AN ANALYSIS OF THE IMPACT OF DIRECT TAXES ON THE ECONOMIC GROWTH OF NIGERIA (1970-2020)

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Abstract

This study examined the impact of direct tax on the economic growth of Nigeria for the period of 1970-2020. The objectives that guided this study include: to establish the impact of companies’ income tax (CIT) on economic growth of Nigeria from 1970-2020; and to investigate the impact of petroleum profit tax (PPT) revenue on economic growth of Nigeria from 1970-2020. The study used data from Federal Inland Revenue Services, Central Bank of Nigeria (CBN), and the National Bureau of Statistics (NBS). The used Ordinary Least Square (OLS) Model, Augmented Dickey-Fuller (ADF), linear and multiple regression as data analysis tools. The finding of the study indicated a positive impact of companies’ income tax on the economic growth of Nigeria (R-Square = 0.0562, Prob > F = 0.0940). Furthermore, there was a positive impact of petroleum profit tax on the economic growth of Nigeria (R-squared = 0.1013, Prob > F = 0.0229). The study concluded that both CIT and PPT have a positive impact on the economic growth of Nigeria. The study recommended that the federal government of Nigeria should come up with diversification mechanisms that will avert over-dependence on oil revenue (petroleum profit tax) since when oil prices fluctuate, it can have detrimental effects on the economic growth of the country. The study further recommended that government should begin to emphasize tourism, agriculture, and telecommunications to expand its tax base.

Keywords: Direct Tax, PPT, CIT, GDP

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1. Background of the Study

Taxation is an important fiscal policy instrument at the disposal of governments to mobilize revenue and promote economic growth and development. Governments use tax revenue to carry out their traditional functions such as the provision of public goods and services; maintenance of law and order; defence against external aggression; and regulation of trade and business to ensure social and economic maintenance (Yaru, 2020). Effective tax revenue mobilization reduces an economy’s dependence on external flows which have been found to be highly volatile. Taxation also allows governments’ greater flexibility in designing and controlling their development agenda (Combes & Ouedraogo, 2016). The 2008/2009 global financial and economic crisis provided useful lessons for countries on the need to direct more attention to domestic resources mobilization efforts, including through increasing tax revenues, and shift away from over-dependence on external financial flows and export revenues (León-Manríquez, 2017).

As one would expect, there is need for a paradigm shift to taxation revenue as an alternative source of revenue for Nigeria, other than depending on oil. However, the machinery and procedures for implementing a good tax system in Nigeria are inadequate; hence tax evasion and avoidance of the self-employed individuals and organizations whose database is not captured in the relevant tax authority’s data system (Egbunike, Emudainohwo, & Gunardi, 2018). The need for the government to generate adequate revenue from internal sources has therefore become a matter of extreme urgency and importance (Ojong, Anthony, & Arikpo, 2016). The desire for Nigeria to maximize revenue from taxes collected from tax payers cannot be overemphasized. This is because, the importance of tax lies in its ability to generate revenue for the government, and regulate economy through its influence on vital aggregate economic variables (Alabede, 2018). In light of the above, this study examines the impact of direct tax on the economic growth of Nigeria for the period of 1970-2020. The objectives that guided this study are: to establish the impact of companies’ income tax on economic growth of Nigeria from 1970-2020; and to investigate the impact of petroleum profit tax revenue on economic growth of Nigeria from 1970-2020.

2. Literature Review

The Impact of Companies Income Tax on Economic Growth of Nigeria
Companies income tax (CIT) is a tax imposed on profit of a company from all sources. It is one of the main taxes administered and collected by the Federal Inland Revenue Service (FIRS). It is a tax paid on the income of incorporated companies. Company’s Income taxes are regulated by the Companies Income Tax Act (CITA), Cap. C21, LFN 2004 (as amended). The Companies Income Tax Act (CITA) 2007 as amended defines a “company” in section 105 as: “any company or corporation (other than corporate sole) established by or under any law in force in Nigeria or elsewhere. The tax is payable on each year of assessment on the profit of any company at the rate of 30%, these include profit accruing in, derived from or brought into or received from a trade, business or investment (Ovie & Igwe, 2016).

The first legislative law on Companies Income Tax in Nigeria was introduced in 1939 through the instrumentality of the Companies Income Tax Ordinance. Before the law came into existence, the regulation of personal and business taxation was vested in the same legal act. The Companies Income tax Ordinance vested administration of the tax in a commissioner to be appointed for that purpose by the Governor and the proceeds from the tax were to be remitted to the government treasury to form part of the general revenue of Nigeria. This ordinance was found to be unproductive as it failed to bring individuals into the tax net (Gwangdi & Garba, 2015). The government in 1961 established the Companies Income Tax Act 1961 due to the weakness of the various ordinances. This Act, which was aimed at the exclusive taxation of companies in order to boost revenue yield was still ineffective, as further reviews were carried out in 1979 and 1993. On returning to democracy in 1999, the Obasanjo’s administration quickly saw the need to broaden the revenue base of the nation, which led to reform in companies’ income tax (Ovie & Igwe, 2016).

A group of researchers investigated company’s income, customs and excise duty tax gap and infrastructural development in Nigeria for the period of 1981-2018. Their study used ex post facto research design. Data were sourced from the Central Bank of Nigeria (CBN) annual reports and the Federal Inland Revenue Service Reports (FIRS). Data were analyzed using descriptive and inferential statistics employing the Auto Regressive Distributed Lag (ARDL) approach. The study found that “there is significant positive impact of tax gap of companies income tax gap (CITG) and customs excise duty tax gap (CEDTG) on infrastructural development. It was revealed that CITG and CEDTG have positive significant relation with capital expenditure on economic services” (Ejemai, Akintoye, & Adegbie, 2020).
Furthermore, some academicians examined the impact of tax revenue on the economic growth of Nigeria from 1980-2015. The variables under analysis included Gross Domestic Product (GDP) as the dependent variable, while Petroleum Profit Tax (PPT), Company Income Tax (CIT), and Customs and Excise Duties (CED) were the independent variables. The analysis of the study was carried out using the OLS technique and Multiple Regression Analysis. The results of the study indicated that PPT and CIT have no positive and significant impact on the economic growth of Nigeria. However, CED was found to have a positive and significant impact on the economic growth of Nigeria (Abomaye, Aminadokiari, Eyo, & Chika, 2018).

Similarly, a team of researchers examined the impact of direct and indirect tax on the Nigerian economic growth for the period (1994-2013). Direct tax was proxied using CIT and PPT, while indirect tax was proxied using VAT and CED. The data source was CBN statistical bulletins. The OLS regression method was used. The findings indicated that both the direct and indirect tax have a positive impact on the economic growth of Nigeria (Ogundana, Ibidunni, & Adetoyinbo, 2017).

Additionally, Ovie and Igwe examined the impact of companies’ income tax (CIT) and value added tax (VAT) on Federal Government revenue generation in Nigeria (2001-2016). The source of data included CBN statistical bulletin, and Federal Inland Revenue Service Reports (FIRS). The method of analysis was multiple regression, analysis of variance (ANOVA) and Pearson product moment correlation. The findings of the study indicated that CIT and VAT contribute positively and significantly to revenue (Ovie & Igwe, 2016).

Last not least, Ibanichuka and his colleagues investigated the effect of tax revenue on the economic development of Nigeria for the period of 1995-2014. The data was analyzed using Multiple Regression Analyses. The findings revealed that “revenues collected by the federal government through CIT, VAT and CED have a positive relationship with Human Development Index”. Based on the findings, it was concluded as follows: That revenues collected by the federal government through company income tax, value added tax, customs and excise duties help to improve the human development index of Nigeria (Ibanichuka, Akani, & Ikebujo, 2016).

**The Impact of Petroleum Profit Tax Revenue on Economic Growth of Nigeria**

PPT is imposed on income of companies in petroleum operations (Upstream). The tax is governed by the Petroleum Profits Tax Act, Cap P13 LFN 2004 (as amended). Companies
liable to PPT are not liable to Companies Income Tax (CIT) on the same income. The administration of these laws involves assessment, collection and accounting for revenues accruing to the Government of the Federation. Petroleum Profit Tax was first introduced in 1957 by the Colonial Masters but it became effective and operational in 1958 when Nigeria commenced exportation of crude oil to the world market (Abomaye-Nimenibo, 2017). The Petroleum Profit Tax is levied on any resident company or person in charge of a non-resident company who are exploring for petroleum or producing it in Nigeria. This also includes any liquidator, receiver, or agent of liquidator or receiver of any company carrying on petroleum operations in Nigeria. Petroleum Profit Tax is payable by companies which are engaged in petroleum operations (Ifeanyi et al., 2016).

Petroleum tax is particularly related to rents, royalties, margins and profit sharing elements associated with oil mining, prospecting and exploration leases. It is the most important tax in Nigeria in terms of its share of total revenue contributing 95 and 70 percent of foreign exchange earnings and government revenue, respectively. The PPT covers oil and gas taxation. Petroleum profit tax involves the charging of tax on the incomes accruing from petroleum operations. He noted that the importance of petroleum to the Nigerian economy gave rise to the enactment of a different law regulating the taxation of incomes from petroleum operations (Ifeanyi, Onyekwelu, & Iyidiobi, 2016). It is because of the importance that government attaches to oil exploration and production that the taxation of profits or gains of companies engaging in such operations are taxable under the Petroleum Profit Tax Act of 2004 as amended (Adaramola & Ayeni-Agbaje, 2015).

A study was conducted on the impact of petroleum profit tax on economic growth in Nigeria within the period of 1980 to 2017. The econometric methods of Augmented Dickey Fuller, Generalized Method of Moments (GMM) and Granger Causality test were used. The GMM test showed that petroleum profit tax and economic growth have positive and significant relationship. The pairwise granger causality test showed bidirectional causality between petroleum profit tax and economic growth. The study concluded that petroleum profit tax has impacted on economic growth in Nigeria meaningfully during the period of study. Therefore, government should boost petroleum profit tax revenue (Inimino, Otubu, & Akpan, 2020).

Furthermore, an investigation examined the relationship between tax revenue components and economic growth in Nigeria from 1989-2018. Data on GDP and tax revenue were extracted from Central Bank of Nigeria (CBN) statistical Bulletin and Annual Reports of Federal Inland
Revenue Service (FIRS). Data were analysed using descriptive and inferential statistics involving Augmented-Dickey Fuller (ADF) stationary unit root test, Error Correction Mechanism (ECM), Granger Causality tests and correlational statistics. The study found a positive and significant relationship between economic growth (GDP) and Personal Income Tax (PIT), Petroleum Profit Tax (PPT) and Company Income Tax, while Education Tax (EDT), Customs and Excise Duties (CED) were not statistically significant at 0.05 level of significance. The result of the Granger Causality Test shows that EDT, CIT, PIT, PIT PPT and VAT cause economic growth and that economic growth also causes EDT, CED and PPT. It was concluded that tax revenue components play vital role in economic growth in Nigeria (Etim, Nweze, Umoffon, & Elias, 2020).

Likewise, a group of researchers used the annual time series data to examine the effect of taxation on economic growth in Nigeria over a period of 1980 to 2018. To achieve the objective of the study, data were collected from the Central Bank of Nigeria (CBN) statistical bulletin, and the annual data publication of Federal Inland Revenue Services (FIRS). The variables on which data were collected are the Gross Domestic Product (GDP), Petroleum Profit Tax (PPT), Value Added Tax (VAT) and Personal Income Tax (PIT). Data on GDP was collected from CBN while data on the other variables were collected from FIRS. The data were analyzed using autoregressive distributed lag (ARDL) model. Findings reveal that in Nigeria, the various categories of taxation such as Petroleum Profit Tax, Personal Income Tax and Value Added Tax selected for this study have significant effects on economic growth process. The effect of these taxes on economic growth in Nigeria is even more pronounced in the long-run than in the short-run (Alexander, Keyi, & Alfa, 2019).

Moreover, a scholar investigated the relationship between tax and economic growth (GDP) using the Auto-Regressive Distributed Lag (ARDL) bound test approach. The study further decomposed tax into company income tax (CIT), petroleum profit tax (PPT), value-added tax (VAT) and excise and custom duties (ECD), then examined the effect of each of them on economic growth. The data for the study were obtained from Federal Inland Revenue Service (FIRS) and Central Bank of Nigeria (CBN) bulletin, spanning from 1981-2014. The ARDL results show no cointegration among the variables. Interestingly, the short run results reveal that total tax is insignificant while the decomposed taxes are significant. Petroleum profit tax and value-added tax have positive relationship with GDP while company income tax and excise and custom duties have negative relationship with GDP (Nwanakwere, 2019).
Additionally, some researchers examined the impact of petroleum profit tax on economic growth of Nigeria, assessed the effect of company income tax on economic growth of Nigeria and ascertained the influence of value added tax on the economic growth of Nigeria. The ex-post facto research design was employed; time series were collected data from the statistical bulletins of the CBN and the FIRS. The study’s model reflected variables including gross domestic product, petroleum profit tax, company income tax and value added tax. Data collated for these variables were analyzed to ascertain the short and long run effect of the variables using the Multiple Regression Analysis, Co-integration and other post estimation tests. Findings from the study indicated petroleum profit tax exerts a positive significant impact on economic growth, company income tax also influences positively and significantly on economic growth while the value added tax was also discovered to have a noticeable and positive effect on economic growth (Edewusi & Ajayi, 2019).

3. Research Methodology

Data source

This study used data from Federal Inland Revenue Services, Central Bank of Nigeria (CBN), and the National Bureau of Statistics (NBS). The data period of investigation was from 1970–2020.

Model specification

The used Ordinary Least Square (OLS) Model to regression the impact of direct tax on the economic growth of Nigeria. The dependent variable was economic growth proxied by Real Gross Domestic Product (RGDP), while the independent variable was direct tax measured using the two most common types of direct taxes in Nigeria, companies’ income tax (CIT), and Petroleum profit tax (PPT).

The linear model showing the impact of indirect tax on GDP is give as:

\[ RGDP = f (CIT, PPT) \] 

(1)

The model in its log transformation is given as:

\[ log RGDP_t = a_0 + a_1 log CIT_{1t} + a_2 log PPT_{2t} + U \] 

(2)
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Where: $\text{RGDP} =$ Real Gross Domestic Product growth rate; $\text{CIT} =$ Companies’ Income Tax; $\text{PPT} =$ Petroleum Profit Tax; and $U =$ Error term while $a_0, a_1, a_2$ are estimators of the model.

Unit Root Test

This study used the Augmented Dickey-Fuller (ADF) test technique because it is more popular and accurate than other techniques like Phillips-Perron (PP) tests or DF-GLS Test for unit root. Using ADF, the null hypothesis is that when absolute value is less than the critical value at 5%, then there is no stationary.

Cointegration Technique

The study used the linear and multiple regression to establish the impact of direct taxes on the economic growth of Nigeria.

4. Results

Table 1: ADF Stationarity Test

<table>
<thead>
<tr>
<th>Variable</th>
<th>Test statistic at Level (Absolute value)</th>
<th>5% Critical value</th>
<th>Order of integration</th>
<th>First difference</th>
<th>5% Critical value</th>
<th>Order of integration</th>
</tr>
</thead>
<tbody>
<tr>
<td>logRGDP</td>
<td>-2.246</td>
<td>-3.504</td>
<td>Not Stationary</td>
<td>-3.959</td>
<td>-3.508</td>
<td>Stationary</td>
</tr>
<tr>
<td>logCIT</td>
<td>-2.173</td>
<td>-3.504</td>
<td>Not Stationary</td>
<td>-5.010</td>
<td>-3.508</td>
<td>Stationary</td>
</tr>
</tbody>
</table>

The findings in Table 1 showed that all variables were not stationarity at Level, however, after first difference, all the variables were stationary. This is because after the first difference all the absolute values of RGDP, CIT, and PPT were greater than the critical values. For instance, after first difference, RGDP ($Z(t) = -3.959$) is greater than the critical value ($\tau = -3.508$) at 5%. In addition, after first difference, CIT ($Z(t) = -5.010$) is greater than the critical value ($\tau = -3.508$) at 5%. Likewise, after first difference, PPT ($Z(t) = -5.471$) is greater than the critical value ($\tau = -3.524$) at 5%.
Table 2: The Impact of CIT on GDP

<table>
<thead>
<tr>
<th>Source</th>
<th>SS</th>
<th>df</th>
<th>MS</th>
<th>Number of obs = 51</th>
<th>F(1, 49) = 2.92</th>
</tr>
</thead>
<tbody>
<tr>
<td>Model</td>
<td>7.6644e+22</td>
<td>1</td>
<td>7.6644e+22</td>
<td>Prob &gt; F = 0.0940</td>
<td></td>
</tr>
<tr>
<td>Residual</td>
<td>1.2877e+24</td>
<td>49</td>
<td>2.6279e+22</td>
<td>R-squared = 0.0562</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>1.0643e+24</td>
<td>50</td>
<td>2.7266e+22</td>
<td>Adj R-squared = 0.0369</td>
<td>Root MSE = 1.6e+11</td>
</tr>
</tbody>
</table>

The finding in Table 2 revealed that up to 5.6% of the changes on GDP is caused by CIT (R-Square = 0.0562, Prob > F = 0.0940). This implies that a unit increase in CIT revenue collection, there will be an improvement of 5.6% in the economic growth of Nigeria.

Table 3: The Impact of PPT on GDP

<table>
<thead>
<tr>
<th>Source</th>
<th>SS</th>
<th>df</th>
<th>MS</th>
<th>Number of obs = 51</th>
<th>F(1, 49) = 5.52</th>
</tr>
</thead>
<tbody>
<tr>
<td>Model</td>
<td>1.3818e+23</td>
<td>1</td>
<td>1.3818e+23</td>
<td>Prob &gt; F = 0.0229</td>
<td></td>
</tr>
<tr>
<td>Residual</td>
<td>1.2261e+24</td>
<td>49</td>
<td>2.5023e+22</td>
<td>R-squared = 0.1013</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>1.3643e+24</td>
<td>50</td>
<td>2.7286e+22</td>
<td>Adj R-squared = 0.0829</td>
<td>Root MSE = 1.6e+11</td>
</tr>
</tbody>
</table>

The finding in Table 3 show that approximately, 10% of the changes in GDP is caused by PPT (R-squared = 0.1013, Prob > F = 0.0229). This implies that a unit increase in the PPT revenue collection can impact up to 10% of the economic growth of Nigeria.
Table 4: The Impact of Direct Tax on GDP

<table>
<thead>
<tr>
<th>Source</th>
<th>SS</th>
<th>df</th>
<th>MS</th>
<th>Number of obs = 51</th>
</tr>
</thead>
<tbody>
<tr>
<td>Model 1</td>
<td>1.3944e+23</td>
<td>2</td>
<td>6.9719e+22</td>
<td>Prob &gt; F = 0.0752</td>
</tr>
<tr>
<td>Residual</td>
<td>1.2249e+24</td>
<td>48</td>
<td>2.5518e+22</td>
<td>R-squared = 0.1022</td>
</tr>
<tr>
<td>Total</td>
<td>1.3643e+24</td>
<td>50</td>
<td>2.7266e+22</td>
<td>Adj R-squared = 0.0648</td>
</tr>
</tbody>
</table>

The finding in Table 4 show that about 10.2% of the variance of GDP is accounted for by a combination of CIT and PPT (R-squared = 0.1022, Prob > F = 0.0752). This implies that revenue collected from direct taxes can promote economic growth of Nigeria by 10.2%.

5. Discussion

The Impact of CIT on GDP

The finding of this study revealed a positive impact of companies’ income tax on the economic growth of Nigeria (R-Square = 0.0562, Prob > F = 0.0940). The finding of this study agrees with the finding of other studies such as Ejemai, Akintoye and Adegbie (2020); Ogundana et al., (2017), Ovie and Igwe (2016), and Ibanichuka et al., (2016).

For instance, Ejemai et al., (2020) when investigating the company’s income, customs and excise duty tax gap and infrastructural development in Nigeria found that there is significant positive impact of tax gap of companies income tax gap (CITG). Likewise, Ogundana et al., (2017) examined the impact of direct and indirect tax on the Nigerian economic growth and found that direct tax (i.e. Company Income Tax and Petroleum Profit Tax have a positive impact on the economic growth of Nigeria. Similarly, Ovie and Igwe (2016) examined the impact of companies’ income tax (CIT) and value added tax (VAT) on Federal Government revenue generation in Nigeria and found that CIT and VAT contribute positively and significantly to revenue. Additionally, Ibanichuka et al., (2016) while investigating the effect of tax revenue on the economic development of Nigeria for the period of 1995-2014 found that revenues collected by the federal government through CIT, VAT and CED have a positive
relationship with Human Development Index. However, this study disagrees with the finding from the studies of researchers such as Abomaye et al., (2018) who found the contrary. For instance Abomaye and his colleagues examined the impact of tax revenue on economic growth of Nigeria from 1980-2015 and found that Petroleum Profit Tax and Company Income Tax have no positive relationship with economic growth of Nigeria.

The Impact of PPT on GDP

The finding of this study revealed a positive impact of petroleum profit tax on the economic growth of Nigeria (R-squared = 0.1013, Prob > F = 0.0229). The finding of this study is in line with several other studies such as Inimino et al., (2020), Etim et al., (2020), Alexander et al., (2019), and Edewusi and Ajayi (2019).

For instance, Inimino et al., (2020) while studying the impact of petroleum profit tax on economic growth in Nigeria within the period of 1980 to 2017 found that petroleum profit tax and economic growth have positive and significant relationship. Additionally, Etim et al., (2020) examined the relationship between tax revenue components and economic growth in Nigeria from 1989-2018 and found a positive and significant relationship between economic growth (GDP) and Personal Income Tax (PIT), Petroleum Profit Tax (PPT) and Company Income Tax. Similarly, Alexander et al., (2019) used the annual time series data to examine the effect of taxation on economic growth in Nigeria over a period of 1980 to 2018 and found that Petroleum Profit Tax, Personal Income Tax and Value Added Tax have significant effects on economic growth process. Furthermore, Edewusi and Ajayi (2019) examined the impact of petroleum profit tax on economic growth of Nigeria and found that petroleum profit tax exerts a positive significant impact on economic growth. However, the finding of this study disagrees with the finding of other studies such as Nwanakwere (2019) who while studying the relationship between tax and economic growth (GDP) found no relationship between PPT and economic growth.

6. Conclusion and Recommendations

The study concludes that both CIT and PPT have a positive impact on the economic growth of Nigeria. The study recommends that the federal government of Nigeria should up with diversification mechanisms that will avert over-dependence on oil revenue (petroleum profit tax) since when oil prices fluctuate, it can have detrimental effects on the economic growth of the country. The government should begin to emphasize tourism, agriculture, and
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telecommunications to expand its tax base. Additionally, the government should fight corrupt officials who mismanage PPT and CIT tax revenue with all its power to ensure that those who misappropriate tax payers’ revenues are dealt with according to the law and prosecuted. Methods like naming and shaming, freezing of accounts, and sale of the property and businesses of corrupt officials who embezzle government funds should be adopted.

REFERENCES


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