The Effect of Tax Avoidance on Government Budget Implementation in Southwest Nigeria

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Abstract

The study examined the effect of tax avoidance on government budget implementation in Southwest Nigeria for the period 1999-2014. Out of the six states in Southwest Nigeria (Lagos, Ondo, Ekiti, Oyo, Osun and Ogun), simple random sampling was used to select Ekiti, Ondo, Osun and Ogun states. Secondary data on VAT, PAYE, CGT, and WIT were gathered from office of Budget and Economic Planning, Research Department and Internal Revenue office of sampled Southwest states. The estimated parameters for tax avoidance variables from the model were statistically significant at 0.05 for assessing and determining the performance of budget implementation. Descriptive and inferential statistics were used to analyse the data. The f-statistic value 5.409 and the probability of f -statistic 0.0005 revealed that the panel regression model was appropriate, valid, reliable, and acceptable for the study. The results showed that 61 percent of the expected revenue of the states was hampered by avoidable consequence of tax avoidance through non compliance with collection and remittances. The level of tax avoidance through implementation of tax laws and policies in Southwest Nigeria revealed negative performance of government budget implementation and as such affected the development of the economies of sampled states (t = 3.84, 6.36 and 9.94 for VAT, CGT and WIT respectively). The study concluded that there is a linear relationship among three out of the four independent variables considered (VAT, CGT and WIT) and budget implementation in South West Nigeria. The study recommended that government should develop a well equipped database aiming at identifying all possible sources of tax avoidance by companies and individual tax payers, which will help in checking truancy of tax payers, thereby leading to reduction in non compliance and remittances of appropriate tax dues. It was equally recommended that state governments should establish proper accountability and transparency agencies to monitor the collection and remittances of tax revenue. Tax agencies must be strictly positioned to discourage every form of unwholesome or corrupt practices connected with the tax system.

Keywords: Taxation, Tax avoidance, Value added tax, PAYE, Capital gains tax, Withholding tax, Government Budget, Panel regression.

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I. Introduction

Taxation as defined by Anyanwu (1997) is a compulsory levy by the government on individuals, companies, goods and services to raise revenue for its operations and to promote social equity through the redistribution of income. In line with this frame of thought, it appears that taxation is a source of government revenue by which individuals and cooperate bodies are mandatorily required to pay certain proportion of their earnings to the government for the course of development. Bhatia (2003) also defined tax as a compulsory levy payable by an economic unit to the government without any corresponding entitlement to receive from the government.

It is not a price paid by the tax payer for any definite service rendered or a commodity supplied by the government because the benefits received by tax payers from the government are not related to the tax they paid. Thomas and Chaido (2005) asserted that all sums levied by a government or through its accredited agents on the people residing in a country either as individuals or organizations (direct tax) or on goods imported or home produced (indirect tax) to enable the government meet its expenses and for the provision of general benefits are regarded as taxation.

Tax revenue is the lifeblood of any government (Christensen & Murphy, 2004). Olaseyitan & Sankay (2012): Saratu (2015) stated that taxes constitute the principal source of government revenue, and the effectiveness of any government largely depends on the ability of its citizens to voluntarily discharge their tax obligations without any coercion or harassment.

Avoidance of tax reduces government revenue and endangers the reputation of tax system. Thus, government needs to prevent tax avoidance or keep it within safe limits. The competition that exists among firms, industries and banks influences the avoidance of tax so that firms can have more investment money to compete favourably in the market (Cai, & Liu, 2009).

Tax avoidance is an important factor as it affects both the volume and nature of government finances. Both the Federal and State Government may lose both individual and corporate income tax revenue due to tax avoidance.

Obara (2013) posited that, for the government to meet the need of its citizenry, budget making and budget implementation are involved. This includes the process of identification of public needs and the determination of the quality of goods and services to satisfy these needs through the political process, by economic analysis with the overall development plan. He further stated that government prepares budget in form of public policy to serve as a driver through which her mission could be achieved. As good as our budget is in Nigeria, the performance of which can be measured in terms of accomplishment is nothing to write home about. Budget accomplishment is far from reality and the disparity between budget and accomplishment are so wide and kept on abating as years pass by.

Nigeria tax system which was meant to achieve core economic, political and social objectives such as, revenue generation for the sustenance of economic and social needs, control consumers demand, encourage investment and savings, fight economic depression, inflation and deflation, guarantee equitable distribution of income and wealth, control the general trend of the national economy, and ensure a proper allocation of national resources has hither-to failed because of several impediments (Asaba, 2011). This has resulted to the recurrent problem of dwindling revenue generation characterized by yearly budget deficits and insufficient funds for economic growth and development at the national and state levels.

According to Adegbile & Fakile (2011), Nigeria citizens lack knowledge and education about taxation. Thus, there is greater desire for tax evasion, avoidance and non-compliance with relevant tax laws. In this respect, the country has been more adversely affected because of absence of tax conscience on the part of individuals and companies and the failure of tax administration to recognize the importance of communication and dialogue between the government and the citizens in matters relating to taxation. Although tax evasion and avoidance are problems that face every tax system, the Nigerian situation seems unique when viewed against the scale of corrupt practices prevalent in the country (Adebisi & Gbegi, 2013). This study therefore intends to establish the model, relationship and impact between tax avoidance and budget implementation in southwest geopolitical zone of Nigeria.

The broad objective of this research work is to assess the effect of tax avoidance on government budget implementation in Southwest Nigeria while the specific objectives are to:

i.   Determine the relationship between tax avoidance and performance of government budget implementation or revenue;

ii.   Examine the impact of tax avoidance of each selected state in Southwest Nigeria on government budget implementation or revenue.

The hypotheses tested in this research are:

H_{01}: There is no significant relationship between tax avoidance and government budget implementation /revenue.

H_{02}: Tax avoidance does not have significant impact on government budget implementation / revenue.

2.0   **Literature Review**:

In every government set-up, there is an expectation that, citizens are to contribute part of their earnings as tax to the development of the nation. The value collected is to be utilised and managed well. The Board of Inland Revenue is mandated to come-up with the estimate and ensure that target has been achieved. Managing the tax will in turn play a great role towards economic growth of any nation. This is because, tax is part of the nation's sources of income and it is from this revenue that the government use in providing goods and services. Therefore, if tax is well managed, it will impact on nation's development. Tax management in this context refers to the way and manner upon which the Board of Inland Revenue is able to raise the expected amount of revenue and manage it to the extent that at the end it will be impacted on the economy of the nation (Ibrahim, 2011).

According to Dandago and Alabede (2001) and Ibrahim (2011), taxation can also be used as instrument for economic stabilisation and tool for government fiscal policy regulations.

Though, Worlu & Nkoro (2012) posited that the use of tax as an instrument of fiscal policy to achieve economic growth in most developed countries cannot be reliable because of dwindling level of revenue generation, they stated that in Nigeria, the contribution of tax revenue has not been encouraging. Thus, expectations of government are being cut short. Corruption, tax evasion and tax avoidance indicators are strongly associated with low revenue.

A tax system offers itself as one of the most effective means of mobilising nation's internal resources when it lends itself to creating an environment conducive to the promotion of economic growth (Ogbonna & Ebimobowei, 2012).

According to Sanni (2007) and Okafor (2012), tax is an instrument of social engineering that stimulates general and / or sect oral economic growth. In that regard, taxation could have a positive or negative effect on both individual and government. To the individual, low income tax rate constitutes an incentive to work or save, while high income tax rate represents a disincentive to work or save. To the government, high tax rates provide the most reliable, important and dominant source of government revenue, for promoting the economic development of the nation. The vitality and necessity of tax prevail in the reality that it provides income for the government. Without such income, government will be powerless to carry out important ventures that cannot be shouldered by individuals on their own (Ohaka & Agundu, 2012).

Saratu (2015) examined the impact of competition on tax avoidance activities among Nigerian Deposit Money Banks. The study used panel regression model to analyse the data obtained from the financial statements of 15 banks operating on the Nigerian Stock Exchange for a period of 10 years. The result of the random effect revealed that competition has a positive and an insignificant impact on tax avoidance. Nwaorgu, (2015) examined the effect of dominant individuals on budget implementations in Nigeria using content analysis. The study recommended that budget should be based on thorough evaluation of revenue and needs and the issue of probity, transparency and accountability should be properly addressed in the budget process.

Without missing words, the major source of government revenue in any country is from taxation. Any government, that really wants to succeed and fulfil its economic, legal, political, and technological objectives must ensure that its taxation system is not only expansive but rather possesses the principles of equity, certainty, convenience, simplicity, neutrality and efficiency (Ogbonna, 2007).

Theory of Tax Avoidance

The General Theory of Tax Avoidance was propounded by (Stiglitz 1986). In his theory, he stated that in a perfect capital market, the principles of tax avoidance are so powerful that they can enable the astute taxpayer to eliminate all taxation on capital income, and possibly all taxation on wage income as well. He noted in particular that much of the general equilibrium gained from tax avoidance arises from differences in tax rates, both across individuals and across classes of income rather than from postponement.

Stiglitz (1986) stated that the tax laws constantly change the opportunities for tax avoidance but underneath, there remain three basic principles of tax avoidance within an income tax which are postponement of taxes, tax arbitrage across individuals facing different tax brackets and tax arbitrage across income streams facing different tax treatment.

The first principle which is postponement of taxes explains that the present discount value of a postponed tax is much less than that of a tax currently paid, while the second principle involving transactions among different individuals within a family would in the long run reduce the aggregate tax liability as a result of the same individuals facing different marginal tax rates at different times.

The third principle states that long-term capital gains are taxed at lower rates than other forms of income from capital. This provision is inducement to convert the returns on capital (or on labour) into long term capital gains. He also added that special treatment is given to the return on capital in the form of housing and pension. Many tax avoidance devices involve a combination of these three.

Adam smith theory of taxation

Adam Smith is best known for the first theorem of welfare economics--an unfettered market will automatically, as if by an invisible hand, allocate nations' resources in the most efficient manner possible. Smiths' theory of taxation follows from that principle.

Taxes should be levied only to support a limited government and should satisfy four maxims: equity, transparency, convenience, and efficiency. According to Smith, nations that maintain free markets and limited taxes will maximize their wealth.

Smith believed taxes should support four legitimate functions: national defence, justice, universal education, and good roads and communications. All four functions are beneficial to the whole society and may therefore, without any injustice, be defrayed by the general contribution of the whole society. He added that user fees should help to cover roadway expenses, and that the rich should pay for their children's education. He thus anticipated both social externalities and user-pay principles. The first of Smiths' tax maxims, equity: reflects his belief that the wealthiest benefit most from government and can most afford to pay. The rich should contribute to the public expense not only in proportion to their revenue, Smith believed, but something more than in that proportion. Equity, according to Smith, requires progressive taxation.

Smiths' second maxim is that the tax which each individual is bound to pay ought to be certain and not arbitrary and clear and plain--that is, transparent to everyone. Transparency would help prevent unscrupulous tax gatherers from undermining trust in the system. The third maxim is convenience. Every tax said Smith, ought to be levied at the time, or in the manner, in which it is most convenient for the contributor to pay it. Smith spoke of tax simplification in this context and said Britains' duties on customs could benefit from the same degree of simplicity, certainty, and precision, as those of an excise on domestic consumption.

Smiths' fourth maxim is efficiency: Every tax should be devised so as both to take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of a state. This requires keeping administrative costs and economic distortions to a minimum.

Economic distortions might obstruct the industry of business people and thereby prevent them from giving employment to great multitudes of people. The most efficient tax, according to Smith, would leave the annual produce of the land and labor of society, the real wealth and revenue of a nation the same as before.

3.0 Method:

Population and Sample

The study population comprised all the states of the Southwest geo-political zone in Nigeria [Ekiti, Ondo, Osun, Ogun, Oyo and Lagos]. Simple random sampling was used in selecting the four (4) states sampled.

Sources of data

Secondary data was used. The data used span from 1999 through 2014 which is expected to cover the period under current democratic dispensation in Nigeria.

The Scope and Method of Data Collection

The data was sourced from the office of budget and economic planning, research department and internal revenue office of Ekiti, Ondo, Osun and Ogun states of the southwest Nigeria using transcription from the records.

Variables Description, Model Specification and Estimation Technique

Budget implementation is captured by the actual revenue generated by the states under investigation while tax avoidance incidence is proxied by the difference between the actual revenue generated and the expected or estimated revenue to be generated from value added tax, pay as you earn, capital gains tax and withholding tax. However, the data gathered will be modelled using panel regression.

The adopted model is specified as follows;

$$BIM_{it} = \propto + \beta_{it} VAT_{it} + \beta itPAYit + \beta itCGTGit + \beta it WITit + \mathcal{A}_i + \mathcal{B}_t + \epsilon_{it}$$

Where;

BIM$_{it}$ = government budget implementation and expected development of the states or economy

VAT$_{it}$ = tax avoidance incidence through value added tax

PAYE$_{it}$ = avoidance through non remittance of pay as you earn taxes

CGT$_{it}$ = avoidance through capital gains tax generated

WIT$_{it}$ = avoidance through withholding tax

S = number of entities (states) Y = number of time periods (years)

Parameter α represents the overall constant in the model, while the $\mathcal{A}$i and

$\mathcal{B}_t$ represents cross-section or period specific effects (random or fixed).

4.0 Analysis and Interpretation of Results

Table 1: Descriptive Analysis of tax avoidance and budget implementation in Nigeria

	BIM	VAT	PAYE	CGT	WIT
Mean	1.29E+10	4.30E+08	3.80E+08	14947060	83569486
Median	9.96E+09	4.06E+08	52711217	3329138.	2340444.
Maximum	1.08E+11	1.99E+09	6.93E+09	3.84E+08	1.27E+09
Minimum	1.42E+08	301666.1	238786.7	33750.00	11980.00
Std. Dev.	1.69E+10	3.91E+08	1.02E+09	50570586	2.37E+08
Skewness	3.666930	1.405300	4.736313	6.366767	4.193854
Kurtosis	18.80590	5.681931	28.52814	45.91205	20.54662
Jarque-Bera	809.6317	40.24595	1977.110	5342.898	1008.633
Probability	0.000000	0.000000	0.000000	0.000000	0.000000
Observations	64	64	64	64	64
Cross sections	4	4	4	4	4

Source: Researchers' Computation, 2016

Table 1 shows the descriptive results of all the activities regarding the effect of tax avoidance on budget implementation and its implication on development for the period 1999-2014.

The budget implementation measured the expected development or transformation of the states while tax avoidance is captured by avoidance from value added tax, pay as you earn capital gains tax and withholding tax from the south west geopolitical zone in Nigeria.

The result revealed that the average expected revenue required for the states from various tax avoidance variables such as expected revenue, value added tax, pay as you earn, capital gain tax and withholding tax are #12.9 billion, #0.43 billion, #0.38 billion, #14.947 million and #83.569 million respectively and as result have a negative impact on the performance of government budget implementation and expected development of states in Nigeria.

Also, it was discovered that the value added tax, pay as you earn, capital gains tax and withholding tax from the selected states are positively skewed which implies a poor tax policy administration and implementation which affect negatively the government performance budget implementation and the expected development in the states. The Jarque-Bera and probability values revealed that tax avoidance variables identified in this study have statistical and significant impact in determining the performance of government budget implementation as well as the development of Nigerian economy.

Table 2: Pooled Least Square Panel Regression Result

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	3.37E+09	3.06E+09	1.098445	0.2765
VAT	20.27773	5.278348	3.841682	0.0003
PAYE	-1.319378	2.230343	-0.591558	0.5564
CGT	26.14277	4.107751	6.364254	0.0131
WIT	9.993484	1.005013	9.943655	0.0000

R-Squared = 0.63 Adj. R-Squared = 0.61 F-Stat. = 5.4087 DW = 1.255 Prob. (F-Stat.) = 0.0005

Source: Researchers, Computation, 2016

Table 2 shows the result of the pooled panel regression output. It was discovered from the result that linear relationship exists between budget implementation and tax avoidance variables such as value added tax, pay as you earn, capital gains tax and withholding tax in Nigeria. The result showed that a negative linear relationship exist between the value added tax, capital gains tax, withholding tax and budget implementation while a positive linear relation was discovered between the pay as you earn and the budget implementation.

This result further revealed that the non compliance to tax obligation and untimely response to payment and remittance hindered the performance of budget implementation negatively by 20, 26 and 10 percent respectively.

The pay as you earn value of -1.32 implies that the pay as you earn tax policy or strategy adopted in the south west geopolitical zone by the government in Nigeria will improve performance of budget implementation and there by contribute to economic development of the country level by 1.32 units. The probability values of 0.0003, 0.0131, and 0.000 respectively revealed that the estimated parameters for tax avoidance variables from the model are statistically significant in assessing and determining the performance of budget implementation.

Fiscal policy implementation is a critical factor and must be a well considered strategy as it is a major determinant of budget implementation. Effective tax policy is crucial to the government budget implementation. This result affirmed the position of Worlu & Nkoro (2012) who posited that the use of tax as an instrument of fiscal policy to achieve economic growth in most developed countries cannot be reliable because of dwindling level of revenue generation. He further stated that in Nigeria the contributions of tax revenue has not been encouraging, thus expectations of government are being cut short. Corruption, tax evasion, tax avoidance and haven indicators are strongly associated with low revenue.

The adjusted R-squared of 0.61 shows that the performance of budget implementation in Nigeria will improve by 61 percent if there is total compliance to all the tax laws and policies regarding collection and remittance. Thus, the result implies the negative impact of tax avoidance to the development of the Nigerian economy.

Above all, the probability of the F- statistics 0.0005 showed that the pooled panel regression fitted is valid, reliable, appropriate, and acceptable for determining the effect of tax avoidance on the government budget implementation. The Durbin-Watsin statistic of 1.255 shows that the estimated parameters are free from autocorrelation problem. Hence, there is no overestimation or underestimation of the parameters and that the estimated standard error and the probability value used in testing hypothesis are adequate and appropriate.

Table 3: Fixed Panel Regression Model Result

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LOGVAT	19.53243	5.587576	3.495689	0.0009
LOGPAYE	-0.500389	2.413966	-0.207289	0.8365
LOGCGT	6.570179	1.218362	5.39263	0.0011
LOGWIT	8.417959	0.975408	8.630192	0.0161
Fixed Effects (Cross)				
ONDO--C	5.42E+09			
OGUN--C	4.51E+09			
OSUN--C	-1.16E+09			
EKIT--C	3.17E+09			

R-Squared = 0.64 Adj. R-Squared = 0.61 F-Stat. = 5.845 Prob.(F-Stat.) = 0.0012

Source: Researchers' Computation 2016

In table 3, the result of the fixed effect panel regression model on the effect of tax avoidance variables on government budget implementation was presented and it was revealed that negative linear relationship existed among the tax avoidance variables such as value added tax, capital gains tax, withholding tax and the government budget implementation in Southwest Nigeria. It was discovered that a positive linear relationship existed between the pay as you earn and government budget implementation.

The result further showed that value added tax, capital gains tax and withholding tax limit performance of budget implementation by 19.5, 6.6 and 8.4 percent respectively.

As such, expected developments are hampered due to the unfavorable approach to collections and remittance of these taxes in Southwest Nigeria. Tax deduction paid through pay as you earn improve the performance of budget implementation and thereby lead to 0.5 percent improvement of expected total revenue. The test for the statistical significance of these estimated tax avoidance variables or parameters using the standard error test and the probability value revealed that the non compliance to law, policy and administration of value added tax, capital gains tax and withholding tax have statistical significance on the performance of budget implementation and above all affect the economic development of the nation negatively.

A thorough examination of the result based on each selected state in Southwest geopolitical zone in Nigeria shows that tax avoidance rate or non compliance to tax obligation are very high in Ondo, Ogun and Ekiti States as the value stood at the rate of 5.4, 4.5 and 3.2 respectively. Meanwhile, the result revealed that the compliance rate in Osun State was encouraging with positive response to collection and remittance as a result of their commitment to government tax law, policy and administration with the tax returns rate of 1.2.

This is in line with Ogbonna & Ebimobowei (2012) that a tax system offers itself as one of the most effective means of mobilising a nations internal resources and it lends itself to creating an environment conducive to the promotion of economic growth. The proportion of variation and improvement in the performance of budget implementation can be explained by tax avoidance variables under consideration by 61 percent.

The probability of F-statistics and the F-statistics value revealed that fixed effect panel regression model is statistically significant and thus valid, reliable, appropriate and acceptable for this study. Comparing the pooled panel regression model with the fixed effect panel regression model used for this research, it was discovered that fixed effect panel regression model is more efficient, consistent, sufficient, and unbiased for determining the effect of tax avoidance on the performance of government budget implementation in Nigeria. This decision was based on the model with the highest value of F-statistics.

5.0 Conclusion

Having examined thoroughly the effect of tax avoidance on government budget implementation in Southwest Nigeria and its implication on the development of Nigerian economy, it was discovered from the descriptive and inferential analyses that tax avoidance has a grave consequence on the performance of budget implementation. The results showed that 61 percent of the expected revenue in Nigeria has been hampered by the avoidable consequence of tax avoidance through non compliance to the collection and remittance of value added tax, pay as you earn capital gains tax and withholding tax in the south west geopolitical zone in Nigeria. Tax avoidance through implementation of tax laws and policies on value added tax, capital gains tax and withholding tax on the selected states in the Southwest Nigeria was revealed to have negatively dented the performance of government implementation and as such affected the development of Nigerian economy.

This negative effect of tax avoidance rate was more visible in Ondo, Ogun and Ekiti States as a result of their non compliance to tax law, administration and obligations as revealed by the fixed effect panel model. Thus, the study concluded that government should develop a well equipped database aiming at identifying all possible sources of tax avoidance by the companies and individual tax payers. This will help in checking truancy of tax payers thereby leading to reduction in non compliance and remittance of appropriate tax dues. There is urgent need by the government to establish proper accountability and transparency agencies to monitor the collection and remittance of tax revenue in Nigeria. The agencies must be strictly positioned to discourage every form of corrupt practices regarding all the activities of tax system in Nigeria. Government must clearly define the basic objectives of its tax system and their relationship with budget implementation and the development of the economy. This will give the tax administrators a sense of direction and make the companies and individual tax payer see a clear reason why tax should not be avoided.

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