

EFFECTIVE IMPLEMENTATION OF THE SELF-ASSESSMENT SYSTEM OF TAX COLLECTION IN THE INFORMAL SECTOR IN NIGERIA

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Abstract

This paper reviews the taxation of the informal sector in Nigeria. There is no doubt that the supposed revenues from the informal sector in Nigeria are not being taxed effectively and extensively. Most times the sector is not even captured in the tax net. The greater percentage of tax is collected from the formal and salaried workers. The over reliance on revenue from oil has already dwindled and recently Nigeria has relied on loans from developed countries to meet her developmental needs. This paper therefore makes a call for the taxation of the informal sector considering the great percentage of revenue lost in the sector due to tax evasion and avoidance.

Keywords: Informal Sector, Self-Assessment, Tax, Revenue, System, Revenue, Government.

1. Introduction

There is no doubt that tax is a global means by which governments raise revenues for the effective development and governance of any country. The importance of tax cannot be underestimated and that is why globally, most countries, both developed and developing are fashioning out ways and means for the effective collection and administration of tax. Tax means a compulsory levy which is required to be paid by every citizen for yielding income for the utilisation in the provision of amenities for the economic well-being of the society. In other words, the main objective of tax is to raise sufficient revenue for government to finance its activities.

Self-Assessment System (SAS) in tax on its own is one of the measures implemented by many countries in order to increase revenue collection. It is a “do-it-yourself” process whereby taxpayers are required to file their tax returns, reporting their respective income that is assessable to tax and determining their respective tax liabilities on the basis of their tax returns. Under the self-assessment system, the onus is placed squarely on the taxpayer to understand, interpret and apply the laws to their own circumstances. In addition, taxpayers are responsible for timely and accurate reporting and to make payment of taxes by the due date. In discharging these obligations, taxpayers must understand the tax laws, compute and pay the correct amount of tax liability, as well as keep accurate records.¹ Therefore, the basic feature of a SAS is that it is the taxpayer

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¹ N S Sapiei, J Kasipillai, Impacts of the Self- Assessment System for Corporate Taxpayers, [2013] 3(2) *American Journal of Economics*,75-81

rather than the tax authority that is responsible for the responsibility for the assessment of tax liability.²

Globally, the self-assessment system has been embraced by tax administrators as the means by which voluntary compliance of tax obligations can be achieved. In Nigeria, various tax laws which the tax authorities operate for various tax types being administered all contain provisions for the self-assessment tax system. First of all, the Constitution of the Federal Republic of Nigeria 1999 (as amended)³ provides for the implementation of self-assessment. Section 24 Subsection F stipulates that it shall be the duty of every citizen to declare his income honestly to appropriate and lawful agencies and pay his tax promptly. This section of the Constitution in summary made provision for the self-assessment tax regime as the taxpayer is granted the right by law to compute his own tax liability, pay the tax due and produce evidence of tax at the time of filing his tax returns at the tax office, on due date.⁴

Again, the Personal Income Tax Act, 2004 in sections 41 and 44 made extensive provision for the adoption and application of the self-assessment system in Nigeria. These two Sections are the statutory provisions that guarantee self-assessment under the Personal Income tax Act. Upon the receipt of such return of income as prescribed by section 41, the relevant tax authority shall proceed to assess the taxable person chargeable with income tax as soon as may be possible after the time allowed to the person for the delivery of the Returns.⁵ This by implication means that the self-assessment afforded a taxpayer can only be defeated by his failure to file the returns correctly or total failure to file the returns.

The legal backings received by self-assessment system in Nigeria also include that as provided under the Tax Administration (Self-Assessment) Regulations 2011,⁶ Companies Income Tax Act 2004,⁷ and Value Added Tax Act.⁸ Etc. No doubt, the self-assessment system as provided under the Nigerian statutes were provided mostly for the great benefits it provides as against the administrative assessments or official assessment whereby taxpayers are required to submit their Returns 30 days from the date of service. The administrative or formal assessment was considered to be time-consuming, costly and complex to administer. It encouraged late tax collection and placed a huge demand on human resources and also required a high volume of returns to be processed resulting in a backlog of un-assessed cases and delays in processing and issuing returns. Most

² T K Sarker, Tax Compliance in Developing Countries through Self –Assessment Systems: What Bangladesh can learn from Japan? *Asia Pacific Tax Bulletin* [2003] 9(6), 3-34

³ Constitution of the Federal Republic of Nigeria, 1999 [as amended] LFN 2004.

⁴ A Ebimobowei, OG Nkwazem, Self-Assessment and Revenue Generation in Nigeria [2014] 4, (10) *Developing Countries Studies Journal*, 102.

⁵ PITA 2004 S.54 (1).

⁶ Tax Administration (Self-Assessment) Regulations 2011 S.3

⁷ CITA S.55(1)

⁸ VATA S.16

importantly, it was argued that the formal system of assessment did not encourage voluntary compliance as compared to the self-assessment system of tax collection. The effectiveness of the self-assessment system as recognised in the developed and some developing countries attest to the effectiveness in the voluntary compliance in the payment of tax. In the United States of America, for the years 2019 to 2020, the estimated tax gap was \$441 billion while the voluntary compliance rate (VCR) was 83.1% to 83.8%.⁹ It is noteworthy that the gross tax gap is the amount of true tax liability that is not paid voluntarily and timely and these estimates remain the most recent published available. Self-Assessment which was adopted in the USA for almost a century attests to the fact that where same is properly implemented can lead to overall high compliance rate. The success in tax compliance in USA is glamorous as compared to what is obtainable in Italy, another developed country.

It is well known that data compliance is low in Italy.¹⁰ Italy consistently ranks near the bottom. It has been reported that tax evasion in Italy costs the State 129 billion pounds per year in lost revenue.¹¹ The fight against tax evasion has been one of the most important topics under discussion by the new Italian government formed in 2019. Also Italy has a high compliance burden associated with its individual tax system. It takes businesses an estimated 169 hours to comply with the individual income tax which is highest by far in the OECD.¹²

It is noteworthy that the OECD average is 66 hours. In contrast, the USA has one of the lowest tax burdens in the OECD and tax evasion is relatively low especially compared to Italy. Tax systems are very complex and to fully explain the similarities and differences between countries would require long essays which we are constrained to do in this article but given the nature of this work, it is pertinent to use USA and Italy to expatiate that tax collection is arduous as here are two developed countries on top of their game in tax collection, the latter, just like Nigeria, is still tackling with the issue of voluntary tax compliance especially in the informal sector.

In Nigeria the issue of voluntary tax compliance has been a lingering problem. This is coupled with the fact that COVID-19 threw the country into an unprecedented coming in and going out of recession. The dwindling revenue from oil is the reality of the present Nigeria. Individuals and corporate entities are battling for survival. Notwithstanding, the importance of government and the resulting need for taxation gives rise to the duty for the public to comply with tax payments despite the tragedy that sprung on the world in recent years.

⁹ Forbes, *Tax Gap Estimates show that Compliance Rates Remains Unchanged* <<https://www.google.com/amp/s/www.forbes.com/sites/insider/2019/10/18/tax-gap-estimates-show-that-compliance-rates-remain-unchanged/amp/>> assessed on 20th March, 2021.

¹⁰ J d'Attoma, *Explaining Italian Tax Compliance*, [2018] Oxford Scholarship Online, <https://oxford.universitypressscholarship.com> accessed 3 March 2021.

¹¹ A Santoro, *L'evasione fiscale*,

¹² B Daniel, *Asen, International Tax Competitiveness Index [2020]* Tax Foundation, <taxfoundation.org/publication/international-tax-competitiveness-index> accessed 3 March 2021

Bird says that:

In an ideal law-abiding society, people would pay taxes they owe, and tax administration would amount to little more than the provision of facilities for citizens to discharge this responsibility. No such country exists, or is likely ever to exist. Compliance with tax laws must be created, cultivated, monitored and enforced in all countries.¹³

Even the best economically placed countries are working on improving their tax collection most especially done through the self-assessment system as no doubt, voluntary payment of tax remains fallacious and as Broomberg¹⁴ and Kruger said 'most people at best of times, dislike paying tax'.¹⁵ If most people even at best of times dislike paying tax, what now happens during hard times like during the COVID-19 pandemic, especially in the informal sector of the Nigerian economy?

2. Informal Sector of the Nigerian Economy and its Taxation

We begin by defining the informal sector. The informal sector as it relates to taxation is mainly used for small and micro-enterprises that are outside the purview of government regulation and taxation. That is, businesses in the subsistence economy that is neither taxed nor monitored by any form of government. According to the OECD,¹⁶ people who work in the informal sector typically operates at a low level of organization with little or no division of labour and capital as factors of production, and on a small scale. Labour relations, where they exist, are based mostly on casual employments, kinship, or personal and social relations rather than contractual arrangements with formal guarantees.

The informal sector also known as the underground economy is part of a country's economy that is not recognised as normal income sources. People who work in the informal sector do not declare their income and pay no tax on them.¹⁷ According to the World Bank, informal employment deprives governments of potential tax revenue and diminishes a government capacity for regulatory oversight. The informal sector is much greater in developing nations like Nigeria and the term also includes those who deliberately do not declare their income and evade paying tax.

It is a market-based production of goods and services whether legal or illegal that escapes detection in the official estimates of gross domestic product (GDP)¹⁸. The informal sector

¹³ RM Bird, 'An Economic Approach to Tax Administration Reform' [1995] University of Toronto, Faculty of Management, International center for Tax Studies, Discussion Paper, 3.
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¹⁵ EB Broomber, D Kruger, [2013] Tax Strategy,

¹⁶ International Labour Organization (ILO) Resolution Concerning Statistics of Employment in the Informal Sector, [1993] Adopted by the 15th International Conference of Labour Statisticians, Para 5.

¹⁷ Market Business News (MBN), 'What is the Informal sector? Definitions'
<<https://marketbusinessnews.com/financial-glossory/informal-sector-definition-meaning/>> accessed on 7 March, 2021.

¹⁸ P. Smith, Assessing the size of the Underground economy: the Canadian Statistical Perspective, Ottawa: Statistics Canada, 1994.

consists of economic activities that take place without official recognition and records.¹⁹ It has also been suggested that income strategies organised around reciprocal network, such as those found in family and household labour and relations characterize the informal sector. No doubt as can be seen by the definitions above, informal sector in Nigeria has common defining characteristics which are generally marked by lack of adequate data, non-registration under any laid down regulations, in other words, the activities under the informal sector are not officially regulated and usually operate outside incentive system offered by the state and its institutions.

In Nigeria, persons operating under the informal sector produce goods and services for sale or for other form of remuneration but are unregulated and not covered or sufficiently covered by formal arrangements. Examples of such persons are those engaged in street trading, the roadside motor mechanics, the tailors, and every other person operating any business which escapes the recognition of the law enforcement agents and more particularly, the tax authorities. It is also to be noted that most times these sets of people in the informal sector earn more than their counterparts engaged in the formal sector, especially the government salaried workers but they are not captured in any tax bracket and so escape been taxed.

It is further adumbrated that the measurement of the Nigerian informal sector is not adequately reflected in the national accounts. It is doubtful if the use of GDP as a measurement for economic development does always reflect the actual situation. However, the informal sector has been a means of economic expansion in Nigeria. The informal economy's growth or decline has essentially been linked to the growth or decrease of the formal economy²⁰. This is albeit the fact that by the nature of informal activities, measuring the size of the informal sector is a hideous task.

The size of the informal sector in Nigeria is estimated at about 65% and consists of activities that range from agricultural production to mining and quarrying, small scale building and construction and machine shop manufacturing, traditional Nigerian crafts in clothing and furniture, mechanical repair utility services, parallel finance structure operating mostly on unwritten rules and providing credit services, among others.²¹

An unpublished survey in 2008 suggested that the informal sector in Nigeria accounted for about 90% of new jobs in the country, about 80% of all non-agricultural employment and about 60% of urban jobs created.²²

This is huge and cannot be side-lined. Imagine the great economic contribution of such sector if it contributes to the national revenue through taxation. This poses a great escape route for revenue as there are no available data on their operation. There are also poor records keeping for the self-assessment system to work. Most of their transactions are

¹⁹ S. Turner, *Economy, Informal*, International Encyclopaedia of Human Geography(2nd Edition) 2020

²⁰ K F Becker, *The Informal Economy*, Department for Infrastructure and Economic Cooperation, Sida, Edita Sverige Ab, 2004.

²¹ J Oduwale, A. Sanni Civil Society Legislative Advocacy Center(CISLAC), *Expanding the Tax Base in the Informal Sector in Nigeria*.

²² *Ibid.*

also cash-based and recently mobile transfer of cash-based. There are also no registrations with the relevant tax authorities for the payment of personal income tax and value-added tax (VAT) These and more characterizes the activities under the informal sector which results in huge loss of revenue in Nigeria.

3. Recommendations

Consequent upon these, there is a great need to capture the great majority of persons scattered under the informal sector and bring them under the Nigerian tax net. This is because the Nigerian economy is now highly dependent on loans for the provision of basic infrastructures for its citizens and the huge percentage of tax paid are on the employees in the formal sector who are being paid merger sums of money, the least being 30,000.00 Naira based on the National Minimum Wage. We have a great number of small and medium scale enterprises which evade tax and are outside the tax capturing because of certain issues which are reversible. These issues when adequately resolved can greatly lead to a huge movement of such persons and enterprises in the informal sector to the formal sector.

First of all, it is suggested that the high cost and stress of registrations of business enterprises be reduced to a minimum. The unnecessary bureaucracy especially in the Corporate Affairs Commission offices throughout Nigeria should be stopped. The online registration should be top-notch and simple to operate. The long months of incorporating a business is not motivating for most unregistered businesses in the informal sector to move to the formal sector, so as to be captured by the various tax authorities.

Again the low wages paid to salaried workers aid in the breed of side hustles by such employees. These employees sometimes hide under their businesses to amass profits which are often undetected. They are often government employees who also engage in commercial businesses but don't pay tax on the earned profits. Therefore, the government, it is suggested, should pay living wages to its workers to dissuade secret income earnings without being taxed.

Additionally, in order to encourage compliance in the informal sector, it is suggested that there should be a de-emphasis on record keeping of account as provided in the Personal Income Tax. It is a well-known fact that most of the people in this sector do not keep books of account. The average petty trader does not keep books of account but it is a known fact that most of them make more profits than most minimum waged government workers. It is therefore suggested that the uniform lump-sum method wherein uniform lump- sum payments, which is a form of presumptive taxation, which is based on an income average in an industry, be adopted in the informal sectors in Nigeria. In this case, a flat tax liability is imposed on all firms or individuals operating under the same occupation or trade. This could be an attractive tool for Nigeria because it is simple to administer, and tax authorities do not need to verify records in order to arrive at tax liabilities. The taxpayers in such sector are also relieved of the cumbersome burden of calculating the amount due to be paid as it is a flat payment.

Furthermore, the lack of provision of infrastructure in Nigeria such as power and excellent roads in a way discourage taxpayers in the informal sector. Some persons and enterprises in such sectors provide their own source of power, create passage roads and survive on their own without contribution from the government and would rather prefer to be informal and unregistered despite amassing huge incomes. It is suggested that the provision of basic amenities will create a boost in the movement of enterprises from the informal sector to the formal sector thus boosting revenue for the government.

Finally, the general nature of Nigerians to avoid paying tax should be upturned by all stakeholders. Just like Kruger said “most people at best of times dislike paying tax”, it is the writer's opinion that the major reason why people dislike paying tax is because of the lack of information on the benefits of fulfilling their tax obligations. This is where tax education and local dissemination of information comes in. The sensitization of the public in the informal sector on the benefits of paying tax, the incentives mapped out by government especially on new enterprises or companies will go a long way in encouraging voluntary tax compliance in the informal sector.

The informal sector is a worldwide challenge both in the developed and developing countries and not just peculiar to Nigeria. A review of the above suggested issues will go a long way in moving some persons and enterprises in the informal sector to the formal sector and under the tax ruder and ultimately contribute in voluntary tax compliance, leading to more revenues in the coffers of the Nigerian government.

4. Conclusion

The most effective systems of tax collection are those that encourage most taxpayers to voluntarily comply, leaving the tax authorities to focus on their enforcement efforts on some numbers of tax evaders who may be limited in numbers. It is the writer’s belief, therefore, that the implementation of the suggestions in this paper will go a long way in the increase of revenues in Nigeria in order to meet the developmental needs of the country.