NIGERIA TAX REFORM: CHALLEGES & PROSPECTS

1.0. INTRODUCTION

Let me as a matter of due courtesy, commend the Business Club Ikeja, for organising this luncheon talk which I learnt has been sustained for some time now. Events like this create an opportunity for all stakeholders in the nation's economy to take a critical look at some burning issues within the Nigerian economy. This forum is not only timely but highly desirable for the Nigerian polity that is currently experiencing far reaching transformation.

Distinguished ladies and gentlemen, in discussing this topic, which could not have come at a better time than now when the Federal Government is taking various steps towards reforming the tax system, the recent pronouncement on the increase in the Value Added Tax (VAT) from 5 percent to 10 percent, particularly with the subsequent reversal and the controversy so far generated among stakeholders.

Nigeria as a nation with federal political structure has a fiscal regime that adheres strictly to the same principle, a fact which has serious implications on how the tax system is managed. It is also characterised by unnecessary complex, distortionary and largely inequitable taxation laws that have limited application in the formal sector that dominates the economy.

This paper is therefore, aimed at x-raying various steps so far taken by the government and stakeholders in the nation's tax system with a view to correcting perceived flaws in it. It will also dwell more on VAT vies-a-vis the entire reform process in the nation's tax system and how to improve the efficiency of tax practitioners and administrators and help in mapping out ways towards a more efficient tax administration in Nigeria.

2.0. Pre 2002 Tax Reform Efforts

The Federal Government had taken far-reaching steps aimed at reforming the nation's tax system before the Pre 2002 reform efforts. Among these are;

The 1978 Task Force on Tax Administration headed by Alhaji Shehu Musa. The major thrusts of the report of the task force are;

- Introduction of the Withholding Tax (WHT) regime
- Imposition of 10 per cent special levy on Bank's excess profits
- Imposition of 21/22 per cent turnover tax on building and construction companies.

The 1992 Study Group on Nigerian Tax System and Administration headed by Professor, Emmanuel Edozien, recommended;

- The establishment of FIRS as the operational arm of FBIR and
- Setting up of Revenue Services at the other tiers of government (State and Local Governments).

The 1992 Study Group on Indirect Taxation headed by Dr. Sylvester Ugoh recommended a policy shift from direct taxation to indirect/consumption (VAT evolved).

2.1. HISTORY OF THE CURRENT TAX REFORM PROCESS (Overview of the report of the Study Group (2003) and the Working Group (2004) on the Nigerian tax system)

The current reform process commenced on August 6, 2002, after series of proposal forwarded by our Institute to the Federal Ministry of Finance. A Study Group was eventually inaugurated to examine the tax system and make appropriate recommendations to the government, on ways to entrench a better Tax Policy and improve tax administration in the country.

Distinguished participants, it is instructive to note that the Study Group on the Review of the Nigerian Tax system that was inaugurated on August 6, 2002 with the 11-Point Terms of Reference. In all intents and purposes, the Study Group which had three members of our Institute, was set up to take a critical look at the existing tax laws, the inherent lapses and proffer ways and means of enhancing the tax system through feasible recommendations.

A comparative analysis showed that Terms of Reference of the 2002 Study Group was broader in scope than the 1991 Study Groups in that while the latter's exercise covered the review of direct taxes under the jurisdiction of Federal and State Revenue Services, the 2002 exercise was more comprehensive as it covered the entire gamut of taxes at Federal, State and Local Government levels. The Study Group had its main Report in 20 Chapters of 17 volumes. In all, about 39 taxes, levies and fees, including 8 Federal, 11 State and 20 Local Government taxes and levies captured in the taxes and levies (Approved list of collection) Decree No. 21 of 1998 were thoroughly appraised by the Group consequent upon which study recommendations were made to the Federal Government. Some of its recommendations include;

- Nigeria to have a 24 clause national tax policy;
- Compilation of registers of individuals and corporate tax payers and also issuance of smart tax identity cards for all tax payers;
- Raising of the threshold of personal income tax up to N200, 000, consolidation of personal income tax free allowances to a single bulk of 40% of assessable income and the highest income rate should be 20%;
- Limitation of special tax incentives such as tax holidays and import duty reliefs to only industries located in rural areas, fully export oriented industries, solid minerals production companies and oil and gas operations;
- A company to make profit before being exposed to companies' income tax in any assessment year;
- Reduction of companies' income tax rate to 20% from the current 30% rate;
- Companies with less than N50, 000,000 to henceforth pay its companies income tax to state where it operates;
- Speedy constitutional amendments to confirm the legality of Value Added Tax(VAT) which should be shared among states after 3% had been deducted as part of its administration cost nationwide; and
- Local government to charge tenement rate and capitation rates and other clear-cut user charges for services directly beneficial to the citizens only.

After a thorough appraisal of the technical issues involved in the implementation of its far-reaching recommendations, the Group also suggested a tax environment where taxpayer is registered as the "King" and tax system with a "human face" as a strategic option of achieving the broad policy of its sundry recommendations. The Study Group submitted its report in July 2003.

A private sector driven-group was constituted on 12 January 2004 and was fundamentally based on the issues covered by the Study Group's report of 2003.The Working Group was mandated in its Terms of Reference to "critically evaluate the recommendations of the Study Group and propose prioritised set of strategies whose implementation would give effects to the reform of the Nigerian tax system, which were grouped into;

a) Short Term: Within 6 months of submission of the WG's Report

b) Medium Term: Within 2 years of submission of the WG's Report

c) Long Term: within 5 years of submission of the WG's Report.

Both Groups addressed macro and micro issues in tax policy and administration. Among the macro issues discussed were the drafting of a National Tax Policy, Taxation and Federalism, Tax Incentives and Tax Administration generally.

2.2. Reasons for the Reform

The Study Group and Working Group recommendations and subsequent evaluations saw the need for more inputs from stakeholders in the nation's tax system, hence the convening of the 1st National Tax Retreat, tagged "Tax Reform and Democracy" held in Lagos from 22-24 August, 2005.

Stakeholders agreed at the end of the Retreat that the following reasons were not only expedient but necessary for the Nigerian tax system;

- Efficient and effective tax administration
- Stimulate the non-oil sector of the economy
- To resolve contentious issues in tax administration
- Redistribute wealth and entrench a more equitable tax system
- Capacity building for administrators and taxpayers
- Centralisation of revenue agency and computerisation
- Reduce effective tax rates and simplify tax regime
- Develop a tax policy for Nigeria, etc.

Distinguished ladies and gentlemen, the Public Hearing of December, 2005 on the 8 Tax Bills by the National Assembly and the drafting of the National Tax Policy which draft copies had already been distributed to all stakeholders for their inputs were the consummation of the various initiatives of the Federal Government and stakeholders in reforming the nation's tax system. The Chartered Institute of Taxation of Nigeria was not left out in this quest. The Institute in furtherance of its statutory responsibility was among the first stakeholders to forward its position papers on the 8 tax bills and participated actively during the public hearing. Thereafter, the Institute, based on its invaluable contributions to the public hearing and previous inputs to the tax system re-engineering process, was requested by the Finance Committee of both Houses of the National Assembly to serve in the Think-Tank group that assisted in packaging the final tax bills that were passed into law by the National assembly. Today, 4 out of the 8 Tax Bills, namely; (I) Bill for an Act to establish the FIRS as an autonomous Service (ii) Bill for an Act to amend the Companies Income Tax Act (iii) Bill for an Act to amend the Petroleum Profit Tax and (iv) Bill for an Act to amend the National Automotive Council Act were passed by the National Assembly and signed into laws by President, Olusegun Obasanjo, on April 16, 2007, while the remaining four (4) Tax Bills are still at the fiscal debate stage of the parliament.

3.0. GENESIS OF VALUE ADDED TAX (VAT)

Simply called the goods and services tax (GST), it is levied on the value added that results from each exchange. It is an indirect tax collected from someone other than the person who actually bears the cost of the tax. It was invented by a French economist Maurice Laure' in 1954 and was first introduced in France on April 10, 1954.

The Federal Government introduced VAT in January, 1994. Nigerians believed it was introduced as a means of avoiding taking loans from international agencies. According to analysts, the tax was intended to be a "Super Tax" to eradicate completely many other taxes related to goods and services. VAT was then imposed on virtually all goods and services whether produced or rendered in Nigeria or not. Exemptions however, was granted in respect of medical and pharmaceutical products, basic food items, fertilizers, agricultural and ventenary medicine, books and educational items, farming and transport equipments, etc. The Value Added Tax effectively replaced the "Former Sales Tax", which, under the constitution, was supposed to be charged by States and not the Federal Government. Since 1994 VAT has become a major source of revenue for the government.

3.1. VAT PROCEEDS SINCE INTRODUCTION

In 1994, a total of N8.194 million was generated from VAT. This figure was 36.5% higher than the projections made for that year. Ever since then, VAT proceed have been on the increase and is now the third generator of revenue for the government after Petroleum Profit Tax (PPT) and Company Income Tax (CIT).

VAT collected by the Federal Inland Revenue Service (FIRS) rose from N48.7 billion in 1999 to N232.7 billion in 2006. In the year 2000, Federal Government raked in N58 billion from VAT. Details of further proceeds are as follows;

Year	Amount (N billions)
2001	91.7
2002	108.6
2003	136.4
2004	163.3
2005	192.7

In 2005, a total of N1.7 trillion was generated from different taxes with VAT contributing 11.10 percent. Last year, VAT represented 12.53 % of the N1.8 trillion generated from various types of taxes including the Petroleum Profit Tax and Educational Tax.

3.2. Summary of Recommendations on the Position Paper on the Value Added Tax (VAT) Presented by the Chartered Institute of Taxation of Nigeria (CITN) to the National Assembly Public Hearing on Tax Bills, December, 2005.

Value Added Tax Amendment Bill 2005

- Companies operating in the oil and gas sector should not be treated like government agencies and parastatals;
- Vat rate should remain 5%
- Vat base and administration should be expanded to untapped areas

- Exemption granted to goods and services should be limited to imports;
- Goods and services purchased for use in donor funded agency should be zero rated
- Zero rates should be limited to those producing for export
- There should be consistency in the use of either" taxable person" or "taxpayer" to preclude any confusion.

3.3. THE MINISTER OF FINANCE's PUBLIC NOTICE ON VAT INCREASE

The office of the Honourable Minister of Finance issued a Public Notice in the dailies notifying the public on the increase in VAT Rate from 5% to 10% with effect from May 23, 2007, citing Section 34(a) of the Valued Added Tax (VAT) 1993 (as amended), which vested on the Honourable Minister of Finance, the power to amend the rate of tax chargeable under the Act. Reasons adduced for the increase were as follows:

- The VAT rate of 5 per cent is the lowest in the African Sub-region and has remained without change since the commencement of VAT in 1993, thereby constituting a source of distortion to trade and discouraging competition within the region;
- Nigeria, being a strong member of ECOWAS is obliged to review its current VAT rate in line with the policy directives of the Commission in harmonisation of VAT and Excise Duties within the ECOWAS between now and 2009;
- The ECOWAS Commission has for this reason, suggested a transition period of two (2) years, terminating in 2009, within which member-States presently applying low VAT regime should close the gap to a point within the range of 10-20 per cent;
- With the recently promulgated VAT amendments, certain key features of a standard VAT system are now being introduced into the country's VAT system in order to make it attractive for business. The input-output credit adjustment mechanism will eliminate inflationary effects; the Public Notice concluded.

3.4. VAT INCREASE & ITS IMPLICATIONS FOR THE ECONOMY

African Economic Research Consortium (AERC), in a work carried on VAT system in Nigeria conducted some years ago, stated that Nigerian companies treat their VAT expenses as input costs and pass these to the consumer's while the government injects most of the VAT revenue back into the system as consumption expenditures, causing huge disruptions to the economy. In a country where basic physical infrastructure- for transport, communications, power and information technology-to strengthen competitiveness and expand productive capacity are lacking, the increase in VAT was not only ill timed, but counter-productive in the already highly distorted Nigerian economy. Nigeria's infrastructure is of poor quality by any standard and constrains business, even if it is better than average for Africa. In a recent World Bank Survey, manufacturing companies in the country ranked infrastructure as their most severe business constraints. Apart from the negative implications of VAT increase as highlighted above, the following issues are likely to be the problems associated with the increase;

A) Total collapse of the Real Sector:

Before now, there has been a sharp drop in capacity utilisation in one real sector from about 40 per cent in 2005 to more than 80 per cent in 2006 of the manufacturing industries in business and further increase in VAT rate will further disrupt the manufacturing sector and lead to astronomical increase in prices of produced goods. The sector which is already grappling with the problem's of multiple taxation, poor road network, and epileptic and non-functional power supply. The increase will not only lead to higher cost of production but also increase the volume of unsold goods with its attendant result in reduced capacity utilisation; consequently, it will increase the rate of unemployment and exacerbate the poverty level in the country. Local and foreign investors currently operating in the economy would find the environment much more economically volatile than ever and be discouraged.

B) Rise in inflation:

As a matter of fact, the increase in VAT rates will automatically increase the inflation rate. VAT being a consumption tax, will have further excruciating effects

The real income of the final consumers (especially fixed income earners). Manufacturers had already jolted their prices of goods and services, even where such goods and services are not expressly subject to VAT.

For instance, composite goods producers and services providers may still be indirectly exposed to adverse conditions that could lead them under necessity to increase prices because the spate of uncontrolled hike in prices already being witnessed. Nigerians, who are already living under the $1 (Dollar) with the attendant low purchasing power of the already improvised Nigerian's income earners, will only but compound the poverty situation in the country. Already analysts are projecting possible rise of inflation to 18 per cent arising from the ratchet effect of the increase of VAT rate.

C) Unemployment:

One of the attendant implications of the VAT rate increase for the economy is the high rate unemployment. Already it is estimated that over 8 million graduates of tertiary inclement operating clime. Social vices like, armed robbery, which are already on the increase are likely to become more pronounced in the society, and many other social vices will be embraced by the Nigerian graduates. The fact of the matter is no longer whether Nigerian graduates are responsible for these vices, but the simple truth is that, they are one of the social groups always at the receiving end of the whole bad economic policies.

D) Strike: The recent hike in the VAT rate and Fuel prices resulted to total collapse of the economy. For over 4 days, the entire Nigerian economy witnessed a terrific slump. Economy watchers estimated the cost at over N 160 billion. Such trend is not good for a growing economy like ours.

3.5 INSTITUTE'S VIEW ON THE MINISTERIAL PUBLIC NOTICES.

In view of the forgoing, the Chartered Institute of Taxation of Nigeria (CITN) took a critical look at the VAT rate increase and in her position paper to the Minister of Finance and the Executive Chairman, Federal Inland Board of Internal Revenue (FIRS), recommended as follows;

1. It will be recalled that CITN had earlier advocated an increase in the VAT base (i. e., bringing more taxpayers into the VAT net) as against an increase in VAT rate. Nevertheless, our Institute is ready to support the Federal Government in its efforts to harmonize Nigerian VAT rate with what obtains within the ECOWAS region;

2. Our Institute also fully supports moving gradually away from direct to indirect taxes;

3. However,

    a. we humbly submit that this VAT rate increase should be compensated with palliatives for the tax payers. Such palliatives include reduction in the current rate of personal income tax and other direct taxes rates;

    b. we have wished that the remaining four tax reform bills would have been passed and signed into Laws by the commencement of this VAT rate increase. Nevertheless, we urge your good office to do everything possible to ensure that those outstanding bills are speedily passed and signed into laws. Our Institute will continue to support the government in this direction;

c. since “taxation with representation” is now the global trend, we are strongly appealing to your honourable office to ensure that the stakeholders buy into this VAT rate increase by widespread enlightenment campaign, so as to foster high rate of compliance. Our Institute is already mobilizing its members to also embark on this exercise also.

d. a bill to amend section 4 of the VAT Act changing 5% therein to 10 percent should be introduced to the National Assembly soon for passage into law so as to avoid any controversy;

e. the refund system should be vigorously implemented and widely publicized in order to strengthen the tax payers’ confidence in the VAT system.

f. Minister’s circular should address the ‘borderline’ contracts that had already been signed at the old rate of 5% but which are yet to be executed fully as at the date of the rate increase;

g. In spite of the rate increase, we still recommend that the VAT base be widened to bring the informal sector into the VAT net so as to stem possible evasion even by those faithfully complying under the old rate.

h. we humbly recommend that all the offices of the Federal Inland Revenue Service be given a facelift as part of the move to foster voluntary compliance.

i. We also want to remind the governments at all levels to utilise the VAT proceeds to improve the standard of living of the populace and improve on the infrastructure;

j. The Chartered Institute of Taxation of Nigeria will continue to support your office and governments at all levels to take Nigerian taxation system to a greater height.

Since the 3-points proposal of our great Institute had been forwarded to all relevant agencies of government and published in the national dailies, I would not like to dwell into their decisions this paper. Suffice it to say therefore that so much had been said about VAT issue that anybody interested on its implications for national development has got enough information on it.

CONCLUSION:

Distinguished ladies and gentlemen, in concluding this paper, I would like to bring to the fore some salient points raised earlier that I consider crucial to overcoming the challenges inherent in the entire tax reform process with a view to enabling our country desire the potential benefits of this far-reaching fiscal policy re-engineering exercise.

Firstly, I would like to point out that in order to achieve the long term benefits of the ongoing reform, there is urgent need to have a National Tax Policy from which other measures would derive. A tax regime that lacks the policy hub cannot achieve the desire objectives. In fact, this is the practice globally and Nigeria cannot be an exception.

Secondly, it is also imperative for government to always consider taxpayers’ and other key stakeholders’ interests in fiscal policy formulation and implementation in order to achieve improved tax compliance rate in the country.

In other words, since taxes are statute-derived, government should encourage far-reaching consultation across the broad spectrum of the economy in tax law formulation. Adequate time and resources should be committed to the legislative process in order to have tax laws that are easily implementable. In this regard, the powers of the National and States Legislative houses should be left sacrosanct in line with the provision of the 1999 constitution. Any attempt to fast-track the process by any Executive fiat as the recent VAT issue as demonstrated would only be counter-productive.

Thirdly, since professionals are at the vanguard of development initiatives in other parts of the world, especially in the developed economies, Nigerian professionals, that is chartered tax practitioners should not only made to be involved but also allowed to play leading roles in any tax reform process. This is the only sure way to achieving our collective desire for a fully professionalized tax system in our country.

Overall, the current tax reform process has chartered the road map to Nigeria's drive to a globally competitive tax system but the task of pushing the drive to a destination that would accelerate our economic development is a collective one. It is therefore important that all stakeholders, particularly corporate taxpayers must lend their hands, when required, to every tax reform initiative in our national interest.

Distinguished ladies and gentlemen, I wish to thank you all immensely for the time you have committed to listening to this paper which I trust would elicit some discussions and further enhance our knowledge on the core issues.

God bless you all.