# Taxing the Informal Economy in Nigeria: Issues, Challenges and Opportunities

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### *1.1 Introduction*

The recent global economic challenges as a result of the fall in oil prices and the weak value of the Naira in the global economic market have raised many critical issues and economic questions, as to how the three tiers of governments in Nigeria, will financed their budgets, in the coming years. The shortfall from oil revenue accruing to government in recent years, have negatively affected the economy with many implications as well as evoking the questions of whether taxing or not taxing the informal sector for revenue and for economic reasons should be undertaken. Three important issues have influenced this thinking. They are: (1) how to create additional sources for more revenue generation; (2) how to improve upon economic growth and (3) the quality of governance. Taxing the informal economy or Informal sector in recent times have received greater economic attention and occupies an important domain in revenue generation among developing economies. Informal economy or informal sector is that part of economic unit which is not officially registered and monitored by any form of government regulations (Calbreath 2010).

The sector is made up primarily of self employed persons, small and microenterprises and other forms of economic activities. Incomes generated by the operators in the sector, in many cases, are not officially captured into the tax net of the States or Nation. The sector operates their businesses using the facilities provided by government from taxes paid by other taxpayers in earning income, without paying taxes. Informal sector forms a greater percentage of tax defaulters, increasing cases of tax evasions leading to leakages in government revenue. It is an economic unit for which statistical data are not easily obtained and are not fully captured into the tax net of the State. Informal economy is a concept originally introduced by the International Labour Organization in its Kenyan Mission study 1972, and has defined informality as ‘a way of doing things’ and characterized by seven drivers; (a) ease of entry; (b) reliance on indigenous resources; (c) family ownership; (d) small scale operations; (e) labour intensive and adaptive technologies; (f) unregulated and competitive markets. Carr and Chen (2001); ILO (2002) emphasized that; informal sector provides critical economic opportunities for the poor and has been expanding rapidly. Joshi, Prichard and Heady (2003) supported the idea expressed by the ILO and viewed informal sector as being businesses in subsistent economy. The Swedish International Development Cooperation Agency (SIDA) (2011) in another fact finding study listed six key drivers to the growth of informal sector and they include: (a)limited absorption of labour, particularly in countries with high rate of population or urbanization, (b) excessive cost and regulatory of entry into the formal economy, often motivated by corruptions; (c) weak institution, limiting education and training opportunities as well as infrastructure development (d) increasing demand for low-cost goods and services; (e)migration motivated by economic hardship and poverty; and (f) difficulties faced by women in gaining formal employment. Informal economy has been described in many other terms to refer to ; “black market”, “shadow economy”, ”the underground economy”, “under the table”. “off the books”, and working for cash”. It is also described as a grey market in labour.

Over the past forty-three years or thereabout, many studies carried out by individuals, groups and organizations on informal economy including: (ILO 1972 & 2002); (Torgler 2003); (Terkper 2003); (Gerxhani 2004); (Schneider and Klinglmair 2004); (Schneider and Klinglmair 2004); (Hart 2005); (Kenyon 2007); (Schneider et al 2010); and others, have characterized this economic unit as one item occupying the most challenging domain in taxation. Various economic indicators are pointing to the direction of taxing the informal sector of the economy, for increased revenue, which had been neglected in the past years. Taxing the informal economy in most developing countries has enlisted greater attention reflecting the increased recognition of the potential benefits to the economy.

With reference to the three important factors earlier stated above, revenue, growth and governance; Schneider and Klinglmair (2004); and Schneider et al (2010) observed that, in many developing economies, informal sector contributes a large proportion of revenue which represents significant source of growing share of the Gross Domestic Products (GDP). Alm et al (2003) and Torgler (2003) also held the view that, taxing the informal sector firms may become necessary in sustaining tax morale and compliance among larger entities. On the issue of 'growth', Perry et al (2007) and Leoprick (2009) assert that, it would be necessary to 'cloth' the informal sector to become formal in order to fast track the growth so as to bring about increased benefits for the existing formal firms. In respect to the third factor 'governance', Joshi and Ayee (2008); Prichard (2009) affirm that, for informal sector to pay taxes to government, it may bring about social and economic relationship with the State and thus promoting good governance and accountability.

However, in spite of the sound argument raised by the proponents for taxing informal sector of the economy, such critic like; Keen (2012); have expressed the opposing view that, the potential yield will be low and the administration costs will be high. He further argued that, the high costs of collections will negate the economic principles of good tax system. Beneria and Floro (2006); UNRISD (2010) argued that, informal sector typically earn less income, have unstable income, and do not have access to basic protections and services and for such reasons believe that, informal sector lacks the potential for growth. For obvious reasons, the topic has become controversial and challenging on the question of whether or not taxing the informal sector should be a priority in revenue issues to government. The increased thinking of taxing the informal sector by some major stakeholders in the Nigerian Tax System; bearing in mind the new National Tax Policy (2012), is founded on the importance to good governance, growth and increased revenue yield. In spite of the growing acceptance of the informal sector in many countries as a source of revenue, there are still some areas of disagreements about the definition.

In support of the statistical data on the size of informal economy in 110 developing, transition and OECD countries in the world, Nigeria is listed as occupying the 8th position with 57.9% informal sector population, Cameroon listed as number 58 with 32.8%, while South Africa is listed as number 66 with 28.4% informal sector population. Among the three African countries, the economy of Nigeria is far better than the other two which should not be the case. The data shows Switzerland and United States of America as having the least informal population of 8.8% and occupying the bottom position. In spite of the growing acceptance of the informal sector in many countries, there are still some areas of disagreement Akwa Ibom State is one of the federating units of the Federal Republic of Nigeria under the 36 States structure created in 1987. The State is endowed with abundant human and material resources and is one of the oil mineral producing states in Nigeria. Before 2007, the State had lost enormous revenue from the federation account due to the obnoxious "on and off shore" dichotomy policy.

Like other States in the federation, it formulates policies for social and economic development for the well being of its citizens. It is part of the unit sharing in tax policies, laws and administration based on the National Policy on Taxation and other economic programs. As one of the developing areas in the country, revenue generation from taxes and other sources are grossly inadequate to cater for the development of the vast land mass and population of the state. In order to achieve the desired objectives of the National Tax Policy, Akwa Ibom State in compliance with the policy has established machineries for generating revenue from internal sources. However, as honest as the policy would be, the machinery for tax collections according to the report of the National Policy on Taxation (2012), and statistical data from NBS/JTB (2013) have shown evidence that, IGR by states are not effectively and efficiently pursued, to seal the leakages in tax revenue collection system from informal sector of the States' economy.

**1.2 Statement of the Problem**

The dwindling oil revenue arising from the fall in oil prices across the globe and the weak value of Naira have left the Nigerian economy in a precarious state. In spite of the inflow of revenue from oil in the recent past, many States were unable to muster revenue from internal sources to meet their planned development programs. In addition to the dwindling revenue from oil, the reports on revenue from January to April 2015, recorded persistent fall in oil revenue and low receipts from non-oil sources, resulting in revenue dropping by ₦1.3 trillion (Punch, May 7, 2015). Tax revenue collected from non-oil sector in Akwa Ibom State has not shown significant impact on the total IGR. Data from National Bureau of Statistics/Joint Tax board (2013) for period 2010 to 2013 have shown an unimpressive revenue receipts from informal sector of ₦44,183,061.00 (0.43%) for 2010; ₦345,579,745.00 (2.96%) for 2011; ₦368,698,731.00 (2.73%) for 2012; and ₦624,518,067.00 (4.06%) for 2013 respectively. The data showed average revenue collections of 2.54% for the four years before the fall in oil prices.

Many States, which were relying mostly on allocations from the Federation Account, will be worse-off in their future programs. There is a revenue gap existing owing to the fall in oil prices and the weak value of Naira and have hypothesized serious economic challenges to government. According to the National Tax Policy (2012), leakages in any tax system makes up for significant drain on government's revenue and affects efficient tax collection. Series of questions have been asked as to how the incoming administration at the Federal, States and Local Governments levels will tackle these problems and close the existing gap. Reflecting on the imminent economic challenges which governments at all levels will be facing; due to dwindling oil revenue; weak value of Naira, and in addition to the change of batons in governance, the challenges are becoming more pronounced and require immediate attention to fully exploit alternative revenue sources. It is against this background that, this study is undertaken to examine and identify various issues and challenges in taxing the informal sector in Akwa Ibom State, as well as creating opportunities for increased revenue yield to government.

### 1.3 Objectives of the study

The overall objective of this study is to identify the major issues, challenges and to draw government's attention on taxing the informal economy in Akwa Ibom State for increase revenue generation. Other objectives are:

(a) To find out the challenges in taxing the informal sector in Akwa Ibom State
(b) To evaluate the system of tax assessment and collections from informal economy in Akwa Ibom State
(c) To analyze the opportunities open to the State on taxing the informal economy in Akwa Ibom State.

### 1.4 Research Questions

In order to assist the researcher to arrive at an explicit result in the study, the following questions were formulated:

(a) What are the challenges in taxing the informal economy in Akwa Ibom State?
(b) Is tax assessment and collections system from informal sector in Akwa Ibom State properly articulated?
(c) What are the opportunities open to Akwa Ibom State on increasing revenue yield from informal sector?

### 1.5 Significance of the study

The importance of taxation as a tool for revenue generation by governments to finance its public expenditures cannot be overemphasized.

(a) This study will be of significant endeavour in contributing to the existing knowledge of taxing the informal economy which in the past was not officially captured into the tax net of the State.
(b) It would be useful to the three tiers of governments in the federation as a potential source of additional revenue generation process and would promote a wider coverage for taxation.
(c) It would also support government plans for increased revenue yield to close the existing revenue gap due the fall in oil prices.
(d) It would influence public policy on taxation of informal economy and would provide understanding of the economic impact of small scale and micro-enterprise activities in the sector.
(e) It would develop better theoretical models in Akwa Ibom State which will be useful to other States for integration into their tax system.
(f) It would also be useful to other researchers in the field of Accounting, Finance and Taxation.

## *2.0Literature review*

### 2.1Taxation

Taxation, civilization and development are closely related. The first known system of taxation was in Ancient Egypt around 3000 – 2800 BC in the first dynasty of the old kingdom (Genesis Chapter 41:34; 47:24 – New Jerusalem Bible); (University of Pennsylvania Almanac 2002). Taxation as a tool for revenue generation by government was first introduced in Nigeria in 1904 by the late Lord Frederick Lugard and it was then operational in Northern Nigeria. The amalgamation of the Southern and Northern Nigeria in 1914, made it possible for the introduction of taxation to all parts of the country. (Ola 1974). From that time on, many tax reforms have been carried out in Nigeria and which had finally rest upon the introduction of the National Tax Policy 2012. The introduction and adoption of the new National Tax Policy (2012) in Nigeria has been acknowledged as a fundamental turning point for optimizing revenue generation by the three tiers of government. This is so, because the well articulated Policy has been developed through intensive and extensive consultations with many stakeholders in the Nigerian Tax System.

The system has embraced both formal and informal sectors of the economy and has by extension assumes an important factor in facilitating the socio-economic development of the nation. The importance of taxation as one of the major tools for revenue generation of many nations in funding national budgets is recognized as a veritable tool for wealth creation and cannot be overemphasized. Nigeria is no exception.

However, the current global economic challenges as a result of the fall in oil prices and the weak value of the Naira in the global economic market have raised many critical socio-economic questions. One of such questions is on revenue generation to meet up government's proposal in financing its budgets in the coming years. Three important economic issues have influenced this thinking. They are; revenue generation; sustainable economic growth and governance". Before Nigeria attained independence from Britain in 1960, revenue from agricultural products was the main stay of the country's economy. After the discovery of oil in the late 1950s, the nation had an increased revenue yield from oil exploration and production in the 1970s. Because of the increased income from oil, intensive tax collections from individuals and corporate entities had hitherto been relaxed, in favour of oil revenue. Income from oil as at that time had afforded government an easy means of deriving revenue and it was sufficient to sustain government's planned programs without much effort. With the dwindling fortunes from oil revenue, the anticipated development programs will be difficult to attain. Two major economic components, formal and informal sectors are fundamentally important in every economic planning. The success or failure in tacking the problems of informality in the system depends on how government will handle the situation in the short run as a prelude to the long run plans. The introduction of certain policies which have been made in the National Tax Policy 2012 must be enforced with a political will power that the present regime can put in place.

### 2.2 The concept and characteristics of informal economy

The concept of informal economy or informal sector was introduced into international usage by the International Labour Organization (ILO) in 1972 based on a study report on Kenyan mission. The idea was initially referred to employment outside formal labour markets. Wikipedia (2015) affirms that, development theories about the concept of informal sector thus had moved to concentrate on the legal status of the business; whether registered or not but followed an appropriate legislation. Gerxhani (2004), Kenyon (2007) also held the view that, this legal definition has widespread use today as they contravene or are not subject to some of the variety of rules and regulations including labour laws, environmental laws, registration and taxation. (Meir and Rauch 2005) classified workers in the informal economy as employed and the type of works that makes up the informal sector is diverse, particularly in terms of capital invested, technology used and income generated. Major economic reasons attributable to people participating in the informal sector are for the ability to evade taxes and circumvent government business policies and regulations, and to avoid higher set-up costs.

This study adapts the typology of enterprises informality from Zinnes' (2009:8) as adaptation of Djankov et. al. (2002) cited in Joshi, Prichard and Heady (2013), on three distinct groups which are liable to pay taxes; informal, small and microenterprises who are subject to inclusion in taxing by targeting regimes, and small and medium firms who are large enough to be included in the standard tax net but are excluded.

| Features | Informal Economy | | | Formal Economy |
|---|---|---|---|---|
| | Subsistence Enterprises | Microenterprises and Small Businesses | Small and Medium Businesses | Small, Medium and Large Businesses |
| Degree of informality | Totally informal for the most part | High proportion of sales undeclared and workers not registered | Some proportion of sales undeclared and workers unregistered | Labour and firms registered and regulated |
| Type of activity | Street traders, cottage/microenterprises, subsistence farmers | Small manufactures, service providers | Small and medium manufacturers, service providers | Range of manufacturing and services |
| Technology | Labour intensive | Mostly labour intensive | Mixed labour and capital intensive | Knowledge and capital intensive |
| Owner profile | Poor, low education, low level of skills | Poor and non-poor, well educated, high level of skills | Non-poor, likely educated skilled | Non-poor, highly educated, sophisticated level of skills |
| Markets | Low barriers to entry, highly competitive, high product homogeneity | Low barriers to entry, highly competitive, some product differentiation | Some barriers to entry Established markets | Significant barriers to entry, established market/product niche |
| Finance needs | Working Capital | Working capital, some investment capital, supplier credit | Investment capital and working capital letters of credit, supplier credit | Investment capital and working capital, letters of credit, supplier credit |
| Other needs | Personal insurance, social protection, security | Personal and perhaps business insurance and business support services security | Personal and business insurance, business development services | Personal and business insurance, business development services |
| Tax implications | Earnings can be below minimum tax threshold. No recordkeeping, cash transactions | Liable for tax, difficult to identify and assess, poor or no recordkeeping, cash transactions | Liable for tax, under-report earnings, use loopholes, escape formal tax assessments | Taxed under formal tax assessment |
| Tax design desired features | No tax liabilities | Low rates to encourage registration, minimal compliance costs, low administration costs | High rates to encourage graduation into formal regime | |

**Source:** Adapted from Zinnes' (2008:8) adaptation of Djankov et. Al. (2002)

### 2.3Growth and social implications of informal sector

Informal sector plays an important and controversial role in economic development of many nations. It provides jobs and reduces unemployment. However, in spite of the advantages the informal sector stands to provide, the disadvantages seem to override the good side of the sector and end up in large scale tax evasion. The types of work practiced in the informal economy are small scale businesses, manufacturing, street hawking, taxi driving, fruit selling etc. UNRISD (2010); Benaria and Floro (2006) observed that, workers in informal sector typically earn less and unstable income and do not have access to basic protection and services. As earlier mentioned in this study, Nigeria has the highest population figure among the informal sector operators with about 57.9% contributing to the GDP of the country. The population of informal sector of the economy is larger than the formal sector with children and women forming a greater percentage of the total population (Nigerian Population Census 1991 as updated in 2011). Informal sector lacks the potential for growth as they are mostly engaged in menial jobs in the households. Another social implication on informal sector is the fact that, owners may decide to undertake that part of their work instead of hiring them out. An example of this development is with civil servants in Akwa Ibom State who takes their articles of trade to offices and display for sale. Instead of renting a shop and employing shop attendants, the workers engage themselves in sales during official working hours resulting in inefficiency and low productivity.

### 2.4Tax Reforms in Nigeria

This study would not be complete if mention is not made about the various Tax reforms made through the concerted efforts of succeeding governments in Nigeria in making the tax law, policies and administration working. The National Tax Policy has identified taxpayers as the single most important group of stakeholders in the tax system.

Tax reforms in Nigeria have focused on measures to be adopted in increasing the revenue yield of government in order to assist in the development programs of the nation. Consequent upon this thinking, the need for constant review of tax laws and its administrative procedures cannot be overemphasized. The direction of the economy leads the direction of tax reforms and always remains dynamic. The tax system has gone through many reforms which at most times have brought about the introduction of new tax regimes.

One of such regimes was the institution of a task force on tax administration in 1978 headed by Alhaji Shehu Musa. The major thrust of that reform brought about the introduction of withholding tax; imposition of 10% special levy on banks' excess profit; and 2.5% turnover tax on building and construction companies. Another tax reforms in 1992 headed by Dr. Sylvester Ugoh on indirect taxation shifted the reforms emphasis to consumption tax which brought about the introduction of Value-Added-Tax (VAT) by imposing 2.5% on consumption of certain products and later rose to 5% which is still operative till date. One but more important of these reforms was that of a study group headed by Professor Emmanuel Edozien in 1992 which recommended the establishment of the Federal Inland Revenue Service as an operational arm of the Federal Board of Inland Revenue. From the results of these study groups, revenue services with the other tiers of governments were set up at State and Local Governments levels. The main objective of the reform was to improve services delivery to taxpayers which introduced the National Tax Policy.

### 2.5 National Tax Policy

The accepted recommendations on National Tax Policy (NTP) specifically distinguish Taxation from other components of Revenue. Section 1.2 of the definition of taxation by the final draft on National Tax Policy adopted in 2012 defined tax as a "monetary charge imposed by government on persons, entities, transactions or properties to yield revenue". NTP also defined tax as a "pecuniary burden laid upon individuals or property to support government expenditure" and not a voluntary payment or donation but an enforced/compulsory contributions, exacted pursuant to legislative authority (NTP 2010). This definition has earlier been discussed in this study. However, the policy also defined revenue as "income received from all activities engaged in by the receiving entity". Revenue in this context is the entire amount received by the Government from sources within and outside the government entity. Government revenue includes proceeds from sale of crude oil, taxes, penalties, interest, fines, charges and other earnings received from government investments.

The policy made it clear that, revenue is believed to be the main purpose of taxes by government. Section 1.4 of the policy explicitly explained the rationale for and purpose of the policy and recognizes taxation as a veritable instrument for national development. Furthermore, apart from being a major source of revenue for governments to provide goods and services needed by their people, taxation policies can stimulate economic growth and job creation through its impact on investment and capital formation in the economy. The National Assembly through the constitution has been empowered exclusively to legislate and impose taxes on incomes, profits and capital gains and this is recognized in the National Tax Policy. This same policy imposes taxes on documents of corporate organizations; and also State Governments are empowered to collect those taxes from individuals resident in their respective States.

Section 2.6 of the approved NTP 2012 provides for the fundamental features and the cannons of taxation as proposed by Adam Smith (1776), which include:

*(a) Simplicity, Certainty and Clarity*
*(b) Economy efficiency, Low Compliance and Administration Cost*
*(c) Fairness and Equity*
(d) *Flexibility*

## *Empirical Framework*

### 2.6 Tax assessment and collections

NTP 2012, Section 3.6, described "Taxpayers" as a single most important group of stakeholders in the tax system. The system recognizes it as the bedrock of the tax system and the source of revenue generated by the Tax Authority. Personal Income Tax (PIT) is a direct tax levied on income of a person or partnership. The taxpayers are classified into two groups, resident and non-resident. PITAM 2011 is based on the assessable income of the taxpayer either from Trade, Business, Profession or Vocation.

### 2.6.1 Assessment

An assessment is the act of judging or forming an opinion about something. In taxation, the overriding objectives of assessment function is to ensure that all taxpayers within a defined tax jurisdiction are brought into the tax net and assessed in order to pluck all possible leakages. According to FIRS information circular No. 2006/06 of February, 2006, assessment function in an Integrated Tax System include filling of assessment with respect to all taxes collected. Assessments are normally raised on the income or profit of individuals, partnership and companies carrying on business in Nigeria. Two principal classes of assessment are:

**(a) Self assessment**

A taxpayer under this scheme is expected to accompany its tax returns with self-assessment notice and evidence of payment to the IRS through appropriate designated colleting bank.

**(b) Government assessment.**

Tax assessment by this method is raised on behalf of the government by the Relevant Tax Authority with audited accounts or the use of Best-of-judgment (BOJ) assessment based on estimated profit or profit perceived to be fair and reasonable. The Nigerian tax system has undergone many significant changes to replace the obsolete provisions that had worked against the specified cannons of taxation.

### 2.6.2 Tax Collection

Tax collection is based on the assessment made on the income derived from trade, business, profession and vocation. It has a graduated rate at which the tax is collected based on progressive principles. It allows for minimum tax where the income is below a certain amount. Appendix 4 and 4.1 on the strategy for implementation of the tax policy has made good recommendations on the introduction of Presumptive Income Assessment, on Small and medium enterprises, to encourage tax payment by persons that have historically failed to comply with the tax laws. The procedure if well articulated will require less documentation and will result in a quick and effective method of providing assessment and collections. Tax assessment and collections from informal sector may take additional steps to enforce self assessment which may not be difficult for taxpayers in this sector to honour.

### 2.7 Issues and Challenges in Tax assessment and collections from informal economy

Supriya (2005) stated that, both the objectives and functions of modern government have increased thereby necessitating large resources. Nigeria is no exception. For obvious reasons the contributions of Adam Smith (1776) to the economic theory on taxation are still regarded as the highest class in the study of economic thoughts. His clear definition of the canons of taxation can hardly be exceeded in clarity and simplicity. The four canons of “Equality, Certainty, Convenience and Economy”, are still regarded as pertinent characteristics of a good tax system. These principles are to promote economic growth and development, especially in the developing countries like Nigeria. Tax assessment and collections from informal sector have their challenges. The factors responsible for these challenges are listed hereunder:

(a) No statistical database due to non-registration of businesses in the informal sector
(b) Lack of accounting record keeping of business transactions
(c) Issues relating to Residence of the taxpayers
(d) Unstable nature of business carried out by operators in the informal sector which makes it difficult to establish a tax base
(e) Lack of trained and skilled staff of Relevant Tax Authority
(f) Lack of incentives to official by government
(g) Lack of modern operational vehicles and equipment
(h) Lack of security of staff to Relevant Tax Authority
(i) Costs and benefits of tax collections from informal sector

For any Relevant Tax Authority (RTA) to be able to obtain a database for assessment it must first of all establish the residence of the taxpayer. Principal place of residence though mostly applied to persons working under employment seems to be silent on self employed persons. This set of would-be taxpayers find solace in this clause. Self employed persons including professionals in private practice are major offenders in tax assessment and collections. Ayua (1999) cited in Kiabel and Nwokah (2009) labeled this group of informal sector operatives as those persons who blatantly refused to pay tax by reporting losses every year. Finding on their lifestyles do not depict the nature of losses reported in their financial statements.

Experience gained through observations show that, some of the traders in informal sector operate their business in private and commercial vehicles travelling to various markets on market days. The traders exploit the good road network in the State to move from other neighboring states on big market days in Akwa Ibom State to do their businesses. After the day's sales they return to their States of origin which they pay tax.

**2.8 Tax Database**

A database is an organized collection of data and is typically organized to model relevant aspects of reality in a way that supports processes requiring this information (Wikipedia 2014). Database is created to operate large quantities of information by inputting, storage, retrieving and managing that information. A good Database Management System has four main groups. These are:

- *Data definition*
- *Data Update*
- *Data retrieval, and*
- *Data administration*

Among the four groups, administration focuses on registering and monitoring users, enforcing data security, monitoring performance, maintaining data integrity, dealing with concurrency control and recovering if the system fails. A good example of database maintenance is the current exercise conducted by banks to capture bio-data of an account holder. This system will go a long way to assist in crime detection. This study has placed more emphasis on database generation for the informal economy. Many advantages would be derived if database for proper assessment and collections of taxes from the informal sector are developed which in the long-run will make for good economic planning and for security of people, lives and property. As a first step the study takes a swipe look at the census of occupants of all houses in the urban centers and highlights the employment data of these occupants. The statistics of the data will catch a large group of self-employed people whose businesses are not registered but earn a sizeable income that can be taxed by use of preemptive tax system.

Taxation is recognized as a tool for wealth creation and employment. This assertion is supported by Section 4.1 of the NTP 2010; which lists the role of taxation in wealth creation as a way of stimulating growth in the economy by increased trade and economic activities. One major obstacle on revenue generation in Nigerian States is the fact that, no proper attention is given to database of nearly all factors of our developments. Where data exist, it is highly politically motivated for personal gains of individuals and groups in authority. Shau'ara (2010) in a paper presented at the UNESCO Institute of Statistics workshop on Education in Anglophone countries, Windhoek, stated that, data as a national issues have their challenges. The challenges range from (1) No Data (2) Obsolete Data (3) Missing Data and (4) Politicized Data. These challenges have sum up to "good policies that never seem to work". He further listed the following issues as his national experience on Data collection, Data Production and Quality assurance. The issues are:

*1. For data Collection:*
*(a) Politics of Data – For What? , From Whom, and By Who?*
*(b) Regulatory agencies determine Parameters and Co-ordinate.*
*(c) General Data - Parameters good and reliable but need in-depth expansion*
*(d) Finance – Correctness difficult to ascertain*
*(e) Data Timeliness*
*2. For Data Production:*
*(a) Data Production different compliance Rates*
*(b) Storage and Use of ICT – weak*
*(c) Systemic Capacities – high turnover of Personnel*
*(d) Funding – Competing Demands*
*3. Quality Assurance:*
*(a) Convergence and Data Bank – need for synergy, regular updating*
*(b) Erring Sector - Need for stiffer penalties*

Shau'ara (2010) summed up these three statistical issues to add up to weak planning and policies. For effective tax planning there is needs for emphasis on database for proper assessment and collections from informal sector as this sector is difficult to be captured into the tax net of any State.

### 2.9 Leakages and Tax evasions.

Tax evasion, tax avoidance and corruption are three main sources of leakages in tax revenue of any nation. Though tax avoidance may not carry the same devastating effect as tax evasion, but tax avoidance is also harmful to the economy. Tax evasion than avoidance is commonly found among the informal sector of the economy, mostly among self employed groups whose activities are not regulated or at most a seeming lesser level of regulation. Corruption is mostly found in tax officials who circumvent some principles to defraud and possible embezzle the collected revenue or connive with the taxpayers to cheat on government.

A leakage in economics is a term used to describe the diversion of funds from some iterative process. It is the non-consumption uses of income, including saving, taxes, and imports. Nigeria as a country suffers from revenue leakages due to various reasons which include:

*(a) Complicated tax system which gives too much discretionary powers to tax officials.*
*(b) Non-transparency leading to corruption and revenue leakages.*
*(c) Lack of infrastructure*
*(d) Scarcity of qualified tax officers*
*(e) Low incentives for tax officers.*
(f) *Low tax morale*
(g) *Political influence*
(h) *Weak legal sanctions for taxpayers*

In order to overcome these challenges, this research suggest some measures that the State may use in its efforts to reduce the level of losses due to non-availability of database on tax assessment and collections from informal sector. The measures include:

*(a) Census of houses and tenants living in such houses with specific variables stating*
*Address of property*
*Name of occupants*
*Age*
*Nature of employment (if in employment)*
*Name and address of the employers*
*Nature of business (if self employed)*
*Location of business*
*How long since the business was established*
*(b) Name of Local Government Area where business is carried out*
*(c) Branch/branches (if any)*
*(d) Educational qualification*

Efforts should be made to bring into operations; Presumptive Tax System (PTS) to enable Relevant Tax Authority (RTA) register every individual and business to determine how much each unit will pay as tax.

### 2.10 Presumptive Tax System

Various options in the past tax reforms in Nigeria have significantly and repeatedly pointed at the direction of strengthening the administrative incentives to pursue reforms. It has been suggested that, the success of any tax system will depend on the effectiveness of the administration, irrespective of policy choices. The effectiveness of tax administration is supported by the often quoted maxim that 'tax administration is tax policy' (Casanegra de Jantscher 1990). The success in taxing the Informal sector lies principally on regular interactions between the tax collectors and taxpayers which involves less scope for enforcement. Leoprick (2009) had suggested the use of mobile banking system to make it easy to facilitate informal sector taxation.

Presumptive tax system is a form of assessment of tax liability using indirect methods such as income reconstruction or by applying base-line taxation across the entire tax base (InvestorWords.com 2015). It is considered to be most effective tax system due to its ability in reducing tax avoidance as well as equalizing the distribution of the tax burden. According to the Acting Chairman FIRS (2013) this system of taxation is most appropriate and effective in capturing the informal sector of the economy into the tax net of the nation.

In a sensitization campaign embarked upon by the FIRS (2015), the acting Chairman disclosed that it would be interacting with informal sector operators across the country to enlighten the taxpayers from the informal sector on the financial benefits the society and government would stand to benefit. He cited section 6 of the PITA (amendment) 2011 that introduces a new sub-section (6) to Section 36 of the Principal Act. This section has specifically provided for situation where for all practical purposes the income of the taxpayer cannot be ascertained for proper assessment of income, and then such a taxpayer shall be assessed on such terms under a presumptive tax regime. He further cited some developing countries in Africa like Ghana and Zimbabwe who are operating the proposed regime.

## *3.0 Research Methodology*

### 3.1 Design of the Study

The study is descriptive, collecting primary data from Professionals in private practice, Hotels and Guest Houses, Restaurants and drinking bars, various road side traders, street hawkers, mechanics, hair dressing and barbing saloons, general provisions shops, (aka super markets) dealers on second hand clothing, handbags and shoes, Suya spots etc, using a multi-dimensional sampling method. Some of these groups operate mostly in the afternoons and evenings. This group of informal sector was chosen, because they form a greater percentage of the business communities in the State. They operate in every part of the town including government offices and any available open space. Different questions from that of the operators in the informal economy were administered to the officials of the Board of Internal Revenue and those of the Sub-offices.

### 3.2 Population and Sample procedure

The population of the study is the 31 local government areas of Akwa Ibom State. Sample of 12 local government areas were selected based on the personal judgement of the researcher. The selected LGAs were considered on the premise of urbanized status, population and large commercial activities going on in these areas. For the officials of the Board of Internal Revenue, a consultant, four senior staff from the headquarters were chosen and one from each of the twelve LGAs under study making a total sample size of eighteen for officials of BIR and 100 operators from 4 LGAs each of the three Senatorial District. The total sample size for informal sector is three hundred respondents.

### 3.3 Data collection method

Two sets of questionnaires were designed; one for the officials of the Internal Revenue while the other was for the operators in the informal sector. The questionnaires were short and simple for information gathering considering the level of educational attainment of some of the operators in the informal sector. Twenty five different operators in the list of businesses mentioned above were selected as respondents from each LGA. Though this number is negligible small, but it will form a major parameter for future research. Because of time and cost involved in data collection, three research assistants were employed, one for each Senatorial District of Uyo, Eket and Ikot Ekpene to administer the questionnaire and conduct interviews on the respondents. It was really cumbersome but very successful because of the experience and dynamic handling of the assignment by the research assistants.

### 3.4 Method of Data Analysis

Data collected were collated, presented and analyzed using simple mathematical tables and percentages to explain the result. The percentage being calculated as:

*% frequency = $(f/\sum f) \times 100$*
*Where $f$ = frequency*
*$\sum f$ = sum of the frequency*

4.0 Data Analysis

**Table 4.1: Questionnaire distribution to the officials of the Board of Internal Revenue**

| Variables | Number of Questionnaire sent out | Number of Questionnaire returned | Percentage % |
|---|---|---|---|
| Tax Assessment Authority | 1 | 1 | 5.55% |
| Tax Consultant | 1 | 1 | 5.55% |
| Directors | 4 | 4 | 22.23% |
| Representatives working in LGAs sub-offices | 12 | 12 | 66.67% |
| Total | 18 | 18 | 100% |

**Table 4.1** shows the questionnaire administration. 18 questionnaires were distributed to the respondents and the total number were duly completed and returned representing 100%.

**Table 4.2**: **Questionnaire distribution to the informal sector Questionnaire distribution to the three Senatorial Districts**

| Activities | Respondents | | | |
|---|---|---|---|---|
| | Uyo SD | Ikot Ekpene SD | Eket SD | Total |
| Professional/Consultants | 10 | 10 | 10 | 30 |
| Hotels/Guest Houses | 12 | 12 | 12 | 36 |
| General Retail Shops | 8 | 8 | 8 | 24 |
| Secondhand Material sellers | 18 | 18 | 18 | 54 |
| Timber dealers | 10 | 10 | 10 | 30 |
| Auto Mechanics/Welders | 18 | 18 | 18 | 54 |
| Hair dressing/Barbing salons | 12 | 12 | 12 | 36 |
| Restaurants | 12 | 12 | 12 | 36 |
| Total | 100 | 100 | 100 | 300 |

**Source:** Field study 2015

In table 4.2, 100 questionnaires were sent out to each of the three senatorial districts making a total of 300 questionnaires.

**Table 4.3: Questionnaire returns from Uyo Senatorial District**

| Activities | No. of Respondents | No. Returned | Percentage of Returns |
|---|---|---|---|
| Professional/Consultants | 10 | 10 | 100% |
| Hotels/Guest Houses | 12 | 12 | 100% |
| General Retail Shops | 8 | 8 | 100% |
| Secondhand Material sellers | 18 | 16 | 88.89% |
| Timber dealers | 10 | 9 | 90% |
| Auto Mechanics/Welders | 18 | 16 | 88.89% |
| Hair dressing/Barbing salons | 12 | 12 | 100% |
| Restaurants | 12 | 12 | 100% |
| Total | 100 | 95 | 95% |

**Source:** Field study 2015

In table 4.2 100 questionnaires were sent out and 95 were returned representing 95%

**Table 4.4: Questionnaire returns from Ikot Ekpene Senatorial District**

| Activities | No. of Respondents | No. Returned | Percentage of Returns |
|---|---|---|---|
| Professional/Consultants | 10 | 8 | 80% |
| Hotels/Guest Houses | 12 | 10 | 83.33% |
| General Retail Shops | 8 | 8 | 100% |
| Secondhand Material sellers | 18 | 17 | 94.44% |
| Timber dealers | 10 | 10 | 100% |
| Auto Mechanics/Welders | 18 | 15 | 83.33% |
| Hair dressing/Barbing salons | 12 | 10 | 83.33% |
| Restaurants | 12 | 10 | 83.33% |
| Total | 100 | 88 | 88% |

**Source:** Field study 2015

In table 4.3, 100 questionnaires were sent out and 88 were returned representing 88%

**Table 4.5: Questionnaire returns from Eket Senatorial District**

| Activities | No. of Respondents | No. Returned | Percentage of Returns |
|---|---|---|---|
| Professional/Consultants | 10 | 8 | 80% |
| Hotels/Guest Houses | 12 | 10 | 83.33% |
| General Retail Shops | 8 | 6 | 60% |
| Secondhand Material sellers | 18 | 18 | 100% |
| Timber dealers | 10 | 9 | 90% |
| Auto Mechanics/Welders | 18 | 17 | 94.44% |
| Hair dressing/Barbing salons | 12 | 10 | 83.33% |
| Restaurants | 12 | 12 | 100% |
| Total | 100 | 90 | 90% |

**Source:** Field study 2015

In table 4.4, 100 questionnaires were sent out and 90 were returned representing 90%

## *5.0 Discussion and findings*

5.1 The study had as its focus, major issues relating to the rationale for taxing the informal economy. The issues were: (1) increase in revenue yield to assist government in closing the existing gap due to the fall in oil prices; (2) improved economic growth to help in poverty alleviation of the citizens and (3) good governance to allow for transparency and accountability.

*5.1.1Revenue and Equity implications of taxing informal economy*

This study had listed three important factors to be considered in the study of informal economy having in mind the implications on the social and economic life of the citizens of the nation, the operators in the sector and government. The question whether government should tax the informal sector has been answered several times in this study. The potential benefits and importance of taxing the informal economy cannot be ignored. The fact remains that, increased revenue will fast tract development of infrastructure, growth and governance, with the additional revenue earned. When the additional revenue is earned, the taxpayers will be expecting improved service deliveries from government. Taxing the informal sector directs more attention to direct taxation which will accrue more revenue and also improve the equity implications as well as the cost and benefits to be derived. However, it is expected that the gains from the additional revenue are likely to be modest over the short-run with the expectations to expand and grow in the long-run.

*5.1.2 Implications for growth*

Economic growth is the increase in the inflation-adjusted market value of the goods and services produced by an economy over time and measured as the percent rate of increase in real gross domestic product (Wikipedia 2013). The implications for the expanded taxation will be for the growth of micro-enterprises which will support job creation and the development of wider tax base in the long-run. Economic theory of taxation hindering growth may not hold but will have a significant benefit for growth. The growth of micro-enterprises will reduce poverty level among lower income group.

*5.1.3 Governance implications*

The expanded taxation on informal economy will bring about the sector's motivating interest by promoting good governance leading to political accountability. When there is a voluntary compliance from the informal economy, the state may be more responsive and accountable to the groups that pay taxes. Moore (2008) held the view that, the expanded taxation of small firms pursued in a comparatively contractual manner could become an important basis for expanding political voice among relatively marginalized groups. Many research studies in countries like Ghana, Ethiopia and Sri Lanka by Joshi and Ayee (2008); Prichard (2009) and (2010); and Mel et al (2012), all agreed that, there were some degree of bargaining between the informal sector associations and the government, which prompted greater inclusion of informal sector in business involvement, in overseeing the success of presumptive tax regime and fostered expanded trust in the state. Learning from the policy outcome of the above named countries and the implications of such approach it is a major focus of this study that, business reforms will reduce the costs of formalization and bring about increased benefits.

Another major strategy which government should adopt to foster voluntary compliance by the informal economy is emphasizing on transparency by officials who are engaged in its services. The use of consultants in tax collection rights would also strengthen taxation of informal sector firms for maximization and enforcement of collections.

*5.1.4 Research question one: What are the challenges in taxing the informal economy in Akwa Ibom State?*

The research question one of this study was addressed to the officials of the Board of Internal Revenue using variables 6, 7, 8, 9, 10, 11, and 12, in the set of the questionnaires. The outcome suggested that government approach in establishing tax database for informal sector has not been properly articulated. Weakness in so doing could be attributed to lack of political will to undertake proper census of the operators in the informal sector which could have discovered many businesses operating without paying taxes. The sector lacks database for tax assessment and collections. The study revealed that there was poor taxpayers' education, inadequate qualified staffing, poor funding and the Board lacked adequate equipment for mobilization to facilitate quick access to many areas and taxpayers. The use of non indigenous consultants who are familiar with the terrain was a serious and big undoing which caused low internally revenue generation. No regular staff training and attendance to professional mandatory training programmes were envisaged by government. This had a serious effect on the staff in carrying out the sophisticated jobs of tax assessment and collections from the sector.

*5.1.5 Research question two: Is tax assessment and collections machinery for the informal sector properly articulated by the State Government?*

The second research question relates mostly on the quality of rules and regulations established for the maintenance of database by the Board of Internal Revenue of the State, and proper orientation of the staff of the Board. Proper structure of tax base and templates for assessing and collecting taxes from the informal sector has not been properly expressed. The suggestion in using the presumptive tax regime is a new innovation and has not been adequately incorporated into the current tax laws and policies. Tax administration organ in relations to presumptive tax regime has not been properly fitted into the tax laws of the State. Staffs are not yet trained in the use of the new system to avoid conflict with the taxpayers in the course of their duties. Any conflict arising from the application of the presumptive tax policies without accurate database on the population will result in tax evasion and avoidance.

*5.1.6 Research question three: What is the opportunity open to the State Government in increasing the revenue yield from the informal sector?*

Questionnaires numbers 6, 10, 12, 13, 14 and 14 from the questionnaires sent to the operators of the informal sector while questionnaires numbers 7, 8, 9, 10, 11 12 and 13 and were answered qualitatively in research question number three which were directed towards obtaining information from the officials of the board. In this question, the conduct of population census of business operators based on residence or itinerant nature of the living if taken will expose those prospective taxpayers who have been hiding under the cover of informality to evade tax payment. Operators in the informal sector should be educated on the need and encourage in keeping accounting records for the businesses. The capture of income from informal sector into the tax net of the state will increase revenue yield from the hidden business operators. And finally the introduction or regular tax audit should be enforced and more taxpayers education should be carried out by government and also publicize government activities and programmes. The reward system for productivity should be encouraged to make for accountability and transparency.

*5.2 Conclusion*

This study was set out to identify and critically examine issues, challenges and opportunities open to government in taxing the informal economy in Akwa Ibom State. Furthermore, the study was to determine how revenue from informal sector could be captured into the tax net of the State. The reason and motivation for the study revolves around increase revenue accumulation by government to close the revenue gap due to the fall in oil prices and weak value of the Naira in the global economic market. Extensive literature was reviewed in relation to the report of the National Tax Policy 2012 with particular reference to informal economy on the introduction of Presumptive Tax Regime. The increase revenue yield from taxes will enhance the provision of infrastructural facilities for the benefit of the society and the wellbeing of the citizen and good governance. The main empirical findings are chapter specific and were summarized within the respective chapters. Issues on the concept of revenue, economic growth, and governance were discussed relating to implications on tax policies.

The theoretical implications provide the contribution and implications of informal sector in revenue generation by the State with respect to the research questions and how they may affect individuals and government. In identifying the policy implications of the research, the policy of data collection with extended theoretical underpinnings was the adoption of the National Tax Policy recommendations. While many questions are left unanswered about the challenges in tax assessment and collections from informal sector of the State's economy, many possible truths have been established and drawn from this study. The study was undertaken to identify and examine the challenges in taxing the informal economy in the State and how the revenue from this source could be captured into the tax net of the State. However, many environmental problems affecting the growth of revenue generation from the sector were identified as listed earlier in this study. They include:

(a) How to effectively establishment and maintain taxpayers database
(b) The political will by government and politicians to conduct accurate house population census for effective monitoring of taxpayers in the sector.
(c) The use of presumptive tax system in personal income tax assessment and collections

*5.3 Recommendations*

From the findings made in this study, the following recommendations are made:

(a) Adequate training and manpower development should be carried out regularly;

- Professionalism by Staff of the Board of Internal Revenue should be encouraged
- Staff of the Internal Revenue Service should be sent on provisional training on relevant tax operations.
- Deployment of trained staff on supervision of staff and feedback.
- Mass education of taxpayers and other stakeholders in the economy and publications of government projects (completed and ongoing).
- Redesigning the operating processes and procedures with respect to assessment, collections and administration machinery

(b) Provision of modern equipment for officials of the Relevance Tax Authorities

- Provisions of manual of operations
- Provisions of templates for on-the-job training of staff.
- Tax guide specifying types, methods of assessment and collections.
- Use of the services of Consultants on tax audit and investigation
- Engagement of tax consultants should be divided into three sections; i.e. (i) Direct taxation for formal sector; and (ii) direct taxation for informal sector. (iii) Indirect taxation for formal and informal sectors.

(c) Development of ICT and training of staff for ICT compliance

- The ICT technology should be upgraded where it exist or develop where none existed to facilitate communications and also provide means of mobility for staff to enhanced productivity.
- Introduce the Presumptive Tax regime into tax collection from informal sector
- Develop and deploy model IGR templates for the State and Local Government Councils
- Upgrade taxpayers database for optimal performance
- Conduct census for tenants and occupants of houses in the urban areas to provide database to relevant tax authority. This will be useful for economic planning in providing infrastructure and for security system.
- All contracting companies and servicing companies operating in the State's Ministries, Departments and Agencies should register with the Board of Internal Revenue before commencement of operations.
- Enforcement of compliance by means of legal prosecution of defaulters to reduce tax evasion.

As very important recommendation, the political will of government to prosecute defaulters will be the most effective means of enforcing compliance.

*5.4 Recommendation for Further Studies*

This study was specifically undertaken to cover selected Local Government Areas in Akwa Ibom State with urbanized status and selected commercial activities. The commercial activities did not include fishing, farming and palm oil production and other specific trades and businesses which are widely practiced by the State indigenes and others resident in the State.

These businesses yield huge profits to the operators in the informal sector of the economy. It is recommended that an in-depth study on other local government councils as well as other businesses in the sector be carried out in other states of the federation in order to generalize the results.

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