NBA, LAGOS (YLF) ESSAY COMPETITION 2021

FULL NAME:	ABDULLATEEF OLASUBOMI ABDUL
EMAIL ADDRESS:	abdullateef.abdul999@gmail.com
PHONE NUMBER:	(+234) 08028708559
ENROLMENT NUMBER:	102095
NBA BRANCH:	LAGOS BRANCH
YEAR OF CALL:	2015

ESSAY LENGTH:	1469 WORDS (EXCLUDING COVER PAGE)
TOPIC:	REVENUE GENERATION THROUGH TAXATION VERSUS INVESTMENT ATTRACTION THROUGH TAX INCENTIVES; IN SEARCH OF A BALANCE

Introduction

Taxation is the most consistent and dependable source of revenue for modern governments. By recent estimates, tax revenues account for more than half of total government revenue in nearly every country. There is therefore increasing focus by governments on revenue generation through taxation. On the flip side, modern governments also often seek to attract capital investments and stimulate economic growth through tax incentives, which have the effect of reducing tax revenue. The dilemma then is whether government should focus on generating revenue through taxation or attracting investments through tax incentives. Against this backdrop, this essay discusses and proposes ways effective tax administration and governance ensures government generates revenue through taxation whilst at the same time attracting capital investments and thus stimulating economic growth.

Revenue Generation Through Taxation

Taxation, apart from being a revenue source, is a tool of economic management and development. In Nigeria, different taxes are imposed and administered by the different tiers of government. Whilst the federal government administers companies income tax (CIT), value added tax, education tax amongst others; state governments administer personal income tax and other residual taxes; and local governments administers numerous rates, levies and charges.

Various studies have examined the impact of taxation on revenue generation and economic growth. Chigbu et al. analysed the link between economic growth and taxation in Nigeria for the period 1970-2009 and concluded that taxation as an instrument of fiscal policy affects Nigeria's economic growth. Ihenyen and Mieseigha similarly concludes that taxation is an instrument of economic growth in Nigeria. A study found that tax revenue has significant impact on Federal Government Budget implementation in Nigeria. Another study, which examined the impact of taxation on revenue generation in Nigeria with reference to the Federal Capital Territory and some states in Nigeria, concluded that taxation contributes significantly to both revenue generation and Nigeria's Gross Domestic Product (GDP).

Nonetheless, statistics show that Nigeria's tax-to-GDP ratio in 2018 was, at 6.3%, significantly lower than the average of 30 African countries (16.5%) and the Latin America and the Caribbean (23.1%).

Investment Attraction Through Tax Incentives

Nigeria, like many countries, offer tax incentives to attract capital investment, especially foreign direct investment (FDI). Most notable amongst these incentives are tax holidays, reduced corporate tax rates, exemption of CIT for export companies, free economic zones, and special corporate tax deductions, allowances, and credits.

The justification for tax incentives is that they are vital to the development of the economy as the business that has been helped by tax incentives can be expected to support the government by the payment of regular taxes.[1] It has also been argued that tax incentives reduce risk and tax burden for investors. International tax competition is also an important force behind many tax incentives, as countries jostle to enhance themselves as location for capital investment, especially in developing countries where tax incentives are seen as compensating investors for poor investment climate.[2]

The pertinent question, however, is whether tax incentives are effective in attracting investment? Ferede and Dahlby, examining the impact of the Canadian provincial governments' tax rates on economic growth using panel data covering the period 1977–2006, found that a higher provincial statutory corporate income tax rate is associated with lower private investment and slower economic growth. Edame and Okoi, examining the impact of taxation on investment and economic growth in Nigeria from 1980-2010, also found that a one percent increase in CIT will result in decrease in the level of investment in Nigeria. These studies implicitly establish that reduced corporate income tax rate boosts investment.

Empirical studies however found that tax incentives (apart from reduced corporate tax rates) are not effective in attracting investments. When, in Uganda, tax holidays and selective tax incentives programmes were terminated in favour of a more attractive general tax regime, the following resulted: an increase of one percentage point in the ratio of investment to GDP, 70 percent increase

---

[1] George E. Lent, 'Tax Incentives for Investment in Developing Countries' (1967) I.M.F. Staff Papers <https://www.elibrary.imf.org/view/IMF022/12418-9781616352875/12418-9781616352875/12418-9781616352875_A005.xml?language=en> accessed 9 April 2021

[2] Van Parys Stefan, 'The effectiveness of tax incentives in attracting investment: evidence from developing countries' (Reflets et perspectives de la vie économique, 2012/3 (Tome LI)) 129-141 <https://www.cairn.info/revue-reflets-et-perspectives-de-la-vie-economique-2012-3-page-129.htm> accessed 9 April 2021

in foreign investment inflows, and a one percent of GDP increase in tax revenue.[3] A study on the effectiveness of tax incentives in four Middle East and North Africa (MENA) region countries concluded that no clear link exists between tax incentives and FDI attraction and also between tax burden and investment location decisions.[4] An investor survey also found that tax incentives, rather than encouraging FDI, were either not taken into account or operated to discourage investment.[5]

There is therefore no evidence supporting the effectiveness of tax incentives and the impact of tax incentives on investment in Africa has been found to be insignificant.[6] An explanation for this is that the investment climate in Africa is so poor that granting tax incentives is not sufficient to compensate for the investment climate.[7]

In Search of a Balance

As studies have established, taxation significantly influences investment, GDP and government expenditure in Nigeria. But tax incentives are generally considered to be the least important factors in investment location decisions, with factors like market characteristics, relative production costs, and resource availability accounting the most for cross-country variation in FDI inflows.[8] One study even suggests that while tax and non-tax revenues have clear significant impact on Nigeria's economy growth, investment does not. Government should therefore exercise restraints in depending on tax incentives as a tool of investment attraction and economic growth stimulation. Hence, Nigeria need not be concerned about matching or exceeding the tax incentives of other countries to attract FDI.

Studies have also shown that investments depend more on a generally favorable economic and tax regime than on particular incentives to compensate for the lack of a long-term solution[9] and that investors exhibit a strong preference for stable and sound tax systems that did not deviate significantly from international norms.[10] Hence, transparency, simplicity, stability and certainty in

---

[3] OECD, 'Tax Incentives for Investment – A Global Perspective: experiences in MENA and non-MENA countries' (2007) <https://www.oecd.org/mena/competitiveness/38758855.pdf> accessed 9 April 2021
[4] Ibid
[5] Ibid pp. 9-10
[6] Supra note 2
[7] Ibid
[8] Supra note 3
[9] Yitzhak Hadari, 'The Role of Tax Incentives in Attracting Foreign Investments in Selected Developing Countries and the Desirable Policy' (1990) 24 Int'l L 121 <https://scholar.smu.edu/til/vol24/iss1/6> accessed 9 April 2021
[10] Supra note 3

the application of the tax law and in tax administration, often ranked by investors ahead of tax incentives, should be prioritised and the Nigerian tax system reformed along these lines.[11] This would increase transparency and efficiency in tax administration, strengthen government's capacity to generate revenue, and thus also attract investments.

Government should also improve the investment climate as FDI also rises as the investment climate becomes better. In this regard, infrastructure, security, and rule of law, amongst others, are vital. Countries such as Mauritius, Costa Rica, Ireland and Malaysia have been successful in attracting investments by offering conducive climate and advantages to investors other than tax breaks, such as stable economic and political conditions, good infrastructure, open trade for exporters, dependable rule of law, and effective investment promotion systems.[12]

Further, government should increase the efficiency of its compliance efforts to capture and bring within the tax net all eligible taxpayers. By an assessment, about 50.5 million employed Nigerians operate outside the tax net and the average tax payments per business in 2019 was 1,710 Naira. Adequate training of tax officials is therefore imperative as the manner in which tax authorities go about revenue generation would impact the country's economic growth.

Additionally, tax revenues should be judiciously employed to encourage tax compliance. An analysis of the federal government budget for some recent years revealed that tax revenue has been essentially spent on debt financing and recurrent expenditure, a significant part of which goes to salaries, travels and other overheads with the result that 70% of Nigerians in a recent survey stated that they do not pay tax because they cannot see taxpayer money at work.

Conclusion

Taxation is the most dependable revenue source for governments. Governments in developing countries are however faced with the dilemma of encouraging investments, especially FDI, through tax incentives (which erodes or reduces tax revenues), whilst at the same time generating revenue through taxation. This paper (a) points out the significance of taxation to revenue generation and economic growth and the lack of evidence supporting the effectiveness of tax incentives in attracting investments, and (b) so recommends that reliance on tax incentives as a

[11] Ibid
[12] Ibid

tool of investment attraction be reduced and focus should instead be directed at simplifying the tax system, creating favourable tax regime and investment climate, and enhancing the efficiency of tax administration in Nigeria. This paper therefore advocates that the National Tax Policy and Nigerian tax laws be reformed accordingly.