Economic growth and employment generation:
What taxation can and cannot do

By Taiwo Oyedele

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A Bill seeking to amend the Companies Income Tax Act Cap C21 LFN 2004 to, among other things, make provisions for tax incentives for economic growth and creation of employment opportunities is currently under consideration by the National Assembly.

The Bill, if passed into law, will grant a ten-year tax holiday to any new company established in an area with no electricity, water or tarred road. Where such facilities provided by government are located within 10 kilometres away, the company will be entitled to investment allowance ranging from 20% to 100% of expenditure incurred in providing such facilities.

It is not clear if the investment allowance currently provided for in the tax law will be in addition to the tax free period now being proposed or they are mutually exclusive. Also it is not clear if the tax free period will be based on the unavailability of at least one or all of the facilities.

Also the Bill seeks to increase the tax holiday of a new company going into mining of solid minerals, or gas utilisation from the current 3 and 5 years to 5 and 7 years respectively.

The proposed amendment, subject to the necessary fine-tuning if it must go through, would likely be a welcome development for some investors and taxpayers although there is no empirical evidence of a direct relationship between tax incentives and economic growth or employment generation. Therefore, the pertinent question is *"How far can tax incentives go in facilitating economic development and employment generation?"*

The economic growth of any nation is measured by her Gross Domestic Product (GDP). According to the International Monetary Fund (IMF), Nigeria's GDP for 2011 was US$238.9 billion making Nigeria number 41 in the world. The GDP has grown by between 5 and 8% in the past few years. Sectorally. Agriculture with 34.47% contributes the highest percentage to our GDP ahead of Crude Petroleum and Natural Gas. Sadly, Manufacturing contributes less than 2%.

The 20th largest economy in the world as at 2011 was Saudi Arabia with a GDP of US$577.6 billion. To achieve this level of GDP by 2020, even if we assume that other economies will be stagnant, Nigeria's GDP must grow annually by more than 10%.

In terms of employment generation, again it is important to know where we currently stand as a nation. The International Labour Organisation (ILO) defines unemployment to covers persons aged 15 to 64 who during the reference period were available for work, seeking for work, but were unable to find work.

According to the National Bureau of Statistics (NBS), Nigeria's unemployment was 23.9% in 2011. In computing the unemployment rate, the total population is divided into labour force (currently active) and non-labour force (not currently active). The economically active labour force population covers persons aged 15 to 64 years. The definition of unemployment therefore covers persons aged 15 to 64 who during the reference period were available for work, seeking for work but were without work. A person is regarded as employed if he/she is engaged in the production of goods and services, thereby contributing to the GDP. This means for instance university graduates who ride *Okada* for a living and those engaged in farming as a result of their inability to secure white collar jobs are considered as employed. Also, there is no distinction between contract, casual or temporary employees and those who have regular employments.

The category of persons considered not in labour force include those without work, who are not seeking for work and/or are not available for work as well as those below or above the working age. Examples of these are full time housewives, under-aged children, physically challenged and incapacitated persons and such others not employable.

Just to put things in proper perspectives, Nigeria's population is currently estimated at 164 million out of which 92 million are economically active. Of this number, the labour force is 67 million out of which 51 million are employed *(never mind our definition of employment)*. Hence the 23.9% unemployment rate translates to about 16 million. The unemployment rate is higher in the rural area 25.6% than in the urban area 17.1%.

Within the past five years there has been an average of about 2 million new entrants into the active labour market every year. Unfortunately, employment generation during the same period averaged only 160,000 per year with declines recorded in 2009 and 2011. As a result, unemployment rate has increased steadily from 12.3% five years ago to 23.9% in 2011.

It is estimated that, more than 70% of Nigerians in employment are engaged in farming or by small and medium size enterprise (SMEs). Yet due to the harsh operating environment, empirical evidence shows that only 6 out of every 100 start-ups make it to their 5th anniversary while only 4 eventually make it to the 10th anniversary.

It therefore follows that to generate employment and ensure economic growth that will translate into prosperity for the ordinary people; government must put in place infrastructure and investment friendly policies to develop not only large scale conglomerates but also SMEs. Granting tax incentives, especially where it has not been considered from a cost/benefit point of view, is unlikely to be the right solution. There is no reliable data to show the impact of existing tax incentives in this regard. In my view, investors don't just want incentives, what they crave for is a conducive business environment incorporating a sensible tax system where policies are predictable and are consistently applied in a business friendly manner.

Given the federal government's policy direction to move away from selective tax incentives, because they create uneven playing field, the proposed tax incentive should perhaps apply to all companies in Nigeria. The reason for this, which is not far-fetched, is that many companies do not rely on water or electricity provided by government. Also in many cases roads are in a terrible state that they are as bad as un-tarred. Consequently, this means virtually all companies operating in Nigeria (including those located in cities) should be eligible for the incentive. In fact, in many homes individuals generate their own electricity and water. May be such individuals should also enjoy tax free holiday from personal income tax.

Other than the lack of infrastructure, insecurity and the likes, some of the major policies discouraging investment in Nigeria include the requirement in the Companies and Allied Matters Act for a foreign company wishing to carry on business in Nigeria to incorporate a Nigerian company for that purpose. Many times the nature and duration of business to be undertaking do not require incorporation where a branch or representative office will do. There is also the commencement rule under the income tax laws, which levies double taxation on the profit of a start-up company. In addition, there is excess dividend tax provision which penalises a group of company and other entities that invest their profits rather than distribute them. When such profits are subsequently distributed, the company is made to suffer addition 30% tax on the past profits reinvested. As a matter of fact, the excess dividend tax provision nullifies the effect of any tax incentive. These are some of the issues that must be addressed as a matter of urgency if we desire economic growth and truly wish to stop our unemployment rate from reaching a breaking point.

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