Raising the Internally Generated Revenue of States – Lessons and Opportunities

Background Paper[1] for the Nigeria Governors' Forum 2017 National IGR Peer Learning Event

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At the State-level, Internally Generated Revenue (IGR) are revenues sourced solely by the State and its local governments. It covers not just those sources defined in the taxes and levies (approved list for collection) Act of 2004 (as Amended 2015) but all other sources of revenue such as charges for land use and government services.

2.0 The 2015 Peer Learning Event:

In November 2015, the Nigeria Governors' Forum Secretariat organised the first IGR peer learning event[3] which provided States with the opportunity to learn about perspectives and replicable good practices in IGR mobilisation and management, including sub-national, national and international lessons. The event also covered technical paper presentations, State case presentations and breakout sessions to share experiences and potential solutions to revenue challenges. But more importantly, was a self-appraisal using a nascent dashboard where states indicated their status on tax administration, tax procedures, tax processes and tax enforcement. The activity led to an action planning activity in which states were asked to highlight short, medium and long term actions they would implement to improve the effectiveness of their SBIRs.

The innovative approach adopted in the event ensured that key challenges faced by States and replicable practical measures adopted to curb the challenges were brought to the fore. A summary of key findings is presented below. These are categorised under, the real cost of engaging tax agents, major challenges and replicable practical measures

The event subsequently developed into the NGF IGR Dashboard, an online tool allowing states to conduct a more detailed self-assessment and report their IGR figures monthly with a view to understanding areas where they could share good practice with others, and where they could also identify more clearly, areas that they need to focus on and areas that require technical assistance.

Real cost of engaging tax agents

- Information asymmetry - because of the very poor level of awareness of tax obligations, laws and rights, tax agents exploit the taxpaying public to the maximum possible while, at the same time, under-reporting (where possible) tax potentials to policymakers,
- Collection concentrates on a few sectors where heavy investment is not needed to milk taxpayers. These sectors include stalls, markets and parks where potential taxpayers can easily be exploited, and where extortion is easy because taxpayers have a high incentive to keep their businesses running.
- Huge costs to political goodwill as agents undermine the social contract between politicians and citizens.
- Poor monitoring systems encourage a multiplicity of taxes. Agents can easily multiply payable taxes, inflate tax rates and demand double payment of a tax. This they are able to do because they are aware that there are no routes for channelling grievances to government.

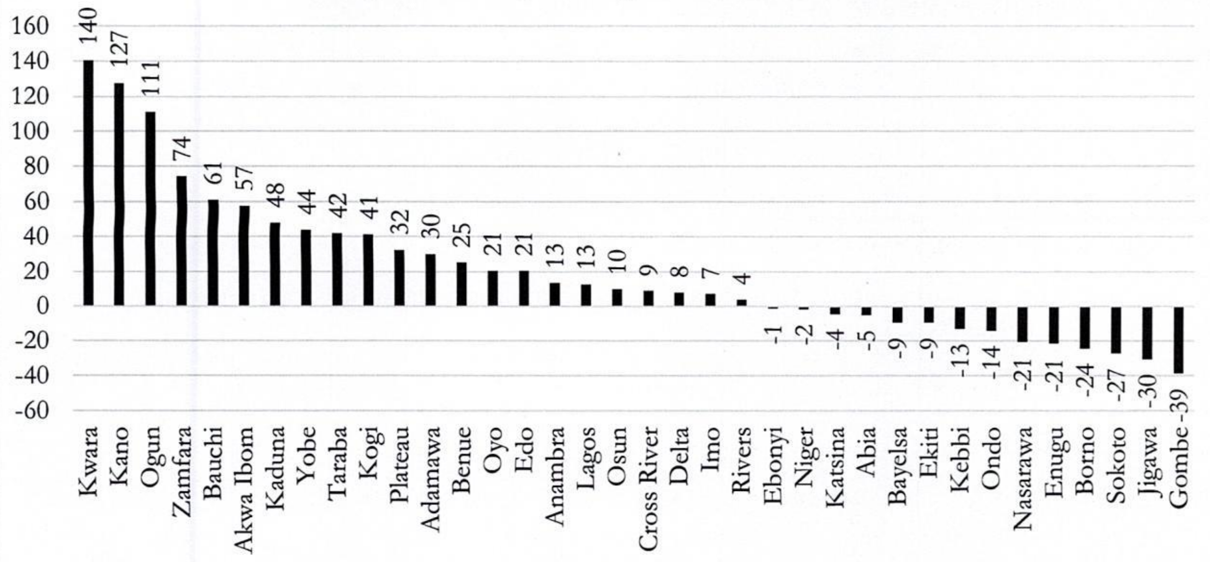
[3] The programme was organized in partnership with the State Partnership for Accountability, Responsiveness and Capability (SPARC), Federal Public Administration Reform Programme (FEPAR), State Accountability and Voice Initiative (SAVI) and Growth and Empowerment in States (GEMS3), the World Bank, Enhancing Nigerian Advocacy for a Better Business Environment (ENABLE2), the Federal Inland Revenue Service and Joint Tax Board.

Replicable practical measures

- Introduction of cutting-edge technology to simplify revenue collection and tax administration through:
  - Elimination of sources of revenue leakages
  - Creation and improvement of tax databases
  - Generation of projected revenue from different sources
  - Generation of reports showing revenue distribution.
- Institutionalization of far-reaching tax reforms with formulation of IGR strategies and action plans which result in improvements in tax collection.
- Strengthened land administration
- Setting up of better functioning tax institutions, to open up opportunities for more direct appropriation of revenue
- Establishment of financial and administrative autonomy for States Internal Revenue Services through the enactment of relevant laws
- Improved tax planning, professionalism, and staff morale as this has proven to rapidly improve tax collection and compliance among large companies
- Improved outreach and monitoring capacities of revenue staff who regularly visit formal businesses and informal sector organizations to identify potential taxpayers, explain the tax payment process, and check for payment certificates
- Improvement on compliance and strong commitment to enforcement, including sealing delinquent businesses
- Strong commitment on the part of governments to improve the tax environment through improvement in collection and remittance infrastructures, improvement in the collection processes and better engagement of taxpayers through town hall meetings, education and enlightenment activities.
- Introduction of Hotels and Events Centres Occupancy and Restaurants Consumption Law thereby introducing consumption tax on hospitality industry for goods and services
- Introduction of Land Use Tax Law (incorporating Property Tax, Ground Rent and Tenement Tax)
- Expanding base for Capital Gains Tax (CGT) and Stamp duties through land registration "amnesty" window and reduction in CGT and stamp duty rates
- Issuance of new Regulations and Guidelines for conduct of lottery, pools betting, casino and gaming activities
- Identification of revenue that was not being collected or enforced
- Expansion of existing tax base by bringing more persons and activities into the tax net including taxing the informal sector (Presumptive Tax initiative)
- Enhanced procedures for assessment of tax liabilities
- Major organizational restructuring and business process re-engineering of IRS including automation of processes and HR capacity development
- PoS terminals at tax offices linked to the revenue account
- Introduction of e-filing system
- New coding system for PAYE
- New website to support online tax payment
- Specialized taxpayer service units in tax offices
- Electronic TIN registration kits deployed in tax offices
- State-wide electronic taxpayer enumeration survey
- Improvement in the business environment to attract private capital investments

Figure 2 shows the 2016 annual growth in internal revenue across all the 36 States with Kwara State (140%) recording the highest growth rate followed by Kano (127%), Ogun (111%), Zamfara (74%), Bauchi (61%), Akwa Ibom (57%) and Kaduna (48%). However, Lagos, Rivers and Ogun State remain highest in nominal terms with their IGR at N302.43 billion, N85.2 billion and N72.9 billion respectively.

Figure 2: IGR growth (percent), 2015 - 2016



Data Source: Computed based on data from the Joint Tax Board (2017)

4.0 Government policy responses

Following the changing economic landscape and cautious fiscal sustainability forecast for the country, governments at both the national and sub-national levels have adopted several policy measures aimed at ameliorating the country's macroeconomic and fiscal conditions. These have been primarily hinged on domestic revenue mobilisation as the vehicle for fiscal recovery, stability and economic development. The major policy responses undertaken by governments include the following:

4.1 The National Economic Council Retreat (2016):

The first practical step was the National Economic Council Retreat of March 2016 which birthed 71 Resolutions, with a dedicated theme on Revenue Generation and Fiscal Stability. The Retreat Technical Report states that for Nigeria to attain the average revenue to GDP ratio of similar economies, it has to increase its tax revenues by 300 percent from less than 7 percent to 20 percent of GDP, and that at least 70 percent of its revenues must come from non-oil sources to ensure sustainability and forestall the country's exposure to shocks in oil prices.

S/N	Resolutions	Key Benefits	Responsibility
11	Expand compliance on VAT by adopting a gradual plan for rate increase.	To improve government VAT tax revenues.	• FIRS • SIRS
12	Embark on fiscal responsibility campaigns at all levels of Government (focus on fiscal responsibility as a critical element in macro-economic balance).	To ensure stakeholder buy-in for fiscal responsibility y drive.	• Federal Ministry of Finance • State Ministry of Finance
13	Maintain a minimum level of capital expenditure of 30% in the budget.	To increase focus on capital projects that will increase economic output.	• Federal Ministry of Budget & Planning • State Ministry of Budget & Planning

4.2 The Economic Recovery and Growth Plan (ERGP) (2017 -2020):

The Economic Recovery and Growth Plan (ERGP), a medium-term plan for 2017 – 2020, was developed to restore economic growth hinged on the expected recovery of crude oil production (from 2.2 mdpd in 2017 to 2.5 mbpd in 2020) and growth in non-oil GDP (from 0.20 percent in 2017 to 7.28 percent by 2020). Growth in non-oil revenue are hinged on improved tax and customs administration, including the introduction of taxes on luxury items. The plan provides for effective collaboration and coordination with the States to ensure that the Federal and State Governments work towards the same goals.

4.3 The Fiscal Sustainability Plan (FSP):

Developed by the Federal Ministry of Finance in May 2016, the Fiscal Sustainability Plan (FSP) was designed as part of a 'Budget Support Facility' for States. It highlights five (5) key strategic objectives, followed by 22 recommended action points, with a view to improving government fiscal behavior and align both short and long term sustainability objectives of both the Federal and State Governments. From 2016 onwards, all State governments were expected to abide by the plan's strategic objectives to achieve accountability and transparency, increase in public revenue, rationalization of public expenditure, public financial management reforms, and achieve sustainable debt management. Specifically relating to increasing public revenue, the strategic objective is to:

> *'Focus on the need to create a sustainable system of revenue generation for the States by increasing independently generated revenues and improving the viability of States as "stand-alone" entities that can on the back of their own revenues, raise capital and receive support from development institutions".*

Among revenue-related actions, the FSP recommended reform actions to set realistic targets for IGR, strengthen the collection of value added tax (VAT), withholding tax (WHT) and pay-as-you-earn (PAYE) through measures such as the review of all revenue-related laws/rates/tariffs, and improved collaboration between the Federal Internal Revenue Service (FIRS)/States Internal Revenue Service (SIRS). These actions as stated in the plan, are shown below:

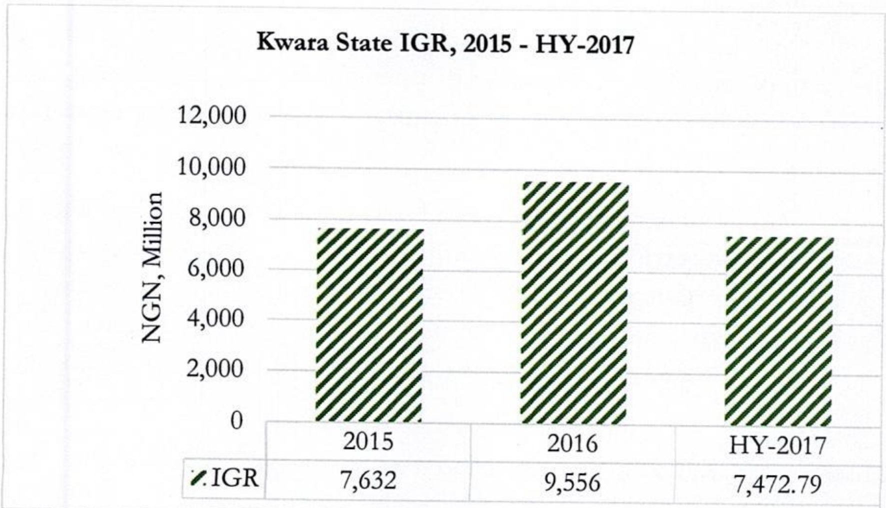
5.1 Kwara State

The Kwara State Internal Revenue Service (KW-IRS) has initiated several reforms since 2015 to ensure growth is revitalised. These reforms include achieving full autonomy, and a restructuring exercise for the Service. The new law also mandated the KW-IRS to be the sole revenue collector for the State.

In the 2015 NGF IGR Peer Learning Event, the Service had listed the following actions as its next steps to improve revenue performance:

- Bring in the informal sector by fast-tracking consultations with relevant stakeholders, complete the process of [taxpayer] enumeration and collection of categories.
- Optimise collection of taxes from High Net-Worth Individuals (HNWIs) by advocacy and interaction.
- Increase present IGR level by 100 percent by completing the automation process.

Since the workshop, Kwara State Internal Revenue Service has established an informal sector directorate. Consequently, it was able to register 10,000 new taxpayers between December 2015 and January 2016. With strategic stratification of the sector and deepened engagements with key stakeholders, the State enrolled additional 26,770 and 49,125 new taxpayers from the market and artisan categories respectively. To ensure flexibility in collection and block existing leakages associated with manual receipting, the informal sector directorate introduced POS machines for artisans, markets and local governments.



Data Source: Joint Tax Board (2017)
Note: 2017 half year (HY) data is provisional

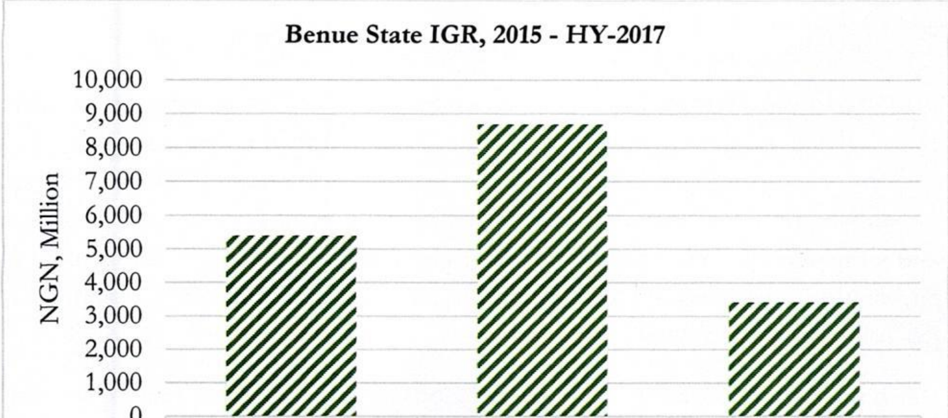
Growth in direct tax was an obvious outcome of these reforms. Over the one-year period, direct assessment increased by 120 percent, from N314 billion in 2015 to N689 billion in 2016. The trend has continued, with half year 2017 results reaching N458 billion for the tax category. Other reforms implemented include the institution of a centralised and automated tax collection platform integrated with the State's Electronic Revenue Management System (ERMS) for easy monitoring and reconciliation.

Since then, the Service has undergone series of reforms, including reconstitution of the Board and management of the Service to drive its change process, review of obsolete rates in the 2015 Benue State Administration and Revenue Collection Law, and implementation of relevant extant tax laws. The BIRS also automated its revenue collection, remittance and reconciliation processes ensuring leakages associated with manual processing were blocked. MDA revenues and contracted out collection to tax consultants are now monitored using an electronic dashboard which monitors collections real-time. Over 5,000 POS machines were deployed across hospitals, courts and other revenue generating MDAs (including consultants' outposts) to streamline payments and receipting, and curb sharp practices.

In addition to these reforms, MDA revenue accounts were closed, and their collections consolidated into a pool account using the Nigeria Interbank Settlement System (NIBSS). The BIRS has been able to shove up revenue with idle and undisclosed funds being captured. And to compliment this, the BIRS deployed multiple payment channels including e-banking and a web payment platform.

To address the complaint of delays and inadequate release of refunds to essential MDAs who had begun reneging on compliance with the consolidated revenue system, the Service had gotten such MDAs to open expense accounts, into which an agreed percentage cost of collection is refunded daily upon consolidation and reconciliation of revenue inflows. This action improved compliance an addressed a major problem faced by most States

The Service also embarked on large-scale taxpayer enumeration drives to capture more taxpayers in its database, especially from the informal sector. Through strategic engagement channels, it could sensitize and convince taxpayers in the sector to become more compliant and pay taxes especially those in the agricultural sector. The active exploitation of its database has also allowed the Service conduct targeted debt recovery, which has yielded successful back duty audits. A 24-hr hotline was also created to access enquiries and complaints.

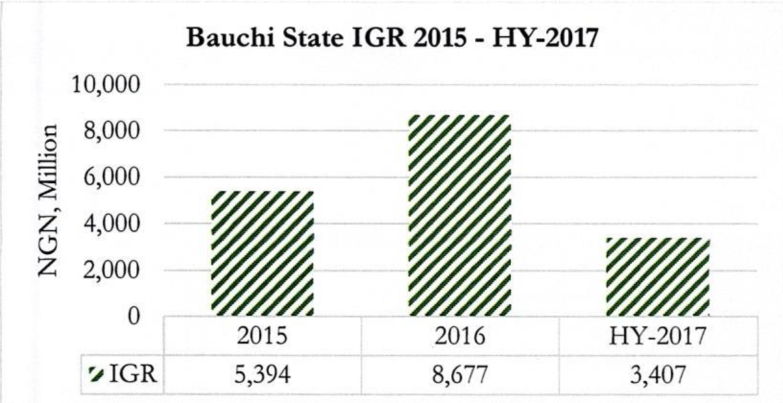


	2015	2016	HY-2017
IGR	5,394	8,677	3,407

Data Source: Joint Tax Board (2017)
Note: 2017 half year (HY) data is provisional

Since attaining administrative autonomy and improved funding, the Board has been able to restructure its Service; recruit professionals for its work streams and incentivise staff to execute the mandate of the Service effectively. Part of these incentives includes a 2 percent monthly payment and a contributory pension scheme for new entrees. As part of the restructuring exercise, the Board instituted within the Service, a High Net Worth Individuals (HNWI) unit responsible for engaging and managing HNWIs. The unit employs a "personal banking" model by providing bespoke services for this taxpayer group.

To compliment these reforms, and ensure greater efficiency in the Service the Board introduced several innovative technologies to ease tax collection, block leakages, improve administration and ensure accountability by staff. Amongst processes improved was its payment system using the Paydirect system and POS machines, along with the installation of the Integrated Tax Administrative System (ITAS) to ease account reconciliation, reporting, budgeting, registration, assessment and issuance of notices. The deployment of ITAS, ICT infrastructure, and a cloud-based server network across all its offices made operations in the Service more efficient and effective, reducing the turnaround time for executing tax processes.



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These reforms have resulted in IGR growth by 61 percent from N5.4 billion in 2015 to N8.7 billion in 2016. To promote taxpayer confidence, the Service has a professionally run corporate communication department that facilitates awareness programmes, linking taxes to the provisions of social and public services by the State government. To complement this, a tax complaint management process was introduced to give advice to taxpayers and deal with complaints. Objections to tax assessment are dealt with separately by the financial units. In addition, a detailed chart of legal taxes, rates and levies is made available to the public to discourage touting and illegal collections.

4. **Poor Planning:** Lack of a clear strategic plan leaves operations running on reactive rather than proactive decisions. Lack of manpower and clarity to execute and implement these plans has also put pressures on their ability to meet these plans, such as processes to manage key categories of taxpayers including the informal sector and HNWIs.

5. **Poor Taxpayer Database Management:** Some States are yet to integrate their TIN database with other relevant databases as suggested by the NTP 2017. This is worsened by poor inter-agency collaboration between the SBIRs and relevant data agencies such as Banks (BVN), Corporate Affairs Commission, Ministry of Lands, Survey and Country Planning. While the JTB has taken the lead in this regard, providing States with collaborative opportunities, some States are yet to fully engage and exploit the benefits therein.

6. **Non-Institution/Designation of Revenue Courts:** Only a few States have instituted or designated revenue courts to prosecute tax offenders and recover debts more effectively. The absence of revenue courts continues to undermine the efforts of SBIRs in debt recovery, with cases spanning years unresolved.

7. **Poor Adoption of Modern Technology:** Many States still lack basic ICT infrastructure to facilitate efficiency in the SBIR. More predominant and disturbing is the inefficient manual process of documentation and assessment still being employed by many SBIRs who are yet to adopt digitalized and electronic systems for tax administration.

8. **Inadequate Capacity Building:** Inadequate skilled manpower worsened by poor capacity building and training programmes for tax officers continues to hinder any significant efficiency gains from other reforms that they undertake.

7.0 Key Recommendations

The following recommendations remain key to ensuring effective tax administration and sustainable revenue result. These key recommendations are grouped under five (5) major themes including:

1. **Strong Political Drive:** A common driving force for the States that recorded remarkable growth in 2016 is the strong political support from their Governors, ensuring that appropriate enabling laws are presented to the State Houses of Assembly and passed while providing adequate funding for effective administration of taxes by the SBIR. The NTP 2017 advocates similarly, that tax related laws be periodically reviewed, and adequate funding be provided to ensure that revenue authorities execute their mandate effectively and efficiently. State Governors should take a cue from their colleagues and support strategic reforms needed to push effective tax administration in their State.

2. **Autonomy:** It is evident from the States examined in this paper, that granting administrative and financial autonomy to SBIRs is positively correlated with improved revenue performance. This is because the SBIR is able to implement necessary reform actions to address inherent challenges that characterise poorly structured Services. In addition, the SBIRs should be made

attain a top-50 position on the global index of ease of paying taxes by 2020 and consistently improve on the ranking

5. An administrative framework for amnesty and whistle blowing as part of the strategies for curbing evasion and widening the tax net
6. And a requirement for INEC to mandate political parties to articulate, prepare, provide and make public their tax agenda before and during election campaigns

The NTP also highlights an appendix of potential changes required to existing laws, laws to repeal and suggested new enactments.

4.5 Voluntary Assets and Income Declaration Scheme (VAIDS):

Arising from one of the recommendations of the NTP, VAIDS was introduced to incentivise voluntary engagement and increase taxpayer population. The scheme was designed to be implemented within a limited window of 9 months (1 July 2017 – 31 March 2018). Many taxpayers know that they should comply with the tax laws but are concerned that if they come forward, having ignored their responsibilities for a while, they may be hit with back duty investigations with large penalties and interest charges or even prosecuted for acquiring certain assets. The VAIDS process insures the taxpayer against back duty investigations, penalties and interest, provided full disclosure is made and that all outstanding sums are paid within the period of the scheme. Where the tax bill is huge, it may be paid in instalments over up to three years, but payment made after the window will attract interest while no penalties will apply. VAIDS applies at all tiers of government, and although mainly targeted at high net worth individuals and companies, it can be used by all Nigerians. It provides a supportive leverage for SBIRs to manage their high net worth taxpayers.

4.6 Passage of State revenue-related laws

One of the key responses implemented through the JTB, is the inauguration of Joint State Revenue Committees to harmonise taxes and levies and amend obsolete provisions in tax laws. These activities involve wider collaboration with stakeholders including the Ministry of Finance, the Ministry of Justice, and the National Assembly (for national laws); and State Houses of Assembly (for State laws). The domestication of the presumptive tax regime has also created a healthy framework to tax the informal sector based on the nature and location of their businesses.

4.7 FIRS-SBIR collaboration through the Joint Tax Board

Collaboration between the FIRS and SBIR through the JTB has contributed significantly to an increase in joint audit exercises, which have led to the sharing of useful information on unremitted taxes in many States. Other measures have included the Taxpayer's Identification Number (TIN) upgrade to facilitate data sharing and tracking across the 36 States; integration of BVN and TIN aimed at capturing a greater number of people in the TIN and FRSC databases to the existing 17 million people registered under the Bank Verification Number (BVN) initiative.

These measures have been complemented by reforms implemented at the federal level to strengthen the collection of value added tax (VAT), withholding tax (WHT) and pay-as-you-earn

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