Locker room taxation and lessons for Nigeria – Part 1

Based on statistics, only 1% of the population should account for about 50% of the tax revenue accruing to the government. Of course, this is not cast in stone and may defer from one jurisdiction to another but it gives an indication of where the revenue generating potential of any state lies.

By Kenneth Erikume

Background

Donald Trump's name has always been connected with controversy, at least since he started running for president. A new controversy came up when his tax returns for 1995 was leaked to the press. One of the outcomes of this is that it became clear that some rich people don't necessarily pay huge amount of income taxes even in developed economies. In fact, they sometime pay much less than the poor or average taxpayer.

Interestingly the tax controversy about Donald Trump has also attracted mixed reactions. Some people call it "being smart", others say it is dubious. But it seems he has played according to the rules and was able to utilise some losses from previous business failures against his earnings in the period covered by the tax returns. I am not settling the debate on whether it is clever or immoral. The conclusion that people will reach on that point is actually subjective, based on personal beliefs on tax or whether you are a supporter of Donald Trump or Hillary Clinton.

I would rather raise a different question. What would be your reaction if you discovered that you pay more tax than your richest neighbour? Would you feel cheated? Maybe or maybe not.

What if it was due to the rich neighbour's ability to take advantage of loopholes in the law or the tax authorities just never bother to ask or enforce the law? While you may feel the same between the two options, you are likely to react differently.

I bet that you would direct most of your anger at the government if you discovered that the reason why this has happened is not because your neighbour is taking advantage of loopholes in the tax laws but because the system of tax administration makes it possible for your neighbour not only to evade tax but to never be caught. But, this is exactly what the Federal structure of tax administration in Nigeria makes possible due to lack of coordination and carving up the States into small bits with different tax authorities.

I was recently giving a lecture where I gave an example of a man whose family resides in Delta State, but he works in Lagos State and is an indigene (in fact a chief) from Ogun State. While the law clearly spells out that his taxes should be collected by the relevant tax authority where he is resident, the problem is that he can declare to Lagos that he is resident in Ogun State and also declare to Ogun State that he is resident in Delta State or any cycle he prefers. As long as these State tax authorities do not talk to themselves, they will all assume that taxes are not due in their respective states. If only one tax authority collected the tax, there will be no question regarding where he is tax resident. The taxes will be collected.

Another problem that the States will have is disputing where he is resident because of lack of data and intelligent information. To build a case on tax evasion, you need to be able to provide convincing evidence. However, a number of States do not have a reliable database of taxpayers in their States and building on that, they also do not have data analytics capability to draw reasonable conclusions on taxpayers from 'big data' at their disposal.

To provide a real life example, if I say I am an Urhobo man, it will be difficult for anybody to challenge me because my surname sounds Urhobo and my pidgin English is very fluent because I lived in Warri during my formative years. You would need some other external information about me to come to the conclusion that I am actually an Ika man. These are some of the reasons that the Federal Inland Revenue Service began to look at assisting states with a joint tax audit. But joint tax audits will only scratch the surface in terms of inter-State tax evasion. This is not the messiah that will suddenly pull out the States from their debts. There must be full implementation of collaborative tax administration.

On a very high-level, here are some of the solutions to ensure that the tax system is fair to all especially to the taxpaying middle class who are taxed compulsorily because they are subject to PAYE.

Solutions for states to widen the tax net

Enumeration of all taxpaying individuals and businesses (including sole proprietorships, trustees and partnerships) resident in the state – The mistake the states make here is that they conclude their enumeration based on individuals that they identify at a point in time within the state. In reality, this approach will always give the wrong result because tax is assessed on individuals based on residency. Any enumeration would therefore require an enumeration of tax residency of individuals and companies.

Plugging into one source of data – Irrespective of enumeration, people can move their residency around within a country because they do not need visas to move inter-state. All the 36 states therefore need to come together to ensure that they set up one uniform database for the identification of individuals. The Joint Tax Board has initiated a joint tax identification number system that allows for a ten finger authentication for registration of individuals. However, many States have not fully tapped into it.

Collaboration – There has to be a lot of collaboration especially between neighbouring states. Collaboration could be in the form of sharing of information on taxable individuals, carrying out joint audits and setting up forums where complex inter-state issues are handled.

No favouritism – This is the biggest challenge. Even in taxation, Pareto principles may apply. It may be that 80% of the potential tax in a State can be collected from 20% of taxpayers. Oxfam International issued a report called, "Working for the Few". Some of the interesting statistics include:

- Almost half of the world's wealth is owned by just 1% of the total population.
- The bottom half of the world's population owns the same as the richest 85 people in the world.
- Seven out of ten people live in countries where economic inequality has increased in the last 30 years

In an ideal world, based on the above statistics, 1% of the population should pay 50% of the personal income tax accruing to government. Of course, this is not cast in stone and may defer from one jurisdiction to another but it gives an indication of where the revenue generating potential of any state lies. However, the statistics in Nigeria shows that States collect more in PAYE than direct assessment of personal income tax of the rich. The reason for this may be that either the rich are too powerful to be taxed or employ legal tax avoidance schemes to reduce their taxes like Donald Trump.

Conclusion

One thing is clear, the people who need to contribute more in terms of proportion to income also have connections with people who make the laws and those charged with tax administration. Unless the trend is reversed, States would have to learn to cope with paltry level of PAYE revenue especially in a recession when companies are downsizing.

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