RESEARCH ARTICLE

Taxation in a Decentralized Value Added Tax Regime: Implications for States in Nigeria

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Abstract: The study examined the implication of a decentralized Value Added Tax system for states in Nigeria. It is a theoretical presentation that made is made of journals, articles, and data from the National Bureau of Statistics (NBS) accessed on Google Scholar Websites. A total of eighty (80) articles were accessed. Results from a theoretical review revealed that while few states in Nigeria are in favor of a decentralized VAT administration in the country, quite a number of them (States) are averse to the new VAT regime due to differences among the states in terms of volume of business activities and economic power as many of the states rely on federal allocation. The study, therefore, recommends Partial Decentralization (PD) of VAT administration in Nigeria as a measure of autonomy for states that will guarantee fairness in resource control in the Nigerian Society.

Keywords: Taxation, Value added, Administration, Resource, Control, Decentralized

1. Introduction

Value added tax (VAT) is a consumption tax that has been embraced by many countries around the world as a consumption tax that is easy to administer and difficult to evade. The two critical attributes of the tax-easy administration and the difficulty of evading make the yield from tax fairly accurate and measurable and responsible for the growth of many economies since purchasing power deter-mine the yield increases with economic growth. Darlon & Richard [1] opined that VAT is adjudged to be an ideal form of tax that has significantly contributed to resource mobilization and capital formation of many economies especially developing ones. Given, the notable contribution of the tax and its positive impact on revenue mobilization and infrastructural development, the federal government through the Finance Act, 2020 increased the VAT rate to 7.5% from the initial rate of 5% as contained in the provi-

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sion of VAT ACT CAP VILTN 2004. The implementation of the increased rate became effective on 1/2/20. VAT is a Federal Government tax centrally collected and administered by the Federal Board of Inland Revenue (FBIR) through Federal Inland Revenue Service (FIRS). The yield from the tax is to be shared among the federating units (Federal, State, and Local Government Areas) in Nigeria. The sharing formula for the yield in 1993 when VAT was introduced was 50%, 35%, and 15% for Federal Government, state, and Local Government areas respectively. According to Larry & Morle [2] the formula changed to 15%, 50%, and 35% for Federal, State, and Local Governments respectively based on factors of equity, population, and derivation from 1999 to date.

The essence of the formula is to ensure fairness in the distribution in society. Unfortunately, however, the debate around resource control, fiscal federalism questions, and the issue of the tier of government that should be responsible for the collection and administration of VAT continue nagging. These issues of resources questions have on many occasions led the federating units especially States and Federal governments to arbitration on the matter in court.

The judgment was delivered by the Federal High court – Port Harcourt Division on the 9th of August 2021 in AG Rivers State. FIRS & AG of the Federation appeared to have put to rest the controversy surrounding the tier of government that should be responsible for the administration of VAT in Nigeria as FIRS (VAT collection of the Federal Government) was barred from VAT collection/administration in the country. With the court's decision on VAT, states like Lagos and Rivers quickly went to the drawing board to develop their VAT laws which will govern the administration of VAT in their States. Manma & Hashfu [3] stated that while the outcome of arbitration appeared to have favoured States, the pertinent question raised by the court decision bothers on the implication of a decentralized VAT regime for states given the fact that states in the country have varying endowments and financial capabilities. Therefore, the objective of this study is to examine the implications of a decentralized VAT regime for the states in Nigeria to proffer solutions to the issue of revenue generation on which welfare and development purposes of government rotate.

2. Literature

2.1 Conceptual Review

VAT: It is a broad-based tax that covers items of goods and services including professional services, telecommunications, banking, and insurance. Osita [4] describes VAT as broad-based to the extent that its imposition makes no distinction between locally manufactured goods and services and their imported counter-part against the narrowed-based sales tax it replaced that covered only nine categories of goods and services in hotels, motels, and similar establishment. Mokolu & Ogodor [5] defines it as a multi-stage consumption tax collected at each stage as goods and services pass firms' production, distribution, and consumption. Thus, Yaluwa [6] viewed VAT as a multi-stage tax on the value added to goods and services as they (Vatable goods and services) proceed through the stages of production and distribution to the final consumers that bear the burden. Through VAT is a multiple-stage tax, it has a single effect and does not add more than the specified rate to the consumer price no matter the number of stages at which the tax is paid. The cardinal advantages of VAT according to Ebungor and Doglas [7] and Udah and Oyinlola [8] are ease of collection since it is paid at the point of consumption, of goods and services, cost-effective in administering the tax and ease to check its evasion. The uniqueness of the VAT administration process stems from its assessment. It is a self-assessed tax paid when returns are rendered with the inbuilt refund or credit mechanism provision of the Act.

2.2 Empirical Review

In literature, VAT has been a valuable revenue source across nations developed and developing. For instance, in the UK, Kartom and Duke [9] found that VAT collection contributes significantly to finance available for public expenditure. In the USA, Armstrong and Arthur [10] examined the relationship between the size of VAT revenue and inequality. The authors found that revenue consequences of VAT are positive but that income-based inequality has increased due to VAT adoption.

In Nigeria, Okoli [11] did a study on the correlation between VAT and national revenue: An ECM model. It was found that VAT revenue is the second long-term source of federally collected revenue suggesting that VAT revenue is a significant revenue source and dictates the quantum/size of public expenditure and programs to undertake.

Apere and Durojay [12] investigated the relationship between VAT and government total revenue to assess the impact of VAT on government revenue generation in Nigeria. Ordinary Least Square (OLS) was used to analyze data obtained from the Central Bank of Nigeria (CBN). Phillip-perron unit root test and correlation test was also conducted to ascertain the strength of the relationship between the variables. The results showed a long-run significant and positive relationship between VAT and government revenue. The result underscores the importance

and significance of VAT as a veritable source to finance government expenditure.

Onochie, Nkiru and Anayo [13] evaluated the impact of VAT on revenue generation in Nigeria intending to assess the contribution of VAT to the total revenue of the government. Total Federal Collected Revenue (TFCR) is the dependent variable while VAT Petroleum Profit Tax (PPT), Company Income Tax (CIT), Custom Duties (CDs), and Excise Duties (ExDs) were the explanatory variables. Data obtained from 2009-2017 were analyzed using OLS regression. The result showed that all the explanatory variables have a significant impact on TFCR with that VAT second to PPT. Further, Disu and Haliru [14] in their study on the role of financing sources for Federal, State, and Local Government councils in Nigeria, found that federal allocation, stabilization fund, and VAT have a significant impact on revenue available to defray government expenditure.

On revenue allocation challenges in Nigeria, Sylvester and Sunday [15] examined revenue allocation challenges in Nigeria: implications for sustainable national development: the purpose was to examine the structure and formula for revenue allocation in the country. The study utilized the methodology of Group Unit Root Test (GURT), Auto regression Distributed Lag (ARDC), Bound Test (BT), and co integrating long run test. It was found that the revenue allocation formula has been the major challenge in fiscal federalism in Nigeria. Enefola and Tajudeen [16] provided further insight into revenue allocation challenges in Nigeria. The study is an expository review of various attempts at solving revenue allocations problems in Nigeria. It was found that the issue has been a nightmare as commissions set up to address the problems right from pre-independence to the present day post-independence era have not found enduring solutions. Frank and Nduche [17] provided a comprehensive study on the challenges of revenue sharing in the country. The study was exploratory research that made use of primary data. Responses to a questionnaire designed to reflect five (5) point Likert scale on problems confronting revenue allocation were descriptively analyzed using mean scores graphs and t-statistics of non-parametric statistics. The results indicated that the financial weakness of states and insincerity on the part of the government to address the problem of revenue sharing in Nigeria are the major issues of revenue allocations in Nigeria.

On agitation for fairness and equity in the distribution of yields of VAT collection, Edhu and Ellias [18], Umanah and Ekpo [19], Ekola and Teslim [20], and Desmond and Hamstron [21] in their separate exploratory review of studies conducted on VAT collection and distribution among the federating units in Nigeria found that disparity and disproportion exist in the distribution of VAT revenue among the tiers of government. This disparity led to various agitations and a court action that gave judgment in favour of a decentralized VAT administration in Nigeria. Digboru & Ochima [22]; Emulefor & Ayo [23] in their separate empirical studies reported similar evidence on VAT allocation issues. In another study, Ukalor and Onya [24] investigated the problem of VAT distribution among the three tiers of government in Nigeria. The authors measured the perception and reactions of Nigerians to VAT distribution in the country. The results of the analysis using graphs revealed evidence of inconsistent legal structure as a major factor confronting fairness in VAT allocation in Nigeria. Also, Neigbogu and Tobi [25] in ranking and analyzing problems of VAT distribution in Nigeria found that disconnection exists between what is generated from states and what (states) get as allocation as a reason for agitations around VAT administration in Nigeria.

2.3 Theoretical Framework

The study is anchored on the income distribution theory propounded by David Richardo in 1911 according to Wedler and Daslon [26]. The theory is a systematic attempt to ask important questions and reasons for equitable sharing of national income revenue among stakeholders or different sections of a nation. The assumed that diversity exists in terms of endowments in the society and such, the theory raised critical questions on how national revenue is to be fairly distributed among the units/factors that produce the revenue/income. Questions such as what determines the share of the national revenue, capital, land and the resources embedded? These are the problems of sharing and the basic questions the theory attempts to answer as noted by Barilon & Rofman [27]. Statistical Institute (SI) according to Menda [28] published evidence on income/revenue distribution based on various statistical concepts and indices such as dispersion of earnings and inequality of wealth in the society as bases for fair distribution of national wealth.

The theory is relevant and important to this study as the research is an attempt to proffer solutions to continuous agitations for fairness in the VAT administration system in Nigerian society.

3. Materials and Methods

It is a theoretical presentation that made use of relevant literature on the subject matter. Published journals and data obtained from bulletins of the National Bureau of Statistics (NBS) were accessed with the use of keywords

such as VAT distribution and implication of decentralization. Up to eighty (80) articles were consulted for this study on the Google Scholar website.

The model of this study is conceptualized as follows:

Figure 1 above depicts the model of this study. There is a link between the decentralization of VAT administration and decentralized resource control/diversification of the Nigerian economy. Decentralized resource control, utilization, and fairness in sharing of resources in the society will lead to healthy competition for growth and development among states, the aim of a decentralized VAT regime in Nigeria.

The econometric form of the equation depicting the theoretical illustration above is as follows:

$$HCG \& D = a + \beta_1 \, D \, VATR + \beta_2 \, DRC$$

where:

a = Intercept

HCG & D = Healthy Competition for Growth and development among States

DVATR = Decentralized Value Added Tax Regime

DRC = Decentralized Resource Control

Competition for growth and development among states

in Nigeria translates to national economic growth which, according to Enefola & Tajudeen [16], Ukalor & Onya [24], and Mokolu & Ogodor [5], is the aim of decentralization of VAT administration in Nigeria.

Figure 2 shows three years of VAT distribution among states of the federation from 2018-2020.

In the distribution, Lagos states for instance commercial hubs of the nation received a sum of N342. 2 billion between 2018-December 2020 representing 18.6% of the total revenue shared by the states and Federal Capital Territory (FCT). Interestingly, the state's VAT collection accounts for over 55% of the total VAT collection in the country according to Williams & Adeoye [30]. Other states that followed in terms of the size of VAT revenue share during the period are Kano, Oyo, Rivers, Kaduna, Delta, and the Bauchi States having N68.95 billion, N61.32 billion, N59.62 billion, N52.96 billion, N48.73 billion, N45.95 billion and N44.03 billion respectively.

To Lagos, Rivers, and other states in the southern part of Nigeria, the amount they have been receiving from VAT collection is small relative to what they generate. The disproportionate distribution of VAT collection among the
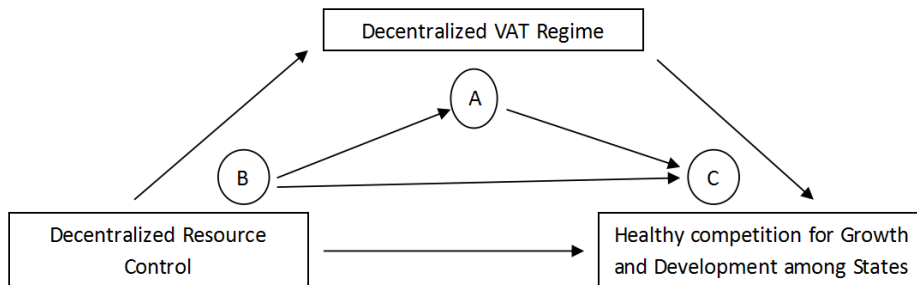

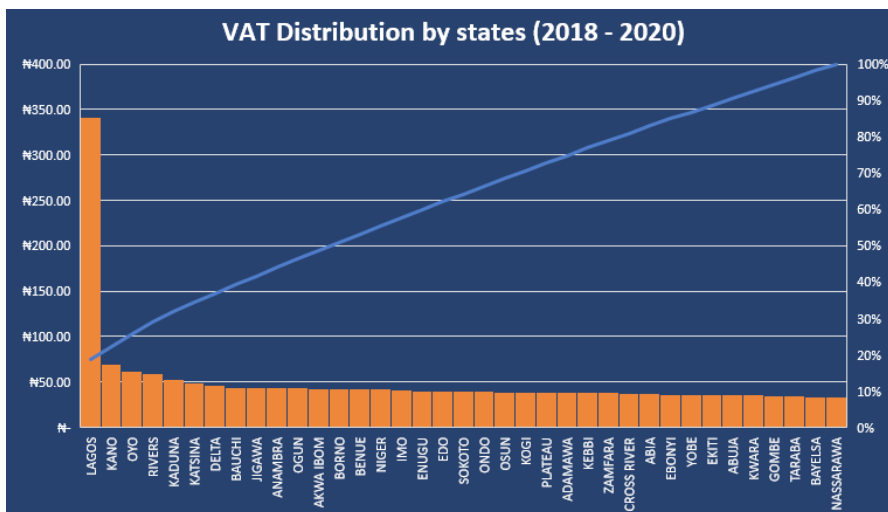**Figure 1.** Conceptualization of the Model of the Study.

Figure 2. Pattern of VAT distribution in Nigeria

Source: National Bureau of Statistics NBS report cited in Samuel [29]

federating units, as noted by Ogor & Kelechi [31], has been a singular reason why some states mainly in the southern part have been clamoring for decentralized VAT systems in the nation. Uta & Enulema [32] opined that decentralization will make the power to collect and administer VAT reside at the state level and a percentage of the collection remitted to the Federal Government. With decentralization as supported by the court decision in the case of Rivers State and FIRS in 2021, several states in the country will likely feel the unfavourable effect of the new VAT regime especially those with low Internally Generated Revenue (IGR).

Figure 3 below depicts the states in Nigeria and their revenue composition in 2020.

While states in the southern part, especially Lagos and Rivers, support a decentralized VAT administration system in the country, their Northern counterparts are against the system. The contradicting agitations regarding how VAT should be administered stem from the difference in the volume of business activities and economic powers between states in the southern and northern parts of the country according to Chekwue & Otule [33].

From Figure 3, while quite a few states especially Lagos and Rivers make more IGR, the majority of the states rely on allocation from the federation account of which VAT is a big contributor. This, therefore, implies that the majority of the states in the country will be affected under

a decentralized VAT regime since VAT revenue forms a significant part of the federal allocation. Decentralized VAT administration will therefore mean that many states of the federation will have a lot to contend with in terms of finance to undertake their constitutional responsibilities. This is perhaps why Chekwue & Otule [34] averred that the welfare and development of the citizens are critical responsibilities of the government and revenue from VAT (Finance source) has been very significant in Nigeria over the years.

4. Conclusions

For years, the debates around issues, agitations for resource control, revenue allocation, and fiscal federalism have been on the front burner in Nigeria's socio-economic policy. The debates and agitations became prominent in wake of the increase in the VAT rate, a significant contributor to federally collected revenue. The agitations cumulated in a court action that gave judgment in favour of the decentralization of VAT administration in Nigeria. The study, therefore, investigated the implications of the decentralized regime in the nation. To achieve the objective, the relevant literature on the subject matter obtained from journals accessed on Google Scholar Websites and NBS bulletins were contacted. Findings indicated that several states in Nigeria may likely feel the immediate brunt of decentralization of VAT administration in Nigeria (allow-
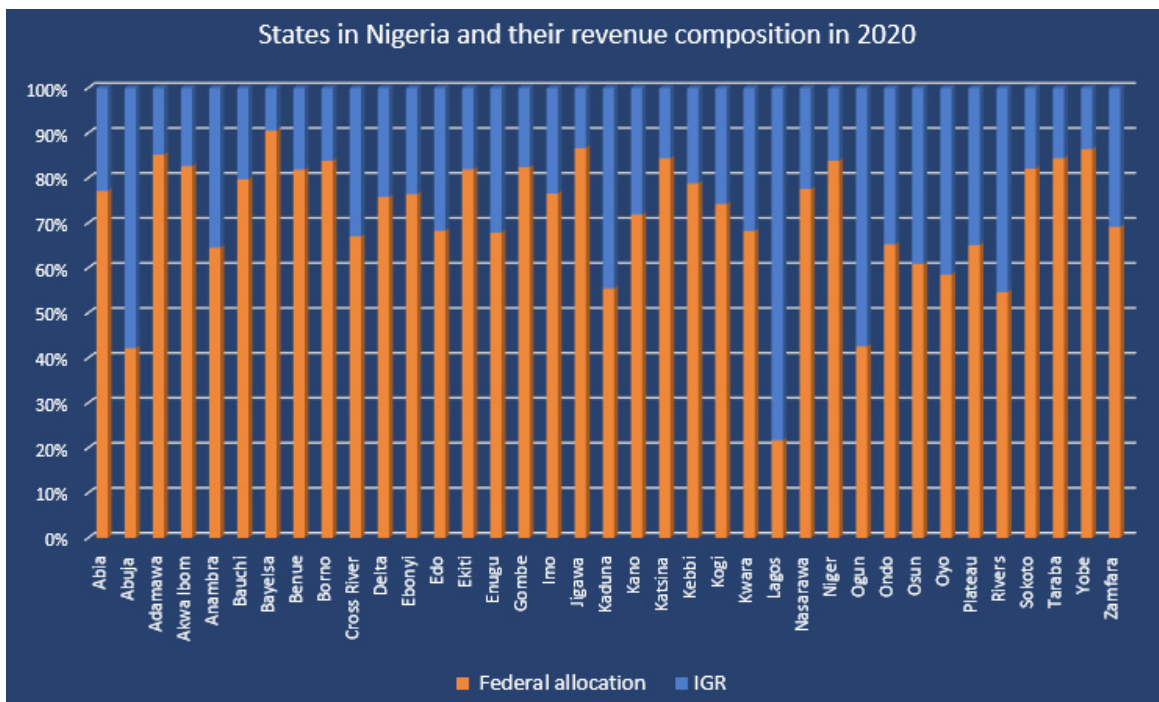

Figure 3. States in Nigeria and their Revenue Composition in 2020

Source: National Bureau of Statistics (NBS cited in Samuel [29])

ing states to collect and administer VAT at that level of government) as many of them (states) with low economic activities and IGR depends largely on federal allocations. It was also found that few states with a large volume of business activities and IGR under a decentralized VAT regime will continue to have a broad revenue base and finance to carry out more developmental activities in their states. This may appear to widen the disparity in welfare and development in Nigerian society between the well-to-do and not too well-to-do states in terms of economic power.

Therefore, for fair competition, growth, and development among states in Nigeria, the study recommended Partial Decentralization (PD) of VAT administration in the country. By this recommendation, VAT collection from non-import taxes should be administered by states while, VAT from import taxes such as customs duties, excise duties, international services, and interstate transactions should be collected by the federal government and shared strictly on the existing basis. The recommendation if faithfully implemented will spur states for more economic activities. The multiplier effect of economic activities is an increase in IGR for states to finance developmental projects.

Acknowledgment

Conflict of Interest

There is no conflict of interest.

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