BRIDGING TAX GAP IN NIGERIA THROUGH TAXING HIGH NET-WORTH INDIVIDUALS: A MYTH OR REALITY?

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ABSTRACT

The current economic challenges in Nigeria as a result of dwindling oil revenue have forced the Federal Government to look into other ways of improving revenue profile of the nation. One of these other ways is the taxation of incomes of high net worth individuals (HNWIs). Despite the several tax laws and reforms in Nigeria, the HNWIs still evade tax freely. Therefore, this paper examines the taxation of HNWIs in Nigeria as a means of improving revenue profile of the nation using exploratory research method. The study found out that HNWIs in informal economy like Nigeria, are powerful to the extent that the existing tax laws are rendered redundant because they are not well enforced by Federal Inland Revenue Service (FIRS). The paper concluded that tax authority must enforce the existing tax laws without fair and favour of the HNWIs

Keywords: High Networth Individuals, Informal Economy, Revenue Profile

Introduction

The economic recession which recently happened in Nigeria had revealed that the Nigerian economy can no longer survive based on revenue derived from oil. Also, Nigeria's low tax revenues are at variance with the lifestyles of a large number of its people and with the value of assets owned by Nigerian both at home and abroad. Samed (2017) asserts that in the process of tracing stolen funds, it has become apparent that a significant number of Nigerians have assets and lifestyles that are not consistent with their income as declared on their tax returns. Kangave, Nakato, Waiswa, Nalukwago, and Zzimbe (2018) opine that with the exception of employees, very few individuals comply with their tax obligations, especially, many wealthy individuals in the private and public sector either do not pay taxes or grossly under-declare their income. The consequence is that very little tax is being collected from this category of taxpayers. Hence, it is suffice to say that many Nigerians especially the high networth individuals evade tax. Adeosun (2017) reiterated that about 130,000 high networth individuals/companies were discovered by the mining process of the Federal Ministry of Finance, therefore, the voluntary Assets and Income Declaration Scheme (VAIDs) was purposely designed to bring more of the high networth individuals into the tax net by the end of June 2018. However, VAIDs has been criticized of not being capable of leading to high revenue generation as obtainable in developed economy. According to PWC (2018) the inability of the tax authorities to chase after the tax defaulters by the end of VAID exercise has pointed to the fact that the system only has teeth that does not bite.

The Nigerian tax system is characterized by legion of problems that are too difficult to address by simple mechanisms (PWC, 2014). The problem of taxing High NetWorth Individuals (HNWIs) is not an absence of laws providing for the taxation of these wealthy individuals rather, it is that these laws are rarely implemented especially in Nigeria where such wealthy people wield a lot of power behind the throne or scene and have become largely untouchable or are in deal with tax officials in exonerating them. What a country decides about taxes on the rich has profound consequences on its revenue profile for future economic growth and the distribution of economic resources and opportunities. In some parts of the world, progressive tax is commonly used to mitigate the widening income gap between the rich and poor. The question is how effective is progressive tax in Nigeria?

Despite the major tax reforms and restructuring in Nigeria, over the years, Nigeria's fiscal deficit is still ever increasing and the revenue base highly skewed in favor of oil-revenue, only little revenue is generated from taxation of employees and companies in the formal sector while there are many HNWIs in the informal sector of the economy that evade tax in Nigeria. Taxation of these HNWIs is a major gap in the Nigeria tax system that needs to be bridged, hence, this study seeks to find out if taxation of HNWIs is a myth or reality in Nigeria

Literature Review

Conceptual Review

Revenue

The stream of wealth that flows into the public sector coffers from the available economic activities is termed Public revenues. Government revenue in Nigeria is categorized into various sources such as oil revenue, non-oil revenue and federal government independent revenue. The federal government and its sub-national components have over the years utilized these revenues to optimize their various fiscal responsibilities, which includes the provision of infrastructure, debt servicing, social amenities as well as the judiciary and others, all geared towards economic development of the nation.

Oil and non-oil revenues are the major sources of government revenue in Nigeria. The oil revenue includes proceeds from sales of crude oil, petroleum profit tax, rents and royalties while the components of non-oil revenues are companies' income tax, customs and excise duties, value-added tax and personal income tax. The federal government independent revenue sources includes; rent on federal government properties, mining revenue, proceeds from federal government privatization, dividends from federal government investments, fees paid in federal government courts, passport offices and hospitals, among others. Since the 1970s, oil revenue has been the dominant source of government revenue, contributing over 70 percent to federally collected revenue (CBN, 2000).

Umar, Derashid and Ibrahim (2017) asserted the challenges of tax revenue generation in developing countries; adopting the carrot and stick approach. The study identifies tax noncompliance as a key factor for the current underperformance of tax revenue in developing countries. The study advocates for the carrot and stick model in tackling the challenges of tax compliance in developing countries. It argues that an optimal mix of the carrot and stick factors will go a long way in tackling the tax revenue challenges of developing countries. Citizens engagement in tax policy formulation and tax service quality are the carrot factors that encourage high compliance in tax payment while, sanction of tax defaulters in line with extant law is the stick factor.

High NetWorth individuals (HNWIs)

Tanzi (2012) defines High Net worth Individuals to have more wealth, more income, better social connections, better tax advisers, better access to the "institutional capital" of countries, and increasingly, more activities that are global in scope. He stresses that HNWIs cannot be based on the absolute income of the taxpayers but must be related to the per capita incomes of the countries.

Freear and Wetzel (1994) define high net worth individuals as business angels who invest a portion of their assets in high-risk, high-return entrepreneurial ventures.

Deliotte (2017) defines High Net worth Individuals (HNWI) as people with net assets of USD1 million and above, the report estimates the number of HNWIs in Nigeria to have risen to over twenty thousand (20,000) individuals, from approximately five thousand (5,000) recorded at the turn of the 21st century. Also a recent study prepared by Wealth-X, there are 62,960 *ultra* HNWIs in North America, 54,325 in Europe, and 42,525 in Asia-Pacific. These are individuals with a net worth of at least USD 30 million each. India was reported to have 8,200 such individuals, and Indonesia 725. However, one does not need to have a net worth of over USD 30 million to be considered rich and to be able to pay higher taxes than the rest of the population.

Paul (2019) posits that there is an ongoing debate across the world about taxing the rich, how big the tax contribution of the wealthy should be and whether it should be increased. Some category of politicians generally wants higher taxes for the wealthy, insisting that they can easily afford to make a larger contribution. Whereas another category opposes and argues that increasing taxes for higher earners is counterproductive and may actually worsen many of the problems that it is supposed to solve.

Informal Economy

The informal economy or grey economy is the part of an economy that is neither taxed nor monitored by any form of government. Unlike the formal economy, activities of the informal economy are not included in a country's gross national product or gross domestic product. According to Chen (2012), the informal economy is a diversified set of economic activities, enterprises, jobs, and workers that are not regulated or protected by the state. The concept originally applied to self-employment in small unregistered enterprises. It has been expanded to include wage employment in unprotected jobs.

According to Feige (2005), the informal economy has been used so frequently, and inconsistently; he argued that the informal economy comprises those economic activities that circumvent the costs and are excluded from the benefits and rights incorporated in the laws and administrative rules covering property relationships, commercial licensing, labor contracts, torts, financial credit, and social systems.

Papanikos (2015) reiterates that people decide to produce in the informal sector because they do not want to pay taxes, producing in the informal economy results in the accumulation of personal wealth without paying taxes. According to Terka (2005) there has been a growing interest in taxing the informal sector in most developing countries for a number of reasons including Increase in revenue, the phenomenal size and growth of informal sector, Impact on tax compliance in the formal sector**.** In spite of the tax revenue potentials of the informal sector in Nigeria, Abiola (2007) reports that the level of tax compliance of the informal sector in Nigeria is less than 27 percent.

Deliotte (2017) opines that while it may be easy to identify HNWIs in the formal sector, there is no accurate statistics of the number of HNWIs in the informal sector of the country's economy. Necessity is therefore laid upon the revenue authorities to bring all such persons into the tax net. In the process of tracing stolen funds, it has become apparent that a significant number of Nigerians have assets and fund lifestyles that are not consistent with their income as declared on their tax returns. With the assistance of international asset tracing professionals, the government of Nigeria has already identified that the number of potential tax defaulters is significant. These individuals in order to hide, and also not to pay taxes have invested in the informal sector and even when exposed, use the power in the money they possess to stall justice in the court of law. The government of Nigeria has to intensify its efforts in engaging with the informal sector where a large number of HNIs operate in order to derive maximum revenue in form of tax from the sector. It is the constitutional duty of every citizen to declare his income honestly to the appropriate and lawful agencies and pay his taxes promptly.

Theoretical Review

Ability to pay Theory

The ability to pay tax theory was introduced by John Stuart Mills in 1872. This theory assumes that the tax payers in which the tax is levied will have the same level of income. As such, it is based on ability to pay. Each tax payer should be levied the amount he/she will pay as tax with regards to his/her income. Those with high incomes should be tax high and those with low income should be tax low based on the income they receive. In practice, effective administration with a well-articulated process will encourage voluntary compliance by the tax payers because such process is to ensure that tax payers are not over-burden in terms of the amount to pay as tax which is a function of their incomes. This theory holds that tax payers carry out their civil responsibilities because they are buoyant to do so and not a kind of commercial dealings between the tax payers and the government which oblige both parties to fulfill all conditions in the terms of agreement, rather the ability to pay is to ensure equity and justice in the amount of tax that an individual will pay (Musgrave & Musgrave, 2004; Bhartia, 2010; Appah, 2011; & Jhingan, 2012). Progressive Tax Rate system is in line with this theory so also taxation of HNWIs is not out of place

Deterrence Theory

This theory places emphasis on incentives. The theory suggests that taxpayers are amoral utility maximizers who are influenced by economic motives such as profit maximization and probability of detection. Hence, the taxpayers analyze alternative compliance paths for instance whether or not to evade tax, the likelihood of being detected and the resulting repercussions and then select the alternative way that maximizes their expected after-tax returns after adjusting for risk. Therefore, according to the theory, in order to improve compliance, penalties for non-compliance should be increased. Thus, there is a theoretical positive relationship between tax penalty and tax compliance by HNWIs. Increase in tax penalty would lead to increase in tax compliance and *vice versa*.

Psychology Theory

Psychology theory posits that taxpayers are influenced to comply with their tax obligations by psychological factors. It focuses on the taxpayers' morals and ethics. The theory suggests that a taxpayer may comply even when the probability of detection is low. As opposed to the deterrence theory that emphasizes increased penalty as solution to compliance issues, psychology theory lays emphasis on changing individual attitudes towards tax systems. Thus, one instrument of changing taxpayers' attitude to tax matters is tax education. It is assumed that improved tax education would increase tax compliance by HNWIs and *vice versa*.

Theoretical Framework

This study is anchored on Ability to pay Theory because the focus is on taxation of high net worth individuals who are rich and hence, they have the ability to pay the tax levied on them. The problem is not that the HNWIs do not have ability to pay but these high net worth individuals evade tax because they are seen to be more powerful than the law.

Resolving HNWIs Tax Compliance Challenges

The following are suggestions on resolving tax compliance challenges by HNWIs

Progressive Tax Rate

This is a rate of tax levied according to an individual's ability to pay. It is based on the principle of the more you earn, the more you pay. This principle is supported by the bible verse; to whom much is given, much is required. The burden of a progressive income tax falls on individuals with higher incomes or wealthy individuals.

According to Murphy, Roberts, and Wolfson (2007), Canada has a progressive system of taxes and transfers, which means that high-income recipients contribute a disproportionate portion of total taxes, which in turn help finance a range of government activities including transfer payments to those lower in the income distribution. The status of the high-income population is thus important to the financing of government activities.

Proper classification of HNWI

This is important as there are no set parameters for determining individuals who fall within this bracket. Some state revenue authorities at their discretion have adopted the income rate of N6million as the minimum threshold for HNWI, but this rate in reality varies according to the state of residence of the tax payer. Clearly, adopting a $1million threshold would not be appropriate. State tax authorities should review this critically and adopt a very realistic threshold for HNWI income in their respective jurisdictions.

Presumptive Income Tax Assessment (PITAS)

Presumptive taxation was introduced into Nigeria tax laws in 2011 with the amendment to the Personal Income Tax Act (PITA). Presumptive taxation is a concept of taxation involving the use of indirect means to ascertain tax liability, which differ from the usual rules based on taxpayers' accounts (Thuronyi, 2003). Presumptive assessment is intended as a means of ascertaining the taxpayer's income in the face of inadequate data. Presumptive taxation (PPT) and uniform lump-sum presumptive taxation (ULT) are two forms of presumptive taxation that have been widely used in developing countries on the size of the informal sector, tax revenue, output and social welfare.

While it may be easy to identify HNWIs in the formal sector, there is no accurate statistics of the number of HNWIs in the informal sector of the country's economy. Necessity is therefore laid upon the revenue authorities to bring all such persons into the tax net. This has led to the proposal of PITAS. PITAS is focused on taxable persons who historically failed to comply with the tax laws, due to size and lack of fixed business address; by providing simplified tax assessment procedures.

Harmonization of individual data

Different sectors of the economy have individuals' data for their respective purposes. This includes the Bank Verification Number (BVN) which have streamlined customers' accounts and provides a single link for accessing individual banks' transactions from various banks. The tax authority can leverage this platform to access the HNWI to account for their fair share of tax to the government.

Voluntary Asset and Income Declaration Scheme (VAIDS)

It is perhaps the invisibility of the HNWIs that drove the National Economic Council (NEC) to approve another tax amnesty scheme, Voluntary Assets and Income Declaration Scheme (VAIDS). It is a program initiated by the Federal Government of Nigeria which is aimed at providing an opportunity for corporate and individuals to regularize their tax status relating to previous tax periods. Under the scheme, taxpayers were given the opportunity to benefit from total waiver of outstanding and overdue interests and penalties. They also stand to be the beneficiaries of the assurance that they will not face criminal prosecution for tax offences or be subjected to further tax investigations. To profit from the scheme, taxpayers will be required to fully and honestly declare previously undisclosed assets and income.

In addition to raising tax revenue for the period of its operation, VAIDS will provide an opportunity to increase general tax awareness and compliance among the general public. VAIDS aims at aiding the current global movement against tax evasion and illicit financial flows and will encourage voluntary declaration of undisclosed income and assets with consequential payment of applicable tax liabilities over a defined period. It is expected that corporate and individual taxpayers will utilize the limited amnesty to remedy their tax compliance. VAIDS is a time limited opportunity covering all non-oil taxes with up to three (3) years instalment plan subject to agreement with revenue authority.

Why taxation of High Networth Individuals

Improved Revenue Profile

Ebi and Ayodele (2017) posit that the primary motivation for tax reforms-cum-revenue mobilization in Nigeria has been the need for diversified tax base and increased revenues. The need to raise more revenue against the backdrop of high expenditure has taken added importance when compared to other sources of resource mobilization such as deficit financing and money creation; and the fact that Nigeria federally collected revenue has been basically from oil.

Tanzi (2012) opines that governments can increase the economic liberty of individuals, and maintain their attachment to democratic institutions, by increasing their economic opportunities. To be able to do so, they need revenue, and the tax revenue can be obtained from those who have taxable capacity. Significant ability to pay, or significant taxable capacity, in many countries, is concentrated among the HNWIs.

Andrew (2018) affirms that taxing the rich to pay for programs that help the poor and middle class, on things like infrastructure or national defense, which will benefit all citizens makes common sense economically. Money allocated to programs such as affordable healthcare, will be redistributed into the economy and stimulate growth. Tax hikes on the rich would have little impact on their spending, since most of this income would likely have gone into savings. Even with higher tax rates (and fewer loopholes), the country's wealthiest will be fine. But for the government to provide basic housing, nourishment, health care and education to the rest of its citizens, the money must come from somewhere.

Paul (2019) observes that a progressive tax system can prevent wealth discrepancies from getting too large. When the gap between rich and poor gets beyond a certain point, there is an increased risk of social instability and strife, such as crime and political turmoil. Big differences in wealth are also seen by many economists as one of the factors that led to the Wall Street Crash in 1929.Taxing the rich can also be justified on moral grounds, if it is used as a form of wealth redistribution, with the tax money raised being used to aid the poorest sections of the population.

Widening Tax Net

According to Deliotte (2017), a significant catchment of potential taxable persons that must be brought within the tax net are those operating in the informal sector of the economy." With respect to HNWI as a critical catchment of the informal sector, it is important to understand why tax collection from HNWIs is low, several HNWIs who do not pay personal income tax or pay very little do so because they have devised ingenuous means of avoiding taxes e.g. taking advantage of specific provisions of the law, in which case they structure their business in a certain way such that they legally avoid taxes. In these climes it is abnormal to find a HNWI who does not account for taxes and it is usual to find the tax authorities go after HNWIs for violating tax regulations.

According to Fowler (2018), there are many defaulting billionaire taxpayers, leveraging on banks data. Most of such taxpayers, who have between N1b and N5 billion in their accounts have no Taxpayer Identification Number (TIN), or have TIN and have not filed any tax returns as taxpayers. Widening the tax net will impact considerably on the revenue profile, as there are many high net worth individuals outside the tax net. We do not need new taxes. We need new taxpayers, people that are gainfully employed, making money and paying into the tax system. And then we need a government that has the discipline to enforce the tax laws in Nigeria. FIRS should increase the tax net by increasing the number of taxpayers or potential taxable persons in the tax base.

Methodology

The research design adopted for this study is the exploratory survey design. The method of collecting data is the *expost facto* through the use of secondary data from Central Bank of Nigeria (CBN) Statistical Bulletin which was used to analyze the trend of aggregate revenue in Nigeria.

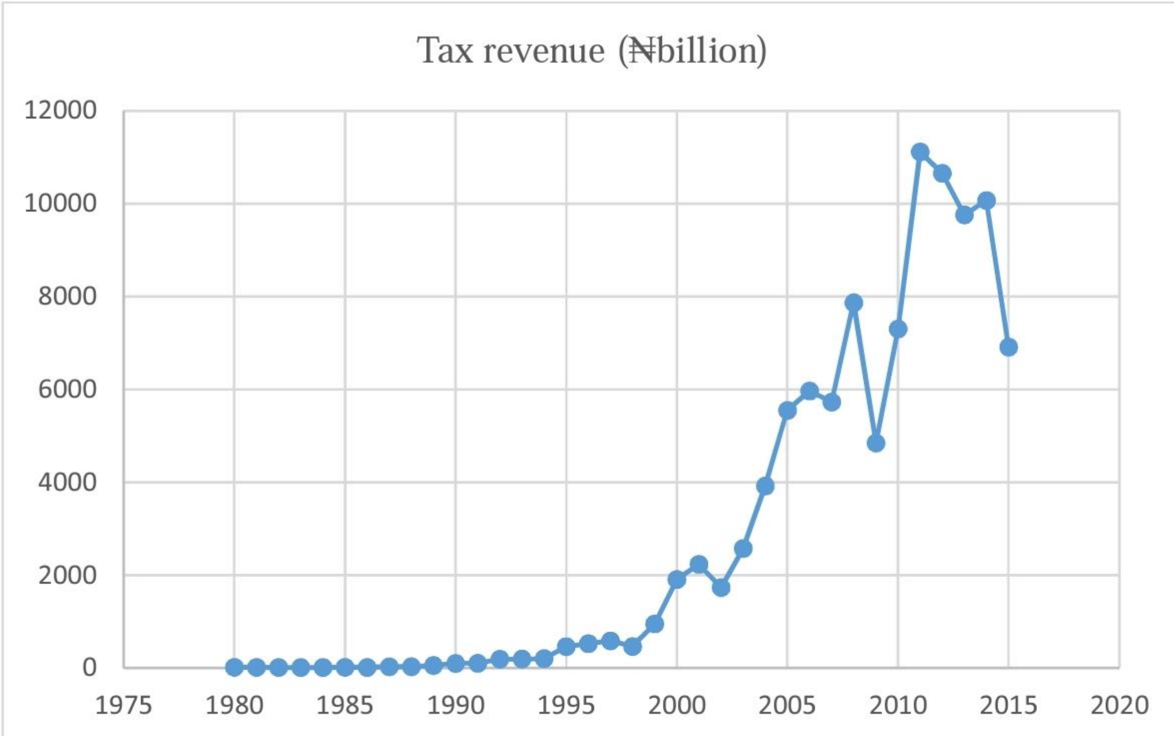

Fig. 1. Trend of aggregate revenue in Nigeria

Source: Idris, Salhabinti, Ahmad, and Bismark (2017).

Analysis of Trend of Aggregate Revenue Profile in Nigeria

The revenue profile of the Nigerian government as shown in the statistical bulletin of 2016 indicates that total revenue has considerably declined over the period, decreasing from ₦15.23 billion in 1980; to ₦13.29 billion in 1981; ₦11.43 billion in 1982; and ₦10.51 billion in 1983 (see Fig. 1). The decreased in aggregate government revenue was largely heighten by the economic recession that hit the global economy coupled with the overall decline in the crude oil price. Oil revenue in Nigeria accounted for over 70% of the aggregate revenue and a major component of the foreign earnings, hence the reason for the decline in total federally-collected revenue. From 1984, the value begins to increase up to ₦15.05 billion in 1985 and later decline to ₦12.60 billion in 1986. In preparation to implement the development strategy (Structural Adjustment Programme: SAP) advocated by World Bank to developing countries, the value in 1987 increase rapidly to ₦25.38 billion; ₦27.60 billion in 1988; ₦53.87 billion in 1989 and ₦98.1 billion in 1990. The initial period of SAP is witnessed by an increase in the level of aggregate revenue in contrast to pre-SAP period. Subsequently, the aggregate value of total revenue begins to increased rapidly with over 100% initial increment from 1991 to 1999 where the value stood at ₦949.19 billion by the end of 1999. This may partly be as a result of various economic and complimentary reform programmes introduced during the planning period.

Supplementary dividends are expected to surface the economy with the transition and change from the governing style of military dictators to a much-celebrated democratic arrangement. In the year 2000, tax revenue stood at ₦1,906.16 billion, it then later increases from ₦2,231.60 billion in 2001 to an average of ₦7,866.59 billion in 2008. Though, these increase trend in tax revenue has not reflected on the life of an average Nigerian given the rising trend of the poverty level and unemployment rate in spite of a corresponding increase in total government expenditure during that period. By the fiscal year 2009, total federally collected revenue was valued at ₦4, 844.59 billion, this trend continues up to the last quarter of 2015 where it recorded an annual amount of ₦6,912.50 billion [22]. The prevalence and continuous increase in the level of debt and deficit indicate that the contribution of total revenue to ensure budgetary balance within the Nigerian public finance is insignificant. This may be attributed to inadequate enforcement machinery, skilled labour force, a tax structure that is not buoyant and inelastic, as well as the structure of the economy which makes it difficult, if not impossible, for others to be taxed due to their social or political status. Until proactive measures at all levels are adopted by the public authorities to strengthen transparency, fight corruption and abuse of public resources within the statutory institutions responsible for tax related matters, otherwise the negative effect and high increase in the level of debt and deficit will continue to surface in the current account balance thereby affecting the fiscal prudence and the position of macroeconomic stability in the country.

CONCLUSION

This paper has shown that a larger number of potential tax payers (high net worth individuals) are hidden in the informal sector which is not in the immediate purview of the FIRS. The paper concludes that there is no need for more tax laws but the FIRS should device means of penetrating into the high net worth individuals to widen the tax net and the result will improve revenue profile of the government.

RECOMMENDATION

Tax Concessions for Informal sector: - Apart from the provision of certain tax incentives such as low tax rate, tax holiday, and investment tax credit to motivate the citizens to pay tax, tax concessions such as national awards for tax compliance to be given to those in the informal sector should be instituted. The Nigeria governments have a culture of punishing tax defaulters in the informal sector without rewarding those who have fulfilled their obligations.

The introduction of progressive tax rates at source for elective political office holders and appointees with jumbo salaries/allowances may make Net base of the PIT significant and buoyant.
Participation in Government Decision Making: The extent to which HNWIs taxpayers can participate in the political decision-making process has a positive impact on tax compliance. If HNWIs tax payers are allowed to participate in decisions affecting them and if the decision process is perceived as transparent and fair taxpayers will be ready to contribute to public goods and services. Therefore, direct political participation on the tax payers using popular referenda and voter initiative is being advocated.
Transparency and Accountability: - The Nigeria government need to provide her citizens more accurate information on how much money is collected, and how much is spent, where and for what purpose, and what its future obligations are likely to be. When governments become transparent and accountable in this form, people will naturally pay their taxes.

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