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## STRATEGY TO CLOSE TAX GAPS CREATED BY TAX AVOIDANCE AND TAX EVASION IN NIGERIA: AN OVERVIEW

Olufemi F. Oladejo, Ph.D

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**ABSTRACT:** *The increase in the tax avoidance and tax evasion among the taxpayers has become a subject of discourse among the tax authorities and other stakeholders across the globe. Tax evasion and tax avoidance, a problem which seems to have defied solution, had been deviled the tax system right from colonial times. While some had blamed the situation on tax authorities for not living up to expectation with regards to tax administration, others attribute it to the unpatriotic attitude of taxpayer. In view of the above, this paper examines the strategy to close tax gaps created by tax avoidance and tax evasion. Contents analysis research design was adopted by reviewing the available literature in the field of this study. It was discovered that Voluntary Asset and Income Declaration Scheme, effective communication of tax benefits to the taxpayers enhance voluntary compliance with payment of tax by taxpayer. Equitable distribution of amenities without using sentiment ,religion, tribe among other things will also increase tax revenue while ,transparency and accountability, consistent updates to the taxpayer's registry, equitable distribution of income and use electronic channels for simple transactions were also identified as part of strategies to close the gap created by tax avoidance and tax evasion.*

**KEYWORDS:** tax avoidance, tax evasion, tax administration, Voluntary Asset and Income Declaration Scheme, Nigeria voluntary compliance, taxpayer, tax revenue taxpayers' registry, equitable distribution of income.

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## INTRODUCTION

This paper provides an analysis of the strategy to close tax gaps in Nigeria using content analysis research design. The craving to raise one's country or nation is the first yearning of every devoted citizen. Payment of tax is a civic duty of every taxable citizen and companies so as to enable the government to cater for the need of the citizen or run public utilities and execute other social responsibilities. Taxes, thus, constitutes the major source of government revenue. However, one of the major problems confronting Nigerian Tax System as well as Africa is the problem of tax evasion and tax avoidance. Tax avoidance is the use of legal methods to modify an individual's financial situation to lower the amount of income tax owed. This is generally accomplished by claiming the permissible deductions and credits. This practice differs from tax evasion, which uses illegal methods, such as underreporting income to avoid paying taxes. These "Twin fiends" have generated a great bay between actual and potential revenue. The government has for the umpteenth time criticized the prevalent incidence of tax avoidance and evasion in the state as companies and

other taxable individuals adopt various tax avoidance devices to get away or minimize their taxes or intentionally device fraudulent techniques and means of evading tax altogether sometimes with the collaboration of the tax administrators.

Tax avoidance and tax evasion are major problem faced by every tax system most especially the developing countries. Nigeria case is peculiar because of the high level of corruption in the system coupled with the unpatriotic attitude of some of the leaders. Poor tax collection system most especially among the self-employed people has been identified as a major problem in Nigeria. The tax authorities find it difficult to determine the actual personal tax payable by people that are self-employed like traders, contractors and other professional practitioners like lawyers, doctors, and accountants among others.

## **REVIEW OF RELEVANT LITERATURE**

### **Conceptual Review**

The conceptual difference between tax evasion and tax avoidance centers on the lawfulness of the taxpayer's actions. Tax evasion is a defilement of the law: When the taxpayer abstains from reporting revenue from labor or capital which is in standard taxable, he involves in an unlawful activity that makes him liable to administrative or legal action from the authorities. In evading taxes, he worries about the possibility of his actions being detected. Tax avoidance, on the other hand, is within the legal framework of the tax law. It consists in exploiting loopholes in the tax law in order to reduce one's tax liability; converting labor income into capital income that is taxed at a lower rate provides one class of examples of tax avoidance. In engaging in tax avoidance, the taxpayer has no reason to worry about possible detection; quite the contrary, it is often imperative that he makes a detailed statement about his transactions in order to ensure that he gets the tax reduction that he desires. If tax avoidance is legal, what is the difference between avoidance and the reaction to high taxes that arises because of price effects on demand and supply? Suppose a higher tax on air travel makes me travel more by train, or that a higher marginal tax on labor income makes me switch some hours from work into leisure activities. Am I then engaging in tax avoidance? A simplistic definition of tax avoidance is one that focuses on the lawmakers' intention and says that avoidance is a type of action that is an unintended, although legal, consequence of tax policy. By this definition, the price effects should perhaps not be classified as avoidance. However, it is often far from simple to discover what the intentions of politicians really are. Official estimates of the revenue effects of tax changes often assume that tax bases are constant, which suggests that political intentions are formed on the assumption that price elasticities are zero. But when a tax increase leads to a reduction of the quantity demanded and supplied and, therefore, to lower revenue than the official estimate, one could then classify this as an unintended effect of the tax increase, so that the price effect becomes a kind of avoidance. Clearly, the simplistic definition fails to capture the distinction between tax avoidance as a specific type of activity and effects on demand and supply via relative price effects. Slemrod and Yitzhaki (2002) argue that avoidance consists in actions that do not change the individual's consumption basket (which presumably

includes his consumption of leisure), and that this distinguishes it from real substitution responses. This definition focuses on the absence of relative price changes for consumption goods, but it neglects the income effects that arise from increases in disposable income. Perhaps the borderline between tax avoidance and “ordinary” demand and supply effects must by necessity remain somewhat vague.

### **Causes of Tax Avoidance and Tax Evasion**

The reasons for tax evasion and avoidance has been seen as major issue hindering development especially in developing countries. Below are the major reasons why citizen engage in tax avoidance and tax evasion.

#### **The Absence of a “Quid Pro Quo”**

The average human being detests the payment of tax. He sees taxation as a discredited imposition and evidently unbearable. This stems mainly from the absence of a “quid pro quo” i.e. something of value given in return by the Government) for the taxes paid. It is commonly argued, taxes should not be paid as the authority does not provide amenities which are in any way commensurate with the taxes paid. There is no guaranteed compensatory benefit.

#### **Inequitable Distribution of Amenities**

In many parts of Nigeria citizens are opposed to the payment of any form of taxes and rates on the ground that government had been unfair in the distribution of amenities and other good things of life. This thinking is often a root cause of most civil disturbances in parts of the country.

#### **Misappropriation of Collections Made**

More often than not there are reports in the news media of how government functionaries misuse taxpayer’s money. Evidences of wastage of public funds abound in the form of inflated contract prices and conversion of government properties to personal use has been one of the major reason for tax avoidance and tax evasion.

#### **Detachment of Taxpayers from the Government**

Most taxpayers develop hatred for the most of government functionaries because most people in government created a class between them and the taxpayer by living a flyanbout live at the expense of the taxpayer .In view of this, most taxpayers find it difficult to part with their hard earned resources for the upkeep of these (imagined) enemies. The creation of local government councils, which is believed to bring the government closer to the people failed the purpose for which it was created for.

#### **Absence of Spirit of Civic Responsibility**

Many Nigerians due to illiteracy and lack of knowledge fail to realize that they owe certain responsibilities to government, one of which is the payment of tax. Even when the government says it is poor they would rather claim that the government should print more currency to resolve

her difficulties. This lack of spirit of civic responsibility amongst the majority of Nigerians is a major cause of tax evasion in Nigeria.

### **Tax Gap**

The difference between total amounts of taxes owed to the government versus the amount they actually receive. Generally, a **tax gap** is caused by taxpayers overstating deductions and understating their income so they can pay fewer taxes; but late paying taxpayers also cause the **tax gap**

### **Theoretical Underpinning**

There are three theories of interest to this study, Benefit Theory, The sacrifice theory and Ability to pay theory.

#### **Benefits Theory**

According to this theory, the state should levy taxes on individuals according to benefit conferred on them. This mean that, the more benefits a person derives from the activities of the state, the more he should pay to the government. This theory seeks to ensure that each individual's tax obligations are as far as possible based on the benefits that he or she receives from the enjoyment of public services. The application of this theories in Tanzania is such that there are various taxes(levies) that are collected in the local jurisdictions example, in market, bus stands which are collected by various local government authorities, at the end this fund is further used to develop various social facilities which results to social benefit to the society members

#### **The sacrifice theory:**

This theory attempts to determine the burden that rests upon an individual in virtue of his payment of taxes and how much of his or her income remains for purpose of his own subsistence. According to this theory payment of tax is a sacrifice that an individual makes towards the support of the government. The measure of such sacrifice is found in the giving up of enjoyments, which is, giving up a portion of individuals' means (income) of satisfying wants (consumption). Practically the sacrifice theory demands that individuals should only pay tax on that portion of income that is spent on luxuries, the sacrifice should only be in respect of individuals' means over and above subsistence

#### **Ability to pay theory**

This theory was developed due to inadequacies in benefit and sacrifice theories of taxation. This is the most popular and commonly accepted principle of equity or justice in taxation, that is, citizens of a country should pay taxes to the government in accordance with their ability to pay. It appears very reasonable and just that taxes should be levied on the basis of the taxable capacity of an individual. For instance, if the taxable capacity of a person A is greater than the person B, the former should be asked to pay more taxes than the latter.. It seems that if the taxes are levied on this principle as stated above, then the justice can be achieved.

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### Empirical Review

There is a clear cut difference between tax avoidance and tax evasion. One is legally accepted and the other is an offence (Skanda and Kumarasingam, 2002 as cited by James and Nobes, 2008). Tax avoidance is the legal utilization of the tax regime to one's own advantage, to reduce the amount of tax that is payable by means that are within the law. By contrast, tax evasion is the general term for efforts not to pay taxes by illegal means (Sharma and Dang 2011 as cited by Mohammed and Mohammed, 2012). It is also perceived that both tax avoidance and tax evasion are linked with shadow economy and Schneider and Enste (2000) as cited by Faseun (2001) reported that shadow economy is that economy in which people do not show their real income and taxable income that they have earned through legal activities including better and monetary activities in order to avoid paying tax. According to Muhammed and Muhammed (2012), government has protested against these two above mentioned evils for number of times but corporations and all other persons whose income is taxable, they make use of tax avoidance strategies to get away or curtail the taxes or they willfully employ fake techniques with the support of tax officials to evade the total tax. Lefebvre et al. (2011) conducted study in Netherlands, France and Belgium (Flanders and Wallonia) while examining the behavior of people. He compared the behavior of people regarding welfare dodging and tax evasion. Results indicated that people adopt less evaded behavior in tax treatment than in welfare treatment; and people evade more tax in Netherlands and France but tax evasion is more in Flemish than Walloons. Liadiet al. (2010) conducted study in Nigeria while examining relationship between personal income tax evasion and cultural factors like religiosity, trust in government, and legal enforcement. Study found positive impact on personal income tax of trust in government and legal enforcement. However, no significant relationship found between religious variables and tax evasion in Nigeria. Boylan and Sprinkle (2001) conducted study in which he tried to explore the behavioral of the determinants of tax evasion. He used experiment technique in order to acquire desired objectives such as to identify the factors that motivate the tax compliance and characteristics of noncompliant taxpayers. Pommerehne et al. (1994) conducted study in order to recognize the determinants of tax evasion. They used the presence of grievance in absolute terms in their study. Results indicated that as the sentiments of grievance increased in absolute terms, the level of tax evasion also increased and the level of tax moral belief decreased. Fisher et al. (1989) also examined the behavior of taxpayers in order to explore the behavioral determinants of tax evasion. He used random survey technique in order to acquire desired objectives like to identify the factors that motivate the tax compliance and characteristics of noncompliant taxpayers. Skinner and Slemrod (1985) conducted a study in order to investigate the determinants of tax evasion. In this study, only strict economic determinants proposed by seminal models were taken. Study found that considerable share of effective tax compliance cannot be explained by using these solely variables. Srinivasan (1973) also introduced seminal theoretical models and conducted study while exploring the determinants of tax evasion. In this study, he explained that the behavior of tax evasion was based on level of risk aversion, amount of penalty imposed, and probability of being audited. Likewise, study found an ambiguous relationship between marginal tax rate or income and tax evasion. Orewa (1957) conducted study and investigated the characteristics of tax evasion. Study found that high degree of inter-district

mobility is the main reason of tax evasion on the part of taxpayers and argued that mobility of wage earners, salaried persons and self-employed persons with permanent and known addresses is an important factor of tax evasion because they keep themselves in movement from one place to another in order to earn legal money. He also found the reasons of partial evasion such as: resentment toward illiterate persons that present only their salaries and wages as taxable income and traders maintain inadequate records.

## **METHODOLOGY**

The methodology adopted was contents analysis research design. The following secondary sources have been relevant and used in the study framework: research articles; journals; textbooks; websites relevant laws.

## **DISCUSSION OF RESULTS**

### **Strategy to close tax gap**

The tax gap is commonly defined as the difference between the tax which would be raised under a hypothetical, perfect enforcement of tax laws and the actual tax payments. Thus, a tax gap may arise, firstly, due to assessment risk, which comprises the difference between the tax which is due and the tax actually billed to the tax payer. The assessment risk thus reflects both underreporting of income and the nonfiling of returns. Secondly, a tax gap may arise due to collection risk which is captured by the difference between tax payments received and the tax actually billed to the tax payer. It thus reflects the underpayment of taxes which are billed to the tax payer. The major fraction of the tax gap is caused by the underreporting of income and non-filing of returns (around 90% of the overall tax gap in developed economies) while under-payment hardly contributes to the total tax gap (around 10% of the overall tax gap).

To close the gap created by tax avoidance and tax evasion, the follow strategy has been identified; Voluntary Asset and Income Declaration Scheme (VAIDS)

VAIDS is a time-limited opportunity for tax payer to regularized their tax status relating to previous tax period .In exchange for fully and honestly declaring previously undisclosed assets and income, tax payer will benefit from forgiveness of overdue interest and penalties and assurance that they will not face criminal prosecution for tax offences or to be subjected to tax investigations. The introduction of the scheme will enhance the tax revenue and close the gap created by tax avoidance and tax evasion in the following ways;

- I. The scheme will burden the tax base and make the citizen to comply with section 24F of the constitution which state that the citizen must voluntarily declare their income and pay their tax promptly
- II. VAIDS will move Nigeria tax to GDP ratio which is currently at 6% upward to compete favorably with likes of Chana and South Africa with ratio of 15.9% and 27% respectively



- III. The scheme is a global initiative to tackle the problem of illicit financial flow and tax evasion, which has contributed to the country underdevelopment.

**Effective Communication of tax benefits to the tax payers**

Communication has been identified as one of strategies to close the wide gap created by tax avoidance and tax evasion. Effective communication about tax programs to the tax payers will convey the benefits of paying taxes, educating taxpayers about how to comply, and increasing the perception of risk for noncompliance which will eventually increase tax revenue. Effective communication will promotes voluntary compliance. By communicating specific tax initiatives even to residents who weren't necessarily affected by them, one country more than doubled their impact because the general population felt obliged to comply with broader tax rules.

**Equitable Distribution of Amenities**

Government at all levels must ensure that distribution of amenities from revenue generated from tax must be fair. In developing countries must especially in Nigeria, the tax payer identified that government uses tribe, religion among others to provide amenities to the citizen and as a result decided to reduce their taxable income while some refused to pay tax at all. In order to ensure that citizen oblige to pay tax, government must remove sentiment in allocation of amenities to all regions in the country.

**Transparency and Accountability.**

The mechanism that will ensure transparency and accountability among the tax authorities must be put in place. All revenue payable to government through tax must be made directly to government account. Effective payment system that will prevent the tax official from diverting the tax revenue must also be put in place.

**Ensure consistent updates to the taxpayer registry**

In many developing countries, it can be tough to keep an up to date central taxpayer registry, as much of the economy is made up of "informal" and small-scale businesses, and tax authorities lack the external controls necessary to ensure that such entities stay within the system. To counteract this, registration should be made more rigorous and feedback systems introduced to ensure that taxpayers regularly update their information. Additionally, quick and simple controls can be put in place to raise the alarm if taxpayers fail to comply with their obligations

**Equitable Distribution of Income**

The tax system must be progressive. To ensure that citizen oblige to payment of taxes in the developing counties and most especially in Nigeria, the rich must pay more than the poor. Also, the work force must be adequately remunerated.

### **Use electronic channels for simple transactions**

In most rapidly developing economies, mobile and Internet penetration are relatively high. Government can therefore introduce electronic channels such as Internet portals, mobile-payment options, and ATMs. By using these channels for simple taxpayer transactions (such as declarations and payments), tax authorities can increase the level of voluntary payments while conveying a strong sense of its public purpose. Such approaches reduce the length of queues at tax offices while also removing a barrier to compliance.

### **Simplify the tax system to encourage formalization**

The tax systems in most developing economies are highly informal and often unnecessarily complex. Simplifying the tax code encourages voluntary compliance, while at the same time sending the message that efforts to formalize the system are a priority.

## **CONCLUSION**

The study aims to identify strategies to close the gap created by tax avoidance and tax evasion. This result showed that Voluntary Asset and Income Declaration Scheme ,effective communication of tax benefits to the tax payers enhance voluntary compliance with payment of tax by tax payer. Equitable distribution of amenities without using sentiment ,religion, tribe among other things will also increase tax revenue while ,transparency and accountability, consistent updates to the taxpayer's registry, equitable distribution of income and use electronic channels for simple transactions were also identified as part of strategies to close the gap created by tax avoidance and tax evasion

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