Tests

To ensure reliability and validity of the empirical result, some diagnostic tests were conducted. In order to test for the presence of multicollinearity in the model, the Variance Inflation Factor

Table-2. Ordered Probit Regression Analysis

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>z-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>TAXRATE</td>
<td>0.137130</td>
<td>0.118511</td>
<td>1.157108</td>
<td>0.2472</td>
</tr>
<tr>
<td>TAXAUTHORITY</td>
<td>-1.324417</td>
<td>0.148370</td>
<td>-8.926443</td>
<td>0.0000***</td>
</tr>
<tr>
<td>PENALTIES</td>
<td>0.333505</td>
<td>0.092196</td>
<td>3.617356</td>
<td>0.0003***</td>
</tr>
<tr>
<td>Pseudo R-squared</td>
<td>0.240401</td>
<td></td>
<td></td>
<td>1.286177</td>
</tr>
<tr>
<td>Schwarz criterion</td>
<td>1.380861</td>
<td></td>
<td></td>
<td>-130.9778</td>
</tr>
<tr>
<td>Hannan-Quinn criter.</td>
<td>1.324442</td>
<td></td>
<td></td>
<td>-198.5719</td>
</tr>
<tr>
<td>LR statistic</td>
<td>135.1881</td>
<td></td>
<td></td>
<td>-0.614919</td>
</tr>
</tbody>
</table>

Source: Research computations (2013)

*** significant at 1% level
(VIF) was carried out, the Heteroskedasticity test was conducted using Breusch-Pagan-Godfrey test, while the Breush-Godfrey LM test was conducted to test the presence of autocorrelation in the model. The results are shown below:

### 4.3. Variance Inflation Factor

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Uncentered VIF</th>
<th>Centered VIF</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>0.096341</td>
<td>49.59138</td>
<td>NA</td>
</tr>
<tr>
<td>TAXRATE</td>
<td>0.003112</td>
<td>23.67744</td>
<td>1.077859</td>
</tr>
<tr>
<td>TAXAUTHORITY</td>
<td>0.002435</td>
<td>24.11916</td>
<td>1.035588</td>
</tr>
<tr>
<td>PENALTIES</td>
<td>0.001773</td>
<td>8.764667</td>
<td>1.054855</td>
</tr>
</tbody>
</table>

Source: Researcher’s computations (2013)

The table above shows that all the variables in the regression model are relevant to the study since the VIF factors are below the benchmark of 10. This indicates the absence of multicollinarity in models.

### 4.4. Serial Correlation Test

<table>
<thead>
<tr>
<th></th>
<th>Breusch-Godfrey Serial Correlation LM Test</th>
</tr>
</thead>
<tbody>
<tr>
<td>F-statistic</td>
<td>0.681994</td>
</tr>
<tr>
<td>Obs*R-squared</td>
<td>1.394336</td>
</tr>
</tbody>
</table>

Source: Researcher’s computations (2013)

The table above shows that the F-statistic and Obs*R-square values of 0.68 and 1.39 with p-values of 0.50 and 0.49 respectively indicates the absence of autocorrelation in model since the F-statistic and Obs*R-square with p-values of 0.50 and 0.49 are greater than the critical values at 5% level of significance. Thus, we can conclude that there is no presence of autocorrelation in the model.

### 4.5. Heteroskedasticity Test

<table>
<thead>
<tr>
<th></th>
<th>Breusch-Pagan-Godfrey Heteroskedasticity Test</th>
</tr>
</thead>
<tbody>
<tr>
<td>F-statistic</td>
<td>1.30071</td>
</tr>
<tr>
<td>Obs*R-squared</td>
<td>6.27660</td>
</tr>
<tr>
<td>Scaled explained SS</td>
<td>3.02843</td>
</tr>
</tbody>
</table>

Source: Researcher’s computations (2013)

The table above shows that the F-statistic and Obs*R-square values of 1.3 and 6.2 with p-values of 0.84 and 0.63 respectively indicates the absence of heteroskedasticity in model since the F-statistic and Obs*R-square with p-values of 0.84 and 0.63 are greater than the critical values at
5% level of significance. Thus, we can conclude that there is no presence of heteroskedasticity in the model.

5. CONCLUSION
The importance of tax revenue to governments at all levels makes the issue of tax evasion a very noisome one to tax authorities. Several states of Nigeria have resorted to boosting their revenue base through internal generated revenue, hence the need to enforce compliance to achieve this goal. This study appraised the reasons behind tax evasion in Nigeria using Benin City as a case study. The findings from the study are revealed that high tax rates; poor relationship between taxpayers and tax authority and weak tax penalties are disincentive to tax compliance in Nigeria.

The study also revealed that tax evasion represents one of the fundamental problems of tax administration in a developing country like Nigeria.

Based on the findings of this study, the following recommendations are suggested:

i. Apart from the existing punishment and penalties for tax offenders, efforts should be made such that maximum publicity of cases prosecuted are carried out in order to serve as a deterrent to others. The revenue officials should be adequately equipped to ensure that defaulters are brought to book.

ii. The tax authority should consider the tax payers as partners in progress. They should maintain a cordial relationship with tax payers to foster voluntary compliance.

iii. The government should refrain from the tradition of arbitrary hike in tax rates as this jeopardizes the convenience criterion of a good tax system and consequently discourages compliance.

iv. Concealment of taxable items and income should be discouraged via quality reporting. To this end, the Financial Reporting Council of Nigeria and other regulatory bodies should make it a point of duty to ensure that financial reports are presented without material misstatements.

REFERENCES