Value Added Tax (VAT) and its Administration in Nigeria

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Abstract

Value Added Tax, as a consumption tax, was introduced to improve the fiscal policy in Nigeria and also as a source of revenue from the non-oil sector of the economy. Since its introduction, VAT has had a positive impact on the socioeconomic development of this country although only few VAT payers and the general public are aware that they pay this form of tax. This paper attempts to create more awareness and understanding about VAT as an important revenue generating source to government, one which has to be improved upon for greater efficiency and appreciation. The paper contains the conceptual framework, concept and evolution of VAT in Nigeria, types of VAT as well as its administration. So far VAT has achieved, to some extent, the objectives for which it was introduced, though it needs some “panel beating”. Suggestions based on discussions with VATable persons are made on how to improve the implementation of VAT system to enhance revenue generation.

Introduction

Before the introduction of Value Added Tax, otherwise known as VAT, the Nigerian economy depended largely on revenue derived from petroleum products. The non-oil sources of revenue generation contributed just a little to the country’s total revenue. As the price of oil in the world market keeps fluctuating, thus leading to a continuous decline in the country’s annual revenue base, it became obvious that government would source somewhere for additional revenue to meet its ever growing public expenditure. One of the sources open to government was obviously an increase in taxes.

It was against this background that VAT was introduced by the Federal Government of Nigeria as one of the ways of raising additional non-oil revenue internally. This was consequent upon the recommendation of a study group set up by Federal Ministry of Budget and Planning.

The objective of this paper is to make the readers know and understand the concept of VAT and how it has the potentials for revenue generation in Nigeria. To achieve this objective, the paper is divided into seven parts. Part one deals with the conceptual framework, while part two highlights the concept and history of VAT in Nigeria. Types of VAT are treated in part three. Part four focuses on the administration of VAT in Nigeria. The advantages and disadvantages of VAT are examined in part five. Parts six and seven contain the suggestions and conclusion respectively.
Conceptual Framework

Taxes according to Lipsey (1979:433) are of major importance in the pursuit of many government policies. This is because, they provide the funds needed to finance expenditure and are also used as tools in their own right for a wide range of purposes. Altering the distribution of income (revenue) is one of such purposes. Taxes are regarded as a compulsory levy charged by government or by public authority to pay for expenditure. It is the means by which government appropriate part of the private sectors' income.

Taxes are therefore, divided into two broad groups depending on whether people or things are taxed. In the first instance, there is the Direct Taxes, which are levied directly on persons and vary with the status of the taxpayer. Here we have the income tax. The personal income tax falls sometimes on the income of households and sometimes separately on each member of the household. It varies with the size and source of the taxpayers' income and other characteristics, stipulated by law e.g. marital status, number of children, number of dependants, age of parents etc. Limited Liability Companies (that are individuals legally) also pay direct taxes.

In the second instance there is the Indirect Taxes, taxes levied on a thing and it is paid by an individual by virtue of association with that thing. For example, in Nigeria, the local rates on property constitute indirect taxes. By far, the most pervasive and important of the indirect taxes are taxes on the sale of currently produced commodities. These taxes are known as excise taxes (when levied on manufacturers) and sales taxes (when imposed on the sale of goods from retailers to consumers). In Nigeria, this tax is levied comprehensively on all transactions whether at the retail, wholesale, or manufacturers level. This form of tax is called Value Added Tax (VAT).

Value Added Tax is defined as "Tax on spending". According to Federal Inland Revenue Service (FIRS) it is borne by the final consumer of goods and services. To Anyanwu (1995:41) "the VAT is not a tax on the total value of the good being sold but only on the value added i.e. the difference between the value of factor services and materials that the firm purchases as inputs and the value of its output". It is the value that a firm adds by virtue of its own activities to it by the last seller. The definition of VAT shows clearly that the seller is liable to pay a tax not on its gross value, but net value. the gross value minus the value of the services and materials purchased from other firms.

The Concept and History of VAT

According to Franklin in Meijer W.B. and Meijer R.T (1983:658) "A dollar of income tax saved is worth two dollars of income earned". Better put in this with the Nigerian environment. "A dollar of income tax saved is worth two dollars of income
earned. The use of tax (whether VAT or not) has been with us for a long time. In
St. Luke 2:1 the concept of tax was revealed:

"And it happened in those days that there went out a decree from
Caesar Augustus that all the world should be taxed."

It is a modification of the above statement (or decree) that we have today
what is referred to as VAT. Countries all over the world are striving to achieve rapid
development through optimum tax collection and expanded revenue base. Nige-
ria, a developing nation, is trying hard to boost its revenue earning in order to
improve the socio-economic conditions of its citizens and achieve rapid economic
growth. This has necessitated the introduction of new forms of taxes. One of such
taxes is the introduction of VAT as earlier mentioned. The introduction of VAT in
the Nigerian tax system has actually replaced the Sales Tax, which has been in
operation under Decree No. 7 of 1986. The rationale behind this replacement was
informed by a number of factors (a) The base of sales tax in Nigeria under Decree
No. 7 of 1986 was narrow - a negation of the fundamental principle of consumption
tax. (b) The Decree only targeted locally manufactured goods. (c) The revenue
from sales tax was relatively low and (d) Sales tax was to some extent resisted by
the payers.

Historically, VAT was introduced in Nigeria to tax spending following the
successful implementation of it in other countries, especially African countries.
Elements of VAT were first noticed in Germany in 1919. After a successful intro-
duction of VAT in France, the European Economic Community the EEC (as it was
then known) adopted VAT under a treaty signed in Rome in 1957. In 1967, the
adoption of VAT became a condition for membership of European Community
(EEC) (Guenede (1996) confirmed that between 1967 and 1970 VAT spread rapidly
cross the world. In him, seventy (70) countries embraced VAT by the end of 1992.
Vinko (1997) claimed that Nigeria is the 11th African country to introduce VAT
but VAT is operational in all the 36 states of the Federation with office in many
local government headquarters.

The idea of introducing VAT in Nigeria, as earlier said, was to support oil as
ea revenue earner. During the Gen. Ibrahim Babangida administration, a study
group was commissioned in 1994 to review the tax system. The committee in its
report, proposed VAT as the most viable system to boost the revenue base of the
government. The report was accepted in 1999. After proper legislation, the VAT
Scheme took effect on 1st January 1994 under Decree No. 102 of 1993.

Reasons for the introduction of VAT

According to the Decree, reasons for the introduction of VAT include:

1. To broaden the tax base: sales tax covered only nine items such as liqu-
cigarettes, jewellery and mineral water among others. The base was for

2. To reduce evasion and promote compliance: VAT is based on the

3. To provide a uniform tax rate: the uniform tax rate of 5% is appli-

4. To facilitate trade and investment: VAT encourages foreign invest-

5. To increase revenue: VAT is expected to generate additional revenue for

6. To simplify the tax system: VAT simplifies the tax system by re-organizing

7. To promote economic and social development: VAT is expected to promote

According to FIRS, there are seventeen categories of goods and twenty-four categories of services that are VATable. Goods and services exempted under VAT Decree 102 include the following:

i. Medical and Pharmaceutical products
ii. Basic Food Items
iii. Books and Educational Materials
iv. Newspapers and Magazines
v. Baby Products
vi. Commercial Vehicles and their spare parts
vii. Agricultural equipment, products and veterinary medicine
viii. Medical Services
ix. Services by Community Banks, peoples Bank and Mortgage institutions
x. Plays and performances, conducted by educational institutions as part of learning.

VAT Administration in Nigeria

As earlier stated, many consumers are not aware that the price they pay for certain products and services are VAT inclusive. This is because they do not understand the administration of VAT. This section attempts to explain how VAT is administered in Nigeria. VAT in Nigeria is backed by Decree No. 102 of 1993. The system is administered by the FIRS. The VAT Directorate is centrally located at the Head Office in Abuja with a network of Zonal and Local VAT offices throughout the Federation. Unlike other African countries that vary the rate from 5% to 75%, the VAT rate in Nigeria is at 5%. As an illustration, if a product moves from Raw Material Producer (A) to manufacturer (B) at N1,000, then to wholesaler (C) at N2,500, then to Retailer (D) at N3,000 and finally to the consumer who pays N2,500 to the Retailer. VAT payable to government at 5% rate of VAT on the product is calculated as follows:

<table>
<thead>
<tr>
<th>VATable Person</th>
<th>Sales Price Before VAT</th>
<th>VAT Collected (Out Tax)</th>
<th>VAT on Inputs (Input Tax)</th>
<th>VAT Paid to Government</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>1,000.00</td>
<td>50.00</td>
<td></td>
<td>50.00</td>
</tr>
<tr>
<td>B</td>
<td>1,500.00</td>
<td>75.00</td>
<td>50.00</td>
<td>25.00</td>
</tr>
<tr>
<td>C</td>
<td>2,000.00</td>
<td>100.00</td>
<td>75.00</td>
<td>25.00</td>
</tr>
<tr>
<td>D</td>
<td>2,500.00</td>
<td>175.00</td>
<td>100.00</td>
<td>125.00</td>
</tr>
</tbody>
</table>
From the above illustration, the total VAT paid to government in the four transactions is N125,000, which is 5% of the final consumer price of N2,500.

A prospective VAT payer will obtain and complete VAT form 001 and return it to the nearest VAT office. A permanent VAT registration number is given to each registered payer (see appendix I). All existing manufacturers, distributors, importers, and suppliers of goods and services are required to register for VAT at the nearest Local VAT office. As mentioned earlier, except for goods and services exempted by the Decree, all goods and services are Vatable.

Returns are rendered by manufacturers and suppliers of taxable goods and services to the VAT directorate. Every Vatable person must keep records of all supplies made and received. Returns are made on a specific form -- VAT 002 (see appendix II). The VAT sharing formula among the three tiers of government is now 15% (Federal), 50% (state) and 35% (local).

The administration of VAT in Nigeria is faced with a number of problems. These problems include the slow acceptance of VAT despite several enlightenment campaigns by government, the issue of sharing formula, the inflationary impact on prices, the issue of unpaid VAT inspection/collectors, the fraudulent behaviour of VAT inspectors and collectors etc.

Advantages and Disadvantages of VAT

Advantages: Anyanwu (1993:41) has put forward the following advantages of value added tax:

i. It helps the economy to adopt those forms of production, which are economically more suitable. This is because VAT is neutral to the form of production and commercialisation.

ii. It compliments revenue from the oil sector. As a replacement to sales taxes, VAT is wider in terms of coverage hence more revenue is generated from governmental programmes. According to FIRS, VAT accounted for more than N80bn in 2001.

iii. It is more difficult to evade VAT. This occurs due to the cross auditing method involved such that the government is aided in “plugging” the tax leakages.

iv. VAT encourages export of goods of this nation. This is because Nigeria as a country can refund the taxes paid on exportable goods.

v. VAT also encourages firms to be efficient in the production of goods and services. VAT is not levied on profit but on value produced. Each firm tries to be efficient by improving its performance thereby reducing the cost of production. Other advantages of VAT as highlighted in the 1994 Federal Government budget include:

(a) The ability to promote flexibility in public sector revenue to allow for the maintenance of developmental expenditure in the light of fluctuations in
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off revenue.
(b) Its ability to broaden the tax base with equal burden on imports and domestically produced goods and services.
(c) VAT ability to diminish the distortion to private savings and investment by shifting the incidence of taxation towards expenditure rather than income and according to Dosumu (1995) VAT has the capacity of attracting more people into tax thereby making the entire citizenry very alive to their civic responsibilities.

Disadvantages

i. VAT system is complicated. It requires advanced financial and economic structure as well as honest and efficient government machinery for its successful operations. This is very difficult to come by.
ii. If the administrative machinery of government is ill equipped to do the necessary cross checking, then the system is opened to tax evasion. Purchasers could be taxed thereby creating room for tax evasion.
iii. VAT is highly uneconomical for small-scale firms. This is because an elaborate and costly account is required for a successful operation of the system. Small-scale firms cannot afford this elaborate and costly accounts.
iv. Where there are differential rates and exemptions, VAT becomes unattractive and difficult to operate. Though this difficulty could be removed if trained and qualified personnel are involved.

Suggestions for Effective Implementation of VAT

This section presents suggestions based on discussions with Vatable persons and personal findings. It is evident that VAT has recorded an appreciable success since its inception in 1994. The system will operate better if the following suggestions are effected in the administration of VAT in order to accomplish its objectives:

a. VAT rate should be varied. Instead of having a uniform rate of 5%, expensive and luxury goods and services should attract say, 10% while goods and services that are necessary or intended for low income earners remain at the present rate of 5%.

b. There should be a proper inspection for VAT. After the registration of taxable goods and services and Vatable persons, regular inspections by qualified and dedicated tax officers be conducted to ensure that the amount remitted to government is correctly done and within the time stipulated by law.

c. Local governments should be compelled by law to execute certain projects
specifically from their share of VAT. This will ensure that the local government share from VAT is used for the overall benefit of the people (tax payers) especially at the grassroots level.

d. There should be information from government and VAT directorates on regular basis concerning additional registration of Vatable persons, amount remitted either on weekly, monthly, or quarterly basis, local government, and state VAT figures etc. This information should be contained in the FIRS information circular. This will improve public awareness.

e. Government should encourage the production of goods and services by removing all the bottlenecks that hinder effective production, hence VAT is a tax on value added in the course of economic transactions.

f. Finally, those who are charged with the responsibility of collecting VAT at all levels should be properly motivated and controlled to ensure that the system operates as intended.

Conclusion

VAT has a far-reaching effect on the socio-economic development of Nigeria. The success story of VAT so far is a triumph of economic and social expertise. It is the result of government determination to improve the fiscal policy of this country. With VAT, it is clear that the revenue of this country does not come from one section to satisfy the other sections as the case with oil revenue. It has actually enhanced the volume of government revenue. It is expected that in the near future, the tax regime will even contribute more to the gross tax yield and increase the tax portfolio of Nigeria and enhanced meaningful industrial and infrastructural development.

References


Value Added Tax Decree No 102 of 1993.