

Tax Audit and Tax Compliance in Nigeria

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Abstract

The study focused on tax audit and tax compliance, so as to be able to determine how tax compliance is influenced by tax audit. The population was a hundred persons comprised of staff forty staff of the Edo State Federal Inland Revenue Service (FIRS), forty civil servants and twenty private practitioners. Sample size was determined using the Yamane (1967) formula. Data was gathered by means of questionnaire distributed randomly. The data gathered were analyzed using the simple regression analysis. The dependent variable being tax compliance and the explanatory variable is tax audit. The research revealed a weak but positively significant relationship between tax audit and tax compliance. It is thus recommended that tax audit should be intensified alongside working on other factors that may help voluntary compliance.

Key words; Tax, Compliance, Audit, Evasion, Avoidance

INTRODUCTION

Tax revenue is the mainstay of major economics of the world. The issue of tax compliance has caused many governments to review their tax laws and tax policies over time. Researchers have given their voices as to how best to tackle the issues of tax evasion and avoidance. Even though tax avoidance is seen to be legitimate; both have been considered as impacting negatively on government revenue (Melville 2013; Adebisi & Gbegi 2013). If our Lord Jesus Christ could pay his tax, then it leaves nothing to be excused of anyone that would be non-compliant.

Generally, the issue of tax compliance borders round tax evasion and avoidance. Tax non-compliance is the most common and critical of all problems of tax administration. This statement clearly captures the

situation in our country Nigeria, where tax evasion is almost the order of things. As in most developing countries with large number of self-employments that are not formalized, Nigeria has continued to suffer loss in tax revenue. Number of legislations has been put in place to track tax revenue and improve compliance. One of such moves is the introduction of the self-assessment scheme in 1991, which however, took full effect in 1998.

The problem is how government can achieve taxable personalities (individual and corporate) that would not evade tax and would be patriotic enough to pay tax rather than pay tax experts to help avoid tax. Thus increasing revenue accruing to government and making it better positioned to achieving its responsibilities to the people.

Research question

This work sets to provide answer to the question; Does tax audit influence tax compliance?

Research Objective

The objective of the study is to study tax audit and tax compliance, and how tax audit affects compliance. The specific objective therefore, is to determine the influence of tax audit on tax compliance.

Research Hypothesis

Going from the objective above, the research hypothesis is stated thus:

Ho: Tax audit has no influence on tax compliance.

Scope

The study was conducted in Edo State and used sample of fifty participants drawn randomly from the staff of the Federal Inland Revenue Service in the state.

Significance of the study

It is intended that this work would add its voice to existing literatures bordering on tax compliance, thereby creating citizens that are tax compliant, reducing government cost of collecting various tax as may be liable to taxpayers from time to time. While it is hoped that government would be responsible as they spend taxpayers' money.

LITERATURE REVIEW

As long as there is tax there would always be issues of tax evasion and tax compliance. Research on tax compliance dates back to late sixties, with the work of Becker. However, it was not a tax work; it was a study on criminality. Becker (1968) tried to use economic deterrence framework to explain compliance to law. He considered punitive and persuasive measures as means of enforcing compliance. A few years later following Becker, Allingham and Sandmo (1972), did a study on tax compliance, they came up with the assumption that taxpayers are rational beings as such maximizes utility irrespective of the moral consequences. They claimed that taxpayer would see tax evasion a worthy venture if the gains outweigh the financial costs. Thus, decision to comply is based on cost- benefit judgment.

Subsequently, Tittle and Logan (1973), questioning the economic deterrence framework from an enforcement perspective found that the probability of apprehension is more important than the sanction actually imposed. This implies that if a taxpayer knows that the chance of getting away with evasion is slim, he would not even want to consider the sanction that would follow but to simply comply. Other studies have tried to consider tax compliance from sociological perspective, Fisher (1992) came up with the idea of equity and fairness theory. His opinion was that fairness in the tax process will yield better compliance.

Here in Nigeria, tax compliance has also been an issue; most probably because of the introduction of the self-assessment scheme. The scheme was expected to generate voluntary compliance; however, the reverse has been the case. Tax gap has continually been an issue despite the new position of the Federal Inland Revenue Service (FIRS). Hence, there have been a number of studies on tax compliance (Abdulrazaq, 1993; Anyanduba and Modugu, 2014 & Badara, 2012). A stream of literature exist on tax compliance, but there seem to be no consensus on what rely cause taxpayer to pay tax.

What is tax?

Tax has been defined as a compulsory levy imposed by the government for the purpose of generating revenue that will be used by the government to run the economy. Anyanduba (1999) defines tax as:

A compulsory levy imposed by a public authority on the income, capital, profit or wealth of individual, family, community, estate, corporate or unincorporated body e.t.c for the public purpose

Tax is generally categorized into direct taxes and indirect taxes. The direct taxes in Nigeria include: Personal income tax, company income tax, petroleum profits tax, capital gains tax and education tax. The burden on these forms of tax cannot ordinarily be shifted unlike indirect tax, the burden of the indirect taxes are shifted to the final consumer. In Nigeria, indirect taxes include: Value Added Tax, Stamp duties, property tax, custom and excise duties, mineral royalties and casino tax. Tax is traceable to the Holy Bible; King Solomon in his wisdom recognized the need for tax (1 Kings 4:7, 9:15 and 12:4, King James Version). Our Lord Jesus Christ argued in favour of tax and even paid his tax (Luke 20:22-23; Matt 17:27, Kings James version). Many nations survive majorly on tax revenues, especially the developed countries like the United Kingdom, the United States, and Canada. Bird and Zolt (2005) reported that in Malaysia and Indonesia, income tax formed

60.3% and 58.7% respectively of total tax revenue in 2004. In Kenya VAT contributed 47% to the total tax revenue in 2005 (FIRS, 2012).

Taxation is a strong fiscal wheel that the government uses to steer the economy toward economic stability. Anyanwu (1997) posited three main objectives of taxation. These are: to generate revenue for the government; to regulate the economy and economic activities; and to control income and employment.

The government through tax is able to carry out its functions of:

Distributing income and wealth; discouraging wasteful spending; allocation of public and merit goods; economic stabilization; and administration of justice and defence

In spite of the fact that governments need tax to help function well and serve the citizenry better, extant literature have revealed that individuals are ordinarily unwilling to pay their taxes, this unwillingness to pay tax causes evasion and avoidance among tax payers and, have made it difficult for governments to achieve optimum tax collection (Alm, Martinez – Yazquez & Schneider, 2003).

WHAT IS TAX EVASION?

Tax evasion is a deliberate act on the part of a tax payer to reduce tax liability or not to pay tax due. Melville (2013) describes tax evasion as a dishonest behavior that involves conceding a source of income Anyanduba (1999) and Ojo (2009) describes tax evasion as a criminal offence. Tax evasion is a global challenge, it is common among the self-employed and particularly high in the developing countries because of large volume of informal economic activities (James and Nobes, 2011; Terkper, 2003).

WHAT IS TAX AVOIDANCE?

Tax avoidance according to Ojo (2009) "is generally considered as a way of identifying the loopholes in the law and then taking advantage of such loopholes to reduce tax".

James and Nobes (2011), Ojo (2009) agreed that tax avoidance is not considered an offence, Anyaduba (1999), though of the same view, went further to say that avoidance of tax borders on immorality and unpatriotism. Indeed, I strongly align with him, for it seems unreasonable for a taxpayer to hire a tax expert to look for the loopholes in the law to reduce tax rather than just paying the tax. This leaves some morality questions unanswered. Considered deeply, even though tax avoidance is not illegitimate, it tends towards non-compliance.

Both tax evasion and avoidance, impacts negatively on tax revenue and are "twin devils", in the words of Adebisi and Gbegi (2013). James and Nobes (2011) reported that the loopholes in most tax laws in the United Kingdom are being closed and as such tax avoidance is becoming reduced.

All over the world issues of tax compliance has posed a great challenge to tax administrators, developing countries like Nigeria have continued to suffer great loss of tax revenue due to non-compliance (Abdulrazaq, 1993 & Cobham, 2005).

In recent times, concerns have been directed to the issue of tax compliance while some other researchers have also considered reasons for non-compliance (Usman, 2008 & Bello, 2001).

WHAT IS TAX COMPLIANCE?

According to Federal Inland Revenue, 2012

Compliance strategy, within the context of tax administration, refers to all the structural and procedural

platforms put in place to ensure that tax payers fulfill their obligation under the tax laws (p. 193).

The importance of tax compliance lies in the fact that no taxation will be successful when tax payers do not comply. However, I do not see a tax system that would enjoy hundred percent compliance as there are various reasons why people pay tax. One of such is the fear of tax offences and penalties and another may be the fear of tax audit. When a tax payer goes on to pay tax because the law is watching, that does not amount to compliance. James and Nobes (2011) define compliance thus:

The degree of compliance with tax law and administration without the need for enforcement activity (P. 138)

It is from the point of “enforcement activity” I make my argument. We must strive towards voluntary compliance. The need for voluntary compliance brought about the self-assessment system. One would think that since tax payer are allowed by law to assess their taxable income and tax liability, the issue of compliance would be gone for good. It is however, sad to note that researchers have continued to think on how best to overcome the challenge of tax non-compliance and achieve a voluntary compliance from taxpayers.

SELF ASSESSMENT SYSTEM (SAS)

The governments, in an attempt to improve tax collection and reduce the cost of collection introduced self-assessment system. The self-assessment system is a system whereby a taxpayer assesses his income, compute his tax liability and voluntarily goes on to make payment to the relevant tax authority: Many countries have adopted the system to encourage voluntary compliance (FIRS, 2012), it became mandatory in 1998 for all taxpayers to file self-assessment returns with the relevant authorities.

According to FIRS (2012) the merits of, and impediments to self-assessments system are:

MERITS OF SAS

The major merits of the SAS are: Cost effectiveness, eliminating the administrative aspect of assessment, encouraging early and timely collection of taxes, and reduced corruption by reducing contact with taxpayers.

IMPEDIMENT TO SAS

Impediments to SAS include: Lack of tax education among taxpayers, poor public relation activities on the part of the authorities and inadequate penalty provisions for errant taxpayers

In Nigeria, before now, a taxpayer gets one percent bonus on tax payable for prompt and accurate filling of tax return. Presently, with the amendments to the Companies Income Tax Act and the personal income tax act in 2007 and 2011 respectively, the one percent bonus has been repealed. This is because the system recognized that it is the obligation of the taxpayer to assess himself, as such the need for a reward does not exist.

The SAS is based on trust and honesty of the taxpayer, there is therefore the need to measure compliance. To measure compliance, the arrangement for tax audit was put in place. Countries all over the world engage tax audit as part of their tax system.

TAX AUDIT

Tax audit is a specialized form of audit carried out by a tax authority to examine the accounts and other documents of taxpayers and review the self-assessment returns for the purpose of determining the income and tax liability of such taxpayer. International tax audit is done to examine the tax reports of multinational corporations in order to ascertain their

compliance with applicable tax laws and regulations. Oyebanji (2006) opined that SAS is subject to the satisfaction of the tax authority. This satisfaction can only be determining through tax audit. One of the most effective policies to prevent tax evasion according to Slemrod (2000) is tax audit. However, in a country like Nigeria where the numbers of taxpayers cannot be determined, tax audit becomes limited and evasion continues to thrive. There is therefore an urgent need to formalize all forms of self-employment so as to track more tax revenue.

The government though has tried, but there is still much to be done in the area of creating proper database for the population of this country as this will help in the formalizing of the bulk of self-employed and improving the tax revenue. Various government efforts towards creating a database in recent time include: the introduction of taxpayer identification number, Bank Verification Number (BVN), Issuance of National Identity Card etc.

These efforts, singly cannot achieve much, they need to be harmonized and built upon so that gradually the gap between the formalized self-employments and the non- formalized self-employments would become smaller.

Tax audit, unlike the statutory audit is not done annually, and it is carried out at the discretion of the tax authorities without the taxpayer being a party to the decision to audit.

SELECTING WHO TO AUDIT

The taxpayer has no part in deciding whether he is to be audited or not, the tax authority at any particular time based on certain reasons and by random selection, selects taxpayers to be audited. This individual taxpayer could be on individual or on organization. In the United State of America they employ the use of software to determine who to audit. Such software packages are:

- Discriminant Index Function (DIF); and
- Unreported Income Discriminant Function (UIDIF)

They also make use of random selection, thus error need not be found before a tax audit is done.

In Nigeria the federal Inland Revenue service has the audit and investigation departments, this department provide the guidelines and criteria for the selection of taxpayer to be audited. Such criteria include:

1. Selection at intervals not exceeding two years from the date of the last self-assessment
2. Tax payers that break-even or sustain loss consistently
3. Taxpayers with very low adequacy ratios
4. Claims made under double taxation
5. Transfer pricing arrangements
6. Directives from top government hierarchy; and
7. Information arising from examination of audit and investigation of other taxpayers

TYPES OF TAX AUDIT

Tax audit are majorly grouped into Desk audit and field audit

Desk Audit: This involves the routine check in the tax office to ensure that a taxpayer has submitted the necessary documents and there have been no noticeable mistake in the returns filled.

Field audit: This is usually results from the desk audit. It may be carried out at the premises of the taxpayer.

Other forms of audit, especially in the U.S are: Mail Audit, Office Audit and Joint Audit.

Mail audit: In this type of audit, the tax authority request additional documentation to substantiate various items submitted on the tax return. If the tax authority gets sufficient proof and is satisfied, that concludes the audit. Where it is not satisfied an office audit may be required.

Office audit: It is carried out in the local tax office, the taxpayer is invited to bring specific documents to the office and it usually include questioning by a tax audit officer

Joint tax audit: This is the examination of a taxpayer return by a single audit team consisting of members from two or more states. The focus of this audit is on cross border tax situations. The purpose is to allow the tax auditors gain uniform, actual and legal assessment concerning such situation.

OBJECTIVES/REASONS FOR TAX AUDIT

Whatever the form of audit; Erard, (1994) and James (1993) mention some reasons for tax audit, these include: tax audit is done to assist the government in collecting tax revenue; to ensure the satisfactory returns are submitted by the taxpayers; to minimize the degree of tax evasion and avoidance; to ensure compliance to tax laws by taxpayers; to improve the degree of voluntary compliance by tax payers; and to ensure that amount due is collected and remitted to government to establish a viable and effective tax administration that will be able to deal with a constantly changing economy.

Overtime, some researchers have established a positive relationship between tax compliance and tax audit. Oyebanji(2006) opined that the self-assessment system is subject to the satisfaction of the tax authority. Slemrod (2000) is of the view that tax audit will effectively prevent evasion, other researchers that have found tax compliance to be a function of tax audit include Anyanduba and Modugu(2014), Badara (2012), James (1993) amongst others. In Nigeria, review of the various tax act have brought stiffer penalties, yet it seems it has not impacted much on compliance this could be as a result of poor audit influence and enforcement issues. Other factors that may improve tax compliance as have been posited by various literature include, tax awareness, literacy, improved government provisions. Indeed, Halil and Mustapha (2011)

found direct relationship between government spending and tax compliance.

METHODOLOGY

The study seeks to establish the influence of tax audit on tax compliance. The survey research design was adopted for this study because the study intends to explain what effect tax audit may have on tax compliance.

The population for the study was a hundred persons comprised of: forty staff of the Edo State FIRS, Forty civil servants and twenty private practitioners. The sample was randomly selected and the size was fifty; as determined by the Yamane (1967) formula given as: $n = N / (1 + N(e^2))$.

Where: n = sample size, N = population and e = error interval.

Data was primarily sourced with the use of questionnaire.

Model Specification:

A simple model was employed to determine the relationship between tax audit and tax compliance and it is presented thus:

$$TC = F(TA) \dots \dots \dots (1)$$

$$TC = \beta_0 + \beta_1 TA + \varepsilon \dots \dots \dots (2)$$

Where: TC = Tax compliance, TA = Tax audit, β_0 = constant,

β_1 = coefficient of the independent variable.

ε = error term

DATA ANALYSIS

To establish the relationship between tax audit and tax compliance, the tables below presented the test statistics and the regression results.

Table 1: Correlations

	Tax audit	Tax compliance
Tax Audit	1	0.433
Tax compliance	0.433	1

Correlation is significant at 0.01.

Source: Author's computation from SPSS.

Table 1 shows the Pearson Correlation between TC and the independent variable (TA). As presented, TA shows a positive and significant relationship with TC. The variance inflation factor (VIF) is less than 10 as presented in table 2, which implies there is no multi collinearity.

Table 2: Regression Analysis

Variable	Coefficient	t-statistic	Probability	VIF
C	3.381	7.547	0.000	-
TA	0.307	3.257	0.002	1
R	0.433	f-statistic		10.608
R ²	0.187	Prob (f-statistic)		0.002
Ad.R ²	0.170			

Source: Authors compilation from SPSS output (2016)

The table above represents the result of the regression analysis.

The adjusted R-squared of 0.187 shows that 18% of the variations in TC is explained by TA. The overall significance of the model is shown in prob (f-statistic) of 0.002. The t-statistic and the probability shows that TA has positive relationship with TC at a significant level of 5%; this implies that the TC is influenced by TA.

As a result of the foregoing, the null hypothesis is rejected; thus tax audit has a positive and significant influence on tax compliance, though not strong. This finding supports the deterrent model (Allingham & Sandmo, 1972; Becker 1968)

CONCLUSION AND RECOMMENDATIONS

The study was to determine whether tax audit has any influence on tax compliance. A weak relationship was found. This implies that tax audit

has some positive influence on tax compliance though, not strong enough to generate voluntary compliance. This result somewhat buttressed earlier studies that have opined that deterrent is not all there is to tax compliance.

In the light of the foregoing, it would be fair to conclude that there are some other factors that may motivate taxpayer to pay tax which we hope to consider in subsequent research. Notwithstanding, government should intensify efforts through its relevant authorities, on tax audit as well as consider some other factors that may help compliance as revealed in the literature review.

Thus the following is recommended for government consideration: a purposeful move to formalize the informal sector; collaboration with the major telecommunication network operators to get data of most of the self-employed; and ensure fairness in the tax process

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