

The Effects of Personal Income Tax Evasion on Socio-Economic Development of *Nigeria*

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Abstract- *The study examined the effects of personal income tax evasion on socio-economic development of Nigeria. The study adopted ex-post-facto research, secondary data covering a period of 10 years. The data collected were analyzed using multiple regression analysis. From the result of the analysis, result finding evidently shows that personal tax evasion has a significant negative implication for socio-economic development of Nigeria. It was found that there is high rate of evasion among tax pay and this needed to be curbed. Hence, it is recommended that Government should make policies that make it easy for all sundry to pay their tax duties without feeling the burden.*

Indexed Terms- *Personal Income Tax, Taxation, Economic Development.*

I. INTRODUCTION

- Background to the study

Tax revenues for financing public services and infrastructure is a key factor for economic growth and development. In recent times, emerging economies fail to generate the required tax revenues for expenditures (Fuest & Riedel,2009). However, tax evasion is a key challenge which slow development of emerging economies (GIZ sector programme public finance, administrative reform,2010). Surprisingly, studies analyzing tax payers' ethical reasons and the impacts of tax evasion on the economy are lacking (Fagbemi *et al*,2010). The ability of governments in developing countries to provide adequate resources dwindle with incessant tax evasion among its citizenry. Governments in most developing countries impose high taxes on their citizens as well as resorting to borrowing from developed countries to fund public expenditure hence over-crowding the underground economy and experiencing huge public debts. The factoring of economic element into government goal of imposing high tax rate is mostly as a result of

taxpayers' social, cultural and moral characteristics. Tax evasion and avoidance are exploited by individuals and corporate firms to curtail taxes as well as employing fake techniques with the support of tax officials (Muhammed & Muhanimed,2012).

- Tax evasion and avoidance have strong impact on socio-economic development of most nations especially developing countries like Nigeria (GIZ sector programme public finance, administrative reform,2010). This is why Governments mostly resort to taxes or other revenue making systems to fund public expenditures as well as improving the standard of living of its citizens. Therefore noncompliance to tax payment negatively reduce governments' funding whiles improving the standard of living of few individuals who evade or avoid taxes. Corporations or institutions prefer to satisfy their shareholders by evading taxes in order to declare more profit for the success of their businesses. In most developing countries, tax evasion pose serious threat to developing countries as compared to the developed countries (GIZ sector programme public finance administrative reform,2010).
- Taxes for civil servants are applied on payroll before salaries are received but for those in private sector, the individuals' needs to file their returns before taxes are being calculated. This increases the propensity to evade taxes under this sector because there may be a possibility that individuals from this sector may not file their appropriate returns for taxes to be calculated. In ensuring compliance to payment of taxes, reforms have been ensured tax systems for the past three (3) decades. A Fiscal adjustment programme is usually designed by most government to re-instate tax base but the constant over-valuation of local currency is major challenge to the tax base re-instatement. The tax base re-instatement for some government like in Nigeria is expected to reduce

tax evasion, widen tax net and reduce tax burden. In view of the slack fiscal adjustment programme, Value Added Tax (VAT) was introduced in minimize changes with respect to the conducts of economic agents. Tax administrative reform is focused on the improvement of tax equity as well as enhancing efficiency in the administration of taxes. In spite of the numerous tax reforms established in Nigeria and African countries as a whole, tax evasion still poses a serious threat to the socio-economic development of the country (Annan *et al*, 2010). It is as result of this, that this study focus on investigating the effects of personal income tax evasion on socio-economic development of Nigeria.

- **Statement of Problem**

Tax evasion is problem that faces every tax system, Nigerian situation seems unique when viewed against the scale of corrupt practices prevalent in Nigeria. Under 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. Some persons do blatantly refuse to pay tax by reporting losses every year. Many of these professionals live a lifestyle inconsistent with reported income, which is usually unrealistically low for the nature of their businesses. Though Civil Servants and their salaried workers are the only class of people that actually pay tax in Nigeria. However, even among the salaried workers, many have turned the statutory personal allowances and relief into a fertile ground for tax evasion. Almost all Nigerian taxpayers are married with four children, similarly, despite the tax provision meant to plug loopholes through which taxable persons can minimize tax liability the self-employed persons employ all kinds of evasion schemes to minimize or escape tax liability and makes one wonder whether there are still any tax officials working in that capacity. Such scenario, no doubt, speaks a lot about tax administration system in Nigeria both in its design and in the disposition of some taxpayers towards taxation and this has greatly affected economic growth in Nigeria. The continued existence of these ills makes one thinks that tax administration in "Nigeria, and of course, lacks the ability to convert inputs of funds into

programme and projects that enhances development. This has greatly affected the economic growth of this country Nigeria. It is against this backdrops that this investigating the effects of personal income tax evasion on socio-economic development of Nigeria.

- **Objectives of the Study**

The major objective of the study is investigating the effects of personal income tax evasion on socio-economic development of Nigeria. Specifically, the study will ascertain

1. the extent personal income tax evasion have affected social economic growth in Nigeria.
2. the extent personal income tax evasion has impacted on revenue generation in Nigeria economy.
3. the level of personal tax evasion in Nigeria economy.

- **Research Questions**

In order to guide the study and give direction to it, the following research question are posed as follows

1. To what extent does personal income tax evasion affected social economic growth in Nigeria?
2. To what extent does personal income tax evasion impact on revenue generation in Nigeria economy?
3. What is the level of personal tax evasion in Nigeria economy?

- **Research Hypotheses**

The following Null hypothesis is posed to test the study as follows;

There is no significant effects of personal income tax evasion on socio-economic development of Nigeria.

- **Significance of the Study**

The research findings of this study is importance to policy makers at National and state level as they design policies aimed at eliminating reducing to barest minimum cases of tax evasion and enhancing of tax revenue for economic growth. Those who wish to undertake further research on taxation will also find the literature from this study to be of great value.

- The study will help citizen of Nigeria to come to appreciate the value of paying their taxes at when due and to see reasons why they should not evade paying their tax

- Scope of the study

The scope of the study covers effects of personal income tax evasion on socio-economic development of Nigeria. The scope also 10years (2004-2013).

II. LITERATURE REVIEW

- Concept of Taxation:

Taxation refers to obligatory or coercive cash collection through a levying authority, typically a government. The term "taxation" applies to all forms of involuntary levies, from profits to capital profits to property taxes. According to McLure (2015) taxation is a obligatory monetary price or a few different form of levy imposed upon a taxpayer (an person or different felony entity) through a governmental company with the intention to fund numerous public expenditures.

Taxation according to Chijioke *et al*(2018), is an obligatory levy by the Government collected through it agency from its subjects. These levies are made on non-public income, inclusive of salaries, commercial enterprise profits, interests, dividends, reductions and royalties. It is likewise levied towards company`s profits, petroleum profits, capital profits and capital transfer

Taxation is the most important source of revenue for modern governments, typically accounting for ninety percent or more of their income. Tax is a common source of income generation for financing government activities. Individuals and organizations are expected to fulfill their obligations on tax payments as required by law to give the government the financial power.

Socio-economic development hinges on the generation of revenue for infrastructural development. The generation of revenue for providing these infrastructural development is through an efficient tax system adopted by countries. Efficient tax systems gives government extra revenue needed in discharging its obligations for the development of the country. Taxes are one of the most effective means of mobilization of the internal resources of a nation which in turn leads to the creation of a conducive environment for the promotion of economic growth. Tax constitutes the main source of revenue for the

federation account shared by the local governments and federal states.

Attainment of macroeconomic objectives such as high and sustainable economic growth, employment, stability of prices etc. have been every economy's priority. The attainment of these macroeconomic variables is not automatic but entails policy guidance. Fiscal policies (taxation and public expenditure) and monetary policies (reserve requirements, discount rates and open market operations) are the key instruments in achieving these objectives. Taxes are levied to finance government expenditure. This however, help government to finance certain infrastructural needs such as roads necessary for trade by defining and regulating the issuance of money from taxes. This is why several tax policies are put in place to ensure efficient tax revenue generation. Tax policies are implemented either to: (i) finance a budget deficit, (ii) promote long run growth or (iii) counter other influences in the economy (Romer & Romer,2018).

Taxes have an impact on factor accumulation whiles total factor productivity can affect the growth of a country. Taxes distort factor prices and induce loss of efficiency in resource allocation. However, high tax rates can discourage investments and reduce incentives to invest(Bruhn,2011). Hence, providing tax incentives for some sectors of the economy can distort allocation of capital as well as reduce productivity of overall investment. A long run relationship between tax structures and economic growth within the Organization of Economic Co-operation and Development (OECD) showed that long run economic growth could be enhanced by steadily raising taxes on consumption and immovable property whiles improving the design of individual taxes(Jens *et al* 2021). An estimation of corporate taxes, taking into consideration wage bargaining and reduction in investment in a economy revealed that an increment in the liability of corporate tax may 44 to 77 percent decrease in wage bill(Fuest *et al*,2013).

Taxation yields substantial revenues to government. It has a bearing on GDP which serves as an indicator to the socio-economic development of a nation. Taxes vary according to the economic policies adopted by

governments. Taxes are instruments of social engineering to stimulate economic growth.

- Tax Evasion

Tax evasion is a major concern across nations. In public economics, tax evasion is a fundamental issue. Tax reductions affect tax payers' public complaints and citizens' income for public services rendered. Furthermore, evasion of taxes leads to misallocation of resources and affects the accuracy of macroeconomic statistics(Alm,2013). Non-compliance to taxes alters the distribution of income in an arbitrary and unpredictable way(Alm,2013).. High proportion of tax evasion connotes government inability to provide adequate services to citizens(Fuest & Riedel,2009). Therefore, an increment in tax revenues is a common objective to governments. However, taking into consideration economical elements, the chances of raising tax revenues might not be successful on the basis of social and cultural characteristics of societies as well as moral issues. Tax evasion is a challenge in most countries and it arises from sources such as lack of faith in the abilities of government, tax laws etc. Studies conducted by researches projected losses of tax revenues through the evasion of taxes(Amos,2013). Loss of revenues due to tax evasion in the United States is estimated to be approximately \$21 billion in the next five years(Adams,2013). In addition, another research conducted in the United Kingdom estimated a loss of \$21 billion a year(Adams,2013). Also, an estimate made in Greece shows a \$30 billion per year loss of tax revenues (Daley 2010). However, these estimations are tax save estimations of tax evaders. The burden of taxes on individuals is viewed empirically or theoretically as a determinant of tax evasion. In Italy, officials' latest estimates from the underground economy generated a value added figure of €200 billion. Worldwide revenue loss from tax evasion for all countries was estimated by the Tax Justice Network to be \$225 billion by basically using a 7.5% return and a 30% tax rate. An estimation of the overall tax revenue lost due to tax evasion in developing countries is equal to \$285 billion per year. In 2001, the United States personal income tax gap amounted to \$345 billion– which is above 15% of the estimated actual (paid plus unpaid) tax liability (Bismark *et al*,2015).

The evasion of taxes generally affects the socio-economic development of every nation. Tax evasion increases entrepreneur's accumulated resources but lessens public services provided by governments thus leading to negative consequences of economic growth (Fuest & Riedel,2009). Evasion of taxes have an impact on capital accumulation thus affecting economic growth and output in diverse ways. High evasion of taxes infers more capital accumulation and may lead to economic growth. Again, high tax evasion leads to lower tax revenues and less provision of public services from government thus low economic growth rate. Over the period of 1999 to 2007, the relative size of the underground economy involving goods and services which are paid for in cash, and therefore not declared for tax in 162 countries, decreased whereas the unweight average of GDP per capita of the same countries within the same time frame also increased(Schneider *et al*,2011). Countries displaying high rates of tax evasion may experience weak direct democratic rights or low quality institutions and a further argument deployed on this subject matter describes these countries as typically developing countries with low per capita income(Bethencourt & Kunze,2013).

Tax Evasion and It's Effect On Government Revenue
Tax evasions have adverse effect on government revenue. Tax avoidance generates investment distortion in the form of the purchase of assets exempted from tax or undervalued for tax purposes. Avoidance takes the form of investment in arts collection, emigration of persons and capital. These practices erode moral values and build up inflationary pressures. This point can be buttressed with the fact that because of the evasion of tax, individuals and companies have a lot of money at their disposal. Companies declare higher dividends and individuals have a high take home profit. This increases the quantity of money in circulation but without a corresponding increase in the goods and services. This then build up what is known as inflationary trends where large money chases few goods. Kiabel and Nwokah (2009) states that tax evasion and avoidance have adverse effect on government revenue, whereby tax avoidance generates investment distortion in the form of the purchase of assets exempted from tax or under-valued for tax purposes.

- Personal Income Tax Evasion

A regime of personal income tax in any economy is equally as important as corporate tax. Progressively, personal income tax redistributes income in order to narrow the gap between the rich and the poor in addition to being a potent source for raising government revenue. Opportunities for avoiding and evading payment of this form of tax are more pronounced for those in informal employment otherwise called the self-employed. This is in view of the fact that taxpayers in formal employment are subjected to what is called the withholding tax system which is administratively a more efficient system of tax collection. By contrast, particularly in developing countries like Nigeria, it is difficult to identify taxable persons in self-employment and even when identified, it is almost impossible to ascertain their incomes for tax purposes. These create very vibrant opportunities for tax avoidance and evasion. Personal income tax avoidance and evasion manifest in different forms, and their nature varies in accordance with the purpose for which they are devised. In Nigeria, the following are well known forms of evading and personal income tax: Under-estimation of incomes and over-estimation of family responsibilities to minimise tax liability. In Nigeria, the tendency to under-estimate income for tax purposes is common among people employed in the informal organizations and the self-employed since their incomes can hardly be ascertained. Civil servants and taxpayers in formal employments, on the other hand, overestimate their family commitments to qualify for the generous tax reliefs and allowable deductions provided by the Personal Income Tax Act(Personal Income Tax Act, cap., 2004) .

Even in terms of payment of tax by taxpayers in formal employments through the withholding tax system, further problems have been created. First, some employers fail to deduct tax from their employees' salaries and contractors and secondly, where they do, refuse or fail to remit same to tax authorities as and when deducted. As seen in the case of Seven-Up Bottling Co. Pic; Lagos State Board of Internal Revenue, the Court of Appeal held that failure to remit tax deducted from salaries or emoluments of employees were a debt to the Lagos State Board of Internal Revenue which is enforceable and recoverable in the Court of law. The Court was also emphatic that refusal to deduct withholding tax from

contractors for the supply of spare parts, goods, services etc was unlawful. Presumably tax evasion and all the non-deductions, under deductions and non-remittances are recoverable failure or willful default in the supply of information or disclosure concerning taxpayer's sources of income. As earlier noted above, this practice is common among the self-employed.

This failure or willful default in the supply of information on income was the subject of litigation in the case of Ola V. verses Federal Board of Inland Revenue. This case was an appeal by the defendant taxpayer against the dismissal by the Board of Appeal Commissioners of his appeal against the refusal of the Board of Inland Revenue to consider the objection raised by the taxpayer to additional assessment made against him in respect of the years 1962-1968 inclusive. After stating that there was clear and abundant evidence that the appellant was guilty of failure or willful default in the supply of information or disclosure concerning his source of income, an offence under the Income Tax Management Act, 1961, the court went ahead to observe that the appellant was different from the ordinary run of culprits who are unwilling to pay their rates and taxes and who hide and deny ownership of their own properties or sources of income, and that it was the duty of the court in the public interest, to ensure that officials of the Revenue Board are discouraged and in fact prevented from using their power of taxation as a punitive measure. The court then set aside the additional assessment and allowed the appeal. Such instance often time lead to evasion of tax to the government and which could in a way or the other affect the economic growth of the state and the nation in general. Curbing Tax Avoidance and Evasion in Nigeria It has been suggested by Christensen that a major step towards reversing the general trend towards corporate tax avoidance would be the adoption into tax law of what is commonly called General Anti-Avoidance Principles (GAAP). It may be added that the GAAP adoption should not only be in respect of companies' income tax but in respect of all taxes. These provide tax authorities with the power: to consider whether the main purpose, or one of the main purposes, of any transaction is the evasion or reduction of a tax liability and, this if so, to allow the authorities to assess the person who has undertaken it to additional tax in order to counteract the avoidance or reduction of liability that they sought to achieve. There are clear advantages to such provisions. Firstly,

tax authorities would have a measure that allows them to enforce both the letter and the spirit of the law. This point is important .since persistent and aggressive tax avoiders normally seek to exploit the loopholes that any legal wording makes inevitable. (i)

Secondly, since a General Anti-Avoidance provision can effectively check transactions whose sole or principal purpose is to avoid tax, such transactions shift from the legal activity of tax avoidance into the illegal activity of tax evasion. Nigerian tax laws contain elaborate general and specific Anti-Avoidance provisions which could be effectively followed and used as one of the measures to curb tax evasion and avoidance in Nigeria.

III. THEORETICAL FRAMEWORK

This study is anchored on Karl Marx Economic theory propounded in 1883 and Voluntary Exchange Theory propounded by Musgrave 1939

- Karl Marx Economic theory.

This Economic Theory also known as deterrence theory place emphasis on incentives. The theory suggests that taxpayers are a moral utility maximizers- they are influenced by economic motives such as profit maximization and probability of detection. As such they analyses alternative compliance paths for instance whether or not to evade tax, the likelihood of being detected and the resulting repercussions and then select the alternative that maximizes their expected after tax returns after adjusting for risk. Therefore, in view of the fact that tax payers will always look for ways of evading tax when there is no incentives or when tax burden is high on them, make the use of this theory appropriate for anchoring the study. Hence, giving credence to the theoretical foundation used in the study.

- Voluntary Exchange Theory

This theory propounded by Musgrave 1939 says that the taxation should be levied according to an individual's ability to pay. It says that public expenditure should come from "him that hath" instead of "him that hath not". This theory is fittings and justified since the income ability of all citizens in Nigeria are not equal, this implies that those who earn higher income has the ability to pay high taxation rate

and those that earn low income also has the ability to pay taxation as they earn. This follows the PA YE (pay as you earn) principle thus, equal sacrifice can be measured as:

- i. Each taxpayer surrenders the same absolute degree of utility that he or she obtains from his /her income;
- ii. (ii) Each sacrifice the same proportion of utility she/he obtains from her / his income;
- iii. (iii) Each gives up the same utility for the last unit of income; respectively.

IV. EMPIRICAL REVIEW

Liadiare *et al.* (2010) conducted study in Nigeria examining the relationship between personal income tax evasion and cultural factors like religiosity, trust in government, and legal enforcement. In his study he found positive impact on personal income tax of trust in government and legal enforcement. However, he noted that they were no significant relationship found between religious variables and tax evasion in Nigeria. Liadiare's study is related to the present study in that both study were carried out in Nigeria and looked at tax evasion, factors which could possibly lead to it and the relationship between tax variable. Further, both studies differs from each other in terms of the kind of relationship being examined, geographical location and year of study. While their study focused on tax evasion and cultural factors like religiosity, trust in government, and legal enforcement. effects of personal income tax evasion on socio-economic development of Nigeria

Owolabi and Okwu (2011) also examined the contribution of Tax to growth of Lagos State Economy, using simple regression models as abstractions, their study considered a vector of economic growth indicators as dependent variables and in regressing each on VAT revenue of Lagos State. They noted that economic growth such as infrastructural development, environmental management, education sector development, youth and social development, agricultural sector development, health sector development and transportation sector development etc; are dependent on VAT revenue and other form of revenue which has contributed positively to the economic growth of the

• Hypotheses Testing

H0₁: There is no significant effects of personal income tax evasion on socio-economic development of Nigeria.

Table 2 Analysis of Variance (ANOVA)

	D F	SS	MS	F	P
Regression	3	17716865 9249.593	59056219 749.864	50. 567	<0. 001
Residual	6	70072444 68.807	11678740 78.134		
Total	9	18417590 3718.400	20463989 302.044		

Tested at 0.5% Level of Significance.

From table 2 above, it is evident that probability (P) value is less than 0.5%. At this level of significance, null hypothesis stated is rejected. This therefore implies that personal income tax evasion has effect on socio economic development of Nigeria.

• Summary Of Major findings

Finding of the study has shown that personal income tax evasion has substantial economic setback on the rate of development. It has also indicated that when there is evasion in tax of any form, it could have a significant negative influence on socio economic indices which in return jeopardizes growth of any nation. The level of tax evasion in Nigeria was also noted to be on the increase. This could be due to the fact that most taxpayers give false report of the revenue generation or due to the fact that most of the tax payers use other subtle means to avoid the payment of tax to the appropriate government agency.

CONCLUSION AND RECOMMENDATION

Taxpayers will be willing to pay their taxes in an ideal world. However, in a real-world situation, no one enjoys paying taxes hence the existence of tax evasion and avoidance of tax. Evidences from the study shows that personal income tax evasion impact negatively on economic growth of Nigeria and as well it being on the high side which in returns has decreases the repaid level of economic development of human society. Hence, it is recommended that Government should

make policies that make it easy for all sundry to pay their tax duties without feeling the burden.

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