DESIGNING A ROBUST TAX SYSTEM FOR NIGERIA: LESSONS FROM AN INTERNATIONAL PERSPECTIVE

by

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Dedication

I would like to dedicate my work to God Almighty, my strength and my rock.

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Abstract

This thesis argues that Nigeria can adapt its tax system for better gain from investment and other taxation. It outlines the foundation for a good tax policy, and explores initiatives by the Organisation for Economic Co-operation and Development (OECD and the United Nations (UN) regarding harmful tax practices and tax incentives. Their recommendations and those of scholars, conclude that tax incentives are ineffective in attracting foreign direct investment, may result in taxpayer abuse, and erode the revenue base of capital importing countries like Nigeria. Utilizing internationally accepted features on effective tax incentive design, examining the operation of the Nigerian tax system in their light, and accepting that distortion in the tax regime is inevitable, the analysis recommends balanced solutions to Nigeria's tax policy and economic problems. It urges tax law reform through policy and fresh legislations, while correcting such problems as official corruption in Nigerian tax administration.

List of Abbreviations and Symbols Used

BEPS	Base Erosion and Profit Shifting
BIAC	Business and Industry Advisory Committee
CRA	Canada Revenue Agency
FCT	Federal Capital Territory
FDI	Foreign Direct Investment
FIRS	Federal Inland Revenue Service
GDP	Gross Domestic Product
HTP	Harmful Tax Practices
IMF	International Monetary Fund
LFN	Law of the Federation of Nigeria
MCAA	Multilateral Competent Authority Agreement
MNE	Multinational Enterprises
NIPC	Nigeria Investment Promotion Council
OECD	Organisation for Economic Co-operation and Development
OFC	Offshore Financial Centres
R&D	Research and Development
TE	Tax Expenditure
TUAC	Trade Union Advisory Committee
UBS	United Bank of Switzerland
UN	United Nations
₦	Nigerian Naira
$	United States dollar

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CHAPTER ONE

Introduction

1.1 The Importance of a Robust Tax System

Nigeria bemoans revenue shortage[1] due to dropping oil prices and serial attacks on pipelines.[2] Meanwhile the Nigerian tax system has been ineffective in raising revenue for the state.[3] I argue that beyond the need for economic diversification, which has long been acknowledged with no concrete action to work toward it,[4] Nigeria must close the loopholes in its tax system. Specifically, harmful tax practices, which are a drain on the nation's potential for fiscal viability, must be curtailed. The particular practice which, overall, is the focus of this thesis, is the national system of general and sectoral incentives whose collective goal is to attract investment and, thus, to spur national economic development. But this composite regime works to undermine realization of the very goals that constitute the justification for its enactment.

Harmful tax competition enables the erosion of the tax base.[5] It should be pointed out also that by allowing harmful tax competition under its laws, Nigeria enables the

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[1] Olalekan Adetayo, "Nigeria has become poor", *The Punch* (11 August 2016), online: <http://punchng.com/nigeria-is-a-poor-country-says-buhari/>; See also Oyetunji Abioye, "External Reserves Shed 2.1% in one month", *The Punch* (20 August 2016), online:<http://punchng.com/external-reserves-shed-2-1-one-month/>.

[2] The Niger Delta Avenger bombed several crude oil export pipelines which further depressed the economy of Nigeria. See Ovie Okpare, "Niger Delta Avengers Bomb ExxonMobil pipeline", *The Punch* (26 July 2016) online: < http://punchng.com/niger-delta-avengers-bomb-exxon-mobil-pipeline/>.

[3] Miftahu Idris & Tunku Salbabinti Tunku Ahmad, "Tax Revenue and Macroeconomic Growth in Nigeria: A contextual Analysis" (2017) 3:2 Asian J Econ, Bus & Acc 1 at 3.

[4] The Federal Government is currently promoting the Agricultural sector as an alternate source of revenue for Nigeria. This is to be achieved through the Anchor Borrowers Scheme. This is likely to result in a two-prong benefit of conserving scarce foreign exchange as well as a revenue earner, if exported, in addition to helping to promote food security, online: <https://www.cbn.gov.ng/out/2017/dfd/anchors%20borrowers%20programme%20guidelines%20-dec%20%202016.pdf>.

[5] OECD, *Harmful Tax Practices-2017 Progress Report on Preferential Regime: Inclusive Framework on BEPS: Action 5* (Paris: OECD, 2017) at 12.

erosion of the tax base of other countries.[6] This alters normal trade and investment patterns, thereby undermining the fairness and neutrality of tax systems.[7] Thus, for Nigeria, as for other states, the losses of tax revenue hinder the state from being able to afford infrastructure and related facilities needed to support the economy and social services.

This chapter provides an overview of the basic principles of taxation that, if reasonably well observed, could help all nations run efficient revenue systems in the current global economic environment. It examines the purposes that a good tax policy is meant to serve, and reviews the criteria for assessing such a policy for its soundness. The overriding argument is that observance of the composite principle of transparency engenders tax compliance. Building from this, the chapter also analyzes tax expenditure and its policy implementation in its positive and negative aspects. In essence, this chapter makes an argument for what comprises a good national tax policy and what factors should inform beneficial tax policy implementation in an efficient tax jurisdiction in line with economic and social development objectives.[8]

1.2 What is a Good Tax Policy?

A good tax policy is one that functions as an effective tool for achieving its assigned government goals. It is one that is designed to support government in raising the revenue required to finance its expenditure, in stabilizing the economy, in achieving a generally acceptable distribution of income and in pursuing the appropriate level and

[6] George Lent, *Tax Incentive for Investment in Developing Countries* (London: Palgrave Macmillan, 1976) at 308.
[7] OECD, *Harmful Tax Competition: An Emerging Global Issue* (Paris: OECD, 1998) at 8.
[8] Reuven Avi- Yonah, "International Tax as International Law" (2004) 3:2 U Mich J L & Econ 1 at 3.

quality of economic growth.[9] The prevailing view is that good tax policy must ensure that everyone bears an equitable tax burden according to their ability to pay.[10]

All governments use tax policy to regulate private activities in order to promote certain economic and social policies. This also means that decisions as to who to tax, what to tax, and when to do so, arise from fundamental social and economic considerations.[11] As a matter of international economic exchange, trade barriers are continually coming down, making capital more mobile and highlighting that the formation of sound tax policy is a must for every country. [12]

The need to replace foreign trade taxes with domestic taxes has been accompanied by growing concerns about profit diversion by foreign investors due to weak provisions against tax abuse in national tax laws, as well as inadequate technical training of tax auditors in many developing countries.[13] A concerted effort to eliminate these deficiencies is, therefore, of utmost urgency. Every country's tax policy must recognize and consider the effect of what goes on in other countries. Thus, it is obvious that the administration of tax law requires international coordination and co-operation. In today's global economy, this has become fundamental to good tax policy in each country.[14]

1.3 Why Do We Need a Good Tax Policy?

It is imperative for states to have a sound tax policy. There are probably more reasons that justify the need for states to have good tax policies than can be canvassed in this thesis. Five of the salient ones are identified here. First, without a doubt, the provision

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[9] Tim Edgar et al, *Materials on Canadian Income Tax*,14th ed (Toronto: Carswell, 2010) at 65.
[10] Joel Slemrod & Jon Bakija, *Taxing Ourselves* (London: The MIT Press, 1996) at 13.
[11] Peter W Hogg et al, *Principles of Canadian Income Tax Law,* 8th ed (Ontario: Carswell, 2013) at 4.
[12] *Ibid* at 14.
[13] Vito Tanzi & Howell Zee, *Tax Policy in developing countries* (Washington DC: IMF, 2001) at 1.
[14] Tim Edgar et al, *supra* note 9 at 41.

of social infrastructure is indispensable to the development, growth and expansion of any society. This requires huge funds to actualize. It is for this reason that revenue mobilization is key to sustainable development in any society. Governments naturally show great concern for how funds can be made available to execute their social programmes, including the provision of infrastructure and social services. For developing states in general, taxation offers an antidote to dependence on external aid. It also provides fiscal resources on a sustainable basis to promote the growth they seek.[15]

A second reason that justifies the need for a good tax policy is that the tax system must be able to raise essential revenue without excessive borrowing,[16] and, in the process, to not discourage economic activity, but ensure that the economy is competitive.[17] This is why increasing attention have been directed by many jurisdictions to how tax instruments can be employed to redistribute income and create incentives to generate more efficient outcomes in private markets.[18] Good tax policies harness these tools to support and achieve a nation's economic policy objectives.

A third reason is the need to deal with tax evasion and avoidance schemes. These undermine the goal of wealth redistribution, which is one of the outcomes taxation policy usually seeks to achieve.

Fourth, it must be kept in mind that the new world that we live in makes national boundaries less important to business and investment. Even though political boundaries and national sovereignty are relevant in non-economic areas, a robust tax

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[15] OECD, "Taxation revenues as a motor for sustainable development" in *Development Co-operation Report 2014: Mobilizing Resources for Sustainable Development* (Paris: OECD, 2014) at 92.

[16] Micah Leyira et al, ''Tax Systems in Nigeria- Challenges and the Way Forward" (2012) 3:5 Research J Fin & Acc at 1.

[17] Tanzi & Zee, *supra* note 13 at 1.

[18] Mark Sproule-Jones et al, *Taxes as instruments of Public Policy* (Toronto: University of Toronto Press, 1994) at 4.

policy is unavoidably influenced by international factors. Hence, a tax system needs to be constantly reviewed in the context of economic globalization.[19] The flexibility needed for this must be built into a good tax policy in each jurisdiction.

Finally, the need for a good tax policy is justified by the concept of taxation itself, along with its practical implications for what the government does to tax economic actors. Tax has been defined as a "compulsory charge imposed by a public authority on the income of individuals and companies as stipulated by government decrees, acts or case law, irrespective of the exact amount of services rendered to the payer in return.''[20] Tax is designed to raise the revenue required for the expenditure authorized in a government budget, and budget expenditure is meant to promote social and economic justice and equality among citizens and social groups within the state. Obviously, as such a powerful tool for economic and social policy making, taxation enables governments to levy compulsory contribution from individuals, firms or property to fund its operations.[21] Being, therefore, the principal source of revenue to most governments, the generation of tax revenue is intricately linked to the tax base and the tax rate.[22] Revenue can be increased or decreased by enlarging or contracting the tax base. The smaller the base, the higher the rate required to generate a given amount of revenue. [23]

Taxes being an instrument of resource redistribution from those favored by the market economy to those less advantaged,[24] it becomes the civic responsibility of citizens to pay their taxes as their contribution to the development and administration of society at large. This is why the presence of good tax policy and its effective and efficient

[19] Peter W. Hogg et al, *supra* note 11 at 58.
[20] Olalekan Soyode & Sunday O Kajola, *Taxation Principles and Practice in Nigeria* (Abeokuta: LekSilicon, 2015) at 4.
[21] Vern Krishna, *Fundamentals of Income Tax,* 4th ed (Toronto: Carswell, 2009) at 12.
[22] *Ibid* at 34.
[23] *Ibid* at 36.
[24] Idris & Ahmad, *supra* note 3 at 4.

administration is imperative to overcome tax resistance.[25] Otherwise, government cannot equitably apportion the tax burden, stimulate private choice, allocate resources and shape the economic welfare of its citizens. The basic elements of fiscal policy, namely, taxation and spending, require efficient regulation to achieve equitable outcomes. The health of this whole edifice is rooted in the tax concept and this must be underlain by good tax policy. This is why the erosion of the tax base is a growing concern for all governments. A good tax policy must find ways to keep this under check.

1.4 Functions of A Good Tax Policy

In view of the reasons that justify the need for a good national tax policy, the logical question is what purposes or functions are served in the development of good fiscal policy. A good tax policy should be characterized by the four functional features discussed below.

1.4.1 Efficient Resource Allocation

The first major function of fiscal policy is to determine exactly how funds will be allocated.[26] This is closely related to the issues of taxation and spending, because the allocation of funds depends upon the collection of taxes and government use of it for specific purposes. The national budget determines how funds are allocated. This means that a specific amount of money is set aside for purposes specifically laid out by the government. This has a direct economic impact on the country.

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[25] Ierkwagh Kwaghkehe & Shankyula Tersoo Samuel, "Global Perspectives in Tax Evasion and Avoidance: The Legal Quagmire in Nigeria" [2009] Nigerian Inst of Advanced Leg Stud J Bus L 158 at 158, online: <www.nials-nigeria.org/journals/Ierkwagh%20and%20Shankyula.pdf>.
[26] Idris & Ahmad, *supra* note 3 at 3.

Government has to provide for public goods and services such as national defence, health, education, police, government administration, and so on. These goods and services confer benefits that cannot be easily restricted to those willing and able to pay, and so, cannot be provided through market mechanisms; government has to provide them. This resource allocation responsibility reverts to tax policy to lay out the parameters by which the needed resources can be secured, hence the importance of such a policy.[27]

1.4.2 A Morally Acceptable Distribution of Income

Second, the government, through its tax and expenditure policy, affects distribution of household income in a manner that is supposed to be just and fair between rich and poor. The redistributive function of taxation is required in a market economy where wealth can become too concentrated in a few hands. The centuries-old means of progressive taxation is meant to bring equity into the tax burden borne by the rich and poor. The rich pay more as a percentage of their income than the poor, and what they pay finances schemes which benefit the poor.

1.4.3 Economic Stabilization

Third, stabilization is another important function of fiscal policy, in this case, to ensure stable economic growth. Each nation's economy experiences fluctuations, like economic boom and depression. Such changes benefit some and harm others.[28] Fiscal policy is designed to anticipate and mitigate the effects of these events. Consequently, it is necessary for the government to put in place appropriate policy measures to affect

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[27] *Ibid* at 3.

[28] S M Adesola, *Tax Laws and Administration in Nigeria*, 3rd ed (Ile-Ife: Obafemi Awolowo University Press, 1998) at 5.

aggregate demand. Called stabilization measures, they are aimed to avoid inflation and unemployment situations.[29]

1.4.4 Economic Growth and Market Efficiency

A fourth major function of fiscal policy is to spur development and thus economic growth. An adjunct to economic growth is efficiency, which is a reality beyond producing goods at the lowest possible cost. Efficiency means providing consumers with goods and services with the least use of scarce resources. Economists argue that if markets are competitive, if accurate information is available, if resources are mobile, and if individuals engaging in the transactions bear their full costs and receive the full benefits of their transactions, economic efficiency will be achieved.[30] Markets rarely meet all these criteria, and when deviations from the ideal occur, the result is said to be market failure.[31] Sometimes deviations from the ideal are minor and do not pose significant costs to society, but when deviations are significant, there is often a call for government intervention.[32]

For instance, a type of market failure that leads to externality is pollution. An externality is an activity that has effect on people not involved in the particular transaction. Thus, when a manufacturing company causes pollution, there is a transaction between the company and the consumer who purchases the product. But if one who lives near the plant suffers from asthma due to the smog it produces, this becomes the case of an affected party not directly compensated from the transaction.[33] Externalities will generally cause competitive markets to behave inefficiently from a

[29] *Ibid*.
[30] *Ibid.*
[31] *Ibid*.
[32] Kwaghkehe & Samuel, *supra* note 25 at 5.
[33] Idris & Ahmad, *supra* note 3 at 4.

social perspective, since those involved in the transaction do not bear its full costs.[34] In this case, government may intervene by taxing the transaction and using the money to negate the harmful effects or to compensate those affected by the negative externality.[35] For instance, in many Canadian provinces, like Nova Scotia, there is a small charge – often 5 or 10 cents on beverage containers made of glass or plastic.[36] This charge is partially refundable if the empty container is taken to the recycling plant. Similarly, when a transaction produces positive externalities, efficiency is achieved when the government subsidizes the transaction.[37] Education is an example of a transaction that has a positive effect on society.

Another market that does not operate efficiently on its own are public goods. A public good has two attributes: non-excludability, which means the producer cannot prevent the use of the good by others, and non-rivalry, which means that many people can use the good simultaneously.[38] Free markets will generally produce less than the optimal amount when a good is non-excludable and non-rivalrous, which means that a government can make the market more efficient by producing the public good. By using tax revenue, governments can avoid the problem of free riders and produce an efficient quantity of public goods even when the free market cannot.[39] Perfect examples of these are public utilities, such as transportation facilities, and public services, like healthcare and education.

In summary, a good fiscal policy should provide for measures that spur both economic growth and efficiency, seeing that both are mutually reinforcing. The

[34] *Ibid* at 4.
[35] *Ibid*.
[36] It is common knowledge that for purchase of products in packs, cans, there is a 10 cent charge.
[37] Idris & Ahmad, *supra* note 3 at 4.
[38] *Ibid* at 4.
[39] *Ibid*.

logical question that arises, therefore, is how a good tax policy premised upon a good fiscal policy can be assessed. This matter is considered next.

1.5 Criteria for Assessing a Good Tax Policy

Tax policy is concerned with the efficiency of transfer of resources from citizens to the government by way of taxes, and the value and benefit that society derives from the process.[40] To this end, it is imperative that the policy ensures not only that revenue is secured in an equitable, efficient and sustainable manner, but also that the revenue generation process has an overall symmetry.[41] The symmetry principle refers to identical treatment of citizens for tax purposes in relation, for instance, to the taxation of capital gain and the deductibility of its losses.

The criteria that have emerged for evaluating good tax policy relate to the equity, neutrality and simplicity of the policy and the regime it fosters.[42] The internalization of domestic economics demands that the principles be modified and added to in order to regulate specific features of each domestic economy.[43] Some of the additional principles are competitiveness, efficiency, effectiveness, fairness, certainty, administrability, flexibility, transparency and accountability. Commentators like Neil Brooks, Peter Hogg, Joanne Magee and Jinyan Li recognize equity, neutrality and simplicity as the traditional criteria for evaluating a tax policy.[44] It should be noted as well that the additional principles are cognate with these three and share considerable

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[40] Soyode & Kajola, *supra* note 20 at 12.
[41] The symmetry rule can also be viewed in instances where the cost of imported goods is deflated for custom duties payment and the real value used for the purpose of computing the allowance.
[42] Slemrod & Bakija, *supra* note 10 at 41.
[43] *Ibid* at 42.
[44] Neil Brooks, "The Logic, Policy and Politics of Tax Law" in Tim Edgar et al, eds, *Materials on Canadian Income Tax*, 14th ed (Toronto: Carswell, 2010) at 65. See also Peter W Hogg et al, *Principles of Canadian Income Tax Law,* 8th ed (Ontario: Carswell, 2013) at 46.

commonality with them. The discussion that follows takes all of them into account to evaluate a tax policy as to its efficiency.

1.5.1 Equity

The first criterion is that a good tax policy must be equitable. It must be fair and seen to be fair. The tax burden must be equitably shared among taxpayers. In determining how this can be done, the principles of benefit and ability to pay provide some insight.[45] The benefit principle suggests that the rate for high income and wealthy taxpayers should be higher because they have more to lose if government withdraws essential services like defense, police, the justice system, and so on.[46] The ability to pay principle demands that the tax burden be related not to what a family receives from government, but to its ability to bear the burden. The rate structure is the most visible tool that underscores government commitment to social justice.[47] It is particularly unfair when a highly-paid executive receives tax free economic benefits.[48] This is clearly against the principle of equality of sacrifice. Hence, failure to tax fringe benefits violates the principle of equity.[49]

Two aspects of the fairness of the system are vertical and horizontal equity. The horizontal equity principle states that taxpayers with the same income should pay equal taxes. The vertical equity principle states that the tax liability of taxpayers in a good tax system should increase as income increases and decrease as income decreases.[50]

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[45] Slemrod & Bakija, *supra* note 10 at 41.
[46] *Ibid* at 53.
[47] Peter W Hogg et al, *supra* note 11 at 6.
[48] Kim Brooks, ''Delimiting the Concept of Income: The Taxation of In-Kind Benefits'' (2004) 49 McGill LJ 255 at 266.
[49] Peter W Hogg et al, *supra* note 11 at 13.
[50] *Ibid* at 41.

Information exchange is vital to enhance tax fairness and equity in the global tax environment and to promote economic development. Equity has also been cited as one of the reasons for worldwide taxation of individuals.

1.5.2 Neutrality

Second, a good tax policy must be neutral. It must not promote any form of tax bias.[51] Thus, it must minimize interference in the resource allocation process.[52] For example, the top marginal personal income tax rate should not materially differ from the corporate income tax rate, such that it provides an incentive for taxpayers to choose the corporate form of doing business, purely for the purpose of tax avoidance. This is because professionals and small entrepreneurs can, over time, easily siphon off profits through expense deductions and permanently escape the highest personal income tax bracket.[53] This criterion proposes that the tax system should be neutral so that decisions are made, generally, on their economic merits and not necessarily for tax reasons.[54]

In the international context, all investments within a country should face the same tax burden, regardless of whether they are owned by a domestic or a foreign investor (taxing non-residents and residents similarly).[55] As well, investors should pay equivalent taxes on capital income, regardless of the country in which the income is

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[51] Hana Polackova Brixi, Christian MA Valenduc & Zhicheng Li, *Shedding Light on Government Spending Through The Tax System: Lessons from Developed and Transition Economies* (Washington, DC: World Bank Publications, 2004) at 6.

[52] Tanzi & Zee, *supra* note 13 at 6.

[53] *Ibid* at 7.

[54] Peter W Hogg et al, *supra* note 11 at 41.

[55] Shiro Abass, "Can Non-Oil Exports Boost Agriculture Sector Performance in Nigeria" (2013) 4:19 Journal of Management & Sustainability at 8. This opinion was also echoed by Shiro Abass A. He recommended that the Nigerian government should make its economy very attractive to Nigerian investors first. Only then will foreign investors be willing to take a plunge.

earned (taxing foreign source income and the domestic income of a resident similarly).[56]

However, there are instances where departure from the neutrality principle is unavoidable. Government may deliberately create distortion by taxing, for instance, polluting industries or by subsidizing certain things such as education. Government may deliberately subsidize education through tuition fee credits, tuition and textbook credits and exemption of scholarship from tax, because it places a premium on having educated citizens and wishes to encourage people to receive education.[57]

Neutrality also means that a tax policy should ensure that tax rates are not a disincentive to taxpayers engaging in paid work,[58] or seeking to increase wealth through savings because taxes are too great a burden.[59] In other words, neutrality questions the value of imposing taxes at too high a rate to discourage participation by the taxpayer in income-producing activity. [60]

1.5.3 Administrability

This third major criterion recognizes that tax administration is a vital tool for the development or industrialization of a nation. A core success factor for any tax system is its ease of administrability. An effective tax policy document should, therefore, establish clear guidelines on crucial tax administration issues.[61] In reality, the administrability factor is often evaluated in terms of the simplicity of the tax system, its administrative practicality, how big the burden of the cost of compliance to the

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[56] Under the Capital Gains Tax Act, Cap 354 LFN, 1990, foreign companies carrying on business in Nigeria are exempted from capital gains tax on disposal of assets, except such proceeds as are brought into Nigeria.

[57] OECD, *Taxation and Skills: How Tax Systems Impact Skills Development in OECD Countries* (Paris: OECD, 2017) at 15. The OECD concludes that the failure to invest in skills now has the potential to reduce future tax revenues.

[58] Slemrod & Bakija, *supra* note 10 at 77.

[59] For detailed analysis on Income tax versus consumption tax, see generally, Joel Slemrod & Jon Bakija, *Taxing Ourselves* (London: The MIT Press, 1996) at 168.

[60] Slemrod & Bakija, *supra* note 10 at 41.

[61] *Ibid* at 41.

taxpayer is, and how low the administrative cost of raising tax revenue is in terms of compliance and enforcement.[62]

That a tax system is administratively efficient is, in practice, seen in the elements of its structure, as explained above, namely its simplicity, certainty and low compliance and administration costs. These are now elaborated.

1.5.3.1 Simplicity

A good tax policy must not be complex but instead should be simple to understand by the people to whom it applies. The logic of the relevant laws should be obvious such that stakeholders understand the basis for tax imposition.[63] It must be pointed out that in many jurisdictions the effort to make taxation equitable has resulted in fine- tuning tax rules to such an extent that they have become too complex for the average taxpayer to understand.[64] To some extent, this has led to underachievement of the tax system in some jurisdictions.[65] Some commentators have argued that it is more beneficial to tolerate some level of inequality in order to have a simpler tax system.[66] The more complex the tax system, the more the tax planning industry flourishes.[67]

This also undermines the simplicity factor which is important to a tax system that is administratively efficient.

1.5.3.2 Certainty

The element of certainty is crucial to a tax system. Sometimes it is considered in the same context as stability.[68] This is because a tax system that is certain would likely be

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[62] S M Adesola, *supra* note 28 at 7.
[63] Peter W Hogg et al, *supra* note 11 at 45.
[64] *Ibid* at 47.
[65] *Ibid* at 51.
[66] Vern Krishna, *supra* note 21 at 28.
[67] Neil Brooks, *supra* note 44 at 72.
[68] This theme was stressed by some of the panellists at a two-day stakeholders' forum held on June 6th and 7th 2016 by the Nigerian National Assembly on "Realizing the Full Potentials of the Nigerian Economy through Proactive Capital Market Legislation." The consensus is that certainty of government policy is a vital ingredient for gaining investor confidence, especially in sectors where

stable. Certainty in the tax system is important even for government because if a government should be able to budget realistically for its imminent spending, it must base its plans on a realistic estimate of the revenue it will receive and the funds it will have available.[69] On the flip side, the tax which an individual is bound to pay must be certain and not arbitrary. The time of payment, the manner of payment, and the amount to be paid must be clear to the contributor and to every other person. This was echoed in the Carter Commission report to the effect that the taxpayer should be able to determine promptly, with certainty and at a modest cost, the tax consequences of a proposed course of action.[70]

1.5.3.3 Low Compliance Cost

Also, basic to the administrability of a tax system is what it costs for a taxpayer to comply with its rules. Low compliance cost places the taxpayers' interest at a high premium.[71] The Canadian tax filing system seems to accord the taxpayer this premium, and for this, I supply my personal experience. During the 2016 filing season in March/April, I volunteered at a number of Community Income Tax clinics at the Halifax Libraries and the Dartmouth North Public Library. The taxpayer simply books an appointment and is assisted to file his or her return free of charge, in a courteous manner and in the shortest possible time. This costs him or her nothing except the cost and time of getting to the location nearest to him or her. This way, the government also ensures that the largest number possible would file their tax returns. Some private firms charge about $100 for filing a simple tax return for the taxpayer.[72]

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long-term commitment is needed, online: <http://www.heirsholdings.com/profile-news/deepening-nigerian-capital-market-include-privatized-systemically-important-entities/>.

[69] ACCA "Certainty in Tax (2015), online:<http://www.accaglobal.com>.

[70] Canada, *Report of the Royal Commission on Taxation*, vol 2 (Ottawa: Queen's Printer, 1966) at 14.

[71] Vern Krishna, *supra* note 21 at 12.

[72] A chat with a cleaner at the Killam Library, Dalhousie University, Halifax, Canada, reveals that he was charged $100 by a private tax firm for his tax return to be filed.

1.5.3.4 Low Cost of Administration

Finally, for tax administration to be feasible, the process itself must not cost an undue amount to the public purse. Consequently, there should be a thorough cost-benefit analysis before taxes are placed on citizens. The administrative cost of collecting and enforcing the law should be reasonable to ensure efficiency of the tax system.[73] As a matter of fact, tax administration is reasonably effective in public institutions and agencies and most private employers because taxes are deducted at source, leaving the net to be paid to workers. In essence, this factor demands that it must not cost more than the money that is raised to collect the tax in the first place. Simultaneously, the costs of enforcement must be maintained at reasonable levels, which means keeping a rein on the tendency to make the tax system more complex.[74]

The argument is that the policy that founds a good tax system is judged as to its goodness by a series of interlocking criteria. The discussion has explained the criteria of equity, neutrality and administrability along with the factors that make the latter feasible and efficient. Other criteria which must underlie a good tax policy and regime relate to competitiveness, flexibility and transparency in the resultant tax structure and its administration. These three criteria are now discussed.

1.5.4 Competitiveness

Each jurisdiction must consider the tax regimes of other countries in its region, as well as international practices,[75] so as to craft its own tax system to be competitive. A competitive system must be marked by rates that are not too high. Otherwise, no one will want to invest or work in that jurisdiction. Nor should rates be too low, so as to

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[73] Alex Easson & Eric M Zolt, *Tax Incentive* (Washington D.C: World Bank,2003) at 11.

[74] Michael Carnahan, "Taxation Challenges in Developing Countries" (2015) 2:1 Asian Pac L & Pol'y J 169 at 172.

[75] Easson & Zolt, *supra* note 73 at 4. Alex Easson and Eric Zolt also argued that it is particularly important to consider the tax regimes of other countries because their residents may be potential investors or potential consumers of products produced in the country, or the country itself might be a competitor for foreign investment inflow.

make the jurisdiction a "haven". As well, a competitive system must avoid reliance on poorly targeted tax incentives as the main vehicle for investment promotion.[76] A tax incentive should only be granted if it can be justified as helping to address some form of market failure, especially those that involve externalities and consequences that affect actors other than the specific beneficiary of the incentive.[77] Overall, a truly competitive tax system would not affect decisions as to where a company is incorporated. A competitive system should ensure that the jurisdiction's corporate income tax rate compares favourably with those of peer nations. This is because international competition tends to limit the tax rate that national governments can impose.[78] This also limits government expenditure for social services, as the taxes it can levy become more acute. This is why an international agreement on tax policy to keep national revenues from being eroded by competition is desirable;[79] hence, there is a need for regional and international consensus on cooperation between jurisdictions.

1.5.5 Flexibility

The criterion of flexibility demands that the tax system be run in such a way that it is responsive to changes in the local and international fiscal environments. The introduction of new taxes and review of existing taxes should be directed to this end. The process of adjustments should be designed such that it will pose no undue difficulty to the process of tax administration.

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[76] Tanzi & Zee, *supra* note 13 at 11-14. See also Kim Brooks, ''Tax Sparing: A needed Incentive for Foreign Investment in Low-Income Countries or an Unnecessary Revenue Sacrifice'' (2009) 34:2 Queen's L J 1 at 14-18; Kim Brooks argued that more often than not, it is ill-conceived.

[77] United Nations Conference on Trade and Development, *Tax Incentives and Foreign Direct Investment: A Global Survey* (New York: UN, 2000) at 14.

[78] *Ibid* at 13.

[79] James A Baker, "The Momentum of Tax Reform'' (Paper delivered at the Herbert Stein Tax Policy in the Twenty-first Century conference, 6 October 1987). James Baker predicted that the rapid integration of the world economy will change motives behind tax, thereby creating vigorous tax competition, and that advances in technology will bring both benefits and complications. As well, changing demographic and social patterns will pose new challenges in tax policy.

1.5.6 Transparency

Finally, it is desirable that a taxation regime be transparent, that is, accessible to the public and in its dealings with other countries. It must not undermine the sovereignty of other countries by, for example, the enactment of bank secrecy laws that shield the identities of investors.[80] In terms of obligations to citizens, government expenditure must be transparent so as to encourage voluntary tax compliance by citizens. Related to this is the taxpayers' perception of how wisely a government spends taxpayers' money. Compliance will be higher if taxpayers perceive that the government is not wasteful.[81] Governments must not only aim to eliminate waste; they must also convince taxpayers that their money is being spent wisely. For instance, in Canada, the Department of Finance annually publishes a document titled *Government of Canada: Tax Expenditure* [82] in which it lists, describes and estimates the cost of its tax expenditures. This gives an assurance of responsibility toward, and respect for taxpayer interest and loyalty to support the state to realize its economic agenda.

The criterion of transparency demands that tax expenditures be calibrated against the dynamics at play in realizing the socio-economic goals at stake in the performance of the national economy. In sum, all the criteria considered just above to ensure a good

[80] United Nations, *supra* note 77 at 97.

[81] While the ordinary Nigerians continue to groan under the pressure of the harsh economic crisis, the National Assembly is seen to be indifferent and financially reckless. In terms of tax compliance, the payslip of the speaker of the house of assembly Hon. Yakubu Dogara was made public. It showed a monthly net pay of ₦346,577.87 and a tax liability of N55,952.50 which is difficult to believe to be adequate tax and contrary to widely held believe that the Nigerian National Assembly members are the highest paid in the world. Musa, "Yakubu Dogara Publishes his payslip as House of Representatives Speaker, blasts Gov El Rufai", BuzzReporters (12 April 2017), online:< https://buzzreporters.com/2017/04/12/yakubu-dogara-publishes-his-payslip-as-house-of-reps-speaker-blasts-gov-el-rufai-photos/>.

[82] The issue of transparency and accountability in governance was a cause of contention at a retreat on April 5th, 2017 "Repositioning the National Assembly for effective service delivery". The Governor of Kaduna State Mallam Nasir El- Rufai stirred controversy by challenging the Senate and called for an open national assembly. He lampooned the leadership of the national assembly as indifferent, an opposition to the fight against corruption and demanded that they shield light on its budget. This drew an immediate response and trading of words. The Centre for Anti-Corruption and Open Leadership (CACOL) a civil society organisation in a press release is calling all office holders to be accountable, online: <https://www.dailytrust.com.ng/news/politics/story/193635.html>.

tax policy regime must be reflected in expending the returns from the application and administration of such a policy. The way in which this interconnected set of demands may play out are considered next as part of the review in this thesis of tax expenditure evaluation.

1.6 Criteria for Evaluating Tax Expenditure

Though it is expected that a good tax system should significantly conform to the above principles of effective taxation, there are situations where non-conformity to the principles are essential to attain some government policy goals.[83] Neil Brooks argues that "presumably, most people would agree that the fairest, most neutral, and simplest tax system would be no tax system at all".[84] This is because in addition to its principal function of revenue generation, the tax system is also an instrument for achieving social and economic policy objectives. These may be realised by applying preferential tax treatments calculated to favour certain activities, industries or categories of persons. The preferential tax measures could be in the form of "permanent exclusions from income, deductions, deferrals of tax liabilities, credits against tax, or special rates."[85] These measures are termed tax incentives, tax subsidies, or tax expenditures (TEs). This is because the opportunity cost of these objectives are lower tax revenue to the government. For this reason, it is important that the expenditures be regularly analyzed for relevance, effectiveness and efficiency.[86] In countries like Canada, the Netherlands and the United Kingdom, there is no legal obligation to prepare tax expenditure reporting. Even so, it is undertaken to

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[83] Oduntan Omobolanle, "The role of taxation in Nigeria's Oil and Gas Sector reforms- Learning from the Canadian Experience" (LLM Thesis, University of Saskatchewan, 2015) at 74.
[84] Neil Brooks, "The Changing Structure of the Canadian Tax System: Accommodating the Rich" (1993) 31:1 Osgoode Hall Rev 138 at 184.
[85] Stanley S Surrey & Paul R McDaniel, *Tax Expenditures* (Cambridge, MA: Harvard University Press, 1985) at 3.
[86] *Ibid* at *19.*

offer insights into the budgetary cost of tax expenditure and to facilitate annual budget discussions and debate.[87]

Tax expenditures (TE) can be evaluated by three approaches:[88] revenue foregone, revenue gained, and revenue outlay equivalence. It must be admitted that there are conflicting points of view on the need to evaluate tax expenditures. For this reason, it is necessary to mention briefly the positive and negative aspects of tax expenditures before considering how the exercise itself is undertaken.

1.6.1 Positive Aspects of Tax Expenditures

Using the tax system as a tool for achieving social and economic objectives,[89] as opposed to alternative policy tools,[90] is considered by some to be beneficial because it is more administratively efficient for achieving public socio-economic objectives. As well, doing so limits the possibility of fraud or abuse.[91]

1.6.2 Unfavorable Aspects of Tax Expenditure

Some scholars have refuted the argument that TEs can decrease tax administration and compliance costs. They argue that TEs make tax laws complex because they require "numerous distinctions" with respect to qualifying activities or taxpayers.[92] They maintain that intricacies in the tax laws not only raise compliance costs for taxpayers, but also make it more challenging and costly for the tax authorities to administer tax laws. Some scholars also think that TEs reduce the fairness of the tax system because they are usually regressive in nature. Others note that TEs are a politically attractive alternative because they are not subject to regular scrutiny and

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[87] Surrey & McDaniel, *supra* note 85 at 10-11. The case is not so different for countries where tax expenditure is a legal obligation like Australia, Austria, Belgium, France, Germany, Italy and United States. The purpose is to shape tax reforms and reduce deficits / facilitate budget process.

[88] OECD, *Tax Expenditures in OECD Countries, Budget and Public Expenditures* (Paris: OECD, 2010) at 7.

[89] *Ibid* at 25.

[90] *Ibid* at 24.

[91] *Ibid* at 4.

[92] Eric J.Toder et al, *Bad Breaks All Around: The Report of the Century Foundation Working Group on Tax Expenditures* (New York: The Century Foundation Press, 2002) at 35.

are difficult to estimate, as opposed to direct spending programs.[93] In view of these conflicting arguments, it is necessary to verify whether the tax system is the best approach by which to achieve intended policy objectives. This inquiry demands a discussion of tax expenditure methodology.

1.6.3 Methods of Evaluating Tax Expenditures

Clearly, it is not in all cases that TEs are the best policy for achieving government objectives. There is a need to assess program objectives on a case-by-case basis.[94] The 2014 European Commission report[95] suggests that an evaluation of the efficiency of TEs requires identifying different policy areas and assessing how tax expenditures could help meet given economic objectives in these areas.[96] The parameters for appraising TEs are many and multidimensional and so the task is a very challenging one, but a more serious problem is the failure to try.[97] The OECD suggests that a thorough assessment of TEs should consider their effectiveness, distributional impact, and compliance and administrative costs in relation to possible policy options that could achieve the same social and economic objectives. The OECD categorized the framework for evaluating TEs into two: ex-ante assessments and ex-post evaluations. An ex-ante assessment or evaluation takes place before the introduction of a TE, while the ex-post evaluation is conducted after the TE has been in operation for a number of years.[98] These two categories involve the evaluation of TE in terms of parameters that include, but are not limited to, the revenue costs or value of the TE to the government, its performance in terms of meeting policy objectives, and its economic relevance.

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[93] Brixi, Valenduc & Li, *supra* note 51 at 4.
[94] Toder et al, *supra* note 92 at 66.
[95]Brixi, Valenduc & Li, *supra* note 51 at 6.
[96] Lerkwagh & Samuel, *supra* note 25 at 48.
[97] OECD Tax Expenditures, *supra* note 88 at 16. It was argued here that engaging in tax expenditure reporting would, at least, help government to estimate their hidden costs.
[98] *Ibid* at 16.

The ex-ante assessments and ex-post evaluations discussed in this thesis draw on the key evaluation questions suggested in the recent guidelines developed by the Ireland Department of Finance.[99] Given the numerous methods available for TE evaluation, the Irish Department of Finance (like other sources) recognized the challenges posed to efforts to find a comprehensive framework for this exercise. For this reason, it sought to fill the gap by developing a concise framework that focuses on key evaluation questions to be asked during the ex-ante and ex-post processes. These guidelines were developed from a review of several economic literatures on tax expenditures, and an analysis of international approaches to tax expenditure evaluation. Drawing on the OECD's parameters for evaluating tax expenditures in different countries, including Canada, the United States and Germany, the guidelines provide some robust and comprehensive criteria for evaluating TEs. While a detailed assessment of all possible dimensions of TE evaluation is beyond the scope of this thesis, it explores the major elements of the ex-ante and ex-post evaluation methods.

1.6.3.1 Ex-ante Assessment

This process considers whether or not to introduce a new TE into a tax system and, thus, focuses on the rationale behind a government's intervention in a particular area of public policy, as well as the planning and design of the policy. According to the OECD, ex-ante assessment comprises three stages. The first examines the need that the new TE intends to address and the suitability of using the tax system for that particular objective.[100] The second stage identifies and sets the objectives of the proposed TE. The last stage relates to appraising the use of the tax system as the tool for achieving the objectives against alternative policy options. The assessment process considers five (5) major issues that must be accounted for before the introduction of a

[99] *Ibid* at 18.
[100] OECD Tax Expenditures, *supra* note 88 at 291.

new TE. These relate to the objective of the TE, the market failure the TE proposes to address, the efficacy of the TE in achieving the policy objectives, the likely economic effect of the TE and the expected cost of the TE.[101]

1) The objective the TE aims to achieve

Before a TE is introduced, the desired outcome should be clear. For instance, the objective of government may be to stimulate investment in economically disadvantaged areas. As such, the TE must be specific to a particular need, measurable in terms of outcomes that are achievable, relevant and time bound.[102] These yardsticks are important to provide a benchmark against which to measure its effectiveness after implementation.

2) The economic impact of the TE

It is important to assess the expected impact of the TE upon identifying the objective(s), the market failure and the suitability of the proposed TE. This can be done by looking at the design of the TE in terms of meeting the policy objectives in issue, as well as the influence the TE will have on connected sectors of the economy.[103] Such an evaluation can be conducted by drawing on the result of impact assessments conducted on similar (existing) TEs within or outside the jurisdiction in which the proposed policy[104] is to be implemented. This stage of the ex-ante assessment should also "set out criteria against which the impact and efficiency of the scheme will be evaluated at the ex-post stage.''[105] This is particularly important so

[101] *Ibid* at 51.
[102] OECD, *Choosing a Broad Base- Low Rate Approach to Taxation,* No 19 (Paris: Tax Policy Studies OECD, 2010) at 76.
[103] *Ibid*.
[104] *Ibid*.
[105] Ireland, Department of Finance, "Report on Tax Expenditure with Guidelines: Incorporating Department of Finance Guidelines for Tax Expenditure", (October 2014) online :< http://www.budget.gov.ie> at 11.

that arrangements for the collection of the necessary data to be used in the ex-post stage can be put in place at the introductory stage of the TE program.

3) The expected cost of the TE

An ex-ante assessment should also examine the opportunity cost of implementing the policy through the tax system.[106] According to the OECD, the "revenue foregone" method is the most practical approach for estimating the expected costs of the proposed TE. This method considers the cost of the TE in monetary terms. The calculation is based on the assumption that the revenues from other taxes remain constant.[107] Even though the calculation fails to acknowledge the behavioural aspects of the tax incentive and any likely interactions the TEs may have with other TEs, it provides an estimate of the revenue lost or voluntarily waived by the government as a result of departure from the normal system of taxation.[108]

4) The market failure the TE intends to address

An ex-ante assessment must confirm that the proposed TE addresses an actual need which is consistent with the government's policy priorities.[109] In addition to identifying the objectives of the proposed TE, it is also necessary to justify the government's intervention in relation to the policy objective.[110] In other words, the ex-ante assessment should examine: (i) whether there is a need for government intervention in the area of the proposed policy, and (ii) why and how a tax break would address that need.[111]

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[106] *Ibid* at 18.
[107] *Ibid* at 19.
[108] *Ibid*.
[109] *Ibid* at 20.
[110] *Ibid* at 78.
[111] *Ibid* at 83.

5) Effectiveness of the TE in achieving policy objectives

An ex-ante assessment must consider whether a TE is the most appropriate method for government intervention. Though the existence of a market failure could provide a strong justification for government intervention in the area of the proposed policy, it does not imply that the tax system is the most efficient means to remedy the market failure. This is because there could be alternative policy options by which the government could address the failure.[112] This can be done by comparing the benefits and limitations of TEs with alternative delivery options. The comparison can be done in terms of accessibility of the proposed TE to beneficiaries, administrative cost of implementing the policy, and the similarity of the TE to existing policy interventions.[113] The goal is to avoid duplication of policy measures.

1.6.3.2 Ex-post Evaluation

The primary focus of the ex-post evaluation is to assess the impact and continuing relevance (or otherwise) of the TE. As earlier mentioned, ex-post evaluations are the assessments that review the efficacy of an existing TE. These evaluations are conducted after a particular TE has been in operation for a number of years. A major connection between the ex-post and ex-ante evaluations is that the more effort that went into the ex-ante evaluation in terms of identifying methods for the ex-post evaluation and setting up the necessary data collection processes, the easier it will be to undertake the ex-post evaluation. Therefore, an ex-post analysis is less complicated where the necessary ex-post evaluation framework was considered during the ex-ante assessment of the TE.[114]

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[112] *Ibid* at 9.
[113] *Ibid*.
[114] *Ibid* at 12.

There are four (4) key themes in the review of existing TEs under the ex-post assessment process. These themes are relevance, cost, impact and efficiency of the TEs.[115]

1) Is the TE still relevant to the circumstance that led to its implementation?

Engaging in an ex-post evaluation provides an opportunity to evaluate the consistency of the TE with government policy priorities to determine if the TE persuasively addresses an actual need.[116] In doing this, it is necessary to evaluate the continued relevance of a TE.[117] This can be done by looking at its primary objective(s) and taking into account the social and economic conditions or current policy priorities of the government. The primary objectives of TEs are usually set out in policy documents, including budget papers, news releases or minutes of legislative committee meetings and debates.[118] Evaluating these objectives is essential for verifying whether the TE remains valid, given changes in the economy, relevant market, industry or the government's policy priorities since the introduction of the TE.[119]

In addition, an ex-post assessment may consider other policy interventions, such as direct expenditures or regulations that may have been initiated since the inception of the particular TE under review. This is because the existence of alternatives that address the policy objectives of the TE being reviewed could call into question the need for the scheme.[120] Thus, the changes in the external environment of a TE should also be taken into account in assessing the continued relevance of the expenditure.[121]

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[115] Brixi, Valenduc & Li, *supra* note 51 at 36.
[116] *Ibid* at 20.
[117] OECD Tax Expenditure, *supra* note 88 at 17.
[118] *Ibid* at 20.
[119] *Ibid* at 66.
[120] Brixi, Valenduc & Li, *supra* note 51 at 12.
[121] Surrey & McDaniel, *supra* note 85 at 18.

2) How much did the TE cost?

According to the OECD, there are three methods for calculating costs associated with TEs;[122] namely, by means of the revenue foregone, the revenue gained, and the outlay equivalence. The revenue foregone method estimates the cost of the TE in terms of the monetary amount the TE is recorded as costing the government. It calculates the loss in government revenue incurred as a result of the TE, while holding all other factors constant. The cost of a particular tax credit using the revenue foregone method will be the actual monetary amount of the tax credit.

Therefore, a tax credit's estimated cost is the figure derived from the actual take-up of the expenditure. With respect to a tax deduction, the revenue foregone depends on the take up rate and the marginal tax rate of the taxpayer. However, the assumption of unchanged behaviour and unchanged revenues from other taxes makes the revenue foregone method theoretically inadequate to provide an accurate cost estimation of a TE. This is because the estimation "ignores the behavioural aspects of a tax incentive and ignores any possible interaction with other tax expenditures."[123]

Alternatively, the cost of TEs could be measured by the amount of the revenue gained when they were repealed. This estimation method is called the final revenue loss (gain) method and it calculates the potential increase in tax revenue if certain TEs are discontinued.[124] Unlike the revenue foregone method, this method considers the behavioural effects arising from the discontinuation of a TE. Specifically, it considers the behavioural effects on taxpayers, the potential impact the discontinuance may have on the overall level of economic activity, as well as the effects (of the discontinuance) on revenues from other taxes.[125]Thus, the method is expected to

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[122] OECD Tax Expenditure, *supra* note 88 at 18.
[123] Ireland, *supra* note 105 at 66.
[124] *Ibid* at 62-64.
[125] Surrey & McDaniel, *supra* note 85 at 102.

accurately reflect the amount of revenue that would be raised by the government if a TE is removed from the tax system.[126]

The third estimation method, called the outlay equivalent method, attempts to estimate the cost of an existing TE based on the cost of a direct expenditure which would achieve the same policy objective(s). That is, it considers the cost of the TE in terms of the cost of delivering the same policy objectives outside the tax system.[127]

Despite the shortcomings of the revenue foregone approach discussed above, this estimation method is still considered the most attractive for many governments for practical reasons. For one thing, most governments consider it to be a relatively simple estimation method that does not require collecting individual or government behavioural responses.[128]

3) Is the TE still meeting its objectives effectively?

The third theme in the review of a TE relates to its impact. The measure of the impact of a TE can be determined by "establishing whether a tax expenditure has been successful in changing behaviour, improving performance or increasing economic activity over what would otherwise have been the case."[129] It is important to note that the impact of a TE is closely related (but not synonymous) with its effectiveness. For instance, if a research and development (R&D) tax credit has a very high take-up rate amongst R&D active companies, then that tax credit could be described as an effective scheme. But for the tax credit to have an economic impact, it should have encouraged previously non-R&D active companies to engage in R&D, and for existing R&D active companies to have increased levels of R&D investment.[130]

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126 OECD Tax Expenditure, *supra* note 88 at 11.
127 *Ibid* at 15.
128 *Ibid* at 18.
129 Ireland, *supra* note 105 at 12.
130 *Ibid* at 20.

However, identifying the impact of a TE through a cost benefit analysis can be challenging because the situation that would have prevailed in the absence of a TE is unknown. Even though the TE beneficiaries can be asked through surveys whether their behaviour or activity (relating to the policy objective) changed as a result of the TE, such information cannot always be relied upon.[131]

4) Was the TE efficient?

Finally, there is the question of the efficiency of the tax measure in view of the implementation of the TE. The inquiry focuses on the manner in which resources are allocated in an economy. A particular economy is said to be operating efficiently when resources are fully employed and are producing as much output as possible.[132] While a TE may have been successful in meeting its objectives, the success has to be set against the costs of the TE to determine its efficiency. The measure of the efficiency of a TE should also be compared to the potential efficiency of other policy alternatives available to the government.[133]

1.6.4 Evaluating Tax Expenditure: Overview

It is obvious from the foregoing discussion that the comprehensive picture of the juggling exercise of tax expenditure evaluation puts many governments in a fairly stringent fix. For one thing, either ex-ante or ex-post, the evaluation retains degrees of uncertainty as to revenue generation or revenue loss in the short or long term, and thus, makes it difficult to assess the benefits to the economy of applying and administering the TE. For developing countries like Nigeria that use TEs to attract foreign investment to improve their economies and generate revenues for social development purposes, the uncertainty at play deepens the challenge for assessing the benefits of their TE regimes. Even so, as discussed later in this thesis, the alternative

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[131] Brixi, Valenduc & Li, *supra* note 51 at 19.
[132] Ireland, *supra* note 105 at 66.
[133] Brixi, Valenduc & Li, *supra* note 51 at 163.

evaluation methods constitute ready tools for Nigeria to choose from in order to introduce beneficial changes into the administration of its TE regime.

1.7 Conclusion

In sum, this chapter establishes that a robust tax system is fundamental to vibrant national economic performance. Especially in developing countries, this is so to the extent that tax revenue is a major source of funds to enable government carry out public services, participate in stimulating economic growth, and exercise control over the fiscal ability of major local economic actors and foreign investors to bear their due tax responsibilities within such a structure. As shown, a key principle underlying an equitable tax policy is transparency in tax administration.

For this reason, the exception of tax expenditure or tax incentives constitutes a challenge that could be acceptable as equitable only to the extent that its evaluation, either ex-ante or ex-post, is done transparently. The goal must be to secure to the state and therefore, to the taxpayers who do not benefit from it, the returns that they would otherwise have made.

The foregoing challenge demands an in-depth understanding of the performance and value of tax incentives for economies in general. The literature on this subject is considered in the next chapter.

CHAPTER TWO

The Value of Tax Incentives: Literature Review

2.1 Introduction

This chapter reviews the literature on tax incentives. The dominant theme is the general acceptance of tax incentives as a means of attracting foreign investment.[1] However, there is a division as to the effectiveness of these incentives to achieve the purposes for which they are granted, especially in view of the domestic tax practices of capital importing countries.[2] Most scholars reject the notion of tax incentives as compensating for deficiencies in the "investment climate to attract foreign investment."[3] Other scholars think that there are some investment decisions that are tax sensitive but that taxpayers will only respond after they have made the decision to invest. The conclusion reached by this chapter is that tax incentives are not the main determinant for foreign direct investment (FDI). Where they are, the investments associated with their use are minimal.

The chapter proceeds by conceding the preponderance of the use of tax incentives by developing countries. It reviews the various scholarly arguments for and against this practice in an attempt to identify who the beneficiaries of these incentives are. It must be pointed out that sometimes tax incentives are preserved by a tax sparing provision in treaties. The chapter concludes with a summation of the real factors that drive foreign direct investments.

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1 United Nations Conference on Trade and Development, *Tax Incentives and Foreign Direct Investment: A Global Survey* (New York: UN, 2000) at 3.

2 Micah Leyira et al, ''Tax Systems in Nigeria- Challenges and the Way Forward" (2012) 3:5 Research J Fin & Acc at 1.

3 *Ibid* at 13. Of a truth, current events in Nigeria as earlier stated are pointing in this direction. Unstable foreign exchange policies, running inflation, derelict infrastructure, high energy cost, failing business confidence as some airlines are finding it difficult to repatriate their funds due to scarcity of foreign exchange and administrative and insecurity is gradually crippling the Nigeria economy.

2.2 Cost of Tax Incentives for Economic Development

Governments have many social objectives. These can be achieved through a variety of tools,[4] including tax policy.[5] It has been mentioned already that among other purposes, taxes are used by governments to raise revenue, to correct for market failures, and to create incentives for particular activities that they consider to be desirable.[6]

Tax incentives have become some of the most widely used measures adopted in developing countries to promote economic development.[7] This is because it is easier to provide tax incentives than to correct deficiencies in the investment climate.[8] Additionally, tax incentives do not appear to require expenditure by the government.[9]

Tax incentives take the form of special investment tax credits, preferential tax rates, accelerated depreciation, deferral of tax liability and favourable tax treatment for expenditure on research and development.[10] The objective for introducing them is to encourage investment that would ordinarily not have been made but for the tax incentive.[11]

The International Monetary Fund (IMF) views tax incentives as of no significance in stimulating investment and has concluded that even when they do result in some incremental investment, their cost often outweighs their benefits.[12] Despite the IMF's criticisms, the use of tax incentives seems to have become more rampant as most

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[4] David G Duff et al, *Canadian Income Tax Law,* 5th ed (Ontario: LexisNexis, 2015) at 10.
[5] Alex Easson, & Eric M. Zolt, *Tax Incentive* (Washington DC: World Bank Institute, 2003) at 2.
[6] David G Duff et al, *supra* note 4 at 15.
[7] *Ibid* at 9.
[8] *Ibid* at 11.
[9] *Ibid* at 9.
[10] *Ibid* at 3. See also OECD, *Tax Incentives for Investment- A Global Perspective: experiences in MENA and non-MENA countries* (OECD: Paris, 2007) at 4.
[11] *Ibid* at 2.
[12] S M Adesola, *Tax Laws and Administration in Nigeria*, 3rd ed (Ile-Ife: Obafemi Awolowo University Press, 1998) at 25.

countries continue to embrace their use.[13] Perhaps this explains the pressure that multinationals put on countries to adopt them. The United Nations Conference on Trade and Development conducted a survey that shows that a number of investors agree that even when tax incentives are not part of the factors considered to make an investment decision, investors would still ask for them because it has a way of improving their bottom lines.[14]

Virtually all developing countries offer inducements to approved firms in the form of reductions or exemptions from import duties or income taxes for a given period of time, tax holidays for a limited duration, regional investment incentives, reduced import tariffs or custom duties, special trade zones and re-investment incentives.[15]

One goal of tax policy is to increase the ratio of taxes to national income, especially from the growing sectors of the economy.[16] But if taxes are frozen substantially in the form of incentives, then government faces a formidable challenge in raising adequate revenue to meet its social obligations.[17] In view of its nature, therefore, and the ways in which it can be extended, it can be said that, in sum, the cost of the incentives is their immediate and cumulative ability to deprive the state of revenue that should otherwise be gained to support economic development.

2.3 Tax Incentives: Why They Are Favoured

Notwithstanding their cost, developing countries desiring to attract foreign investment tend to remove restrictions and disincentives to business by the use of fiscal incentives. They seek to encourage those investments that would not have been made but for the tax incentives, and that are likely to result in benefits such as transfers of

[13] Easson & Zolt, *supra* note 5 at 3.
[14] United Nations, *supra* note 1 at 12.
[15] Easson & Zolt, *supra* note 5 at 2.
[16] S M Adesola, *supra* note 12 at 15.
[17] Micah Leyira et al, *supra* note 2 at 1.

technology and increased employment or investment in less desirable areas of the country.[18] This desire for foreign direct investment often hinges on the expectation that it will generate some positive externalities,[19] like increasing the skill levels of workers, better technological knowledge transfer to be gained from the foreign company to benefit local firms via multiplier effects,[20] and advanced managerial techniques.[21] A second justification is the prospect that the presence of multinationals will help to bridge information inadequacies[22] underlying underdevelopment in the low-income economies. A third is the hope that tax incentives would offer an easy way to compensate for other government-created obstacles in the business environment which, otherwise, take long to tackle.[23] These justifications, it must be admitted, constitute a formidable temptation set to which developing economies quickly fall. It is however, conceded on empirical evidence that some forms of capital are tax sensitive and that concessions to induce them might be needed.[24]

2.4 Tax Incentives: Why They Are Not Beneficial

Even so, various scholars believe and argue that some tax incentives are not necessarily sensible. Kim Brooks thinks they amount to revenue loss to low income countries.[25] Because the incentive laws tend to be broadly targeted, they are more likely to include even highly profitable investment which would have been made for other reasons. She also points out that incentives motivate rent-seeking activities

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[18] United Nations, *supra* note 1at 3.
[19] Micah Leyira et al, *supra* note 2 at 12.
[20] Easson & Zolt,, *supra* note 5 at 10.
[21] Micah Leyira et al, *supra* note 2 at 12.
[22] *Ibid* at 13.
[23] *Ibid*.
[24] Various scholars with empirical studies of various types such as econometric studies, surveys of corporate officials involved in investment locations decision and with case study focused on particular countries have argued that most capital mobility decisions are motivated by tax minimization. See generally, Ekeocha Patterson et al, "Revenue Implications of Nigeria's Tax System" (2012) 2:8 J Econ & Sustainable Dev.
[25] Kim Brooks, ''Tax Sparing: A needed Incentive for Foreign Investment in Low-Income Countries or an Unnecessary Revenue Sacrifice'' (2009) 34:2 Queen's L J 1 at 14.

because they may give rise to large savings if the multinationals are able to lobby successfully.[26] Again, that they may foster a sense of unfairness,[27] especially among domestic firms, particularly if the incentives are available to only large foreign firms. Beyond this, incentives may generate resentment from citizens who cannot join the dots between their value, but could only conclude that with lesser taxes paid by corporations, government expenditure must still be met through raising regressive sales and excise taxes.[28] Incentives also create unintended economic distortion,[29] lead to wasteful and unhealthy tax competition,[30] and ultimately, to a "race to the bottom."[31]

There are other reasons why incentives are not considered to be beneficial, indeed, particularly unnecessary. First, the claim that they are effective is difficult to prove.[32] Second, that they can be used to compensate for information inadequacies rests on the premise that investors will source sufficient information on foreign jurisdictions, no matter how daunting it may seem.[33] Thus, using tax incentives to compensate for deficiencies in the investment climate is said to be flawed on the ground that unless weaknesses in the investment climate are relatively marginal, granting tax incentives to make up for them is unlikely to override negative factors like political instability, poor enforcement of contracts and unstable exchange rate policy and control.[34]

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[26] *Ibid* at 17.
[27] *Ibid* at 15.
[28] Ierkwagh Kwaghkehe & Shankyula Tersoo Samuel, "Global Perspectives in Tax Evasion and Avoidance: The Legal Quagmire in Nigeria" [2009] Nigerian Inst of Advanced Leg Stud J Bus L 158 at 165, online: <www.nials-nigeria.org/journals/Ierkwagh%20and%20Shankyula.pdf>.
[29] United Nations, *supra* note 1 at 15.
[30] *Ibid* at 17.
[31] Alex Easson, *supra* note 5 at 19.
[32] Micah Leyira et al, *supra* note 2 at 13.
[33] *Ibid* at 13.
[34] *Ibid*. Despite the use of tax incentive, the Vice President of Nigeria, Professor Yemi Osinbajo, at a policy dialogue of the Lagos Chamber of Commerce and Industry in August 2016 hinted that foreign investment had crashed by 86%.

A more difficult reality to justify, it is argued, is the fact that as a departure from the normal tax regime, a tax incentive provides opportunities for tax avoidance,[35] and introduces uncertainty into the tax system. This leads to corruption[36] which complicates the process of tax administration,[37]and multinationals "price in"[38] these uncertainties. On top of this, Kim Brooks points out that multinationals usually invest in locations where the return on investment is high and,[39] when the tax factors are measured against the myriad non-tax factors which motivate their investment choices, tax incentives only attract marginal "footloose" investment.[40] In light of these grave disadvantages to the low-income jurisdiction, she thinks that if at all, tax sparing should be included in tax treaties between high and low income countries, rather than it being granted reciprocally. [41]

Another angle to the consideration of the non-beneficial nature of incentives focuses on the granting of tax holidays. In this regard, Wells, et al, argue that these do not determine the location decisions of many foreign investors.[42] However, in terms of

[35] Micah Leyira et al, *supra* note 2 at 16.
[36] *Ibid* at 17.
[37] *Ibid* at 16.
[38] In reality, multinationals will expect a premium to compensate for the extra risk and demand more incentives before investing.
[39] Kim Brooks, ''Tax Sparing: A needed Incentive for Foreign Investment in Low-Income Countries or an Unnecessary Revenue Sacrifice'' (2009) 34:2 Queen's L J 1at 23. Kim Brooks argued that tax incentives for the exploitation of natural resources in low-income countries are generally unnecessary since the return on these ventures usually have a good deal of economic rent.
[40] *Ibid* at 14. She espoused a long list of non-tax factors influencing investing decisions, which includes nearness to market, closeness to raw material, the size of the local market (the size of the population, the needs of which the product is intended to meet), the infrastructural development, the skills of the available workforce, prevalence of corruption, proportion of property rights, political stability, enforceability of contracts, the extent of bureaucratic discretion in enforcing law, systemic risk in the financial sector due to inadequate regulation and oversight, exchange control plus ease of repatriation and so on and concluded that even with a certain transparent stable and fairly administered tax laws, it still not sufficient to override the effects of the aforementioned non-tax factors in the decision making process. The United Nations Conference on Trade and Development also concede that tax incentives can be a major investment locational factor for some foot-loose export oriented investor. United Nations Conference on Trade and Development, *Tax Incentives and Foreign Direct Investment: A Global Survey* (New York: UN, 2000) at 16.
[41] *Ibid* at 23.
[42] Loius T Wells Jr et al*, Using Tax Incentive to Compete for Foreign Investment: Are they worth the Costs*? Occasion Paper 15, The IFC and the World Bank (Washington D.C: World Bank, 2001) at 3,

effectiveness, the benefits of the tax holiday pales in comparison to its cost to the host state.[43] Alex Easson and Eric Zolt actually maintain that taxes may affect decisions as to the source of financing rather than the level of investment. This is because investors have several alternatives for funding new ventures or expanding existing operations. Thus, taxes are more likely to play a role in deciding whether to make a new equity investment using internal or external borrowing, or using retained earnings. They report that business executives admit that tax was not a major consideration for them in deciding whether and where to invest. Rather, it influenced their choice between countries in the same region.[44] Steve Clark draws on several empirical works to conclude that host country taxation is, indeed, an important factor in locational decisions, and not in regard to an investment decision on its own.[45] Therefore, on balance, an incentive in the form of a tax holiday would attract an investor to such a jurisdiction, but the host state's hope of benefit will not necessarily bear fruit.

In view of the foregoing, some scholars argue that incentives must be granted according to criteria that make them more predictable to investors. First, it must be determined whether the investor would have invested in the absence of incentives.[46] Second, where a corporate income tax in one jurisdiction is competitive with that of other jurisdictions, and there is a treaty in place to avoid double taxation or double

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online:<http://documents.worldbank.org/curated/en/2001/01/1614958/using-tax-incentives-compete-foreign-investment-worth-costs>.

[43] *Ibid* at 5. This view was also supported by George Lent and several other commentators. In the case of Indonesia, its Corporate Income Taxes was as high as 60% under the 1925 Company Income Tax Ordinance and so it seems plausible to exempt foreign investors for a period of up to 5years in their case and from withholding tax on dividends for those periods even when remitted later. Once the 5th year of the tax holiday lapses, the applicable tax rate for foreign firm could still be reduced. This tax holiday benefit was later extended to domestic investors as well.

[44] Easson & Zolt, *supra* note 5 at 9.

[45] Many studies concede to this argument. See United Nations Conference on Trade and Development, *Tax Incentives and Foreign Direct Investment: A Global Survey* (New York: UN, 2000) at 11: See also, Alex Easson & Eric M Zolt, *Tax Incentive* (Washington D.C: World Bank, 2003) at 11.

[46] George E Lent*, Incentive for Investment in Developing Countries* (London: Palgrave Macmillan, 1976) at 249.

non-taxation, there is no reason to grant a tax holiday.[47] Third, Lent[48] also points out that if taxes are low or tax enforcement is lax and evasion is prevalent, the advantages to having any tax concessions are reduced.[49] In other words, the higher the level of taxes, and the more effective, the greater the cost of enforcing the temporary relief.[50]

Another criterion by which to decide on extending an incentive is to de-emphasize the size of the potential investment. In other words, the belief that if eventually attracted, a large investor will help to boost confidence in other potential investors is not necessarily well founded. Louis Wells thinks that incentives, if at all, should go to the firm that invests in the needed sectors, while tax holidays should be channeled to other purposes, since it is better to lose a few investment opportunities than to incur high-cost incentives.[51] This means that the argument that it is economically efficient, cheaper and equitable to reduce corporate tax rates and to "incentivize all investors" does not remove the reality that the burden of these incentives will be borne by other taxpayers in the form of other taxes, since government expenditures must be met.[52] In the result, the incentive shifts the tax burden, while its expected benefits may never be realized.

In essence, Louis Wells argues that incentives can result in a net balance of payment outflows if tax savings are remitted abroad.[53] Therefore, investment incentives may not enhance the profitability of a newly established business to contribute to a

[47] *Ibid*.
[48] George Lent and several other writers argue that monitoring and enforcement are crucial.
[49] In the case of Canada, after the April 2016 leak of the Panama papers, the CRA got a bolster of nearly $500 million mainly for the purpose of tax enforcement. In addition to this, in 2016 alone, 230 personnel were added to the compliance department and lawyers incorporated into the investigating teams. In fact, a new branch called International Large Business and Criminal Investigations to take on complex, big ticket cases with an offshore component was added to the CRA. See "Tax agency's 'more aggressive' approach: Panama Papers fuelled new investigations and regulations *Metro News* (20 March 2017) at 6.
[50] George Lent, *supra* note 46 at 264.
[51] Easson & Zolt, *supra* note 5 at 74.
[52] George Lent, *supra* note 46 at 264.
[53] Louis Wells et al, *supra* note 47 at 78.

country's economic objectives.[54] In this sense, they are neither necessary nor sufficient for any country to attract foreign investment.[55] The real obstacles in the way of attracting investment are political stability, viability of the economy and security concerns.[56] In other words, the practice of granting tax benefits in place of correcting political or economic deficiencies is misplaced, as the incentives only play a role after the decision to invest might have been taken.[57]

It is also said to be better for incentives to be extended to both foreign and domestic investors to prevent "round tripping," whereby domestic capital is re-imported with a foreign label.[58] In as much as tax concessions are offered to certain sectors of an economy, the tax system should, as much as practicable, be designed to be general and across the board.

Overall, the huge body of research on the effects of incentives establishes that investors will only be attracted to countries where markets, investment climates and policies are attractive, whether or not a country offers tax holidays. Therefore, the justification that incentives will take the place of deficiencies in a country's "investment climate" is misplaced.[59] This conclusion highlights the need to pinpoint the real beneficiary of tax sparing arrangements,[60] next.

2.5 Tax Incentives: Who Benefits from Treaty Provision on Tax Sparing?

The fact that one country decides to advocate for tax incentives does not mean others should protect those incentives with tax sparing provisions. Foreign investment

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[54] George Lent, *supra* note 46 at 250.
[55] Louis Wells et al, *supra* note 47 at 53.
[56] Ibid at 40.
[57] George Lent, *supra* note 46 at 250.
[58] Louis Wells et al, *supra* note 47 at 53.
[59] George Lent, *supra* note 46 at 250. He clarified that a favourable investment climate in this context should be construed as a necessary (though they are good to have) but not a sufficient condition for attracting foreign investment.
[60] *Ibid* at 250.

promotion agencies[61]are particularly culpable in demanding tax incentives. They are quick to argue that the reason for some lost investment opportunity hinged on the absence of tax incentives.[62] Obviously, because these agencies' performances are measured in terms of the investment they attract, they really do not cast a care for the economic cost of tax incentives.[63] As well, because these costs are difficult to measure, they barely resist them.[64] Multinationals also put pressure on developing countries to enact tax incentives legislation. They often pitch neighboring countries against each other and, in order to tip the balance in their favour, they influence countries to grant endless tax incentives despite their well-documented shortcomings.[65]

Tax sparing is the term given to a situation where one country, the host country, provides tax incentives for businesses to be established there, and the home country gives a tax credit or exemption for income that would have been taxed at the normal rate in the host country but for the existence of the tax incentives. The effect is that the 'spared taxes' are treated by the home country as having been paid. Kim Brooks claims that for tax incentives given to a capital-exporting country to be meaningful, a tax sparing provision is needed in the tax treaty between both countries.[66] She maintains that tax sparing provisions are more important to foreign investors whose home countries do not exempt the business income of foreign subsidiaries of their

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[61] Foreign Investment Promotion Agencies are bodies like the Nigerian Investment Promotion Commission.
[62] George Lent, *supra* note 46 at 18.
[63] The Nigerian House of Representatives recently advised the federal government to take appropriate steps to evolve a clear-cut policy on import duty waivers, concessions and grants, restructure and streamline the functions and responsibilities of the Budget Office of the Federation and the Ministry of Finance, with a view to abolishing unproductive incentives, online: <https://www.thisdaylive.com/index.php/2017/11/09/house-to-probe-abuse-of-import-duty-waivers-custom-ict-infrastructure/>.
[64] George Lent, *supra* note 46 at 24.
[65] United Nations, *supra* note 1 at 18.
[66] *Ibid* at 4.

corporations, such as the United States, but instead, operate a "gross up and credit system."[67] In this case, the United States provides a tax credit for those foreign taxes paid when such are repatriated, usually in the form of a dividend. This tax is deferred in the United States until the income is repatriated, which could be into perpetuity. Alternatively, the tax-liable entity may opt to repatriate its foreign profits through a third country that serves as a conduit and which does not tax the income.

Clearly, the reasons home countries agree to tax sparing arrangements are at odds with inter-nation equity principles. This is because the home country foregoes a greater share of tax revenue than it would normally be required to lose. Kaufman argues that the existence of tax sparing arrangements reinforces the notion that the entitlement theory is not applicable in terms of inter-nation equity. Furthermore, she sees tax sparing agreements with developing countries as ''indicating an acceptance of a certain degree of redistribution within the international tax system.''[68] It definitely contradicts the "ability to pay principle", and the "benefit and economic allegiance" approaches.[69] It is evidence of developed countries wanting to assist developing countries by encouraging businesses to expand at the cost of accepting less revenue.

The main beneficiaries from tax sparing agreements are the MNEs that establish business operations in developing countries that provide tax incentives.[70] From an equity perspective, tax sparing contradicts notions of horizontal equity and inter-nation equity.[71] The reason developing states prefer fiscal incentives is because they serve to reduce the burden on investment undertakings, and as a means to induce

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[67] *Ibid* at 5.
[68] See generally John Andrew McLaren, *Will Tax Havens Survive in the New International Legal Environment?* (DCL Thesis, RMIT University College of Business, 2010).
[69] *Ibid*.
[70] Micah Leyira et al, *supra* note 2 at 5.
[71] John Andrew McLaren, *supra* note 68 at 57.

foreign investment in specific sectors or locations of an economy.[72] But given its operation and outcome, as earlier indicated from the literature, the ultimate beneficiary of incentives and tax sparing treaty provisions are investors and home countries, not the host developing countries.

2.6 Factors Influencing Investment Decisions in Developing Countries

In the end, it is left to point out the factors that persuade investment in poor economies. In general, the literature points to non-tax and tax factors. Tax incentives provide indirect support in the form of tax breaks, lower tariffs, etc. Non-tax incentives offer direct support in the form of structural facilities. They include market size; access to raw materials; effective, transparent and accountable public administration; language and cultural conditions; adequate legal, financial, physical and institutional infrastructure; availability and cost of skilled labour; access to infrastructure; transportation costs; political stability; consistent and stable macro-economic and fiscal policy (foreign exchange); and financing costs. Transparency and fairness in the decision-making system, another major investment-attracting factor, is a major challenge for most developing countries.[73] This is because their absence induces corruption and rent-seeking behaviour. This reality undermines the prospect for simplicity and certainty in the application of tax law and tax administration, and adversely influences what general level of taxation prevails and how tax incentives may be applied. It is into this uneasy situation that, as the literature discloses, tax incentives operate rather unprofitably for developing country economies.

2.7 Conclusion

Overall, the most important conclusion to be drawn from this chapter is that, although tax incentives are often used in an effort to attract foreign direct investment in

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[72] *Ibid* at 98.

[73] *Ibid* at 2.

developing countries, they do not guarantee adequate benefits for host countries. Although as a general matter this review of the literature suggests that tax incentives are an ineffective method for attracting investment, there appears to be a shift among tax advisers. They no longer recommend against the use of tax incentives. Rather, they offer assistance to improve the use and design of tax incentive regimes[74] so as to avoid taxpayer abuse and erosion of the revenue base of capital-importing countries. They do this because many countries persist in offering tax incentives, particularly the developing states.

With this in mind, the next chapter looks at the global initiatives to counter harmful tax practices. The expectation is that when the relevant features are incorporated into legislation and treaties, and notionally and comparatively applied and administered, perhaps tax incentives begin to be less of economic and fiscal liabilities to capital-importing states, especially the developing ones, than they have been so far.

[74] Easson & Zolt, *supra* note 5 at 6.

CHAPTER THREE

Global Initiatives on Harmful Tax Practices

3.1 Introduction

Chapter 1 explained the general principles of taxation and emphasized the need for countries to institutionalize good tax policy regimes. It established that a good tax policy is marked, among others, by principles of equity, neutrality, competitiveness, including administrability. The value of the analysis is the conclusion that a jurisdiction that operates its tax regime by these principles minimizes the chances for tax avoidance and evasion. Chapter 2 provided a review of the relevant literature to arrive at the conclusion that tax incentives are ineffective as a means of attracting foreign investment, despite their widespread use. This chapter discusses the various global efforts designed to curb nations' vulnerability to tax evasion and avoidance, especially targeting the evasion and avoidance opportunities presented by rampant use of tax incentives.[1]

3.2 Why Counter Harmful Tax Practices

One economic rationale for fighting harmful tax practices (HTP) is to prevent the avoidance of the implementation of residence based taxation, contrary to the principle of capital export neutrality,[2] unless domestic tax authorities have information on revenues generated abroad.

Capital Export Neutrality can only be achieved if an investor from a specific country faces the same rate of return on their investment irrespective of location.[3]As well, it must be noted that the removal of trade barriers, technological progress and financial

[1] Ikechukwu Ene, "A tax function for the future-what it should look like", *This day* (23 July 2015) 35.
[2] Gaetan Nicodeme, "On Recent Developments in Fighting Harmful Tax Practices" (2009) 62:4 Nat'l Tax J 755 at 757.
[3] Obinna Chima "Naira tops agenda as MPC meets today", *This day* (23 July 2015) 46.

integration, which now combine to allow "banking without borders,"[4] have caused an increase in the mobility of tax bases, particularly capital. Indeed, the removal of trade barriers has led to the creation of new opportunities, opened new frontiers, provided greater choices for consumers, and led to increased competition and taxation challenges. One of the challenges a government faces is to keep its tax system competitive. It is to facilitate this concern and to curb harmful tax practices that the Organization for Economic Cooperation and Development (OECD) has put forward the suggestions discussed below.

The OECD, in response to the prevalence of harmful tax practices around the world, approved a report in 2006. The aim of that report was to create an environment in which all countries, large and small, OECD and non-OECD, whether or not they have an income tax base, can compete freely and fairly.[5] To this end, the two elements of transparency and cooperation achieved through effective exchange of information are important to the outcome of implementing the report's suggestions.[6]

The OECD's effort speaks to the importance of the situation. Initially, the effort met with stiff opposition. The United States was particularly vocal that no organization could prescribe the appropriate level of taxation, or dictate the design of any country's tax system. However, following the exposure of hundreds of individuals in Germany evading taxes by using an anonymous Liechtenstein based trust,[7] and of tens of thousands of wealthy Unites States citizens evading taxes ably facilitated by the Union Bank of Switzerland (UBS),[8] erstwhile "uncooperative" tax havens have

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[4] Gaetan Nicodeme, *supra* note 2 at 756.
[5] *Ibid* at 763.
[6] OECD, *Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews, Nigeria 2016: Phase 2: Implementation of the Standard in Practice*, Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews (Paris: OECD, 2016) at 7.
[7] Gaetan Nicodeme, *supra* note 2 at 755.
[8] *Ibid* at 755.

become committed to join in the fight against harmful tax practices.[9] These events occurred in a period of severe economic crunch during which governments were seeking additional revenue to ease economic woes. For this reason, it became clear that even if tax evasion (tax havens) are not the root causes of financial crises, dealing with them is, nevertheless, part of the solution.[10]

3.3 Concept and Features of Harmful Tax Practices Regimes

As indicated, the OECD and, as discussed later, other bodies have assumed leadership in the effort to curb harmful tax practices. Their efforts in this direction proceed from identifying what these practices are, along with recommendations as to what can be done about them.

3.3.1 Concept of Harmful Tax Practices

"Harmful tax practices" (HTP) can be described as the deliberate setting of tax policies with the intention to attract a mobile tax base, usually in a way that is not transparent. The goal of the OECD is to reduce the discretionary influence of taxation on the location of mobile financial and service activities, thereby encouraging an environment in which free and fair tax competition can take place.[11] Its goal is to secure the integrity of tax systems by addressing the issues raised by regimes that apply to mobile activities and that unfairly erode the tax bases of other countries, potentially distorting the location of capital and services.[12] If countries or governments compete with one another in offering incentives, it can lead to a "race to the bottom."[13] That is why it is preferred for countries to institute agreements among

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[9] *Ibid* at 756.
[10] *Ibid* at 758.
[11] OECD Website <http://www.oecd.org/>.
[12] Alex Easson, & Eric M. Zolt *Tax Incentive* (Washington DC: World Bank Institute, 2003) at 37.
[13]OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance* (Paris: OECD, 2014) at 28 online: <http://dx.doi.org/10.1787/9789264218970-en>.

themselves to eliminate tax incentives completely, as their cost can be monumental, especially when compounded with the cost of compliance and enforcement.[14] Naturally, the question that arises is why seek such an outcome.

3.3.2 Combating Harmful Tax Practices: Rationale for OECD's Initiatives

Professors Eden and Kudrle contend that the origins of the OECD's harmful tax competition project can be traced to two key actors within the OECD – the United States and the European Union.[15] First, the existence of cross-border financial transactions through electronic commerce via the Internet and the existence of offshore financial centres (OFCs) were perceived by the US Government to have the capacity to erode the tax base unless international cooperation could be obtained.[16] Second, as a result of the '1992 single common market initiative' and the removal of barriers, the European Union became concerned about the effect of different tax rates among members, especially Ireland.[17]

Cooperation between OECD member states became crucial to prevent the erosion of their tax bases. Since the late 1990s, the OECD has been active in trying to identify and eliminate harmful tax competition. The harmful tax practices project was aimed at tax havens and OFCs and involved the 'naming and shaming' of some 36 tax havens. Since then, a large number of tax havens have agreed with the OECD to reform their bank secrecy laws and to become more transparent in their dealings with other

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[14] John Andrew McLaren, *Will Tax Havens Survive in the New International Legal Environment?* (DCL Thesis, RMIT University College of Business, 2010) at 34.

[15] Maria Flavia Ambrosanio & Maria Serena Caroppo, "Eliminating Harmful Tax Practices in Tax Havens: Defensive Measures by Major EU Countries and Tax Haven Reforms" (2005) 53:3 Can Tax J 685 at 687.

[16] OECD Website <http://www.oecd.org/>.

[17] Gaetan Nicodeme, *supra* note 2 at 755.

countries.[18] The OECD has been actively trying to protect the national tax bases of its member states, and this has now become imperative in view of global financial crises and government deficits. The project, pursued since 1998, appears to be receiving worldwide acceptance.[19] Major tax havens have agreed to comply with the OECD's project and to provide details on non-resident taxpayers that use their financial systems for tax avoidance and tax evasion.[20]

The reality of global financial crises has pushed the OECD member states to recognise that the time for action had come and that pressure must be put on recalcitrant tax havens to make information exchange agreements. The immediate emphasis is to promote a level playing field by eliminating domestic bank secrecy laws and concluding agreements which, among OECD member states, must facilitate information exchange on non-residents using their financial services.[21] But to really accomplish these demands knowing how to identify a harmful tax regime.

3.3.3 Features of Harmful Preferential Tax Regimes

The OECD report outlines four key factors that assist in identifying harmful preferential tax regimes. These are first, that the country imposes a low or zero effective tax rate on the relevant income, similar to a tax haven. Second, the tax regime is 'ring fenced,' in that residents of that state do not have access to tax concessions which are only offered to foreign investors or businesses. Third, there is a lack of transparency in the tax system; and fourth, there is a lack of effective exchange of information on investments and bank accounts operated by non-residents.[22]

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[18] OECD, *Harmful Tax Practices 2017 Progress Report on Preferential regime,* (Paris, OECD, 2017) at 15.
[19] Ibid at 21.
[20] John Andrew McLaren, *supra* note 14 at 34.
[21] OECD Website, online: <http://www.oecd.org/>.
[22] OECD, *supra* note 18 at 15.

Beyond the foregoing, the report notes also that a harmful preferential tax regime exists in the presence of these other factors: first, an artificial definition of the tax base which may allow some non-resident investors or businesses to obtain certain exemptions from tax, or receive tax concessions that are not offered to residents and non-residents in similar circumstances; second, a failure to adhere to international transfer pricing principles; third, negotiable tax rate or tax base; fourth, secrecy provisions relating to bank account details or the allowing of bearer shares; and fifth, the existence of a wide network of taxation treaties between countries which may allow for abuse through treaty shopping.[23]

It is no longer news that most nations, irrespective of their stages of development, have been actively promoting themselves as investment locations of choice in order to attract foreign direct investment.[24] They have adopted several measures as incentives in support of their investment objectives, including the use of tax incentives.

The United Nations (UN) defines foreign direct investment (FDI) incentives as "any measurable advantages accorded to specific enterprises or categories of enterprises by (or at the discretion of) a Government, in order to encourage them to behave in a certain manner."[25] This includes measures specifically designed to either increase the rate of return of an FDI enterprise or to reduce its costs and the level of risk it assumes. The UN also defines tax incentives as "any incentive that reduces the tax burden of enterprises in order to induce them to invest in particular projects or sector".[26] The United Nations points out that investors adopt a two-stage process

[23] Ibid at 22.
[24] United Nations Conference on Trade and Development, *Tax Incentives and Foreign Direct Investment: A Global Survey* (New York: UN, 2000) at 16.
[25] *Ibid* at 17.
[26] *Ibid* at 18.

when appraising countries as possible investment locations.[27] First, countries are screened for the presence of fundamental determinants[28] like access to raw materials and availability of skilled labour. Only those countries that pass the first stage are evaluated in terms of tax rates, grants and other incentives. Because tax incentives are intended to encourage investment in certain sectors or geographical areas, they are often provided with conditions attached.

Given their potential to facilitate HTPs, the OECD, United Nations (UN) and other supranational organizations have sought to provide guidance to policymakers[29] on whether to adopt tax incentives and how best to design them. These efforts are now considered more specifically, first for the OECD, and then the United Nations.

3.4 The International Tax Policy Advisory Bodies: The OECD and The United Nations

3.4.1The OECD Tax Incentive Initiative

3.4.1.1 The OECD Initiative: The Institutional Concept

The mission of the OECD is to promote policies that will improve the economic and social well-being of people around the world.[30] Its work is based on continued monitoring of events in member countries, as well as outside the OECD area, and includes regular projections of short and medium-term economic developments. The OECD works with governments to understand what drives economic, social and environmental change.

[27] *Ibid* at 21.
[28] These fundamentals according to the United Nations include market size, access to raw materials and availability of skilled labour.
[29] Easson & Zolt, *supra* note 12 at 4.
[30] OECD, *Harmful Tax Competition: An Emerging Global Issue* (Paris: OECD, 1998) at 5.

The OECD publishes regular outlooks, annual overviews and comparative statistics. The OECD also co-operates with civil society on a number of levels. Its core relationship with civil society is through the Business and Industry, and the Trade Union Advisory Committees, respectively, the BIAC and TUAC. [31]These advisory bodies contribute to most areas of OECD work through policy dialogue and consultations. Over the years, this co-operation has been complemented by activities with other representatives of civil society, such as non-governmental organizations, think tanks, and academia. The OECD also maintains close relationship with parliamentarians, notably through its Global Parliamentary Network and long-standing links with the Council of Europe and NATO Parliamentary Assemblies.[32]

The annual OECD Forum is a global platform for exchange of ideas, sharing knowledge and building networks that bring together all stakeholders including government Ministers, representatives of international organizations, and leaders of business, trade unions and civil society. The OECD Forum is held in conjunction with the annual ministerial meeting and enables all stakeholders to discuss key issues on the ministerial agenda with government Ministers and senior officials of international organizations.

Tax competition has received increased focus. The OECD published its first report on this matter in 1998.[33] The focus of the OECD's efforts relates to geographically mobile activities such as financial and other service activities. The 1998 Report established a number of criteria for determining whether a preferential tax regime was harmful. OECD member countries that approved the 1998 Report committed to eliminate any of their preferential tax regimes found to be harmful. In fact, the initial

[31] *Ibid*.
[32] *Ibid*.
[33] OECD, *Harmful Tax Competition: An Emerging Global Issue* (Paris: OECD, 1998) at 6.

work focus was (1) to identify and eliminate harmful features of preferential tax regimes in OECD member countries; (2) to identify "tax havens" and seek their commitment to the principle of transparency and effective exchange of information; and (3) to encourage non-OECD economies to associate with the work.[34] The OECD Global Forum on Taxation (The Global Forum) is the committee tasked to engage, through dialogue, the non-OECD economies on tax issues.

3.4.1.2. Overview of the Initiative

The OECD Model Convention was originally meant to apply between two high–income countries,[35] and so did not explicitly endorse the inclusion of sparing provisions in tax treaties.[36] However, it suggests how to draft such provisions to limit their scope. It also recommends that treaty partners might consider either exempting tax income from activities that developing countries seek to encourage, or agreeing to tax sparing arrangements that would credit the tax amount that would have been paid had no relief been granted.[37] It seems plausible that countries that do not tax foreign-earned active business income will not be inclined to have tax sparing provisions. The truth is that it is irrelevant to them.[38] As to crafting the provision, the OECD suggests that tax sparing should be limited to some business income and not extend to passive income.[39]

Following the report on taxation of foreign direct investment,[40] the OECD issued a caveat regarding the need to reconsider tax sparing provisions because of the

[34] *Ibid* at 8.
[35] Kim Brooks, ''Tax Sparing: A needed Incentive for Foreign Investment in Low-Income Countries or an Unnecessary Revenue Sacrifice'' (2009) 34:2 Queen's L J 1 at 9.
[36] *Ibid* at 8.
[37] *Ibid*.
[38] *Ibid*.
[39] *Ibid* at 23.
[40] *Ibid* at 11.

potential abusive tendencies associated with their use, the concessions granted in terms of accepting lower tax revenue,[41] and the abundant literature pointing to the ineffectiveness of tax incentives in promoting foreign direct investment.[42] It recommended that tax sparing should only be used in instances where the economic level of the country conceding it is significantly worse than the OECD country.[43] Flowing from these developments, countries like Canada decided not to include tax sparing provisions in their tax treaties, or, in Canada's case, when it does, to include a "sunset clause".[44]

3.4.1.3 The Initiative in Detail

The earlier 1998 Report established a number of criteria for determining whether a jurisdiction has a preferential tax regime that is harmful. The first and also the gateway criterion for determining whether a regime is preferential is whether it has "no or low effective tax rate,"[45] though this is not a sufficient reason to infer that a preferential tax regime is harmful. As such, a jurisdiction must satisfy several other criteria for it to be black–listed. Thus, second, for a regime to be considered preferential, it must be ring-fenced from the domestic economy. This means that the regime must be offering some form of tax preference to foreigners that is not available to domestic investors. The point is that the regime must be preferential in the context of the application of the general principles of taxation in the relevant country, and not by way of comparison to the taxation regime of another country.[46] Third, there must be lack of transparency, which aids foreign taxpayers to evade taxes in their home

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[41] See generally for a full list of concessions reached on taxation of interest, "Dividends, Pensions and Annuities and Royalties Non-Resident Withholding Tax Rates for Treaty Countries'', online: https://www.kpmg.com/.../TaxRates/Non-Resident-Withholding-Tax-Rates-for-Treaty-*Countries-v2-3.pdf>. May 2015.*
[42] Kim Brooks*, supra* note 35 at 23.
[43] *Ibid* at 11.
[44] *Ibid* at 15.
[45] OECD*, supra* note 13 at 40.
[46] *Ibid* at 45.

country. Fourth, information exchange must be ineffective. This is because the decision of a country to prevent access to bank information is likely to adversely affect tax administration. Effective exchange of information exists where it is possible to assess the legal and administrative framework on exchange of information and to have access to information on banking, property ownership, and accounting.[47] A fifth criterion is that there must be substantial activity to justify taxation in that jurisdiction.[48]

3.4.1.4 Specific Elements of the OECD Initiative

The OECD has championed various initiatives to curb harmful tax practices. This sub-section discusses three specific elements, namely, naming and shaming, country-by-country reporting, and the Base Erosion and Profit Shifting (BEPS) project.

Naming and Shaming: Since the early 1990s, the OECD has tried to 'name and shame' tax havens and eliminate competitive tax practices through its harmful tax competition project. It wanted to achieve a 'level playing field' for all nations in this matter.[49] The goal is to ensure that tax havens eliminate their bank secrecy laws and become more transparent in their dealings with other countries.[50]

Country-by-country reporting: To boost transparency on the part of multinational enterprises (MNEs), the Multilateral Competent Authority Agreement (MCAA) was instituted, followed by a release of the standardized electronic format for the exchange of Country-by-Country (CbC) Reports between jurisdictions. This is based on Article 6 of the Multilateral Convention on Mutual Administrative Assistance in

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[47] OECD, *supra* note 6 at 95.
[48] OECD*, supra* note 13 at 48.
[49] OECD website, online: <http://www.oecd.org/>.
[50] OECD, *supra* note 33 at 15.

Tax Matters.[51] It puts in place the automatic exchange framework for exchanging Country-by-Country Reports, as contemplated by Base Erosion and Profit Shifting (BEPS) Action 13.[52] This agreement requires MNEs to provide aggregate annual information in each jurisdiction where they do business, relating to the global allocation of income and taxes paid, together with other indicators of the location of economic activity within the MNE group.[53] The country-by-country MCAA allows all signatories to bilaterally and automatically exchange Country-by-Country Reports with each other as contemplated by Action 13 of the BEPS Action Plan. This will help ensure that tax administrations obtain a complete understanding of how MNEs structure their operation without compromising the confidentiality of such information. First exchanges start in 2017-2018 on 2016 information.[54]

Under the country by country MCAA, the tax administrations located in the region where a company operates will get aggregate annual information, starting with 2016 accounts relating to the global allocation of income and taxes paid, together with other indicators of the location of economic activity within a multinational enterprise group.[55] It will also cover information about which entities do business in a particular jurisdiction and the business activities each entity engages in.[56] The information will be collected by the country of residence of the parent of the MNE group, and will then be exchanged in accordance with the agreements.[57]

The OECD/G20 BEPS Project: The OECD/G20 Base Erosion and Profit Shifting project, or BEPS, is primarily aimed at preventing multinationals from artificially

[51] OECD, *supra* note 6 at 17.
[52] The BEPS Project has 15 action points of which Action 13 relates to Transfer Pricing documentation.
[53] OECD, *supra* note 6 at 15.
[54] OECD, *supra* note 13 at 7.
[55] *Ibid* at 17.
[56] *Ibid* at 12.
[57] *Ibid* at 9.

moving their profits into lower-tax jurisdictions. Otherwise, the practice erodes the revenue base of the countries the MNEs operate in.[58] The OECD/G20 BEPS Project set out 15 key actions to reform the international tax framework and ensure that profits are reported where economic activities are carried out and value created.[59]

The term, Base Erosion and Profit Shifting (BEPS) is used to describe aggressive tax planning strategies that rely on mismatches and gaps between the tax rules of different jurisdictions to minimize the corporation tax that is payable overall by either making tax profits "disappear," or by shifting profits to low tax operations where there is little or no genuine activity.[60] Consequently, it either makes profits available for tax purposes, or shifts them to areas experiencing nil or little actual activity where taxes are minimal. The result is the payment of nil or minimal total corporate taxes.[61] BEPS is of major significance for developing countries due to their heavy reliance on corporate income tax, particularly from MNEs.[62]

The final BEPS package was negotiated by OECD members, the G20 and non-OECD members (including Nigeria) as equal partners.[63] The project seeks to strengthen a global tax system which is believed by some to be inadequate at the moment, and which had allowed multinational enterprises (MNEs) to reduce their effective tax rates in jurisdictions that have no corresponding value-creating economic activities as do their home jurisdictions.[64] Addressing base erosion and profit shifting is a key priority of governments around the globe. Beyond seeking to secure revenues by realigning taxation with economic activities and value creation, the OECD/G20 BEPS Project aims to create a single set of consensus-based international tax rules to address

[58] OECD, *Action Plan on Base Erosion and Profit Shifting*, (Paris: OECD, 2013) at 12.
[59] *Ibid* at 13.
[60] *Ibid* at 15.
[61] *Ibid* at 16-17.
[62] *Ibid* at 21.
[63] *Ibid* at 27.
[64] *Ibid* at 10.

BEPS, and hence to protect tax bases while offering increased certainty and predictability to taxpayers.[65] A key focus of this work is to eliminate double non-taxation. However, in doing so, the idea is that new rules should not result in double taxation, nor in unwarranted compliance burdens or restrictions on legitimate cross-border activity.[66]

The BEPS approach focuses on three broad measures: coherence in tax systems globally; economic substance in cross border dealings; and transparency with respect to relevant taxpayer data to assist revenue administrations' tax investigation efforts.[67] According to the BEPS report, every country or state is free to design its corporate tax system, including the taxation rates.[68] The report's recommendation/objective is to help restore and consolidate taxation rates by ensuring that each country imposes tax on profits arising from economic activity undertaken within its jurisdiction.[69] For effective tax payment by the multinational organization that avoids taxation by shifting mobile capital and income to lowly taxed zones, the BEPs report stipulates guidelines in tax collection to help create regimes to implement them.[70]

In particular, the mandatory disclosure regime requires taxpayers and promoters to disclose to tax administrators the usage of schemes presenting particular unusual features or hallmarks.[71] It is impractical for this regime to target every transaction that may raise tax avoidance concerns. However, hallmarks act as tools to identify features within the schemes that facilitate tax avoidance. The timely information received on

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[65]Anthony Ekulube, *Countering Double Non- Taxation in Nigeria* ,1st ed (Ile-Ife: Obafemi Awolowo University Press, 2016) at 75.
[66] *Ibid* at 81.
[67] *Ibid* at 83.
[68] *Ibid* at 71.
[69] Katharina Finke, *Extending taxation of interest and royalty income at source- an option to limit base erosion and profit shifting,* (Mannheim: Zentrum fur EuropWirtschaftsforschumg, 2014), online: <ftp.zew.de/pub/zew-docs/dp/dp14073.pdf>.
[70] OECD, *supra* note 58 at 11.
[71] *Ibid* at 17.

possible abusive or aggressive tax planning schemes allows tax administrators to establish early counteraction.[72]

The BEPS report offers diverse options that allow countries to design systems that suit their need to obtain early information on abusive and aggressive tax planning schemes. Tax administrations may use information collected to counter tax avoidance structures. In ensuring compliance with the tax administration system and legislative changes, risk assessment and audits of strategic communications by tax administration are crucial.[73]

According to the report's recommendations, countries are at liberty to decide on the introduction of mandatory disclosure regimes. When a country agrees to adopt the regime, the recommendations offer the needed flexibility to balance a nation's quest for better and timely data regarding a taxpayer, with the ultimate goal to prevent tax avoidance.[74] In fact, the BEPS project is not centered on increasing corporate tax rates. However, BEPS features when such tax rates are achieved via practices that artificially isolate a taxable earning from activities that create it. This, in turn, increases tax disputes.[75] The project aims to undermine tax havens by restricting the use of shell companies to hoard profits offshore and to neutralize schemes that artificially shift earning and profit offshore.[76] It also seeks to enable states to attract foreign investors that have no plans to enrich themselves at taxpayer's expense.[77]

The BEPS report also addresses dangerous tax practices, as they impact negatively on both multinationals and governments. It is argued that unhealthy tax competition distorts and introduces imbalance between businesses operating at global and

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[72] *Ibid* at 10.
[73] *Ibid* at 15.
[74] OECD, *supra* note 13 at 19.
[75] OECD, *supra* note 58 at 17.
[76] *Ibi*d at 18.
[77] *Ibid* at 27.

domestic levels.[78] To survive the competition and attract investors, countries are forced to employ particular tax policies, including incentives. Tax avoidance by MNCs leaves citizens with increased tax burdens to support government expenditure.[79] For this reason, economic development in poor and developing countries is greatly frustrated.

3.4.2 The United Nations

For its part, the United Nations emphasizes that a government in the process of developing an incentive system should list and analyze the market imperfections that the incentives are designed to reduce or eliminate.[80] It advocates for a periodic review of an incentive regime with the goal to prevent revenue leakages by eliminating excess of incentives, or to update incentive packages to provide real value to investors and, thus, to attract more investment.[81]

In terms of preserving tax incentives, a United Nations model treaty was designed to be more favourable to low-income countries.[82] But the treaty makes no express provision for tax sparing. This absence was interpreted as either suggestive of a continued bias in favour of high income countries, or a neglect of the distinct needs of low income countries.[83] The closest the UN model treaty came to endorsing tax sparing provisions was to state that a tax sparing credit is needed to preserve tax incentives and concessions granted by developing countries.[84] According to the United Nations, the argument as to the cost effectiveness of using tax incentives is not conclusive because it is difficult to determine the quantum of investment that can be

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[78] *Ibid* at 48.
[79] Matthew Watson, *The Political Economy of International Capital Mobility*, 1st ed (Basingstoke: Palgrave Macmillan, 2007) at 25.
[80] United Nations, *supra* note 24 at 18.
[81] Kim Brooks, *supra* note 35 at 10.
[82] *Ibid*.
[83] *Ibid*.
[84] *Ibid*.

traced to the use of tax benefits. Moreover, tax incentives are often used with other reforms, and this makes it more difficult to estimate the new investment attributable to tax benefits.[85] But the UN agrees that certain well-designed tax incentives could be successful in attracting and increasing investments if properly designed.[86] Thus, it proposes the use of tax incentive budgets and general tax expenditure analysis to promote accountability and transparency of tax incentives.[87] This is in addition to its inclusion in the formal tax expenditure budget.

Commenting on the UN initiatives, Eric Zolt submits that the design and effectiveness of tax incentives will differ depending on the type of investment in question.[88] Some of these features speak to eligibility issues. Since tax incentives are departures from the norm, a special tax privilege should only be available in the case of those desirable investments that would not be made without the tax benefits.[89]

3.5 Overview and Conclusion

The foregoing discussion establishes that tax avoidance, and the use of tax incentives to attract foreign direct investment into developing countries, constitute anti-competitive tax structures. Together, the jurisdictions that facilitate them constitute tax havens. In terms of the global economy, the existence of such havens not only erodes the tax bases of the havens themselves; they also facilitate revenue loss by jurisdictions whose taxation efforts they undermine.

This global adversity, in the face of global economic and financial difficulties, necessitates cooperative efforts to reverse harmful tax practices problems. As

[85] Easson & Zolt, *supra* note 12 at 5.
[86] *Ibid* at 12.
[87] *Ibid* at 17.
[88] *Ibid* at 8.
[89] *Ibid* at 8.

discussed, the Organization for Economic Cooperation and Development (OECD) and the United Nations (UN) have been instrumental in seeking solutions to this common problem. Between them, they emphasize the need for agreements to facilitate information exchange regarding banking and efforts to eliminate banking secrecy laws. The more detailed OECD Initiative is distinguished by being open to non-OECD states, including, as noted, their participation in the projects.

Those recommendations are forthright about what must be done. Starting from the moral strategy of "naming and shaming" tax havens, they further seek to encourage country-by-country reporting and information exchange to promote transparency and cooperation in inter-state taxation administration and enforcement. More broadly and in greater detail, its design of the base erosion and profit shifting project with action steps is intended to institutionalize a global tax regime which structures national tax administration on policies and principles common to all participants with the ultimate objective that both low and high-income jurisdictions would derive due and legitimate tax income, particularly from the activities of MNEs irrespective of which jurisdiction they operate in around the globe.

The functioning of this regime on the basis of treaties that do not allow or facilitate treaty shopping would benefit jurisdictions like Nigeria. Given that Nigeria and other developing states are particularly tied to the use of tax incentives to attract investment, the OECD and the United Nations' recommendations on how to design an incentive system to undercut harmful tax practices is particularly useful to consider. This is the focus of the next chapter.

CHAPTER FOUR

Considerations for Designing, Granting and Monitoring Tax Incentive Programs

4.1 Introduction

The preceding chapters established a number of fundamental points that are crucial to the operation of a national taxation regime that must generate sufficient national revenue from taxation administration to fund public services and finance the provision of public facilities. This is the ultimate goal for tax reform for Nigeria.

So far, this thesis has established that the point of departure is an effective tax policy. The policy must ensure transparency and fairness in taxation among different economic brackets of taxpayers. As well, tax administration must be efficient in the sense that the cost of tax liability enforcement must be effective as against revenue realized. Second, tax legislation must not foster harmful tax practices. More specifically, the need of developing states like Nigeria to attract foreign direct investment via provision of incentive regimes must not be allowed to undermine the requisite revenue that the nation must derive from investors that may benefit from the implementation of such schemes.

Thirdly, it was shown that not only do incentive regimes do not necessarily promote investment, additionally, they result in promoting the loss of revenue to jurisdictions other than those that provide the incentives. This is because the corporate entities that take advantage of the incentive schemes, particularly MNEs, organize their operations to transfer earnings to low or no tax jurisdictions from higher tax ones where, otherwise, they are liable to taxation on their activities. It was discussed that the international concern this has raised for financial accountability and fairness in tax competitiveness among states prompted initiatives like those by the OECD and the UN discussed in Chapter 3. The goal of those initiatives is to ensure that jurisdictions that choose to provide tax incentive schemes to attract investment do so according to criteria that are internationally acceptable. In meeting the criteria, it must ensure that harmful tax practices, in particular, the creation of tax havens and structures that encourage tax avoidance and evasion, are minimized among states, or more hopefully, eliminated totally.

Building on the preceding chapters, this chapter discusses in detail the guidelines that a state could utilize to design an effective tax incentive regime. It discusses four broad steps for this process, namely, the designing of the incentive itself; the process of granting the incentives; the implementation of the conditions under which the incentives are granted; and follow up of compliance with the terms of the incentive.[1]

The discussion is laid out as follows: regarding the design of the incentives, section 4.2 demonstrates that this exercise should take into account the specific type of investment being targeted and for which the investment is meant. Additionally, countries must limit the duration of tax incentives to reduce the potential costs of unsuccessful or poorly designed incentive programs. As well, the incentive structure they put in place must include sunset and anti-abuse clauses, and the option of a regional approach to granting incentives. Section 4.3 argues that the investors and other companies that benefit from the incentives must be qualified. Also, the officials who administer the incentives must be professionals knowledgeable in such disciplines as accounting and economics, disciplines that are germane to the sector.

[1] United Nations Conference on Trade and Development, *Tax Incentives and Foreign Direct Investment: A Global Survey* (New York: UN, 2000) at 23.

Again, there must be a balance between discretionary and non-discretionary approaches to granting incentives by the officials to ensure a creative application of the rules. Section 4.4 turns to the implementation of the incentive conditions. As shown, this lays upon the national tax administration the need to ensure the audit of these companies even during the tax holiday period. Section 4.5 describes how compliance with incentive terms are monitored and evaluated. It emphasizes that this requires administrators to enforce and closely monitor incentive compliance to make sure that investors pursue the approved projects that qualify them for the incentive. Section 4.6 concludes that enforcement and monitoring are crucial to realizing the benefits expected from tax incentive schemes, a prospect which is a challenge to most developing countries.[2] Indeed, it cannot be over-emphasized that a well thought incentive scheme can be misdirected if it is not well monitored.

4.2 Incentive Design

Before offering design details, it is useful to reiterate the basic challenges that incentive schemes pose to the jurisdictions that grant them. To start with, it should be noted that the granting of tax holidays to new firms which qualify under statutory criteria without distinguishing between pioneer and established businesses is not desirable.[3] According to Alex Easson, tax incentives are bad in theory and practice because they are often unproductive and prone to exploitation.[4] Kim Brooks argues that low income countries must desist from granting tax incentives because they promote remittances rather than reinvestment,[5] and they do not offer suitably designed approaches by which to improve social and economic circumstances in developing

[2] *Ibid* at 25.

[3] Alex Easson, "Tax Incentives for foreign direct investment in developing countries" (2012) 9:4 Australian Tax Forum 387 at 415.

[4] Alex Easson, & Eric M Zolt, *Tax Incentives* (Washington DC: World Bank Institute, 2003) at 1.

[5] Kim Brooks, ''Tax Sparing: A Needed Incentive for Foreign Investment in Low-Income Countries or an Unnecessary Revenue Sacrifice'' (2009) 34:2 Queen's L J 1 at 3.

countries.[6] She is particularly strident that a multinational enterprise (MNE) from a resident country using worldwide taxation will not be able to take advantage of this incentive outside the regulatory regime of a tax treaty between both contracting states. This is why the scheme brings an unnecessary loss to the low- income country.[7] In the other words, tax incentives may indicate a good intention but lead to a bad result.[8] This is because the multinationals end up not paying taxes in the capital importing countries and may not even pay in their resident countries.[9] In the end, the beneficiary is not the host state but the multinational.[10] The issue to address, therefore, is how design elements can assembled to minimize the exposure of an incentive-granting jurisdiction to the extremes of these dangers.

4.2.1 Tax Incentives Should Be Narrowly Targeted

In designing a tax incentive under an investment treaty between states, the first concern is to determine the types of investment that the incentives are intended to attract.[11] This helps ensure that the incentives are tailored toward the types of investment identified. It also reduces costs that may be incurred through other needless, generally targeted incentives.[12] To this end, it is necessary to clearly spell out in detail the applicable qualifying criteria that enable an investor to benefit from each incentive. Consequently, the incentives offered must be narrowly targeted (with one particular proposed investment in mind) and, thus, de-emphasize generally targeted beneficiaries (all new investments, foreign or domestic). [13]

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[6] *Ibid* at 1.
[7] *Ibid* at 21. See also United Nations, "Tax Incentives and Foreign Direct Investment a Global Survey" United Nations Conference on Trade and Development," ASIT Advisory Studies No. 16 (New York and Geneva: United Nations, 2000) at 28, online: <http://unctad.org/en/docs/iteipcmisc3_en.pdf>.
[8] *Ibid* at 3.
[9] *Ibid* at 17.
[10] *Ibid* at 5.
[11] United Nations, *supra* note 1 at 23.
[12] Alex Easson, *supra* note 2 at 15.
[13] United Nations, *supra* note 1 at 24.

One disadvantage of the selective approach is that the more precisely an incentive granted is, the greater the distortion it creates. This distortion can take the form of a company changing its investment decisions to take advantage of incentives, a step that results in the misallocation of resources.[14] Competition may also be distorted between the firms that may enjoy the incentives and those that do not.[15] Therefore, the better approach is to bring the corporate tax regime closer to international practices, rather than grant favourable tax treatment to specific investors.[16] For instance, according to Kim Brooks, an incentive should not be extended to tax expenditures that relate to passive income. It should be restricted to business income excluding returns from exploration activities which already have high economic rent.[17]

An effective incentive design should also include three inter-related features. The first is reciprocity, meaning that the incentive should only be provided via tax treaties between high and low-income countries, and they should not be reciprocal. The second is restrictiveness. This is because the recent trend suggests that it is less cumbersome to extend such benefits to only corporate taxpayers. The rationale is to check possible abuse on a larger scale and to enhance auditing. Third, the scheme must enhance specificity, meaning that the benefit in view should be specifically targeted to a particular activity and not to a wide range of tax incentive provisions.[18]

4.2.2 Sunset Clauses under an Incentive Scheme

Another important feature of incentive design is the need to limit its duration in order to reduce the potential costs of an unsuccessful or poorly designed incentive program.

[14] *Ibid* at 27.
[15] *Ibid* at 29.
[16] Easson & Zolt, *supra* note 4 at 4.
[17] Kim Brooks, *supra* note 5 at 14.
[18] *Ibid* at 20.

To do this requires including specific sunset provisions[19] in the original legislation.[20] Incentive regimes must demand information reporting by beneficiaries to investment agencies, and to specify what government agency has responsibility for monitoring and enforcing qualification and recapture provisions.[21]

The use of sunset clauses is becoming prominent in treaties.[22] The clause is intended to restrict the ability of investors to benefit indefinitely by imposing some time restrictions. An instance of such restriction is if a circumstance has changed, such as when a once low-income country advances to a middle-income status.[23] However, this still does not completely eliminate perverse incentives.

Without the introduction of a sunset provision, taxpayers can benefit from the incentive as long as the treaty is in force. The sunset provision can be instituted once a treaty is signed or when it comes into force. One likely effect of this is that it creates an incentive for a taxpayer to quickly repatriate profit.[24]

Another sunset approach is to limit how long a particular taxpayer may have a right to benefit from the tax incentive. The time duration motivates the setting up of new companies, or deploying transfer pricing to move profits between associated companies,[25] a situation that blurs the line between new investment and re-investment. It is recommended that for the sake of simplicity, parties should be able to

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[19] A sunset provision is a measure within a statute, regulation or law that provides that the law shall cease to have effect after a specific date or upon the occurrence of an event unless further legislative action is taken to extend the law.
[20] Kim Brooks, *supra* note 5 at 17.
[21] *Ibid* at 23.
[22] *Ibid* at 19.
[23] *Ibid* at 23.
[24] *Ibid*.
[25] *Ibid* at 24.

terminate an incentive within a reasonable time without having to renegotiate the treaty.[26]

4.2.3 Anti-abuse Clauses and Reporting Requirements

It is also recommended that anti-abuse clauses be included to prevent treaty abuse. As well, high-income countries must report on their use of incentives in tax expenditure accounts. It behooves the foreign investor to provide its resident government with an annual report of qualifying activities and reliefs.[27]

4.2.4 Regional Approaches to Harmonisation

Because incentives affect the tax income of other states, it is important in the context of cooperation, that countries agree on a set of tax incentives that may be offered to investors. This situation requires individual countries to meet certain guidelines with respect to those incentives. For example, a group of countries could agree to offer tax holidays to investors,[28] but require that holiday periods should not exceed a certain length of time, such as three years.[29] Countries could also agree to not allow tax holidays, but allow different types of tax incentives, such as "super" depreciation or investment tax credits.[30] Finally, it is also important in the design of incentives to consider the tax regimes of other countries from various perspectives: that their residents may be potential investors; that they are competitors for other foreign investors; and that their residents may be potential consumers of products produced in the incentive-granting country.[31] With these in mind, the scheme must account for its impact, positive or negative, on the functional effect of those factors once it comes into operation.

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[26] *Ibid* at 25.
[27] *Ibid* at 23.
[28] George E Lent*, Incentive for Investment in Developing Countries* (London: Palgrave Macmillan, 1976) at 280. George Lent recommended this approach.
[29] United Nations, *supra* note 1 at 27.
[30] *Ibid* at 29.
[31] *Ibid*.

4.3 Granting Incentives

4.3.1 Employment of Professionals.

The next step after incentive design is what considerations should inform its grant to entities that may benefit from the incentive. In this respect, it is important to establish the revenue foregone in the light of the benefits to be derived.[32] Revenue foregone, according to Alex Easson, includes revenue not received from projects that would have been undertaken even if the investor did not receive any tax incentives; lost revenue from investors who had improperly claimed the incentive; additional revenue loss due to taxpayer abuse through disguising illegitimate operations to qualify for tax benefits, a ploy that also includes allocation of resources or too much investment in certain activities to the detriment of other non-tax favoured areas; and the cost associated with monitoring and enforcing compliance, coupled with opportunities for corruption where officials carry much discretion in granting tax incentives.[33] The greater the complexity of the tax incentive regime, the higher the enforcement and compliance cost.[34] Hence, the professional qualifications of officers given the responsibility to review incentive applications must include extensive background in social sciences, especially accounting and economics. In the case of Nigeria, where about 12.6% of its workforce are professionals who are not regularly trained, and the rest being support staff, the prospect of putting together that calibre of tax incentive administrators is daunting.[35]

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[32] Ellen Harpel, "Evaluating and Improving Tax Incentives: Lessons learned" (2017)26:2 J Comp L. She offered that doing this type of appraisal helps a government to avoid over committing its resources to investors. The United Nations Trade and Development supported this view with an analysis of the case of the state of Alabama, which committed $220 million in return for an investment of $300million for the installation of a Mercedes- Benz plant in Tuscaloosa. See, United Nations, "Tax Incentives and Foreign Direct Investment a Global Survey" United Nations Conference on Trade and Development," ASIT Advisory Studies No. 16 (New York and Geneva: United Nations, 2000) at 28.

[33] Jeffrey Owens & Alessandra Sanelli, *Fiscal Havens in Latin America and the Carribbean in Tax Systems and Tax Reforms in Latin America* (2008: New York) at 29.

[34] George Lent, *supra* note 28 at 280.

[35] Michael Carnahan, "Taxation Challenges in Developing Countries" (2015) 2:1 Asian Pac L & Pol'y J 169 at 172.

4.3.2 Review of the Incentive-granting Process

There is need to reduce administrative discretion in the incentive-granting process. Leaving it to officials to grant tax incentives could lead to abuse. In the case of Nigeria where corruption is pervasive, discretion in this process must be curtailed.[36] If not, it is highly possible that officials may collude with investors so that incentives would be granted to those that may not qualify for them, but who would make money by coming under them. In such situations, the officials would receive their kickbacks, leaving state coffers bereft of revenue that should otherwise be collected.

4.4 Implementing Incentive Conditions[37]

4.4.1 Auditing Companies Under Tax Holiday and The Use of Tax Credits Account

A basic implementation condition is auditing. Entities that enjoy an incentive like a tax holiday must still file tax returns even during the tax holiday. Alex Easson maintains that if no tax return is filed during the holiday period, this may give rise to tax avoidance and abuse, especially if the enterprise is allowed to carry forward losses incurred during the holiday period.[38]

Vito Tanzi & Howell Lee propose that companies enjoying tax holidays should still file tax returns. In their opinion, this will go a long way to help tax authorities to determine with greater certainty the revenue cost of tax incentives.[39] They consider it

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[36] United Nations, *supra* note 1 at 55.

[37] As discussed earlier, Nigeria's situation is more accurately captured by the aphorism, that "necessity is the mother of invention", which speaks to the weakness in enforcement and compliance. On May 24, 2016, the House of Representatives embarked on a probe of $3 billion in tax incentives to multinationals. A Committee on Finance and Public Accounts was instituted with the mandate to revert to the house in a month. The probe also seeks to recover money by serving import duty demand assessment notices running into billions, for indiscriminate use and abuse of waivers granted by the federal government. A lot of atrocities which amount to economic sabotage and flagrant abuse of executive powers were uncovered with respect to handling of incentives. In some cases, companies exceeded quotas granted to them especially for the importation of rice. Some also secured custom duty waiver offer by just donating foodstuffs. See Alex Okoro, "Reps probe $3billion tax incentives to multinationals", *Business Day* (24 May 2016), online: <https://www.orderpaper.ng/reps-probes-3bn-tax-incentives-multinationals/>. Nigeria knows these realities, but there is weak political commitment to address the malaise.

[38] Easson & Zolt, *supra* note 4 at 15.

[39] Vito Tanzi & Howell Zee, *Tax Policy in Developing Countries* (Washington DC: IMF, 2001) at 13.

improper to argue that if no tax is payable during the holiday period, then no formalities are required. The tax credits account provides transparency and certainty to government and the potential investor.[40] It is a hybrid of tax holiday and investment tax credit. When complied with, the cost of the incentive to the host government is known, and it removes any built-in advantage for those investments that make quick profits.[41] Essentially, the tax credit account resembles an investment tax credit because the credit amount is a fixed sum that is not determined by the amount of the investment. Consequently, it does not provide a preference to capital-intensive investments [42] over those that are not, and, therefore, it should be transparently accounted for.

4.4.2 Transparency in granting tax incentives

Transparency seeks to equalize and ensure fairness among incentive beneficiaries. This condition must be observed by the state in its administration of the incentive scheme. Doing this can assume legal and regulatory, economic and administrative dimensions.[43] The legal dimension speaks to the need for tax incentives to have a statutory basis in the relevant tax law. The economic dimension is to the effect that the rationale for granting incentives be clearly set forth in terms of the costs and benefits of a proposed incentive, along with clarity about the assumptions and methodology that inform its determination. The administrative dimension demands that the qualifying criteria must be simple, specific and objective so as to minimize the discretion afforded officials who grant the incentives.[44]

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[40] *Ibid* at 14.
[41] *Ibid* at 13.
[42] Easson & Zolt*, supra* note 4 at 20.
[43] SC Rapu et al, *Fiscal Incentives in Nigeria: Lessons of Experience* (Lagos: CBN, 2013) at 52.
[44] Most scholarly literatures on incentives report that offering incentive in a transparent manner can reduce the risk of corruption.

4.4.3 Set up a Tax Incentive Budget

Another implementation condition the state must assess is goal congruence between tax authorities and the department in charge of foreign direct investment (FDI). Clearly, the deliverable for the department in charge of FDI is to attract foreign investment. Its concern is less in regard to protecting the tax base, and so it tends to hand out incentives without determining whether they are necessary.[45]Alex Easson suggests the need for agreement between tax authorities and these foreign investment agencies on both a target amount and a methodology for determining the revenue costs associated with the incentives.[46]

4.4.4 Undue Emphasis on "large investment"

Again, for the state to impose a dollar threshold for foreign investment can also be distorting, apart from the fact that it crowds out domestic investors because they are highly unlikely to be able to raise the qualifying threshold revenue.[47] The way around this is for an interested investor to alter the source of financing of its investment, or even to inflate the value of the assets it contributes to meet this qualification requirement.[48] Consequently, the project may fail or under-perform for reasons rooted in how this qualifying requirement is satisfied by the investor.

4.4.5 Unrestrained Use of Tax Holidays

Another factor that the state must implement carefully is how investors use tax holidays as an incentive. To protect against abuse, policy-makers could tie tax incentives directly to employment. They could demand the creation of a stipulated number of jobs as a condition for qualifying for the tax holiday or other incentives.[49] In rank, a tax holiday is often viewed as the most expensive incentive, followed by

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[45] Jeffrey Owens and Alessandra Sanelli, *supra* note 33 at 47.
[46] Easson & Zolt, *supra* note 4 at 13.
[47] George Lent, *supra* note 28 at 280.
[48] United Nations, *supra* note 1 at 29.
[49] *Ibid* at 29.

investment allowance and then accelerated depreciation.[50] The appeal of investment allowance and tax credit is that the revenue cost is directly related to the amount of investment, and so their maximum cost is more easily estimated.[51]

Scholars have argued against the reckless use of tax holidays. They concede that granting tax holidays without thinking about the potential profit at stake is unscrupulous. They point out that sometimes investors believe their investment will earn above market returns and, if a tax holiday is still granted for their type of investment, it amounts to a loss of revenue without any benefits to the state.[52] The fact is that investors would still have invested even without a tax incentive in view of the potential of above market returns. But it is also admitted that short tax holidays are not desirable; they are of limited value or interest to potential investors who want to embark on substantial investments in regard to which it will take several years before they break even, and by the time the investment may become profitable, the holiday period is over.[53] For this reason, it is advised that short-term tax holidays are more applicable to highly mobile sectors, such as export–oriented businesses like textiles production, which are expected to show quick profits. The idea is that short-term tax holidays will attract "foot-loose" projects.[54]

4.4.6 No segregation Between Foreign and Domestic Investors

A final factor in considering incentive implementation relates to the place of national or domestic investors. These investors do not have much reason to invest elsewhere, and so it can be argued that only foreign investors need incentives. Therefore, restricting tax incentives to only foreign investors seems justifiable on the ground that

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[50] Tanzi & Zee, *supra* note 39 at 28.
[51] *Ibid* at 26.
[52] Easson & Zolt, *supra* note 4 at 19.
[53] United Nations, *supra* note 1 at 29.
[54] *Ibid* at 16.

it reduces potential revenue loss.[55] The flip side is that it becomes discriminatory. Apart from causing resentment, it can also be ineffective because domestic investors may resort to self-help in the form of "round tripping," that is, they may disguise domestic investment as coming from foreign sources.[56] Obviously, effective implementation of an incentive system must find ways around this problem. Some solutions suggested are that it is better to incentivize all investors or reduce the general taxation rate.[57]

4.5 Ensuring Compliance with Incentive Terms

The creation and implementation of an incentive regime comes full circle with enforcing and monitoring compliance with its requirements. The broad need for monitoring and enforcement is, in this regard, set against paying due regard to the impacts of implementation of the regime on the revenue of other states, especially investor home jurisdictions. The issues here are considered accordingly.

4.5.1 Enforcement and Monitoring

The United Nations particularly points to the need for states to follow up on the firms benefiting from the incentives they offer. It notes that monitoring is particularly weak in developing countries.[58] This means that governments only have data on investment approvals, but they have no grip on the magnitude of actual investment inflows. In other words, foreign investors agree to government dictates in order to obtain investment licenses and incentives, but end up pursuing the approved project as they like,[59] rather than according to the requirements which qualified them for the incentive. Project monitoring is necessary to align this.

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[55] Jeffrey Owens & Alessandra Sanelli, *supra* note 33 at 80
[56] Easson & Zolt, *supra* note 4 at 25.
[57] *Ibid* at 27.
[58] United Nations, *supra* note 1 at 25.
[59] *Ibid* at 25.

4.5.2 Host States Must Consider Tax Regimes of Investor Home Jurisdictions

To determine whether the tax benefits granted to foreign investors are reduced or eliminated by taxes imposed by the investor's country of residence, countries generally tax their corporate taxpayers on their foreign source income under one of two alternatives. First is the credit method whereby corporate taxpayers are taxed on their world-wide income and receive a foreign tax credit against their domestic tax liability for foreign income taxes paid on the foreign source income.[60] Second is the exemption method whereby the corporate taxpayers are generally taxed on only their domestic source income and can exempt certain foreign source income in computing their tax liability.[61] In theory, foreign investors from countries that adopt the credit method are less likely to benefit from tax incentives as the revenue from the favoured activities may be effectively transferred to the investors' revenue service from the tax authorities in the host country.[62]

4.6 Conclusion

The four broad steps discussed in this chapter do, indeed, constitute essential elements for the design and assessment of an effective incentive regime. They ensure that any jurisdiction that employs tax incentives to attract investment to develop its economy and employment prospects must think of what sectors to open up for this operation. As well, the incentive granting process must close opportunities to undermine its proper application through corruption. In implementing the scheme, the state must ensure, among others, that beneficiaries are audited and that no loopholes are left for misrepresenting a qualifying investment. Compliance with the scheme must be ensured not only by requiring clear accounting for the revenue "gained" by the investors as its incentive. As well, the impact on the tax arrangement of the investors'

[60] Kim Brooks, *supra* note 5 at 16.
[61] *Ibid* at 16.
[62] *Ibid*.

home jurisdictions must be carefully rationalized with enforcement of the incentive scheme.

The foregoing considerations lay the ground for assessing the operation of Nigeria's incentive structure and its functioning. Nigeria, like other developing states, has clung to seeking to attract foreign investment by extending an array of incentives in major sectors of its economy. The examination in the next chapter establishes that this tool has, so far, largely caused Nigeria to remain a tax haven. As well, it has not seen the investment it has sought through its tax incentive arrangements.

CHAPTER FIVE

Are Incentives, Corruption, or Poor Monitoring and Enforcement Making Nigeria a Tax Haven?

5.0 Introduction

This chapter discusses the factors that are responsible for making Nigeria a tax haven. The discussion relates to various economic sectors. It explores whether loopholes in tax legislation, corruption, or poor monitoring and enforcement by the federal tax administration and the judiciary, facilitate the advantage taken by corporations to avoid or evade tax liability, contrary to the requirements of relevant legislation.

The chapter reviews the Nigerian tax environment, arguing that Nigeria exhibits some features of a tax haven. Nigerian tax legislation is examined in terms of its enforcement by the judiciary. This is salient because the authoritative interpretation of applicable tax requirements informs the attitude of relevant actors toward their tax liabilities. Following this, the tax incentives program in Nigeria is reviewed in terms of sectoral investment in four sectors that benefit from it, namely, agriculture, export, petroleum and manufacturing. The review considers whether thus far, Nigeria has benefitted from extending tax reliefs to investors. It also assesses how the Nigerian economy has fared in view of the exemptions.

5.1 Globalization and The Nigerian Economy

Nigeria is the largest economy in Africa.[1] The country's population is estimated at 177 million, with an annual growth rate of more than 3 percent.[2] Nigeria has 36 states, a federal capital territory (Abuja) and 774 local government areas. It has three major

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[1] J O Fatoki, "An Empirical Study of Tax Evasion and Tax Avoidance: A Critical Issue in Nigeria Economic Development" (2014) 5:18 J Econ & Sustainable Dev at 1.

[2] OECD, *Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews, Nigeria 2016: Phase 2: Implementation of the Standard in Practice*, Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews (Paris: OECD, 2016) at 5.

sea ports in Lagos, Warri and Port Harcourt, and 11 international airports. Nigeria's main trading partners are the European Union (specifically France, Italy, the Netherlands, Spain and the United Kingdom), the United States, India, the People's Republic of China (China) and Brazil.[3]

The Nigerian economy's large dependence on oil amidst the failure of the state to earn its due take through taxation from that sector has a great adverse impact on its national income.[4] This is more so given that over the last decade, Nigeria experienced remarkable growth in the establishment of multinational enterprises in the oil industry.[5]

Globalization has boosted trade and increased the flow of foreign direct investment into the country. However, this is not without the attendant risk of the impact of cross-border activities on the exercise of Nigeria's right to tax all economic activities within or touching its jurisdiction. In this context, the logical question revolves around the extent to which the relevant tax laws have set the basis for enforcing tax liability, and what role the judiciary has, or has not played to make effective enforcement a reality.

5.2 A Description of Nigerian Tax Legislation

The various Nigerian governments have, over the years, passed several tax statutes to authorize raising of revenue to run the state machinery and to provide social services. The various tax laws in force in Nigeria, contained in the Laws of the Federation of Nigeria (LFN) 2004, include the Capital Gains Tax Act,[6] the Companies Income Tax

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[3] PwC, "Nigeria: Looking Beyond Oil (2016)," online:<https://www.pwc.com/ng/en/assets/pdf/nigeria-looking-beyond-oil-report.pdf>.
[4] *Ibid*.
[5] *Ibi*d.
[6] *Capital Gains Tax Act* Cap 354 LFN 1990. This legislation has witnessed various amendments over the years, the recent one being *Capital Gains Tax Act,* (amendment No 45 of 1999). The rate was reviewed downwards from 20% to 10% effective 1st January 1996 to stimulate activities in the capital market.

Act,[7] the Education Tax Act,[8] the Federal Inland Revenue Act,[9] the Personal Income Tax Act,[10] the Petroleum Profits Tax Act,[11] the Stamp Duties Act,[12] and the Value Added Tax Act.[13] To ensure that this legislation is administered properly, the government has established the Federal Inland Revenue Service, the State Board of Internal Revenue and the Local Government Revenue Committee as the agencies responsible for the administration of tax matters at the federal, state and local government levels respectively.

Like other countries, the Nigerian tax system has a tripartite structure, comprising tax policy, tax legislation and tax administration. Tax policy is the basis for tax laws, while tax administration describes its implementation. Consequently, to have an efficient and effective tax system, appropriate policies must be in place and they must be well implemented.

Taking the legislation in force individually, the following observations are pertinent. First, under the Companies Income Tax Act, 2004,[14] income tax is imposed on all corporations registered in Nigeria, or which derive income from Nigeria. These entities do not include those engaged in petroleum operations. This Act was amended in 2007 to distinguish between a Nigerian company and a foreign company. The profits of a non-resident company or a foreign company are taxable in Nigeria to the extent that they are attributable to operations carried on by a company in Nigeria. Its

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[7] *Companies Income Tax Act* Cap. 60 LFN 1990 Act Cap C21 LFN 2004. The *Companies Income Tax Act* 2007 distinguishes between a Nigerian company and a foreign company. Under it, the profits of a non-resident or a foreign company are taxable in Nigeria to the extent that they are attributable to operations carried on by the company in Nigeria. Its profit is determined and taxed in the same manner as that of a resident company.

[8] *The Education Tax Fund (Amendment No 17) Act*, Cap E4 LFN 2004.The state also gains tax revenue under the Education tax which is charged at the rate of 2% of assessable profit.

[9] *Federal Inland Revenue Service (Establishment) Act No 13,* 2007.

[10] *Personal Income (Amendment) Act,* Cap P8 LFN, 2011.

[11] *Petroleum Profit Tax Act*, LFN 2004, c 13.

[12] *Stamp Duties Act*, LFN 2004, c S8.

[13] *Value Added Tax Act* LFN 2004, c V1.

[14] *Companies Income Tax Act*, 2004 c 21 LFN, 2004.

profit is determined and taxed in the same manner as that of a resident company.[15] The tax rate is 30% and it is applied to the total assessable profit or chargeable profit of the company.

Second, the Federal Inland Revenue Act empowers the Federal Capital Territory (FCT) Internal Revenue Service (FCT IRS) to assess and collect taxes from all persons chargeable with tax in the FCT. This power was historically vested in the Federal Inland Revenue Service (FIRS) by section 2(1) (b) of the Personal Income Tax Act, 2004[16] as amended, and the FIRS (Establishment) Act 2007.[17]

Third, an education tax, under the Education Tax Fund (Amendment) Act, 2003,[18] was introduced in Nigeria in 1993 as a form of social obligation on all companies to support the Nigerian educational system. Education tax is 2% of assessable profit and is treated as an allowable expense of the company.

Fourth, by the Personal Income (Amendment) Act, Cap P8, 2011,[19] personal income tax is imposed on individuals who are either employed or running their own businesses under a business name or partnership. The top marginal rate is 25%. Recent Nigerian tax policy hinged on the need to move away from direct tax to indirect taxes. Overwhelming evidence, however, supports direct taxation because of its sustainable nature and, as well, that shifting away from income taxes is likely to reduce the long-term sustainability of the national revenue stream.[20]

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[15] OECD, *supra* note 2 at 82.
[16] *Personal Income Tax Act*, LFN 2004.
[17] FBIR, Tax *Laws in Nigeria* (Lagos: Princeton, 2011) at 85.
[18] *Ibid* at 87.
[19] *Ibid* at 112.
[20] The consensus among various commentators is that income taxes are less volatile than sales taxes. They also stressed on the need to refocus tax (non-oil tax base) as a sustainable means of government revenue. This is because a volatile tax base (oil revenue) exhibits large unanticipated deviations from trends while a less volatile tax base displays only small deviation. They submit that volatile tax base is uncertain and usually complicates the job of fiscal authority in tax revenue such that knowing the

Fifth, the Petroleum Profit Tax Act, LFN 2004, c 13,[21] imposes tax at a rate of between 50% and 85% of the profits of corporate entities that derive income from oil and gas operations. This Act requires all companies engaged in the extraction and transportation of petroleum products to pay tax. The tax is related to rents, royalties, margins and profit sharing elements associated with oil mining, prospecting and exploration leases.[22]

Sixth, the Capital Gains Tax Act LFN 2004, introduced this type of tax in 1976 at the rate of 20%. This was reduced to 10% from 1st January 1996, to stimulate activities in the Nigerian capital market.[23] It is imposed on capital gains derived from sales or other disposal of chargeable assets.

Seventh, the National Information Technology Development Agency Act (NITDA), authorizes the imposition of a 1% tax on the profit before tax of certain selected corporate entities. They include telecommunication, internet service providers, pension managers, banks, insurance companies and other financial institutions with an annual turnover of 100million Naira (₦) and above.[24]

Eighth, under the Stamp Duties Act, LFN 2004, c S8, stamp duty is raised by requiring stamps sold by government to be affixed to certain designated documents, such as debentures, warrants and conveyance documents.[25] This provision was not actively enforced until 2016, when government has needed to seriously raise money to cover the deficit in the 2016 budget. The rate on stamp duties varies.

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current year's performance provides little indication of what the tax base will do the following year and that such uncertainties lead to unpredictable revenues with the potential risk of large budget gaps.

[20] Ekeocha Patterson et al, "Revenue Implications of Nigeria's Tax System" (2012) 2:8 J Econ & Sustainable Dev 206; Micah Leyira et al, "Taxation Systems in Nigeria- Challenges and the Way Forward", (2012) 3:5 Research J of Fin & Acc at 6.

[21] FBIR, *supra* note 17 at 89.

[22] *Ibid* at 102.

[23] FBIR, *supra* note 17 at 26.

[24] *Ibid* at 26.

[25] Stamp duties Act, LFN 2004, c S8

Ninth and finally, the Value Added Tax Act LFN 2004, c V1, imposes a value added tax (VAT) on the net sales value of taxable goods and services at the rate of 5%, except for those goods specifically exempted. This tax came into effect to replace the repealed sales tax.[26]

The tax legislation in Nigeria is sometimes not properly drafted leaving room for various interpretations.[27] As well, the tax administration process is weak and highly vulnerable to tax avoidance schemes.[28] In essence, the Nigerian tax regime does not operate in any way that may remotely reflect any manifestation of the equity principle of taxation. This is particularly seen in tax legislation enforcement through the courts which, as discussed next, reinforces ineffectiveness in tax administration.

5.3 The Nigerian Judiciary and Tax Enforcement

The Nigerian judicial system has shaped tax policy through the operation of judicial precedent and *stare decisis.* Five cases highlight the impact of the Nigerian judiciary on assessing taxable income. Essentially, these cases show that Nigerian courts are not a strong ally when it comes to enforcing legitimate tax obligations.

The first illustrative case is *Shell Petroleum Development Company of Nigeria* v. *Federal Board of Inland Revenue* (FBIR).[29] In this case, the Supreme Court unanimously allowed an appeal by Shell against FBIR with respect to the treatment of "exchange losses" which Shell claimed as a tax deductible item in computing chargeable tax under the *Petroleum Profits Tax Act*, PPTA. FBIR disallowed the claim. The Supreme Court based its decision on four agreements entered into by Shell and the FBIR between 1967 and 1972, which required the oil company to pay

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[26] Value Added Tax Act, *Tax Laws in Nigeria* (Lagos: Princeton, 2013) at 24.
[27] A M Sani "An appraisal of the legal framework for Taxation in Nigeria" (2015) 34:2 JL Pol'y & Globalization.
[28] Micah Leyira et al, "Taxation Systems in Nigeria- Challenges and the Way Forward" (2012) 3:5 Research J of Fin & Acc at 6.
[29] (1996) 8 Nigerian Weekly Law Reports 256.

tax, in *pound* sterling, into the Central Bank of Nigeria's account in London. The court's decision adversely impacted the efficacy of Nigerian tax law, in particular, as to what constitutes taxable income under PPTA.

In *Marina Nominees Limited* v. *Federal Board of Inland Revenue*,[30] the appellant was a partnership which incorporated a company to perform secretarial functions which it had previously performed. It did this in a bid to reduce its tax burden. When the agent company was faced with assessment for tax purposes, the appellant, as principal, challenged the assessment by claiming that as an agent, the incorporated company was not subject to tax for tasks performed for it. At the Supreme Court, it was held that using an incorporated company for the purpose of performing a task does not obviate the fact that the incorporated company is a separate legal entity which must fulfill its own obligations under the law, including the obligation to pay tax.

The device of incorporating a company was clearly a means to avoid tax, as it would mitigate the tax burden of the partnership. To combat such situations, the provisions of section 19 of the Companies Income Tax Act (CITA) LFN 2004, empower the revenue authority to deem and/or treat the undistributed profit of a company that is controlled by five persons or less as distributed where its distribution will not be detrimental to the company. Again, to the extent that the tax agency would diligently investigate and uncover the use of such tax avoidance devices, it is possible for the state to receive its due in tax entitlement in situations of this nature.

Third, in *Stabilini Visioni Ltd v FBIR,*[31] an appeal was taken against the ruling of the Value Added Tax Tribunal. The question before the appellate court pertained to the

[30] (1986) 2 Nigerian Weekly Law Reports 48.
[31] (2009), TLRN 1.

constitutionality of the provisions of section 20 of the Value Added Tax Act,[32] which established the now defunct Value Added Tax Tribunal. The appellant's claim was that the section radically violates the provisions of section 251 of the Constitution of the Federal Republic of Nigeria, 1999, which vested exclusive jurisdiction in the Federal High Court in matters in which the Federal Government or any of its agents was a party and prayed the court to dismiss the suit on the ground that the Tribunal lacked jurisdiction to hear it. After considering the relevant provisions, the court granted the prayer of the appellant. With regards to the constitutionality of the Value Added Tax Act 1993 and the Tribunal's jurisdiction, it held that the respondent's position was inconsistent with the Constitution and so declared the Act null and void.[33] However, by virtue of the provisions of the Federal Inland Revenue Service (Establishment) Act 2007, which abolished the VAT Tribunal and established the Tax Appeal Tribunal (TAT),[34] the legal quandary in which the VAT Tribunal was placed has been addressed.

The fourth illustrative case is *Lagos State Board of Internal Revenue v Eko Hotels Ltd & Anor.*[35] One of the issues for determination was whether the judge of the Federal High Court was right when he held that the Value Added Tax (VAT) imposed by Lagos State was unconstitutional, and that Eko Hotels Ltd is a remitting agent to only the Federal Board of Inland Revenue in respect of tax on sales to its customers, and that it would amount to double taxation to require the Respondent to yield to the demands of both the Federal Board of Inland Revenue and the Lagos State Board of Internal Revenue. The core of the court's decision was that VAT and sales tax are the

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[32] Value Added Tax Act LFN 2004, c VI.

[33] *Stabilini Visioni Ltd v FBIR, supra* note 31 at 22-23

[34] This is pursuant to *Federal Inland Revenue Service (Establishment) Act* (FIRSEA), s 59 which established the Tax Appeal Tribunal (TAT) with powers to settle disputes between the tax authorities and taxpayers in Nigeria.

[35] (2008) All FWLR (pt. 398) 235.

same. VAT is ordinarily a national tax on sales of goods and services. With reference to whether the provisions of the VAT Act and Sales Tax Law create double taxation, the court held in the affirmative. It reasoned that the actual burden of the VAT/Sales tax falls on the consumer and the tax is charged on similar consumable items as defined in the schedules of both the VAT Act and the Lagos State Sales Law.

Value Added Tax is neither on the Exclusive nor Concurrent Legislative Lists contained in the Second Schedule to the 1999 Constitution. This means that VAT is a residual matter. The import of this decision on the Nigerian tax system is that while the House of Assembly of a State may legislate in the residual field, where the National Assembly has already legislated on an item, the law passed by the House Assembly is null and void because the "field" in question has already been "covered."[36]

Finally, in *Haliburton (WA) Limited* vs. *Federal Board of Inland Revenue* [2009],[37] the extent of the powers of the Federal Board of Inland Revenue was put to test. An additional assessment arose from contract transactions between the respondent, Haliburton (WA) Limited, a non-resident company incorporated in the Cayman Islands, and its affiliate operating in Nigeria under the entity called Haliburton Energy Services Nigeria Limited (HESNL). It was agreed between the respondent and HESNL that the respondent would obtain contracts from third parties in Nigeria for execution by HESNL, with billing for the contract made in United States dollars (USD). It was the income in USD derived by the respondent from the service rendered by HESNL to third parties that the appellant, Nigeria's Federal Board of

[36] Section 4(5) of the *Constitution of the Federal Republic of Nigeria* provides that "If any law enacted by the House of Assembly of a State is inconsistent with any law validly made by the National Assembly, the law made by the National Assembly shall prevail, and that other law shall to the extent of the inconsistency be void.

[37] Nigerian Tax Cases 1 at 433.

Inland Revenue (FBIR) taxed additionally in 2002 to the tune of US$6,972,248 for the years 1996 – 1999. This brought the dispute to the Federal Court of Appeal.

The appeal rested on the fact that the appellant, the Federal Board of Inland Revenue (FBIR), made the additional assessment for the 1996-1999 tax years. The respondent sought to set aside the judgement and for a declaration that the said additional assessment was invalid, null and void, and to direct the appellant to refund the sum with interest.

In resolving the dispute, the court held that the working arrangement between the appellant and HESNL was illegal in that the division of the contract sum between the respondent and HESNL on turnover was not incorporated in the main contract between all the parties to that contract. This is because the foreign company, though not registered in Nigeria, is deemed to have generated income in Nigeria by the transaction done in Nigeria. The tax authority was concerned, essentially, with and targeted only the income made or deemed to be made on Nigerian soil from any transaction conducted within Nigeria, as was the case here.

Utilizing the concept of legitimate expectation,[38] the respondent found substantive grounds to argue that the impact of the clear words of section 26 of the Companies Income Tax Act (CITA)[39] is to override all other provisions of CITA. Specifically, that Section 26 of CITA overrides other provisions by virtue of the phrase ‘’notwithstanding any other provisions of this Act’’ used in the opening and closing parts of the section.

[38] The doctrine of legitimate expectation is based on the idea of fairness, certainty and equality in the conduct of public affairs by ensuring that public authorities should not alter abruptly existing policies to the detriment of the legitimate expectation of members of the public who had arranged their affairs in accordance with the existing policy. Relating to the case in question, the cross appellant argues that the assessment of the additional income breaches the certainty of tax principle.
[39] Companies Income Tax Act, *supra* note 14.

The court concluded that since HESNL is a subsidiary or an affiliate of the respondent, by making the additional assessment to tax on the undeclared income of the respondent, which was subsequently discovered by the appellant in the course of an audit, the appellant cannot be accused of revisiting or taxing over again the initial declared income that was taxed earlier, as to amount to double taxation. It was agreed that what the appellant assessed to tax was the income omitted to be declared to the appellant by the respondent in the original assessment submitted by the respondent. In the absence of full disclosure by the cross appellant in the first exercise, the cross appellant cannot benefit from the doctrine of legitimate expectation which is rooted in utmost good faith on the part of stakeholders, in this case, the appellants.

This case raises a glimmer of hope that some Nigerian judges are bold enough to check tax avoidance. The court's treatment of the matter raises the issue of interpretation of tax laws: whether they should be construed narrowly or strictly. The attitude of the Nigerian courts is that one has to look merely at what is clearly said, and that there is no room for any analysis based on intention or purpose. There is no equity about a tax nor any presumption about it. Nothing is to be read in and nothing is to be implied; one can only look fairly at the language used. This literal view may, in the end, not help the state achieve its tax policy objectives, and, therefore, may not be helpful in the fight against tax avoidance in Nigeria. It also raises other challenges when Nigeria's economy is considered within the global context, including the challenge to fashion a global tax regime to curb, among others, tax avoidance.

In summary, the most forceful observation that can be made is that while they uphold the law, the Nigerian courts do not seem to appreciate the ultimate objective of tax legislation. Nor do they demonstrate an appreciation for the skillfulness of tax avoiders, including their determination to utilize the courts to interpret extant tax rules to favour their tax liability preferences.[40] The various tax authorities themselves do not measure up in all key indicators and performance outcomes, including efficiency of tax administration, accountability and transparency, robust taxpayer base, ease of filing and tax payments, quality of reporting and dispute resolution.[41] Though the world has changed and Nigeria has, so far, enjoyed almost 19 years of unbroken democratic governance, the tax laws and their administration system have largely remained unchanged. Laws in effect date back to the period of military rule,[42] except for the 1999 Constitution.[43] Laws have been amended on a yearly basis in conjunction with the annual budget to correct loopholes, but this has given rise to contention in tax dispute adjudication.[44]

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[40] In Canada, the literal meaning approach, the principles of which are that a tax statute is to receive a strict or literal meaning; a transaction is to be judged not by its economic or commercial substance but by its legal form; that a transaction is effective for tax purpose even if it has no business purpose and that taxpayers are entitled to arrange their affairs to minimize their tax liability was in place until the landmark case of *Stubart Investment Ltd v MNR* [1984] CTC 294, 84 DTC 6305 SCC. The court in this case employed a purposive interpretation hoping it will "reduce the attraction of elaborate and intricate tax avoidance plans and reduce the rewards to those best able to afford the services of the tax technicians" as well as "reduce the actions and reactions endlessly produced by complex, specific tax measures aimed at sophisticated business practices and the inevitable, professionally guided and equally specialized taxpayer reaction. Even the adoption of a plain meaning approach may result in interpretation that contradicts fundamental principles of tax law of symmetry and inclusiveness. Also, this shift to plain meaning approach was accompanied by the recognition of "legal" substance and rejection of "economic" substance. Canada moved away from the plain meaning and adopted the contextual, and purposive Interpretation approach in (*Canada Trustco Mortgage Co. v. Canada* [2005] 2 SCR 601; *Mathew v. Canada* [2005] SCJ No 55, *Placer Dome Canada Ltd v. Ontario* (*Minister of Finance)* [2006] 1 SCR 715 and *Imperial Oil v. Canada* [2006] 2 SCR 447). However, the *Stubart Investment Ltd v MNR* [1984] 1 SCR 536 case signaled a clear departure to a more purposive interpretation of the Act, even though its final outcome still did not reflect the "object and spirit" of the law because nothing in the Act empowered the Minister to disregard the legal consequence of the taxpayer's arrangement. See also *Canada v. Antosko[1994]2 SCR 312; Shell Canada Ltd v. Canada [1999]3 SCR 662; Singleton V Canada [1993]* 3 SCR 622. The Antosko case is the first post-*Stubart* case. In this case the Supreme Court of Canada limited the relevance of legislative purpose or intent to instances where the legislative provision is ambiguous and so saw no need in going beyond the plain meaning. This implied that the plain meaning approach fared no better that the strict or literal meaning approach.

[41] Micah Leyira et al, *supra* note 28 at 5.

[42] Nigeria has cumulative of 29 years of democratic rule and 28 years of military rule since independence in 1960. However, Nigeria only has a continuous 18 years of democracy since 1999 to date with four successful general elections.

[43] *Constitution of the Federal Republic of Nigeria (as amended), Law of the Federation of Nigeria 1999.*

[44] Michael Carnahan, "Taxation Challenges in Developing Countries" (2015) 2:1 Asian Pac L & Pol'y J 169 at 172.

Given the ineffectiveness of the enforcement of tax laws, the question arises whether Nigeria utilizes other tools to push for realizing the objectives it seeks to achieve through tax administration.

5.4 Other Elements of Tax Policy

Over the years, Nigeria's governments have resorted to various fiscal commissions and study groups to fine tune the tax and fiscal regime. It is safe to say that the determination of the current Nigerian government to curtail tax avoidance (and general corruption) is partly shaped by the cumulative impact of the studies and commission reports.

Another instrument of tax policy is the budget. This tool is used to indicate the policy direction of the government with the endorsement of the legislature via its passage of the budget bill into law in the form of an Appropriation Act.[45] Needless to point out, the government expresses the need and intention to curb tax avoidance through this Act.

It must be highlighted that the various income tax laws have always contained provisions enabling the government to enter into treaties and/or agreements with foreign governments/entities, and to make regulations necessary to give effect to the treaties and/or agreements. The considerations for entering into a treaty relationship are determined by the general economic objectives of the state. Since Nigeria has always desired to attract foreign investment, it seeks to remove restrictions and disincentives to business. As discussed in chapter three, one major policy instrument in this regard is avoidance of double taxation agreements (ADTAs).[46] ADTAs are

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[45] Constitution of the Federal Republic of Nigeria*, supra* note 43.

[46] See list of Double taxation treaties to date. Online at Nigeria, Federal Inland Revenue Service "Tax Treaties'' (Abuja: Office of the Director, Tax Policy & Legislation Department, 2016), online: < www.firs.gov.ng/Tax-Management/Pages/Tax-Treaties.aspx>.

reciprocal arrangements where two countries agree to relieve or reduce the tax liability of individuals or companies, so long as there is some connection between the incomes in each of the countries.[47] In theory, ADTAs foster and encourage international trade and commerce because they are geared toward reducing the cost of doing business across state borders.

During the colonial era, a number of these agreements were concluded on behalf of Nigeria by Britain, with such countries as Ghana (1950), Sierra Leone (1950), the Gambia (1950), New Zealand (1951), Sweden (1954), Demark (1955) and Norway (1956). All these agreements were repealed by the Federal Military Government on 25 April 1978.[48] From 1977 to 2013, Nigeria had comprehensive avoidance of double taxation agreements in force with the United Kingdom, France, the Netherlands, Belgium, Canada, Pakistan, Romania, South Africa, Philippines, Czech Republic (now called Czechia), Slovakia and China, and an air and shipping only agreement with Italy.[49]

Again, the collective utilization of these policy tools has not necessarily made Nigeria a jurisdiction conscientious about enforcing its tax rules and maximizing its tax revenue. This is why it is necessary to assess if Nigeria is a jurisdiction that allows tax evaders and avoiders to operate comfortably.

5.5 The Concept of a Tax Haven

The assessment whether Nigeria is a tax haven must be calibrated against what such a jurisdiction is, conceptually, their types, and how they may be identified. Following

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[47] OECD, *supra* note 2 at 32.
[48] B Ochei, *The Nigerian Taxman's Book* (Lagos: Pyramid, 2010) at 312.
[49] Nigeria, Federal Inland Revenue Service, "Tax Treaties'' (Abuja: Office of the Director, Tax Policy & Legislation Department, 2016), online: <www.firs.gov.ng/Tax-Management/Pages/Tax-Treaties.aspx>.

this, an assessment of Nigeria's incentive scheme under which its tax haven status emerges, is undertaken in section 5.6 onwards.

A tax haven is a country that offers foreign individuals and businesses little or no tax liability in a politically and economically stable environment. Tax havens also provide little or no financial information to foreign tax authorities. Individuals and businesses that do not reside in a tax haven can take advantage of these countries' tax regimes to avoid paying taxes in their home countries. Tax havens do not require that an individual reside in, or a business operate out of that country to benefit from its tax policies.[50]

Tax havens are sometimes called tax shelters, secrecy jurisdictions, international financial centres, or simply offshore financial centres (OFCs)**.** It may also refer to a state, country, or territory which maintains a system of financial secrecy that enables foreign individuals to hide assets or income to avoid or reduce taxes in the home jurisdiction.[51]A key feature of tax havens is that they have very strong domestic bank secrecy laws that prevent bank details from being disclosed unless they relate to criminal activity.[52] It is for this reason that many non-resident taxpayers feel confident about moving capital and investments to tax havens.

Many developed economies[53] provide special tax concessions that, in many instances, are not transparent, in order to encourage investment. In some instances, the tax concessions are similar to those offered by tax havens and OFCs. The extent of tax

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[50] OECD Website, online: <http://www.oecd.org/>.

[51] *Ibid*.

[52] Unless it relates to criminal activity, some secrecy laws are overly protective under the guise that they do not encourage "fishing expedition".

[53] Gaetan Nicodeme, "On Recent Developments in Fighting Harmful Tax Practices" (2009) 62:4 Nat'l Tax J at 756.

hypocrisy[54] in the developed world arguably provides tax havens and OFCs with more than sufficient ammunition to counter any actions to force them out of business by the OECD or the G20. Even Transparency International alluded to the fact that the United Kingdom's record was mixed, and concrete action was needed on tax evasion and secrecy in the wake of the Panama Papers disclosures.[55] It also says that there is a need to stop tainted firms from bidding for public contracts and to protect the whistleblowers who expose corruption.[56]

5.5.1 Forms of Tax Havens

Tax havens take a variety of forms. According to Kudrle and Eden,[57] there are four types. The first, a 'production haven', is a jurisdiction that grants a tax holiday to foreign production facilities located there, but still levies an income tax on domestic corporations and individual residents. Foreign investors are encouraged to produce

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[54]The Anti- Corruption Summit, "Tackling Corruption Together'', in May 2016 in London was an eye opener as to the level of hypocrisy in the battle over corruption and tax hypocrisy. The summit was overshadowed by the truthful gaffe by the then British Prime Minister, David Cameron, in which he called Nigeria and Afghanistan "fantastically corrupt" nations. He said this in a conversation with the Queen about the week's anti-corruption summit in London. See "David Cameron calls Nigeria and Afghanistan Fantastically Corrupt", *BBC News* (10 May 2016), online:<http://www.bbc.com/news/uk-politics-36260193>; Nigeria was also ranked 136 out of 167 countries in Transparency International's 2015 "Corruption Perception Index" countries. See the Index online: <https://www.transparency.org/cpi2015>. Furthermore, there was accusatory trade-off between the US and the UK on the part they played in the fight against corruption and tax havens. The Anti-corruption watchdog, Transparency International, criticized Mr. Cameron's comments, accusing the UK of being part of the problem by "providing a safe haven for corrupt assets" at home and in its overseas territories, and challenged the British government to close Britain's constellation of tax havens which together constitute the largest financial secrecy network in the world. This concern was also echoed by Allan Bell, Chief Minister of the Isle of Man, which has signed up to information sharing, but maintained that there would be no real progress unless the United States made its own tax havens, such as Delaware, more transparent.

[55] The Panama Papers is an unprecedented leak of the secrets of the world's rich and famous, who use offshore companies to hide assets. Current and former world leaders, prominent politicians, celebrities and public officials from around the world were implicated. This scandal forced the Prime Minister of Iceland to resign, as his wife was exposed to own an offshore company used to hold bonds of major Icelandic banks. These findings and many others emerge from millions of secret files obtained by the International Consortium of Investigative Journalists, German newspaper Süddeutsche Zeitung and more than 100 other news organizations, online: <http://panamapapers.icij.org>.

[56] This decision is also helpful for the Nigerian government to dissociate itself by disqualifying companies that are not tax compliant from bidding or getting any government business. In the same vein, going by the leaks since the beginning of the Whistle blowing policy, the government is advised to protect the identity of the whistle-blowers who expose corruption.

[57] Robert T Kurdle & Lorraine Eden,"The Campaign Against Tax Havens: Will it Last? Will it Work?'' (2003) 9 Stan JL Bus & Fin at 67.

goods or services because of the low taxes and tax concessions offered by the host country. Ireland was considered a 'production haven', as many multi-national companies set up operations there because of its tax regime.[58] Singapore also offers very generous tax concessions for businesses to set up production facilities or service companies.[59] Other countries with generous production concessions include India, Indonesia, China, Brazil, Argentina, Mexico, Poland and Thailand.[60]

The second category is a 'headquarters haven,' where companies are encouraged to incorporate, even if shareholding is located elsewhere. Singapore and Belgium are examples of headquarters havens. The third and most contentious category is the 'sham haven'[61] where the host country imposes little or no income tax on profits generated by the foreign investor. The offshore financial centre located in the sham haven provides banking and insurance products for the foreign entity.[62] The best examples of 'sham havens' are the Pacific tax havens, such as Vanuatu, and the Caribbean tax havens, such as Bermuda and the Cayman Islands.[63] The fourth category is a 'secrecy haven' which ensures that details of monetary transactions are kept secret from the taxpayer's home country. The best examples of a 'secrecy haven' are Switzerland, Luxembourg, Austria and Singapore. In these countries, tax rates are not as important as the ability to hide investments.[64]

The OECD has expressed concern with its member countries that have harmful preferential tax practices with the goal to attract investment and other 'financial and

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[58] In the same vein, historically, tax concessions in the form of long term exemptions and the non-restriction of foreign payments and capital transfers played a major role in the economic development of Panama despite its small market.
[59] United Nations Conference on Trade and Development, *Tax Incentives and Foreign Direct Investment: A Global Survey* (New York: UN, 2000) at 103.
[60] *Ibid* at 128.
[61] The traditional offshore tax haven has no income tax and sometimes no significant tax at all.
[62] OECD, *supra* note 2 at 27.
[63] *Ibid* at 32.
[64] *Ibid* at 35.

geographically mobile activities.'[65] One specific area that the OECD is concerned about is when a country 'ring fences' its own residents from taking advantage of taxation benefits that are only offered to foreign investors that are non-residents. They are excluded from these benefits by a 'ring fence' and so, by definition, is a tax haven according to the OECD guidelines.[66]

The OECD claims that preferential tax regimes harm 'global welfare'.[67] Littlewood argues there is no supporting evidence for this claim, particularly in terms of preferential tax regimes. He contends that the only beneficiaries are the G7 countries' treasuries, while developing countries lose investment capital if they comply with the OECD guidelines on this matter.[68]

5.5.2 Identification of Tax Havens: The 1998 OECD Report[69]

As discussed in chapter three, the 1998 OECD Report identifies two distinct jurisdictions that threaten the tax bases of the OECD member states. They are tax havens and countries that have harmful preferential tax regimes but are not tax havens. These states may or may not belong to the OECD. However, it is of note that some members of the OECD offer preferential tax treatments to attract investment capital and other financial service activities, such as Switzerland.

The OECD Report finds it unsatisfactory that some states may impose tax at higher than normal rates on some income, but no tax on other forms of income.[70] The progress report issued by the OECD in June 2000 lists 35 countries considered to be tax havens, and identified 47 potentially harmful preferential tax regimes in OECD

[65] OECD, *Harmful Tax Competition: An Emerging Global Issue* (Paris: OECD, 1998) at 23.
[66] *Ibid* at 26.
[67] *Ibid* at 27.
[68] *Ibid* at 27.
[69] This report had the list of countries whose taxation regime was considered preferential.
[70] *Ibid* at 15.

member countries.[71] By 2008, only three countries on the original list of 35 had not committed to the OECD to effectively exchange information. The three are Liechtenstein, Monaco and Andorra.[72] However, as at 17 April 2009, all three had pledged to enter into exchange of information agreements. This allowed the OECD to gain cooperation from all the countries named on the 'black list' in the 2000 progress report.[73]

In light of the foregoing, the question now is whether the role of incentive programs and their operation in Nigeria makes it a tax haven. For this purpose, some of Nigeria's popular incentives are reviewed to see the extent to which they exhibit features of a tax haven.

5.6 Role of Incentive Programs in Economic Development in Nigeria

The need for foreign direct investment has always hinged on the expectation of "a package of cheap capital, advanced technology, superior knowledge of foreign markets for final products and capital goods, immediate inputs and raw materials,"[74] inflow of investment capital and the needed revenue to acquire technical skills. To appraise Nigeria's experience in the operation of its investment incentive laws requires analyzing records of businesses formed under the scheme, the number of projects approved in its various industries, size of employment generated, and amount of capital involved. As discussed in chapter two, it is necessary to substantiate the role played by the incentives and to make a conclusion as to their effectiveness. The analysis is undertaken against the criteria of relevance, effectiveness and efficiency.

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71 *Ibid* at 3.
72 OECD website, online: <http://www.oecd.org/>.
73 *Ibid*.
74 United Nations, *supra* note 59 at 11.

As earlier discussed, a detailed assessment of tax expenditures (TEs) should consider tax incentives' effectiveness, distributional effect, and compliance and administrative costs in relation to possible policy options that could attain the same social and economic goals.[75] Thus, assuming that some investors are sensitive to tax incentives, it is only proper to estimate the benefits associated with attracting such firms against the cost of the tax holiday programs offered to them. How do these considerations find expression under the Nigerian regime?

5.7 Tax Incentives and Foreign Direct Investment in Nigeria

Investment in Nigeria is regulated by the Nigerian Investment Promotion Commission.[76] It serves as the regulatory agency for foreign investors operating in the country as partners with the Nigerian Government and people to develop the Nigerian economy.

The Minister of Finance and of Industry and Commerce has the authority to examine and approve new investment projects.[77] This relationship is intended to be reciprocal, not exploitative. The Nigerian Government guarantees security of investment to encourage investors to discharge their obligations in regard to taxation and corporate social responsibility, among others.[78]

Consequently, tax incentives are used to attract, retain or increase investment in particular sectors to stimulate growth in those areas and to assist companies and individuals as they set up businesses. In other words, the wisdom of the incentive regime is to bring about general growth and development across identified sectors and the economy at large.

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75 Ireland, Department of Finance, "Report on Tax Expenditure with Guidelines: Incorporating Department of Finance Guidelines for Tax Expenditure", (October 2014), online:< http://www.budget.gov.ie> at 92.
76 NIPC Website http://www.nipc.gov.ng/.
77 *Ibid*.
78 *Ibid*.

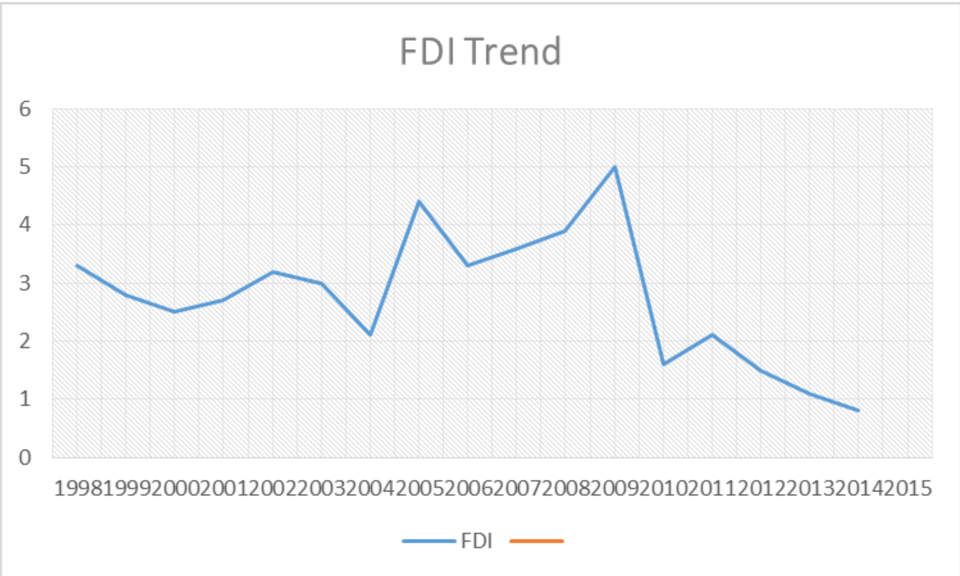
Though the general belief is that tax incentives are desirable to increase foreign direct investment, the empirical evidence below that measures the relationship between foreign direct investment and the GDP of Nigeria shows that incentives are not as valuable to increased investment as they are said to be. The data for discussion are presented in the graphical table and graph below.

Table 1: Evaluation of FDI in Nigeria in relation to GDP from 1998- 2015 (US$ million)

Year	1998	1999	2000	2001	2002	2003	2004	2005	2006
FDI	3.3	2.8	2.5	2.7	3.2	3.0	2.1	4.4	3.3
GDP	32.0	35.9	46.3	44.1	59.1	67.6	87.8	112.2	145.4
Year	2007	2008	2009	2010	2011	2012	2013	2014	2015
FDI	3.6	3.9	5.0	1.6	2.1	1.5	1.1	0.8	0.6
GDP	166.4	208.1	169.5	369.1	411.7	460.9	515.0	568.5	481.0

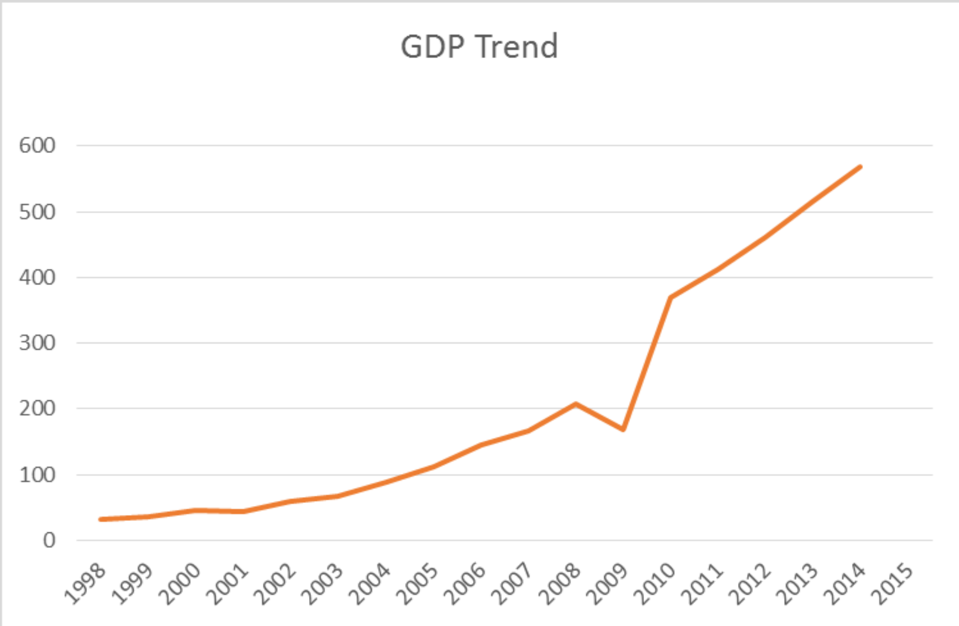
Source: World Bank data catalog: online at datacatalog.worldbank.org

Chart 1: Graph depicting FDI trend in Nigeria in relation to GDP from 1998- 2015



Source: World Bank data catalog: online at datacatalog.worldbank.org

Graph 2: Graph showing GDP trend with no correlation to FDI from 1998- 2015



Source: World Bank data catalog: online at datacatalog.worldbank.org

The above graphical presentation shows that despite the presence of incentives for all the periods[79] indicated, FDI tends to decline in the year leading to an election and in this instance for 1998, 2002, 2006, 2010, and 2014, due to heightened fear of electoral violence. This points to political turmoil, insecurity, and the uncertainties which characterize a typical election year in Nigeria. It is also a reflection of the uncertainty in government policies with the coming of a new administration. A typical fear is that of expropriation of investment under a new regime. From the foregoing, it can be safely concluded that incentives are not the main stimulus for FDI inflow into Nigeria. The urgent message, however, is that Nigeria must work harder on its "investment climate"[80] by, for example, tackling pervasive corruption, inadequate power supply

[79] At a Presidential policy dialogue held on August 11, 2016, organised by the Lagos Chamber of Commerce and Industry (LCCI) the Vice President of Nigeria, Professor Yemi Osinbajo, reported that foreign portfolio crashed by 86%.

[80] OECD, "Taxation revenues as a motor for sustainable development" in *Development Co-operation Report 2014: Mobilizing Resources for Sustainable Development* (Paris: OECD, 2014) at 68.

and transportation infrastructure, high energy costs, an inconsistent regulatory and legal environment, insecurity and a slow and ineffective judicial system.

The foregoing result must, however, be buttressed by a discussion of the incentives regime on its own terms.

5.8 Appraisal of Tax Incentive Programs

Before an incentive program is rolled out, there must be criteria which should influence the industries and products to be promoted by means of tax benefits. The nature and scope of the tax benefits granted, including the time for which they should be granted, must be known with certainty. There must also be a mechanism in place to administer the program, whether on a quasi-automatic qualifying or on a discretionary basis.[81] Again, the effect and influence of the administrative style for attracting new industries should be analyzed, and controls should be established to monitor the approved companies and sanctions to be applied to ensure compliance with the terms of the contract.[82] The success of these incentives in attracting the desired new investments in terms of cost and revenue foregone should be compared to establish the benefit received. Finally, the nature and structure of the benefits that appear to be most attractive must be determined.[83]

As noted earlier, a holistic appraisal can only be undertaken based on the record of new businesses formed, including the number of projects approved in the different industries. Also, data must include the amount of capital invested, the size of domestic employment created, payroll and other relevant data. The appraisal must be ex-post in order to determine how successful the plan is in attracting foreign capital. Though

[81] Alex Easson & Eric Zolt, *Tax Incentives* (Washington D.C: World Bank, 2003) at 33.
[82] George E Lent, *Incentive for Investment in Developing Countries* (London: Palgrave Macmillan, 1976) at 288.
[83] United Nations, *supra* note 59 at 15.

difficult, the cost of the fiscal incentives to government in relation to the benefits received must also be determined notwithstanding that, in reality, this might be difficult to do because of the varying degrees of the risk involved in most new ventures.[84]

It is also important to determine the influence that methods of administering the incentives have on attracting them. As well, the nature and structure of the benefits that appear to be most attractive must be understood.[85] Since it is impossible to determine exactly by how much tax benefits actually exceeded the amount necessary to induce a business, knowing the quantum of benefits to be granted cannot be exactly done. More so since the value at stake is not even accounted for by the tax concessions granted for investments that would nonetheless, have been made.[86]

5.9 Tax Incentives Program in Nigeria: An Appraisal

In concrete terms, the theoretical expectation is that the operation of the incentives system should be sensitive to the circumstances of the economy; the competence of tax administration; the type of investment being encouraged and the budgetary constraints of the government.[87] In terms of outcome, an effective and efficient incentive should stimulate investment in the desired sector or location, with occasional minimal revenue leakage, and must provide minimal opportunities for tax planning. It must also be transparent and easy to understand, and must have specific policy goals.[88]

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[84] George Lent, *supra* note 82 at 301.
[85] *Ibid* at 291.
[86] *Ibid* at 308.
[87] United Nations, *supra* note 59 at 12.
[88] *Ibid* at 22.

5.9.1 Tax Incentives and the Nigerian Investment Promotion Commission

The Nigerian Investment Promotion Commission (NIPC) is the Federal Government Agency established by the NIPC Act N0. 16 of 1995 to promote, co-ordinate and monitor all investments in Nigeria. The One Stop Investment Centre (OSIC)[89] coordinates and streamlines the processing and issuance of necessary business entry requirements by simplifying, shortening and clarifying administrative and regulatory requirements for entry into the economy. The Centre provides statistical data and information on the Nigerian economy, investment climate, legal and regulatory framework, as well as sector and industry specific information to aid existing and prospective investors in making informed business decisions.[90]

The Nigerian Government has put in place a number of investment incentives for the stimulation of private sector investment from within and outside the country. While some of these incentives cover both private and public sectors, others are limited to some specific sectors. The nature and application of these incentives have been considerably simplified as identified and discussed below.

The incentives are now applied in virtually all sectors of the economy, namely, industry, agriculture, manufacturing, petroleum, solid minerals, energy, tourism and several others. Even though the basic forms of tax incentives are financial, fiscal and regulatory,[91] Nigeria prefers fiscal incentives because they are easily affordable to promote investment, and do not require upfront use of government funds.[92] The regulatory incentives take the form of concessions, exemptions from labour or

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[89] NIPC Website, online:<http://www.nipc.gov.ng/>.
[90] *Ibid*.
[91] S C Rapu et al, *Fiscal Incentives in Nigeria: Lessons of Experience* (Lagos: CBN, 2013) at 1.
[92] United Nations, *supra* note 59 at 12.

environmental standards, and subsidized infrastructure. [93] The incentives can be sub-divided into general and sector-specific ones.

5.9.2 General Incentives

General incentives are those available to all organizations irrespective of their sector. They include pioneer status tax holiday, capital allowance and various forms of investment allowances. For the purpose of this thesis, I focus on pioneer status tax holiday.

5.9.2.1 Pioneer Status Tax holiday

The pioneer status incentive is administered by the NIPC in collaboration with the Industrial Inspectorate Department of the Federal Ministry of Industry Trade, and Investment (FMITI), and the Federal Inland Revenue Service (FIRS). It is a tax holiday granted to qualified or (eligible) industries anywhere in the Nigerian federation. It can be extended for a period between 3-5years and up to 7 years in respect of industries located in economically disadvantaged local government areas of Nigeria. To qualify, a joint venture company or a wholly foreign-owned company must have a minimum share capital of 10 million Naira and must have incurred a capital expenditure of not less than five million Naira. A qualified indigenous company should have not less than N150, 000.00 in share capital. In addition, an application in respect of pioneer status must be submitted within one year of the applicant company starting commercial production; otherwise the application will be time-barred.[94]

A pioneer status incentive is granted to companies in industries that are deemed not operated on a scale suitable to Nigeria's economic requirements. It is in the public interest to exclude them from payment of taxes in their formative years. However, the

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[93] Rapu, *supra* note 91 at 15.
[94] NIPC Website, online: <http://www.nipc.gov.ng/>.

profit so generated is expected to be ploughed back into the business.[95] The status is granted to a firm that qualifies in a list of pioneer industries approved by the President.[96] This list is reviewed periodically.[97] During the pioneer status holiday period, dividends are tax free, and losses and capital allowance incurred on assets can be carried forward.[98]

Nigeria grants a tax holiday between 3 to 5 years. This comprises an initial period of 3 years plus the possibility of renewal for another two years.[99] In reality, the NIPC, for over a decade, granted tax holiday to successful applicants for a straight period of 5 years. It was only recently that it decided to revert to the three-year rule.[100] The length of the holiday depends on the region of the country in which the investment is made. Another factor is the class of industry and degree of the investment.[101]

5.9.2.2 Accessing Pioneer Status in Nigeria

The NIPC is interested in the value addition which can be brought in through utilization of local raw materials, products, and services, in order to stimulate the growth of indigenous capacity, employment generation with evidence for capacity building, transfer of technology, and ability to develop local know-how for indigenous employees to boost entrepreneurship and investment in the economy. On top of these, an applicant must have a corporate social responsibility policy statement which must show intended contribution to sustainable development in the immediate community in which the investment is located.[102] The commitment must be in areas such as provision of portable water, roads, and schools. As well, the investment must

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[95] United Nations, *supra* note 59 at 12. In the case of China, the expectation is that investors will reciprocate the grant of 40percent tax refund by reinvesting the profit for at least 5years.
[96] NIPC Website, online:<http://www.nipc.gov.ng/>.
[97] It was reviewed in 2017.
[98] Rapu, *supra* note 91 at 28.
[99] NIPC Website, online:<http://www.nipc.gov.ng/>.
[100] *Ibid.*
[101] *Ibid.*
[102] NIPC Website http://www.nipc.gov.ng/.

show an export potential to complement foreign exchange inflow into the Nigerian economy.[103]

Without a doubt, there is an abundance of these incentives directed at various industry sectors. For purposes of this thesis, l examine two (2) of the sectoral incentives in the agricultural and the manufacturing sectors.

5.9.3 Sectoral Incentives

These incentives are designed for specific sectors, and virtually every sector of economic activity has some form of them. For instance, in 1999, the tourism sector was accorded the preferred sector status in preparation for the FIFA World Youth Championship hosted by Nigeria. This qualified the tourism sector for tax holidays and soft loans with longer moratorium periods. In the telecommunication sector, installation of telecommunications related equipment is considered a pioneering activity, and so enjoys 3 to 5 years' tax holiday in addition to other non-fiscal incentives.[104] Likewise, in the transport sector, investment in shipbuilding, repairs and maintenance of vessels, boats and barges are considered as pioneer activities and so enjoy 3 to 5 years' tax holiday depending on their location.[105]

5.9.3.1 Agricultural Sector

Companies in the agro-allied business in Nigeria do not have restrictions imposed on their capital allowance. It is granted in full, i.e., 100%. The payments of minimum tax by companies that make small or no profits at all do not apply to agro-allied businesses.[106] Agro-allied plant and equipment enjoy enhanced capital allowances of

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[103] *Ibid.*
[104] Rapu, *supra* note 91 at 34.
[105] NIPC Website, online:<http://www.nipc.gov.ng/.>.
[106] *Ibid*.

up to 50%.[107] In addition, the processing of agricultural produce is regarded as a pioneer industry; consequently, it enjoys 100% tax-free period for 5 years.[108]

Agricultural and agro-allied machinery also enjoy 1% duty on their machinery and equipment. They are also supported by the Central Bank of Nigeria through the Agricultural Credit Guarantee Scheme Fund (ACGSF) with up to 75% guarantee for all loans relating to agricultural production and processing granted to the sector by Nigerian commercial banks.[109] Furthermore, there is, under the Interest Drawback Program Fund, a further benefit in the form of a 60% repayment of interest paid by entities that borrow from banks under the ACGSF, for the purpose of cassava production and processing, provided such borrowers repay their loans on schedule.[110]

5.9.3.2 Manufacturing Sector

This sector comprises those industries involved in adding value to raw materials and turning them into products.[111] The expectation is that the manufacturing activities will contribute to Nigeria's GDP. The various benefits extended to them are set out in the sub-sections that follow.

5.9.3.2.1 Capital Allowance

Capital allowances are tax savings on acquisition of capital assets by a company. These are of two types: initial allowance and annual allowance.[112] Together, they permit companies to write off the capital costs on qualifying assets for tax purposes in a given accounting period.[113] The amount of capital allowance to be enjoyed in any year of assessment is restricted to 75 percent of assessable profit per annum for companies in the manufacturing sector, 66 percent for other sectors, and those in

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[107] Rapu, s*upra* note 91 at 32.
[108] NIPC Website, online: <http://www.nipc.gov.ng/>.
[109] Rapu, *supra* note 91 at 32.
[110] *Ibid* at 32.
[111] NIPC Website, online<http://www.nipc.gov.ng/>.
[112] Rapu, *supra* note 91 at 30.
[113] *Ibid* at 20.

agro-allied industries are granted 100 percent on leased assets and an additional investment allowance of 10 percent on leased assets for agricultural plants and equipment.[114]

5.9.3.2.2 Investment in Infrastructure

This is a form of incentive granted to industries that provide facilities that, ordinarily, should have been provided by government.[115] Of course, this incentive also benefits the investors' access to its location. The people in the locality where it is established also enjoy the spillover effects, including to facilitate their economic activities. The facilities in view include access roads, pipe borne water and electricity. Twenty percent (20%) of the cost of providing these infrastructural facilities, where they do not exist, is tax deductible.[116]

5.9.3.2.3 Investment in Economically Disadvantaged Areas

Without prejudice to the provision of the pioneer status enabling law,[117] a pioneer industry sited in an economically disadvantaged Local Government Area is entitled to 100% tax holiday for seven years, and an additional 5% capital depreciation allowance over and above the initial capital depreciation allowance.[118]

5.9.3.2.4 Replacement of Obsolete Plant and Re-Investment allowance

Manufacturing industries further enjoy an additional 15% investment tax credit for expenditure incurred to replace all obsolete plant and machinery. As well, where a manufacturing company incurs qualifying capital expenditure for purposes such as approved expansion, a generalized allowance of capital expenditure is granted for

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[114] NIPC Website, online:<http://www.nipc.gov.ng>.
[115] *A Bill to Amend Some Sections of the Companies Income Tax Act (CITA)* passed its second reading, and has been referred to the Senate Committee on Finance for further deliberation. The bill seeks to expand the scope of incentives granted to companies that provide infrastructure, where such are not provided by government and also to increase the tax holiday to companies engaged in mining of solid minerals from 3 to 5 years and gas utilization for 3 to 5 years and renewable for additional 2 years.
[116] NIPC Website, online:<http://www.nipc.gov.ng>.
[117] *Ibid*.
[118] *Ibid*.

three activities: expansion of production capacity, modernization of production facilities and diversification into related products.

5.9.3.2.5 Duty Drawback Scheme and Facilities

First, the duty drawback scheme provides for refunds of duties/surcharges on raw materials, including packaging materials used for the manufacturing of products upon effective exportation of the final products.[119] The new scheme gives automatic refunds (60%) on initial screening by the Duty Drawback Committee and upon the presentation of a bond from a recognized Bank, insurance company or other financial institution.[120] The bond covers 60% of the refund to be made to the exporter and will only be discharged after final processing of the application is made.[121] After processing an exporter's claims, the Duty Drawback Committee grants a balance where applicable, or in regard to a request for refund for any over-payment made.[122]

Second, a duty drawback facility provides for fixed drawback and individual drawback facilities. The fixed drawback facility is for exporters/producers whose export products are listed in the fixed drawback schedule to be issued from time to time by the Committee.[123] When the import content of the export produce is constant, and import prices (including exchange rate), tariff rates and technology used are relatively stable or "fixed", it is possible to calculate a standard Input-Output Co-efficient Schedule (ICS) for these categories of products based on which a fixed drawback rate can be computed to be rebated per unit of export product.[124]

Since the individual drawback is for producers/exporters who do not qualify under the fixed drawback facilities, it is a straight forward traditional drawback mechanism

[119] Rapu, *supra* note 91 at 32.
[120] *Ibid* at 31.
[121] *Ibid*.
[122] *Ibid* at 35.
[123] *Ibid.*
[124] *Ibid.*

under which duty is paid on all import inputs. Subsequently, the duties are rebated on inputs used for export production.

As a general case, the final export/producer can apply to benefit under the scheme. As well, a trading company which collects industrial products from one or more manufacturers, as well as a trading company which imports raw material inputs including packaging and packaging materials used for the production of goods exported by him, could also apply under the scheme.[125] Such a trading company must have entered into a contract with a final producer of the product in such a way that the Duty Drawback Committee can obtain the necessary information and documents to enable it decide appropriately. Applicants must be companies incorporated in Nigeria.[126]

As outlined, the operation of the schemes in Nigeria can now be appraised in regard to their key features and performance outcomes. Specifically, I consider exemptions from import duties offered to the manufacturing sector, the incentives to export through free trade zones, subsidies to the upstream and downstream petroleum sector, and the credit schemes and capital allowances given to the agricultural sector.

5.9.4 Incentive Schemes in Operation: An assessment

A pioneer status incentive is granted under the Industrial Development (Income Tax) Relief Act ("IDITRA"). The grant consists of tax holidays to companies in terms of exempting their profits from taxation under the principal statute, the Companies Income Tax Act. Entities that gain this privilege rely heavily on "packaging"[127] to merit it. Consequently, there are homogenous products that do not receive the same

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[125] NIPC Website, online:<http://www.nipc.gov.ng/>.
[126] *Ibid.*
[127] Most companies engage the service of a consultant to put together all relevant documents needed to access this benefit. This is referred to in Nigeria as "packaging".

privilege. But overall, the proliferation of incentives to cushion the operating and financial risks of doing business in Nigeria have not brought the beneficial impact on economic development that the scheme promises. The reasons for this are as follows.

5.9.4.1 General Overview

First, in the manufacturing sector, the provision of government intended support in the form of reduced import duties on raw materials is bedeviled with corruption. Only people who have some influence in government enjoy this benefit.[128] This policy, on its own merit is desirable. However, its implementation is poorly monitored in an atmosphere of pervasive administrative and governance corruption. The process is further politicized, meaning that in practice, manufacturing companies that apply without adding the appropriate "thank you" to the application will not be granted the status even when they are qualified.[129] In the midst of all this, it is worth pointing out that not many manufacturing industries are aware that the incentives exist.[130]

Second is the case of the export free trade zone. The politicization of its benefit begins with the cost of real property in the zone: the cost is not within the reach of small and medium sized industries.[131] A case in point is the location of Dangote Oil Refinery that intends to serve the whole of West Africa.

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[128] During the time of the former Finance Minister, these people were referred to as "those that visit the President at night".

[129] Due to endemic corruption that pervades the whole economic spheres of the Nigerian economy, it is almost impossible to get anything meritoriously without parting with something. In the case of contract bidding, the price is usually inflated so that the interest of the grantor is secured, online: <https://www.premiumtimesng.com/news/top-news/259494-perception-corruption-worsens-nigeria-transparency-international-report.html>.

[130] Uwuigbe Olubukunola Ranti et al, "Tax Incentives and the Growth of Manufacturing Firms in Nigeria" (2016) 11:7 The Social Science Journal 1338 at 1342. They pointed out that there are a number of incentives that manufacturing industries in Nigeria are unaware of and calls for awareness in this regard.

[131] See online:<http://www.nepza.gov.ng> for procedures and other requirements to participate in the Nigeria's Export Free Trade Zone.

Third, Nigeria's manufacturing industries contend with rapid technological change.[132] This is much worse where the investment in machinery is custom-made. In this case, the net realizable value is virtually nil to the company. Overall, the key performance indicators, such as liquidity, profitability, cash flow and market growth are not impressive for the sectors. Consequently, the return on investment measured by return on equity and cost of debt capital is dismal.

5.9.4.2 Monitoring and Enforcement in Nigeria

A major issue in regard to assessing incentive as noted earlier, is monitoring and enforcement. Nigeria's experience is that once an approval is given, the responsibility to ensure that the terms of agreement are implemented is usually not assigned to anyone within the administrative structure. In other words, no official oversees the activities of the approved entity in relation to agreed commencement time, price and quality controls, employment of local labour force, local content percentage and other matters set out in the agreement.[133] Sanctions against violations of the terms of the incentive laws and contracts in the nature of fines for offences like failure to start production within agreed timeline, or inadequate record keeping are not applied. Worse is the fact that more serious contraventions of the terms of the contract that should result in suspension or cancellation of the tax benefits are not addressed.

5.9.4.3 Monitoring Tax Holidays in Nigeria

As already discussed, relief from income taxes increases the profit prospects of new ventures and enables a firm to recover its capital costs more quickly. This reduces its risk of exposure. But tax holidays place a significant burden on tax administration and on other taxpayers who have to bear the tax shortfall. The holidays can be

[132] Of a truth, the inability to edge the problem of rapid technological has a direct relationship with the spread of supermarkets in developing nations which further hurts the productive sector.

[133] George Lent, *supra* note 82 at 288 - 90. He espoused various approaches adopted by different countries to enforce the terms of the contract of agreement.

manipulated and used to cause distortions in the pricing system of a company and to enable it to shift profits from taxed activities to untaxed activities. Though tax administrators may be able to determine what constitutes "arm's length" prices and re-allocate prices appropriately, the fact is that the exercise is a difficult one. National tax administrators have difficulty determining the actual incomes and expenses of a company, especially one that is part of an MNE group operating in different jurisdictions and with highly integrated operations.[134]

The general experience is that the granting of tax holiday on account of pioneer status has been grossly abused.[135] During the period of tax holidays, tax authorities, most often, do not check the books of account of the companies. This allows the companies to take advantage of loss carry forward opportunities.[136] These have been the experience of Nigeria with respect to the performance of the tax liability regime in the three sectors identified, namely, manufacturing, agriculture and exports.

5.9.4.4 Import Duties Exemptions on Raw Materials

Nigeria has import and export duty exemptions and reductions on several items. These duties are the oldest form of modern taxation.[137] They represent taxes on imports into Nigeria and are charged as a percentage of the value of the imports or as a fixed amount contingent on quality.

Import duties were Nigeria's highest yielding indirect tax[138] prior to the introduction of the Structural Adjustment Program (SAP) in 1986.[139] The Nigerian Custom Services (NCS) administer the tax. Relief from customs duties on imports of

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[134] OECD, *Action Plan on Base Erosion and Profit Shifting*, (Paris: OECD, 2013) at 20.
[135] NIPC Website, online:<http://www.nipc.gov.ng/>.
[136] *Ibid.*
[137] Ekeocha Patterson et al, "Revenue Implications of Nigeria's Tax System" (2012) 2:8 J Econ & Sustainable Dev 206 at 208.
[138] George Lent, *supra* note 82 at 310.
[139] Structural Adjustment Program (SAP) is an economic policy package suggested by the multilateral agencies (IMF and World Bank) for Nigeria as a pre-condition for granting it loans.

equipment and construction materials enables a firm to reduce its capital requirements and lower its fixed costs. When custom duties are high, partial or total exemption may provide an incentive for new investment.[140]

Nigeria has little to show for the exemption of raw materials from import duties due to poor monitoring and enforcement. There are instances where these waivers which, ideally, are meant for raw materials, machinery and spare parts, are granted indiscriminately to cover many questionable items like clothing, furniture, and other luxury items that have no bearing on the economy.[141] Relief from duties on imports of raw and semi-processed materials and of components generally provides a competitive advantage for establishing a domestic or foreign market. They are necessary as instruments of economic growth in the value chain. The most unsettling factor is that most of these waivers are granted on the basis of political patronage,[142] which makes them an economic waste and a major source of tax evasion. George Lent tells us that, import duty concessions to pioneer companies from 1955 and 1965 in Nigeria was estimated at £17 million. Along with other financial benefits of £14.3 million, it adds up to £37.3 million lost revenue. In today's terms, this total loss to Nigeria's economy is even heavier. Indeed, as shown in section 5.7 above, Nigeria's losses from granting incentives, including the holiday benefits, continue to increase to the detriment of the national treasury.

5.9.4.5 Export Expansion Grant, Loss and Depreciation Deferring

Finally, are a trio of incentives whose application also occasion losses for Nigeria. First is the export expansion grant introduced in 1976 to encourage non-oil products

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[140] Lent, *supra* note 82 at 265.

[141] See Oluwakemi Dauda, ``Import duty waivers… a tale of abuses", *The Nation* (3 February 2014), online:<http://thenationonlineng.net/import-duty-waivers-a-tale-of-abuses/>.

[142] See "Import Duty: Retrieving Waivers from Wasteful Hands", *Vanguard*, (22 February 2012), online:<http://www.vanguardngr.com/2012/02/import-duty-retrieving-waivers-from-wasteful-hands/>. See also Emma Ovuakporie, "Tambuwal to FG: Stop Arbitrary Tax Waivers",*Vanguard* (27 September 2011), online:<http://www.vanguardngr.com/2011/09/tambuwal-to-fg-stop-arbitrary-tax-waivers/>.

exports with the export expansion grant. This entitles exporters to a certain percentage of their turnover. However, its abuse is rather startling, so much so that the Federal Government has suspended the programme.[143] This outcome is one casualty of the lack of monitoring, enforcement and sanction which have marked the administration of the program.

Second, while the loss carry-over period allows a sufficient period for a company to offset its operating losses, the period should not be in perpetuity. The non-inclusion of sunset clauses in Nigeria's incentive legislations has greatly encouraged the presence of such long periods of exemption from taxation under this scheme. Obviously, the loss to the state is very high.

Finally, in Nigeria, a pioneer company is deemed to start a new business on the day following the end of its relief period.[144] It is from this point that initial and annual allowances begin to be granted. If the tax holiday period is extended due to losses, the initial allowance is reduced by one fifth for each year of the extension.[145] Some scholars believe this practice is not justifiable because, in effect, it permits the tax-free recovery of capital investment twice. The first time is when depreciation is deferred during the exemption period and, second, when it is subsequently deducted to arrive at the taxable income. This distorts accounting records and creates reconciliation challenges.[146] Over all, the state has to wait for overly long periods to recoup any corporate tax, if at all.

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143 "Why Nigerian Government stopped Export Expansion Grant", *Premium Times* (18 August 2016), online:<http://www.premiumtimesng.com/business/business-news/208834-nigerian-govt-stopped-export-expansion-grant-minister.html>.
144 George Lent, *supra* note 82 at 274.
145 *Ibid* at 291.
146 Vito Tanzi & Howell Zee, *Tax Policy in Developing Countries*, (Washington D.C: IMF, 2001) at 12.

5.10 Conclusion

Nigeria's integration within the global economy demands that it creates and maintains a competitive edge in order to advance its economic performance through growth. A major means of doing this is to attract foreign direct investment into salient areas of economic potential. As shown, Nigeria's petroleum industry, along with agriculture and manufacturing, among others, offer ripe avenues for this purpose. Notwithstanding its uncertain benefits, tax incentives have been utilized since Nigeria's independence, to facilitate and enhance economic establishment and output in identified sectors. The calculated expectation is that within a reasonable time, the state would derive tax income from these thriving sectors to fund other aspects of overall national socio-economic development and services.

This chapter's description, analysis and performance assessment of Nigeria's tax incentive, from the primeval tool of tax holiday to various grants and loss and depreciation deferrals, show that the regimes' operation has not worked well. Its administration has been bedeviled by untrammeled exercise of discretion by the civil administrators of the schemes. As well, the scheme has run on political patronage. This culture of corruption has been compounded by virtual absence of monitoring and compliance enforcement of expectations and obligations set out for each specific incentive scheme.

The overall result is heavy loss of tax revenue and distortion of economic development priority goals. There is also a large undermining of the rule of law in economic administration and virtual ignoring of the objectives of national tax policy. The logical question is whether Nigeria can reform such a moribund and resourcedraining scheme, and in what ways. These concerns are spoken to in a few salient areas in the next chapter.

CHAPTER SIX

6.0 Conclusion

This thesis began with a concise description of the fundamental principles of taxation, emphasizing that a functionally effective economy must be underlain by a good tax policy regime marked, ultimately, by equitable principles of tax imposition and administration. Given its focus on identifying the problems with using tax incentives to boost socio-economic development in Nigeria, the preceding chapters drew on studies and scholarly analyses to conclude that developing countries do not, on balance, benefit their econpomies by using tax incentives to attract investment. Not only do they deprive them of tax revenue, they also do not play any major roles in attracting the desired investments. More specifically, it was shown that though Nigeria's incentive regime is generous to investors and includes salient features that could ensure its reasonably successful operation, the corruption culture that bedeviled the process contributed to the losses the incentive has brought about for the country.

This final chapter offers some recommendations to inform a reform of the regime. My modest ideas call for tax policy reviews along with the overhaul of the scheme's legislative and regulatory provisions to better express and authorize implementation of the new policy. I also draw attention to the need to change the culture of politics and civil administration that oversees the implementation of the rules, including judicial views of what objectives and targets Nigeria's tax laws should serve. The conclusion highlights the main theme of this thesis and the overall tenor of its reform recommendations.

6.1 Tax Policy Review

As discussed, taxation is the most sustainable means of generating government revenue. Naturally, Nigeria must broaden its tax base by taxing capital gains, benefits in kind, and other types of passive income. Doing so will enhance fairness and equity in the tax system. It also requires that Nigeria's taxes must be streamlined, rather than for energy to be spent framing more areas of taxation, as the country recently did by increasing its number of taxes from 39 to 61.[1] Such a move, in fact, compounds the problem of "the ease of doing business"[2] that the government recently committed to eliminate. This policy must be accompanied by its corollary, namely, clear decisions on what socio-economic issues must be tackled by tax expenditures. In other words, the current over-broad accommodation of sectors that can benefit from tax expenditure must be streamlined through rationalization. The comprehensive point to make here is that Nigeria's National Development Plans must contain criteria to determine what sectors may be admitted into the incentive program and what socio-economic and fiscal realities may justify the extension of a benefit to a particular economic actor.[3]

A third and related policy change is the need for government to ensure that it is able to estimate the cost of incentives as a basis for assessing its effectiveness.[4] A simple and effective way, according to Vito Tanzi and Howell Lee, is that the Nigerian government can do this is to determine the amount of credit due to a qualified

[1] "Taxes payable by manufacturers up from 39, now 61", *Vanguard* (17 June 2016), online:<http://www.vanguardngr.com/2016/06/taxes-payable-manufacturers-39-now-61/>.

[2] The latest World Bank Doing Business Report 2018 reported that of 190 countries surveyed, Nigeria occupies the 145th position. World Bank, *Doing Business 2018 Reforming to Create Jobs* (Washington, DC: World Bank Publications, 2018) at 7, online: <http://www.doingbusiness.org/data/exploreeconomies/nigeria/#close>.

[3] In some cases, an incentive is tied to a particular purpose, for instance, if government want to encourage employment of locals, it can include a threshold as to the minimum number of Nigerians that must be employed.

[4] United Nations Conference on Trade and Development, *Tax Incentives and Foreign Direct Investment: A Global Survey* (New York: UN, 2000) at 18.

enterprise and to "deposit" this amount into a special tax account in the form of a book keeping entry.[5] In all other respects, the enterprise must be treated like an ordinary taxpayer, subject to all applicable tax regulations, including the obligation to file tax returns. The only difference would be that its income tax liabilities would be paid from credits "withdrawn" from its tax account.[6] In this way, information is always available regarding the budget revenue foregone and on the amount of tax credits still available to the enterprise.

A policy decision to institute the foregoing suggestions will re-launch Nigeria's incentive program on a course of potential effectiveness, if not in terms of their fiscal benefit to the country, at least, in regard to political commitment to integrity and responsibility in overseeing its implementation and administration. On this footing, it will be easy to decide, on the basis of reliable records and data, whether any scheme should be scrapped, when, how, and for what reason, or modified and in what respect.

6.2 Legal Complexity and Judicial Interpretation of Tax Laws and Regulations

Nigeria's tax laws are complex and difficult for the common taxpayer to understand. As well, some tax cases are problematic even for officials and tax administrators to resolve. In addition to lack of understanding, many taxpayers are unaware of the existence of certain tax liabilities under the existing tax laws. Compliance with this system is made more challenging by the laziness of tax officials, uncooperative taxpayers and the official habit of quick fixes.[7] In Nigeria, 'the best of judgement assessment' approach has become the handy resort for tax administrators in resolving tax liability disputes. This does not only reflect poor tax education of officials and the

[5] Vito Tanzi & Howell Zee, *Tax Policy in Developing Countries* (Washington D.C: IMF, 2001) at 12.
[6] *Ibid* at 13.
[7] Micah Leyira et al, ''Tax Systems in Nigeria- Challenges and the Way Forward" (2012) 3:5 Research J Fin & Acc at 10.

public regarding responsibilities (for officials), and for the public, of their tax rights, duties and entitlements.[8] It is suggested that simplified tax legislation that is also comprehensive in its coverage of taxable income-generating activities will more easily yield to official and public education about its requirements.[9]

The accompaniment to this reform of the tax laws is their interpretation. Thus far, Nigeria has glued itself to interpreting its tax laws according to the literal understanding of their provisions.[10] The attitude of the Nigerian courts is to look merely at what is clearly said. They take the view that there is no room for tax law interpretation to be informed by legislative intent. As discussed in chapter 5, this literal view may not help the state achieve its tax policy objectives, and, therefore, may not be helpful in the fight against tax malpractice in Nigeria. In this regard, Nigerian courts can learn from those in Canada. To curtail, particularly, tax avoidance, Canadian courts have adopted various approaches to the interpretation of tax legislation. They have moved away from a strict or literal meaning approach, towards a textual, contextual and purposive interpretations. This combination allows for judicial creativity on the basis of principle, and encourages boldness to enable judges shed the timidity engendered by the literal rule which, in Nigeria, as discussed in chapter 5, allowed the judges to let off foreign investors from their tax liabilities to the state.

[8] The Best of Judgement assessment is a tax assessment method employed where a taxpayer does not provide an audited account or where an individual did not provide a statement of net worth for the purpose of tax assessment. It also refers to a situation where the tax authorities believe that the assessable profit declared for the purpose of determining tax liability is under-declared, in which case, it may be requested to pay more tax.

[9] Vern Krishna, *Fundamentals of Income Tax,* 4th ed (Toronto: Carswell, 2009) at 32.

[10] The rule in *IRC v Duke of Westminister* [1936] AC 1 has been profoundly influential in forming tax opinion based on the literal interpretation of the Act.

6.3 Current Problems with the Incentive Structure

6.3.1 Capacity / Training of Tax Administrators

Along with the foregoing, tax administration must be strengthened in line with new policy changes that must be introduced, including those suggested above. In particular, enhanced technical training must be instituted for tax auditors. It is inadequate and inconsistent with the demands of a robust tax regime, including a structure of incentives, to have, out of six thousand plus workers, only 13% professionally qualified tax administrators.[11]

The Nigerian tax administration[12] and related individual agencies suffer from limitations in manpower, money, tools and machinery to meet the increasing challenges and difficulties of administering tax. In fact, the negative attitude of most tax collectors toward taxpayers is said to arise from their poor remuneration and motivation.[13] Anecdotal evidence for Nigeria shows that staff are not provided with regular training to keep them abreast with developments in tax-related matters.[14] This makes the administration of taxes in terms of total coverage and accurate assessment very weak. Clearly, capacity enhancement through training must go hand in hand with improved remuneration if Nigeria is to have an informed, competent and dedicated group of government revenue service workers.

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[11] Micah Leyira et al, *supra* note 7 at 10.

[12] In terms of efficiency, Nigeria tax administration has performed woefully. See World Bank data on paying taxes in Nigeria Online: <http://www.doingbusiness.org/data/explore economies/nigeria/#paying-taxes>. According to the World Bank, if governments can embrace standard world best practice in the area of ease of paying business taxes, transfer of property, exporting goods, importing goods and resolution of commercial dispute, more than 45 million days of entrepreneurs' time will be saved. See <www.doingbusiness.org/reports/case-studies/2014/cost-of-red-tape>. Published May 2015.

[13] Micah Leyira et al, *supra* note 7 at 10.

[14] *Ibid* at 12.

6.3.2 Incentive Granting Committee

Fundamental to appropriate incentive grants to qualified entities is the competence and interests of those who make the grant decisions. For the granting of pioneer status, it is recommended that government agencies most concerned should be part of a committee that should make this decision. The committee should consist of an advisory board drawn from representatives of the agency mandated with the review of investment proposals. Other bodies to be represented, according to Louis Wells,[15] are the planning and development boards, the Ministers of Finance, Commerce and Industry, Minister in charge of the sector where the firm will operate, a technical official to review and appraise the technical merits of the proposal, and the agency in charge of implementation, compliance review and enforcement of investment laws. In addition, I propose that officials from the Federal and State Inland Revenue Agencies should be members of the committee. This is to ensure adequate representation from all concerned parties. Nigeria's resources exploitation and mining industries have overly generous incentives that need to be streamlined to curb the great deal of rent seeking activity that characterizes them and facilitates above market returns for the companies working in the sector.[16]

An important aspect to this administrative change is the discretionary element of the exercise of decision-making authority by this body. It is advisable to minimize the discretionary element in the incentive-granting process. This will enhance the need for

[15] There seems to be agreement between Louis Wells and George Lent on the constituting members for the review of such application. See Wells Louis J et al, *Using Tax Incentive to Compete for Foreign Investment: Are They Worth the Costs*? Occasion Paper 15, The IFC and the World Bank (Washington D.C: World Bank, 2001), online:<http://documents.worldbank.org/curated/en/2001/01/1614958/using-tax-incentives-compete-foreign-investment-worth-costs> at 34; George E Lent, *Tax Incentive for Investment in Developing Countries* IMF (London: Palgrave Macmillan, 1976) at 283.

[16] Rent seeking behaviour is particularly pervasive in the petroleum sector. Of course, this is also the case for other sectors, including agriculture. Despite government effort to support farmers by providing quality seedlings, it has to do this in conjunction other agents who thwart the process and divert these benefits to "leather-box farmers". To this end, all wind fall gains are rent.

manifest transparency in the decision-making process, and limit the corruption and rent-seeking activities that have, thus far, virtually oiled it.[17]

6.4 The Broader Taxation and Political Environment

A series of inter-related elements of taxation and its administration in the overall political oversight of economic management are germane to the success of the reforms that more directly pertain to reform of the incentive system. Some of these are now addressed.

6.4.1 Curb Unhealthy Tax Competition

Tax competition has undermined the potential for the incentive regime to be effective in Nigeria. As discussed earlier, Nigeria's overall tax system is riddled with incentives. This inevitably provides fertile ground for rent-seeking activities. Therefore, to allow Nigeria's market to take proper root towards fiscal profitability, the Nigerian government must refrain from reliance on poorly targeted tax incentives as the main vehicle for investment promotion.[18] In this regard, its tendency to also impose foreign exchange controls exacerbates, in reverse fashion, the business and regulatory challenges that companies doing business in Nigeria face. These controls throttle their business opportunities and potential to be competitive and profitable. Consequently, by these controls, the state undermines its own opportunities to raise revenue from corporate dividend and profit tax liabilities. Broadly associated with this

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[17] Recently, the National Assembly invited senior management of a prominent oil firm over an oil deal in which even the former president of Nigeria was indicted. See The Guardian March 5, 2017 "The oil deal, the disgraced former minister, and $800m paid via a UK Bank, online:<https://www.theguardian.com/business/2017/mar/05/the-oil-deal-the-disgraced-minister-and-800m-paid-via-a-uk-bank>.

[18] The Nigerian government appears to have realized the fact that non-tax factors are even more important. The government is working tirelessly to rein in on the issue of insecurity which has metamorphosed into a humanitarian crisis. Also, in May 2016, the Kaduna State government declared a state of emergency following an outbreak, which threatens the supply of tomato, called Tomato Ebola. However, the government having curtailed the vandalization of pipeline has been able to ramp up accretion to the federation account. The CBN is actively managing the availability of forex to crucial sectors of the economy and this is beginning to be reflected, for instance in the Consumer Price Index (CPI).

is the country's need to remove inconsistencies in its regulations regarding, among others, protection of intellectual property and profit repatriation.[19] Nigeria needs to arrest these regulatory inconsistencies in the interest of fiscal stability.

6.4.2 Structural Problems in the Economy

Nigeria has been moving away from direct to indirect taxation, a change considered to be less distortionary. The potential for maximizing the benefits of this change is constrained by structural problems in the economy.[20] First is the predominance of the informal sector. This constitutes more than 50 percent of the country's economy and enables most domestic production to circumvent, for instance, the Value Added Tax (VAT).[21] Income tax is similarly difficult to assess and collect because operations in the informal sector are rudimentary and keep inadequate records. Consequently, the guesses that the Nigerian tax administration often makes for the tax liabilities of actors in this sector open up tax evasion opportunities.[22] It is pointed out that the proportion of the self-employed, relative to the total working population, is substantial.[23] Thus, for the tax authorities to not have devised appropriate and effective means for collecting personal income tax from this group leaves the national treasury poorer, and deepens inequity in the structure of tax liability.[24]

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[19] This is the case with airline funds trapped in five countries due to foreign exchange challenges Venezuela, $3.780 billion; Nigeria, $591 million; Sudan, $360 million; Egypt, $291 million; Angola, $ 237. The International Air Transport Association (IATA) hinted that foreign airlines may withdraw services in Nigeria and other countries where their revenues were trapped unless they urgently release the trapped money estimated at about $5.1 billion, online: https://africanbusinessmagazine.com/sectors/finance/airlines-hit-african-foreign-currency-crunch/>.

[20] Micah Leyira et al, *supra* note 7 at 11.

[21] *Ibid* at 11.

[22] The Minister for Information and Culture dropped the hint alluding that Nigeria losses about $1tn to tax evasion and avoidance. See "FG: $1tn Lost to Tax Evasion, Avoidance" *This day* (4 August 2016), online: <http://www.thisdaylive.com/index.php/2016/08/04/fg-1tn-lost-to-tax-evasion-avoidance/>.

[23] There is a high population of self-employed persons who are not yet in the tax net.

[24] The Federal Inland Revenue Service (FIRS) boss Babatunde Fowler stated that the tax base for individuals in Nigeria is 10million. See "Total Tax Base of Individuals in Nigeria is 10million", *The Punch* (19 July 2016), online: <http://punchng.com/total-tax-base-individuals-nigeria-10m-fowler/>. Fowler said this at the 2016 Tax Week of the Chartered Institute of Taxation of Nigeria (CITN) with the theme: "The dilemma of improving tax revenue generation in tough economic times''.

This situation further aggravates the public perception that in Nigeria, not only is tax liability very unfair, but it is made so through enforcing it by corrupt procedures.[25]

At what point Nigerian policymakers, bureaucracies, and taxpayers are ready to make fundamental changes toward reducing corrupt practices is a question to which there is no easy answer. But as noted earlier, globalization has increased the urgency for such fundamental changes. Whether the needed changes will appear or not depends largely on political will. Given the internal dynamics of Nigerian society and governance, the point to emphasize here is that whenever changes are put on, they must be on a variety of fronts, and they must be applied on an on-going basis over a long period of time. The changes must involve individual and societal mindsets, as well as institutional procedures and their enforcement. The changes in view must begin at the core of government's own operations, such as those pointed out in the next sub-section.

6.4.3 Non-Transparent Tax Expenditure

The failure of the three tiers of government to provide social amenities affects tax compliance. Apart from resources mismanagement, more than 70 per cent of revenue is spent on recurrent operations, leaving barely anything to fund development projects.[26] To many taxpayers, this means that the fundamental purpose of government is always unrealized, and so the moral obligation to pay taxes also no longer exists.[27] In this regard, it seems hopeful that the Nigerian government has

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[25] Micah Leyira et al, *supra* note 7 at 28.

[26] There had been accusations and counter accusations on the cost of governance. Many Nigerians are even questioning the rationale for a National Assembly. The governor of Kaduna, Mallam El-Rufai challenged the National Assembly to shed light of their budget. In a swift reaction, the National Assembly points out that they only gulp 5% of the national budget which is over N100billion, online: <https://www.premiumtimesng.com/news/headlines/228511-el-rufai-accepts-dogara-challenge-publishes-details-salary-kaduna-security-vote-other.html>.

[27] The citizen tax sensitivity is recently heightened due to hardship borne by many Nigerians. Professor Itse Sagay decried the prevailing situation and exposed some data on the spending of political office

realised the need to work transparently, and the current government is working assiduously to improve transparency. It is, however, too early to conclude that this commitment is yielding fruit.

6.4.4 Attention to Non-Tax Factors

Finally, there are a range of non-tax factors that condition the prospects of success for any tax reform agenda. Nigeria's economic life is full of them. The details of how these may be tackled is beyond the scope of this thesis and the focus of its modest tax incentive reform recommendations. But it completes the recognition and acknowledgement that taxation, however organized and administered, including its specialized schemes like incentives, depend on every other factor of socio-economic life and activity to achieve its objectives. So, these factors which Nigeria must assess and work on in terms of their implications for, and impact on tax incentives reform include: national market size; access to raw materials for relevant operators; availability and cost of skilled labour; access to and condition of infrastructure including transportation facilities; political stability; macro-economic stability (foreign exchange); and business financing costs.[28]

6.5 Conclusion

As demonstrated especially in Chapter 5, the various tax incentives have had little or no positive effect on the Nigerian economy. At best, it can only be argued that though

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holders, online: <https://www.vanguardngr.com/2017/09/sagay-hits-senate-says-ones-buying- clothes-wear/>.

[28] The International Trade Administration (ITA) a department of the U.S. Department of Commerce put together a market overview on Nigeria. See <https://www.export.gov/apex/article2?id=Nigeria-Market-Overview>. On the flip side, the Nigerian government has been encouraging more Nigerians to go into farming, especially rice cultivation. It believes that with the effort currently being made in Nigeria to stop the importation of rice by meeting the nationwide demand of 7 million tonnes through local production annually by the year 2018, the country will be saving $7m daily in its foreign reserves. Also, government is subsidizing tractors, mills and fertilizers as well as arranging cheaper loans to boost production. Despite rice growing being a government priority, many farmers still grow with their bare hands. Government also provides quality seedlings and teaches farming practices to improve output. However, farmers complain that endemic corruption means government help does not always reach them.

laden with good intentions, the yield from operating the regime in Nigeria has done virtually nothing to bring economic benefits in terms of fair taxation of locals and foreign investors and, therefore, no improvement in government revenue intake from the incentive sector.

Nigeria's huge potential in human and mineral resources should have accorded her the right of first refusal to direct foreign investment. However, this advantage has not been utilized because of bad leadership and corruption.[29] Also culpable is the attendant infrastructural decay which has reduced the country to desperately seeking FDI to improve this area. In the process, Nigeria competes with smaller economies to attract the same investment revenue but without any greater success.[30]

Nigeria's population of over 177 million makes it a large market and a depository of affordable labor. But even these factors do not necessarily make her a choice investment location because of its huge infrastructural weakness and inconsistent investment policy pursuits.[31] This is why many companies have relocated their factories to neighboring countries in the face of a plethora of incentives that attracted

[29] Following the adoption of the whistle blowing policy by the federal government, it is mind boggling the amount of cash that has been discovered within a week at various locations such as shops and apartments running into billions of naira that ideally should have been rolled into the economy and would have generated more jobs. See Soni Daniel, "Update: How EFCC Recovered \$9.8m from Yakubu, Ex-NNPC GMD", *Vanguard*, (10 February 2017) online: <http://www.vanguardngr.com/2017/02/efcc-recovered-9-8million-yakubu-ex-nnpc-gmd/>. See also "EFCC discovers N448m cash in Lagos shop", *The Guardian*, (8 April 2017), online:<https://guardian.ng/news/efcc-discovers-n448m-cash-in-lagos-shop/>.

[30] Ghana is ranked 120th out of 190 countries in the 2018 World Bank`s Doing Business Rankings while Nigeria occupies the 145th position. World Bank, *Doing Business 2018 Reforming to Create Jobs"* (Washington, DC: World Bank Publications, 2018) at 4. See 2108 World Bank Group Flagship Report, online: <http://www.doingbusiness.org/~/media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB2018-Full-Report.pdf>.

[31] The Federal Government recently launched an Economic Recovery and Growth Plan (ERGP) the thrust of which is to serve as a road map for security improvement, war against corruption, economic revitalization and a compendium of government sectoral plans for agriculture and food security, energy and transport infrastructure, industrialization and social investments. Nigeria, Ministry of Budget & National Planning, "Economic Report and Growth Plan 2017-2020" (February 2017). See online: <https://www.thisdaylive.com/index.php/2017/04/09/new-economic-recovery-plans-the-road-ahead/>.

them to Nigeria in the first place.[32] The major discouragement has always been unreliable energy supply and poor roads. The companies that remain and continue to enjoy the incentives are not monitored for their compliance with the incentive obligations. Just as well, the rules are not enforced when breaches are identified. In the result, the national treasury continues to lose revenue from offering investment incentives.

On another score, Nigeria was instrumental in the emergence of the Organization of African Unity (OAU), now the African Union.[33] As well, it was a standard-bearer in the formation of the Economic Community of West African States (ECOWAS).[34] However, due to the poor administration of its national economy, including its taxation and tax incentive regimes, Nigeria has not been able to take advantage of the opportunities created by these organizations to expand its participation in the economies of its regional and continental neighboring markets.

Overall, therefore, Nigeria's investment-attracting incentive regime needs rethinking if the losses it engenders for revenue generation are to be reversed as part of general tax reform to improve economic performance. First, underlying tax legislation must be redone to streamline the tax reliefs given to investors. The goal must be to shorten the time, and to close the loopholes that allow investors to ceaselessly enjoy not paying any taxes under the incentive regime. Second, tax administration, especially compliance enforcement, must be incentivized by training and paying well, a

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[32] Notable companies that relocated recently include Dunlop Nigeria Plc, Michelin, Prilleri. Some other companies are rumored to be contemplating to do same. "Why Companies will Continue to Leave Nigeria for Ghana," This Day (28 March 2017), online: <https://www.proshareng.com/news/General/why-companies-will-continue-to-leave-Nigeria-for-Ghana-/7324>.

[33] Muritala Dauda, Muritala Zaki Bin Ahmed & Mohammed Faisol Keling, "Nigeria's role and its peacekeeping challenges in Africa: An assessment" [2017] 2:3 European J Soc Sciences Stud 128 at 135.

[34] Olatunde J. B Ojo, "Nigeria and the formation of ECOWAS" [1980] 34:4 International Organization 571 at 575.

dedicated cadre of revenue workers.[35] The goal here is, at least, to minimize corruption, including political influence over tax administration, factors that have long allowed Nigeria's tax haven status to thrive to the detriment of national revenue generation. Finally, the law should more equitably distribute the tax burden between local entrepreneurs and foreign investors. Hopefully, with these changes, Nigeria may find more tax revenue to help run its national economic activities.[36]

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[35] The Nova Scotia government is engaged in skill acquisition for its labour force. In furtherance of this objective, the Association of Workplace Educators of Nova Scotia (AWENS) is instituted to ensure continual training of employees in Nova Scotia. Other support includes the job junction as well as a number of employment agencies across the province.

[36] Nigeria's tax revenue to GDP ratio is among the lowest in the world. Online: <https://www.thisdaylive.com/index.php/2017/04/23/adeosun-nigerias-tax-to-gdp-ratio-among-lowest-in-the-world/>.

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