
THE EFFECT OF TAX AUDIT ON PRODUCTIVITY OF INTERNAL REVENUE SERVICE: CROSS RIVER STATE EXPERIENCE

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ABSTRACT: *This paper focused on the effect of tax audit on productivity of Cross River State Board of Internal revenue service. The result of the study showed that tax audit strategies have direct insignificant relationship with productivity. However, tax audit is employed by the relevant tax authority (RTA) to achieve target revenue and also reduces the problem of tax evasion and avoidance. The study further revealed that tax payers do not usually cooperate with tax audit personnel during audit. That the relevant tax authority should put policies in place that would enable tax payers to cooperate with tax audit personnel during audit exercise.*

KEYWORDS: Tax, Productivity, IRS, Audit quality

INTRODUCTION

The development of any state depends on the amount of revenue generated and applied by the government on public infrastructure for the benefit of members of that society. According to Appah (2010), the development of any nation depends on the amount of revenue generated by the government for the provision of infrastructural facilities. However, the revenue and expenditure in Cross River State is a very serious problem affecting both the State and the 18 Local Government Areas. According to Osiegbu, Onuorah and Nnamdi (2010), the complaints of the government in Nigeria is that the statutory allocation to the various tiers of government is not enough to carry out effective administration as well as finance capital projects. Kiabel and Nwokah (2009) reported that the increasing cost of running government coupled with dwindling revenue has left various state governments in Nigeria with formulating strategies to improve their revenue base. Hence two very important strategies that can be applied to increase the revenue base of the federal and state governments in Nigeria is the application of efficient tax administration. This can only be achieved through well implemented tax audit strategy for the citizens of the state. Ola (2001) argues that tax non-compliance is a great disservice to and a betrayal of the tax administration and revenue system. It should be seen by citizens of Nigeria as an unacceptable behaviour and an act of economic sabotage. Therefore, in order to safeguard tax administration and sustain the confidence of tax payers, tax audit programmes have to be installed to monitor and detect the non-compliance trait in the state by Cross River State Board of Internal Revenue Service. The tax payer is always looking for a way to dodge when it comes to the issues of tax payment. An unwilling taxpayer therefore needs to be pushed into paying what is required of him to the government. Tax audit helped to increase productivity of Cross River State Board of Internal Revenue Service.

Adediran, Alade and Oshode (2013) opined that, tax audit just like financial audit involves the gathering of information and processing it for determining the level of compliance of an organization

with tax laws of the territory. For tax audit to take place it is important for the auditor to arrange his work in order that his duty is successfully and effectively accomplished.

For the past ten years, tax audit has been a critical issue often discussed in Cross River State. It has had lots of sleepless nights trying to check the tax payers' books with the particular aim of increasing productivity for the state (CRSIRS, 2015). The question is to what extent has tax audit contributed to the productivity and revenue generation of Cross River State Board of Internal Revenue?

Tax is a compulsory levy by government through its agencies on the income, consumption and capital of its subjects. These levies are made on personal income such as salaries, business profit, interest, dividend, discount or royalties to obtain revenue. It is levied against company profit, petroleum profit, capital gains and capital transfer (Bello, 2001). Therefore, taxation is a compulsory payment or transfer of resources from private to public sector levied on the basis of the determined criterion and without reference to specific benefit received in order to accomplish some of the nation's economic and social objectives. Taxation is primarily aimed at generating revenue for government in order to cater for its expenditure (Alzakari, 1995).

Tax audit is an independent examination and expression of opinion on the books and tax records of an enterprise by an appointed auditor in accordance with his terms of engagement and compliance with statutory regulation and professional requirement (Daniel, 2009). Every individual or organization liable to income tax for a year of assessment is required to submit returns of his income and other relevant matters to the tax authorities having power to assess him to tax. And this is subject to satisfaction of the returns by the tax authority (Oyebanyi, 2006). Similarly, Slemrod (2000) is of the view that tax audit is an effective policy used to prevent tax evasion. The level of tax audit can be determined by two elements; one is how many tax payers are selected for audit and the other is how intensive the audit is. The first element is easily measured by the number of audited tax payers. However, the latter is so difficult to measure due to non-published information about tax audit progress. It is commonly measured by the first element to indicate the level of tax audit for practical comparison.

The relative composition of a tax audit system has implication for economic growth and stability especially when it is considered that tax is primarily mobilize to finance government expenditure. A good tax system is therefore adjudged by the strength of its productivity. The productivity of a tax system is the ability of the tax system to yield maximum revenue for the government with a given tax base without placing a difficult economic burden on the taxpayer in return (Osoro, 1991).

Statement of the problem

Low tax compliance is a matter of serious concern in Cross River State Internal Revenue Service. This is because it limits the capacity of the Board to raise revenue for the state developmental purposes. The major problem investigated in this research work was how tax audits affect the productivity of the Cross River State Board of Internal Revenue Service and the level of non-compliance to tax rules and regulations by individuals and corporate bodies in the state. The debt due to the state government have been known to accumulate at alarmingly high levels and its recovery has become a contemporary challenge to the relevant tax authorities tasked with the responsibility of collecting such backlog of revenue. Over the years, productivity from taxes by Cross River State Board of Internal Revenue Service has been very low and hence no tangible

infrastructural development arising from tax proceeds actually took place, hence the impact on the less privilege is not being felt.

Fraudulent activities of the tax payers and tax collectors, inadequate tax personnel and lack of understanding of the importance to pay tax by tax payers are other problems of this study. It is therefore the focus of this study to subject tax audit and productivity to empirical analysis in Cross River State Board of Internal Revenue Service.

Objectives of the study

The main objective of this paper was to examine the effect of tax audit on productivity of Cross River State Board of Internal Revenue Service.

Specifically, the sub-objectives were:

- i. To find out the effect of tax audit on productivity of Cross River State Board of Internal Revenue Service.
- ii. To determine the relationship between taxable income and internally generated revenue (IGR) in Cross River State Board of Internal Revenue Service.

Theoretical Framework:

The Policeman Theory

This theory of auditing was formulated by Awe (2008) on assumptions that once monitoring is done on the systems at unspecified times then that is like policeman guarding a place and thus, called it policeman theory. It was further asserted that auditing is purely on the arithmetical accuracy and on the prevention and detection of fraud. This theory makes the auditor to detect and prevent errors and fraud in organizations. It then adds a factor of monitoring to the auditing theory.

Conceptual Review

Ebimobowei and Peter (2013) define tax audit as independent assessment of the returns made available by taxpayers to the relevant tax authorities (RTAs) in order to determine the level of tax compliance by taxpayers. Frank (2010) concludes that audit policy can have important effects on production decision by firms. The effects depend on the firm's ability to be successful in all its dealings. A well designed audit policy can achieve compliance and higher productivity, for any given output and materials spend on audit may have effects that can be normally considered desirable in a wider economic context. Yongzhi (2005) concluded that this study does find a positive relationship between the audit and the voluntary compliance.

The Nigeria tax system has failed on the area of its administration. Personal and Company Income tax administration in Nigeria today does not measure to the appropriate standard. The self-employed persons earn more than those in paid employments. The self-employed earn four times than those in paid employment but the bulk of personal income yield comes from those in paid employment whereas those who are self-employed earn most of the money. As a result of lapses in monitoring taxes paid, lots of those who are self-employed evade tax. This calls for the need for a good and standard tax audit and investigation. Tax audit and investigation are terms which embrace a variety of sectors. It simply means the advanced part of auditing practice that involves examination of books of account in order to check if the assessable profit showed by the tax payer is correct (Adediran, Alade and Oshode, 2013).

It is important to say that if professional examiners are not in place as a control over the tax payer, the government will not actualize its aims and objectives. The tax payer is always looking for a way to escape when it comes to the issues of tax payment. He therefore needs to be pushed into paying what is required of him to government. Tax audit has helped to increase productivity in the State Board of Internal Revenue Service.

Classification of tax audit

Adediran, Alade and Oshode (2013) also classified the following as types of tax audit:

Mail audit: No matter what type of audit the IRS decides to conduct; you will receive notification of it by mail. A mail audit is the simplest type of IRS examination and does not require you to meet with an auditor in person. Typically, the Internal Revenue Service request additional documentation to substantiate various items you report on our tax return. For example, if you claim \$20,000 in charitable deductions, the Internal Revenue Service may send you a letter requesting proof of your donations. Generally, submitting sufficient proof will conclude the audit in your favour if the Internal Revenue Service is satisfied.

Desk (or Office) Audit: An Office or Desk audit is an in-person audit conducted at a local IRS office. These auditors are typically more in-depth than mail audits and usually include questioning by an audit officer about information on your return. Here, a taxpayer is asked to bring specific information to an office audit, such as the books and records for your business or your personal bank statement and receipts. The taxpayer also has the right, where necessary, to bring an accountant or lawyer to represent him/her at these meetings. In this type of audit, no official notice is given to the taxpayer of the impending desk audit exercise, which the taxpayer only gets to know when letters are written to him/her requesting for certain documents or explanation. The essence is to ensure some level of compliance with tax laws, rules and regulations as well as performing the administrative checks on returns submitted.

Field audit: The field audit is the broadest type of examination that the IRS conducts. In these cases, an IRS agent will conduct the audit at your home or place of business. Generally, field audits are conducted when the Internal Revenue Service is questioning more than just a deduction or two. A field audit is generally very thorough and will cover many if not all items on your return. Field audit involves physical verification of documenting evidence and materials at the premises of a taxpayer so as to confirm the facts and figures of the tax returns filed by individual or corporate taxpayers. The scope or depth of verification depends on the outcome of the desk audit work carried out by the tax auditor as well as the risk factors of the audit exercise.

The Role of Cross River State Board of Internal Revenue Service in Increasing Tax Productivity

According to the Chairman, Cross River Board of Internal Revenue Service, productivity generated by taxes is limited by laws which define tax jurisdiction for each of the three tiers of government. The federal government spelt out the classes of taxes to be collected by each tier of government, that is, federal, state and local government. The Cross River State Board of Internal Revenue Service is left with the option of perfecting the performance of the existing sources. However, measures are being embarked upon by both State Board of Internal Revenue Service and the state government.

Information processing centres have also been opened to process and issue new national driving license. The state government has also opened up new motor licensing offices in each of the eighteen (18) Local Government Areas (LGAs) of the state. In some cases, radio jingles of Cross River State Broadcasting Corporation (CRBC) services are constantly calling on people to be patriotic by paying their taxes and join hands in building the state.

Tax offices and sub-tax offices have been opened up in each of the 18 local government areas of the state. This brings the tax officials close to the taxpayers for an increased productivity. Government participation as the major collector of revenue rather than using contractors have helped in attracting revenue to government through which tax could be raised by stamp duty and withholding tax. The status of Calabar as a state capital has always attracted a lot of business and the environment friendliness of the state has also attracted some companies. In a bid to sustain its tourism drive, the Cross River State Government has banned the operations of the popular Okada (motorcyclist) and has in return introduced Keke NAPEP to minimize the rate of crimes committed through the use of Okada and with a view of generating greater revenue in the state.

In view of the foregoing, the government of recent has been encouraging revenue generation by releasing the needed funds for the procurement of the working materials. With time, according to the Cross River Board of Internal Revenue Service, productivity yield will increase.

Summary of review

In view of the related literature reviewed above. There are several theoretical and empirical studies on tax audit and productivity. These studies provide mix reaction on the relationship between tax audit and productivity. Alm and Mckee (2006) investigates the application of experimental methods to examine the individual compliance responses to a “certain” probability of audit, and conclude that compliance rate rises if an individual knows he will be audited and the rate falls if he knows he will not be audited.

METHODOLOGY

The research design employed in this study was the survey research type which is fundamentally based on determining the nature of a situation as it is at the time of investigation (Kirchler, 1997). The population of Cross River State Internal Revenue Service is put at 217 staff, while the board is comprised of 9 members. Of this number, there are 98 senior staff and 119 junior staff (Policy Research and Communication, 2016). The target population of this study is 98, comprising senior staff of the Service.

The sample size was arrived at with the help of the Taro Yammani’s (1964) statistical method. This is a simplified formula for determining sample sizes at 95percent confidence level. This is expressed as:

$$n = \frac{N}{1 + N(e)^2}$$

Where n = sample size

N = population (98)

1 = constant

e = error

By simple substitution, we have,

$$n = \frac{98}{1 + 98(0.05)^2}$$

$$n = \frac{98}{1 + 98(0.0025)}$$

$$n = \frac{98}{1 + 0.25}$$

$$n = \frac{98}{1.25}$$

$$n = 78.4148$$

Therefore: $n = 78$

The sample size of this study was pegged at 78 as shown in the calculation above, so as to make for even distribution among the groups sampled.

The data treatment technique used was the linear multiple regression. It is a very important and reliable tool. Regression measures the relationship existing between the dependent and independent variables. This is seen by the various individual contributions of each independent variable to the dependent.

The regression line is given as follows:

$$Y = a + b(x)$$

Where;

Y = productivity

a = intercept

b = slope (coefficient of regression)

x = sub-variables

Specifically, the regression model developed for this study is as follows:

$$Pr = f(TA)$$

$$Pr = a_0 + b_1(DR) + b_2(IG) + b_3(ID) + b_4(LS) + \dots + \mu$$

Where:

Pr = productivity

TA = Tax audit

a = intercept

b = coefficient of regression

DR = Debt recovery

IG = Income generation

ID = Income definition

LS = Legal system of tax audit

μ = error term

Data presentation*Table 1: Sex distribution of respondents*

Sex	No of respondents	Percentage
Male	47	60.3
Female	31	39.7
Total	78	100

Source: Field survey, 2018

Table 2: Age distribution of respondents

Age	No of respondents	Percentage
30-40	11	14.1
41-50	27	34.6
51-60	24	30.8
61 and above	16	20.5
Total	78	100

Source: Field survey, 2018

Table 3: Education distribution of respondents

Education	No of Respondents	Percentage
OND/NCE	20	25.7
HND/B.Sc.	43	55.1
M.Sc./MBA	15	19.2
Total	78	100

Source: Field survey, 2018

Data analysis

Table 1 shows the percentage of both male and female respondents from the sample. The table shows that male respondents comprised 60.3 percent of the sample, while 39.7 percent indicated the female respondents drawn from senior staff of Cross River State Board of Internal Revenue Service. Table 2 above shows that 11 respondents representing 14.1 percent of the total respondents were between the ages of 31-40, 27 respondents representing 34.6 percent were those that falls within the age of 41-50, 24 respondents representing 30.8 percent were entrepreneurs who falls between the age of 51-60 years while those of 61 and above were 16 respondents that reprinted 20.5 percent of the total responses.

Table 3 indicates that 20 respondents were OND/NCE holders representing 25.7 percent, HND/B.Sc. had 43 respondents which represent 55.1 percent, while 15 respondents which represents 19.2 percent for M.Sc./MBA holders. This implies that there was no respondent with a doctorate degree in the state who took part in questionnaire-filling exercise.

Test of hypotheses

The general purpose of testing of hypothesis is to examine the reasonableness of a statement of hypothesis and specified the parameter of a particular population.

Many statistical techniques are available for the testing of hypothesis but for the purpose of this research, the researcher made use of percentages as a simple statistical technique.

The hypotheses tested were formulated in chapter one of this study. The need to test the hypotheses is to validate and or otherwise the formulated hypothesis based on the result of the analysis of data from the field work.

Ho₁: Tax audit has no significant effect on productivity of Cross River State Board of Internal Revenue Service.

Ho₂: Taxable income does not significantly affect internally generated revenue (IGR) of Cross River State Board of Internal Revenue Service.

Table 4

Linear multiple regression analysis for the prediction of tax audit on productivity of Cross River State Board of Internal Revenue Service.

Source of variation	Sum of squares	df	Mean square	F	Sig.
Regression	867.901	4	216.975	30.261	0.000
Residual	521.086	73	7.138		
Total	1388.987	77			

Source: Analysis of data using linear multiple regression

Model	B	STD Error	Beta	t.	Sig
(Constant)	3.587	1.147	-	3.128	0.003
Debt recovery	0.235	0.242	0.155	0.969	0.336
Revenue generation	0.489	0.252	0.299	1.937	0.056
Income definition	0.473	0.260	0.302	1.819	0.073
Legal system	0.146	0.233	0.083	0.6 23	0.535

Interpretation

The results of the analysis are presented in table 4.4 and show the composite effect of tax audit on the productivity of Cross River State Board of Internal Revenue Service. The independent variable here is tax audit in terms of debt recovery, revenue generation, definition of income and result of tax audit, while the dependent variable is productivity. The linear multiple regression analysis test statistic was employed in testing data for this hypotheses.

The results indicate that a 0.05 level of significance with 4 and 73 degrees of freedom, the calculated f-value of 30.261 is greater than the critical f-value of 3.128. This means that, tax audit combined together significantly affect productivity. By this result, the null hypothesis is rejected.

The coefficient of debt recovery (0.235) shows that, while other variables are kept constant, a percentage change in debt recovery would lead to 23.5% increase in productivity. Similarly, the coefficient of revenue generation (0.489) also shows that, a percentage change in revenue generation, while other variables are held constant would lead to a 48.9% increase in productivity. The coefficient of income definition (0.473) shows that, a percentage change in income definition, while other variables remain constant would lead to 47.3% increase in productivity. Also, the coefficient of legal system of tax audit (0.146), shows that a percentage change in legal system of tax audit, while other factors are held constant would represent 14.6% increase in productivity.

The R^2 of the multiple regression measures the degree of association between tax audit (debt recovery, revenue generation, income definition and legal system of tax audit) and productivity. It shows that 62.5% of the variation in productivity is explained by the variation of tax audit strategies (debt recovery, revenue generation, income definition and legal system of tax audit), while 37.5% of the variation in productivity is explained by other variables which are extraneous to this study. The t-statistics in the table above shows that, the calculated t-value for debt recovery (0.969), revenue generation (1.937), income definition (1.819) and legal system of tax audit (0.623) are all in their absolute term lesser than the critical t-value of 1.99 at 0.05 level of significance, with 73 degrees of freedom. That is, various tax audit strategies have direct insignificant relationships with productivity of Cross River State Board of Internal Revenue Service.

DISCUSSION OF FINDINGS

Based on the hypotheses tested, findings have revealed that debt recovery, revenue generation, income definition and result of legal system on tax audit collectively contribute to the productivity of Cross River State Board of Internal Revenue Service thereby impacting positively on the economy of Cross River State by boosting her internally generated revenue (IGR), though it is insignificant.

Sealing up of businesses has been identified as a potent strategy of debt recovery in the Calabar metropolis as it yields desired results aimed at improve revenue generation. From the study, it can be also being seen that tax audit is a dependable tool of generating revenue. This means that tax audit ensures mathematical accuracy of all figures in account and computation in taxpayers' books. This implies that an increase in tax audit increases productivity from taxes. An increase in tax audit increases tax returns for the government and an increase in tax audit reduces tax fraud and tax irregularities in the tax system. This agrees in part with Yongzhi (2005) who concluded that there is a positive relationship between the audit and the voluntary compliance and totally with the findings of Ariwodola (2000) and Ojo (1996) whose studies both agreed that tax audit ensures that what is due the government is duly recovered.

Secondly, a comprehensive definition of income as to what is considered as chargeable or taxable income including profit salary, wages, gain, bonus, fee, etc as stipulated in the Personal Income Tax

Act (PITA) will help reduce or avoid the need for elaborate tax audit which is carried out at a cost to the government.

In view of the foregoing, the finding shows that the result of legal system of tax audit also affects the productivity of Cross River State Board of Internal Revenue Service. In other words, relevant tax laws aimed at enhancing tax audit exercise contributes positively to income generation and the productivity of Cross River State Board of Internal Revenue Service as a whole, though at an insignificant level. It therefore encourages the Cross River State Board of Internal Revenue Service to be more committed to the issue of overall revenue generation by taking the tax audit variables considered more seriously and to further provide other revenue generating indices targeted towards the collective generation of the internally generated revenue of Cross River State government. When this is done, it will further strengthen government's resolve to carry out developmental projects and hence, the dividends of democracy will be felt more by the citizens of the state. And by way of consequence, it will make the life of the people of the state more meaningful.

Finally, when taxpayers' money is being judiciously put to use with a considerable impact, it will in turn encourage other reluctant taxpayers (by way of tax avoidance and tax evasion) to live up to their civic responsibility of prompt payment of taxes.

CONCLUSION

On the basis of the results arrived at, the study concludes that;

- i. Tax audit is one of the strategies that should be taken seriously to achieve tax compliance because an average Nigerian is known for tax evasion and avoidance using all the available loopholes of not paying the relevant tax to the government.
- ii. That government should show some degree of tax accountability on the revenue collected to enable citizens understand the connection between tax revenue and expenditure.
- iii. That when considering the productivity of the audit work, besides the direct audit collections, audit impact of the voluntary compliance should also be taken into consideration. For this reason, it will provide tax professionals and tax authorities with incentives to strengthen the audit power and to better structure their audit organization to generate more revenue for the state.

Recommendations

Based on the findings and conclusions enumerated above, the following recommendations were made:

- i. The Relevant Tax Authorities (RTAs) at all levels should improve the standard of tax audit employed for effectiveness and efficiency.
- ii. Tax audit process should be aimed at reducing the challenges of tax evasion, tax avoidance and other related tax irregularities.
- iii. The tax audit net should be widened in such a way that will ensure proper submission of accurate and correct returns for proper computation of tax liabilities and also bring in new taxable entities.
- iv. RTAs should formulate policies and carry out awareness campaigns on the importance of tax payment and the effect of non-tax payment, in order to improve the level of compliance.

- v. RTAs should also formulate policies that would compel tax payers to co-operate with the tax personnel throughout each tax auditing exercise.
- vi. RTAs should also improve the standard of tax audit by deploying experienced personnel as well as providing them with up-to-date tools in carrying out the tax audit exercise.
- vii. RTAs should ensure that sanctions/punitive measures are meted-out on non-complying taxpayers to help check the general issue of non-compliance by tax payers with the tax rules and regulations.

Contribution to knowledge

There are a number of issues affecting productivity, but within the context of CRSBIRS, the study has been able to show that tax audit plays a major role and specifically so when considering factors such as legal system, debt recovery as well as clearly defined taxable income. The issue of legal system in particular has until now not really been given the attention it deserves which is one of the areas this study has focused on.

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