POLICY BRIEF ON

TAX INCENTIVES IN NIGERIA

actionaid

FORD FOUNDATION


TAX
POLICY

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ActionAid Nigeria,
Plot 447, 41 Crescent,
Off Sa'adu Zungur Avenue
Gwarinpa, Abuja

P.M.B. 1890, Garki, Abuja, Nigeria.
Info.nigeria@actionaid.org
www.actionaid.org/nigeria
Phone: +234(0) 812 8888 825-7

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INTRODUCTION

In furtherance to the functions of taxation in economic growth and national development, the introduction of tax incentives plays a key role in attracting and retaining such investment that will generate more tax revenues in the long run even when such waivers and incentives are no longer in force.

These special incentives or exemptions in taxes may not be in congruence with the usual structures of a rigid tax system. This is because the system is introduced to galvanise investments' interests, build up tax base, and encourage foreign investors who may not be sure of the profit expectations before investment.

Tax incentives are therefore special privileges granted to individuals or corporations with the purpose of attracting and retaining investments. It is a framework introduced by government to attract investments and generate economic activities. Tax incentives as clearly spelt out in section 2(2) article 5 of the reviewed 2017 National Tax Policy states that: "to attract, retain or increase investment in a particular sector; assist companies or individuals carrying on identified activities and assist businesses carrying on identified activities with main purpose of the policy makers to reduce unemployment rate, increase personal and company income taxes with other attendant benefits from these investments to the economy in the long run".

TAX incentive is a framework introduced by government to attract investments and generate economic activities.

Tax incentives in Nigeria may be granted on industry basis and may include exemption from payment of taxes; reduction in rate of tax to be paid and grant of allowances and deductions from profits subject to tax. Tax incentives should however, be carefully considered before they are granted in view of the argument that they may be violating some principles of taxation and its effect on tax revenue reduction.

According to the stated National Tax Policy: the process of granting and renewing incentives, waivers and concessions shall be transparent and comply strictly with legislative provisions, international treaties, sector focused and not arbitrary or only granted to specific companies or individuals.

The Government may also seek input from relevant sectors of the Nigerian economy and populace in the determination of the desirability or otherwise of such incentives. In addition, even if not stated in the law, incentives that will result in a reduction in income distributable to all tiers of government should advisedly require the involvement of the arms of government affected or impacted. Taxation encourages citizens to make claims on governments and hold them accountable for public expenditure.

“According to 2015 Financial Nigeria report, Nigeria loses an estimated N580 billion ($2.9billion) annually through tax incentives to multinational corporations.” The report titled "The West African Giveaway: Use & Abuse of Corporate Tax Incentives in ECOWAS, " published by ActionAid International and Tax Justice Network Africa, looks at the impact of corporate tax incentives in the Economic Community of West African States (ECOWAS). The study focused on Nigeria, Ghana, Senegal and Ivory Coast. It revealed that Nigeria, Ghana, and Senegal cumulatively lose about $5.8 billion to poor implementation of tax waivers. Extrapolating the revenue loss to the same percentage of the GDP of the other 12 ECOWAS countries, the total revenue losses to the ECOWAS region would be an estimated $9.6 billion per annum.

This policy brief takes a critical look at the implications of tax incentives in Nigeria and makes recommendations to minimising arbitrary grant of tax incentives that will result in a reduction in government's income. It also focuses on developing a progressive tax system that improves revenue generation, fair utilisation to bridge economic and gender inequalities; taking into consideration the contribution of small farmers, slum-dwellers, women within the informal sector and other marginalised groups, to national tax revenue. It referenced research conducted by ActionAid on tax incentives in Rwanda.

TAX

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THE ISSUES

Taxation is one of the major sources of generating revenue for government. This revenue is used for infrastructure development and the running of government (Azubike 2009). Ogbonna and Ebimobowei (2012) notes that taxation is one of the major drivers of economic growth. They further stated that taxation is an avenue for government to raise more revenue needed in performing its responsibilities to the citizens. Taxes can also be for other purposes, such as: monitoring the economy, stabilising the economy and carrying out the goal of national economic growth and development.

Taiwo, Samson & James (2015), study observed that Nigeria has a very low tax to GDP ratio which is attributable to narrow tax base and inelastic tax system coupled with multifaceted system of incentives and exemptions in addition to a complex tax laws. These conditions are results of over-dependence on oil revenue which accounts for almost 80 percent of government earnings. The Nigerian government has several policies designed to transit from the monolithic economy by widening the tax base. Owing to the urgent need to increase non-oil revenue base, offering tax incentives to investors would appear as a counter-productive policy. However, it is the appropriate strategy to stimulate investors' interests and encourage investments.

The report further indicates that tax incentives are not the only motivation for investors, rather, potential investors look for infrastructure, education and the quality of the workforce. Therefore, there is an urgent need for Nigeria to rework its economic strategies and set its priorities right by investing in agriculture, manufacturing and infrastructure rather than plunge resources on incentives with no commensurate reciprocity in the long run.

Nigeria's Federal Inland Revenue Service (FIRS) indicates that the current tax policy is to ensure that incentives are sector based and not granted arbitrarily. FIRS notes that the foreign investment inflows to Nigeria are not impacting significantly on employment and that these incentives and exemptions under various categories are to be reviewed regularly via executive order of the President to confirm if they are serving the expected purpose. The Central Bank confirmed that there is no cost benefit analysis to justify the efficiency of the tax exemptions. The foregoing shows that the fiscal incentives granted in

[1] http://www.actionaid.org/publications/west-african-giveaway-use-abuse-corporate-tax-incentives-ecowas
[2] Ogbonna, G.N. & Appah, E. (2012). Impact of tax reform and economic growth of Nigeria: A time series analysis. *Current Research Journal of Social Sciences* 4 (1).

form of tax exemptions with the hope of stimulating investments into the country is undermining its purpose and intent.

There has been no systematic monitoring and evaluation of the extent to which tax incentives and exemptions are working and the government has not implemented the recommendations of external experts recommending that these two instruments be reviewed regularly to reflect the current need of the economy. Nigeria has in place, a complex system of tax incentives and exemptions for investors. The main beneficiaries are big businesses, many of which are foreign owned, although indigenous businesses can also benefit from some of the incentives and exemptions. While tax incentives are offered to encourage foreign investment inflow, local companies should be offered far more incentives to enable indigenous investors develop and grow the economy to create jobs.

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TAX TO GDP RATIO IN NIGERIA

Among other factors, the 2016 drop in global oil prices and the resulting economic recession in Nigeria culminated into an increased focus on revenue generation through non-oil taxation. However, the tax-to-Gross Domestic Product (GDP) ratio has remained between 6% to 8% despite the reported tax revenue increase by the FIRS.

Recent data from the National Bureau of Statistics indicates that Nigeria's GDP stood at 16.58 trillion in the second quarter of 2018 (Q2 2018) while the total government collection in taxes was barely 1.3 trillion in that quarter.

Nigeria has a very low tax to GDP ratio which is attributable to narrow tax base

When tax revenue grows at a slower rate than the GDP, the tax-to-GDP ratio drops. However, low tax-to-GDP ratio is not an uncommon phenomenon with developing economies including Nigeria.

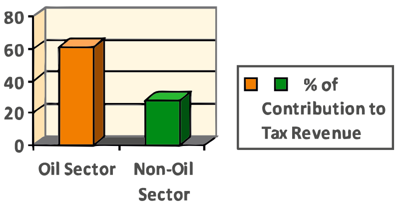
Prior to the 2016 economic recession, Nigeria's GDP was re-based, the exercise pushed Nigeria's economy ahead of South Africa, showing a growth from US $270billion to US $510billion, making Nigeria the biggest economy in Africa. Notwithstanding the reported growth, the tax-to-GDP ratio fell to 6.1% in 2018 which is relatively lower when compared to other developing economies like South Africa 26.9% and Rwanda 13.6%. From studies conducted on the Indian economy and a few developing economies, certain factors were identified as contributing to low tax-to-GDP ratio. These factors include unorganised informal sector, narrow tax base, tax exemption, tax incentives, subsidy policies as well as loopholes in tax laws.

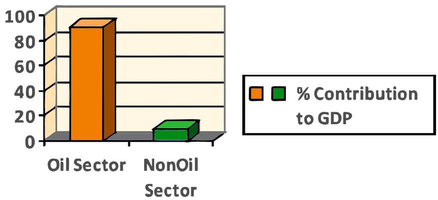
[3] Nigerian GDP Report Q2 2018, FIRS 2018 Q2 Revenue Collection Statistics

THE NARROW TAX BASE

Undoubtedly, a small tax base is a huge burden on compliant taxpayers. According to the International Monetary Fund (IMF), only 10 million of 77 million registered payers in Nigeria are compliant. This situation has adversely affected government's tax-based revenue.

On a broader note, in Q2 2018, the oil sector contributed 8.55% to the total real GDP in Nigeria while the non-oil sector contributed 91.45% to GDP. In contrast, total government revenue in taxes from the oil sector (Petroleum Profits Tax) totalled about 524 billion (39.26% of total tax revenue) while non-oil taxes totalled about 810 billion (60.74%).





These figures reveal a mismatch in the revenue sources from the two broad sectors. If one sector, which contributes only 8.55% of the GDP reels in 39.26% of total government revenue in taxes, there is a clear need to further examine the nation's sectoral contribution to GDP while trying to ascertain governments' focus on revenue drive and the plan to expand the tax base.

A casual overview of the tax-to-GDP ratio may not be useful for proper evaluation and improvement of the tax-to-GDP ratio in Nigeria. For the country to make real progress in maximising the tax collection ratio there would be need for painstaking assessment of the contribution from each sector to GDP. Otherwise, the tax authorities may be left with no alternative than to continue in the traditional approach of collecting tax from the same sources that generate the current tax-to-GDP of 6%.

THE INFORMAL SECTOR

According to the IMF in 2017, the informal sector contributes about 50% – 65% of Nigeria's GDP. This contribution to the GDP does not translate to tax revenue for the government except players within the informal sector pay their taxes. Unfortunately, the tax authorities are still unable to capture the informal economy for tax purposes. Also, the uncertainties that prowl tax administration for the informal sector appear to be incentivizing the disposition of potential taxpayers who continue to operate below the tax radar.

GOVERNMENT TAX INCENTIVE AND EXEMPTION FRAMEWORK

Recent information from the National Bureau of Statistics indicates that agriculture contributes the highest percentage (22.86%) to GDP. However, the agricultural sector also benefits from a number of tax incentives in Nigeria. It is equally important to pay attention to the contribution of each sector to government revenue (tax) vis-à-vis the GDP. As a matter of fact, there may be need to disaggregate the contribution of each sector to tax revenue in proportion to their contribution to the GDP in order to have a holistic view of the tax-to-GDP ratio.

In January 2016, an inter-ministerial committee was constituted by President Muhammadu Buhari. The committee was to review tax expenditures resulting from 52 types of incentives being implemented through its agencies (Nigerian Customs Service, Federal Inland Revenue Service, FIRS and Nigerian Investment Promotion Commission). The committee's preliminary findings indicate that between 2011 and 2015, the Nigerian government conceded N1 trillion (1.28% of GDP) in tax incentives such as import duty waivers/concessions/grants, Value Added Tax waivers/concessions/grants, and Pioneer Status. These estimates do not include incentives granted by government under existing laws such as the Companies Income Tax Act, Personal Income Tax Act, Petroleum Profits Tax Act, or the Minerals and Mining Act.

It is proven that tax incentives stimulate investors' interests and also encourage investments in certain aspect of the economy. As at the last quarter of 2017, total capital inflow into Nigeria was US $12,228.6 million, an increase

[3] Nigerian GDP Report, Q2 2018

of US $7,104.4 million or 138.7% from the figure recorded in 2016. The growth in Capital Importation in 2017 was mainly driven by an increase in Portfolio Investment, which went up by US $5,516.2 million from the previous year to reach US $7,329.1 million in 2017, accounting for 60% of capital importation. While unemployment rate increased from 14.2% to 18.8% in 2017.

But a study launched by World Bank reveals that particular incentives are not among the leading factors that influence foreign direct investments in developing economies. It is, therefore, important for the government to constantly review its tax incentive framework to ensure that such incentives are recovered as revenue to the government in order for them not to be counter-productive to the economy.

THE STATE OF TAX INCENTIVES IN NIGERIA

Going by experiences of revenue shortfall, issues of tax evasion and the need to expand the tax base, one may be forced to ask if there is any justification for incentives on tax. Although there is evidence of a significant increase in private sector investment following the introduction of the 2017 revised National Tax Policy but most of the investments are concentrated in portfolio assets and not FDI as intended. As such, this has not resulted in the creation of new jobs, as unemployment rate is on the increase. Exports have increased and there is evidence of export diversification into areas prioritised by the government as well as an increase in revenue from agriculture. However, the government remain dependent on oil revenue for more than half of its annual budget.

The inability to conduct a thorough tax-based cost–benefit analysis, evaluating the effectiveness of tax incentives and exemptions can hardly provide frank economic perspectives. Nigeria needs to urgently address the core issues that attract investments such as: physical infrastructure, indiscriminate anti-corruption drive, educated workforce, human capital development, ICT driven security architecture and absolute regards for the rule of law among other things. These factors are said to have more influence on business investment decisions most especially as regards foreign investors than the provision of tax incentives and exemptions. It is argued that, at best tax incentive is a second-order consideration for most investors. It is not possible to disentangle the impact of these factors from tax incentives and exemptions. Thus, there is a growing consensus that tax incentives and exemptions in Sub-Saharan Africa countries may not attract investments as expected, rather emphasis should be on prioritising the development of human capital and physical infrastructure with a robust legal and justice system. Nigeria should use tax incentives and exemptions selectively for a limited period and improve on the above stated factors.

CONCLUSION

The International Monetary Fund has also made recommendations for improving the tax system such as a systematic review of tax expenditures that would help quantify the cost of incentives and identify ways to improve the fairness of the tax system and recover lost revenue. To achieve this, it will be necessary for the government to maintain a comprehensive database of taxpayers' records to undertake such assessment.

Furthermore, streamlining and simplifying the tax system will help to not only reduce the cost of doing business in Nigeria, but also increase the efficiency of revenue mobilisation. For the informal sector, it will be most appropriate for the tax authorities to issue clear guidelines stating the modalities for taxation. This will clear a lot of uncertainties and encourage taxpayers to comply.

RECOMMENDATION

There is a need for government to improve business and investment environment for local and foreign investors by creating a competitive and efficient tax incentive policy and the rule should be applied only when there is absolute need for it. An efficient tax system will ensure transparency and accountability while blocking opportunities for tax evasion.
The following are recommendations to ensure an effective, efficient and transparent tax incentive system:

1. Develop an efficient and effective Personal Income and Corporate Tax system that is transparent.
2. Publish comprehensive information on all tax exemptions in an annex to the annual budget while including the cost-benefit analysis of tax incentives and exemptions.
3. Institute systems that will ensure monitoring and evaluation of tax incentives
4. Ensure a minimal number of years for the tax incentives for both local and foreign investors.
5. Improve on infrastructure such as power and transportation to be world-class in order to attract Foreign Direct Investment, FDI.
6. Publish list of goods exempted from Value Added Tax, VAT.
7. Partner with ECOWAS countries to harmonise regional tax treaties including tax incentives and exemptions.

Stop

multinational companies from dodging

tax

ActionAid is a global movement of people working together to further human rights for all and defeat poverty. We prioritise works with the poor and excluded, promoting values and commitment in civil society, institutions and governments with the aim of achieving structural changes to eradicate injustices and poverty in the world.

ActionAid Nigeria is powered by the belief that a Nigeria without poverty and injustice is possible.

actionaid

Abuja
ActionAid Nigeria
Plot 477, 41 Crescent,
off Sa'adu Zungur Avenue
Tel: +234 (0) 812 888 8825-7
info.nigeria@actionaid.org
www.actionaid.org/nigeria

Borno Office
Old G.R.A. Beside
Lodge 7, Maiduguri.

Lagos
1A, Adeboye Solanke Street
Off Allen Avenue (behind
Zenith Bank)
Ikeja, Lagos.
Tel: +234 8126644268

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