

**FEDERALISM AND TAX RAISING POWER IN NIGERIA: THE ISSUE OF VALUE ADDED TAX (VAT)**

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**ABSTRACT:** *Tax is one of the ways successive governments have used in raising funds for government expenses especially in executing projects and programs that are beneficial to the citizens. Value Added Tax (VAT) is among the numerous forms of taxes collected by the government. VAT became a prominent and topical issue among scholars, experts and practitioners following the suit instituted against the Federal Inland Revenue Service (FIRS) by River State Government. The issue has further divided the country along ethnic, primordial, religious and party lines either speaking for or against VAT collection by the Federal Government or State Government. It is against this background that this study seeks to examine the rationale behind the power to raise taxes. The study reveals that there is a constitutional flaw about tax rising, there is also a faceoff between the Federal Government and State Government with regards to who collects Value Added Tax (VAT) in the state. The study further reveals that VAT has made some states to be lazy in terms of exploring other sources of revenue other than waiting for the share from the federal purse. Lastly, if states are allowed to collect VAT and remit the same to the federal government, it will promote true federalism and enthrone financial autonomy to states. The study recommended that the constitutional provision for rising tax should be made clear, the federal might should be curtailed by adequate constitutional provisions, the state should be granted financial autonomy especially in the area of raising the taxes. This is to bring about true federalism and to promote good governance among states.*

**KEYWORDS:** Value Added Tax, Federalism, True federalism, Tax Law

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## **INTRODUCTION**

The power to raise tax is a current national debate among states, federal government and Federal Inland Revenue Service (FIRS) on who is empowered constitutionally to collect certain tax especially the almighty Value Added Tax (VAT). Value Added Tax has been on the front burner, as this has forced many to become constitutional lawyers overnight while also raising tax experts overnight too. The issue of Value Added Tax (VAT) becomes pronounced when a federal high sitting in Port Harcourt, River state delivered a judgment on a suit filed by the River State Attorney General challenging the power of the Federal Inland Revenue Service (FIRS) to collect VAT in the state. This has changed the narrative around Value Added Tax (VAT) in Nigeria. According to Samuel (2021) the value-added tax (VAT) was

*introduced in Nigeria in 1993 by the federal military government via the Value-Added Tax Decree 102. The idea of introducing VAT in Nigeria came from the study group set up by the federal government in 1991 to review the entire tax system. Following the recommendation of the study group, VAT was introduced as a federal tax which replaced the existing sales tax that had been in operation under federal government legislate Decree No.7 of 1986.*

*The year 1999 ushered Nigeria into the democratic era and the 1999 Constitution was enacted into law. Based on Section 315 of the 1999 Constitution, existing laws such as the VAT Decree (promulgated under the Military regime) were converted into Acts deemed enacted by the National Assembly. However, there was little to no scrutiny as to whether the 1999 Constitution empowered the National Assembly to make laws with regards to VAT or sales tax. Scrutiny of the exclusive legislative list in the first schedule to the 1999 Constitution would reveal that the federal government lacks the powers to legislate on matters concerning sales and consumption taxes/VAT. There was also a clear omission of such taxing powers in the preceding constitution in 1979 even though the constitutions of 1960 and 1963 provided powers to impose and collect sales taxes by the regions (states) and the federal government. Since 1999 however, VAT had been administered centrally by the federal government without constitutional backing*

In a judgment delivered by Lordship, Hon. Justice Stephen Dalyop Pam was in favour of River state, according to Kolawole (2021) the judgment of the Court can be summarized in two sentences. (1) The power of the National Assembly to make tax laws is limited to taxation of profit, income and capital gains only as contained in item 7 (a) & (b) of Part II of the Second Schedule to the Constitution and (2) the Federal Inland Revenue Service (Establishment) Act, Personal Income Tax Act, Value Added Tax Act, Taxes and Levies ( Approved List for collection) Act among others are null and void being tax laws not specifically mentioned in items 58 and 59 of the Exclusive Legislative List. The Federal Inland Revenue Service (FIRS) went ahead to appeal the judgment at the Court of Appeal, and the court decided that both parties should return to the status quo.

### **Objectives of the study**

The general objective is to examine federalism and the power to raise tax in Nigeria while the specific objectives are as follows:

1. To investigate the constitutional provision for raising the tax by the various levels of Government in Nigeria
2. To examine the constitutional provision on the collection of Value Added Tax in Nigeria
3. To evaluate the challenges associated with VAT collection in Nigeria

### **Research Question**

The following research questions are posed to guide the study, they include:

1. What are the constitutional provisions for tax-raising power in Nigeria?
2. Which tier of Government does the constitution empower to collect Value Added Tax (VAT)?

3. What are the factors militating against the collection of Value Added Tax in Nigeria?

## LITERATURE REVIEW

### Concept of federalism

Federalism is always a contending issue in Nigeria as there are a lot of legal and constitutional encumbrances surrounding it. Especially the conflictual relationship when it comes to revenue generation and allocation among the various tiers of Government. Dorđević, (1975) observed that the word ‘federalism stems from the word *foetus, foederis* and means a union and collaboration to achieve common goals by per se autonomous and independent subjects and individualities’ Dragan (2012) noted that federalism

*denotes a contract, an alliance, while federalism is meant to be a formation of a union and a voluntary association of different territorial unions of people within the scope of a state, or between several states and political unities for different purposes. Following Littré, federalism, which had come into vogue, especially in France, stems from the Verb fire which translated means "to trust", "to trust in". This is why in those days, meaning by the end of the 19th century, three crucial works dealing with the federal organization of states had been published in French. Till then, the French had paid very little attention to federalism or did not take it into account. The French spirit probably takes a contrarian stands towards this form of state organization, in contrast to the Germans who are very much addicted to federalism. The psychology of the French people itself tends to unitarianism, particularly as one may see an expression of national strength and unity in it.*

According to Miriam Webster online dictionary, federalism is ‘the distribution of power in an organization (such as a government) between a central authority and the constituent’. That is to say, power is shared between the federating units; in the case of Nigeria power is shared among the federal, state and Local Governments. The situation in Nigeria is worrisome as the Federal Government sees the state as an appendage while the state also sees the Local Government as their appendage too, such the constitutional right of the Local Government are infringed upon by the state government, especially in the area of federal allocation and revenue generation while the federal government on the other hands infringed on the constitutional rights of the state too especially revenue generation like in the case of Value Added Tax (VAT), security and resource control.

Federalism offers a clear definition of a function, power and response due to the various tiers of Government. According to Austin (2007), ‘the fundamental notion in federalism is that power and authority are shared; power is decentralized. You have a central/national government existing alongside regional/state government’. From the assertion above, it means that there is an existence of the Federal Government, State Government and Local Government in the case of Nigeria, and

the Local Government which is the third tier; is under the control and supervision of the federal/state government.

The Encyclopedia Americana(2001) defined federalism as the principle according to which two levels of governments, general and regional, exist side-by-side in the state, each possessing certain assigned powers and function while Wheare (1965) sees ‘‘federalism as a system in which two levels of government-federal and regional (state) exist side by side, with each possessing certain assigned functions’’. This connotes that, the two levels of government (federal and state) have a specific function to play without interfering with each other while performing that functions. Agreeing to the above, Fredrick (1968) defines ‘‘federalism as a situation whereby the federal and regional governments are limited to their spheres and within those spheres should be independent of other’’. Independent of each tier of government is an important ingredient necessary when federalism is mentioned, as this empowered the various levels of government to perform their functions without being intimidated. Although, this is not the situation in Nigeria as the federal might always prevail and oppress other tiers of government.

Power-sharing in federalism is also an important element and sometimes problematic as some are written and spelt out in the constitution while others are not spelt out. Encyclopedia Americana gave a comprehensive explanation of power-sharing in a federal system of government using three forms of power-sharing as seen below:

- a. The powers of the general (federal) government may be enumerated and the rest left to the states (E.g. Switzerland, Australia, and the United States).
- b. The powers of the states may be enumerated, and the rest left to the general federal government (E.g. Canada)
- c. The powers of both governments may be listed (E.g. Nigeria and India)

In Nigeria, the powers of both governments are listed in part I and part II to the second schedule of the 1999 constitution of the Federal Republic of Nigeria. They are known as exclusive and concurrent lists.

*Austin (2007:53) x-ray that if the powers, functions of both governments are listed, it is usually provided that conflicts between the two shall be resolved in favour of the general (federal) government, let us add also that the power is not necessarily, mutually exclusive about the sphere or functional areas of government business. There are, of course, shared functions and concurrent powers in every federation and these have been expanding significantly in current times.*

Power-sharing in Nigeria is still problematic as they are constant interference by the federal Government in State Government Affairs and the State Government also interfaces in the Local Government jurisdiction, especially through the Local Government Joint Account. A call from different quarters and stakeholders for true federalism has polarized Nigeria, making it a regional agitation for freedom or independence for regions to go their separate ways. According to Dakuku (2021), the problem with this call has been the connotations it carries; and agitation for ‘‘true’’ federalism or restructuring has gained more recurrent usage in our political lexicon in Nigeria, like poverty and corruption. The voices for a new form of federalism

that will give more powers to the constituent parts of the federation and reduce the powers at the centre are getting louder and heading to a crescendo. The central concern, it appears, is how the national cake can be split more justly among the constituent units of the country.

### **Concept of Value Added Tax (VAT)**

Value Added Tax (VAT) is currently a controversial issue in Nigeria with regards to who gets what and who has the constitutional right to collect VAT. According to Brian and Amanda (2021), ‘‘A value-added tax (VAT) is collected on a product at every stage of its production during which value is added to it, from its initial production to the point of sale. The amount of VAT that the user pays is based on the cost of the product, less any costs of materials used in the product that has already been taxed at a previous stage’’. They further noted that Value-added taxation is based on consumption rather than income. In contrast to a progressive income tax, which levies more taxes on the wealthy, the VAT is charged equally on every purchase. More than 160 countries use a VAT system. It is most commonly found in the European Union.

From the viewpoint of Brian and Amanda (2021) above, it shows that VAT is not without controversy as to who has the constitutional mandate to collect VAT at every point in time. While the Chartered Institute of Taxation of Nigeria (2021) are of the view that:

*VAT is a consumption tax that has been embraced and adopted by many nations across the globe. Because it is a consumption tax, it is difficult to evade and relatively easy to administer. From a buyer's perspective, VAT is a form of consumption tax. From the perspective of the seller, it is a tax only on the value added to a product, material, or service while from an accounting point of view, by the stage of its manufacture or distribution. It is levied on the value-added that results from each exchange. It is an indirect tax collected from someone other than the person who bears the cost of the tax or the tax burden.*

The institute went further to list items that are taxable under the VAT Act, these include any activity, other than those in the exempt list, conducted as a business, vocation, trade, and profession. It includes the activities of public or government authorities, associations, and clubs. It does not matter whether or not the activity is carried out for profit, but it should involve the supply of goods and services to another person for consideration. Besides those expressly exempted by law, several activities are not taxable activities for VAT purposes. These are:

- a. Wages and salary from employment;
- b. Hobby activities;
- c. Private transactions such as the occasional sale of household or domestic articles, furnishings, personal effects, etc.
- d. House rent.

According to KPMG (2021) Amendments to the value, added tax (VAT) law in Nigeria expand the list of exempt goods and services and update the definitions of certain terms to provide for

consistency. The changes are under the “Value Added Tax (Modification) Order, 2021” as published in the official gazette on 21 September 2021.

The list of VAT-exempt goods includes:

- Petroleum products
- Renewable energy equipment
- Raw materials for the production of baby diapers and sanitary towels
- Raw materials for the production of pharmaceutical products
- Domestically produced animal feeds
- Military hardware, arms, ammunition, and domestically manufactured military uniforms
- Gas supplied by gas-producing companies to electricity-generating companies
- Agricultural seeds and seedlings

Services added to the list of VAT exemptions include shared passenger road-transport service.

From the inception of VAT 5% is charged on VAT taxable items but that was amended by the National Assembly and further approved by the Federal Executive Council (FEC) to 7.5%. Agreeing to the above assertion, the Chartered Institute of Taxation of Nigeria (2021) observed that Nigeria's VAT rate since the introduction of VAT through the VAT Decree No. 102 of 1993 has been 5% up until January 2020 when it was increased to 7.5%. The decision by the Federal Executive Council (FEC) to approve the proposed increase did not come as a surprise given the several attempts by recent and past administrations to increase the rate of VAT. The Value Added Tax (VAT) rate of 7.5 per cent took effect immediately after the Finance Act 2019 was signed into law by President Muhammadu Buhari on 13th January 2020.

### **Constitutional provision for Value Added Tax (VAT)**

According to Samuel (2021) VAT was introduced in Nigeria under the General Sani Abacha regime (after having been initially passed under General Babangida's government), when there was neither a legislature nor any form of elected officials at the state or federal level of government. Thus, by military fiat and for close to three decades, the federal government administered the VAT in Nigeria at 5% of the sales value (although there was an unsuccessful attempt to increase the rate to 10% in 2007). Other than an amendment in 2007 by the national assembly and the Finance Act in 2019 (which increased the VAT rate to 7.5%) and another Finance Act, 2020, there has been very little legislative action or scrutiny on the VAT Act.

Although the VAT Act provided for a VAT sharing formula of 15%, 50% and 35% among the federal, state and local governments based on a derivation formula, several states such as Lagos have been unfavourably affected by the distribution formula. For example, the quantum of VAT generated from Lagos state into the federal VAT pool sits as high as 55%, while the share of VAT distributed to Lagos state is lower than 10% of total VAT collection. Based on the foregoing, Lagos state, along with other stakeholders have over time contested the legality of the powers of the federal government to administer VAT.

The legality of the VAT Act has attracted differing views from stakeholders over the years with various court decisions, most of which have largely centred around the supremacy of the VAT Act (i.e. covering the field) over the consumption/sales tax imposed by states. In recent times, however, the jurisprudence on the application of the VAT in Nigeria has advanced to the scrutiny of whether the federal government has any constitutional powers to impose VAT or sales tax ab initio. This gave rise to the recent decisions of the FHC, sitting in Port Harcourt, Rivers state, in the case of Emmanuel Chukwuka Ukala v FIRS (“Ukala Case”) in December 2020 and the AG Rivers case in August 2021. In both cases, the court held that the national assembly had no powers to enact laws on VAT under the 1999 Constitution of the Federal Republic of Nigeria (1999 Constitution).

Specifically, the court held that the federal government is only empowered to enact tax laws, impose and collect taxes that relate to stamp duties, taxation of incomes, profits and capital gains only as contained in Items 58 and 59 of Part I, Second Schedule, 1999 Constitution (exclusive legislative list). The court also held that these provisions must be read to exclude other species of taxes like VAT. The decisions clearly stated that the imposition of VAT is not within the purview of the national assembly /federal government. Thus, the imposition of VAT/sales tax is a residual matter which falls within the legislative and administrative competence of the states.

### **The Value Added Tax (VAT) war in Nigeria**

The issue of who should collect VAT between the Federal Government and State Government is the current issue in the Nigerian political space. Two states are prominent in this ‘war’ of who collect VAT, notable are Rivers and Lagos state. Lagos Government was the first to take the federal government to court over Value Added Tax (VAT) collection. According to Price Waterhouse Coopers. (PWC) (2014) the Lagos State government had sued the FG seeking for a ruling to repeal the VAT Act on the basis that it was outside the legislative remit of the FG to collect the tax. The court however ruled in favour of the preliminary objection of the Attorney General of the Federation on behalf of the FG that the Supreme Court does not have original jurisdiction in the matter as it was a dispute between an agency of the FG and Lagos State and not a dispute between the FG and the Lagos State government. This is on the basis that VAT is collected by the Federal Inland Revenue Service which is an agency of the FG.

The current legal tussle is between the Rivers State Government vs. the Federal Inland Revenue Service (FIRS), where the Rivers State Attorney General filed a suit challenging the power of the Federal Inland Revenue Service (FIRS) to collect VAT in Rivers state. According to Peters (2021) The Federal High Court sitting in Port Harcourt had in a judgment earlier in August declared that it is the Rivers State Government and not the Federal Inland Revenue Services (FIRS) that should collect the Valued Added Tax (VAT) and Personal Income Tax (PIT) in the state. But the Federal Inland Revenue Service (FIRS) filed a motion for stay of execution but lost the case against at the appeal court. According to Egufe (2021) ‘‘A Federal High Court in Port Harcourt, dismissed an application by the Federal Inland Revenue Service, FIRS, seeking to stop Rivers State government from enforcing an earlier court judgment vesting the power to collect Value Added Tax, VAT,

within Rivers State on the state government and not FIRS”. He further noted that “FIRS had through a motion on notice applied for a stay of execution on the earlier judgment delivered by Justice Stephen Pam, affirming the constitutional role of the state governments to collect VAT and not FIRS. Justice Pam, in his ruling on the FIRS application for a stay of execution, said granting same would negate the principle of equity”. The Rivers State Government through the State House of Assembly enacts a law empowering the Rivers State Revenue Service to collect Value Added Tax (VAT). According to Felix (2021), it is against the backdrop of this judgment that Rivers State and Lagos State have enacted their respective VAT Laws to regulate the administration of VAT by their relevant Boards of Internal Revenue. The table below highlights the key features of the VAT Laws in comparison with the extant VAT Act. He went further to highlight the challenges associated with the administration of Value Added Tax (VAT), which are:

- **Input Tax Recoverability:** VAT as we know it, is a consumption tax paid on the value added to a taxable item and it is borne by the final consumer. Typically, the input tax incurred at the point of purchase is recovered from the output tax collected at the point of sale. However, with the development, it is unclear how taxpayers who source products or raw materials from one state will recover the input tax suffered in that state from output tax collected on sales of the products in another State, especially with the disparity in VAT rates across the States. Rather than attempt to administer VAT, States might consider implementing a Goods and Services Tax (GST) regime, as obtainable in some jurisdictions, albeit while aligning the best interests of both the State and taxpayers. This eliminates the issue of input tax claims, as GST will be charged strictly on sales.
- **Recent Developments:** Finance Acts 2019 & 2020 have ushered in major amendments to the administration of VAT. For instance, companies with a turnover of less than ₦25 million have been excluded from charging and collecting VAT, exclusion of interest in land and building from VAT, expansion of exempted items to include tuition, and so on. These have not been considered by both Rivers and Lagos States as observed from their recently enacted VAT Laws. This creates a setback to the progress already made and imposes an additional burden on the taxpayers within the States, especially small companies.
- **Import VAT:** The States’ VAT laws purport to collect VAT on imported goods as a prerequisite to clearing such goods from the port. It will be recalled that the core of the dispute as averred by Rivers State, is that VAT is not on the Exclusive Legislative List and cannot be administered by the Federal Government. By the same argument, maritime shipping and navigation including ports are listed on the Exclusive Legislative List, thus making it a matter reserved exclusively for the Federal Government. Consequently, VAT on goods brought in through these ports falls out of the purview of the State Governments.
- **Consumption Tax:** The Supreme Court in *AG Lagos v. Eko Hotels Ltd & Anor* has held that a State is estopped from concurrently charging both VAT and Consumption Tax. Therefore, States which have an existing Consumption Tax law such as Lagos State must first repeal such law, where it intends to administer VAT.
- **Ease of Doing Business:** Due to the complexity the state-run VAT administration portends, Nigeria risks losing foreign direct investment as non-resident companies are required by the States’

VAT Laws to register in all the states where they carry on business. This process is cumbersome and discourages investment, which in turn will affect the country's ranking on the World Bank Ease of Doing Business Index.

- Penalties: The penalty regimes contained in the States' Laws are steep and punitive. White River State's VAT Law prescribes a penalty of up to ₦100,000 for failure to register with its Board of Internal Revenue, Lagos State imposes a penalty of up to ₦2,000,000 for aiding and abetting. On the other hand, decentralizing the VAT administration may lead to introspection on the part of state governments, to harness innate but untapped potentials to build greater capacity for revenue generation and economic development.

| Features                            | VAT Act  | VAT Law of Rivers State  | VAT Law of Lagos State   |
|-------------------------------------|--|--|--|
| <b>Rate</b>                         | 7.5%   | 7.5%   | 5%   |
| <b>Administration</b>               | Federal Inland Revenue Service   | Rivers State Board of Internal Revenue Service   | Lagos State Internal Revenue Service   |
| <b>Distribution of Revenue</b>      | 15% - Federal Government;<br>50% - State Government<br>35% - Local Government  | 70% - State Government<br>30% - Local Government   | 75% - State government;<br>25% - Local government; ( <i>on derivation basis</i> )  |
| <b>Obligation to render Returns</b> | 21st day of succeeding month   | 21st day of succeeding month   | 21st day of succeeding month   |
| <b>Dispute Resolution</b>           | Tax Appeal Tribunal<br>( <i>Appeal lies to the Federal High Court</i> )  | Tax Appeal Commission<br>( <i>Appeal lies to the State High Court</i> )  | Value Added Tax Appeal Tribunal.<br>( <i>Appeal lies to the State High Court</i> )   |
| <b>Exempted goods</b>               | As contained in the 1st Schedule to the VAT Act (amended by Finance Acts 2019 & 2020, and VAT Modification Order 2020) | Do not cover updated goods and services introduced by the Finance Acts & VAT Modification Order, e.g., locally manufactured sanitary towels, pads or tampons, tuition of nursery, primary, secondary and tertiary institutions, etc. | Do not cover updated goods and services introduced by the Finance Acts & VAT Modification Order, e.g., locally manufactured sanitary towels, pads or tampons; tuition of nursery, primary, secondary and tertiary institutions, etc. |
| <b>Registration</b>                 | Upon commencement of business  | 6 months within commencement of business or law, whichever is earlier.   | 6 months within commencement of business or law, whichever is earlier.   |
| <b>Penalties</b>                    | Up to ₦50,000  | Up to ₦100,000   | Up to ₦2,000,000   |

Source: Felix (2021)

## CONCLUSION AND RECOMMENDATIONS

Value Added Tax (VAT) is an active war awaiting final judgment by the highest court of the land. True federalism is not an achievement if the other tiers of government are not given the necessary autonomy to function fully without any interference, where the federal government does not see the state as an appendage while the state also does not see the Local Government as an appendage too. The issue of VAT is a litmus test the federal and state government must pass to enthrone true federalism. The study, therefore, proposes the following:

- The constitutional provision for raising tax should be made clear. The 1999 constitution and other extant laws on taxes and their raising power should be clearly stated, showing where the power of the state and federal government lay. This is to avoid clashes and an unending legal battle between the state and federal government.
- The federal might should be curtailed by adequate constitutional provision
- The state should be granted financial autonomy especially in the area of raising taxes. This is to bring about true federalism and to promote good governance among states.

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