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Factors Influencing Effective Tax Collection in Informal Sector in Kano State, Nigeria: A Preliminary Study

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Abstract

The purpose of this preliminary study is to examine the relationship between awareness, public governance quality, tax incentives, ease of paying tax, income, and penalty on effective tax collection from the informal sector in Kano, Nigeria. Data were sourced from 30 tax collectors who answered questions on a variety of issues from the questionnaire administered. The statistical package for social sciences (SPSS) was applied to conduct descriptive statistics on the variable under investigation with a view to examine the minimum, maximum, mean and standard deviation values. Similarly, preliminary reliability and validity tests on the variables under examination were conducted. The results show that all variables are significantly interrelated with acceptable mean values, Cronbach's Alpha coefficients and Keiser Meyer Olkin (KMO) measure of sampling adequacy. The results also indicate that the independent variables have a significant influence on the dependent variable (effective tax collection). Therefore, the study recommends that an all-inclusive study can be conducted using the same variables but with a higher population and a broader scope.

Key words: Influence, Informal, Effective, Taxation, Nigeria.

1. INTRODUCTION

Taxation in Nigeria is of utmost importance considering the government's dire need for enhanced revenue generation to tackle the growing demand for critical infrastructure and the need to control the persistent budget deficit in the country. Effective tax collection will alleviate the problems of reliance on a single source of revenue (oil) being a wasting asset. Even though, historically tax governance in the informal economy gained increased recognition and wide acceptance since 1972 in Kenya when the International labour organization convened to discuss and find a precise academic meaning of informal sector (ILO, 1972), its relevance to the Nigerian economy is ignored. This is substantiated by a survey conducted jointly by small and medium enterprises development agency of Nigeria and National bureau of statistics (SMEDAN/NBS, 2013). Furthermore, African countries are facing difficult economic problems ranging from poverty, unemployment and decaying infrastructure. Consequently, governments are looking inwards to identify ways to improve revenue generation through tax collection (Hossain, 2012). In Nigeria, governments at all levels are seriously searching for more sources of revenue to finance their growing expenditure and maintain economic growth which is endangered by the global economic recession.

Similarly, Tax collection in Kano State is in a distress condition to the government. This distress condition has become very serious consequent on the state depending on more than 70 per cent of its revenue coming from Federal subvention (NBS, 2015). This is evidently clear considering the recent global financial crisis brought about by the sudden fall in oil prices which affected the country's oil sales in the international market (Chima, 2014). Therefore, this paper is motivated by the need to address the already impaired revenue generation capacity of Kano state and the worrisome dependence on Federal subvention which requires the expansion of the tax net to accommodate the vibrant informal sector enterprises operating in Kano estimated at 1,934,534 (SMEDAN/NBS, 2013). Based on the above issues and the dire need for effective tax collection from the informal sector in Kano, the objective of this preliminary study is to examine the relationship between awareness, public governance quality, tax incentives, ease of paying tax, income and penalty on effective tax collection from the informal sector in Kano state, Nigeria. The essence is to establish the reliability and validity of the measures for the variables ahead of the main study. The paper is structured and organized in the following sections. Section is the introduction in which the motivation, objective and the structure of the paper were discussed. In section two, literature review was conducted while section three presented the methodology of the study. In section four results of the study was discussed while section five present conclusion and implication of the study.

2. LITERATURE REVIEW

2.1 The Concept of Taxation

The importance of taxation as a reliable tool for sourcing public revenue cannot be emphasized. Taxes are compulsory payments to the state by the private sector (both corporate bodies and individuals) to the government through taxing agencies without expecting direct benefit or return from the state. Therefore, taxes provide governments with a reliable source of revenue in order to facilitate projects execution (Udoh et al, 2008, Asimiyu et al, 2014). The rationale behind collecting taxes by government is to generate enough revenue so that it can finance and provide public welfare services for the benefits to all citizens. Eugine and Abigail (2016) assert that tax is a reliable source of revenue to the government and a means for fiscal policy and macro-economic management.

However, in the Nigerian situation, tax revenue contributes an insignificant share to the total government revenue. This is perhaps due to lack of awareness or inadequate public governance presence. Similarly, revenue from crude oil sales accounts for more than 80% of the total federal revenue while the balance of 20% comes from the non-oil sectors including tax revenue (Otu and Theophilus, 2013). Eugine and Abigail (2016) discovered that, the impact of direct and indirect taxes is insufficient because of the prevalence of informal sector activities in the country.

2.2 The Informal Sector in Nigeria

The Nigerian informal sector is largely heterogeneous and dominates about 65-70 percent of the Nigerian economic activities (NBS, 2013).

The scope of informal sector operations in Country incorporates general trading; spare parts; sale of domestic animals; construction works; credit offices; hair dressing; blacksmithing; transportation; agro-allied business, refrigeration, mechanical and electrical work, dressmaking, services footwear, carpentry, barbing salon, laundry services and many others. Furthermore, the informal sector enterprises are commonly low wage, small time organizations, with independently employed and self-administered individuals working outside the government administrative rules and do not pay any tax. The occurrence of Nigeria's huge informal sector has been attributed to the difficulties inherent in entry into the formal sector. For instance, the costs of organizational enlistment, stringent registration procedures, lack of working capital are some of the factors compelling businesses in Nigeria to operate informally. Fundamentally, as a result of its sheer size, it is very hard to have dependable information on the informal sector enrolment and activities.

However, in Kano State, the informal sector contributes less than 10 per cent to internally generated revenue largely due to weak regulation, weak tax laws and tax evasion (KSIRS, 2019). In fact, Olusola (2014) noticed that internally generated revenue (IGR) as percentage of aggregate revenue in Nigeria were below 15% for all states including Kano state, except Lagos State. Wambai and Hanga (2013) conducted a survey which estimated that more than ₦11.0 billion in tax revenue could be generated annually from a few randomly selected informal sector enterprises in Kano. Recently, Isma'il (2016) projected that Kano state could generate ₦36 billion tax revenue annually from the sector's over 2 million enterprises alone.

2.3 The Concept of Effective Tax Collection

Conceptually, effective tax collection includes all the administrative machinery, processes, strategies and methods applied by states governments to source for, collect and enforce the payment of taxes from both the formal and informal sectors. This includes, tax administration, tax policies and use of professionals to improve tax collection particularly from the informal sector, simplification of the collection process and enhancing quality of governance in general.

It is not easy to enhance tax collection without growing taxes and failure to collect taxes effectively from the informal sector limits the tax base and reduces tax revenue (Ummad & Pierre, 2016). Section 162 of the Nigerian constitution defines revenue as any income or return accruing to or derived by government of the federation from any source. This means that tax revenue includes all incomes generated by government from taxes; rates; fees; rents; fines; duties; proceeds and other receipts of government to which the legislature has power to appropriate. Similarly, Wambai and Hanga (2013) define tax revenue as all income generated by the federal, states and local governments. However, Edogbonya, and Sule (2013) explain that tax collection involves all the strategies applied by governments in order to collect taxes. In general, effective tax collection is an important activity and therefore could be realized by educating tax payers through awareness campaigns, provision of adequate public goods such as health care facilities, provision of adequate incentives, assiting tax payers to grow their incomes through access to cheap finance, provision of facilities that will ease paying taxes and imposing penalties to deter tax evasion and avoidance. In other words, some of the factors that determine effective tax collection from the informal sector include public governance quality, tax incentive, ease of paying tax, income awareness and penalty.

2.4 Relationship between Awareness and Effective Tax Collection

Awareness among tax payers is a vital tool that could be used to improve effective tax collection. Awareness of tax obligation is defined as the possession of tax knowledge, tax education, information on tax laws and other requirements by the tax authorities which apply to both formal and informal sectors of the economy in order to eliminate tax evasion and enhance effective tax collection. According to Alabede (2012), awareness as a human effort together with self-support and will power to perform the rights and obligations of taxation according to rules and regulations.

Furthermore, empirical evidence confirms that awareness has a significant influence on tax collection (Alm, et al., 1992). Similarly, Uzonwanne (2015) found that awareness has a positive significant influence on individual taxpayers’ behaviour in Nigeria. Other studies showed that awareness is related to tax collection decisions

(Wallschutzky, 1985). Moreover, research findings have shown that awareness is a key determinant of tax collection behaviour and perception (Ahmad et al, 2016; Alabede, 2012, Odusola, 2006). However, according to Uzonwanne (2015) the Nigerian tax authorities could not create the required awareness especially among the informal sector so that tax collection could be improved for infrastructural development perhaps due to lack of adequate campaign and defects in information dissemination system. This means that with the adequate campaign targeted at the informal sector, tax collection will be greatly enhanced. Therefore, in order to investigate the nature of influence of awareness on effective tax collection from the informal sector, it is hypothesized that:

H_1: There is a relationship between awareness and effective tax collection from the informal sector.

2.5 Relationship between Public Governance Quality and Effective Tax Collection

Public governance quality is the process by which government provides effective governance through the provision of quality public administration, quality public goods, accountability, and quality regulations (Everest-Philiph & Sandall, 2009). The World Bank (2006) describes public governance as composition of institutions and traditions governing a country for the benefit of all. The concept has also been described in the context of assisting individuals to achieve the highest level of personal wellbeing (UN, 2007), adherence to rule of law and effective management of resources (Kaufmaan. Kraay & Mastruzzi (2007).

Furthermore, the organization for economic cooperation and development (OECD, 2011) policy framework for investment refers to public governance as comprehensive measures that determine how public pronouncements are arrived at and how public events are executed. This policy framework enumerated the key essentials of good public governance notably, accountability, transparency, efficiency, effectiveness, responsiveness, and rule of law. Similarly, Kaufmaan et al (2007) opines that there are six essential dimensions of an excellent public governance quality namely: voice and accountability, rule of law, regulatory quality, government effectiveness, control of corruption and political stability. The literature on public governance clearly shows that it is important to investors and their businesses because it simplifies smooth interaction the state and the public. Therefore, there is a clear relationship between public governance quality and development which requires government to generate enough revenue in order to actualize development.

Similarly, there is a relationship between qualitative governance and tax collection because government is responsible for the provision of public goods such as schools, hospitals and the financing of critical infrastructural facilities from taxes collected. Therefore, governance quality should be a matter of concern to the taxpayers because they provide the finance for its sustenance. Consequently, governance affairs may affect effective tax collection positively or negatively.

Moreover, Lassen (2003) observed that the agreement between taxpayers and the government is a vertical contract. In other words, tax payers enjoy certain benefits in return for paying tax. This means taxpayers are only interested in government providing enough quality goods in return for taxes paid (Lassen, 2003). Therefore, when tax payers perceived a low rate of return or the provision of public goods is below expectation then they will assume that the government is not fulfilling its obligation and consequently, tax collection from the informal sector will deteriorate thereby affecting tax collection negatively (Lassen, 2003). In support of this argument Besancon (2003) disclosed that there is a social agreement between the leaders and taxpayers that is embodied in effective provision of the political goods.

Finally, Egwaikhide (2010) concludes that there is a high correlation between effective tax collection and quality public governance. While, Alm and Gomez (2008) discovered a positive connection existing between perceived benefits derivable from public goods and the enthusiasm to pay tax which will result in increased tax revenue to the state. Therefore, based on the above findings and the need to appreciate the nature of influence of public governance quality on effective tax collection the following hypothesis is developed:

H_1: There is a relationship between public governance quality and effective tax collection from the informal sector in Kano State.

2.6 Relationship between Tax Incentive and Effective Tax Collection

Tax authorities and agencies have identified tax incentive as desirable and powerful factor that facilitate effective tax collection. Tax incentive can be defined as the various strategies and policies put in place by tax authorities in order to motivate individuals and businesses in the informal sector to respond to their tax obligations. This include tax cuts, tax holidays, loss reliefs and tax weivers and forms of reliefs extended to tax payer. Similarly, Omesi and Nzor (2016) defined tax incentives as special provisions in the tax laws made to attract, retain and increase investment, facilitate growth in some areas, assist individuals in conducting identified activities aimed at ensuring the growth and development of the economy.

Previous studies have also discovered the desirability of using tax incentives as a strategy for facilitating tax collection drive by governments and an avenue for managing its unsustainable fiscal deficits (Oriakhi and Osemwengie, 2013). Tax incentive comprises of the whole procedures applied by the government to encourage taxpayers to act in response towards paying tax (Omezi & Nzor, 2016). For instance, some of the tax incentives granted to tax payers include, deductible capital allowance; reliefs and allowances; research and development; rural investment allowance; investment allowance; tax-free dividends; tax free interest; tax holidays and tax treaties.

Furthermore, since tax incentives are regarded as influential determinant of tax collection, it implies that tax incentives are related with tax collection. This means that they can be extended to the informal sector to improve tax revenue. According to Oriakhi and Osemwengie (2013), tax incentives have the potentials of attracting local investments especially from the informal sector (Oriakhi & Osemwengie, 2013). This is expected to improve informal sector income which will impact positively on effective tax collection from the sector. Similarly, Omezi and Nzor (2016). opined that improved tax collection from the informal sector largely relies on the establishment of an efficient and effective tax incentive system. Therefore, based on these arguments and the perceived relationship between tax incentives and tax collection, the following hypothesis is developed:

H_1 There is a relationship between tax incentives and effective tax collection from the informal sector.

2.7 Relationship between Ease of Paying Tax and Effective Tax Collection

Over the years simplifying the process of paying tax will improve tax collection. This study sees ease of paying tax in the informal sector as the provision of facilities, designing methods and strategies to the informal sector businesses in order to simplify the payment of taxes without difficulties and incurring additional costs in the process of paying tax. This include among others friendly environment, modernization of payment system (online payment) and simplification of tax laws.

PriceWaterCorpers (2015), observed that during the recent economic crises (2008-2010) the most common changes that make tax payment easier were reduction in the corporate tax rate and the introduction of online system of paying taxes which appreciably enhances tax collection from the informal sector. During this crisis, about 47 countries like Canada, Fiji, Indonesia and United Kingdom reduced their tax rates gradually over the years as a way of making tax payment easier (PWC, 2015). Therefore, the ease of paying tax in the informal sector is a factor that could encourage compliance with tax laws, minimize tax evasion and improve tax collection (Gosu, 2015). Based on these arguments and the need to appreciate the nature of influence ease of paying tax could have on effective tax collection from the informal sector, the following hypothesis is proposed:

H_1: There is a relationship between ease of paying tax and effective tax collection from the informal sector.

2.8 Relationship between Income and effective Tax Collection

Income is generally believed to be the subject of taxation without which no tax will be imposed on either individuals or corporations. This study defines income as the total of monetary earnings that accrue to an individual or business within a specified period and it is the main factor considered when imposing taxes in the informal sector.

Previous studies notably Genevieve (2016) and Alhanti (2016) have appreciated the informal sector for its wealth creation and income generation capacity through various entrepreneurial activities. Income in general terms is about the class of income to which an income recipient belongs. It can be broadly classified into the upper class, the middle class and the poverty level (Alhanati, 2016).

Similarly, studies by John and Slewrod (2008) discovered mixed relationship between income and tax collection and indicated that low income earners are the highest tax evaders. While others indicate that a significant number of undeclared incomes come from lower class tax payers (Guramu, 2012). On the other hand, the rate of paying tax is higher among taxpayers with high income earnings (Gurama, 2012). In other words, the relationship between the level of income and tax collection could be either way. This is because the higher the income, the higher the contribution towards government expenditure and vice versa (Guramu, 2012).

Therefore, when the informal sector operators are regulated and allowed to improve their income levels, they will be motivated to pay their taxes promptly which will impact positively on tax collection. Based on this and the to understand the nature of influence income could have on effective tax collection from the informal sector, the following hypotheses id developed.

2.9 Relationship between Penalty and Effective Tax Collection

The concept of penalty has been debated severally in legal literature, but it affects all areas of human endeavour. This study defines penalty as the methods applied by constituted authorities on offenders (tax defaulters) in order to serve as deterrence to others. Therefore, penalty covers monetary fine, sanctions, in some cases prison sentence imposed on tax evaders in order to enforce compliance or prevent future occurrence. However, in economic terms, penalty is imposed to strengthen tax enforcement so as to improve efficiency in terms of tax collection. The methods employed by tax administrators to persuade tax payers to cooperate with tax laws is referred to as tax enforcement (Daniel, 2013). Similarly, penalty is a punishment for disobeying the law which could be monetary or otherwise.

Similarly, Allinghan and Sandamo (1972) studied the effect of penalty on tax evasion and found that imposing penalty, high and stringent sanctions to prevent tax payers from tax evasion are negatively related. Therefore, it can be argued that even though most of the discussions on penalty concentrated on tax compliance it can be extended to tax collection from the informal sector. For instance, increase in penalty may affect tax collection negatively (Daniel, 2013). Finally, offences with regards to tax collection that may attract penalty include failure to keep proper records, cash transactions, refusal to declare income and suppression of records. Therefore, based on this assertion, penalty seems to be a form of negative incentive to force tax compliance with the aim of improving tax collection. Drawing from these arguments and the need to understand the influence of penalty on effective tax collection from the informal sector this hypothesis is developed.

3.0 METHODOLOGY

This study is a survey type that collected data from primary sources and adopted quantitative approach to investigate the relationship between awareness, public governance quality tax incentive, ease of paying tax, income and penalty on effective tax collection from the informal sector. It is a preliminary study with a population of 30 respondents. Therefore, 30 questionnaires were distributed to tax collectors (the respondents and unit of analysis) and retrieved for analysis because there was no challenge of a low response rate. Similarly, for the purpose of analysis the data collected was analyzed and explained statistically using statistical package for social sciences (SPSS version 22) in drawing conclusions and inferences in relation to the population of the study.

3.1 Research Design

Research design is grand plan that stipulates the methods and process for data collection and analysis (Zikmund, 2000), it also provides the required direction for conducting a research (Hair et al, 2007). Therefore, this study adopts an explanatory research design and formulated hypotheses in order to offer explanation of the relationships between the independent and dependent and variables.

3.2 Population and sample of the study

Sekaran & Bougie (2010), defined population as the entire group of people, events or things of interests the researcher is willing to investigate and make judgment based on the selected sample of the study. Therefore, the population of this study comprised of 30 tax collectors from the Kano state internal revenue service (KSIRS). The tax collectors were selected as respondents because they are experienced in tax collection and they know the operating environment. The tax collectors can also adequately answer questions on various items in relation to the variables under investigation. In other words, tax collectors are educated, professionally trained and can answer questions on both the informal sector and tax collection. Finally, because the population is small and the study is preliminary in nature, it also served as the sample of the study.

3.3 Measurement of Variables

The variables under investigation in this study were measured appropriately using different measurement items. The items measured were adapted from previous studies and data banks such as Afrobarometer 2005, World Economic Forum 2006, Alabede 2012 and Idawati 2013, Daniel 2013 and Gosu 2015 with some modification and validation by experts to suit effective tax collection. Furthermore, a five-point Likert measurement scale ranging from '1' "Strongly disagree" to '5' "Strongly agree" was applied to measure the items and their degree of agreement with all the constructs of this study. This measurement scale was selected by this study because it has been widely applied by similar studies in the past as well as its power in facilitating understanding by the respondents and ease of analysis to the researcher (Boone & Boone, 2012).

3.4 Technique of Data Analysis

This preliminary study analyzed the collected data using descriptive statistics. Descriptive statistics provides a quantitative explanation of data characteristics to draw conclusions about a population or sample (Sekaran & Bougie, 2010). Therefore, descriptive analysis is applied to explain the variables in relation to minimum, maximum, mean, standard deviation, skewness and kurtosis in order to ensure stability of the data.

4.0 RESULTS

This study prepared questionnaire to evaluate important features such as the reliability, validity, clarity, completeness, and acceptability of the questionnaire. It is a small scale preliminary investigation conducted in order to evaluate the feasibility, cost and duration with the aim of improving on the study design before the real full-scale study (Creswell, 2014).

4.1 Descriptive Statistics of Variables:

The mean and standard deviation are described as common measures of central tendency and dispersion respectively. The mean is the average value of the data set, while standard deviation provides an index of variability in the data set. Sekaran and Bougie (2010) assert that both mean and standard deviation are considered vital descriptive statistics for interval and ratio scale. That means it is imperative to observe the descriptive statistics of the variables because they facilitate inspection of the construct's mean and standard deviation to have an impression of the data before further analysis (Sekaran, 2016). This preliminary study applied Likert measurement scale and adapted Nick, Jantan and Taib (2010)'s clarification of the level of score of less than 2.33 as low level, 2.33 to 3.67 as moderate levels while 3.67 and above are considered as high level.

Similarly, Table 4.1 shows the mean and standard deviation of the variables. For instance, ease of paying tax and income recorded the highest mean (M = 23.96, SD = 4.61) and (M = 23.96, SD = 4.07) respectively. This is followed by public governance (M = 22.13, SD = 2.37). Similarly, awareness scored (Mean = 21.16, SD = 2.18), tax incentives has a mean score of (Mean = 20.70, SD = 4.24), while penalty recorded the lowest mean (M = 19.30, SD = 5.51). However, effective tax collection (the dependent variable) recorded a mean score of (M = 21.93, SD = 2.50). Conclusively, the mean of all the study variables fall within the highest-level range.

Table 4.1

Summary of the Descriptive Statistics

Variable	N-Stat.	Min.	Max.	Mean	Std. Dev.
Effective tax collection	30	17.00	25	21.93	2.50
Awareness	30	16.00	25	21.16	2.18
Public Governance	30	18.00	25	22.13	2.37
Tax Incentive	30	5.00	25	20.70	4.24
Ease of Paying Tax	30	16.00	30	23.96	4.61
Income	30	17.00	30	23.96	4.07
Penalty	30	5.00	25	19.30	5.51
Valid N (listwise)	30				

4.2 Reliability and Validity Tests.

The preliminary study conducted its analysis using SPSS in order to test the adequacy of the questionnaire and corroborate its face and content validity. In this study, 30 questionnaires were administered on the tax collectors who are staff of Kano State internal revenue service. The rate of response from the pilot was 100%. According to Sekaran & Bougie (2013), Cronbach's alpha is acceptable from 0.70 while the KMO is acceptable from 0.50 (Hair, Hult, Ringle, & Sarstedt, 2014). Table 4.2 shows the results of reliability and validity tests conducted and various values of the Cronbach's Alpha coefficient and KMO test of sampling adequacy for both independent and dependent variables. Therefore, the results of the preliminary study found that the Cronbach's alpha and KMO of all the variables ranges from 0.640 to 0.912 and from 0.507 to 0.722 respectively. Based on the results obtained from the data examined one item each from tax collection, awareness and level of income totaling three items were dropped. These items are: 'Informal sector taxation is a major source of tax revenue to government'; 'The informal sector operators are fully aware of their tax obligations'; 'Taxation is a subject of income in the informal sector' respectively. The remaining items of all the other variables have been retained. All the variables were at significant level of 0.000. In conclusion, from the responses generated and the reliability test conducted negatively worded and difficult questions were reworded and amended in order to enhance understanding of the instruments by the potential respondents.

Table 1.1

Preliminary Results of Reliability and Validity Tests

Latent Variables	Original items	Deleted items	Items Reduced to	Cronbach's Alpha	KMO Test	Sig.
Tax Collection	5	1	4	.725	.657	.000
Awareness	5	1	4	.777	.659	.000
Public Governance Quality	5	00	5	.640	.722	.000
Tax Incentive	5	00	5	.912	.720	.000
Ease of Paying Tax	6	00	6	.835	.692	.000
Income	6	1	5	.657	.507	.000
Penalty	5	00	5	.890	.700	.000

5.0 CONCLUSION AND IMPLICATIONS

This is a preliminary study that investigated the influence of awareness, public governance quality, tax incentives, ease of paying tax, income and penalty on effective tax collection from the informal sector in Kano state, Nigeria. Some empirical evidences that tried to show the relationship between the variables were provided. Logically, the study implies that there is need for a wide-ranging research on these variables with reference to public governance quality which has the lowest Cronbach's Alpha coefficient of 0.64. Similarly, the study implies that government should provide more tax incentives which has the highest Cronbach's Alpha coefficient of 0.91. furthermore, all variables have high mean and standard deviation values awareness which has a low-level standard deviation value of 2.18.

Therefore, the study concludes that all the variables examined have significant influence on effective tax collection from the informal sector in Nigeria. It is therefore recommended that regulatory and tax agencies should design policies that will facilitate the incorporation of the informal sector into the tax bracket of the state to enhance effective tax collection.

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