NATIONAL OPEN UNIVERSITY OF NIGERIA

BHM 779

Public Financial Management

Module 1

BHM 779 Public Financial Management Module 1

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Module 1 Basics of Public Financial Management

Unit 1 Basics of Public Financial Management

1.0 Introduction

The main goal of this unit is to define public financial management. The public functions of financial management and their peculiarities will be considered as well. You will be introduced to the basics of public financial management as a vast field of endeavour which encompasses the whole processes of formulating and implementing decisions made on government services.

2.0 Objective

At the end of this unit, you should be able to:

- define public financial management.

3.0 Main Content

3.1 Basics of Public Financial Management

Definitions

Ola and Offiong (2008) define public financial management as "the measures put in place to control people's money or funds." You will note that the word 'public' means the people while 'finance' connotes funds or money. The management of public funds is known as public financial management. Ekpung (2001), also defines public financial management as the management of the flow of money or financial resources through an organisation (public), whether it is a company, a school, a bank, or a government agency. The actual flow of money or financial resources as well as claims against money in a judicious way is its concern. Public financial management is a specialised, functional area found under the general classification, public administration and finance.

The traditional concept of finance (providing funds needed by an organisation) has the merit of highlighting the central core of the financial function –the treasury function- which is simply keeping the organisation supplied with enough funds to accomplish its objectives. In the present modern economy, there is increase in complexity, size, technology, inflation, recession and government control with a lot of implications to financial management in many organisations. In public financial management, every decision is based on equity and efficiency back-up by public policy so as to ensure efficient employment of resources. Thus, public financial management deals with judicious use of funds, and also ensures accountability and financial control.

Self-Assessment Exercise
Define public financial management.

The subject of public financial management is the acquisition and disposal of resources by the government, be it federal, state or local government. It is about government income and expenditure. It deals with budgets which are statements about how a government plans to obtain income (income) and the ways a government plans to spend such income during a particular financial year. A budget can be deficit, surplus or balanced. The flow and management of funds is the life blood of our system of public administration. In public administration, the system of public financial management rest on designs and reforms over the years.

In a modern money-using economy, finance may be defined as the provision of money at the time it is wanted. Every person responsible for finance, whether it be the finance of company (business), household (private) or government (public), is confronted with the prospect during the coming days, months or years of an inflow of receipts on the one hand and an outflow of payments on the other.

The subject matter of public financial management could be summed to be the acquisition and disposal of resources by the government and it agencies through proper management and control through budgeting usually prepared annually or through developmental plans for a specified period depending on the government's needs. At the heart of the design of an effective system of public financial management, are the following principles: Democratic consent, Equity, Transparency, Probity, Prudence and Accountability.

Self-Assessment Exercise

In your own words, explain the concept- 'public financial management'.

3.2 Scope of Public Financial Management

For all tiers of government in Nigeria- Federal, State or Local - public financial management is vital in the governance than other matters; since money (funds) is the hub of the wheel of every government activity. Behind the formulation and execution of financial decisions lie many questions of public policy, and this questions range from:

- what fiscal measures are to be put in place to ensure high standard of living, satisfactory income distribution, resource allocation and public accountability?
- More questions on the tax system to be more equitable and efficient in order to generate substantial funds to meet the needs of the people?

3.3 Aim of Public Financial Management

The aim of public financial management is to enhance the management of the flows of money or financial resources through government and its agencies for the aims of government in the modern economy. The following functions are the summary of aims of government in a modern economy.

- The provision of essential public services.
- The control of certain sectors of the economy
- The application of social policy
- And that government assumes responsibility for the overall state of the economy.

The scope of governance covers the following key responsibilities that require financial management and control.

1. The up-keep of the president, legislature, the judiciary, maintenance of law and order, provision of facilities for defense and diplomatic representation including discharge of international responsibilities.

2. The direct or indirect involvement in enterprises example the postal services, energy, inland waterways, oil and gas etc. It could be through financial assistance or advisory services.

3. This involves revenue and expenditure. Revenue is taxation and its distribution among the community. Expenditure is on social services like education, health etc.

4. The maintenance of a high and stable level of employment, the encouragement of growth in the economy and improve productive capacity, ensure the relative stable prices and the preservation of solvency in its external business relationships.

Self-Assessment Exercise

What is the aim of public financial management in government?

3.4 Modern governments' Intervention and Instrument in the Economy

Modern governments intervene in the market economy in other to fine tune it; this made possible through legislation, regulation, controls and standard legislation. Government intervenes through the provision of public goods and income distribution. The government is concerned with the welfare of its citizenry. Government invests on projects, supposedly, not attractive to private investors, but beneficial to the citizens. These projects are relatively low in profitability. Instruments for government intervention in the economy include the following.

- Fiscal policies- these are government policies through which government revenue and expenditures are manipulated.

- Monetary policies- government through the Central Bank targets the quantity of money in circulation within the economy, considering the cost (interest) and general credit direction.

- Direct control- this comes in the form of rules and regulations involving the passing of laws or executive directives as a supporting tool to enforce implementation of policies.

- Income policy- this aims directly at regulating the disposable incomes accruing to earners to meet government macro-economic objectives, ensuring equitability in income and productivity level. These include minimum wage laws etc.

- Debt management policy- government, normally, incurs internal and external loans for some important reasons. A policy as an instrument of debt management will be in place to avail the team of managers to meet current fiscal obligations.

- Exchange rate policy- with international trade, the exchange rate (price of foreign currency) is of value in the economy, as it affects and influences virtually all other prices for the purpose of controlling the economy.

4.0 Conclusion

Public financial management is concerned with income and expenditure of public funds. Policies of government influence the thrust of public financial management approach in all government activities.

5.0 Summary

In this unit, we have defined and discussed public financial management. We highlighted the subject matter of public sector financial management.

6.0 Self-Assessment Exercise

1. Define public financial management.

2. State the aim of public financial management in Nigeria.

7.0 References/Further Reading

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Unit 2 Monetary Policy

1.0 Introduction

In this unit, we will consider monetary policy. Monetary policy is concerned with discretionary control of money supply by the monetary authorities (Central Bank with Central Government) in other to achieve stated or desired economic goals. With this policy, governments try to control the money supply in order to stabilise the quantity of money in circulation. This helps in checking inflationary trend and position in the economy.

2.0 Objectives

At the end of this unit, you should be able to:

- define monetary policy
- discuss objectives of monetary policy
- state the instruments of monetary policy.

3.0 Main Content

3.1 Monetary Policy

Monetary policy is essentially a programme of action undertaken by the monetary authorities generally the central bank, to control and regulate the supply of money with the public and the flow of credit with a view to achieving predetermined macroeconomic goals. – Dwivedi D.N.

Monetary policy consists of a government's formal efforts to manage the money in its economy in order to realise specific economic goals. Three basic kinds of monetary policy decisions can be made about:

- the amount of money in circulation
- the level of interest rate
- the functions of credit markets and the banking system.

The combination of these measures is designed to regulate the value, supply and cost of money in an economy, in line with the level of economic activity. Excess supply of money will result in an excess demand for goods and services, prices will rise and balance of payments will deteriorate. On the other hand, inadequate supply of money can lead to stagnation in the economy, hence retard growth and development. Consequently, the central monetary authority would normally attempt to keep the money supply growing at an appropriate rate to ensure sustainable economic growth and to maintain internal and external stability.

Self-Assessment Exercise

Define monetary policy.

3.2 Objectives of Monetary Policy

The primary objectives of monetary policy in Nigeria in recent years are, to:

- check the rate of inflation
- sustain exchange rate stability
- promote output and employment growth and
- enhance overall efficiency of the economy.

In pursuit of the above objectives, the stance of monetary policy will be non-accommodating and will ensure efficiency in resource allocation to support private sector. Monetary policy is used to influence these ultimate objectives because there is a belief that there is a relationship between the real variables and the monetary variables.

However, this is valid only for a highly monetary economy. If the economy is not highly monetary, then the efficacy of monetary policy is restricted. In a developing economy like Nigeria, where a large proportion of output is subsistence, the level of output would be independent of supply of money. Therefore monetary policy would not be efficacious in determining the output level of the subsistence sector

Monetary policies are effective only when economies are characterised by well developed money and financial markets like developed economies of the world. This is where a deliberate change in monetary variable influences the movement of many other variables in the monetary sector

Self-Assessment Exercise
Name the objectives of monetary policy in Nigeria.

3.3 Policy Instruments (Measures)

The primary instrument of monetary policy is Open Market Operation (OMO), Reserve Requirements, Discount Window Operations and Moral Suasion. The techniques in use are-direct/portfolio control approach and indirect/market intervention. There is a basic difference between the mechanisms of direct and indirect monetary control. Under the system of direct monetary control, the monetary authority uses some criteria to determine monetary and credit targets and interest rates which are the intermediate targets to attempt to achieve the ultimate objectives of policy.

Indirect monetary control only the operating variables related to the path of the intermediate variables. The operating variables, particularly the monetary base are managed, while the market is left to determine interest rates and credit allocation. These instruments place restrictions on a particular group of institutions –especially deposit banks – by limiting their freedom to acquire assets and liabilities. This method is employed mainly in developing economies in which the financial infrastructure necessary for operating indirect monetary control is under-developed.

On the other hand, the indirect method is used mainly in developed financial systems. It relies on the power of the monetary authority as a dealer in the financial markets to influence the availability and the rate of return on financial assets, thus affecting both the desire of the public to hold money balances and the willingness of financial agents to accept deposits and lend them to users. This is an indirect monetary policy instrument introduced to influence the level of money supply in the economy. This involves the issuance of short-term instruments such as treasury bills and other securities to the public subscription.

Cash Reserve Requirement is the least amount of reserve a bank must maintain with Central Bank of Nigeria expressed as a ratio of each individual banks total liability. Liquidity ratio is the minimum percentage amount of reserve which shall be in form of liquid assets expressed as the banks total deposit liability, promissory notes and certificate of deposits which the banks must keep with the CBN.

Discount Window Operations are transactions in the form of short term, overnight loans, collateralised by the borrowing institution's holding of government debt instruments and other eligible first class securities approved by the CBN. Moral Suasion is the CBN regular dialogue with banks and other financial institutions, under the aegis of the Bankers Committee on monetary and financial issues and to encourage enhanced operational efficiency in the banking industry.

3.4 Monetary Policy Administration in Nigeria

The Central Bank of Nigeria proposes the monetary policy to be considered by the presidency through a memorandum with the caption- monetary, credit, foreign trade and exchange policy proposals for a particular fiscal year. The memorandum is an input of all the policy departments of the CBN. It considers the prevailing economic conditions, prospects and the policy objectives that appear most appropriate to pursue in the immediate future.

The memorandum is, initially, considered by the committee of governors, the highest management body for the daily administration of the CBN. It is deliberated upon and approved by the board of directors of the CBN and transmitted by the Governor of CBN to the presidency for consideration and approval. The Presidency after reasonable consultation with other tiers and agencies of government takes a decision on which proposals to accept and include them in the budget. The CBN conducts periodic and special examinations of the books of all licensed banks as a monitoring tool. The banks are also required to submit regular returns on their operations to the Central Bank in compliance with the monetary policy circular.

4.0 Conclusion

In this unit, we defined monetary policy as a tool of controlling money supply in an economy of a nation by the monetary authorities to achieve a desirable economic growth.

5.0 Summary

In summary, we have discussed and identified monetary policy as one of the primary objectives of monetary policy in Nigeria and have enumerated the Central Bank of Nigeria Instruments (measures) for monetary policy administration in Nigeria. In the next unit, you will learn about fiscal policy as a complementary policy to the monetary policy of the economy.

6.0 Self-Assessment Exercise

1. What is monetary policy?

2. State the monetary policy Instruments of an economy.

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Unit 3 Fiscal Policy

1.0 Introduction

We continue this unit with fiscal policy, the twin of monetary policy. Fiscal policy is the use of government spending and taxation policies to influence the level of economic activity, inflation and economic growth. Fiscal is the expression of taxation, public revenue or public debt. The fiscal year is a 12-month accounting period without regard to a calendar year. The fiscal year for the federal government of Nigeria is from 1st January to 31st December.

In this unit, you will learn about the definition of fiscal policy, the objectives and major instruments of fiscal policy and system and allocation of functions of different tiers of government in Nigeria.

2.0 Objectives

At the end of this unit, you should be able to:

- explain fiscal policy in Nigeria
- identify objectives and major instruments of fiscal policy
- discuss allocation of functions of tiers of government.

3.0 Main Content

3.1 Fiscal Policy

Fiscal policy is the manipulation of government finances by raising or lowering taxes or levels of spending to promote economic stability and growth (Shafritz & Russell 2005). Fiscal policy is the manipulation of government expenditure and taxation in order to influence economic performance (Ola & Offiong 1999).

Fiscal system in Nigeria

Nigeria's economy revolves around the nation's federal capital territory, 36 states and 774 local governments. Nigeria's fiscal federalism supports the general perception that decentralisation is beneficial to the economy as regards the provision of goods and services. Hence, this has fundamental implications for the fiscal system and economic management of the country. The economic role of the public sector in a federal system is the joint responsibility of the multi-levels of government. This joint responsibility of local, state and federal governments in performing the fundamental functions of socio-political administration and economic management introduces complications in the fiscal system which must be technically and constitutionally resolved in the light of political factors and pressures that gave birth to the union.

This role of government sector in economic management is performed through a system of formulation and implementation of economic policy and fiscal policy in the country. This is designed to achieve the objective of price stability, growth, balance of payments equilibrium, full employment, mobilisation of resources and investment. These objectives have influenced government's economic policy design and development efforts in Nigeria since independence. Nigerian governments had designed and implemented four development plans between 1960 and 1985 in the form of different approach, depending on leadership; note the following:

1. Structural Adjustment Programme (SAP) in 1986

2. three-year rolling plans thereafter
3. vision 2010 programme
4. National Economic Empowerment and Development Strategy (NEEDS) and
5. Seven Point Agenda of the present Administration
6. Vision 2020 etc.

All these were put in place for the purpose of achieving economic development and bringing about significant improvement in the living standard of the people.

Self-Assessment Exercise
What is a fiscal policy?

3.1.1 Objectives of Fiscal Policy in the Economy

Fiscal policy enables government to obtain revenue through the follow means:

1. taxation (this will be discussed in the next unit)
2. price stabilisation
3. equity in income distribution
4. increase in investment in the economy
5. maintain a favourable balance of payments
6. exchange rate stabilisation

All these revenue, when obtained, help government in solving socio-economic and political challenges like providing employment, reviving ailing industries and solving national security insurgents etc.

3.2 Major Instruments of Fiscal Policy

The major instruments of fiscal policy include:

- taxation
- government expenditure and
- borrowing from domestic and external sources to finance budget deficits.

A country may achieve growth of Gross Domestic Product (GDP) without corresponding economic development. The experience in Nigeria as in many other developing countries, have also proved the public sector intervention in an economy can result in failure just as the rationale for government intervention is based on the inherent failure of price mechanism to achieve a stable equilibrium in the market economy.

Self-Assessment Exercise
Identify objectives of fiscal policy.

3.3 Fiscal System and Allocation of Functions in the Economy

Theoretically, there is an optimum allocation of functions among the tiers of government in a federation such that the fiscal relations would facilitate the achievement of macroeconomic objectives of price stability, full employment, economic growth and balance of payments equilibrium. If the three tiers of government were to provide the functions of stabilisation, income redistribution and resource allocation simultaneously, inefficiency would result (Musgrave& Musgrave, 1973).

The citizens of a country, incidentally, belong to all the tiers of government in a federal system. There is, therefore, intersection of jurisdiction among the tiers of administration. Local government areas intersect the state constituencies, while the states intersect the national boundary of the federal government. State and local governments engage in the performance of the resource allocation functions along with the federal government in accordance with the provisions of the constitution. However, the stabilisation and income redistribution functions are better performed when localised in the central government to avoid unintended spillovers. Revenue Mobilisation and Allocation Commission is saddled with the responsibility of sharing the national revenue, in consonance with the provisions of the constitution of the Federal Republic of Nigeria

Self-Assessment Exercise
What are major instruments of fiscal policy of government?

4.0 Conclusion

In this unit, we conclude that the fiscal policy and the responsibility of government is the determinant of the level of involvement and commitment of each level of administration. The constitution is the guide and provides the benchmark of performance.

5.0 Summary

We have considered fiscal policy system in the public sector in Nigeria, major instruments of fiscal policy and allocation of functions of fiscal responsibility to government.

6.0 Self-Assessment Exercise

1. Explain a fiscal year in Nigeria.
2. What is the objective of fiscal policy?

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Unit 4 Taxation

1.0 Introduction

This unit will take you through taxation in Nigeria as a source of revenue; it will also focus on types and the purpose, incidence and canons of taxation. Revenue generation is the base of financial management in the public sector; and tax is a reliable and legitimate means of obtaining revenue by any government. You will be shown taxation from the basic point of view.

2.0 Objectives

At the end of this unit, you should be able to:

- define taxation
- identify types, purposes and canon of tax in Nigeria
- list the incidence and effects of taxation in economic amenities
- explain tax evasion.

3.0 Main Content

3.1 Tax as Source of Revenue to Government

Taxation is defined as a compulsory payment or levy imposed via legislation by the government of a country on the income of the residents. The Joint Tax Board defines taxation as "the legal demand made by the Federal Government or the State Government for its citizens to pay money on income, goods and services". Public financial management involves how funds are generated, allocated and managed by the government (Ola and Offiong, 2008). Nigerian income depends so much on the incidence of tax, and different types of taxes are imposed on individuals, businesses and corporate bodies. Government also borrows funds from different available sources in order to meet its general responsibilities. The oil and gas sector, for sometimes now, has contributed greatly to the revenue base of the country as it has helped in the long run to solve social and political problems. It has also helped the government in addressing a lot of issues concerning the populace (despite Nigerian increasing population) the attitude of people towards payment of tax has been in the low level as discussed later in this unit under tax evasion and avoidance.

The attitude of the people has negatively affected the incidence of tax and those who find themselves in the 'corridor' of power have not helped matters because they do not pay their taxes, either. In view of these, the reliance of government on taxes for public expenditure has been relatively low hence the dependence on revenue from oil and gas sector. This has affected the numerous public projects embarked upon by different tiers of government. Sense of responsibility by citizens as tax payers has been neglected and even corporate bodies have also joined this 'wagon'. Invariably, the standard of living of the people has been affected because of shortage of revenue through taxation.

Self-Assessment Exercise

Define taxation.

3.2 Types of Taxes

Here, let us talk about some major types of taxes.

Direct taxes include the following

- Personal income tax

- Company gains tax that is, taxes on profits
- Capital gains tax – taxes on assets held for more than one year
- Death duties- taxes on the property of deceased
- Royalties and mining rents, stamp duties, motor vehicle duties
- Miscellaneous receipts of the government include loans profit from direct government investment, grants and fines.

Direct tax- if the payer bears the burden of the tax and cannot shift the burden to any other person. These taxes are based on income or receipts and their incidences fall directly on the payer. It can be used as a fiscal instrument to adjust disposable income of the citizens and redistribute income through different forms of direct taxes. Different forms of direct taxes are progressive, regressive and neutral (proportional).

Progressive tax-the higher the tax base, the higher the rate will be. The rate of taxation is graduated progressively as income increases. Its major features include the following.

1. Reduces inequality of income
2. Increases aggregate demand
3. Is non-inflationary
4. Yields more revenue to government
5. May induce disincentive as it is exorbitant in additional income of tax payers.
6. Adopted in real life situation.

Regressive tax- the tax rate diminishes as income level/tax base increases. This is the opposite of progressive tax.

Features-

- Low rate of tax is paid at high levels of income
- Creates incentives to efforts
- Widens inequality of income in the economy
- Decreases aggregate demand
- Only rich saves extra income
- The rest discouraged in investment in the economy
- Not applied in real life

Neutral (progressive) tax- this takes no cognizance of the economic situation of the tax payer and the tax is proportional to the tax base/income at a constant rate.

Features-

- Is impartial
- Is not disincentive to efforts
- It does not provide incentives
- It is insensitive to economic situation
- It is against social equity

Self-Assessment Exercise

Identify types of tax in Nigeria

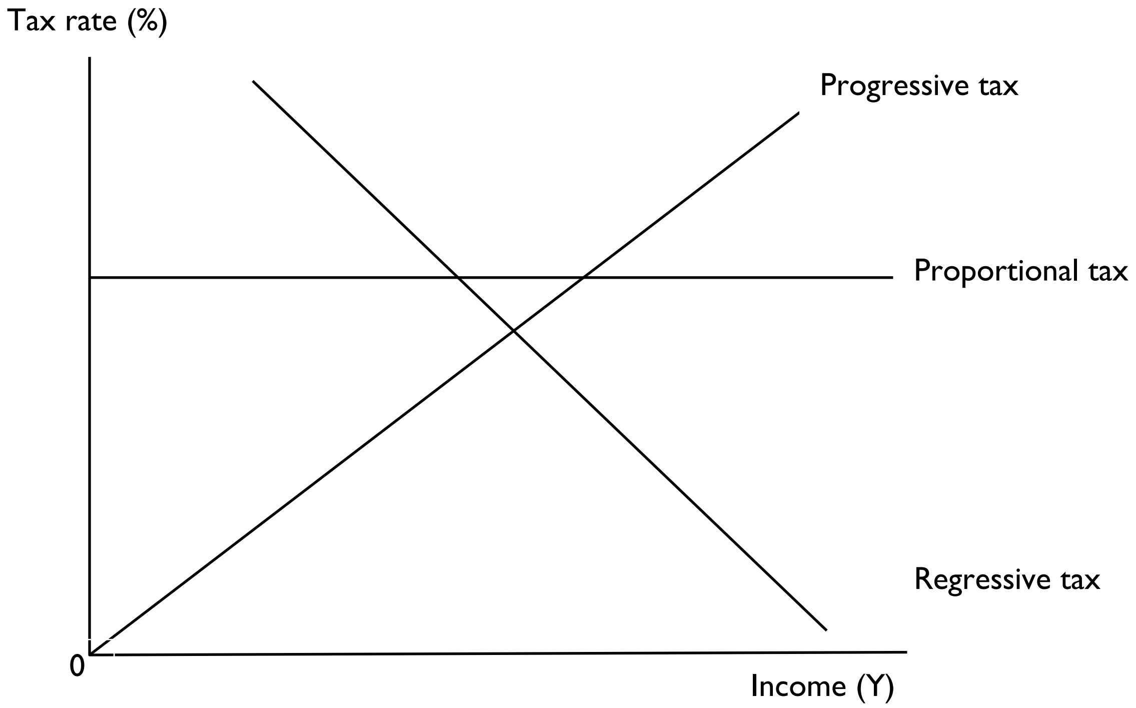

Figure 4.1: Graphical Expression of the Behaviour of the Forms of Direct Taxes

Indirect tax- the payer shifts the burden to someone else. This depend on the elasticity or otherwise of the demand for the goods and services and the object of the tax.

- Tax on expenditure
- It is possible to shift tax incidence (partly or wholly) to someone else.

Indirect taxes are listed below.

- Custom duties – imports and exports

- Excise duties – domestic products
- Purchase tax – on certain goods at wholesale level
- Sales tax – levied and collected either at wholesale or retail level
- Value-Added-Tax- VAT (replaced sales tax since 1994).

Tax base

Taxes are based on something. In Nigeria tax system it is based on three main bases namely- income, capital gains and consumption.

Income tax

This is the regime of tax levied on the financial income of individuals, companies and corporate entities. Diverse income tax regime exists in different degrees of tax incidence – progressive, regressive or proportional which had earlier been discussed above. Income tax is levied on the income or profit of the companies as corporate tax, corporate income tax or income tax. It is based on net income – the difference between gross earnings and expenses and/or any other write offs. When it involves an individual, the income tax is often assessed on the total income less deductions or exemptions statutorily permitted by the law and regulations of tax in a given country. Types of payments that are taxable include: personal earnings, capital gains and business income.

Capital gains tax

This is tax levied on the gains or profits realised from sales of assets. The most common capital gains tax around the world are charged on the sale of stocks (shares), bonds, precious metal, real estate, mutual trust shares, interest on bank deposits, etc. The capital gains take into account the cost of investment and the proceeds realised from the sales of such assets. There are exemptions like agricultural land, primary residential buildings, etc.

Consumption tax

Sales taxes are also known as consumption tax, charged at the point of purchase for certain types of goods and services. The percentage of this tax is set by the government (authorised tax authority – Federal Inland Revenue Service and backed up by their States counterpart). There are exemptions in terms of goods and services which are not subject to sales tax. This sales tax can be included in the sales price of the good or service. By its nature and application, sales tax is considered to be fair and has a high compliance rate which makes it difficult to avoid. The retail sales tax (a version of sales tax) is, usually, affected by charging the tax only on the ultimate consumer as compared to the gross receipt tax levied on the intermediate businesses in production or distribution line.

Value Added Tax(VAT)

The value added tax (VAT) is also known as goods and services tax, and is a tax on exchanges. It is levied on the added value that results from each exchange through the whole gamut of the production of goods to the final consumer. It is an indirect tax because the tax is collected from someone other than the person who actually bears the cost of the tax; the seller of the product or service pays the tax rather than the consumer who benefit the utility of the commodity. VAT is the acronym for valued added tax. This tax which is in other words called consumption tax can be defined as the amount charged by the government for every goods or services purchased from time to time. This means it can only be paid when there is consumption of goods or services (It forms part of the price paid for the good or service).

More Facts about VAT

This was introduced by the federal government in 1994 to replace sales tax. Initially, the federal government received only 20 percent of the VAT proceeds to cover administrative cost of collection while state and local governments received 50 and 30 percent respectively.

VAT was designed broadly to be levied on imported goods, locally-manufactured goods, hotel service, bank transaction etc and to be federally-collected. A uniform rate of 5 percent was fixed on all affected items while VAT proceeds are shared among the three tiers of government at an agreed proportion.

Characteristics of value added tax

These are spelt out as follows.

1. It is a consumption tax- it can be paid when there is consumption of the good or service.

2. Its incidence is borne by the final consumer.

3. It is multi-stage tax. That is, as additional value is created at each stage of production the tax is paid by the consumer of the product at that stage. The total payments make up the consumer's price of the product.

The following goods and services are exempted from VAT

1. Medical and pharmaceutical items
2. Basic food items(food stuffs etc.)
3. Books and educational materials
4. Agricultural equipments, product and veterinary medicine
5. Fertilizer/ agricultural Chemicals
6. Baby product
7. Exported goods.

Services exempted are:

1. Medical services
2. Services by development finance institutions – like Agricultural, Cooperative and rural Development, Mortgage Banking institutions.

3. Plays and entertainments by educational institutions (part of learning)
4. Religious services
5. Exported services

VAT administration

The tax authority for VAT is the Federal Inland Revenue Service (FIRS)- with head office centrally located at Abuja, and has Zonal offices and local offices throughout the federation. The VAT directorate works in close cooperation with the Nigerian Custom's Services and the State Internal Revenue Service.

VAT registration-procedure

1. First step- identification of VAT-able person and address
2. Prepare a comprehensive list of all suppliers of goods and services
3. Form 001 is completed by each VAT-able person
4. VAT identification number is given
5. VAT certificate issued to the VAT payer
6. VAT-able person registers for VAT within six months of the business
7. A penalty of N10,000 is given in the first month of failure and
8. N5000 for each subsequent month if failure continues.
9. Government ministries, statutory agencies have to register for VAT as FIRS agents, for the purpose of collecting VAT and paying to the appropriate VAT office.

Non-resident companies doing business in Nigeria shall register for VAT with FIRS, but the person with whom it has a subsisting contract shall act as agent of FIRS in collecting the VAT and paying over to the VAT office. This formula varied in 1996, 1998, and 1999 **as shown on the table 4.1 .** You should note that revenue from VAT recorded a substantial growth since its inception in 1994, increasing from N726.8 million in 1994(which represented 3.6 percent of totally-collected revenue in that year), to N36,867.7 million or 8.0 per cent of the total revenue in 1998.

Table 4:1 **VAT Revenue**
Allocation Formula (%)

S/N	Governments	1994	1995	1996	1997	1998	1999
1.	Federal	20.0	50.0	35.0	35.0	25.0	15.0
2.	State and FCT	50.0	30.0	40.0	40.0	45.0	50.0

3.	Local	30.0	20.0	25.0	25.0	30.0	35.0
	Total	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

Source: CBN Publication (2000).
Approved Budgets of the Government of the Federal Republic of Nigeria

3.3 Cannon or Principles of Taxation

Here, let us consider the following.

Equity- equality of sacrifice; this principle states that the subjects of every state should contribute towards the support of the government in proportion to the revenue which they respectively enjoy under the protection of the government.

Certainty- by this principle tax paid by individuals must be certain with respect to amount paid, time of payment and manner of payment.

Convenience- the principle of convenience states that the time of payment and the manner of payment should be suitable to the contributor.

Economy- the administrative cost of collecting the tax should not be higher than revenue realised, but should be less enough to leave surplus revenue.

Simplicity- the tax system should be coherent, straight forward and clear to the tax payers and accepted by the public.

Flexibility- the tax system should be such that it should respond to changes.

Impartiality- all similar income earners should pay the same amount of tax.

Productivity/fiscal adequacy- the origin of taxation is to raise revenue for the expenditure of government, hence should be able to cover government's expenditure.

3.4 Incidence of Tax

The incidence of a tax is upon the person who pays it. In the case of income tax, the incidence is always on the person receiving the income because income tax cannot be shifted to someone else. A person's income is always being reduced by the full amount of the tax.

In the case of an indirect tax, one cannot be sure in advance whether the incidence of the tax will be on the buyer or on the seller of the commodity or whether it will be on them. The effect will depend on the elasticity of demand.

Illustration

Suppose a specific tax of N2 is imposed on a commodity previously priced N10. If the price is immediately raised to N12, the incident of the tax is clearly on the purchaser. For now, he has to pay N2 more for it. That is, the old price plus the full amount of the tax. If the demand for the commodity is perfectly inelastic, the price will rise to N12 and the full incidence of the tax will then be on the buyer as shown graphically in figure 4.2

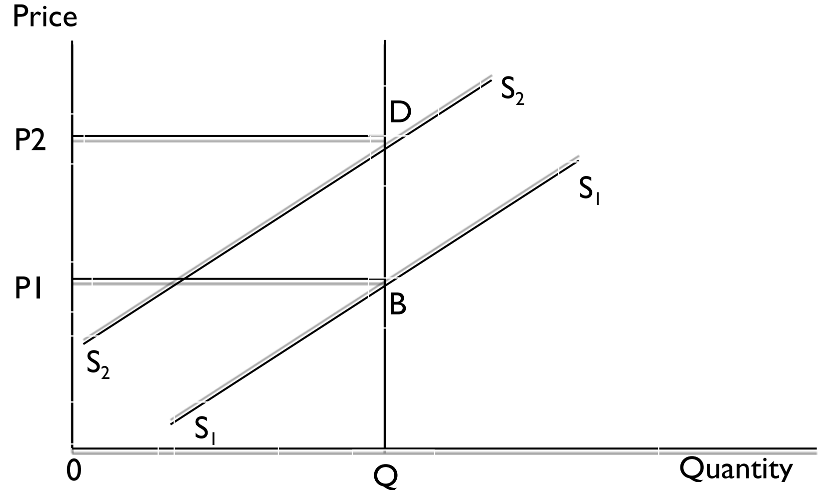

Figure 4.2: Incidence of Tax – Inelastic Demand

Tax AB increases the cost of production by that amount and so the condition of supply moved from S_1 to S_2. The demand curve being perfectly inelastic, the price rises from Op_1 to Op_2, this increase being exactly equal to the amount of the tax AB. If the demand for the commodity is perfectly elastic, the incidence of the tax will be entirely on the seller, since at any price above N10 sales drops to zero as shown in figure 4.3 b. Again tax AB increases the cost of production by the same amount, but because demand is perfectly elastic, price OP remains the same.

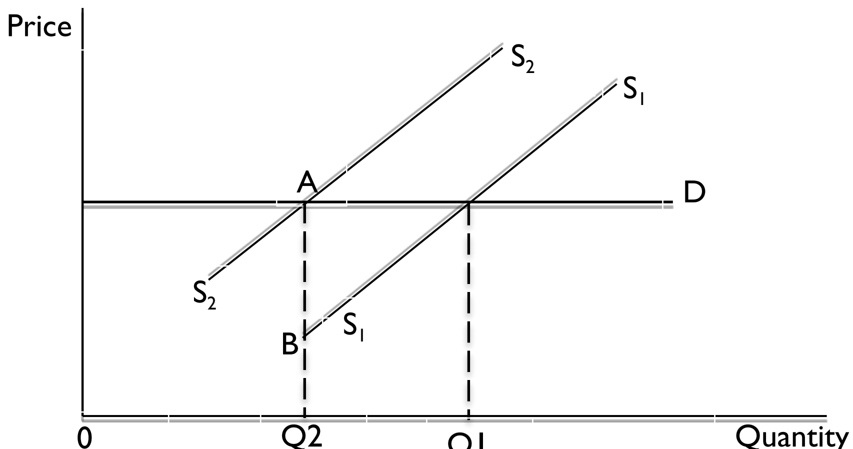

Figure 4.3: Incidence of Tax – Elastic Demand

The above are extreme cases of incidence. If demand is moderately elastic, the quantity demanded will fall off due to increase in price. To keep sales up, the price may be reduced to may be N11. In this case, buyer and seller pay part of the tax each so that the incidence of the tax is partly on the buyer and the seller as shown in the figure 4.4.

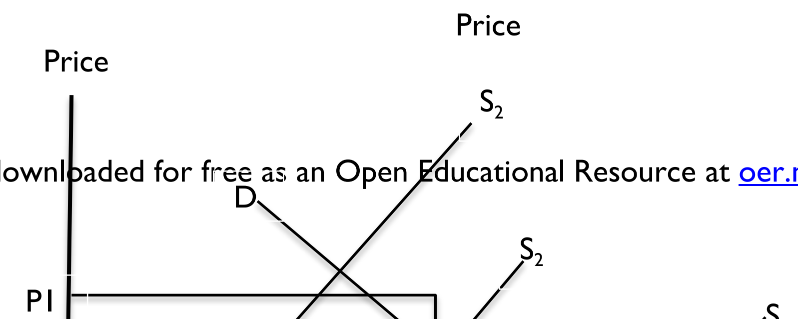

Figure 4.4: Incidence of Tax – Moderately Elastic Demand

From the foregone discussions and graphical presentation, it stands to reason that the commodities most suitable for taxation (when thinking of maximising revenue) will be those for which demand is inelastic. Unfortunately, many of the commodities for which there is a fairly inelastic demand are common necessaries of life, whereas for some luxury goods demand moves towards more elastic. Semi-luxuries like alcoholic drink have to bear an increasing burden of taxation because experience has indicated the demand for them to be fairly inelastic.

3.5 Effect of Tax on Economic Amenities- Purpose of Taxation

The general tax administration and practicing guide for professionals proffers the following reasons for imposition of taxes:

1. to maintain general administration, defence, law & order, and social services provided by government
2. to reduce income and wealth in order check inequality
3. to control consumption of goods and services considered non-essential and harmful
4. to check inflation by reduce the volume of purchasing power
5. to service national debt and to provide retirement benefit etc.
6. to provide subsidies in favour of preferred sectors of the economy-for example, agro-allied industries
7. to implement government policies since budget is now an adjunct to monetary policy
8. to serve as a dependable fiscal tool to plan and direct the economy, by shaping the growth and development of the country.

Self-Assessment Exercise

List the purposes of Taxation.

3.6 Tax Evasion and Tax avoidance

Tax evasion is the manipulation of forms when rendering returns and claims as regard the taxpayer's income status and the accompanying responsibilities. This is a direct violation of the law and it involves a fraudulent or deceitful effort by the tax payer to escape legally stated obligation. It is a criminal offence as it involves illegal means of reducing the tax payable by making false returns or by deliberate omission from the return of some source of income like declaring lower income or refusing to pay altogether.

Tax avoidance

This is where the individual takes advantage of the loopholes in tax regulation and manipulate his/her economic situation accordingly to pay low tax. It occurs when a tax payer takes a perfectly legal course to lower the amount he has to pay in taxes like the taking a life assurance policy, deductible from the total amount subjected to tax or claiming the existence of an aged mother or father- where there not which statutorily attract some deductions from the taxed sum and declaring that he has children whereas he/she has none

Self-Assessment Exercise

Differentiate between tax avoidance and evasion.

4.0 Conclusion

Tax is compulsory levy on the residents of an economy by the government of that economy. In this unit, we will see tax as a compulsory payment which is enforced by law for adults within the work-force age to pay and the non-payment leads to penalties. The other fact is the only government can levy tax as a means of revenue.

5.0 Summary

In summary, we have discussed the definition and historical perspective in Nigeria, highlighting types of tax, canons/incidence of tax, effect of tax on economic amenities, tax evasion and avoidance.

6.0 Self-Assessment Exercise

1. State the purpose of taxation

2. List the incidence and effects of taxation on economic amenities.

7.0 References/Further Reading

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