A CRITICAL ANALYSIS OF THE EQUITY AND EFFICIENCY OF THE NIGERIAN PERSONAL INCOME TAX SYSTEM

THESIS

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The purpose of this study is to analyze the system of personal income taxation in Nigeria, especially with respect to its administration, equity, and effects on efficient resource usage.

There have, in the past, been numerous complaints that the personal income tax in Nigeria does not yield enough revenue for the state governments, primarily because of widespread avoidance and evasion of the tax, especially by persons who do not derive income from wages and salaries.

This study examines this problem in light of questions as to how the tax evolved, how important it is to state governments, how efficient and equitable it is, what administrative problems it faces, and what reforms can be implemented to best solve existing problems.
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CHAPTER I

INTRODUCTION

Purpose of the Study

The purpose of this study is to critically analyze the system of personal income taxation in Nigeria, especially with respect to its administration, equity, and effects on efficient resource usage. In particular, this study addresses the following questions:

(1) How and why did the Nigerian personal income tax evolve?
(2) How important is the tax to State Governments?
(3) How efficient and equitable is the tax system?
(4) What administrative problems does the tax system face?
(5) What reforms, if any, can be implemented to best solve the administrative, equity, and efficiency problems?

Significance of the Study

There have been numerous complaints that the personal income tax in Nigeria does not yield enough revenue for the State governments, primarily because of widespread avoidance and evasion of the tax especially by persons who do not derive income from wages and salaries. In the Cross River State,
for example, much of the blame for the revenue losses has been attributed to the unsatisfactory administration by the Internal Revenue Departments.¹ In addition to the loss of funds, the lack of uniformity and consistency in taxation can lead to a loss of horizontal tax equity for persons with this same tax paying abilities and a burden in excess of the tax yield resulting from tax-induced misallocation of resources.

Organization of the Study

This study is organized into seven chapters. Chapter I presents the introduction. Chapter II exposits the ethnic and political background of the Nigerian people, important ingredients in the institutional structure of the present income tax. The intention is to clarify how the country evolved, the tribal organization of the people, and the role played by the colonial masters in the political structure of the country. Chapter III similarly explains the institutional development of the personal income tax in Nigeria. Chapter IV concentrates on the problems of defining income for tax purposes with particular reference to the Cross River State tax system. Tax rates and itemized deductions in other states are included for comparative purposes. Chapter V examines the particular methods of tax collection and the

problems involved with each. Chapter VI critically evaluates the tax system in terms of equity and efficiency in resource allocation. Chapter VII contains proposals for improved tax administration, equity, and efficiency.

Principles for a Good Tax System

A good tax system is one in which the tax burden is distributed in accordance with the community's concept of fairness, is relatively simple to administer, and promotes efficient allocation of resources. Needless to say, simultaneous satisfaction of these three principles is very difficult, and necessarily involves some compromises. For example, a head tax, simple to administer, will rarely satisfy the community's concept of fairness, although its neutrality will not impair an already efficient allocation of resources. On the other hand, an income tax, while perhaps "fair" by the community's standard, will be more difficult to administer because of complexities associated with defining the tax base and may impair work incentives if graduated rates are used as well as impair efficiency in resource allocation if income from various sources is taxed differently. Acceptable engineering is difficult indeed.

Tax fairness requires that the tax burden be distributed to persons in an equitable fashion. Most writers feel that to be fair, taxes should either be distributed in accordance with benefits received from government expenditure, or in
accordance with ability-to-pay. Because of the nature of public goods, not subject to the exclusion principle, it is seldom possible to adequately identify the beneficiaries of public expenditure, much less ascertain their exact dollar benefits as a basis for taxation. Furthermore, to tax persons on the basis of volunteered information about benefits received would in effect tax the honest and reward the dishonest, making such a system very inequitable in practice.

In the absence of the ability to fairly assess taxes in accordance with benefits received, ability-to-pay criteria alone provide an equitable basis for taxation. Ability-to-pay refers to the taxpayer's economic pleasure. Although Irving Fisher, and more currently, Nikolas Kaldor, have argued that consumption spending is the best index of economic pleasure, and hence, provides the fairest tax base, Robert Haig and Henry Simons have influentially argued that income, or consumption plus additions to wealth better measure economic pleasure and would provide a more equitable basis for taxation.

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3 Ibid., pp. 34-46.
Thus if Nigerians feel that income is the fairest basis for taxation, any deviation from a Haig-Simon income definition must be justified on the basis of increasing tax simplicity, or promoting a more efficient resource allocation.

Tax simplicity and ease of administration are best served by a tax whose base is readily calculated, observable to outside authorities to prevent cheating, and whose rate structure is simplified so that tax assessment may be easily determined.

Tax neutrality and promotion of efficient resource usage primarily requires uniform rates of taxation on incomes (if income taxation is used) and on output (if excise taxes are used). Efficiency in resource allocation requires that resources yield the same return in each alternative use. Without tax interference, normal profit maximizing behavior will ensure that resources are allocated in this manner. However, if tax rates are not uniform, if they are higher on incomes from some sources than on others, then resources will shift until the after-tax return is the same in each alternative use as resource owners seek to maximize after-tax incomes. But if tax rates are not uniform, the before-tax return in each alternative use will not be the same, resulting in a loss of efficiency, since resources yield more in some uses than in others.
These criteria for good taxation, mutually exclusive though they may be, will provide the standard against which the performance of the Nigerian personal income tax system will be measured, and also provide the basis for the proposed reforms.
CHAPTER II

BACKGROUND OF THE PEOPLE AND POLITICAL SYSTEM IN NIGERIA

Nigeria is said to be the most thickly populated country in Africa. At the beginning of 1976, the estimated population was 78.7 million people.¹ These people were and are organized in units with diversities in culture, ethnic origin, language and religious belief.

Despite these diversities, Paden and Soja believe that "the people of Nigeria originated from only two different groups or races."² On the one hand, there are the dark-skinned people with curly hair, broad noses, and thick lips who make up the Negro race. On the other, there is another race with lighter skins, longer hair, and sharper noses who invaded Nigeria from the North and are called the Hamites. The breakdown of these two races form the main population groups--the Hausas, Ibos, Yorubas, Fulani, Kanuri, Tiv, Ibibio, Edo or Bini, Anang, and Nupe.

The Hausas are the largest in number, followed by the Ibos and the Yorubas. The Hausas mainly occupy the northern portion of Nigeria; the Ibos and Ibibios occupy the southeastern portion; while the Yorubas are located on the southwest.

Before the arrival of the British, the important political organ of the people was kinship.³ Paden and Soja explain kinship "as the criterion for relating individuals . . . based upon a recognition either of common ancestry or linkage through marriage, etc. . . ."⁴ Kinship is therefore an important and predominant principle that influences all political activities in Nigeria even to the present day.

Based on the kinship principle, people are organized into traditional and political units. For example, the basic political units for the Hausas in the North are the Emirates, while the Yorubas in the southwest have kingdoms. The political units of the Igbos and Ibibios in the southeast are a bit more complicated. There the population is organized into compounds. A certain number of these compounds go to make up the hamlet (ekpuk), "each occupied by members of an extended family."⁵ In the North the Emirates are ruled by


⁴ Ibid.

Emirs; the Obas rule Yoruba Kingdoms, while the Chiefs rule the hamlets (ekpuk).

Perhaps it is pertinent to mention that historically these Emirs, Obas and Chiefs were always in conflict with one another. Adeleye has noted about the northern Emirates that the administrative arrangements of the various emirates were worked out at the same time as the usual protracted wars of conquest and consolidation were going on. Under the first Emirs, these wars were a more urgent consideration than the details of the administrative structure. 6

Similarly, the Kingdoms of the Obas or 'States' as they were called were always at war. In fact, the city of Ibadan, the largest city in West Africa, originated as a war camp. 7

Thus before the arrival of the British, the people of Nigeria had their history and political philosophy based on kinship. Crowder summarizes: "For this newly created country contained not just multiplicity of pagan tribes, but also a number of great kingdoms that had evolved complex systems of government independent of contact with Europe." 8

British Occupation of Nigeria

While the bringing together of different tribes to form one political unit in Nigeria between 1885 and 1914 is entirely the work of the British Government, this does not mean that the British were the first Europeans to establish contact with Nigeria. Before their arrival other foreign traders had located, mainly along the Southern Coasts. Hence the developments between 1885 and 1914 were to some extent the results of earlier European activities in Nigeria.

The Europeans' trade along the Southern Coast began as early as the late fifteenth century. Those early Europeans depended for their safety on the Nigerians who lived near the coast and made no political impact on Nigeria. But as time went on trading in commodities gave rise to trading in slaves. While the trade was certainly inhuman, it was very profitable and the Nigerian rulers benefited greatly from the trade.

The first check to this trade came in 1807 when Britain passed a law abolishing the trade throughout the Empire. Then she set out to harass other European nations to stop slave trade. Certainly a part of her eventual success was due to the fact that Britain and other European nations

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10 Ikime, *op. cit.* , p. 100.
engaged in the trade were gradually becoming industrialized and the labor of slaves had become less necessary.

On the other hand, the Nigerian slave dealers were reluctant to abandon the trade. They believed that to stop slave trade would seriously damage their economic welfare.

The attitude of the Nigerian slave dealers to prolong slave trade was prompted by the fact that they always had slaves to sell. Since tribes in Nigeria were always at war with one another, the prisoners of war could be profitably sold as slaves. This supply clearly demanded a market, and countries like Portugal and Brazil, in collaboration with the Nigerian slave owners, continued to engage in slave trade until about 1850. Ikime states that Nigerians . . . would continue to sell slaves as long as there were Europeans or Americans to buy them. In the Yoruba Country . . . there were many slaves available for sale as a consequence of the inter-group wars which plagued that part of Yorubaland . . . The greatest slave exporting part of Nigeria was the Eastern delta where Bonny was the leading slave trading state.

The actual British involvement in Nigeria started when it was realized that the Nigerian slave exporters stood in the way of the British attempt to stop slave trade across the Atlantic. When the British Naval Squadron undertook a blockade of the major slave trading ports in Nigeria, the Nigerian rulers who were involved in the trade were furious and regarded the British action as a violation of their territory.

\[11\] Ibid., pp. 5-6.
In 1836, these rulers—especially those from Bonny—came into direct conflict with the British when they arrested and imprisoned the captain of a British gun boat. But as British continued to meet opposition and encounter violence, they strengthened their naval and armed forces against the Nigerian rulers. Ikime's conclusion in this matter is interesting:

The era of gunboat politics had dawned. From now til the actual occupation (of the British) it was no longer "what is right" but might is right. This was one way in which the British determination to put an end to the slave trade began to prepare the way for the eventual British occupation by making our forebears lose confidence in themselves in the face of superior military or naval might. . . .

The Amalgamation of Nigeria

As Britain used her superior military strength to surpress Nigeria, she prepared the way to impose a new political system on the people. It all started in 1861, when Docemo, the King of Lagos, handed over Lagos to the British Crown. Lagos, which now serves as the Nigerian capital, had been an important port for slave trade. Immediately the British took control of Lagos. Then they extended their influence to cover all the tribal territories and overwhelmed their leaders.

\[\text{12} \text{Ibid., p. 21.}\]

\[\text{13} \text{Hicks, op. cit., p. 100.}\]
In 1900 they proclaimed Northern Nigeria a Protectorate, and Sir Frederick Luggard, later known as Lord Luggard, was made the High Commissioner. Luggard was charged with the responsibility of bringing the new Protectorate under effective British control.

The Northern Protectorate was followed by proclaiming the South—except Lagos—a Protectorate; Lagos was declared a Colony.

The turning point in the political history of Nigeria was in 1914, when Lord Luggard amalgamated all the Protectorates and the Colony of Lagos to form one political entity now called Nigeria. Nigeria, which from the very beginning was a composite of States each ruled by natural or traditional rulers, was then brought to survive as a nation.

However, as Adedeji has observed "the amalgamation of 1914 did not bring forth appreciable constitutional change, and until 1946, the North and South continued to be governed as they had before 1914." In general, the objectives of the 1946 constitution were

(1) to promote the unity of Nigeria

(2) to recognize the ethnic, cultural or language diversity of the people

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(3) to increase the participation of Nigerians in the administration of their Country's affairs.\footnote{Ibid., p. 23.}

The people were indifferent about the amalgamation since they were not free to express their opinions in the face of a superior military might. But the British were cautious, at least for a start, in establishing their administration based on the two areas of North and South. Adedeji has noted that because the North and South continued to be governed separately between 1914 and 1946, assimilation between the two was difficult. Lord Luggard, the 'creator' of Nigeria and its first Governor-General, resisted all attempts at centralization and assimilation.

The next development came in 1939, when the Southern area was divided into Eastern and Western Provinces. The North was preserved as a unit. Thus Nigeria was divided into three main regions: North, East, and West, as Map I shows. Today the Hausa tribe occupies the North, the Yorubas the West (including Lagos), and the Ibos and Ibibios the East.

One way of acknowledging the diversity was the creation of regional councils for the Northern, Western and Eastern groups of provinces. At the same time, a legislative council was created at the center, Lagos. The regional councils were purely advisory in their role because they were empowered to initiate and debate bills but not to pass them; only the
MAP I

THE REGIONS OF NIGERIA

Key: 1 Western Region
     2 Eastern Region
     3 Northern Region
     .... State boundaries
     ---- National boundaries
legislative council could enact bills. The regional council also served the purpose of electing members to the legislative council.

The first decisive step towards federalism was in 1951, when the regional councils were given power to enact laws related to certain matters like education, agriculture, and public health. However, the central legislature could veto such bills if there was need.

The actual regional autonomy within a federal system came into being in 1954, exactly forty years after amalgamation. Between that year and 1960, the year of independence, three constitutional conferences were held. These were concerned primarily with providing the necessary federal institutions and with settling outstanding matters about the country's approaching independence.

Thus while the amalgamation of Nigeria in 1914 was imposed on the people by the British Government, the adoption of a federal constitution, according to Perham, was "the creation from below of a natural and democratic unity by the people themselves."\(^{16}\)

Three years after independence, Federal Nigeria became a Republic with a resolution that Nigeria "firmly resolve to

\(^{16}\) Ibid., p. 26.
establish the Federal Republic of Nigeria with a view to ensuring the unity of the fatherland . . . so as to further the ends of liberty, equity, and justice."\textsuperscript{17}

When the military government came to power in 1966, the constitution was suspended. But the laws and regulations that already were made continued to operate. The most significant political change made by the military government was the division of the country in 1967 into twelve states (as shown in Map II). This division, however, still maintained the status quo of the Northern, Western, and Eastern people. In order to give credence and recognition to the tribal setup, the States are usually identified in blocks namely, Northern, Western and Eastern States. Crowder's views on the background and future political system of Nigeria are worth noting:

Any Country is, in a sense, an artificial creation. In the case of Nigeria . . . unity was so sudden and included such widely differing groups of people that not only the British, who created it, but the inhabitants have often doubted whether it could survive as a political entity.\textsuperscript{18}

\textsuperscript{17}Ibid.

\textsuperscript{18}Crowder, \textit{op. cit.}, p. 23.
MAP II

THE NEW STATES OF NIGERIA

ESTABLISHED May 27, 1967

... State boundaries

Key:

1 Lagos State
2 Western State
3 Mid-Western State
4 Central-Eastern State
5 Rivers State
6 South-Eastern State
7 Kwara State
8 North-Western State
9 Benue-Plateau State
10 North-Central State
11 Kano State
12 North-Eastern State

-- National boundaries
CHAPTER III

THE DEVELOPMENT OF PERSONAL INCOME TAX IN NIGERIA

One of the problems that faced the Colonial Administrators was finance. Before the amalgamation of Northern and Southern Nigeria, the total grant-in-aid given to Nigeria by the British government amounted to $4,261,000.¹ After amalgamation, Britain decided to cut down the amount of grant-in-aid and limited the period of the aid to five years. The finance was then reduced while the expenditure continued to increase.

Lord Luggard, in an attempt to avoid a financial crisis, had to fall back on the sources of revenue available in Nigeria. One such source was taxation.

In Nigeria the evolution of the two systems of taxation had followed two different paths. Okigbo reports that Direct taxation was first developed in Northern Nigeria before the British administration, while indirect taxation through customs duties and tolls attained a high level of development in the Yoruba Kingdoms of the Southwest and the 'houses' of the Southeast . . . Consequently the story of the growth of direct taxation in Nigeria reaches its apotheosis in the North, that of indirect taxation in the South.²

²Ibid., pp. 76-77.
For the purpose of this study attention is on one aspect of direct taxation--personal income taxation. However, references are made, when necessary, to aspects of indirect taxation in order to provide a background of the problems now facing the Southern States, especially in the administration of personal income tax. Since Northern and Southern Nigeria had direct and indirect taxes respectively before the arrival of the British, the development of personal income tax in Nigeria is discussed taking these areas separately.

**Direct Taxation in the North**

According to Okigbo, the influence of Mohammedanism, which encourages the people of Northern Nigeria to give a portion of their income for charitable or religious purposes, provides a basis for voluntary compliance.\(^3\) Moreover, the highly organized administration of the Emirs, who reach the village level, thereby establishing personal contacts with the people, also made the process of taxation run more smoothly.

The traditional personal income tax system in the North ended up in the average farmer's paying the "zakka," a tithe on crops and livestock prescribed by the Koran for charitable, religious, or educational purposes. This tax was levied on cattle and grain.

\(^3\)Ibid.
Although the zakka was a religiously prescribed tribute, it was sometimes levied on pagans. These pagans also paid the "Kurdinkasa," a tax on agricultural pagans very much like a capitation tax. The farmers also had to pay plantation tax (called the "Shukka-Shukka") levied on all crops not liable to zakka or levied on special crops at special rates. The cattle raisers paid the "jangali," or cattle tax, a tax on livestock. In addition, special taxes were levied either by reference to the occupation of the taxpayer or by reference to the product, for example, hunters or fisherman.

Market traders paid fees for market stalls, royalties on wares that they sold, and tolls for plying their trade in caravans. Everyone was expected to give presents (gaisua) to his immediate superior and to pay special levies for special occasions.

What is very striking is the death duties that were paid. Okigbo states that in the Bornu Emirate, for example, the Shehu or Emir would send a slave to administer a district. Upon the slave's death, the Emir would confiscate all his assets. These assets were regarded as death duties called "gado."\(^4\)

Also in Bornu a graduated personal tax based on status in office was paid. This tax was called "kurdin sarauta."

\(^4\)Ibid., p. 79.
Land tax was also paid by land owners. The rates varied depending on the distance from a city (administrative headquarters of each Emir) and also on the type of soil the land had.

All of these various taxes and levies were regarded by the people as normal. Luggard, however, found the taxes puzzling, and he worked to combine them to make them simple, understandable, and intelligible to both payers and collectors. He also tried to make them equitable as far as possible. His reform methods were directed toward answering questions like: Who is liable? What is liable? Who makes the assessment? and by what criteria? What sanctions are to be used in case of default, and how would the proceeds of the tax be disposed of?

The reformed procedure of income tax assessment brought in the administrative officers who were instructed to check the land under cultivation and the quantity and value of special irrigation crops, to count the livestock and generally assess the wealth of the nonagricultural sector of the village community. The methods of calculation were to be submitted to the resident for examination and revision and to the lieutenant governor for approval. A sum was then fixed as the tax liability of the community, and this was communicated to the village head. Therefore, the unit of assessment was the village, and the village head had the responsibility to collect the tax from its members. That arrangement ushered in a type of personal income tax called "community tax." This tax will be discussed in more detail later.
So far there was no direct assessment of individuals. But by 1918, the system of taxation had progressed enough for records of individual tax liability to be kept in Zaria and Kano provinces. In a community like Bornu, where fiscal administration was most advanced, tax-demand notices were served on each individual and his payments were receipted.

Another reform method brought about a capitation tax—a tax very much like the poll tax. Under this method the amount to be raised by the population was fixed by reference to cultivated land, livestock, or other visible signs of wealth.

Like the traditional system of the Emirs, Luggard's tax system had a number of weaknesses. For one, the administrative officers had problems in implementing the reform methods because certain expressions were vague. The definition of tax liability, for example, was ambiguous. Was it a tax on income, wealth, or profit, or was it a poll tax? Luggard himself tried to define what he meant by profit as being a yield of land if cultivated to normal standards and including own consumption.

If Luggard referred to profit from land as 'income' there was further confusion in the minds of the assessors. Some preferred to use gross income as basis for assessment while others used the net income interpretation. The problem arose as to what could be allowable deductions and at what percentage of the gross income. Okigbo explains:
. . . Gowers, one of Luggard's officers, contended that twenty-five percent of net income was equivalent to ten percent of gross income in agriculture. Girouard, the Lieutenant Governor, argued that fifty percent of net income was equivalent to twenty percent of gross income. What these officers did not realize, that they were in fact disputing the same value, is evidence of the confusion that permeated this controversy.

About what constituted allowable deductions the officers were allowed to use their own discretion, a procedure that created still more disparities in the personal income tax administration.

The center of another problem was the tax collection. Under the community assessment, the village heads had to collect the taxes and pay them over to the government. But with the land tax and capitation, things were different. Default in payments was rampant and it carried a penalty of court fines. This, however, did not reduce the degree of avoidance or evasion; rather the number of defaulters kept on increasing.

One way Luggard tried to secure compliance with the new tax system was to make the native authorities collect the tax. The proceeds from the tax were divided equally between the central and the native authorities. However, certain primitive areas retained only twenty-five percent or five percent as the case might have been.

Ibid., p. 86.
Thus direct taxation in the North evolved from a system that existed before the British created Nigeria.

Direct Taxation in the South

It will be recalled that indirect taxation dominated the South. In course of time Luggard did away with the indirect taxes and imposed direct taxation on the people. How he did it, and the difficulties he encountered is the theme of this section.

Between 1900 and 1918, Lord Luggard had worked hard to persuade the people of Southern Nigeria to give up indirect taxation. He argued that, though simple, indirect taxes were inefficient because they retarded trade. Luggard wanted to promote free trade between North and South—especially after amalgamation.

The indirect tax on liquor was a good source of revenue to the Southerners. In Luggard's view, cessation of traffic in liquor and spirits was highly desirable on health and moral grounds. The revenue loss would be made up from direct taxation.

Luggard's attempt to discourage indirect taxes and encourage direct taxation was most successful during the World War I, when revenues from liquor declined substantially. This facilitated the introduction of direct taxation in the South. Even so, the Southwest accepted the tax easily, but in the Southeast the matter was decided in the battlefield because Luggard failed to heed the advice of Lyttleton when he
expressly warned "We have not pressed the increase in revenue upon Sir F. Luggard, however glad we may be to have it when it is obtained without undue sacrifice." In spite of the opposition from London, Luggard persisted.

1. Direct taxation introduced in the Southwest. --In 1916, direct taxation was introduced in the Southwest. There the Obas who were supposed to collect the new government tax, were the same people who had previously imposed and collected heavy tributes from their members. The new tax was welcomed because the tributes were made into one single payment and collected by one authority. Okigbo states that in one center alone about £3,400 was paid in twenty-four hours. Other areas were equally happy. In Ondo province and Ilesha division, people voluntarily asked to be included in the tax arrangement. Thus there was no significant problem with the tax in the Southwest.

2. Direct taxation in the Southeast. --The problem of introducing direct taxation in the Southeast of Nigeria shall be discussed in more detail because the study in this region provides a model of most Nigerians' attitude to change.

When the British government gained control of the Southeast, the political system was not as developed as it was in

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7Okigbo, op. cit., p. 88.
the North or in the Southwest. As Alan Pim puts it, the political evolution in that part of Nigeria (Southeast) "had not advanced beyond the local community and subtribal stage." Also, there was no notable system of taxation or payments of tributes. Thus Luggard had nothing on which to base his direct taxation. The revenue accruing to the East, as it was the case with the West, was derived from custom duties.

According to Pim, liquor accounted for seventy percent of the custom duties. As he had done in the Southwest, Luggard discouraged the importation of liquor on moral grounds. Also, he felt that the cessation of liquor importation would be socially beneficial, and that direct taxation would replace the revenue lost from custom duties.

It was about 1914 that Luggard again started to press on the Colonial Office in London to give him approval to extend to the Southeast the capitation tax that was at that time levied on the Northern pagans. Okigbo contends that Lyttleton, who was the Secretary of State in London at that time, failed to share Luggard's enthusiasm for introducing direct taxation in the South along the lines developed in the North. Thus the Colonial Office did not approve the request.

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9 Ibid., p. 227.
10 Perham, op. cit., pp. 462.
11 Okigbo, op. cit., pp. 87-88.
The next move to extend direct taxation to the Southeast was in 1918. In that year, it was considered that the Southeast was ready to accept direct taxation. Accordingly, in August 1924, discussions were held with Chiefs and Elders in the Eastern Nigeria as to the ways and manner direct taxation could be introduced into that region. Deliberations were held mostly on the problems of assessments.

The Native Revenue Ordinance designed for the Northerners made allowance for the traditional rulers to play important roles in the collection of income tax. It was thought that such practice would not work in the East. Obigbo states

The aim was to modify the Native Revenue Ordinance in its application to the Eastern provinces, since the warrant chiefs—being 'to a large extent nominees of the Government'—could not be used in tax matters without raising strong opposition from the public. In 1927, the Native Revenue (Amendment) Ordinance, which applied to the Eastern provinces, was passed. Instead of making use of the "warrant" chiefs, it was thought that the local chiefs and elders who associated most with the people should be utilized to help the tax officials. The tax base

\[ \text{Okigbo, op. cit., p. 90.} \]

was made up of the value of land, the annual value from trade, manufacture, employment, or the value of livestock.

The basis for assessing the income of the people was arbitrary because the district officers were instructed to visit villages in their areas and to estimate the income of each person for tax purposes. This was done by counting the people and their livestock and also estimating the amount of food produced and consumed by each family. The final assessment file had interesting arbitrary figures for a taxpayer.

After assessments were completed and approved in the Lagos Office, the rate of tax for each division was applied. The rate was supposed to be approximately two and one-half percent of the gross income of farmers. In practice the rate took the form of a general head tax or poll tax for the farming population in a specified area. The reason for this practice was mainly that there was no significant variation in the productivity of farmers.

For the non-farming population there were special rates for the various trades and professions or those possessing special types of property. The tax for each adult male in the rural areas ranged from three shillings to seven shillings, depending on the level of income in each division. The tax rates in some divisions are shown in Table I.

In the urban areas like Onitsha and Calabar, occupational classification was used for the setting of the tax rate. The


<table>
<thead>
<tr>
<th>Divisions</th>
<th>Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Calabar</td>
<td>7</td>
</tr>
<tr>
<td>Opobo</td>
<td>7</td>
</tr>
<tr>
<td>Ekoi</td>
<td>5</td>
</tr>
<tr>
<td>Ogonis</td>
<td>6</td>
</tr>
<tr>
<td>Obubra</td>
<td>6</td>
</tr>
<tr>
<td>Obudu</td>
<td>3</td>
</tr>
<tr>
<td>Boki</td>
<td>5</td>
</tr>
<tr>
<td>Aba</td>
<td>7</td>
</tr>
<tr>
<td>Bende</td>
<td>7</td>
</tr>
<tr>
<td>Southern Nkanu</td>
<td>3</td>
</tr>
<tr>
<td>Onitsha</td>
<td>5</td>
</tr>
</tbody>
</table>

Source: *Laws of Nigeria, 1928, Chapter 74, Section 7, Schedule 1.*
schedule used in 1928 to determine the tax for non-farmers can be seen in Table II.

With regard to the sharing of the revenue, it was considered that one-half of the collections should be paid over to the Native Treasury for local expenditure, while the other half belonged to the Central Government.\textsuperscript{14}

The counting of the heads or taxable adults was the cause of confusion and unrest in subsequent years. Okigbo reports that in 1929, in Bende Division, the newly appointed assistant district officer, Captain Cook, set out to update the taxpayers rolls by conducting another census of taxpayers. At this time the enumerators were uncertain whether the women were to be included in the counting. As it turned out, women were counted, although "Captain Cook stated that the new count had nothing to do with the taxation of women..."\textsuperscript{15} The count resulted in a widespread rumor that a law had been passed that all women should be taxed. Based on the rumor, women—mostly from Owerri and Calabar—started rioting. The climax in the rioting came on December 17, 1929, when a mob of angry women attacked the District Office in Opobo. The soldiers fired into the mob, killing thirty-two of the women and wounding many. Due to intensive patrol by both police...


\textsuperscript{15}Okigbo, \textit{op. cit.}, p. 92.
### TABLE II

**TAX RATES BY OCCUPATION IN EASTERN PROVINCES OF NIGERIA IN 1928**

<table>
<thead>
<tr>
<th>Occupation</th>
<th>Rate in Shillings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Artesians</td>
<td>10</td>
</tr>
<tr>
<td>Bicycle Repairers</td>
<td>10</td>
</tr>
<tr>
<td>Butchers</td>
<td>15</td>
</tr>
<tr>
<td>Carpenters</td>
<td>10</td>
</tr>
<tr>
<td>Dealers in wine, beer or spirits</td>
<td>20</td>
</tr>
<tr>
<td>Goldsmiths</td>
<td>15</td>
</tr>
<tr>
<td>Drivers</td>
<td>20</td>
</tr>
<tr>
<td>Auto mechanics</td>
<td>10</td>
</tr>
<tr>
<td>Shoemakers</td>
<td>10</td>
</tr>
<tr>
<td>Shopkeepers</td>
<td>10</td>
</tr>
<tr>
<td>Tailors</td>
<td>10</td>
</tr>
</tbody>
</table>

*Source: Laws of Nigeria, 1928, Chapter 24, Section 7, Schedule II.*
and soldiers, imprisonment of the women, and other security actions, the riot was suppressed. The resistance to taxation by women as reflected in the riot made the Colonial government exempt most women from income tax--a practice that still stands today.

After the women's riot there was no significant development until 1940, when Ordinance No. 4, entitled "An Ordinance to Regulate the Levying and Collection of a Direct Tax in Nigeria," was passed. The Ordinance, among other things, required the Resident to make an assessment of any native community's or individual's income in cooperation with the chiefs or elders in each area taking into consideration the custom and tradition that prevailed in an area.

In this respect, assessments were computed or estimated, based on annual profits or gains derived from land, produce, trade, employment or value of livestock. Annual profits, gains, or value of livestock were defined as "those which can be annually obtained from such land by a native, cultivating and using the same technique and manner of cultivation as prevailing in the neighborhood." The ordinance was also executed by appointing native elites (leaders) as tax collection agents. There was no definite schedule for the tax rates.

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16. Native Direct Taxation (Colony) Ordinance, No. 4 (Lagos, 1940), Sec. 4.
17. Ibid., Sec. 5.
which were fixed by the residents but subject to the approval of the governor.

One aspect to be emphasized in the early income tax arrangements in Nigeria is that up to the passing of the Ordinance of 1940, personal income tax in Nigeria was still a Central Government tax. The headquarters in Lagos had the ultimate jurisdiction over this source of revenue.

Today personal income tax is exclusively a State tax with the Federal Government playing a role to ensure uniformity in the imposition. How the tax came to be made regional responsibility is the subject discussed in the next section.

Development of Nigerian Fiscal System

Under the 1946 Constitution—popularly known as Richards' Constitution—a legislative council was set up for the whole country. In addition, the regional councils were given some measure of financial responsibility. The Governor stated in his dispatch:

I propose to devolve upon the regional councils a large measure of financial responsibility. Each would have its own regional budget, on which would be borne the cost of government services in the region, including the salaries of government personnel. The only exception would be the cost within the region of services declared to be central services, . . . income tax, and audit which would continue to be carried on the Central Estimates . . . Regional revenues would consist . . . of the share of the direct tax at present payable to the Central Government together with any receipts from fees, licenses, etc. . . .

18 Adedeji, op. cit., p. 49.
Thus, about January 1, 1947, the Richard's Construction started the Nigerian federal fiscal system.

According to Eme O. Awa, the regions were given no powers to levy taxes other than revenues derived from fees. Sir Sidney Phillipson, who earlier was the Financial Secretary in Nigeria, was commissioned to study the ways and means of allocating revenue to the newly formed regions. In his report, he recommended that regional revenues should be derived from two main sources:

1. Share of direct tax from the Center and revenue through fees, licenses, etc., declared to be regional
2. A block grant from the Center payable out of the non-declared revenues

Phillipson defined regional revenues as those

1. which were identifiable with the regions and collected locally by that regional authority, and
2. from which no national or important considerations of policy were likely to arise.

The block grant out of the non-declared revenues was

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21 Ibid.
determined by the strict proportion to the contribution which the region made to those other revenues.

Another Constitution, the Macpherson's Constitution, of 1951, amended Richard's proposal. Under the new arrangement, a direct tax in the form of capitation was shifted to the regions. The Center continued to retain jurisdiction over graduated income and company taxes. In spite of that arrangement, regional revenue was inadequate to support increasing services.

The attempt to continue to explore ways and means of financing the regional governments led to another commission made up of Sir Sidney Phillipson and J. R. Hicks. Because D. A. Skelton, who could otherwise have been a member of the commission, died before the commission started its work, the Commission was called Hicks-Phillipson Commission.

The main recommendations of the Hicks-Phillipson Commission were:

(1) Revenues already declared regional should be handed over to complete regional control with regions having to fix the rates of such taxes to be collected.

(2) The import tax on motor spirit should also be handed over to the regions.

(3) One-half of the revenue from taxes on tobacco and cigarettes should be allocated to the regions.\(^{22}\)

\(^{22}\)Hicks and Phillipson, *op. cit.*, p. 159.
These recommendations did not seem to accomplish much. Consequently, Hicks-Phillipsons report was followed closely by the recommendations of Chick's Commission in 1953. Chick recommended, among other things, that the proceeds from the personal income tax should be distributed according to the residence of the taxpayer, and this was a sign of events to come—the transfer of income tax to the regions.23

In 1957, Sir Jeremy Raisman and R. C. Tress were appointed to examine the fiscal system of Nigeria. The Chairman of the Commission was Raisman. Hence the Commission was referred to as the Raisman's Commission. The Commission submitted its report early in 1958. It recommended, among other things, that custom duties, excise, and sales taxes remain with national government while income tax, export taxes (levied by the National Government but assigned to the regions), and the revenues from excise and custom duties on tobacco (levied by the National Government) be assigned to the regional governments as independent sources of revenue. In addition, a system of distributable pool account, comprised of thirty percent of general import revenue and thirty percent of mining royalties and rents, was introduced.24 The account was to be


shared between the regions in the following order:

- North 40 percent
- West 24 percent
- East 31 percent

Southern Cameroon were allocated the remaining five percent.

Thus at that point the regions were given jurisdiction over income tax levied on individuals except the non-Africans. Until 1962, the National Government continued to levy income tax on all non-Africans. But, on the whole, the appropriate authority over personal income tax had been defined by 1958. The Federal Constitution gave recognition to the 1958 arrangements by making income tax a regional responsibility. As a result, the Federal Government was charged with regulatory functions only.

Basis of Present Personal Income Taxation

P. G. Willoughby and Brian Harvey state that "The present detailed division of taxing powers between the Federal and Regional legislatures stems largely from the Report of the Raisman Commission who adopted the existing distinction between company and personal tax."\(^{25}\) In the first place, the exclusive power of the Federal Government to tax is set out in Section 76 (1) and (2) of the 1963 Constitution—as amended by

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the Constitution (Suspension and Modification) Decree, No. 8 of 1976. These provisions set out the areas within which the Federal Government can legislate on matters of income tax (both company and personal). In summary, the Federal Government can legislate exclusively on matters relating to company income tax. But both the Federal and Regional (State) Governments have concurrent legislative powers on personal income tax. The Federal regulations are made to ensure uniformity of the tax on all persons in Nigeria, while the State legislature fixes the rates and lays down the guidelines or procedures for assessment, collection, and enforcement.

Following the Raisman's Report as embodied in the Nigerian Constitution, the taxation of corporate income is restricted to the Federal Government. Since this study deals with personal income tax, discussion about corporate income tax will be discontinued except where mention is made to explain a point relevant to the subject under study.

As already stated, the Federal Government legislation seeks to ensure uniformity throughout the country in the imposition of the tax. The main aims are

(1) To implement any treaty, convention or agreement between the Federal and other Country or any arrangement with or decision of an international organization of which Nigeria is a member.
(2) To secure uniform principles for the taxation of income and profits accruing to persons in Nigeria when such income or profit is earned by persons who are not Nigerian citizens.

(3) To secure uniform principles for the computation of income and profits of all persons (including members of partnerships) for purposes of determining the tax burden.

(4) To regulate the liability to tax of persons within Nigeria by reference to their place of residence or otherwise for the purpose of ensuring that any income or profit does not bear tax under the laws of more than one territory (state).

(5) To provide for the exemption from liability to tax income or profit of persons who are covered in any arrangement made between the government of the federation and the State Government.

(6) To obtain information with respect to income or profits from any source and providing for the exchange of information between different taxing States.26

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26 Ibid., pp. 1-2.
Development of Personal Income Tax Laws

1. Eastern region finance Law.--The Eastern region of Nigeria was the first to pass a comprehensive law relating to the taxation of persons (mainly Africans). The law was comprehensive in that it covered other taxes on entertainment and purchases of petroleum products. \(^{27}\)

The most significant part of this legislation was its reform of the income tax system in the Eastern region. First, it incorporated a poll tax into the tax schedule; then it set forth the amount of tax payable on a certain income; and finally--and most important--it introduced a withholding system of income tax collection called Pay-As-You-Earn (PAYE). The PAYE system was highly criticized by such experts like Okigbo, because the bulk of the population at that time were illiterate and salaries earned by a few Africans were below the minimum. \(^{28}\) However, the system worked out well and was subsequently copied by Western and Northern regions. Unfortunately, the tax was inequitable. For example, a person earning £190 would pay a tax of £13 a year while one earning £210 would pay £27; the rate was seven percent and thirteen

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\(^{27}\) Eastern Nigeria, Finance Law, 1956 (Enugu, 1956), First Schedule.

\(^{28}\) Okigbo, op. cit., p. 149.
percent, respectively. This, in effect, was a sixty-eight percent tax on the £20 increment from £190 to £210.\footnote{29}

To reduce the inequity, the 1956 Finance Law was amended in 1957 and the schedule setting out the amount of tax to be paid for a given income was completely rearranged. In the new schedule the tax payable was computed for incomes at the incremental steps of £10 from £60 up through £3,000. After £3,000 a certain rate of tax per pound of income in excess of £3,000 was levied. This resulted in the single person earning £190 being taxed at the rate of five and one-half percent and the one earning £220 at 6.0 percent.\footnote{30}

The 1957 amendment also led to a repeal of the purchase tax on alcohol because other regions did not impose a similar tax. The result of that inequity had been wide evasion.

In 1960 there was another amendment to the 1956 law. As a result, a person earning £190 was thereafter assessed at the same rate as one who earned £220. The rate of tax was five percent. The purchase tax on gasoline was reimposed at a rate of 3d. per gallon. A similar tax was also levied on diesel oil. Although there were other minor amendments to the 1956 law, it remained the basic law for the assessment and collection of income tax in Eastern region until 1961, when a new finance law was passed. The new law came into effect in 1962. The

\footnote{29}Eastern Nigeria, Finance Law, 1956 (Enugu, 1956), First Schedule.

\footnote{30}Eastern Nigeria Finance (Amendment) Law, No. 10 (Enugu, 1957), First Schedule.
present assessment and collection procedures of the Cross River State of Nigeria which are discussed later are based on this new law.

2. **Western region personal income tax Laws.**—Although personal income taxation had been made a regional responsibility in Nigeria under the Adaptation of Laws Ordinance 1954, no significant legislative action was taken by the former Western Region until 1957, when the income tax law No. 16 of 1957 was passed. This swept away the application of the Direct Taxation Ordinance of 1948.31

   The law established a dual system of direct taxation for both the local and the regional governments who were empowered to levy taxes on income with the local levies designated as rates and the regional levies called taxes. The local authorities were restricted to impose taxes on incomes not above £300 while income above £300 fell within tax jurisdiction of the Regional Government. There were generous allowances, namely, personal allowances of £100, allowances for children of £40 per child up to a maximum of four children, a married allowance of £100 and allowances of £210 for each child being educated abroad up to a maximum of two children. Thus at the maximum a taxpayer with four children could claim allowances up to £780 per annum. While these measures did allow some relief for those with higher incomes, they did not narrow down the income intervals to make the tax rates more

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progressive. In addition, there was a relief up to £100 for life of the taxpayer or his wife. The minimum income was £50 for a male taxpayer. The law did not exempt women from taxation provided that their chargeable income exceeded the personal reliefs. Since the passing of the law, the following amendments have been made:

The Income Tax (Amendment) (No. 1) Law 1958
The Income Tax (Amendment) (No. 52) Law 1958
The Income Tax (Amendment) (No. 35) Law 1959
The Income Tax (Amendment) (No. 2) Law 1960 (1961 Vol. Laws of Western Nigeria
The Income Tax (Amendment) (No. 7) Law 1960
The Income Tax (Amendment) (No. 3) Law 1960
The Income Tax Amendment) Law 1961 and 1962
The Income Tax (Amendment) Law 1964

An interesting amendment is that of early 1960. The amendment was made to give credence to a promise made by the Leader of the Action Group during an electioneering campaign in 1960. The Action Group then proposed a change in the tax system called "democratization" of taxation. That involved giving the people responsibility for the tax system through their elected councils and the abrogation of the Inland

\[32\text{Willoughby and Harvey, op. cit., p. 3.}\]
Revenue Board which was proving unpopular with the higher income earners. 33

The Action Group succeeded in the election and the promise was given attention during the first meeting of the House of Assembly in March 1960. The general impression was that taxation was used as a political weapon by the Action Group. The significant changes in the law were the elimination of Inland Revenue Division, establishment of Regional Tax Board, transfer of regional personal taxation to the local councils, cancellation of local and general rates, and modification of the system of special ratings. The Commissioner of Inland Revenue was named Tax Administrator, while the Regional Tax Board acted in advisory capacity to the Minister of Local Government. The measure also removed personal allowances for male taxpayers but raised them to £300 for women (an allowance made mainly to reflect what had become a highly sensitive issue of political campaign). Family allowances could operate only to the extent that they did not reduce the chargeable income below £300 per annum per male taxpayer. There was no change in the income minimum of £50 for a male taxpayer.

Immediately after the passing of the Amendment, many local councils started to implement it loosely. Some of them did not seek the assistance of the Regional Tax Board Officers.

The 1961 Amendment brought all employees both African and non-African under the Pay-As-You-Earn tax system (PAYE). This amendment and the taxation of expatriate traders were made the responsibilities of the Regional Tax Board.

In persuasion to "democratization" of income taxation, the system of the Area Assessment Committee was reintroduced. Writing about the Assessment Committee at that time, G. Orewa felt that as far as possible, honest and literate non-party men should be appointed to the Assessment Committee in order to remove tax assessments from politics and thus to eliminate the irregularities which this often involves.34 This indicates that the Assessment Committee consisted mainly of illiterates who were often selected on the basis of political application with little regard to personal integrity. Such corrupt and politically minded members must always be expected to favor family or political associates, as well as the levy of regressive, inequitable, or onerous taxes on supporters of opposing political parties.

The 1962 Amendment again divided tax assessment and collection responsibilities between the Regional and the Local

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Governments. The Local Government was again restricted to income up to £300. Also in aid of development, a development contribution of 6d per pound of income was imposed, a kind of surtax on all individuals.

The 1964 Amendment transferred all functions of the Area Assessment Committee to the Regional Tax Board. The Local Authorities could act in advisory capacity to the Board, a reversal of the 1960 Amendment. But the Assessment Committee was retained and its duties were subject to review by the Tax Inspector of each tax area.

3. Northern region personal tax Law.--The personal tax law used in the Northern region regulates the unification and collection of both community tax (poll tax) and the graduated amount of tax. Like other regional income tax laws, the personal tax law of 1963 also passed through series of amendments including Amendment No. 3 of 1964. In addition, there is a considerable volume of subsidiary legislation consisting of statutory rules governing matters such as PAYE, appeals, collection and enforcement.

As a whole, the Nigerian personal income tax developed in stages at different times in each region. It also followed a series of recommendations made by various commissions, the most crucial being that recommendation of Raisman's Commission which passed on the jurisdiction for personal income
tax to the regions. The recommendation provided that the Central Government would have to legislate only to ensure that no one person in Nigeria bore more than one burden of the tax.

Thus the choice to levy and collect the tax at specified rates fell within the prerogative of the states (formerly regions). Accordingly, each state legislature made its sanctions for collection and enforcement activities.

Therefore, there are four basic tax laws used or adopted by the States. (a) The Personal Income tax (Lagos) Law, 1961, is used by the Lagos State; (b) the Income tax Law 1957 is still used by the Western and Mid-Western States; (c) The Finance Law 1962 is used by the Eastern States; and (d) The Personal Tax Law, 1963, is used by all Northern States. These laws all involve a common understanding as to what constitutes income for tax purposes and what constitutes the itemized (allowable and disallowable) deductions. The basis for such an agreement and understanding is the Income Tax Management Act, 1961. This is a Federal Law based on Section 76 (2) of the Federal Constitution. The essence of this law was to regulate the imposition of personal tax throughout the Federation so that internal double taxation of incomes by the different governments could be avoided.

The Act set up a joint Tax Board which is charged with the responsibility of determining technical and other issues which are subjects of conflicts.
The State Laws are basically similar in their procedural approaches. Significant differences are in areas relating to rates of taxes and personal deductions and exemptions. The study in chapter four and five, although concentrating on the assessment and collection procedures in the Cross River State, examines the diversities in the tax rates and itemized deductions among the States. The intention is to use one state (Cross River) tax system as a model and to use the diversities in rates and deductions as a background for examining the equity and efficiency implications of the country's personal income tax system.
CHAPTER IV

PERSONAL INCOME TAX ASSESSMENTS

Problem of Defining Income

Following economic circular flow system, the aim of all productive labor is to create income. This means that production, if quantified and expressed in money terms, results in the dollar income of persons engaged in the production. The share of one person in the production proceeds depends, among other things, on "differences in education, intelligence, skills, work habits, monopoly power, geography, family background, luck and political or social savvy."¹ These differences constitute the basis for the distribution of the "national cake."

This definition agrees partly with the views expressed by William H. Anderson. According to Anderson, "income is really the 'outcome' of all economic effort..."² Anderson choses to use the term "economic effort" instead of production, but his doing so does not change the basic concept of basing income on production.

Thus, for income to exist, there must be production. The question is, what are the variables that make up production?

Many theorists have addressed themselves to this question. These theories are discussed below.\(^3\) 

The first is Irving Fisher's consumption theory. In this theory Fisher defines income as "a flow of services through a period of time."\(^4\) In Fisher's view, income is consumption services, such as the service of a dwelling to its owner (shelter or money rentals), the services of a piano, or the services of food.

A criticism of Fisher's theory comes from Anderson who states that "the concept is contrary to the common notion of the market place which deems as income any goods, services, or money that come within the individual's power to dispose of as he sees fit."\(^5\)

The second theory is that of William W. Hewett—the flow of goods and services theory. The definition of Hewett is as follows: "Net individual income is the flow of commodities and services accruing to an individual through a period of time and available for disposition after deducting the necessary cost of acquisition."\(^6\) This concept would include, as part of income, additions to wealth from current net money income not consumed.

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\(^3\) Ibid., pp. 179-185.  
\(^6\) Ibid., pp. 180-181.
A similar approach--the accretion of economic power theory--is that of Robert M. Haig and Henry C. Simons. In this view income means the money value of the net accretion to one's economic power between two points of time. This definition does not appear to differ very much from that of Hewett. Rather Haig chooses to substitute "power" for flow of goods and services, probably because the latter term would include wealth accumulation as well as consumption services. But Fisher and Haig are far apart in their concept of income. Haig stresses income as economic 'power' (consumption services and addition to wealth) while Fisher emphasizes income--the value of services) only when consumption services are taken.

The writer agrees most with Hewett's definition of income--the value of goods and services accruing to an individual after deducting the cost of acquisition. This definition includes both earned and unearned income. Unearned income accrues to a person without sacrifice in terms of leisure. It appears to be included in Haig's definition of income, which stresses income as accruing to a person whether the income was earned or not. The major difference between Hewett's and Haig-Simons' definition is that the latter would include transfer payments (e.g., gifts, inheritances, etc.) in his definition while Hewett appears to ignore such payments.

\[7\text{Ibid., p. 181.}\]
Fisher's definition appears to emphasize income based on expenditure. He said, "Levy taxes on the proceeds of every sale and remit them on every investment. It would be difficult to avoid injustice, evasion, and fraud."\(^8\)

Unfortunately, none of the above concepts of income fits in exactly with a personal income tax law in the definition of income. Anderson hints that for "various reasons--social, political, or economic--the law expressly excludes certain types of receipts from gross income."\(^9\) Therefore, for the purpose of taxation, income is what the law of a nation states to be income. Many tax laws list what constitutes income; the legality or illegality of the source of income does not matter.

**Nigerian Income Tax Base or AGI**

The main law that defines the types of income chargeable to tax in Nigeria is the Income Tax Management Act (ITMA). This law operates throughout the Federation and its provisions are supreme to the personal income tax laws of the states.

The U. S. Version of income, referred to as Adjusted Gross Income (AGI) is the same as Total Income under the Nigerian tax laws.\(^10\) Both concepts, Adjusted Gross Income and Total Income, express the same thing, the aggregation of income from

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all sources (except one-half long term capital gain, income-in-kind on owner occupational housing, interest on state and local government bonds, etc.) before itemized deductions and exemptions are applied.

The scope of determining AGI or Total Income is outlined in the Section 4 of Income Tax Management Act. Tax is payable for each year of assessment upon all income accruing in, derived from, brought into or received in Nigeria in respect of any or all of the following:

(a) Gains or profits from trade, businesses, profession or vocation
(b) Any salary, wages, fees, allowances, or other gains or profits from an employment
(c) Rent for the use or occupation of any property
(d) Dividends, interests or discounts
(e) Any pensions or annuity
(f) Any other gains or profits that do not fall under any of the above categories.\(^{11}\)

In effect, "all income is taxable if it either arises in Nigeria or arises abroad and is remitted or brought into Nigeria."\(^{12}\)

However, the Act makes provision for the exemption of foreign income of non-residents or temporary visitors to Nigeria.

\(^{11}\)Willoughby and Harvey, op. cit., p. 6.
\(^{12}\)Ibid., p. 7.
Benefits in kind are also taxable. The Act provides that where an asset used by an employee is owned by his employer, the employer shall be deemed to incur an annual expense equal to 5 percent of the total amount expended in acquiring the property. Where the employer rents the property for use by the employee, he is deemed to incur an annual expense of such annual rent or cost of hire. Correspondingly, the employee is treated as having earned an amount (in addition to other emoluments) equal to the annual amount so deemed to have been expended by the employer to acquire the property.

Dividends, a part of the total income (AGI), also require special mention. Dividends received by stockholders in Nigeria are income and therefore taxable. However, tax is deducted at the source by the paying company. The company does not need to account to the government for the tax so deducted since it pays tax on its profits. But as far as the stockholder is concerned, he is treated as having received gross dividend without any tax deduction whatsoever. Whether or not such a taxpayer is qualified to reclaim the tax deducted at the source by the company depends on his taxable income when finally determined. A taxpayer who is liable to low rate of tax (low taxable income) is entitled to a refund.

Where a company instead of paying a dividend capitalizes its profits and issues "bonus" shares credited as fully paid
up, no liability to income tax arises. The combined income from all the sources as stated above make up the AGI or Total Income with respect to an individual.

In 1967, Nigeria introduced a capital gains tax.\textsuperscript{13} The tax is administered by the Federal Board of Inland Revenue. Capital gains are not combined with income or profit from other sources so that it is not a part of AGI as it is the case in the U.S.

The unfair and discriminatory tendency of this tax is that it is assessed and collected from all incorporated companies in the Federation but as it applies to individuals or members in a partnership, the tax is restricted to the Federal Territory of Lagos. Each State is allowed the discretion of adopting the tax. The rate of tax is 20 percent and applies specifically to: (a) "Options, debts, and incorporeal property, (b) non-Nigerian currency, and (c) self-created property."\textsuperscript{14}

These bodies and organizations are exempted: Charitable or educational institutions of a public nature, co-operative societies, trade unions, local or native authorities, statutory companies, and diplomats. Capital gains exempted include: (a) gains arising from disposal of statutory provident funds or retirement benefits schemes, (b) gains arising from the sale of government stock or other Nigerian securities

\textsuperscript{13}Ibid., p. 63.
\textsuperscript{14}Ibid., pp. 64-74.
including treasury bonds, saving certificates, and premium bonds, and (c) gains arising from the sale of business assets if the proceeds are re-invested in other assets used for the purposes of trade. The exemption is lost if such re-investment does not take place or is not unconditionally agreed within twelve months of the disposal. This exemption applies to assets in respect of (1) trade buildings and land if not owned by land developers, (2) fixed plant or machinery, (3) ships, (4) aircrafts, (5) goodwill, (6) gains relating to disposal of life assurance certificates or policies or other deferred annuity contracts, (7) gains arising from the disposal of a main private residence and land occupied and enjoyed by the owner (a provision that would be lost if it could be shown that the house, or any gain attributable to expenditure, was acquired or incurred respectively for the purpose of realizing a gain from the disposal), (8) gains arising from the disposal of tangible movable property (excluding currency) at a price in a year of assessment not exceeding $800, (9) gains arising from the disposal of motorcars unless a type not commonly used as private vehicles and unsuitable to be used as such. A simple illustration of capital gains tax would involve Mr. X acquiring land in 1967 for $500 and selling it in 1968 for $850. On both acquisition and disposal X incurred expenses of $50. The tax is computed as follows:
<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds of Sale</td>
<td>$850</td>
</tr>
<tr>
<td>Less expense of sale</td>
<td>$50</td>
</tr>
<tr>
<td><strong>Total</strong>:</td>
<td><strong>$800</strong></td>
</tr>
<tr>
<td>Deduct cost of acquisition</td>
<td>$500</td>
</tr>
<tr>
<td>Expense of acquisition</td>
<td>$50</td>
</tr>
<tr>
<td><strong>Chargeable gain</strong>:</td>
<td><strong>550</strong></td>
</tr>
<tr>
<td>Tax due (20%)</td>
<td>$50</td>
</tr>
</tbody>
</table>

**Determination of Residence**

In Nigeria the calendar year is different from the government financial year. The latter's yearly operations are carried out between April 1 and March 31 of the following year, in which case the government's new year starts on April 1.

In any year of assessment an individual bears the tax burden of the state in which he resided or was "deemed" to have resided on April 1. However, such place of residence does not include a temporary place of abode, for example, a hotel or being a guest in a state. A person whose place of residence has been determined (depending on his permanent place of residence as of April 1) will pay income tax to the state in which he had that residence for that year. Therefore, no matter which state he is found in during the year, his taxable authority is determined at April 1. Nothing therefore prevents one from taking permanent occupation in a state that has the lowest tax rates and generous allowances or reliefs.
Information for Assessment

To be able to compute a taxpayer's income, the assessment officer must be in possession of information that will give him pertinent data to base his computation of a person's taxable income. By section 18 of the Finance Law, 1962, an assessment officer is allowed to request other organizations, corporations, or agencies to provide information concerning the income status of a taxpayer. Some of the sources of information and their related income categories are scheduled below:

<table>
<thead>
<tr>
<th>Sources of Income</th>
<th>Sources of Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Income of taxpayers in schedule I being income from any source below N200 ($350) per annum</td>
<td>1. General assessment to minimum tax which at present is ₦6.4 from the nominal roll put up by the Assessment Committee of the particular area</td>
</tr>
<tr>
<td>2. Vocations including artisans, bicycle repairers, tailors, ironsmiths, craftsmen, etc.</td>
<td>2. (i) Information obtained from area Assessment Committees</td>
</tr>
<tr>
<td>3. Trade of business of contractors, shopkeepers, hotel owners, large-scale farmers</td>
<td>(ii) The Register of Business Premises kept in each divisional local government office</td>
</tr>
<tr>
<td></td>
<td>3. (i) Divisional Register of Contractors kept in each Resident's office</td>
</tr>
</tbody>
</table>
Sources of Income

4. Rent income

Sources of Information

(ii) Central Register of Contractors kept in the Ministry of Works and Transport Headquarters

(iii) Information from parastatal bodies and private companies which award contracts for goods or services

(iv) Register of Liquor Licences issued in each division, kept in the Resident's office in respect to hotel owners

(v) Register of Business Premises kept in each divisional local government office

4. (i) The register compiled by each assessment officer from reports of his Property Survey Team

(ii) The list of property kept in each urban center in the local government office for valuation of property and imposition of rates.
Source of Income

5. Commercial vehicles

6. Communal income, for example, royalties and rent on communal land

Sources of Information

(iii) Copies of certificates of occupancy issued by each Resident's office for property within his division

5. The Motor Licensing Officer of each division

6. From the payer of such royalties or land rent

Administering Agency

As earlier stated in this study, Nigeria now has twelve states. These States were created from the original Northern, Western, Midwestern and Eastern regions.

Each state has its own Internal Revenue Service. The official designation of the Chief Executives of IRS in the State varies. Some go by the name Commissioner of Internal Revenue while others go by Chairman, Board of Internal Revenue.

Both Commissioners and Chairmen perform the same function. They administer Income Tax Management Act and other tax laws in their respective states. Whether the head of the IRS answers to Commissioner or Chairman depends on the status of the IRS concerned. If the IRS is placed under the control of the

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Ministry of Finance, then it is a division of that ministry. In that case, the head or the chief executive of the IRS is the Commissioner of Internal Revenue.

In the Cross River State, in particular, the IRS was separated from the main Ministry of Finance in 1969. The provisions of the law which decreed this separation made IRS a separate board. This is a statutory body charged with the responsibilities of administering the tax laws in the state. This means that the IRS is supposed to be insulated from the usual bureaucratic norms of the main government agency.

Following the creation of the Board of Internal Revenue (BIR) the title of the Commissioner of the IRS was changed to that of Chairman, Board of Internal Revenue. His assistant (deputy chairman) is one who formerly was designated Assistant Commissioner of Internal Revenue. Six other members of the Board are drawn from government agencies and the private sector. Apart from the Chairman and his deputy, who are ex-officio members and belong to the Public Service, other members are appointed by the minister charged with the responsibility for finance.

The main functions of this board are

(a) to administer the Personal Income Tax Laws. This means that the responsibility of personal income tax

-- South Western State of Nigeria, Board of Internal Revenue Edict, No. 6 (Calabar, 1969), pp. 4-19.
assessments, collection, and enforcement belong to the board.

(b) to control and direct other state taxes or revenue. This places the board in a position to devise efficient methods of collecting other levies notwithstanding the fact that other government agencies are directly responsible for these collections.

(c) to make policies regarding ways and means of finding new sources of revenue for the State Government.

(d) to prepare yearly revenue budgets of the state government. In this case the main Ministry of Finance prepares the expenditure budget for the state while the board prepares the revenue budgets.

It should therefore be noticed that one main difference between the IRS as a division of the Ministry of Finance and the IRS as a board is that the board is ultimately responsible for all revenues accruing to the state while the other collects and accounts for only those revenue items (like personal income tax) entrusted to it by the Ministry of Finance. But when it comes to the administration of personal income tax, the duties of the Commissioner and that of the Chairman are basically the same since both use a common federal law--ITMA. Some minor differences, however, exist in the machinery of collection and enforcement because these are governed by different state tax laws.
Basis of Assessment

Normally income received other than from employment or pension is charged to tax on a preceding year basis. Thus the "profits of trades, businesses, and professions are usually computed for tax purposes from the profit as ascertained at the end of the accounting year ending in the preceding year of assessment."¹⁷

For example, if a business made up its accounts to December 31 each year, in the tax year 1964-65, it would be assessed on the profits as computed for the accounting year that ended December 31, 1963. This arrangement is not as simple practically as it appears in theory. There is some element of current year's assessment, as can be noticed in the following example:

<table>
<thead>
<tr>
<th>Year ending Nov. 30</th>
<th>Year of Assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1962 - Profit $4000</td>
<td>1962-63 (Profit of year ending Nov. 30, 1961)</td>
</tr>
<tr>
<td>1963 - Profit $10,000</td>
<td>1963-64 - $4000 assessed</td>
</tr>
<tr>
<td>1964 - $15,000</td>
<td>1964-65 - $10,000</td>
</tr>
<tr>
<td>1965 - $20,000</td>
<td>1965-66 - $15,000</td>
</tr>
<tr>
<td>1966-67 - $20,000</td>
<td></td>
</tr>
</tbody>
</table>

¹⁷Income Tax Management Act, No. 21 (Lagos, 1961), Sec. 20.
There are exceptions to the preceding year's assessment procedure. The first relates to the starting of a new business. In that case, the assessment will be in the following arrangement: (1) first year of assessment—the actual profits of that year (profits from the commencing date of business to the following March 31), (2) second year of assessment—the profits of the first twelve months from the date that business was started, (3) third year of assessment—the normal preceding year basis. Thus there is an element of double or triple taxation of the same income by this arrangement.

The second exception is that the taxpayer can exercise an option in case of a new trade, business, or profession to be assessed to tax in respect of income for those years (as opposed to being assessed on preceding year's basis). The following illustrates this point.


Example:
(a) If no option is exercised the assessment will be as follows:
First year $3000 (1/4 of $12000), tax year 1961-62
Second year $12000 (profit of 12 months), tax year 1962-63
Third year $12000 (preceding year basis) tax year 1963-64

Fourth year $6000 (preceding year basis) tax year 1964-65

(b) Where the option is exercised the assessment will be as follows:

First year $3000 tax year 1961-62

Second year (April 1, 1961 - March 31, 1962)

\[ \frac{9}{12} ($12000) = $9000 \]
\[ \frac{3}{12} ($6000) = $15000 \]

Third year (April 1, 1962 - March 31, 1963)

\[ \frac{9}{12} ($6000) - $4500 = $6,500 \text{ tax year 1963-64} \]

\[ \frac{3}{12} ($8000) = $2000 \]

Fourth year $6000 tax year 1964-65

Fifth year $8000 tax year 1965-66

It will be noticed that on these figures there is a considerable tax advantage in exercising the option for the second and third years of assessment since in (a) tax will be payable for these years on $24,000 whereas in (b) tax is payable only $1700 a saving of tax on $7000. Willoughby and Harvey conclude that "it is therefore important that a professional advisor appreciates the tax advantage to be
gained on the formation of a trading partnership or company since a well-planned program of expenditure can materially affect the tax position of the new business."\textsuperscript{18}

Assessment of Minimum Taxpayers

1. Assessments in the Cross River State.--The categories of minimum taxpayers are sometimes referred to in Nigeria as "small" taxpayers, "flat rate" taxpayers, or poll taxpayers.

In the Cross River State they are commonly known as Schedule I taxpayers, and a lump sum tax of N4 ($6.4) per head is assessed. This is a kind of a head tax. It bears no relationship to a person's income size or his/her domestic circumstances.

In the Cross River State, persons who are subject to Schedule I tax have to be above the age of 16.\textsuperscript{19} The exceptions are the women who, notwithstanding the legal age requirement, have to earn income above N200 ($320) before they are brought into the tax net. An unfair treatment of equals is built into the Finance Law, 1962, that imposes this tax. A woman who earns employment income pays the tax without reference to the amount of income earned.

The minimum tax of N4 ($6.4) is levied on persons whose total income does not exceed N200 ($320) in any year of

\textsuperscript{18}Willoughby and Harvey, \textit{op. cit.}, p. 26.

\textsuperscript{19}Eastern Nigeria, Finance Law (Enugu, 1962), Sec. 11.
assessment. Although it gives no data, the Report of the Committee on Taxation states that the people of this class form the greatest number of taxpayers. 20

There is no problem with the determination of income assessable to tax in respect of Schedule I taxpayers. However, there is a problem in determining the correct ages of the payers. Tax is payable by persons above the age of 16. Except recently, no birth records were maintained in the rural areas in Nigeria. The result is that assessors have to depend on the decision of the Assessment Committee set up in each village or community to determine the taxable capacity of all adults.

The members of an assessment committee who undertake the assessment of Schedule I taxpayers are appointed by the Tax Assessment Authority. Membership is based on knowledge of locality to be assessed. The duty of the assessment committee is to compile a nominal roll of Schedule I taxpayers. The Assessment Committee is closely assisted by each family and by the village heads. Nominal rolls of past years are also updated. If the members of the assessment committee think that a taxpayer's income has increased during the past year beyond N200 ($320), a recommendation is made to the Assessment authority that he be made to pay graduated income tax.

The assessment of Schedule I taxpayers has to be supervised carefully by the tax officials. Some members of the

assessment committee do discriminate taking advantage of the opportunity to cheat or to exact vengeance on opponents. The report of the taxation committee maintains that: "there have been cases of deliberate exclusion of taxable adults from some nominal rolls. This would arise where a family head suppressed information about some eligible persons in his family."

2. **Assessments in the Western States.**—The method of assessing "small" taxpayers in the Western States are not very different from that of the Cross River State.

In the West a rating authority appoints members of the Assessment Committee for each area or ward. Their appointments, however, are subject to approval by the Minister of Local Government.

During each assessment year, each assessment committee prepares a nominal roll of all taxable adults and assesses their income. The committee members, three to four, are paid "attendance" or "sitting" allowance. A clerk of the local council attends each meeting of the committee.

The duties of the committee are subject to ratification by a tax inspector who is a member of the Regional Tax Board. The problem with this method of assessment is discussed in detail in the section on tax avoidance and evasion. The major problem with the assessment of flat rate taxpayers lies in

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determining the correct taxpayers. Almost every person in Nigeria wants to pay the minimum tax. To identify the taxpayers means trying to identify people with minimum income of about ₦200 ($320) or below. It has not been easy to do so.

Generally, the assessments in each state follow the patterns mentioned by John F. Due:

In Western Nigeria, the local assessment committee is appointed by the Ministry of Local Government but operates autonomously; in Eastern Nigeria, the committee functions under the supervision of the Division Revenue Office. . . . In Northern Nigeria, the village headman is responsible for assessment of individuals . . . Lagos is the major exception to the committee rule (although, of course, it has no rural areas); there are no assessment committees, assessment being made by the federal income tax department, which administers the income rate in the city, as well as the income tax.22

Assessment of Graduated Tax

This method of assessment is common throughout the country except with regard to the rates of tax to be applied to net chargeable income. The procedure which ensures uniformity and avoidance of double taxation is contained in the Income Tax Management Act (ITMA). The main functions of this law have already been discussed in this study.

All persons whose income exceeds ₦200 ($320) in a year and are self-employed come under what the Cross River State Internal Revenue Board calls Schedule II taxpayers.

22 John F. Due, Taxation and Economic Development in Tropical Africa (Massachusetts, 1963), pp. 74-75.
These classes of taxpayers are allowed the option to declare their income in the year of assessment. As already noted, since the income charged to tax follows the preceding year basis, an income declared in 1975-1976 year is meant to be the actual income the taxpayer earned in 1974-1975.

The duty to declare income lies with the taxpayer. However, the Revenue Board is required by law to publish notices not later than the first of May of any year of assessment, requiring every taxable person whose total income exceeds N200 ($320) to prepare and deliver within thirty days from the date of notice, a return of his or her income. For this purpose, the Revenue Board circulates form CRR, which enables a taxpayer to declare his income from various sources as well as make claims for allowances and reliefs.

In addition, a taxpayer is required to submit copies of his financial statements or accounts for the past year along with the income declaration form. Under Section 17 of the Finance Law, 1962, a taxpayer who fails to maintain accounts of his business may be required to do so by the Internal Revenue Board.

Normally the profit as ascertained from the accounts constitutes the gross adjusted income. If exclusions are applied to the AGI or Total Income, net chargeable income is the result.

But unfortunately this position is never attained. The report of the Committee on Taxation shows why it is difficult
to assess self-employed persons based on their financial statements. For one, the number of assessments under Schedule II has been small, "... in fact not up to one percent of the total. The vast majority of assessments are made without reference to any records or accounts of the taxpayer."23 Failure of many taxpayers to maintain accounts of their businesses has resulted in what Section 19 of the Finance Law, 1962, calls "best-of-judgement" assessments. Under best-of-judgement, the assessment officer who is not satisfied with the declaration made by a taxpayer in the return form has the option to reject the declaration, and, in return, assess the taxpayer arbitrarily. This provision also applies if the taxpayer fails to make income declaration in a year of assessment.

Assessments made on best-of-judgements suffer from the following defects:

(a) It is faulty because the AGI would be more or less than the actual income earned by the taxpayer.

(b) Assessment officers have a tendency to manipulate figures to serve a selfish end.

(c) Such assessments lack consistency between years and the logic of granting allowances and reliefs is open to abuses also.

(d) The method promotes tax avoidance and evasion—with consequent loss of revenue.

23 Ubom and Others, op. cit., p. 23.
It may not be right to lay all blame on the taxpayers. The personal experience of the writer shows that many of the Schedule II taxpayers are illiterate. Since many cannot read or write, it is hardly surprising that they are often unable to record their daily transactions. Moreover, they are not properly educated to consult professional accountants to assist them.

If taxpayers wish to complain about an assessment, they must do so in writing to the Assessment Authority not later than twenty-one days after the assessment date. The assessment authority reviews the objection notice, invites the taxpayer for an interview if he considers it necessary, and reviews the assessment. He has the option to decrease, increase, or confirm the original assessment.

If the taxpayer is still not satisfied with the actions of the Assessment Authority, he may appeal to another authority called the Appeal Board. It is to be remembered that Nigeria is an underdeveloped country, and many things are yet to be developed to standard. Hence, income tax assessments often involve several problems; it is a problem to identify taxpayers; it is a problem to identify income; it is a problem to determine ability to pay when taking into account the approximately 80 percent of the labor force who are engaged in agriculture.

Exclusions from Aggregate Gross Income

1. **Deductions allowed.**—The Income Tax Management Act specifically excludes certain items from the total income (AGI).
According to Willoughby and Harvey, two tests must be satisfied before an item can be allowed as a deduction. These tests are:

(a) The payment must be an income or revenue expense and not a capital expense. The principles to be applied in ascertaining what is and what is not revenue expenditure are those of ordinary commercial accounting except that there is no allowance made for depreciation of wasting assets. Whether or not expenditure is revenue or capital can often be decided if one considers whether it relates to fixed or circulating assets. Those items that relate to circulating assets are considered revenue, and are therefore deductible.

(b) The payment must be allowed as a deduction by the Income Tax Management Act. These are simply itemized deductions or specific statutory allowable deductions. They are: (1) rent and premium, the liability for which was incurred during the accounting period, (2) any expense incurred for repair purposes and related to the income or profit, (3) contributions to pension, provident, or other retirement benefit funds or schemes, and (4) any other revenue expense legally excepted, too.

24Nigeria, Income Tax Management Act, No. 21 (Lagos, 1961), Sec. 20.
The major underlying factors or criteria for allowing any expense is that such expense must be incurred wholly, exclusively, and necessarily for the purpose of earning the particular income or profits and the expense must be related to the accounting period in which the income or profit was earned. The test as to what constitutes wholly, exclusively, necessarily incurred expense that is relevant to the accounting period has been the subject of many court cases.

In order to make sure that certain items are not excluded from AGI the ITMA specifically lists the following:

1. capital expenditure of any kind
2. items recoverable under indemnity insurance contracts
3. tax levied by foreign governments where no double taxation relief is given
4. payments in respect of unauthorized retirement benefit scheme
5. depreciation of any assets
6. allowances for bad or doubtful debts except as permitted by the Income Tax Management Act.

**Personal Exemptions and Reliefs**

1. **Personal exemptions.**—In the Cross River State, exemptions fall into two broad categories, namely:

   (a) by person and

   (b) by types of income.\(^{25}\)

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With regard to exemption by person, the State Executive Council or Parliament may exempt from taxation the following people:

(a) Winners of medals for gallantry
(b) People disabled in service of the country
(c) Non-commissioned officers who enlisted in the Nigerian Police before June, 1937
(d) Indigent persons and lepers in a leprosy settlement

The type of income exempted by the State Government includes:

(a) Any interest received by a taxpayer on a security issued or declared by any government in Nigeria to be free of income tax
(b) Any income of a "corporation sole," for example, a church or bishop
(c) The part of the income that accrues to a body of individuals, to a community, or to a family which a person receives as a member of that body, community or family. This type of income is deemed to have been taxable at source
(d) The law also states that the Executive Council (Parliament) may exempt from personal income tax any person or class of persons, any part of income of a taxpayer or any class of income.
2. **Personal reliefs.**—These vary from state to state in Nigeria. The reliefs are granted as follows:

**Federal Territory and Lagos**

- **Married Men's Allowance** $300
- **Child Allowance** (per child up to maximum of 4) $180
- **Dependent Relative Allowance** $300
- **Life Assurance Allowance**—actual expenditure or should not exceed: a) 10 percent of capital sum assured, or b) one-fifth of taxpayers total (AGI) income subject to a maximum total income of $3000

**Western and Mid-Western States**

- None for men but $300 for women
- **Married Men's Allowance** $600 a child
- **Child Allowance** $120 a year
- **Dependent Relative Allowance** $150 maximum
- **Life Assurance Allowance** Same as Lagos

**Northern States**

- **Personal Allowance** $520 (only for married men)
- **Married Men's Allowance** none
- **Child allowance**—relief can be claimed for the actual expenditure on the education of children, whatever their ages, at a University
- **Dependent Relative** none
- **Life Assurance** Same as Lagos
- **Passage Allowance** Maximum of $1800
**Tax rates:**

**Lagos and Federal Territory**

<table>
<thead>
<tr>
<th>Taxable Income</th>
<th>Rate of Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>For every $ of the first $1500</td>
<td>25c</td>
</tr>
<tr>
<td>For every $ of the next $500</td>
<td>30c</td>
</tr>
<tr>
<td>For every $ of the next $500</td>
<td>35c</td>
</tr>
<tr>
<td>For every $ of the next $1500</td>
<td>50c</td>
</tr>
<tr>
<td>For every $ of the next $7000</td>
<td>65c</td>
</tr>
<tr>
<td>For every $ exceeding $10,000</td>
<td>70c</td>
</tr>
</tbody>
</table>

**Western and Mid-Western States**

<table>
<thead>
<tr>
<th>Chargeable Income</th>
<th>Rate of Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>For every $ of first $700</td>
<td>12c</td>
</tr>
<tr>
<td>For every $ of next $200</td>
<td>16c</td>
</tr>
<tr>
<td>For every $ of next $300</td>
<td>20c</td>
</tr>
<tr>
<td>For every $ of next $300</td>
<td>25c</td>
</tr>
<tr>
<td>For every $ of next $600</td>
<td>30c</td>
</tr>
<tr>
<td>For every $ of next $600</td>
<td>40c</td>
</tr>
<tr>
<td>For every $ of next $1000</td>
<td>55c</td>
</tr>
<tr>
<td>For every $ of next $1500</td>
<td>65c</td>
</tr>
<tr>
<td>For every $ of next $3000</td>
<td>75c</td>
</tr>
<tr>
<td>For every $ of next $4500</td>
<td>80c</td>
</tr>
<tr>
<td>For every $ of next $15,000</td>
<td>85c</td>
</tr>
</tbody>
</table>
Northern States

<table>
<thead>
<tr>
<th>Chargeable Income</th>
<th>Rate of Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>For every $ of first $750</td>
<td>15c</td>
</tr>
<tr>
<td>For every $ of next $750</td>
<td>20c</td>
</tr>
<tr>
<td>For every $ of next $750</td>
<td>25c</td>
</tr>
<tr>
<td>For every $ of next $750</td>
<td>30c</td>
</tr>
<tr>
<td>For every $ of next $3000</td>
<td>35c</td>
</tr>
<tr>
<td>For every $ of next $3000</td>
<td>40c</td>
</tr>
</tbody>
</table>
| For every $ of next $7500 | 50c  

Basically there is only one allowance granted, and this is Life Insurance. This has already been discussed. Other reliefs and allowances as obtained in the Northern and Western States are not available to persons in the Cross River State. The First Schedule of the Finance Law, 1962, in which the tax rates are listed was compiled to take account of a taxpayer's domestic circumstances. For example, the schedule specifies four groups under which taxpayers can be classified. Group 1 is meant for single taxpayers and their rates of tax are very high. Group 2 is meant for married persons without any children. Group 3 relates to married persons with not more than two children. And group 4 refers to married persons with three or more children. (An abstract of the schedule appears on Table III).

As noticed in the Table the rates of tax are not stated in percentages. The tax payable according to each category of

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26Willoughby and Harvey, op. cit., p
TABLE III

RATES OF PERSONAL INCOME TAX IN CROSS RIVER STATE (in ₦)

<table>
<thead>
<tr>
<th>Income Range in ₦</th>
<th>Single Person</th>
<th>Married Person No Children</th>
<th>Married Person One or Two Children</th>
<th>Married Person Three or More Children</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-100</td>
<td>Flat rate of ₦1-7-6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>101-109</td>
<td>7.5</td>
<td>5.0</td>
<td>2.0</td>
<td>0.0</td>
</tr>
<tr>
<td>110-159</td>
<td>4.34</td>
<td>3.75</td>
<td>3.13</td>
<td>2.5</td>
</tr>
<tr>
<td>160-209</td>
<td>5.63</td>
<td>5.0</td>
<td>4.34</td>
<td>3.75</td>
</tr>
<tr>
<td>210-299</td>
<td>6.88</td>
<td>6.25</td>
<td>5.63</td>
<td>5.0</td>
</tr>
<tr>
<td>300-309</td>
<td>0.63</td>
<td>2.5</td>
<td>4.34</td>
<td>6.25</td>
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<tr>
<td>310-799</td>
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<td>6.25</td>
<td>5.63</td>
<td>5.0</td>
</tr>
<tr>
<td>800-809</td>
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<td>3.75</td>
<td>6.88</td>
<td>10.0</td>
</tr>
<tr>
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<td>11.88</td>
<td>10.63</td>
<td>9.37</td>
</tr>
<tr>
<td>1010-1109</td>
<td>15.6</td>
<td>13.13</td>
<td>11.88</td>
<td>10.63</td>
</tr>
<tr>
<td>1110-1209</td>
<td>16.88</td>
<td>14.38</td>
<td>13.13</td>
<td>11.88</td>
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<tr>
<td>1210-1309</td>
<td>18.13</td>
<td>15.6</td>
<td>14.38</td>
<td>13.13</td>
</tr>
<tr>
<td>1310-1409</td>
<td>19.38</td>
<td>16.88</td>
<td>15.6</td>
<td>14.38</td>
</tr>
<tr>
<td>1410-1509</td>
<td>20.63</td>
<td>18.13</td>
<td>16.88</td>
<td>15.6</td>
</tr>
<tr>
<td>1510-1609</td>
<td>21.88</td>
<td>19.38</td>
<td>18.13</td>
<td>16.88</td>
</tr>
<tr>
<td>1610-1709</td>
<td>23.13</td>
<td>20.63</td>
<td>19.38</td>
<td>18.13</td>
</tr>
<tr>
<td>1710-1809</td>
<td>24.38</td>
<td>21.88</td>
<td>20.63</td>
<td>19.38</td>
</tr>
<tr>
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<td>25.63</td>
<td>24.38</td>
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<tr>
<td>2210-2309</td>
<td>30.63</td>
<td>28.13</td>
<td>26.88</td>
<td>25.63</td>
</tr>
<tr>
<td>2310-2999</td>
<td>31.88</td>
<td>29.38</td>
<td>28.13</td>
<td>26.88</td>
</tr>
<tr>
<td>3000-4000</td>
<td>35.0</td>
<td>30.0</td>
<td>27.5</td>
<td>25.0</td>
</tr>
<tr>
<td>4001-5000</td>
<td>42.5</td>
<td>35.0</td>
<td>32.5</td>
<td>28.75</td>
</tr>
<tr>
<td>5001-10,000</td>
<td>45.0</td>
<td>40.0</td>
<td>35.0</td>
<td>30.0</td>
</tr>
<tr>
<td>10,000 and over</td>
<td>56.25</td>
<td>50.0</td>
<td>43.75</td>
<td>38.0</td>
</tr>
</tbody>
</table>

Source: First Schedule, Eastern Nigeria Finance Law, No. 5 of 1962
income is progressive. This method of determining total tax due makes it simple and convenient both to the taxpayers and the tax officials to determine the tax burden of a person. It also avoids the mistakes which the untrained and poorly educated tax clerks might make if they were to compute on their own the tax due in each case.

3. **Capital (depreciation) allowances.**—These allowances are in effect a form of statutory depreciation and they operate in reduction of a taxpayers assessment for the year to which they relate. This means that the allowances are provided so as to give tax relief for capital expenditure on wasting assets, one of the main objects of capital allowances being to encourage industry to develop, modernize, and re-equip.

If the assessment for the year (taxable income) is less than the amount of the allowances claimed, the balance may be carried forward indefinitely and set against the first available profit of succeeding years. They differ from expenses which are allowed in computing profits, for expenses are deducted from receipts, and if expenses exceed receipts, the difference is a loss.

Capital allowances are granted as follows: (a) **Initial Allowance**—This is a once-and-for-all allowance and it is set off against initial qualifying expenditure such as plants, mines, industrial building, plantations, and buildings other than
industrial building; (b) Annual Allowances—These are granted yearly at varying rates depending on the qualifying expenditure. Both allowances have the tendency of writing-off the full cost of the asset. The rates of these allowances are shown in Table IIIA.

**TABLE IIIA**

**RATES OF CAPITAL ALLOWANCES**

<table>
<thead>
<tr>
<th>Qualifying Expenditure</th>
<th>Initial Allowance Rate in Percent</th>
<th>Annual Allowance Rate in Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plant</td>
<td>15</td>
<td>10</td>
</tr>
<tr>
<td>Mines</td>
<td>20</td>
<td>10</td>
</tr>
<tr>
<td>Industrial Buildings</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Buildings other than Industrial</td>
<td>NIL</td>
<td>2</td>
</tr>
<tr>
<td>Plantations</td>
<td>10</td>
<td>10</td>
</tr>
</tbody>
</table>


When the expenditure is exhausted by the sale or abandonment of assets, balancing allowance or balancing charge may apply. If the written down value of the expenditure exceeds the amount (if any) realized on sale, a balancing allowance is made equal to the excess. If, on the other hand, the proceeds of the sale exceed the written down value, the excess is added
to the income by way of a balancing charge, restricted, however, to the total of the allowances made on the asset.

In effect, a trade, business, or profession is given tax allowances equal to the net cost of an asset, spread over the life of the asset. For example, machinery is purchased for a business for $1,000. Because this is for a plant, a 15 percent initial allowance will be allowed on this qualifying expenditure. Thus an initial allowance of $150 will be allowed. The annual allowances are then calculated on the balance of the qualifying expenditure at 10 percent a year. Annual allowances will then be as follows:

First year: 10 percent of $850 ($1000-$150) = $85
Second year: 10 percent of $765 ($850-$85) = $76.50
Third year: 10 percent of $688.50 ($765-$76.50) = $68.85

The allowance will be allowed each year on the reducing balance until the total cost of the asset is completely written off.

If after the end of the second year the machinery has been sold for more than $688.50, a balancing charge would be made on the difference. On the other hand, a balancing allowance would be made if the machinery had been sold for less than $688.50.

The outstanding feature of these allowances is that Lagos, the capital territory, receives differential treatment of buildings. For example, rent received by some property may be left out of the account for tax purposes. This, in effect,
allows the capital cost of construction of a dwelling house to be offset against rent received.

Under this unfair arrangement, balancing charges are only introduced to meet the case of a landlord who having taken full advantage of the capital allowances by setting off the entire rent against the cost of construction—then proceeds to sell the property. This balancing charge is based on the excess of the consideration received on the disposal of the property. For example, suppose Mr. X constructs a house for $20,000. He then rents out the house for $2500 a year. After receiving the fifth year's rent, he sells the property for $15,000. An amount of $7500 will be liable to a balancing charge as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of property</td>
<td>$20,000</td>
</tr>
<tr>
<td>Less rent ($2500 x 5)</td>
<td>12,500</td>
</tr>
<tr>
<td>Unrecovered cost after 5 years</td>
<td>7,500</td>
</tr>
<tr>
<td>Value of property after 5 years</td>
<td>15,000</td>
</tr>
<tr>
<td>Balancing charge on</td>
<td>$7,500</td>
</tr>
</tbody>
</table>

4. **Exclusion of losses.**—In ascertaining the assessable income of a taxpayer for a year of assessment, relief is given for the amount of any loss incurred by or in a trade, business profession, or vocation carried on by the taxpayer. Relief is available either (a) against any assessable income of the taxpayer for the year of assessment in which the loss was incurred, or (b) by way of carrying forward the loss and setting
it against future income from the particular trade in which
the loss was incurred.

The first form of relief must be claimed within twelve
months of the end of the year of assessment. The points to
note about this relief are that first it is given in respect
of the year of assessment in which the loss was incurred and
second that the relief is available against the total income
of the taxpayer. When this relief is sought, the whole amount
of the loss must be set off as far as is possible. Any balance
may be carried forward.

The second form of relief allows losses to be carried
forward without time limit against future income but only in-
come of the trade, business, profession, or vocation in
question. Relief must be taken against the first available
profits of the particular trade. This method of relief is
illustrated by the following example:

<table>
<thead>
<tr>
<th>Accounts to Dec. 31 each year</th>
<th>Year of Assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960 Profit $10,000</td>
<td>1961-62 $10,000</td>
</tr>
<tr>
<td>1961 Loss $6000</td>
<td>1962-63 NIL</td>
</tr>
<tr>
<td>1962 Profit $5000</td>
<td>1963-64 NIL</td>
</tr>
<tr>
<td>1963 Profit $7000</td>
<td>1964-65 $6000</td>
</tr>
<tr>
<td>1964 Profit $8000</td>
<td></td>
</tr>
</tbody>
</table>

Assessments in these cases were made on the usual pre-
ceding year basis and losses carried forward until it was
completely exhausted. Thus for the tax year 1962-63, there will be a nil assessment since no profit was made in the accounting year ending in the preceding year of assessment. For the tax year 1963-64, there would be another nil assessment since the carry forward of the loss incurred in the accounting year ending December 31, 1961, cancels out the profit that could have been assessed to tax. In the following year of assessment the outstanding proportion of the loss will be set off against the profits of the accounting year ending December 31, 1963, thus forming an assessment for that year of $6,000.

If relief were sought in the year of assessment in which the loss was incurred, the effect would be to reduce the assessment for the year 1961-62 from $10,000 to $4,000. There are, however, advantages and disadvantages inherent in the two systems: (a) It is a good avoidance of a tax burden to use the first method when relief is required immediately, where profits are falling, or when the rates of tax are likely to be reduced in the future. The taxpayer can therefore manipulate his heavy losses and obtain relief for them during such periods. (b) Tax avoiders could also use the second method if profits are increasing or if the rates of tax are likely to increase.
CHAPTER V

PERSONAL INCOME TAX COLLECTION

The discussion in this chapter centers on methods of tax collection and enforcement with emphasis in the Cross River State. However, the section dealing with tax avoidance and evasion takes a look at some of the ways people try to dodge personal income tax in the Western State of Nigeria.

Collection of Minimum Income Tax in the Cross River State

After assessments have been completed, tax collection begins. As already stated in Chapter IV, a village or family head is appointed an agent to take charge of each ward, village, or family. He collects minimum tax from members in his unit.

Each collecting agent receives notices of assessment from the Tax Office in his area. A notice takes the form of Fixed Income Tax Ticket (FITT).\(^1\) This ticket bears the name of the taxpayer, his local county area, and the minimum amount of tax. Since the tax is a per capita tax, all the notices bear the same amount of tax.

Another important feature of this ticket is that it serves as a tax receipt.\(^2\) Although the law states that these tickets

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serve as notices of assessments, in practice, they are more of receipts than notices. As a matter of fact, they have never been recognized as notices.

When the agents collect the FITTs from the Tax Office, it is deemed that all the taxpayers in the Agents units have been duly served with notices of assessment. It is therefore the duty of the Agent to announce to his members that tax tickets are ready for purchase. The price of each ticket to a taxpayer is the exact amount of tax stated on the ticket. The Agent earns a commission on every ticket he sells.

John F. Due, who made an intensive study of methods of taxation in Tropical Africa, has said:

In Eastern Nigeria, some 13,000 Collectors, working on a fee basis of 6 percent of the amount collected, are locally appointed; they also typically serve as tax agents for the local councils on a fee basis to collect the local poll tax . . . The receipts issued by the collectors, taking the form of tax tickets . . . are of key importance for enforcement. 3

These agents collect minimum tax and account for it to the tax office. There is no direct benefit received by the payer other than the piece of paper received in form of receipt.

In collecting the tax, the tax authorities bear in mind that minimum taxpayers have a convenient time to make payments. The time is the harvest season (between September and November each year). It is at such periods that the Tax Authorities

3 John F. Due, Taxation and Economic Development in Tropical Africa (Massachusetts, 1963), pp. 74-75.
bring pressure to bear on the agents to make collections. If a good bulk of the tax assessed is not collected at this period, it will be difficult to collect at any other time during the year. December is Christmas season and immediately following is the planting season. When the planting season ends about mid-April, the rainy season starts. The people (80 percent of whom are farmers) lack the ability to pay during Christmas, planting, and rainy seasons.

Collection of Graduated Income Tax

The collection of graduated income tax is the direct responsibility of the Tax Office. Each taxpayer in this class has a personal file in the tax office. Every assessment, collection, enforcement, complaint, or appeal made by a particular taxpayer is enclosed in his or her personal file.

A notice of assessment is sent to each taxpayer based on his personal record. This has to be done because it is the provision of the law that

An Assessment Authority shall serve upon every taxpayer a notice in writing specifying the amount of assessed income, the amount of tax payable by him, and the time within which payments should be made. . .

There is also a provision in the law that any taxpayer who fails to receive a notice of assessment should ascertain from the tax office the tax payable by him for that year.

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5 Ibid.
A taxpayer who has been notified as above or takes steps to ascertain the tax due from him is required to pay his tax to the tax office by a specified date.

The assessments and collection of such graduated income tax is mainly carried out in urban areas. Unlike "rural" tax collection (collections of minimum tax), collection of graduated income tax is normally separated from assessments. Payments are typically made by taxpayers by check. About the method of accounting for the tax collected, Due said:

The payment is recorded in the ledger or on the ledger card. After a certain period, visual check is made of the ledger or ledger card, delinquents are ascertained, and notices sent out. Ultimately legal action to compel payment is made if voluntary payment is not forthcoming.

It is to be emphasized that the discussion so far on assessments or collection relate to procedures affecting self-employed persons in both the rural and urban areas. No mention has been made so far about employed persons (persons who earn wages or salaries, weekly or monthly). The taxation of persons in this class is discussed in a separate section under "Pay-As-You-Earn."

**Enforcement Actions**

A tax that remains unpaid after a certain period (generally it is after the year in which the tax was assessed) falls in arrears and the taxpayers concerned become tax defaulters. This

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6 Due, op. cit., p. 55.
section deals with the methods of enforcing the tax on the taxpayers either before or after the tax is in arrears.

1. **Tax drive.**—This is otherwise called "recovery by method of personal demand." The procedure is mainly applicable to minimum or poll tax.

Tax Collecting Agents appear to be given responsibility without authority. They are legally appointed agents to collect the tax, but they have no way to enforce payment. The Tax Assessment Authorities who are legally responsible for all assessments in their respective areas cannot also enforce payment of the tax.

The person who has the ultimate power under "recovery by personal demand" is the Resident of a political division. Under Section 34 of the Finance Law, 1962, the Resident is the Tax Collector and every tax drive operation has to be authorized by him.

At certain periods in the year, especially towards the end of the harvest season, the Tax Collector authorizes, in writing, the staff of the tax office in his division to carry out tax drives. The authorization is preceded by a notice published by the Tax Collector that a tax drive shall be conducted on a specified date, time, and place. Such a notice warns the public to carry with them tax receipts as evidence of payments. People who come under graduated tax (usually

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7*Eastern Nigeria, Finance Law, 1962 (Enugu, 1962), Sec. 34.*
called Schedule II tax) are not bothered during the tax drive, but they are expected to be in possession of notices of assessments or tax receipts to enable them to avoid embarrassments in case they are confronted by the tax drive team.

Members of the tax drive team go out in public places and in highways to stop every person and demand evidence of payment of their taxes. A person without a convincing evidence or proof of exemption, who cannot pay the tax on the spot, is dragged to court. It should be noted that young energetic men make up the drive team.

The trial of tax defaulters brought to court by the tax drive team receives immediate attention. The courts that handle such cases are the Customary Courts and one is summarily condemned without adequate investigations (based on written law).

Customary Courts deal with disputes that require settlement based on knowledge of the custom of the people. They do not handle cases that rest on written (statutory) law. It is not uncommon to appoint an illiterate individual a Customary Court member (a judge). Even a qualified attorney fears being prosecuted in the Customary Court because of the way the proceedings are conducted. Tax Officers like to take tax defaulters to the Customary Courts because in these courts no one is required to prove that the assessments were properly computed or justified or that notices were not served properly. In other words, the legality of the imposition is not investigated by
the Customary Court. Such inquiries are made in the Magistrate Court before the tax defaulter is proved guilty.

Enforcement by method of tax drive is a two-edged sword; it can cut either against the defaulters or against the members of the drive team (who are all tax office staff). In one occasion the writer witnessed an incident in which a tax defaulter was caught and subsequently thrown into a truck to be taken to Customary Court for trial. On the way the defaulter jumped out from the moving vehicle and dropped dead. On the other hand, the writer also witnessed another incident in which the tax drive team in Calabar Riverine area "clashed" with fishermen and timber sawers. One member of the drive team lost his life, while many others were wounded. More serious cases than the examples given above usually occur during tax drive operations. Thus, it is sufficient to say that tax drive is a risky method of enforcing payment of personal income tax.

2. **Persuasive actions.**--Persuasive actions take the form of a tax official or tax agent going from one house to another to counsel, negotiate with, convince, or induce the taxpayer to comply. Frequently this action is preceded by numerous demand notices or letters of reminder. The usual response of the taxpayer is to fail to admit tax officials into their homes. Letters of reminders sent through the mail, are sometimes returned as undelivered. The writer has witnessed on many occasions such
letters being sent by registered mail. The intention is to make sure that the taxpayer receives the notice by acknowledging receipt to the postoffice.

3. Court prosecution.--Failure to comply voluntarily by the taxpayer to discharge his tax liability eventually results in court prosecution. The provisions of the law states,

"... a taxpayer, who without sufficient cause, fails to pay any tax payable by him within the time specified or extended or reduced by the tax assessment authority in any notice served or published ... is guilty of an offense and ... is liable to a penalty of imprisonment for two years and a fine of two hundred pounds ..."\(^8\)

The law also provides that, irrespective of the court prosecutions, the Assessment Authority can add to the tax one-fifth of the tax in default.

A remarkable feature of the law governing failure to pay tax gives the court an authority to "make an order for the payment of the tax in respect of which proceedings were taken."\(^9\) The use of that court order is the topic of the next discussion.

4. Attachment of property.--This drastic enforcement action consists of impounding and selling, with or without court action, the properties of the defaulting taxpayer.\(^10\) If the taxpayer has been convicted for failing to pay tax, the court, can make an order for "attaching" or impounding the

\(^8\)Ibid., Sec. 37.  \(^9\)Ibid.  \(^10\)Due, op. cit., p. 78.
convicted person's properties. The tax officials can also impound the properties of a tax defaulter if they have been duly authorized by the court even if the offender has never been prosecuted.

The properties impounded are sold if the taxpayer or his representative does not "redeem" them within a specified time. The properties are usually sold by an auctioneer or by a bailiff of the tax office. If the proceeds realized exceeds the amount of tax unpaid the difference is refunded to the taxpayer. Personal effects of the tax defaulters are exempted from the 'attachment' and sale. For example, the clothing of the taxpayer cannot be sold.

One problem with this method is that it is rather too harsh since the reason for the taxpayer failing to pay the tax is not considered. Thus, like the tax drive, attachment and sale of properties make no provision for a taxpayer to be heard when he is not satisfied with an assessment.

**PAYE Assessment and Collection**

Pay-As-You-Earn method of personal income tax assessments and collection is the procedure by which certain amounts are retained as tax from the earnings of persons in employments. "Employments" here refers to those occupations wherein the persons so engaged earn wages and salaries weekly or monthly.

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Persons whose income is derived from sources other than employment are said to be privately employed and their assessment and collection procedures have already been discussed under Schedule I or Schedule II tax.

Another name for PAYE is Deduction at Source or "withholding" tax. The Tax Office requires employers to deduct an appropriate amount from each weekly or monthly wage and salary paid to employees in anticipation of employees' tax liabilities for the year. These weekly or monthly tax liabilities are ascertained from the tax tables supplied by the Tax Office. The tables are complete and take into account such complications as domestic circumstances or employees who have not worked for a year.

Employers are expected to pay their collections to the Tax Office or to the nearest government treasury. They are also required to send returns regularly to the Tax Office. These returns show the number of employees for the period, their earnings, tax withheld, and records of payments for the deductions.

The main advantage of PAYE is that it reduces tax evasion although, as shall be noted later, employees also learn how to avoid the tax. The system also enables part of the administrative work and expense in tax collection to be shifted to the employers who are required to act as another class of tax collecting agents. All the States in Nigeria administer PAYE.
Due studied in detail the ways states assess and collect PAYE. His observation is that

... employers must withhold both the income tax and the income rate. But because of allowances, in order to obtain correct withholding, a coding system is established to inform the employer of the amount to be deducted. The code number for each taxpayer being determined by the number of dependents and other allowances. 12

PAYE takes account of the fact that so long as the taxpayer has no source of income except employment, no other direct assessment is necessary. When a taxpayer earns income from a source other than employment, his case is considered an exception from the rule. In this case, assessment is based both on preceding and current year basis. For example, if a person earns a rental income of $10,000 in 1973-74 an employment income of $8,000 in 1974-75, the assessment should relate to 1974-75 on AGI or Total Income of $18,000.

In Western Nigeria, withholding was introduced in 1961. According to Due, "Two sets of tax tables were established for incomes up to £300." 13 No allowances were provided and the employee concerned paid a minimum or poll tax. On those above £300, taxpayers were coded on the basis of allowances.

Northern Nigeria introduced PAYE in 1962. Like in the West, there were two tax schedules. A minimum tax applied to

12 Due, op. cit., p. 45.
13 Ibid.
persons with incomes under £400. Those with incomes above £400 were subjected to PAYE on a graduated basis.

Eastern Nigeria was the first region in Africa to introduce PAYE. The practice in the Eastern States is to apply the PAYE system to those employers who consider that the system is practicable in their organizations. Employers in this state who feel that they can operate the system make applications in writing to the Chairman, Board of Internal Revenue. When the application is approved, necessary documents and forms are sent to the employer to start operating the system. Deductions are made according to the codings on the table included in the form.

Effectiveness of Collection Procedures

One way of testing the effectiveness of the above tax collection procedures is to examine the amount of revenue yield, amount outstanding at the end of each assessment year, and the degree to which people are willing to comply. This section therefore examines the figures of assessments and collections in the Cross River State.

Table IV shows figures of tax assessments and collections for three years, 1973-74 through 1975-76. The figures of assessments are made up of minimum and graduated taxes (Schedule I and II). Figures in respect to PAYE were excluded so that

14Ibid.
the effectiveness of collection of directly assessed tax (Schedule I and II) could be determined. PAYE is collected with minimum cost and the degree of evasion is therefore, minimal.

Analysis of the figures shows that in the 1973-74 assessment year, N2,040,743 was assessed and N930,110 was collected. A total of N1,110,363 was not collected as at the end of that year. The proportion of unpaid tax to assessment is 54 percent. Similarly, the proportion of unpaid tax at the end of the years 1974-75 and 1975-76 are 50 and 59 percent respectively. This position shows that, on the average, about 54 percent of the tax directly assessed for the three years taken together was not paid.

The bulk of the revenue from personal income tax is realized from PAYE. Figures in Table V confirm this position. In 1973-74, out of a total collection of N3,018,323, a total of 70 percent was realized from PAYE. In 1974-75 it was 76 percent.

The importance of PAYE as the only dependable source of revenue from personal income tax can also be noticed from the data of the revenue budget of the Cross River State in 1977-78. In this year the government budget for PAYE was N3,500,000. The budget for direct assessments (Schedule II only) was
### TABLE IV

**TAX ASSESSMENTS AND COLLECTIONS**

(DIRECT ASSESSMENTS)

<table>
<thead>
<tr>
<th>Year</th>
<th>Assessment</th>
<th>Collection</th>
<th>Arrears</th>
<th>Arrears as % of Assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973-74</td>
<td>₦2,040,473</td>
<td>₦930,110</td>
<td>₦1,110,363</td>
<td>54%</td>
</tr>
<tr>
<td>1974-75</td>
<td>1,878,797</td>
<td>930,107</td>
<td>948,690</td>
<td>50%</td>
</tr>
<tr>
<td>1975-76</td>
<td>1,754,915</td>
<td>712,888</td>
<td>1,042,027</td>
<td>59%</td>
</tr>
<tr>
<td>TOTAL</td>
<td>5,674,185</td>
<td>2,573,108</td>
<td>2,059,053</td>
<td>54%</td>
</tr>
</tbody>
</table>

Source: Report of the Committee on Tax Assessment and Collection in the Cross River State

### TABLE V

**ACTUAL COLLECTION OF PERSONAL INCOME**

TAX 1973-74-1975-76

<table>
<thead>
<tr>
<th>Year</th>
<th>Direct Assessment</th>
<th>Percentage of Total</th>
<th>P.A.Y.E.</th>
<th>Percentage of Total</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973-74</td>
<td>₦930,110</td>
<td>30</td>
<td>₦2,088,213</td>
<td>70</td>
<td>₦3,018,323</td>
</tr>
<tr>
<td>1974-75</td>
<td>₦930,107</td>
<td>24</td>
<td>₦2,940,134</td>
<td>76</td>
<td>₦3,870,241</td>
</tr>
<tr>
<td>1975-76</td>
<td>₦712,888</td>
<td>30</td>
<td>₦1,609,333</td>
<td>70</td>
<td>₦2,322,221</td>
</tr>
</tbody>
</table>

Source: Report of the Committee on Tax Assessment and Collection in the Cross River State
One astonishing feature of the budget is the amount of unpaid tax (arrears) estimated to be collected in that year. The figure for the arrears was ₦10,470,000, but there were no arrears shown with regard to PAYE. So the total arrears of ₦10,470,000 were accumulated from assessments made on Schedules I and II (directly assessed taxes).

At the end of 1976, there were 1,169,090 taxpayers in the Cross River State.

Total number of poll taxpayers (Schedule I) 691,948
Total number of graduated income taxpayers (Schedule II) 266,606
Total number of PAYE taxpayers (employees) 210,536

TOTAL 1,169,090

These figures show that there were fewer employees of the state than persons employed in the private sector. Yet the government had made a budget of ₦3,500,000 to be realized from PAYE and only ₦100,000 from direct assessments (Schedules I and II) in 1977-78. This amounts to a total current budget of ₦3,600,000 for that year. Out of this amount employees alone had to pay about 98 percent of the tax. But employees were only 18 percent of the taxable population.

Income distribution is skewed towards the private sector, also. For example, in the Third National Development Plan the

---

Government is to spend a total of ₦5,361,514 between 1975 and 1980. The amount of this heavy expenditure makes its way into private hands as income.

Thus, there is serious tax avoidance and evasion by private persons. The government of the Cross River has realized this problem and has begun to check it. The Committee on Tax Assessment and Collection noted in its report:

It was in recognition of this wide disparity between tax collected from direct assessment in the private sector and the tax collected under PAYE that the Cross River State Government in 1973, instituted deduction of tax at the rate of 2 percent from contracts awarded both directly by it and by its agencies for amounts of ₦700 and above.\(^{16}\)

But this method of deduction at source is limited to government agencies; it has not been extended to cover contracts awarded by the private sector. About the collection of PAYE, the committee also stated:

PAYE has consistently yielded over 70 percent of total personal income tax collected in the State (Cross River State) and since 1970-71, PAYE collection has always exceeded estimates in each year. This is in spite of the fact that PAYE taxpayers are about 18 percent of total assessed population.\(^{17}\)

Unfortunately, the employed persons bear the heaviest burden of personal income tax not only in the Cross River State, but in Nigeria as a whole. The main reason is that

\(^{16}\) Aniema Ubom and Others, "Report of the Study Committee on Tax Assessment and Collection in the Cross River State" (Calabar, 1976), p.

\(^{17}\) Ibid., p. 37.
the income of this class of taxpayers is easily ascertained, and collection is simple through a method of deductions at source. On the other hand, there is no precise way to ascertain accurately the income of self-employed persons in Nigeria. The result is that this class of taxpayers constitutes the majority of tax "dodgers."

A tax unpaid by one person is payable by another either directly or indirectly. John Stuart Mill believed, for he stated, "If anyone bears less than his fair share of the burden . . . some other person must suffer more than his share, and the alleviation to the one is not, on the average, so great a good to him as the increased pressure upon the other is an evil."\(^\text{18}\) Thus, the private sector shifts most of the tax burden to employees who have no way of evading the tax.

Problems of Tax Collection

The problems to be discussed here are classified broadly in two divisions-- (1) administrative problems and (2) assessments and collection problems. Two States in Nigeria are selected for this investigation, the Cross River State and the Western State. The administrative problems are discussed with particular reference to the Cross River State.

1. Administrative problems.--As already stated, the Board of Internal Revenue administers personal income tax in the Cross

River State. According to the report of the Committee on Tax Assessment and Collection "the Board itself lacks a sense of direction and could not implement most of the provisions of the Finance Law of 1962." Moreover, the Board failed to assess about 70 percent of the taxable population in 1973-74 and 1975-76. The few direct assessments that were made were grossly inefficient. Some of the information received about taxpayers was not used in determining their taxable income.

Most of the assessments are based on best-of-judgment (BOJ) and no adequate attempt is made to ascertain the income of Schedule II taxpayers correctly.

Moreover, the Cross River State is surrounded mostly by rivers, and a good number of the taxpayers reside along creeks. Unfortunately, the Board of Internal Revenue fails to provide adequate water crafts for use by its staff. In Andoui District of Opobo Division, for example, tax assessments and collection have been suspended in 1976 due to lack of water transportation. Since a place like Akamkpa has no usable land road, the creeks cannot be penetrated by the tax staff.

The Board of Internal Revenue also provides poor and insufficient accommodation for the tax offices. No accommodation is provided to the staff even along the river creeks.

19 Ubom and Others, op. cit., p. 5.
20 Ibid., p. 34.
Sometimes a small congested room serves a tax clerk as both living quarters and tax office. As a result, many of these offices fail to provide security for the funds collected.

Some of the tax offices are administered by an inadequately schooled staff. It is not uncommon to allow a person who has only completed elementary school to take charge of a tax office. Apart from poor education, such staff are seldom trained for their job. Needless to say, such a staff is often unable to interpret accounts submitted by a taxpayer.

Certainly personal income tax administration in the Cross River State has more problems than those stated above, but most of these problems relate to assessments made on private persons who make up the bulk of tax avoiders or evaders.

2. Problems of tax avoidance and evasion.—The difference between tax evasion and avoidance is that in the case of avoidance, the business has been so arranged as to deceive the Tax Authority into under-assessing, or exempting the owner from taxation on income. In other words, the taxpayer takes advantage of the loopholes in the law. Thus, tax avoidance is legal as the following judgment delivered in Britain by Lord Tomlin in 1936 shows:
Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to an increased tax.  

In the case of evasion, because the business is not organized so as to attract less or no tax, the taxpayer accepts liability under the existing tax structure. He underdeclares his income, or even after being properly assessed, he avoids the payment of the tax due from him. Therefore, tax evasion is illegal. Both problems are as old as income taxation itself.

One way to avoid payment of income tax in the Western State is to convert a one-man business into a partnership whereby one's children, who are minors (and therefore not taxable), are made partners. Another form of avoidance used to occur because between 1960 and 1968, self-employed women were not subject to income tax on income below £300. As a result, big businessmen could register their private enterprises in their wives' names. This practice was most common among monogamists who lived in big cities like Ibadan where there was more co-operation between husband and wife than there would have been in the case of polygamists. This cooperation made it difficult for the tax staff to get at these tax avoiders.

21Willoughby and Harvey, op. cit., p. 4.
Some employees take insurance policies out on their lives and on those of their wives with the ultimate intention of having reliefs from tax. Some make false declarations to enable them to qualify for reliefs. Table VI shows hypothetical tax assessments in which generous reliefs alter taxable income arbitrarily. Taxpayer number six had the following reliefs: wife £200, children £231, life insurance (self) £58 and dependent relatives £50. This reduced his chargeable income to £600. In the same way, total reliefs given to taxpayers number seven and nine were £430 and £550 respectively. These taxpayers, taking advantage of the law, must have manipulated their incomes to attract less tax. It is not unlikely that taxpayers number five and eight will discover the same "way out" to avoid taxation in some parts of their incomes.

Some of the "tax planners" in their attempt to hide the size and identity of their business, take to enterprises which need no permanent premises, such as the running of commercial vehicles. These vehicles are seldom found in the owners' premises because the drivers may be plying them sometimes throughout the day and most of the night time. Tax authorities seldom get at incomes realized from this type of business.

Tax evasion can be viewed in two ways--complete evasion or partial evasion. Evasion is said to be complete when a person has deliberately escaped from the payment of tax due
TABLE VI

EFFECT OF RELIEFS ON CHARGEABLE INCOME (COMPUTED)

<table>
<thead>
<tr>
<th>Numbers</th>
<th>Assessable Income</th>
<th>Reliefs</th>
<th>Chargeable Income</th>
<th>Tax Assessed</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£</td>
<td>£</td>
<td>£</td>
<td>s d</td>
</tr>
<tr>
<td>1</td>
<td>600</td>
<td>-</td>
<td>600</td>
<td>38 15 =</td>
</tr>
<tr>
<td>2</td>
<td>400</td>
<td>-</td>
<td>400</td>
<td>25 = =</td>
</tr>
<tr>
<td>3</td>
<td>1202</td>
<td>576</td>
<td>626</td>
<td>40 14 =</td>
</tr>
<tr>
<td>4</td>
<td>900</td>
<td>-</td>
<td>900</td>
<td>66 5 =</td>
</tr>
<tr>
<td>5</td>
<td>2000</td>
<td>-</td>
<td>2000</td>
<td>278 15 =</td>
</tr>
<tr>
<td>6</td>
<td>1139</td>
<td>539</td>
<td>600</td>
<td>38 15 =</td>
</tr>
<tr>
<td>7</td>
<td>950</td>
<td>430</td>
<td>520</td>
<td>32 15 =</td>
</tr>
<tr>
<td>8</td>
<td>950</td>
<td>-</td>
<td>950</td>
<td>72 10 =</td>
</tr>
<tr>
<td>9</td>
<td>1500</td>
<td>550</td>
<td>950</td>
<td>72 10 =</td>
</tr>
</tbody>
</table>
from him in any year. Partial evasion occurs either due to underdeclaration of income or underassessment by assessing authorities.

One form of tax evasion is mobility of taxpayers between towns and between houses. Table VII shows an increase of taxpayers in the provinces set out for the year 1966-67 as compared with 1965-66. The net percentage increases in Ibadan, Ondo, and Ijebu-Ode are alarming.

<table>
<thead>
<tr>
<th>TABLE VII</th>
</tr>
</thead>
<tbody>
<tr>
<td>TAXPAYERS MOBILITY</td>
</tr>
<tr>
<td>Provinces</td>
</tr>
<tr>
<td>——</td>
</tr>
<tr>
<td>Abeokuta</td>
</tr>
<tr>
<td>Ibadan</td>
</tr>
<tr>
<td>Ijebu-Ode</td>
</tr>
<tr>
<td>Ondo</td>
</tr>
<tr>
<td>Oyo</td>
</tr>
</tbody>
</table>


The mobility may even occur between different local council areas. In the urban centers tenants often move from one house to another in order to take advantage of lower rents or for social reasons. Once a tenant leaves a house in one area for another, if he has not paid his tax in his first
residence, he may escape the payment of tax completely, unless his old landlord discloses his new address to the tax staff. Those who move from one council area to another or between towns do so before they have been duly assessed to tax or after they have been duly assessed but before payment can be collected.

Another form of complete tax evasion is false declaration of age and death. In certain cases, landlords, in an attempt to assist their tenants to evade income tax, usually declare the death of such tenants. Also, some taxpayers may under-declare their ages thereby claiming to be minors below the age of 16 years while others overdeclare their ages to deceive tax authorities to grant them exemption on grounds of old age.

In order to appraise this official estimate of evaders, the position in the state as a whole has been examined with reference to 1966-67 actual number of taxpayers. To determine the number of potential taxpayers in the labor force, the 1963 Census of Population is adjusted up to 1966-67 on the basis of a cumulative population increase of 2 percent per annum. The net figures are those in column three of Table VIII and they represent the potential taxpayers in the provinces listed. Column four represents the actual number of taxpayers (PAYE and others); and the difference between both columns as shown in column five is the estimated number of evaders (those who escape assessment). According to column six, as many as, an estimated 73 percent of the potential taxpayers in the State
escaped taxation. The highest figures are in Ibadan and Ondo Provinces.

TABLE VIII
NUMBER OF TAX EVADERS

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Abeokuta</td>
<td>448,689</td>
<td>366,129</td>
<td>7,104</td>
<td>120,434</td>
<td>238,591</td>
<td>65</td>
<td></td>
</tr>
<tr>
<td>Ibadan</td>
<td>1,688,170</td>
<td>1,377,546</td>
<td>82,422</td>
<td>208,388</td>
<td>1,086,736</td>
<td>79</td>
<td></td>
</tr>
<tr>
<td>Ijebu</td>
<td>297,650</td>
<td>242,882</td>
<td>7,152</td>
<td>69,688</td>
<td>166,042</td>
<td>68</td>
<td></td>
</tr>
<tr>
<td>Ondo</td>
<td>1,115,447</td>
<td>910,204</td>
<td>15,478</td>
<td>173,998</td>
<td>720,728</td>
<td>79</td>
<td></td>
</tr>
<tr>
<td>Oyo</td>
<td>937,741</td>
<td>765,195</td>
<td>11,928</td>
<td>177,242</td>
<td>567,025</td>
<td>75</td>
<td></td>
</tr>
</tbody>
</table>

Source: Western State Statistical Bulletin 1966-77

Since it has not been possible to determine precisely the professional distribution of the total evaders for that year in the state and since the problem of evasion is more serious in the urban centers (and this is not surprising since tradesmen, professionals, and those engaged in industrial and commercial undertakings are associated with urbanization), Table IX is used to show the estimated number of self-employed persons and extent to which they evade income tax. Column four shows actual number of taxpayers in the occupations listed. The differences in both columns three and four--shown in column
five--were the number of tax evaders. Column six shows net percentage of evaders, highest number of whom are the craftsmen.

**TABLE IX**

**TAX EVASION BY OCCUPATION**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Professionals</td>
<td>124,950</td>
<td>101,958</td>
<td>16,859</td>
<td>85,099</td>
<td>83</td>
</tr>
<tr>
<td>Traders</td>
<td>1,291,357</td>
<td>1,053,666</td>
<td>59,910</td>
<td>993,756</td>
<td>84</td>
</tr>
<tr>
<td>Craftsmen</td>
<td>683,259</td>
<td>567,739</td>
<td>26,496</td>
<td>541,243</td>
<td>95</td>
</tr>
<tr>
<td>Farmers</td>
<td>1,529,232</td>
<td>1,247,927</td>
<td>636,799</td>
<td>611,128</td>
<td>48</td>
</tr>
</tbody>
</table>


One form of partial evasion widely practiced in the state occurs when big businessmen declare themselves as foodcrop farmers so that they can be under-assessed. In support of this, they usually underdeclare their incomes. This is done because foodcrop farmers are generally believed to be the poorest taxpayers. Cocoa farmers are no exception to these practices. In general, farmers would seldom agree that they earn income at all, and if given the opportunity, may not declare an income up to $50. In an area like Ogbomosho, where before World War II, when transport facilities for the movement of farm produce between the farming and the urban districts
were inadequate and expensive, the returns from foodcrop farming were poor in relation to those from other occupations. But this is no longer the case, as transport facilities between Ogbomosho and Ibadan and other urban centers are adequate and prices of foodstuffs are reasonable. On the average, taxpayers, whether rich or poor, would like to be assessed on or below minimum income.

In such commercial centers like Ijebu-Ode, traders under-declare their incomes for assessment purposes and generally escape paying taxes on even the minimum income of £50 per annum. Orewa states that in 1957-58, of the 1,936 traders only 201 of them (about 10 percent) paid taxes on incomes above £50.22

The wide use of assessing the income of taxpayers on the basis of best-of-judgment is based on a clear understanding that tax assessors do not rely on the declarations made by taxpayers. It then means that, on the average, every taxpayer's attitude towards income tax is to devise ways and means to avoid or to evade it. But the extent to which a taxpayer succeeds in this course depends on whether his or her income is taxed and collected at source.

3. Reasons for tax avoidance and evasion in the Western State.--One of the major reasons of tax avoidance or evasion

22Orewa, op. cit., p. 27.
is dishonesty on the part of some taxpayers and assessors. Others may be a lack of sense of civic responsibility or the genuine inability to pay tax owing to unemployment or ill health.

Certainly the assessors have a share of the blame for partial evasion by some taxpayers because they sometimes underassess them either due to ignorance or confusion. A number of the illiterate assessors may not know what constitutes taxable income of various classes of self-employed people and in order to be on the safe side they resort to underassessment. Now, for instance, can an illiterate assessor read and understand the complicated accounting records of a lawyer and use them for assessment purposes if that a lawyer declares an income of £2000 to an Assessment Committee? A clerk of the Council that usually sits with the Committee is equally uneducated and untrained in income tax assessments and so cannot assume to give guidance and direction in a field in which he is an amateur. Since the members of the Committee are drawn from various political parties, their activities during assessment tend to pursue selfish ends rather than fulfilling the overall objectives of assessment for the interest of the individuals and the state as a whole. On frequent occasions many of them neither assess themselves, nor assess correctly their brothers, political supporters, and opponents.

Another reason is that few self-employed persons keep accounts. This means that Section 40 of the Income Tax Law
of 1957, requiring taxpayers to keep accounts, has been applied loosely. One reason is that in a city like Ibadan it is sometimes difficult for tax staff to maintain frequent contacts with taxpayers since the town is so badly planned that houses are not easy to locate. In Council areas it is equally difficult to maintain regular contacts with taxpayers because of inadequate staff in the Councils.

Another cause that has facilitated tax evasion is growing urbanization. There is already a tendency for young men to drift from the "land" to the cities and towns due, partly, to a wrong attitude towards farming as a profession, and, to a less extent, to a scarcity of fertile farmland in some areas. In the absence of many large-scale industries in the state to absorb most of these young men, they often rely on relatives for support and thus remain in the towns for a long time without employment rather than returning to their home districts. As a result, these persons have no money with which to pay their own tax, and their benevolent relatives may not pay it for them.

4. **Extent and effect of tax evasion in the Cross River State.**--Table X shows the amount of revenue lost through tax evasion in the State. For the three years, 1973-75, a total amount of ₦10,372,092 was lost because among a potential taxable population of 358,000,000, only 986,977 persons were assessed. This shows that a total of 2,593,092 (about
73 percent) persons escaped taxation. If these persons had paid at least a minimum tax of ₦4 each (₦4 being the current minimum tax), ₦10,372,092 (equivalent of U.S. $16,595,347) would not have been lost.

**TABLE X**

**EXTENT OF TAX EVASION IN CROSS RIVER STATE**

YEARS: 1973-74, 1974-75 and 1975-76

<table>
<thead>
<tr>
<th>Year</th>
<th>Taxable Population</th>
<th>Assessed Population (including PAYE)</th>
<th>Number of Evaders</th>
<th>% of Evaders to total Population</th>
<th>Tax lost</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973-74</td>
<td>1,170,000</td>
<td>325,558</td>
<td>844,442</td>
<td>72</td>
<td>₦3,377,768</td>
</tr>
<tr>
<td>1974-75</td>
<td>1,190,000</td>
<td>335,362</td>
<td>854,638</td>
<td>72</td>
<td>3,418,552</td>
</tr>
<tr>
<td>1975-76</td>
<td>1,220,000</td>
<td>326,057</td>
<td>893,057</td>
<td>73</td>
<td>3,575,772</td>
</tr>
<tr>
<td>TOTAL</td>
<td>3,580,000</td>
<td>986,977</td>
<td>2,593,092</td>
<td></td>
<td>₦10,372,092</td>
</tr>
</tbody>
</table>

Source: Report of the Committee on Tax Assessment in Collection

Moreover, Table IV shows that a total direct assessment of ₦5,674,185 (assessments other than PAYE) was made for the same period (1973-1975). Out of this amount, ₦2,573,105 was collected leaving arrears (uncollected tax) of ₦2,059,053 (about 54 percent of the assessment). Therefore, a total revenue of ₦12,431,145 was not realized.
Because personal income tax does not yield enough revenue, the state depends heavily on the Federal Government for financial support. Table XI shows aggregate of revenue budgets and actual yields in the State from 1970-71 to 1974-75. Internal sources consist of personal income tax, fines, and fees. The figures in the table show that in 1973-74 and 1974-75 about 26 and 11 percent respectively of total revenue from internal sources was realized. The outstanding feature of the data is that the Federal Government has been responsible for financing about 89 percent of the state recurrent budget in 1974-75 and 74 percent in 1973-74. Thus, the personal income taxation serves no function as an important revenue source to the state.
TABLE XI

RATIOS OF REVENUE FROM INTERNAL SOURCES AND FEDERAL GOVERNMENT CONTRIBUTIONS TO TOTAL STATE REVENUE

1970-71-1974-75

<table>
<thead>
<tr>
<th>Year</th>
<th>Source</th>
<th>Approved Budget</th>
<th>Actual Collection</th>
<th>% Actual Revenue Collected</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970-71</td>
<td>Internal</td>
<td>₦5,217,960</td>
<td>₦3,880,192</td>
<td>15</td>
</tr>
<tr>
<td></td>
<td>Federal</td>
<td>14,156,580</td>
<td>21,651,888</td>
<td>85</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>19,374,540</td>
<td>25,532,080</td>
<td>100</td>
</tr>
<tr>
<td>1971-72</td>
<td>Internal</td>
<td>5,633,500</td>
<td>5,791,402</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>Federal</td>
<td>23,774,980</td>
<td>22,819,646</td>
<td>80</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>29,408,480</td>
<td>28,611,048</td>
<td>100</td>
</tr>
<tr>
<td>1972-73</td>
<td>Internal</td>
<td>7,760,700</td>
<td>9,950,527</td>
<td>32</td>
</tr>
<tr>
<td></td>
<td>Federal</td>
<td>21,739,080</td>
<td>21,149,326</td>
<td>68</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>29,499,780</td>
<td>31,099,853</td>
<td>100</td>
</tr>
<tr>
<td>1973-74</td>
<td>Internal</td>
<td>12,688,910</td>
<td>8,477,400</td>
<td>26</td>
</tr>
<tr>
<td></td>
<td>Federal</td>
<td>21,669,570</td>
<td>22,930,618</td>
<td>75</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>34,358,480</td>
<td>31,408,018</td>
<td>100</td>
</tr>
<tr>
<td>1974-75</td>
<td>Internal</td>
<td>11,053,580</td>
<td>8,317,734</td>
<td>11</td>
</tr>
<tr>
<td></td>
<td>Federal</td>
<td>33,146,890</td>
<td>64,724,908</td>
<td>89</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>44,200,470</td>
<td>73,042,642</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Report on Committee for Tax Assessment and Collection
CHAPTER VI

EQUITY AND EFFICIENCY IN RESOURCE ALLOCATION

Equity

1. Ability principle.--Adam Smith is the "father" of equity in taxation. As already mentioned in Chapter I, he advocated the principle of taxation based on the individual ability to pay principle.

Adam Smith's tax idea based on ability principle has been supported by some economists and criticized by others. John F. Due and Ann Friedleander state that the "primary justification for the income tax rests upon equity grounds." By equity they meant "fairness," the bearing of a "fair share" of the tax burden by all taxpayers.

One of the popular equity concepts assumes that individuals in similar income situations should be treated equally. This is the view held by Richard and Peggy Musgrave. The treatment of "equals as equals" is known as horizontal equity. There is also vertical equity which states that unequals should be treated differently. This means that people in varying income situations should be taxed differently according to their abilities.

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2 Musgrave and Musgrave, op. cit., p. 216.
The views expressed above make the ability principle appear vague because there are different theories about ability. According to John Stuart Mill, ability can be expressed in terms of three sacrifice theories.\(^3\)

1. Equal absolute sacrifice theory
2. Equal proportional sacrifice theory, and
3. Equal marginal sacrifice (minimum aggregate sacrifice) theory

Each of these theories defines "sacrifice" in terms of "consumption disutility," that is, the pleasure foregone in alternative private sector uses due to the payment of taxes. The equal absolute sacrifice approach would require that a tax imposed on a higher-income individual cause him an amount of disutility equal to that borne by a lower-income taxpayer. For example, the tax might be designed within the "constraint" of the amount of revenue required by the government from the tax, to cause ten units of disutility to all taxpayers.

The equal proportional sacrifice approach, on the other hand, suggests that a tax should cause an individual to give up the same percentage of his total utility. For example, while taxpayer A's higher income would allow him 200 units of consumption utility, taxpayer B's lower income would allow

him only 100 units of utility. The higher income taxpayer should suffer twenty units of disutility if taxpayer B bears ten units of disutility. Such is the proportional sacrifice tax system, but progressive rates maybe necessary to achieve it.

The equal marginal sacrifice approach suggests that each taxpayer bear an equal marginal decrease in the utility of his income from the payment of the tax. Thus, if the marginal tax dollar paid by taxpayer A causes him five units of disutility while that paid by B renders him fifteen units of disutility, taxpayer A should pay more taxes while B should pay less until their marginal disutilities are equal. The equal marginal sacrifice suggests a highly progressive tax structure.

Herber had some reservations as to the practicability of his theories. Thus, he concluded that the three levels would hold if

1. It is possible to compare consumptive utilities and taxation disutilities among taxpayers.
2. The utilities of individuals are equal within a particular income level, and
3. The marginal utility of income diminishes at an increasing rate as income increases.\(^4\)

The ability-to-pay concept thus implies that the ability to make tax payments increases more than proportionately with

\(^4\)Ibid., p. 134.
increases in income because the marginal utility of income declines at an increasing rate as income becomes greater. Hence, it is argued that, in order to maintain equal sacrifices among taxpayers of differential incomes, the marginal rate of taxation must increase as the income increases.

There are of course, critiques of these theories. William J. Schultz and C. Lowell Harris argue that "ability is a vague term and has been given many interpretations." Their criticism is based mainly on the method of determining the ability of a taxpayer. They drew an example from Colonial America when an individual was held "to be norm of ability, and on this standard a poll tax was considered essentially equitable." Therefore, to determine the tax burden of an individual, the total spending of the government should merely be divided by the number of individuals in the taxable population.

2. Benefit principle.—According to Dan Throop Smith, identification of state and local taxes as the purchase price of public services suggests what students of taxation call the "benefit theory" of taxation. In other words, the burden of taxation should be related to the benefits received. This explanation looks at personal income tax as service charges by the government on its subjects.

6Ibid.
James M. Buchanan is also in favor of purchasing government goods and services with a personal tax. In his organismic theory, Buchanan sees the state as representing the "general interest and not individual interest," Buchanan applied this organismic theory to the expenditure side of the government budget which he observed should be divided equally among all persons. The share of one person should agree with his tax burden. To say this in another way, both the amount of tax payable by a person and his share in the cost of financing public goods should be equal.

3. Public goods.--Due and Friedleander define public goods as those goods "that convey benefits directly to individuals with no interdependence in consumption." The goods are jointly supplied to the community in the sense that benefits accrue collectively to society. Consumption by one person does not reduce the amount available to others. Thus, no one can be excluded from the benefits.

Therefore, the most important characteristic of the public goods is the non-exclusion principle in consumption. For example, the services of the armed forces of a nation are

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8Due and Friedleander, op. cit., p. 3.
available to everyone. In the same way, public hazards or "bads" involve the sacrifice of everyone.

Adam Smith was a capitalist and his principle of taxation, based on ability, might have been prompted in order to give protection to property owners. If this is true, then persons who own no property have a minimum need for government protection and, accordingly, are justified in paying a minimum or a poll tax. Hence a personal income tax could be considered as a benefit tax.

The Nigerian income tax structure can now be evaluated against the background of the above theories. The tax rates per se are intended to give credence to an ability-to-pay principle with emphasis on progression. For example, in the Lagos State and Federal territory rates increase from 25c to 70c on the dollar, but what ultimately makes the tax structure inequitable is the amount of generous reliefs or personal exemptions. For one, there is too much arbitrariness and discrimination in the granting of personal and married men's allowances. It appears there is no rationale to grant both allowances in the first place. Also, in the Northern States, relief could be claimed (actual expenditure) with respect to children's education. Such relief makes it mandatory for taxpayers with children to have more utility for income than taxpayers without children. Utility is subjective and not objective. People do, after all have differing values. Thus, the indiscriminate tax rates and deductions (which are not
standarized) build inconsistencies into the Nigerian income tax system with the consequence that (a) equals are not treated as equals, and (b) unequals are not treated differently.

Efficiency in Resource Allocation

The personal income tax is one possibility for taxation. Some feel that it should be made to redistribute income. About wealth others feel tax distributions should be equal to benefits. On the whole, a personal income tax could change the economic circumstances of those who bear its burden. Whether it improves or deteriorates their economic position depends on how the tax distorts resource allocations. The tax that least distorts resources is said to be the most efficient.

Musgrave and Musgrave define efficiency as follows: "A given economic arrangement is efficient if there can be no rearrangement which will leave someone better off without worsening the position of others." Thus, if, through one form of instrument or another, the economic system is rearranged in such a way that one person gains while no one else is hurt, there is an inefficient resource allocation. The instrument or tax that led to this inefficiency should

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9Musgrave and Musgrave, op. cit., p. 67.
itself be changed. The particular agent that is discussed here is the Nigerian personal income tax system.

1. **Conditions of economic efficiency.**—Before the Nigerian personal income tax system is evaluated in terms of efficiency certain rules or conditions are necessary. Musgrave and Musgrave give three conditions of efficiency while Donald S. Watson lays down five conditions.\(^{10}\) Basically, these economists have no remarkable differences as to the basis for attending economic efficiency. These conditions are summarised below:

(a) Assume the production of two commodities, \(X\) and \(Y\). Efficiency requires that a given amount of \(X\) should be produced so as to allow a certain amount of \(Y\) to be produced at the same time.

(b) The marginal rate of substitution (MRS) between \(X\) and \(Y\) should be the same. This means that the rate at which any two persons are willing to trade off the last unit of \(X\) for an additional unit of \(Y\) should be the same. Thus the marginal rate of substitution relates to the ratio of the prices or exchange rate of the two commodities. Assume there are two consumers \(A\) and \(B\). If \(A\) is willing to give one unit of \(X\) for three units of \(Y\) and \(B\) is willing to give four units of \(Y\) for one unit of \(X\), exchange will take place as both

benefit from the transaction. A and B will continue in the exchange until the rates at which they substitute one commodity for another at the margin are the same. This theory assumes diminishing marginal utilities in the consumption of both commodities.

(c) The marginal rate at which X is substituted for Y in consumption should be the same as the marginal rate of transformation (MRT) in the production of these commodities. The marginal rate of transformation is defined as additional units of X that can be produced if the production of Y is reduced by one unit.\textsuperscript{11} For example, assume the MRS in consumption is 3X for 2Y, while the MRT in production is 3X for 1Y. In this case there is discrepancy between MRS and MRT. A way out is to increase the production of X and limit that of Y until MRT equates MRS.

2. Evaluation.—As already stated, each state collects the tax in its own way using varieties of rates. This method imposes problems to investors and labor. As Adedji noted,

\textsuperscript{11}Musgrave and Musgrave, op. cit., p. 68.
The wide variations in the rates of taxation and personal allowances in Nigeria have undoubtedly reduced the free mobility of resources, particularly of labor and capital, between the various parts of the federation. Thus, employees prefer to remain where the tax rates are low. Similarly, owners of capital like to invest in areas with low rates of tax. In this way their earnings are not seriously eroded by the tax. Moreover, it benefits them to make use of the labor already concentrated in these areas.

Figure I presents the graphical view of the variations in the rates of tax in Nigeria. As noted in the figure, Federal (made up of Federal territory and Lagos State) has almost the lowest tax rate for persons earning a net income of between ₦700 and ₦2000. On the other hand, the Eastern States have the highest rate of tax. In essence, there is the tendency for resources to shift to Federal territory and Lagos State. In fact, this is one of the reasons for the acute congestion at Lagos. Whether or not the movement of resources to low tax area makes for economic efficiency, it is difficult to judge arbitrarily. However, the following analysis helps to explain the position.

If efficiency is to be achieved, a given agent (in this case it is the personal income tax) should not alter the economic setup so as to benefit one person while another is hurt.

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12 Adedji, op. cit., p. 192.
FIGURE I

COMPARATIVE AVERAGE PERSONAL INCOME TAX RATES

IN NIGERIA (for a family of four with estimated maximum allowances)

Income Tax Rates (in percentages)

Gross Income (₦'00)
Figure II illustrates the effect of concentrating resources at Lagos. Investors take advantage of the lower rate of tax there than in the Cross River State. The vertical axis AB measures the rate of return accruing to investors in the Cross River State, while CD shows the rate of return at Lagos. The horizontal line AC measures the total amount of capital. BE and DF are schedules representing rates of return on capital investments in each State. These lines are downward sloping because each additional amount of capital invested yields diminishing returns.

The analysis starts off at point a where investments in both states yield a 5 percent return before income tax. Point a also establishes the position of "Pareto efficiency." "Pareto efficiency," or what Bernard P. Herber refers to as "Pareto Optimality," is the position "whereby social welfare is
said to increase only if one person can gain utility or satisfaction through an allocative readjustment without another losing welfare."^{13}

Now suppose investment income is taxed differently in each state, with Cross River State imposing a 50 percent tax and Lagos none. The tendency would be for capital to flow from the Cross River State to Lagos where there is a higher return. If this happens, the capital invested in the Cross River State is reduced from AH to AG while investment in the Lagos State expands from CH to CG. An imbalance is created, but a case for inefficiency is yet to be established.

Following the increase of resource in Lagos and a reduction in the Cross River State, the competitive rate of return falls in Lagos to 4 percent while in the Cross River State it rises to 8 percent. The question is, what happened during the time of the capital flight between the States? Before the income tax was levied, the total output (assume capital as the only factor in the production) of the two States was $BA Ha + DCHA$. After the personal income tax has been imposed, the total output becomes $BAGI + DCGK$. Since the total output before the tax is greater than the one after the tax by the amount of the triangle $IKa$, there is a loss of welfare resulting from the tax. To say this in another way, the loss

^{13}Bernard P. Herber, op. cit., p. 74.
suffered by the society is greater than the tax yield. This means that the loss in output (IGHa) suffered by the Cross River State has not all been gained in Lagos. Their gain only amounted to KGHa. Therefore, there is a total loss of IKa and this hurts or injures the economic welfare of someone considering the society as a whole.

Perhaps the case would be different if a proportional tax, or poll tax were imposed. None of these taxes would have the same effect on capital movements as noticed above.

Figure III illustrates the position in which a poll tax or a proportional tax is applied to the 5 percent equilibrium rate of return.

![Diagram](image-url)

Figure III

In this case, although the rate of return has declined generally, the same amount of resources are allocated to both States. Moreover, there is no loss of gain in welfare.
CHAPTER VII

SUMMARY AND CONCLUSIONS

Nigeria obtained independence in 1960, but the ghost of the British lingers on. Most political and economic institutions are largely carbon copies from the original British administration. The personal income tax, in particular, remains initially the same as under the British. The single exception is that the Federal Government may now legislate uniform standards for taxation throughout the country.

Nigerians have not easily accepted the personal income tax, making its effective administration very difficult. The negative attitude Nigerians harbor toward the tax, based largely on suspicions of its British colonial pedigree and a lack of confidence in equitable administration, has resulted in very widespread evasion, costly administration, and very low revenue yield. Moreover, the lack of uniformity has probably induced some resource misallocation.

In order to raise adequate revenue from the income tax, each State must completely overhaul its administrative machinery. This includes the system of securing information, efficient assessments, collection procedures, and enforcement methods. The staff who engage in these duties should be selected solely on the basis of adequate training, experience, education,
and not on a political basis. Politicians should be relieved of their duties in income tax administration, and replaced with professionals trained in income tax accounting, whose duty is fair and impartial tax assessment.

Most inequities arising from the structure of the personal income tax itself are the result of non-uniform methods for granting reliefs and allowances, so that persons with the same actual income will be assessed differently, violating horizontal tax equity. Further violations of tax equity result from non-uniform tax rates levied on the income tax base. These problems could be most easily solved by a simplified single deduction, perhaps structured to reflect variation in circumstances of the taxpayer, and the substitution of a simpler head tax in lieu of income taxation for the great majority of Nigerians whose income is primarily from agriculture, and where economic circumstances are nearly identical. Both reforms should greatly simplify tax administration, and improve equity, by eliminating the possibility of non-uniform deductions and non-uniform tax rates for persons with essentially the same income.

Furthermore, a shift toward uniform deductions and uniform proportional tax rates would very likely improve efficiency in resource allocation. By taxing incomes the same from whatever source, the incentive to shift resources to areas of lower taxation from areas of higher taxation would be removed, and resources would then be allocated on the basis of relative economic returns only, which would be unchanged under proportional
tax rates. Moreover, the lump sum head taxes substituted for the bulk of taxpayers would not impair efficient resource usage, since tax payment is fixed and independent of both the way one employs his resources and of his choice of goods purchased in the market place.

If these rather basic and simple reforms were adopted, the difficult goals of fairness, low administrative costs, and promoting economic efficiency could be more closely approached. The current tax system fails the test by a substantial margin.
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