
A conceptual review of the relationship between Personal Income Tax and Internally Generated Revenue in Nigeria

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ABSTRACT

One of the major challenges facing most of the state governments in Nigeria is associated with the nature of the existing fiscal structure which makes most of the states to heavily rely on allocations from the Federal Government at the expense of the States' individual efforts to generate adequate revenue internally. Hence, this paper synthesizes conceptual review and examine relevant empirical findings on the relationship between Personal Income Tax and Internally Generated Revenue in Nigeria. The paper review the concepts of tax, Personal Income Tax, features of a good tax system, concepts of revenue and Internally Generated Revenue. The paper also reviews relevant empirical studies that examined the effect of Personal Income Tax on Internally Generated Revenue.

Keywords: Internally Generated Revenue, Personal Income Tax, Nigeria.

1. INTRODUCTION

The issue of domestic resource mobilization has attracted considerable attention in many developed and developing countries in recent years, In the face of unabating debt difficulties, coupled with domestic and external financial imbalance confronting them, is not surprising that many developing nations have been forced to adopt stabilization and adjustment policies which demand better and more efficient method of mobilizing domestic financial resources with the view to achieving financial stability and promoting economic growth (Kiable & Nwokah, 2009).The most noticeable impact of the crisis on Nigeria as argued by Soludo (2009) as cited in Akuraun and Terngu (2009), included decline in real output growth and decline in oil revenues accruable to government due to the fall in the price of crude oil.

The most vital need of modern government to strive is revenue, which indeed is the breath of its nostril; this is why in the history of Nigeria nothing has created more constitutional, political and legal controversies and sometimes violent clashes than the issue of revenue sharing and management. According to Adesoji and Chike (2013), in recent years in Nigeria there has been a heart provoking outcry by various State Governments over their poor financial base; the situation is becoming even more alarming by the obvious dwindling feature of our oil economy, The increasing cost of running government coupled with dwindling revenue has led various state governments in Nigeria with formulating strategies to improve the revenue base; also the near collapse of the national oil economy has created serious financial stress for all the tiers of government. They also emphasized that despite the numerous sources of revenue available to the various tiers of government as specified in the Nigeria constitution since the 1970s till now, over 70% of the annual revenue of the three tiers of government comes from petroleum source. This view is also supported by Jones, Ihendinihu, and Nwaiwu (2015).

Therefore, this paper seeks to conceptually review the relationship between Personal Income Tax (PIT) and Internally Generated Revenue in Nigeria. The paper is divided into four sections. Section one is introduction; Section reviews relevant literatures; Section three is methodology, while Section four is conclusion.

2. LITERATURE REVIEW

Concept of Tax

Taxes are mandatory contributions levied on individuals or corporations by a government entity whether local, regional, or national. [Tax revenues](#) finance government activities, including public works and services such as roads and schools, or programs such as Social Security and Medicare (Investopedia, 2024).

Yunusa (2003) defines taxation as, “A compulsory payment made by individuals and organization to relevant Inland Revenue Authorities at the Federal, State or Local Government levels. Tobansi (1994) sees taxation as a levy imposed by the Government against the income, profit or wealth of the individual, partnership and corporate organization”.

Types of Taxes in Nigeria

There are various forms of taxes in Nigeria. According to Onojodofia (2023), taxes in Nigeria are of the following types:

1. Personal Income Tax (PIT)

Personal Income Tax is the tax imposed on individuals who are in employment or self-employed through businesses or partnerships. It is paid to the jurisdiction of the State Inland Revenue Service in the payer's state of residence.

Individuals who are in employment pay their taxes which are deducted from their income through a system called [Pay As You Earn \(PAYE\)](#). Self-employed individuals pay through a process called direct assessment.

Direct Assessment is an income tax that is imposed on self-employed persons. It is usually applied to individuals who operate small businesses.

2. Company Income Tax (CIT)

Company Income Tax is the tax paid by all corporate entities in Nigeria to the Federal Inland Revenue Service. It is usually 30% of the company's total profit. All companies registered in Nigeria are expected to pay this tax except companies involved in petroleum activities (This is covered by the Petroleum Profit Tax Act).

3. Value Added Tax (VAT)

Value Added Tax is an indirect taxation imposed on goods and services. The final consumer of purchased goods or rendered services pays the VAT charges. Value Added Tax is usually a 7.5% rate and it is paid to the business owner or service provider who sums it up and pays to the FIRS.

4. Withholding Tax (WHT)

Withholding Tax is an amount deducted from a person's income to pay a tax they will owe. It is not exactly a type of tax but a method of payment. In this case, the employer pays the tax from the income instead of the employee. The percentage deducted from the income varies according to the tax to be paid. But it's usually between 5% to 10%.

5. Petroleum Profit Tax (PPT)

Petroleum Profit Tax is the tax imposed on the income of all companies involved in upstream petroleum activities at a rate of 50% to 85%. Companies who pay this tax are exempted from the Company Income Tax according to the Petroleum Profit Tax Act.

6. Capital Gain Tax (CGT)

Capital Gain Tax is a 10% tax imposed on the profit of chargeable assets, either from sales or exchange. When an asset or investment makes a profit with a positive difference from the original price, a capital gain tax is expected to be paid.

7. Stamp Duties (SD)

Stamp Duties Tax is a kind of tax imposed on written or electronic legal instruments/documents. It affects legal documents such as cheques, receipts, military commissions, agreements, bills of exchange, etc. For instance, in Nigeria, electronic transfers through traditional banks that are above #10,000 attract a stamp duty fee of #50.

8. Education Tax (EDT)

Education Tax is a 2% tax imposed on the income of all registered companies in Nigeria to fund the Tertiary Education Trust Fund (TETFUND). This is then used to fund projects in tertiary institutions.

9. National Information Technology Development Levy (NITDL)

The National Informational Technology Development tax is paid by specific companies with an annual turnover of N100 million and above. It is a 1% tax before profit levy. Companies that pay this tax include;

- GSM service providers and telecommunication companies
- Internet providers
- Pension managers and pension-related companies
- Banks and other financial institutions
- Insurance companies, etc.

Features of Good Tax System

The tax system is a component of the overall fiscal policy and is a complete system which includes tax policies, tax laws and administration. According to Alabede (2001), the following features are used to assess a good system.

1. Equity: This principle specified that tax payer should be treated fairly and equally in all matters pertaining tax, ability should be taken into consideration i.e. each person is to pay based on his ability. Equity can be horizontal or vertical. Musgrave and Peacock (1984) conceived the principles of equity as equal proportion of taxation on every income that is; in principle everyone should pay the same proportion of his

income as tax. This means proportional taxation or some percentage on all incomes and therefore rejected progressive taxation i.e. (higher tax rates on higher incomes). It also means equal taxation of earned and investment incomes, existing private wealth and capital are exempted, taxation is limited to income only.

2. Certainty: These means there should be some element of certainty and clarity, the time and manners of payment and amount to be paid ought to be clear and made plain to the tax payer and everybody. The tax payer should not be placed in doubt by being left to the whims of the tax officials.

3. Convenience: This simply means that the tax system should be designed in such a manner that it will be convenient to both the tax payers and administrator. Tax should be demanded at the appropriate time. Eckeston (1983) has said that a good tax should not impose taxes that are impossible to enforce even when people comply to tax laws voluntarily. The Government should verify the tax payments, if not the tax becomes an invitation to break the law.

4. Economical: A good tax system should be economical in the sense that the cost of collection and administration should not be more than the revenue to be generated. That is cost should be kept to the barest minimum to obtain advantage.

5. Neutral: A good tax system should be neutral that is, it should not have effect on production and consumption decision of tax payers.

The Concept of Personal Income Tax (PIT)

Personal Income Tax (PIT) is a direct tax levied on personal income including wages and salaries, director's fees, dividends, royalties and rental income, amongst others (ActionAid International Briefing, 2019). PIT is paid by resident and non-resident individuals once they engage in taxable or income-generating activities in the country in question. PIT rates may either be flat or graduated, meaning that the tax rate increases as taxable income increases – those earning more pay a higher proportion of their earnings towards taxes. In the graduated approach, which is the most commonly used, tax rates are based on the income bracket of a tax payer. Individuals are taxed on income earned in an accounting period, referred to as the year of assessment – usually a calendar year.

According to ActionAid International Briefing (2019), Payroll deductions, called Pay as you Earn (PAYE) in many countries, are used to deduct tax from wages before they are paid to employees, and are mandatory in the formal sector of most countries. But these generally do not cover other kinds of income such as dividends, or income from self-employed people.

The Concept of Revenue and Internally Generated Revenue (IGR)

Revenue

The concept of Revenue is defined and described in different ways by various experts. Adams (2006) defines revenue as the funds required by the Government to finance its activities. The funds are generated from different sources such as borrowing, fines, fees etc. Isyaku (1997) as cited in Jibrin (2009) states that revenue comprises receipt from taxation as well as those which are not the proceeds of taxation, but of either the realization from the sale of Government properties or from other interest and return from loans and investment earning from user charges. Dandago and Alabede (2001) describe revenue as an income required by Government to finance its growing expenditure.

According to Onuigbo (2021), revenue is the income that an organization or business has from its normal business activities, usually from the sale of goods and services to customers. Some organizations receive revenue from interest, royalties, or other fees. Revenue may refer to business income in general, or it may refer to the amount in a monetary unit, earned during a period of time.

Relatively, revenue is the fund required by the government to finance its activities. These funds are generated from different sources such as taxes, borrowing, fine, fees among others (Agu, 2011). Moreover, it is the total amount of income that accrues to an organization (public or private) within a specified period of time (Alade, 2015).

Internally Generated Revenue (IGR)

Government revenue is the money the government raises from taxes, asset income, and transfer receipts at the federal, state, and local levels. Although the government can also raise funds by borrowing (selling bonds), the funds raised are not considered revenue (StudySmarter, 2024). Further, government revenue is the money the government raises from taxes, asset income, and transfer receipts at the federal, state, and local levels. States revenue comprises of receipt from taxation as well as those which are not the proceeds of taxation, but of either the realization from the sale of government properties or other interests and returns from loans and investment earning (Onuigbo, 2021).

Specifically, Internally Generated Revenue (IGR) is the revenue that accrues to the state or local government apart from the statutory allocation from the Federal Government (FG). Oshisami (1992) states that there are basically two types of revenue that accrues to state governments. These are internally generally generated revenue and revenue allocated from the Federation Account. Internally generated

revenue or self-financing sources are those sources by which governments can raise revenue constitutionally aside from the statutory allocations and grants (Murana, 2016). It should be noted that internally generated revenue sources provide a wide scope for initiative towards attracting fund. For example, the extent to which these revenue sources can yield to the benefit of the Local Government council depends on the ability and vibrancy of the Local Government leadership (Onuigbo, 2021).

Personal Income Tax and Internally Generated Revenue

There are numerous studies on Personal Income Tax and Internally Generated Revenue. For instance, Tanko (2015) examines the impact of Internally Generated Revenue of the state government revenue profile in Nigeria. Data for the study were derived from published secondary sources. The study has established a significant difference between the amount generated as internally generated revenue and the inadequacies of the internally generated revenue to cater for the states' total expenditure profiles. There is also an indication of a higher reliance on the federation account for the States' revenue profile.

Oseni (2013) examines the proportions of internally generated revenues to total revenues of States for a five-year period (2007-2011). Data were sourced from the annual reports of the Central Bank of Nigeria for the period. Descriptive statistics was used and it was found that States getting additional revenue from the statutory allocations as derivation have lower proportions of IGR to their total revenues than the others. States where insurgency has been widespread have the lowest IGR for the period. Dependence on the statutory allocations by the States does not necessarily translate to good dividends of democracy as internally generated revenues can better be relied upon for development. The paper recommends, among others, that the right parameters should be instituted in order to identify the tax payers and the types of businesses they are engaged in.

Additionally, Appah and Ogbonna (2014) evaluated the performance of self-assessment scheme and revenue generation in Nigeria. They utilized data that was collected from both primary and secondary sources. The data collected from the questionnaire were analyzed using relevant statistical models. The analysis reveals that self-assessment compliance rate significantly affects revenue generation in Nigeria. They recommend that the FIRS should be efficient in their internal processes, particularly in processing tax refund and tax correspondence and the government should provide sufficient channels for tax payers to obtain tax guidance and advice in order to achieve greater voluntary compliance.

Similarly, Adesoji and Chike (2013) assessed the effect of internal revenue generation on infrastructural development. The study employed survey research design and purposive sampling method to select respondents from the Lagos State Inland Revenue Office. Questionnaires were the instruments used for the study. Descriptive and inferential statistics were the statistical tool used for the analysis. The descriptive statistics involved the use of simple percentages while the inferential statistics involved the use of Spearman's Rank correlation technique, which shows the direction of relationship between the variables. Two hypotheses were formulated and the Spearman's rank correlation analysis was used to test the relationship between internally generated revenue and infrastructural development. The result shows that there is a positive relationship between internally generated revenue and infrastructural development.

3. METHODOLOGY

To meet the broad objective of this paper, a wide-ranging search was made in the internet within the academic literature in the field of public sector accounting and finance, especially on taxation and internally generated revenue of the government. Searches were mainly made from Google Scholar and Research Gate databases on information concerning taxation and internally generated revenue of the government. Hence, the materials used for this paper were mainly collected from relevant literature searches on the internet.

4. CONCLUSION

This paper conceptually reviews the relationship between Personal Income Tax (PIT) and Internally Generated Revenue (IGR) in Nigeria. The review was mainly based on a conceptual relationship between PIT and IGR. Based on the review of relevant studies conducted, it was established that, a significant relationship exists between Personal Income Tax and Internally Generated Revenue in Nigeria.

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