Manifield Solicitors

THE LEGAL FRAMEWORK AND SYSTEM OF TAXATION IN NIGERIA: A CRITICAL ANALYSIS OF PERSONAL INCOME TAX

By
Mfonobong Unanaowo

www.manifieldsolicitors.com

INTRODUCTION

Globally, taxation is the nucleus and the path to development because it is one of the formidable options to generate revenue by government. The principle that taxation requires the consent of the legislature has become well established in virtually all jurisdictions. This principle interalia ensures certainty in the level of financial distribution within the jurisdiction and perhaps beyond. According to Abiola Sanni,[1] this principle is therefore, a bulwark against arbitrary imposition or increases of tax by the sovereign government.

In some developed economies, a great percentage of government's revenue is derived from taxation. Regrettably, there still exit a lacuna in the ability of government of Nigeria at all level to generate substantial revenue for their developmental needs through taxation. Although the reason for the near failure of taxation in Nigeria is diverse and multi-faceted, the legal framework for taxation is the major factor that inhibits taxation.

Considerable emphasis and incessant debates has been made on the importance of tax policy and administration in enhancing tax revenue. However, less has been said on the role of law in ensuring efficient taxation. Nigeria, like some other federating nations of the world has a multi-tax system which is rooted from the Constitution. It is the Constitution that laid down the taxing powers of the Federating Unit of Nigeria. In addition, the Constitution gives the Federating Unit the enablement to make laws for taxation in areas within their jurisdiction.

Agreeably, the laws enacted at Federal and State level regulates tax policy and administration, including the establishment of tax bodies that administer the respective taxes. For instance, at the Federal level, the Federal Inland Revenue Service is established under an Act of the National Assembly, to administer all federal taxes, though other bodies such as Nigeria Custom Service, etc., also collected levies that can be classified as tax. In the thirty-six states of the federation, there is State Internal Revenue Board established under the respective State's law to oversee the State Internal Revenue Service in tax administration. There is also a less organized Local Government Revenue Committee at Local Government level that administered taxes for which they are directly charged[2].

This paper explores the nature of tax, taxation system in Nigeria and its legal framework. Attempt is made to concisely analyse personal income taxation in Nigeria; tax problems and make recommendation that will ensure a sound legal regime for taxation in Nigeria.

NATURE OF TAX

According to Tolby, R. A., tax system can be described as a universal contrivance whereby the State[3] imposes upon its citizens a compulsory financial levy or contribution for the benefit of society as whole[4]. Putatively, tax is a natural attribute of sovereignty and an essential means of funding governments at all levels.

[1] Abiola Sanni, *Taxation In The Guise Of Administrative Charges - Imperative Of Curbing Abuses Of Regulatory Power For Revenue Purpose In Nigeria*

[2] Arekhandia, Zebedee , *Legal Framework For Taxation In Nigeria: Issues, Challenges And Prospects – Research Project at University of Ibadan, 2015.*

[3] The word 'state' is intended here to mean a sovereign government or a duly authorised sub-national government.

[4] *The Theory and Practice of Income Tax,* (Sweet & Maxwell: London, 1978) p. xix.

Even so, the authority wielded by a sovereign government is not confused to her citizenry, but by her territorial boundaries. A person doing business or having properties abroad will be subject to the authority of his host government; hence tax is not necessarily the exclusive burden of citizens, or even of residents.[5]

WHAT IS TAX?

Black's Law Dictionary[6] defines tax as "a monetary charge imposed by the government on persons, entities, transactions, or property to yield public revenue. It embraces all governmental impositions on the person, property, privileges, occupations, and enjoyment of the people, and includes duties, imposts and excises."

Tax is a compulsory exaction of money by a public authority for public purposes or raising money for the purposes of government by means of contributions from individual persons[7]

According to Akanle[8] taxation is generally "a compulsory levy imposed on a subject or upon his property by the government having authority over him".

TAX FEATURES

A tax in a technical sense has three main features namely,

a. It is imposed by government;
b. It is for public purposes; and
c. It is compulsory[9]

Thus, Taxation is considered machinate to legally compel people to contribute towards the provision of public good. Once a tax is clearly within the power of the Government and passes the necessary constitutional and legal litmus tests, no socio-political, religious, ethnic considerations could serve as a lawful excuse for not paying.[10]

As a cardinal note, under the Nigerian Law, prompt payment of taxes is a constitutional obligation. Section 24(f) of the Constitution of the Federal Republic of Nigeria, 1999 (as amended)[11] provides that it is a duty of every citizen to declare his income honestly to appropriate and lawful agencies and pay his tax promptly.

---

[5] Ade Ipaye, *Nigerian Tax Law & Administration (A critical Review)* London SCO prime Publishers 2014

[6] Black's Law Dictionary , 8th ed, p.1498

[7] Per Chief Justice Lathan of the Australian Supreme Court in the case of Matthews v Chicory Marketing Board (Vict), (1938) 60 C.L.R. 263 at 276.

[8] Akanle, O., "The Government, the Constitution & the Taxpayer" in Aknale O., (ed). *Tax Law and Tax Administration in Nigeria*, (Nigeria Institute of Advanced Legal Studies: Lagos, 1991) p.1

[9] F.R. Davies, introduction to Revenue Law, Sweet & Maxwell, 2nd ed. (1985), p.3.

[10] Abiola Sann, *Taxation In The Guise Of Administrative Charges - Imperative Of Curbing Abuses Of Regulatory Power For Revenue Purpose In Nigeria.*

[11] Cap. C23, Vol. 3, Laws of the Federation of Nigeria, 2004.

TAX SYSTEM

The Nigeria Tax System is made up of tax law, tax policy and tax administration. Abiola and Asiweh[12] stated that the three component of tax system are expected to work together in order to achieved the economic goal of the nation. According to the National Tax Policy[13], the central objective of the Nigerian tax system is to contribute to the well-being of all Nigerian directly through improved policy formulation and indirectly through appropriate utilization of tax revenue generated for the benefit of the people. Somori[14] posited that the features of a good tax system are:

i. it must be simple, certain and clear,
ii. it must have low cost of administration,
iii. it must be fair,
iv. it must be flexible; and
v. it must have economic efficiency.

A good tax system is a product of good law which beget good tax policy; and a good tax policy implemented by competent Tax Administrators, will produce peoples' compliant taxation that ensured increased tax revenue.

TAX STRUCTURE, TYPES AND TAXING POWERS

The structure of Nigerian Tax System has been said to deal with classification and types of taxes in Nigeria.[15] Accordingly, Nigerian taxes are said to be classified by methods and by incidence. Classification by methods includes;

a. Proportional tax (whereby the taxpayer is assessed at a flat rate, on his total assessable income),
b. Progressive tax (whereby a higher rates of tax applies to every increase in the taxpayer's income), and;
c. Regressive tax (whereby the tax payable decreases as the taxpayer's income increases).

Classification by incidence includes;

a. Direct tax (which are Personal Income Tax, Companies Income Tax, Capital Gains Tax, Educational Tax and Petroleum Profit Tax); and
b. Indirect taxes (Value Added Tax, Stamp Duties, Excise Duties and Customs Duties.

Taxing power is the power of a sovereign authority to boost its revenue through taxes within the limits of its jurisdiction. According to Justice Latham of the United States Supreme Court, taxing power is:

> "... the one great power upon which the whole national fabric is based. It is as necessary to the existence and prosperity of a nation as the air he breathes to the natural man. It is not

[12]Abiola, J. &Asiweh, M. 2012.Impact of Tax Administration on Government Revenue in a Development Economy-A case Study of Nigeria.International Journal of Business and Social Science, Vol. 3 N0. 8. P. 101
[13]National Tax Polcy.2012. Op. cit. Footnote 16
[14]Somorin, T. 2011. National Tax Policy, Issues, Challenges and Prospects. In Afeberoh, D. and Okoye, E. 2014.The Impact of Taxation on Revenue Generation in Nigeria: A Study of the Federal Capital Territory and Selected States. Op. cit. footnote 17
[15]Institute of Chartered Accountants of Nigeria .2005.

only the power to destroy; it is also the power to keep alive." [16]

Because of the expropriate nature of taxes and their impact on right to property, the exercise of taxing power is subject to certain principles and legal strictures one of which is that taxation can only be imposed by a statutory authority.[17]

According to Abiola,[18] globally, allocation of taxing powers between different levels of government is a complex problem, and that the most important factor that determines the division of taxing powers in a country is whether the country is operating a Federal or Unitary System of Government. Invariably, the type of government operated in a country will determine the level of taxing powers of each tiers of government.

Under the 1999 Constitution of Nigeria (as amended), taxing powers is divided between the federal and state government. Unfortunately, the Local Government which is the third tier of government and the closest to the people is left out. Commenting on this, Abiola[19] emphasized that the provision of Schedule 4 of the Constitution do not directly rest the local government council with power to collect taxes.

It is pertinent to note that Local Government Councils are not given any direct legislative powers under the Constitution but are made to loop up to the Federal and State Government for their sustenance, via statutory allocation as stated in Section 7 (6) (a) & (b) and Section 162 (5) & (8) of the Constitution of Federal Republic of Nigeria. [20] The Constitution, of the Federal Republic of Nigeria 1999 (as amended) specifically states the types of internally generated revenue that are exclusive to the Local Government Councils. [21] Prominent among these revenue are: collection of rates, radio and television licences, etc.[22]

We need to state here that while the constitution did not specifically spelt out the taxes to be collected by the local government councils, it can be inferred from the provision of Section 7 (1) of the 1999 Constitution of Nigeria which guarantee the sustainability and running of local governments that Local Government Council is allowed to generate revenue through the levying of certain categories of rates such as collection of fees for radio and television licences, establishment of cemeteries, licensing of bicycles, trucks, wheel barrows, etc. However, the Taxes and Levies (Approved List of Collection), Decree No. 102, 1993 (as amended)[23], specifically spelt out the taxes to be collected by local government.

---

[16] Vichols v Ames (173 U.S. 509 (1929), p.505

[17] Op.cit. footnote 8 see also Brandy Syndicate v. IRC [1921] K.B. 64

[18] Abiola, S. 2002. *Division of Taxing Powers.* P. 650 – 651,

[19] Abiola, S. 2002. *Division of Taxing Powers,* Ed. Abdulrazaq M. T. CITN Nigeria Tax Guide and Statutes, Lagos: The Chartered Institute of Taxation of Nigeria

[20] Orifowomo, O. A.2010. Fiscal Federation and Taxing Powers under the 1999 Nigerian Constitution. *Ed. Olugbenga F. Law, Politics and Development, The Challenges of an Emerging Mega-City, NBA Ikeja Branch*

[21] Oseni, M. 2013. Internally Generated Revenue (IGR) in Nigeria: A Panacea for Sate Development. *European Journal of Humanities and Social Sciences, Vol. 21, No. 1, p. 1053*

[22] Ibid

[23] Now Taxes and Levies (Approved List of Collection) Act CAP T2, Laws of Federation, 2004

In light of the forgoing it is safe to say that the Nigerian Constitution[24] is the foundation upon which the Nigeria taxing powers is built. The allocation of taxing powers has been one of the major factors that inhibit even development of taxation amongst the three tiers of government in Nigeria.

TAX COLLECTION

Tax collection on the other hand is different from tax imposition. In other words, the power to collect tax is different from the power to impose tax. Whereas the power to impose tax by a tier of government in Nigeria is derived from the Constitution, a tax Statute enacted pursuant to the taxing powers given to a tier of government by the Constitution may mandated another tier of government other that the one that imposed the tax to collect the imposed tax. For instance, while the Federal Government by virtue of item 59 of the exclusive list is vested with the powers on some sort of taxes pursuant to which the Personal Income Tax Act[25] was enacted, the State Governments are empowered under the law to collected all personal income tax except that of the Armed Forces, the Police, staff of Foreign Ministry, resident of Federal Capital Territory, Abuja and persons resident outside Nigeria whose income or profit is derived in Nigeria.[26] Sokunbi[27] expressed the view that the power to legislate or impose a tax may not necessarily be coterminous with the power of collection or administration of the law regulating the tax imposed. The tax legislations enacted by the National Assembly and in respect of which the states are empowered to collect and administer the taxes imposed are Personal Income Tax, Stamp Duties (individual only) and Capital

---

[24]The Constitution of the Federal Republic of Nigeria, 1999 (as amended). All other Nigerian Constitutions since independence starting from the 1960 Independence Constitution, the 1963 Republican Constitution and the 1979 Constitution, made express provisions for taxing powers in Nigeria.
[25] Personal Income Tax Act, Cap P8, LFN, 2004 (as amended)
[26] Ibid. Section 2 (1A) (a) & (b) and (3) thereof
[27]Sokunbi, T. An Overview of Revenue Law in Nigeria. An Overview of Revenue Law in Nigeria.*Available at http;//www.citn.org/----/tax. Accessed on March 10, 2018*

Gain tax (individual only). Local government council has no power to legislate in respect of tax, they may collect tax if so empowered by law.

LEGAL FRAMEWORK OF TAX IN NIGERIA

The legal framework of taxation is a codified system of order that describes the legal implications of taxation, i.e. government levies on economic transactions. It also provides a well-defined legal backing to the administration of each tax type, stating in clear terms the applicable rate.

Tax laws stipulate what constitutes offence and the appropriate sanctions to each offence and enshrines best practices in terms of ethical and professional conduct.

TAX LAWS IN FORCE IN NIGERIA

The following is a list of Tax Laws currently in force in Nigeria;

i. Federal Inland Revenue Service (Establishment) Act No. 13 of 2007
ii. Companies Income Tax Act (CITA) CAP C21 LFN, 2004 (commencement 1st Jan, 1958)
iii. Personal Income Tax Act (PITA) CAP 8 LFN, 2004 (as amended)
iv. Petroleum Profits Tax Act (PPTA) CAP 13 LFN, 2004 (commencement 1st Jan, 1958)
v. Deep Offshore and Inland Basin Production Sharing Contracts Act
vi. Value Added Tax Act (VATA) CAP D1 LFN, 2004 (commencement 1st Dec, 1993)
vii. Education Tax Act CAP E4 LFN, 2004 (commencement 1st Jan, 1993)
viii. Capital Gains Tax Act (CGT) CAP C1 LFN, 2004 (commencement 1st April, 1967)
ix. Stamp Duties Act CAP S8 LFN, 2004 (commencement 1st April, 1939)
x. National Information Technology Development Agency Act (NITDA)
xi. Nigeria LNG (Fiscal Incentives, Guarantees & Assurances) Act
xii. Industrial Development (Income Tax Relief) Act
xiii. Industrial Inspectorate Act
xiv. Investment and Securities Act, 2007
xv. Insurance Act of 1997 (as amended)

PERSONAL INCOME TAX ANALYSIS

Personal income tax predates the modern Nigerian State having evolved from the pre-colonial era through the colonial era and still evolving in this post-colonial era. Income tax administration post-independence was first regulated by the Income Tax Management Act (ITMA) 1961, which was later replaced by ITMA 1979 (REFs).ITMA 1979 was repealed and replaced by the Personal Income Tax Decree/Act (PITD/A) 1993. The Act[28] was revised in 2004 as Personal Income Tax Act 2004 with some sections and schedules later amended in 2011.[29]

Pursuance to the Personal Income Tax (Amendment) Act, 2011, the administration of the Personal Income Tax is vested on the State Internal Revenue Service (SIRS) in each State and the Federal Capital Territory (FCT) Abuja.

The core concern of the past and present Acts is the determination of taxpayers' tax liabilities, by outlining procedures to determine gross income, allowable and disallowable deductions from income in ascertaining taxable income, non-taxable income, applicable marginal tax rates, exemptions, etc.

Income under the PITA 2004 in conjunction with its Amendment Act 2011 encompasses all income received by a taxable person such as employment-related income including benefits-in kind, income from

[28] The Act provides for certain conditions for deeming income taxable in Nigeria. It provides, among others, that the gain or profit from an employment shall be deemed to be derived from Nigeria if the duties of the employment are wholly or partly performed in Nigeria or the employer is in Nigeria, unless the duties of the employment are wholly performed, and the remuneration paid, in a country other than Nigeria except during a temporary visit or leave in Nigeria.
[29] Cap 68 Laws of the Federation of Nigeria, 2004

self-employment as well as income derived from investment (e.g., interest, dividend, rent). [30]Whilst income from paid employment and self-employment is denoted earned income according to the provisions of the 2004 Act, the one from investment represents unearned income.

This section is specifically restricted to PITA 2004 and its Amendment Act 2011. Moreover, it is intentionally restricted to the tax provisions relating directly to how tax liability is determined, which bear direct relevance to the critique this study set out to provide on the progressivity of Nigerian PIT. Such provisions relate to gross income; earned and unearned income; exemptions, allowances, and reliefs; tax rates; minimum tax; and non-taxable income thresholds.

The First Schedule to PITA 2004 provides that:

> "earned income" in relation to an individual, means income derived by him from a trade, business, profession, vocation or employment carried on or exercised by him and a pension derived by him in respect of a previous employment."

Although the Act uses the term "unearned income," it fails to define what it means. Unearned income apparently represents income other than earned income received by the taxpayer. The importance of these two broad income conceptions is not trivial as they have implications for the overall tax base or taxable income and ultimately the tax liability as we shall discuss in the next section. Gross income suggests comprehensive income without distinguishing between earned and unearned income for the purpose of determining consolidated relief allowance (which replaces Personal relief as used in 2004 Act).

According to the Acts, exemptions, allowances and reliefs are allowable deductions from gross income which effectively reduce the taxable income. Whilst some of these allowable deductions are specified absolute amounts, others are relative as a percentage of a particular base such as gross income or earned income. Consequently, the higher the gross/earned income the higher the allowable deduction will be. Progressive, graduated or marginal tax rates are used such that incremental tax bases are subjected to higher tax rates, thus suggesting that higher income earners are subjected to higher income tax.

The Acts provide for the payment of a minimum tax by a taxpayer who has no taxable income after all allowable deductions have been made from its entire income or when the taxpayer's tax liability is less than 0.5% of the entire income. When that happens, 2004 Act mandates the taxpayer to pay 0.5% of the entire income. This was increased to 1% in 2011 Amendment Act. Another germane issue within these Acts (albeit not explicated in the Acts) is the taxable income threshold. This threshold represents individual taxpayers' income that is shielded from tax, which could have implications for taxpayers' ability to meet subsistence. A critique of these issues in evaluating tax progressivity and equity are discussed in the ensuing section.

BASIS OF LIABILITY

The Personal Income Tax (Amendment) Act makes provisions for certain conditions for taxing incomes derived from employment in Nigeria.

Accordingly, Income from an employment shall be deemed to be derived from Nigeria and therefore taxable in Nigeria if:

a. the duties of such employment are performed wholly or partly in Nigeria, unless the employer is not resident in Nigeria and the remuneration of the employee is not borne by a fixed base of the employer in Nigeria, and
b. the employee is not in Nigeria for an aggregate of 183 days (inclusive annual leave or temporary period of absence) or more in any 12 calendar month period, and

[30] The incidence of taxation on employment income and the relevant authority are determined by residence. Once a place of residence is determined, the relevant tax authority is the SIRS in which the taxpayer has a permanent place of residence. Therefore, in a situation where an employee is resident in Ogun State but works in Lagos State, the relevant SIRS will be that of Ogun State. As such, income tax due from employment (individuals and partners) is due to the state where such employees are resident.

c. the employee's income is liable to tax in that other country under the provisions of the avoidance of double taxation treaty with that other country.
d. The employer is in Nigeria, or has a fixed base in Nigeria.

As a prerequisite, paragraphs a – c must be jointly met for an expatriate to be exempted from taxes in Nigeria.

By the provisions of the PIT Act, a person's place of residence is defined as a place available for his domestic use in Nigeria on a relevant day. This excludes hotel, rest house or other place at which he is temporarily lodging unless no more permanent place is available for his use on that day.

Once a place of residence is determined, the relevant tax authority is the tax authority of the territory in which the taxpayer has his place of residence or principal place of residence, as the case may be.

Thus, the concept of residence is critical in determining the relevant tax authority for the purpose of assessing and collecting taxes.

TYPES OF TAXABLE INCOME

Under the PITA[31], any salary, wages, fees, allowances or other gains or profits from an employment including bonuses, premiums, benefits or other perquisites allowed, given or granted to an employee are chargeable to tax.
Notwithstanding, the following income streams are tax exempt;

a. reimbursement of expenses incurred by the employee in the performance of his duties, and from which the employee is not expected to make any profit;
b. retirement gratuities and compensation for loss of office;
c. interest on loans for developing an owner-occupied residential house

On a related note, the following are tax deductible contributions;

a. National Housing Fund Contribution;
b. Life Assurance Premium;
c. National Health Insurance Scheme;
d. National Pension Scheme

Along with the above listed tax exempts, the Consolidated Relief Allowance (CRA) will be granted as a relief. The CRA is the higher of 1% of gross income or N200, 000.00, plus an additional 20% of gross income.

TAX RATES

Taxable income is assessed to tax at graduated rates ranging from 7 percent to 24 percent, depending on the income band being assessed. Non- residents are subject to the same tax rates as residents. The maximum tax rate is currently 24 percent on taxable income.

EMPLOYEE COMPLIANCE OBLIGATIONS

Every employee in Nigeria is mandated to complete / submit an income tax form for return of income and claims for allowances and relief (Form A), within 90 days of commencement of every year; i.e. 31st March (90 days) of each year to the SIRS through his/her employer.

EMPLOYER REPORTING OBLIGATIONS

Every employer must process/file an employer's annual declaration and certificate (Form H1) and employers remittance card (Form G) for the company, per location where the employees are resident. These forms are expected to be submitted annually on or before 31st January of each year.
In addition, monthly remittance of PAYE tax should be made not later than the 10th day of the following month of deduction.

[31] See section 3 of the Act

PENSION

The Pension Reform Act 2014 (PRA 2014) which repeals the Pension Reform Act 2004 governs and regulates the administration of the contributory pension scheme in Nigeria.

The Act provides for a minimum threshold for private sector employers to participate in the Scheme (i.e. three (3) employees).

The Act also provides that self-employed persons and private sector employees of an employer, who does not meet the minimum threshold, shall be entitled to participate in the scheme, notwithstanding the minimum threshold.

On the subject of contribution rates, the repealed Act had increased the rate of contribution for employees and employers to a minimum of 8% and 10%, respectively. Employers, who choose to bear the full pension cost of their employees, will be required to contribute a minimum of 20% to the Scheme. The rates remain applicable to monthly emoluments[32].

Furthermore, every employer is required to maintain a Group Life Insurance Policy in favour of each employee for a minimum of three (3) times the annual total emolument. Premium shall be paid not later than the date of commencement of the cover.

As a lacuna, the Act[33] is lacking on specific provisions[34] on the requirements for foreigners to participate in the Nigerian pension scheme. However, guidance from the National Pension Commission indicate that foreigners may at their sole discretion join the Nigerian Pension Scheme, without considering whether he/she has an existing pension arrangement in his/her home country.

WORK PERMIT/VISA REQUIREMENTS

Where the non-residents enter the country on a Temporary Work Permit (a permit granted to expatriates who intend to come into Nigeria for a period not exceeding three months) and spend less than a cumulative period of 183 days, then they would not be liable to Pay as You Earn (PAYE) taxes, as long as the salaries of those individuals are not recharged to the Nigerian company.

However, where the non-resident enters into the country on an expatriate quota (document obtained from the immigration office permitting a company to import the services of expatriates) and the non-residents have duly obtained residence permits, which enables them to work in Nigeria, they would be liable to PAYE taxes even where they spend less than a total of 183 days.

A CRITICAL ANALYSIS OF PERSONAL INCOME TAX IN NIGERIA

The preceding section highlighted basic tax issues that will provide the context to critique the progressivity of Nigerian PIT through equality lens. Implicit in the 2004 Act and 2011 Amendment Act is the notion of a progressive income tax that takes more from the rich than the non-rich, underpinned by the notion of equity or income redistribution because more are taken from the rich in tax to meet the common good of the society. However, a close analysis of the relevant elements of the Nigerian PIT apparently contrasts its embedded progressivity and equality notions. An attempt is made to highlight a number of issues arising from the current PIT[35] in force in Nigeria in need of critique. These issues are the;

a. tax rate structure;
b. tax base structure;
c. exemptions, allowances and reliefs;
d. bracket creep;

[32] The Act defines monthly emoluments as 'total emoluments as may be defined in the employee's contract of employment but shall not be less than a total sum of basic salary, housing allowance and transportation allowance. Section 120 Pensions Reform Act, 2014 LFN

[33] Pensions Reform Act, 2014

[34] Perhaps the law makers are intentional as regards this position.

[35] Which is perceived to be a progressive tax

e. minimum tax; and
f. taxable income threshold.

TAX RATE STRUCTURE

It is naïve to suggest that high tax rate structure translates to equitable tax as many other factors such as allowable deductions contribute towards the final tax liability[36] cynicism corroborates the above assertion as follows:

> The current inconsistent income tax features progressive marginal rates. It is thus intended to be a progressive tax …The actual pattern of a tax system's progressivity depends on what sort of loopholes and gaps the tax has and on who can take advantage of them.

The current highest marginal tax rate of 24% is less than the corporate income tax rate of 30%. This will provide incentives for owners (directors) of private limited companies to transfer enormous amount of earnings through directors' remunerations (including pension contribution) and the exemption of 20% of such earnings through consolidated relief allowance.

Although the graduated rates imply progressivity in the absence of critical evaluation, it actually fails to distinguish between the rich class and the (lower) middle class as virtually every middle level income reaches the maximum marginal tax level. Essentially, all the middle income earners fall within the highest marginal tax rate, unlike in developed countries where only a small proportion of income earners fall into this tax band.[37] Considerably, the provisions of the Act suggests that two taxpayers with gross income of N5m and N100m per annum reach the maximum tax bracket even though the former's income level only permits an average living standard in the current day Nigeria.

TAX BASE STRUCTURE

Whilst Nigerian marginal tax rates might appear small compared to those of developed countries, the income brackets for each marginal tax rate category are so small that the average tax rates between taxpayers are largely insignificant thereby tilting towards a proportional tax regime. According to Snyder & Kramer (1988), whereas progressive marginal tax rates appear to produce some level of income redistribution as higher income bracket increases tax liability, it only generates a mildly progressive average tax rate. That is to say, the income of lower-middle class taxpayers virtually falls into the highest marginal rate bracket essentially due to the impacts of inflation and recent review of minimum wage to adjust for economic realities rather the economic prosperity.

EXEMPTIONS, ALLOWANCES AND RELIEFS

The Nigerian tax authorities have failed to address the inconsistent tax reliefs granted to taxpayers. A flaw with the use of gross income, for example, as a relative base for computing tax relief is that it benefits the high income earners more than low income earners. Apart from the very high income earners benefiting more from deductible reliefs, they also fall into the group that could also amass certain income that are exempted from tax, which thus gives rise to double benefit. For example, consolidated relief allowance (CRA) is calculated as 20% of gross income plus the higher of N200, 000 or 1% of gross income. As income from all sources (including those that are exempted from tax) makes up the gross income, the CRA is swelled by the income exempted from tax [first benefit] and that income is later used to reduce the taxable income [second benefit]. A number of income exempted from tax include interests on government bonds and securities. It is almost always certain that such investments are held by the high income groups. For example, if N5m income is exempted from tax, it means it will not suffer tax liability, yet it generates a further N1m CRA implying that N6m has been shielded from tax liability.

Furthermore, the class of high income individuals are allowed to reduce their taxable income by deducting certain expenses they incurred before determining taxable income. Two prominent tax exemptions of this nature are life assurance premium and pension contribution (both compulsory and voluntary), which had been considered above.

[36] see Sicat&Virmani, 1988; Verbist&Figari, 2013. McCaffrey's (2002)
[37] Snyder & Kramer, 1988

Ascribable to the high cost of living and the weak purchasing power in Nigeria, low income and lower-middle income earners barely have enough for subsistence, needless to say have excess to take up life assurance policy. Whilst it might be argued that pension contribution is applicable to both high and low income earners, it is only naïve to accept it produces similar relative impacts on the taxable income of these different income earners. Whilst a large majority of low to middle income earners only participate in the compulsory pension scheme, the high income earners are fortunate to also make voluntary contribution which is also fully exempted from tax. But the voluntary contribution is apparently a tax avoidance instrument for such privileged group as there are no restrictions as to the amount, and the time, the taxpayers could draw from their Pension Fund Administrator (PFA), unlike the compulsory contributory pension with many legal restrictions. These are some loopholes created within the tax system to benefit high earners. In Tran-Nam, Vu & Andrew's, (2007) argument, the upper class or high income earners often take advantage of loopholes in the tax system to avoid tax thereby leading to lower average tax rate. Space will not permit the examination of business income and a number of loopholes self-employed taxpayers potentially adopt to reduce their tax liabilities.

BRACKET CREEP

The "bracket creep" defines a shift of personal income into a higher tax bracket when taxable income grows over time.[38] It occurs due to inflation. Higher inflation possibly increases tax burdens under a progressive personal income tax as taxpayers near the top-end of a tax bracket are more likely to "creep" to a higher bracket.

It is apparent that the recent review of the national minimum wage (although not uniformly implemented across the country) derives from the erosion of purchasing power of workers' disposable income. Although income tax brackets are supposed to be increased to adjust for the impacts of inflation (Snyder & Kramer, 1988), this is not the case in Nigeria despite the evidence of persistent inflation3 reducing the real income of taxpayers. Whilst the increase of taxable income threshold and reliefs in the 2011 Amendment Act is laudable, it suggests a pecuniary rather than real increase when these are adjusted for inflationary impacts.

The impact of the bracket creep depends on the level and duration of the inflation, the highest marginal tax rate and initial income distribution. They provide an evidence of how the US Government adopted the cost-of-living index for the indexation of both the personal exemptions and tax brackets to tackle this discrepancy. In Nigeria, the upward pecuniary review of salaries has practically put the low income earners (relative to the rich or high income earners) into high tax bases and rates. When inflation is not adjusted for in determining marginal rates and income base brackets, it is very unlikely that tax policy will achieve a fair progressive tax. Given the level of inflation and high cost of living in Nigeria, a fixed threshold that takes these factors into consideration would underscore progressivity and effective income redistribution.

TAXABLE INCOME THRESHOLD

Another issue that is relevant to how a particular tax regime could be evaluated as progressive is the threshold of income that is completely shielded from tax. In the United Kingdom, for example, the non taxable income threshold is the same irrespective of the marginal tax rate bracket of the taxpayers. The rationale behind this equal amount exempted from tax for all individuals is underpinned by the notion of shielding income necessary for subsistence from tax. The discussion and assessment of progressive tax cannot necessarily be restricted to marginal tax rates but extended to include the non-taxable income threshold for such tax in order to satisfy income redistribution policy objective. Apparently, the income completely shielded from tax varies per taxpayer as some of the reliefs are based on a percentage of gross income, which suggests a direct relationship between gross income and non taxable income threshold.[39]

Considering the elite taxpayers apparently gifted with higher non-taxable income threshold, both equity and redistribution assumptions of a good tax policy are called into question. Given the level of inflation and high cost of living in Nigeria, a fixed threshold that takes these factors into consideration would underscore progressivity and effective income redistribution. Sometime in 2012, the National Bureau of

[38] Heer & Sussmuth (2013, p. 393)
[39] Sicat &Virmani (1988)

Statistics asserted that income inequality has risen in Nigeria and that about 112 million Nigerians are living in poverty.[40] The World Bank in 2014 equally ranked Nigeria third among the world's ten countries with chronically poor citizens, representing over 70% of the country's population.[41]

MINIMUM TAX

Most tax scholars has argued that the nature of minimum tax is not only a misnomer, but also an instrument that contradicts both income redistribution and tax progressivity, and at worst, an instrument for inflicting double punishment on the poor. The current minimum tax is 1% of gross income, which arises when after tax assessment the taxpayer has no taxable income or the taxable income will only generate tax liability that is less than 1% of gross income. Poor taxpayers thus suffer double punishment for being poor. One, they might not be able to use up all the reliefs and exemptions under the Act yet such unclaimed reliefs lapse in that year of assessment. Two, they are forced to pay tax on their insufficient income even when it is obvious that such income is below the threshold for meeting subsistence in the current day Nigeria. Essentially, the inconsistency of the current non-taxable income threshold which apparently benefits the rich more than the poor further suggests how vicious the minimum tax concept is. For instance, a taxpayer on annual income of N100, 000 is expected to pay N1, 000 as tax even though the individual is entitled to unused-up consolidated relief allowance of N220, 000. This spells injustice.

CONCLUSION

In conclusion, the existence of a pragmatic, dynamic and result-oriented legal framework for taxation in a tax system will produce an efficient and effective taxation that guarantee increased tax revenue for the government. It follows therefore that the faltering of the Nigerian tax system is a consequence of some defects in its tax law.

Notwithstanding the aggressive tax collection machineries put in place by some state governments in Nigeria, the mismanagement of these tax revenues by politicians and bureaucrats alike is apparently cruel than the doubtful equality objective embedded in the current tax system. As considered above, the purported progressive income tax in Nigeria is riddled with a myriad of inconsistencies, which by default (or otherwise) benefit the high income groups more than the low income earners. Thus, this suggests that income tax progressivity in Nigeria that meets the tenet of equality is in doubt.

According to KPMG, it is debatable whether the overall impact of the PITAM on taxpayers is consistent with the National Tax Policy of reducing direct taxes and increasing the disposable income of individuals, especially considering the impact of the recent removal of fuel subsidy, and the fact that PITAM increases the effective tax rate of the lowest bracket of income earners (i.e., minimum wage earners) by 100% (KPMG, 2012, p. 4).

RECOMMENDATIONS

In the light of the foregoing, the following are recommended;

a. That on the subject of the legal framework of taxation in Nigeria, the various tax laws in Nigeria should be amended to provide for adequate punitive sanctions for tax violation, so as to discourage the prevailing avalanche tax evasion and serious punitive sanction should be enacted in Nigerian tax law as punishment for violations and non-adherence to the provisions of tax law by tax administrator and others persons mandated under the law perform specific functions/duties.
b. That the Nigeria constitution should be urgently amended to correct the lopsided distribution of taxing powers and the allocation of responsibility of tax collections, which is presently in force.

[40] Punch, February 14, 2012
[41] Daily Independent, May 2, 2014

More taxing power should be allocated in definite terms to states and local government councils in the spirit of fiscal federalism as obtained in developed federation of the world.

c. The Personal Income Tax Act should be reformed to consider the economic realities of low (poor/non-elites) income earners into cognizance in deciding the thresholds of the various issues this paper have critiqued.

d. There is a need to conduct a comparative study of Personal Income Tax in Nigeria and other developing countries and possibly, a comparative study of Personal Income Tax in Nigeria and developed countries. These studies could be designed to examine

   i. the tax rates (within a single/multiple tax regime(s),
   ii. the reliefs available to the taxpayers,
   iii. the graduated tax bases with their applicable marginal tax rates,
   iv. comparative (minimum) wages, and
   v. the non-taxable income thresholds.

e. That the complexity and ambiguity in Nigerian tax laws specifically PITA, should be urgently corrected so as to create an enabling environment for voluntary tax compliance by tax payers.

f. That a simpler assessment process should be put in place in order to minimize resistance by taxpayers to tax audit by tax officials.

From the above recommendations, if adopted, Nigerians (especially personal income earners) will enjoy a fair and equitable tax regime and this will aid to increase tax revenue as original intended by government.

;

For more information, please contact;

Mani Ojeah
Managing Partner
+234 8027405535
immanioj@manifieldsolicitors.com

Mfonobong Unanaowo
Head, Corporate & Commercial Dept.
+234 8051753754
mu.unanaowo@manifieldsolicitors.com

For further information about the firm, please visit www.manifieldsolicitors.com. This is a publication of Manifield Solicitors and it is for general information only. It should not be construed as a Legal Advice of any kind.

Manifield Solicitors | **16b Omorinre Johnson Street, Lekki Phase 1 Lagos**

| +2348027405535 | +2349093857000 | info@manifieldsolicitors.com | www.manifieldsolicitors.com