

# DISPUTATIONS OF TAX AUDIT ASSESSMENTS ON INTERNALLY GENERATED REVENUE (IGR) SOURCES IN LAGOS STATE, NIGERIA: EXPERTS' PERCEPTION

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## *Abstract*

*The study appraised the most disputed by the taxpayers, of the sources of the Internally Generated Revenue (IGR) in Lagos State, Nigeria, after the tax audit exercise. Primary data through the administration of structured questionnaire on respondents was adopted. The sample size was 301, using Krejcie & Morgan (1970) formula. Personal Income Tax (PIT), Withholding Tax (WHT), Capital Gains Tax (CGT), Stamp Duties (SD), Pools, Betting, Lotteries, Gaming, and Casino Tax (PBLGCT), and Road Tax (RT), were appraised by the tax experts. The study analysed data using descriptive statistical techniques like percentages and tables. The findings revealed that Road Tax (67.8%), Capital Gains Tax (67.5%), Personal Income Tax (65.7%), and Withholding Tax (61.8%) are the most disputed sources of IGR by the taxpayers. The study recommended for the re-evaluation of tax audit process to bridge the gap of disagreement between the taxpayers and the tax auditors/tax authorities for a more efficient tax administration.*

**Keywords:** Internally generated revenue; Tax audit; Tax compliance; Tax evasion; Tax experts

## **1. Introduction**

Globally, nations finance their constitutional responsibilities from diverse sources. These include revenue from natural resources, and taxes, among others. In Nigeria, the sources of revenue include the proceeds from the sale of petroleum products, income from taxes, income from agricultural products, and public loans. Similarly, the other lower levels of government in Nigeria – states and local councils, also have exclusive revenue line constitutionally approved. Accordingly, the states in Nigeria, including Lagos State, improve their revenue from the Internally Generated Revenue (IGR) sources like personal income tax, direct tax, withholding tax from individuals and enterprises, stamp duties, road taxes, and business premises registration, among other sources (Omodero, 2018, citing schedule II of Nigerian 1999 constitution). Thus, the IGR of each state is expected to contribute tremendously to the shared revenue for the federation account. Scholars have however, opined that the inadequacy of

revenue generated in emerging economies like Nigeria posed a serious challenge to the efficient delivery of public good and services as well as financial stability (Omodero, 2018; Okeke, Chidi & Eme, 2017; Asimiyu & Kizito, 2014).

In the recent time, the dwindling revenue of government from the federation account has led to the inward-looking steps of the state government to improve their IGR, which is majorly from tax. This, Asimiyu & Kizito (2014) argued that the state governments in Nigeria now face more challenges in terms of struggling to be less dependent on the federal government for financial resources. This has resulted in the formulation of strategies by the state governments in improving their revenue base (Asimiyu & Kizito, 2014). Despite this strategy to improve the IGR, the low level of tax compliance by the taxpayers have become a concern to the government and other stakeholders in policy making. The effect of revenue from tax may not have been positively felt due to tax evasion (Enofe, Embele & Obazee, 2019). Studies have argued that tax evasion is among the societal issues working against the economic development of emerging economies like Nigeria (Okoye & Ezejiofor, 2014; Ogbueghu, 2016). To reduce the incidences of tax evasion and also improve the IGR, the states in Nigeria embark on tax audit to ensure compliance to tax policies.

Tax audit, which could take diverse modes like desk audit, field audit and back duty audit has the special role to examine the records of the taxpayers for accuracy and authenticity (Enofe, Embele & Obazee, 2019). In Lagos state, the exercise has led to increased revenue as well as additional taxpayers brought into the tax net (LIRS, 2019). The tax audit exercise, especially the field audit has not been smooth sailing without resistance from the taxpayers through objections to post audit assessments. Consequent to this, tax audit process usually leads to disputes between the taxpayers and the tax authorities before reconciliation and eventual payment of the reconciled assessments (Enofe, Embele & Obazee, 2019, citing Nwaiwu & McGregor, 2018, Oyedokun, 2016). In making the assessed figures clearer and more reconcilable among the parties in Lagos state, the assessments are mostly segregated into the respective revenue sources and the amount involved. It is in line with this that this study seeks to analyse the opinion of tax experts as to the revenue areas that are most disputed by the taxpayers.

## **2. Literature Review**

### **2.1 Review of Tax Audit Process**

Tax audit is a periodic exercise of government to ascertain the veracity of the tax documents filed by the taxpayers. In emerging economies like Nigeria, where data of eligible taxpayers may not be effectively ascertained, tax audit could also expose the tax evaders that have not been captured in the tax net. This, Mebratu (2016) opined that tax audit plays a vital role in improving tax administration and increasing taxpayers' compliance to tax policies. In the argument of Akinadewo, Akinkoye, Oyedokun & Asaolu (2019), there have been reports of tax evasion despite the engagement of tax auditors over the years. Enofe, Embele & Obazee (2019) however, believed that due to the high level of tax evasion, the tax audit exercise, which include desk audit, field audit and a back duty is an essential mechanism for authenticating the information contained in taxpayers tax information. Thus, tax audit exposes any underreporting of income, shortchanging of government on tax remitted, and any false information for tax credit. This line of argument is in agreement with the submission of Tjondro, Soegihono, Fernando & Wanandi (2019) that taxpayers' perceptions of tax audits affect the level of compliance.

In states in Nigeria, the field audit involves pre-field assignment, field work, and post field reports. The pre-field is majorly to identify eligible taxpayers that might not have had any

record with the tax authorities. The knowledge of the physical addresses including those of existing taxpayers enables the authorities to effectively communicate on the planned tax audit exercise. The contents of the letter will include - coverage years, expectations from the taxpayers, the list of the documents to be made available, and the possible number of tax experts involved in the exercise. The field work involves the in-depth examination of taxpayers' record with the intention of either substantiating the reliability of the records presented and or identifying with documentary evidence, the unreported income. The unreported income will then be subjected to the relevant tax rules for additional liability inclusive of interest and penalties through assessments.

The taxpayers however, are at liberty and within a time frame, to object to the assessments formally through the presentation of documentary evidence. The success of the objection, which could reduce the tax liability on the assessment however, is done line by line, recognising the respective sources of revenue. Thus, the taxpayer may agree to the additional tax liability on Pay As You Earn (PAYE), but disagree on that of Withholding Tax (WHT) and vice versa. The Nigerian tax authorities often adopt civility in the approach relating to the taxpayers with the primary goal of bringing in more revenue as against prosecution (Enofe, Embele & Obazee, 2019). According to these scholars, it is more difficult, time-consuming and costly to prove an act of tax evasion.

## ***2.2 Practical Investigating Process of Individual Sources of Internally Generated Revenue of States during Field Audit***

The IGR sources, which include the personal income tax, withholding tax, pools and betting, and capital gains tax, among others follow the same investigative technique but with different and diverse evidential documents. The personal income tax and direct taxes of individuals are payable to the states where they are resident (Zubairu, 2014). The Personal Income Tax (Amendment) Act, 2011 allows the imposition of tax by the state on the income of individuals and families, amount due to a trustee or estate, aside from the persons employed by the armed forces, the Nigerian Police Force, officers of the Nigerian foreign service, residents of the Federal Capital Territory, Abuja, and persons resident outside Nigeria, that derives income or profit from Nigeria (Olahanmi, 2012, 2015). In investigating the tax liabilities on personal income tax and direct tax, documents like bank statements and personal assets of the taxpayers will be examined and evaluated. If the taxpayer is an employee of an organisation, then the responsibility for accurate deduction and remittance rests with the employer. The tax auditor will examine the payroll and any evidence of benefit in kind. Benefit in kind involves the use of company's properties like official vehicles which the benefits could be attributable to as personal gains to the employee. Taxpayers have also been objecting to any additional tax liabilities on the benefit in kind because it is primarily contentious and mostly subjective. The audit procedure includes the scrutiny of organisation's bank statements for relevant evidence of the net emolument paid to the employee.

The withholding tax on individuals and enterprises is another revenue source for state governments. This is treated as advance tax for the taxpayers and deductible from the total tax liabilities in each of the assessment years. In affirming the completeness and the accuracy of the payments remitted, the tax auditor will obtain the list and other necessary information of individuals/enterprises that are suppliers of goods and service providers to the organisation being audited. The rates of the withholding tax are - dividend, interest and rates (10%); directors' fees (10%); hire of equipment (10%); consultancy, technical, commission, and service fees (5%); management fees (5%); construction and building, but excluding the survey design and deliveries (5%); and contracts, but not related to any income in the ordinary course of business (5%) – (PwC Tax, 2018; LIRS, 2019). Consequently, any under remittances could

be detected through the analytical inspection of contract agreement with suppliers, suppliers' invoices, payments to third parties from bank accounts and other financial documents, suppliers' individual ledger, and evidence of remittances on behalf of the suppliers to the government. The other revenue sources like the pools, betting and lottery; and road taxes, among others are areas where field audit could also be used to improve the revenue of government through the detection of tax evasion. Thus, Lagos State Lotteries Board was established by the government for effective generation of the expected revenue and efficient tax administration (Akinadewo, Akinkoye, Oyedokun & Asaolu, 2019).

Table 1 – Sample of State Assessment Attachment to the letter to Taxpayer after the Tax Audit Exercise

Abcidon Nigeria Limited		
Summary of Tax Liabilities For the year ended 31 <sup>st</sup> December, 2019		
Actual PAYE (Schedule 1)	N 3,000,000.00	
Amount Paid (Schedule 2)	<u>N (1,250,000.00)</u>	
Outstanding PAYE		N 1,750,000.00
Withholding Tax (Schedule 3)	N 4,250,000.00	
Amount Paid (Schedule 4)	<u>N (2,000,000.00)</u>	
Outstanding Withholding Tax		N ,2,250,000.00
Business Premises (Schedule 5)	N 5,0000.00	
Amount Paid	<u>N (0.00)</u>	
Outstanding Business Premises		<u>N5,000.00</u>
Sub Total		N 4,005,000.00
Add: Penalty		400,500.00
Add: Interest		<u>841,050.00</u>
<b>TOTAL OUTSTANDING</b>		<b><u>N 5,246,550.00</u></b>

Source: Author's Template (2020)

### 2.3 *Theoretical Framework*

Allingham & Sandmo (1972) did a Theoretical Analysis of Income Tax Evasion. The scholars theorised that tax declaration decision is that of an uncertainty. The failure to report full income to the tax authorities does not automatically provoke a reaction in form of a penalty (Allingham & Sandmo, 1972). The scholars, however, opined that if an individual knows that once he is discovered his whole past will be investigated, his behaviour is straightforward, and he will act exactly as he should in declaring everything. This theory is connected to this study through the behavioural actions of the taxpayer when tax audit is conducted.

### 2.4 *Empirical Review*

Studies have been conducted on issues relating to general tax, internally generated revenue, tax audit and disputes thereof. Enofe, Embele & Obazee (2019) determined the effect of tax audit and investigation on tax evasion in Bayelsa State, Nigeria. Survey research design was adopted

for the study with the administration of structured questionnaire to the staff of the state revenue generating agencies. The analysis of data and the testing of hypotheses were achieved through Ordered Logistic regression technique. The findings showed that tax audit through desk audit, field audit, and back-duty audit has a significant negative influence on tax evasion. Tjondro, Soegihono, Fernando & Wanandi (2019) examined the different perception of voluntary tax compliance between three generations – Millennials, X, and Baby Boomers. The study adopted a survey design technique to four major cities in Indonesia. The study used Custom Factorial ANOVA with SPSS to analyse data. The results revealed that Millennials and X had different perceptions of tax audits regarding audit probability, audit procedures, and auditors' behavior, compare to Baba Boomers.

Asimiyu and Kizito (2014) examined the growth rate of state governments' IGR in Nigeria (1999-2011) using descriptive statistics to analyse data. The findings revealed that the IGR growth rate of the state was low at 20.1% and it is higher than those of the rural states than in the urban states. Okeke, Chidi & Eme (2017) examined the ways to enhance IGR in states in Nigeria. The study used secondary data and were analysed through descriptive statistics. The results revealed that IGR constitutes a small proportion of the finance of the states. The findings also showed that the current revenue system is fraught with problems. The study recommended for the establishment of a dependable data base in eliminating revenue leakages through automation and tracking system. Nkechi & Onuora (2018) examined the relationship between IGR and infrastructural development of the South Eastern States in Nigeria. The study employed descriptive statistics, correlation and linear multiple regression to analyse data. The findings revealed that there is a significant relationship between the variables. Omodero, Ekwe & Ihendinihu (2018) investigated the impact of IGR on economic development of Nigeria. The study used ex-post facto research design with time series data (1981-2016). Multiple regression and t-test were applied to test the hypotheses. The findings revealed a significant positive relationship the variables. The study recommended that government officials with corruption history should not be allowed to continue in the handling of revenue generation responsibilities. Despite the reviewed literatures, there is still no feasible study to identify the areas of the internally generated revenue that taxpayers mostly dispute, which this study examined.

### **3. Methodology**

This study employed primary data. Survey research design through the administration of structured questionnaire on tax experts and tax officials in Lagos State, Nigeria, was adopted. The population consist of 1,243 registered tax consultants, and 144 tax officials. Krejcie & Morgan (1970) formula, was used to determine the sample size of 301. The sample was selected with judgemental sampling technique based on ten (10) years tax consultancy experience of the respondents. Descriptive statistics were used to analyze data.

### **4. Data Presentation, Analysis and Discussion of Findings**

The study analysed the opinion of tax experts on the most disputed of the sources of the IGR after the tax audit exercise as shown in table 2.

Table 2 – The Most Disputed of the Internally Generated Revenue (IGR) Sources

IGR Sources	Range 0-10 (%)	Range 11-20 (%)	Range 21-30 (%)	Range 31-40 (%)	Range 41-50 (%)	Range 51+ (%)	Cumm. Freq. (%)	Decision based on range 41 or above
Personal Income Tax (PIT) – Freq. (%)	5 (1.7%)	16 (5.3%)	36 (12.0%)	46 (15.3%)	85 (28.2%)	113 (37.5%)	301 (100%)	198 (65.7%)
Withholding Tax (WHT) – Freq./(%)	12 (4.0%)	23 (7.6%)	22 (7.3%)	58 (19.3%)	111 (36.9%)	75 (24.9%)	301 (100%)	186 (61.8%)
Capital Gains Tax (CGT) – Freq./(%)	4 (1.3%)	25 (8.3%)	31 (10.3%)	38 (12.6%)	104 (34.6%)	99 (32.9%)	301 (100%)	203 (67.5%)
Stamp Duties (SD) – Freq./(%)	6 (2.0%)	31 (10.3%)	36 (12.0%)	57 (18.9%)	109 (36.2%)	62 (20.6%)	301 (100%)	171 (56.8%)
Pools Betting, Lotteries, Gaming, Casino Tax (PBLGCT) – Freq./ (%)	6 (2.0%)	31 (10.3%)	36 (12.0%)	56 (18.6%)	109 (36.2%)	62 (20.6%)	300 (99.7%)	171 (56.8%)
Road Tax (RT)– Freq./(%)	7 (2.3%)	20 (6.6%)	15 (5.0%)	55 (18.3%)	74 (24.6%)	130 (43.2%)	301 (43.2%)	204 (67.8%)

Source: Author's Field Work (2020)

Table 2 explains the responses from the tax experts, on the level of disagreement by the taxpayers with the figures assessed by tax authorities after the conclusion of tax audit.

Regarding PIT, 5 respondents (1.7%) believed that taxpayers dispute from 0-10%; 16 respondents (5.3%) opinionated that taxpayers contest from 11%-20%; 36 respondents (12.0%) believed that taxpayers contest from 21%-30%; 46 respondents (15.3%) were of the opinion that taxpayers normally disagree from 31%-40% of the assessed figures; 85 respondents (28.2%) opinionated that taxpayers dispute between 41-50% of the figure; and 113 respondents (37.5%) opinionated that taxpayers disagree between 51% or above with the assessed figures.

Regarding withholding tax, 12 respondents (4.0%) believed that taxpayers disagree on 0%-10% of the assessed figure; 23 respondents (7.6%) opinionated that taxpayers dispute on 11%-20%; 22 respondents (7.3%) believed that taxpayers dispute on 21%-30%; 58 respondents (19.3%) of the total respondents opinionated that taxpayers dispute on 31%-40%; 111 respondents (36.9%) believed that taxpayers dispute on 41%-50%; and 75 respondents (24.9%) opinionated that taxpayers disagree on 51% or above of the WHT assessment after the tax audit exercise.

Table 2 also shows that 4 respondents (1.3%) opinionated that taxpayers dispute between 0%-10% of the capital gains tax assessed on them after tax audit exercise; 25 respondents (8.3%), believed that taxpayers dispute between 11%-20%; 31 respondents (10.3%) believed that taxpayers dispute between 21%-30%; 38 respondents (12.6%) opinionated that taxpayers dispute between 31%-40%; 104 respondents (34.6%) believed that taxpayers dispute between 41%-50%; and 99 respondents (32.9%) opinionated that taxpayers dispute between 51% or above on the value assessed on them on CGT.

Regarding pools betting, lotteries gaming and casino taxes, 6 respondents (2.0%), believed that taxpayers dispute between 0%-10% of the amount assessed on PBLGCT; 31 respondents (10.3%) opinionated that taxpayers disagree between 11%-20%; 36 respondents (12.0%) opinionated that taxpayers disagree between 21%-30%; 56 respondents (18.6%) opinionated

that taxpayers disagree between 31%-40%; 109 respondents (36.2%) were of the opinion that taxpayers dispute on the figure assessed between 41%-50%; and 62 respondents (20.6%) believed that the taxpayers disagree between 51% or above.

Regarding stamp duty, 6 respondents (2.0%) opinionated that taxpayers dispute between 0%-10%; 31 respondents (10.3%) believed that taxpayers disagree between 11%-20%; 36 respondents (12.0%) were of the opinion that taxpayers disagree on the value assessed between the range of 21%-30%; 57 respondents (18.9%) believed that taxpayers disagree between 31%-40%; 109 respondents (36.2%) said that taxpayers dispute between 41%-50%; and 62 respondents (20.6%) believed that taxpayers disagree between 51% or above of the total amount assessed on them. Table 2 also indicates 7 respondents (2.3%) believed that taxpayers dispute between 0%-10% on road tax assessments; 20 respondents (6.6%) believed that taxpayers disagree between 11%-20%; 15 respondents (5.0%) were of the opinion that taxpayers disagree on the value assessed between the range of 21%-30%; 55 respondents (18.3%) opinionated that taxpayers disagree between 31%-40%; 74 respondents (24.6%) said that taxpayers dispute between 41%-50%; and 130 respondents (43.2%) believed that taxpayers disagree between 51% or above of the total amount assessed on them on road tax.

Consequent on these results and the identification of taxpayers' objections from range 41 or above, experts believed that Road Tax (67.8%), is the most disputed of the sources of IGR in Lagos State, Nigeria. This may not be unconnected to the inability to keep effective data base of vehicles plying roads. This is slightly followed by Capital Gains Tax (67.5%). The CGT is believed to be a difficult IGR source to effectively identified due to the lack of adequate information on such transactions. It is also believed that many of such sale occur daily between sellers and buyers without any active and accurate relevant information process dissemination to the appropriate tax authorities. The experts believed that PIT (65.7%) was the next most disputed after the CGT, and WHT followed with a score of 61.8%. Stamp Duty (56.8%) and PBLGCT (56.8%), were the least among the most disputed of the sources of IGR.

## **Conclusion and Recommendations**

The state government embark on tax audit for effective tax compliance by the taxpayers for the improvement of its IGR. The tax audit, which include field audit, desk audit and back-duty audit have been established as a policy for revenue increase and tax evasion reduction both in the developed and emerging economies, especially on the second-tier government in Nigeria (Enofe, Embele & Obazee, 2019; Mebrutu, 2016). In Nigeria, the tax audit process however, has been generating disputes between the taxpayers and the authorities, especially on post field audit assessment on sources of states' IGR. This study therefore, appraised the sources of IGR that are most disputed by the taxpayers. The findings revealed that road tax is the most disputed. The results also showed that capital gains tax, personal income tax and withholding tax in that order, are the next most disputed by the taxpayers. This study contributes to the body of knowledge through the empirical identification of the IGR sources that create disputes between the government and the taxpayers in Lagos State, Nigeria, which no available study has been able to identify. This is expected to assist the government to reduce the timeframe between the conclusion of tax audit exercise and objection process. This will expectedly resolve tax matters early for timely payment of the assessed tax by the taxpayers. In view of these findings, the tax authorities should re-examine the tax audit process with the intention to ensure areas of disputes with the taxpayers are reduced. The tax authorities should also improve on the tax awareness for taxpayers to effectively educate them of the economic benefits of tax compliance and the consequences of tax evasion.

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