

Internally Generated Revenue

What are the short term options at State level?

Internally generated revenues (IGR) are revenues generated by States within the Nigerian federation, independent of their share of revenue from the federation account.

With the lingering economic struggles, there have been renewed calls for the Nigerian government to diversify the economy away from the oil and gas sector.

Unfortunately, Nigeria's dependence on the oil sector is too critical and the effect of Nigeria's dwindling oil revenue is damaging with reverberations beyond the Federal Government. State Governments who depend primarily on statutory allocations from the federation account have found their ability to deliver the most basic public services (education, health, and others) to the citizenry hampered significantly.

The hardship is most severe in States where IGR is extremely low. For some of such states, the estimated IGR contribution to 2017 budget is below 10%¹. We can all recall that one of the first hurdles this present administration faced upon assumption of office was the debt owed by various state governments especially to their work force. Most of the States had to depend on bail out funds from the Federal Government to settle payroll costs and other recurrent expenditure.

Although some State Governments are genuinely eager to grow their IGR base, there seems to be a general dearth of innovative ideas and a lack of political will to harness available opportunities for revenue diversification. Many legitimate sources of revenue remain unexploited, while procedures for collecting, remitting and accounting for the existing revenue sources often fall short of expectations, giving room for avoidable leakages.

The sources of IGR available to States are broadly classified as:

- tax revenue – e.g. Pay As You Earn (PAYE) which is deducted directly from employees' earnings, direct assessment tax on self-employed individuals and informal sector, road tax, other taxes/levies, etc.
- non-tax revenue – e.g. revenue generated by State owned Ministries, Departments and Agencies (MDAs) during the course of providing various services

This article seeks to highlight some of the challenges in growing IGR, and proffer possible way forward:

Taxation of informal sector

The chart above indicates that compliance monitoring process for non-direct tax deductions is extremely weak resulting in single digit contributions to total IGR. Given the large number of persons/businesses covered in the informal sector, it is obvious that a large proportion of taxable entities are left out of the tax net resulting in huge revenue loss for government. Governments therefore need to improve their capacity to bring in these excluded persons into the tax net.

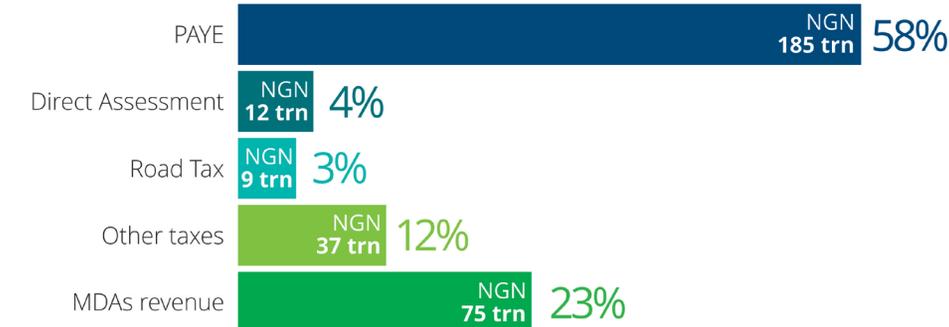
Snapshot of revenue generated by States for Q1 and Q2, 2016

Revenue sources 2016 Q1 & Q2



Source
National Bureau of Statistics

IGR sources 2016 Q1 & Q2



Source
National Bureau of Statistics, IGR at state level report (Jan – Jun 2016)

The challenge with the informal sector is largely the inability to identify the taxable persons in this sector². How do you assess a taxable person you do not know? Further, where such persons can be identified, how do you determine the tax payable with zero record keeping? It should be noted that activities in the informal sector are deemed to constitute a large portion of economic activities in Nigeria; in fact, it is estimated that the informal sector currently contributes about 58% to Nigeria's GDP, according to the United Nations.

Revenue authorities have proposed an interim solution in form of presumptive tax assessment. Under this system, taxable persons will be assessed to tax on the basis of perceived income e.g. income may be estimated by benchmarking the taxable person/business against similar businesses whose records are available. Other indicators could include value of assets, number of employees or even the location of the business, etc. This system however has its pros and cons; whilst it would increase revenue collection, it creates room for uncertainty and subjectivity which is against the underlying principles of taxation in Nigeria.

Ultimately, these "invisible" taxable persons can be uncovered with the help of effective data management and analytics. With all the efforts at getting a unique identifier for everyone in the country, we should be getting closer to the solution. With Bank Verification Number (BVN), National Identity Number (NIN), Tax Identification Number (TIN) etc., we can't continue to argue invisibility³.

Unlocking alternative revenue sources

Based on 2016 half year estimates, Lagos State is the only State which generates approximately 50% of its budget

internally, a lot of states source less than 10% of their budget internally. This is not sustainable and is therefore imperative to diversify revenue sources.

Each State must evaluate its comparative and competitive advantages relative to other States within the Federation, and unlock the sectors of its economy that hold the prospects of contributing significantly to its IGR.

Improved revenue administration

Capacity: Institutions and structures that drive stability in IGR collection are weak or altogether non-existent. Also, most officials of revenue generating agencies lack the requisite knowledge and tools to perform their duties effectively. Governments need to imbibe a structure where policies and projects are run seamlessly, regardless of who is at the helm of affairs. Human resource capacity development is also very key.

Accountability & transparency: Oftentimes, State owned revenue generating agencies are unable to properly account for total revenue collected. There is the challenge of poor record keeping and outright misuse of state funds. In order to ensure transparency and proper accounting, governments should consider investing in technologically driven collection, remittances and accounting mechanisms. Taxpayers and taxable persons (outside the tax net) need to be able to see first-hand, that taxes collected are well utilized. This would help restore citizen's confidence.

Administrative cost: The cost of administering and enforcing compliance is also very high, thus eroding the limited collections made. There should be a major organizational restructuring and business process re-engineering of revenue authorities, including automation

of processes and introduction of cutting-edge technology to simplify revenue collection and administration.

Improved taxpayer enlightenment

Many taxpayers are unable to distinguish between the various kind of taxes subjected to; hence distrust the system based on the belief that they suffer multiple taxation. Also, the compliance process is deemed to be tedious and expensive.

Revenue authorities therefore need to sensitize tax payers regularly to explain legal basis for taxes levied, the payment process, etc. List of approved and authorized taxes and levies collectible by States and Local Governments should be publicized and probably translated in various languages and simplified for people in the grass root, to ensure that taxpayers are certain of their obligations and are not taken by surprise.

The compliance process should also be automated and simplified such that it is convenient for taxpayers to comply. Government may also consider tax reforms where applicable.

Conclusion

Growing IGR at the State level goes beyond mere desire or wishful thinking. It is an objective that must be anchored within a clear and structured strategy, it cannot be approached on an ad-hoc basis.

The State governments must generally review their spending profile to make the most of their limited revenue. They must also renew emphasis on strengthening institutions and ensuring that processes are streamlined in order to ensure efficiency and effectiveness. Above all, actions must be backed up with strong political will without which nothing can be achieved.

¹Source – <http://yourbudget.com/infographic/state/Assembly>
²Source – Deloitte InsideTax article "Presumptive Taxation a Promise or a Threat"

³Source – <https://www.linkedin.com/pulse/presumptive-taxation-taxwiseng-episode-4-yomi-olugbenro>

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