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Value Added Tax Administration in Nigeria: An Inquiry into Irrecoverable Invoices

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Abstract

This paper discusses value added tax (VAT) administration in Nigeria and examines the relationship between irrecoverable invoices and VAT compliance. Twenty small and medium enterprises (SMEs) in the leasing, manufacturing and construction subsectors of the economy were sampled. Data were collected through a survey using questionnaire. Analyses were performed by means of descriptive statistics and Pearson product moment coefficient of correlation with the aid of statistical package for social sciences (SPSS). Findings indicate a statistically significantly moderate negative relationship between irrecoverable invoices and VAT compliance. The tax authority could use the findings to decide on the measures to adopt to achieve efficient VAT administration taking into consideration irrecoverable invoices. This study is of value for better comprehension of VAT administration, particularly by investors entering the Nigerian business environment for the first time. It also highlights irrecoverable invoices factor in enforcing VAT compliance in the context of SMEs.

Keywords: Value added tax, small and medium enterprises, Nigeria.

1. Introduction

VAT has constituted a veritable source of revenue to the government since its inception in 1994 following the enactment of Decree No. 102 of 1993, accounting for approximately 1.9% of Gross Domestic Product (GDP) in 2010 (FIRS, 2011). The decree was consolidated to VAT Act Cap V-I, Laws of the Federation of Nigeria (LFN) 2004. A further amendment was effected on 27th May 2007 as VAT (Amendment) Act, No.12 of 2007.

This positive contribution of VAT to national income is also applicable to other countries. In France, it accounts for approximately 50% of State revenue (Thacker, 2009), 30% of total tax revenue in 1982 in Cote d'Ivoire, Kenya and Senegal (Shalizi and Squire, 1988) and by 1988, occupied 4.5% of total Gross Domestic Product (GDP) in Indonesia (Bogetic and Hassan, 1993).

Nations with high population and increased economic activities are likely to experience appreciable increase in VAT revenue since it is a consumption tax levied on "vatable" goods and services imported and produced in a country. This fact provides evidence that the burden of VAT is on the citizens, with low income earners at the highest receiving end. In the views of Nishiyama (2012: 683 – 704), VAT is definitely regressive especially for low income earners. Though, Nigeria has the lowest VAT rate of 5%, India for example, charges as high as 12.5% (Tripathi, Sinha, and Agarwal, 2011: 32 – 39). VAT operates by adding 5% to the value of goods and services on a vatable invoice. The VAT element of the invoice becomes due for payment by a vatable person as soon as the invoice is acknowledged by the consumer regardless of whether it has been settled or not. The scenario presents compliance difficulties when all or part of the invoice is unsettled. Otherwise, the taxpayer will resort to borrowing to ensure compliance and avoid penalties and prosecutions.

Scholars in the past have undertaken some studies on VAT. Sanni (2012: 186 – 201) reviewed current law and practice of VAT in Nigeria and found that the merging of local VAT offices (LVOs) with integrated tax offices (ITOs) and the abolishing of VAT Appeal Tribunal with the establishment of Tax Appeal Tribunal to handle all appeals in respect of federal taxes have streamlined VAT administration. In addition, Adereti, Adesina, and Sanni (2011: 456 – 471) examined VAT and economic growth in Nigeria. The study identified VAT revenue as accounting for 95% significant variations in GDP. Tripathi *et al* (2011: 32 – 39) in India, did a work on the effect of VAT on the Indian society. They forecasted a change in the nature of trade in the coming years with the medium level of trade facing problems as companies would reduce the tier of marketing. According to them, small retail dealers would be required to maintain more accounts or pay composition money which cannot be collected from the customers. This notwithstanding, VAT was identified as the real goal maker of the Indian government.

None of these studies interrogated the impact of unsettled invoices already subjected to VAT on the vatable person. The purpose of this paper is to identify the influence of irrecoverable invoices on VAT compliance by vatable persons.

Theoretical framework will be discussed in the next section. This will be followed by methodology, data presentation and analysis, discussion of findings, conclusion and recommendation.

2. Theoretical Framework

The administration of VAT refers to the processes adopted in registering, assessing, collecting and accounting for VAT revenue. It encompasses penalties and cases of appeal associated with the making of returns arising from failure to register in line with the VAT Act. The Federal Inland Revenue Service (FIRS) is the tax authority responsible for the administration of VAT.

2.1 VAT Registration

Registration by vatable persons is the starting point of VAT administration. Every person or company carrying on business or trade whose products or services are not exempted is expected to register with the FIRS (VAT Act Cap V-1, sections 8-10, LFN 2004). The period for registration is six months from the commencement of the Act or business, whichever is earlier. Contraventions attract penalty of N10,000 for the first month in which the failure occurs and additional N5,000 for each subsequent month in which the failure continues.

Ministries, parastatals and agencies of government are also to register as collecting agents of the FIRS. To enforce compliance, contractors are to provide evidence of registration with FIRS as condition for obtaining contract. In addition, non-resident companies shall register through their representatives who transact business on their behalf in Nigeria. Registration is, therefore, paramount as it provides a data base of vatable persons against which the success of VAT administration is measured.

2.2 VAT Assessment

VAT assessment complies with the self-assessment procedure in which a Vatable person assesses himself by adding 5% to the total value of his VATable goods and services. Unlike other types of taxes such as the companies income and education taxes, it does not involve elaborate calculations of capital allowances and assessable income.

The assessed tax becomes due for payment once the VATable invoice is issued and acknowledged. This form of assessment is applicable to both input and output value added taxes. An input VAT arises when an individual purchases VATable goods and services (local or imported) for consumption while an output VAT becomes eminent when the individual sells VATable goods and services (excluding exported items) to another person. The excess of the input VAT over the output VAT is refundable while the reverse becomes the valid VAT payable to FIRS (VAT Act, Cap V-1, S.16, LFN 2004). Though, VAT assessment is self assessment oriented, the FIRS may assess on a best of judgement (BOJ) basis if the tax payer fails to render returns or renders an incomplete or inaccurate returns (VAT Act, Cap V-1, S.18, LFN 2004).

2.3 VAT Collection

This dimension of VAT administration addresses the collection and remittance of the tax element of VATable goods and services to the Federal Inland Revenue Service (FIRS). From the assessment perspective, all producers/manufacturers of goods and services, traders, companies, government agencies, ministries and parastatals are collecting agents to the FIRS.

In addition, returns are made to the tax authority (FIRS) on all taxable goods and services purchased or supplied within 30 days from the date of the transaction. Any excess of output VAT over the input VAT shall be paid or remitted, otherwise, the excess input VAT is refundable (VAT Act, Cap V-1, sections 15 & 16, LFN 2004). Allowable input VAT are those on goods imported or purchased for resale and for direct production of new products on which output VAT is charged (S. 17 of the Act, LFN 2004). Payments are accompanied with a schedule indicating the name, address and VAT registration number of each agent, number and amount on the VATable invoice, month of transaction and the VAT payable. FIRS also has a pre-printed format (form VAT 002) issued to VAT agents to enhance the making of returns and subsequent remittance of VAT (FIRS Information Circular No. 9902, 1st January, 1999).

2.4 VAT Accounting

The relevant tax authority (FIRS) keeps records of all taxable persons, VAT collected and accounts for same to the

Federal government. This approach engenders accountability, transparency and provides data for review and improvement of the VAT system.

Similarly, the requirements of the law, mandates all agents to keep accurate records of all taxable goods and services produced and consumed, VATable invoices and imports of VATable goods and services. This facilitates proper determination of VAT due by the FIRS in the case of tax audits. And because some transactions are not VATable, adequate record keeping assists in the separation of taxable from non-taxable invoices, thereby eliminating unnecessary disputes between the tax payer and the FIRS.

2.5 Penalties

Penalties associated with VAT as per the Act (S. 25 – 37) are legion, covering failures to register and render returns. For instance, refusal to register within six months of the commencement of the Act or six months of commencement of business attracts a penalty of ₦10,000 for the first month in which the failure occurs and ₦5,000 for subsequent months in which the failure continues. Non-remittance of tax attracts a penalty of 5% (including interest at commercial rate) of the amount of tax remittable. Failure to notify the FIRS of any change of address within one month of such change, attracts a penalty of ₦5,000.

Also, refusal to issue a tax invoice for goods and services sold or purchased attracts a fine of 50% of the cost of such goods and services for which the invoice was not issued. Obstructing an officer from inspecting the premises and records of a VATable person and refusing to comply with the outcome of such inspection as well as making statements that fail to produce accurate value of VATable goods and services especially where transactions are not for money consideration, is an offence which on conviction attracts a fine of ₦10,000 or six months imprisonment or both.

The foregoing notwithstanding, issuing a tax invoice by an unauthorized person or any person not authorized to act in that capacity gravitates a fine of ₦10,000 or six months imprisonment. A monthly penalty of ₦2,000 is imposed on any person who fails to keep records and accounts of his business transactions, for proper ascertainment of VAT and filling of returns. Failure to collect tax by a taxable person incurs a penalty of 150% of the amount not collected together with 5% interest in excess of Central Bank of Nigeria (CBN) rediscount rate. Failure to submit returns attracts a monthly penalty of ₦5,000 , while aiding and abetting the commission of any offence under the Act attracts a penalty of ₦50,000 or five years imprisonment.

Omission or commission of any of the offences under the Act arising from the misconduct of a taxable person attracts a fine of ₦10,000 or four times the amount of tax that was intended to be evaded by his conduct, whichever is greater or to imprisonment not exceeding six months or both.

On the other hand, furnishing of false documents is subjected to a fine of twice the amount under declared. Evasion of tax attracts a fine of ₦30,000 or twice the amount of tax evaded whichever is greater or imprisonment not exceeding three years, while failure to make attribution or to notify the FIRS of an attribution made incurs a penalty of ₦5,000

2.6 Tax Appeal Tribunal

The Minister of Finance establishes tax appeal tribunals in designated zones of the FIRS to hear the views of aggrieved tax payers who may be uncomfortable with assessments and demand notices made on them. Notice of appeal against assessment contains the name and address of the taxable person, the total amount of goods and services chargeable to tax for each month, any input tax and net amount of tax payable. Others are the copy of assessment notice, the precise grounds of appeal against the assessment and the address for service of notice, process or other document to be given to the appellant and the secretary to the Tribunal.

The Tribunal upon hearing the appeal may confirm, reduce, increase or amend the assessment or make such orders thereon as it deems fit. However, any party not satisfied with the Tribunal's judgement may appeal to the Court of Appeal within 30 days on giving notice to the Secretary of the Tribunal.

2.7 Goods Exempted From VAT

The Act, to make for easy administration, exempts certain goods from VAT. They are medical and pharmaceutical products, basic food items, books and educational materials, baby products, fertilizer, locally produced agricultural and veterinary medicine, farming machinery and farming transportation equipment as well as all goods exported.

Others are plant and machinery imported for use in the export processing zone, plant, machinery and equipment and implements purchased for utilization of gas in down-stream petroleum operations and tractors, ploughs and agricultural equipment and implements purchased for agricultural purposes.

2.8 Services Exempted From VAT

These are few when compared to the number of goods exempted. They are medical services, services rendered by Community Banks, People's Bank and Mortgage Institutions.

Others are plays and performances conducted by educational institutions as part of learning and all exported services.

2.9 VAT Compliance

Approaches to compliance vary from one programme or legislation to the other depending on the nature of activity. From the perspective of the tax law, VAT compliance is the process whereby a tax payer complies with the requirements of registration, assessment, accounting, collection and remittance of VAT to the tax authority. The level of compliance is a function of few tax related variables. For instance, the size of income of the tax payer, knowledge of tax due, frequency of audit, probability of detection by tax authorities and severity of punishment if caught are some of the important determinants of tax compliance model (Naibei and Siringi 2011: 73-88). According to them, tax compliance can therefore be increased if control measures are put in place to detect non compliers and punitive measures instigated.

A good VAT system, apart from including a single tax rate and broad tax base with few exemptions, should aim at modernising procedures for enforcement and compliance. This is essential to ensure adequate compliance. In the UK, it is reported that the VAT gap is £11.5 billion between 2009-2010 which is estimated to be 14% of the potential revenue yield (Nishiyama 2012: 683 – 704). VAT gap represents the difference between tax actually collected and the tax that would have been paid if all tax payers (individuals and companies) complied with the law.

Literature shows that VAT compliance costs constitute part of the gaps noticed. As stated by Eragbhe and Omoye (2014: 614 - 620), VAT compliance costs are all costs, besides the actual tax liability, borne by the tax payers and third parties in the process of ensuring that they comply with the provisions of the relevant tax laws and the requirements laid on them by the relevant taxing authorities, including the inconveniences encountered in the process of becoming and remaining tax compliant. Nishiyama (2012: 683 - 704), noted that compliance costs are regressive and stressful to tax payers, especially SMEs. According to him, a survey in 2004 in New Zealand showed that compliance costs amounted to NZ$1,285 for firms with NZ$40,000 – 99,000 turnover, but NZ$2,646 for firms with more than NZ$1.3 million turnover. The survey revealed that level of stress for New Zealand VAT (goods and services tax, GST) were higher (3.8%) than for pay-as-you earn income tax (3.2%) as they have to be conscious of compliance and to find the money to pay the tax.

2.10 Irrecoverable Invoices

Majority of global economic activities are transacted on credit with payments made subsequently. Borrowings by State and Federal governments all over the world confirm this assertion. This fact boosts consumption; trade and short term sources of finance particularly, industries in the small and medium enterprises (SMEs) sector. Also, the introduction of cashless economy meant that few business activities will be carried out on cash basis. In this context, irrecoverable trade invoices reduces cash inflow and makes it difficult for a taxpayer to remit the VAT element of the invoice in compliance with the VAT Act.

These categories of invoices constitute bad trade receivables which are written off to income statement. They represent costs of financing trade on credit. Credit transactions become irrecoverable as a result of reduction in business activities, unforeseen circumstances such as destruction of goods by flood and erosion, environmental conditions leading to poor harvest of agricultural products and general recession in the economy.

Though, input VATs are expected to compensate output VATs in terms of cash outflow, activities of some business sectors such as professionals rendering consultancy services do not encounter allowable input VAT. Even in the case of activities recognizing allowable input VAT, problem of compliance is the same

for both the seller and the consumer, given the existence of credit transaction. Invariably, enforcing VAT compliance without recognising the complexities of credit sales/purchases may present difficulties.

3. Methodology

Primary data are collected through a survey using questionnaire structured on a four point scale. The questions are six in number; three for respondents' profiles and three for the variables. The study focuses on small and medium enterprises registered as VATable organisations with the FIRS in Port Harcourt, Rivers State of Nigeria. Applying the judgmental sampling technique, 20 companies in leasing, manufacturing and construction subsectors of the economy were selected for sampling.

Respondents were required to indicate their lengths of service with their organizations, employment category (management, senior, supervisory or junior staff) and the departments in which they work. In addition, they were required to indicate the extent to which sales are made on credit as well as become irrecoverable, ranging from no extent = 1 to very great extent = 4. The level of VAT compliance by the companies is also to be rated, from poor = 1 to very good = 4.

Based on the purpose of the study which is to ascertain the influence of irrecoverable invoices on VAT compliance and with the conception that reduction in cashflow as a consequence of irrecoverable invoices may affect VAT compliance, the following null hypothesis is formulated as a guide:

There is no significant relationship between irrecoverable invoices and VAT compliance.

4. Data Presentation and Analysis

One hundred sets of questionnaire were administered (five to each of the 20 companies sampled). Seventy two questions representing 72% of the number distributed were returned and used for analyses.

4.1 Profile of Respondents

The characteristics of the respondents to the questionnaire are shown in table 1. Out of the 72 respondents, 37 representing 51.4% are at the management cadre while 25 which is 34.7% are of the senior cadre. Only 13.9% (10 respondents) belong to the supervisory level.

In respect of the respondents lengths of service, 29 representing 40.3% have put in more than 15 years, 28 which is 38.9% have spent between 10-15 years of service while others (3 and 12 respondents) representing 4.2% and 16.7% have been in the employ of their organisations for 5 years and between 5-10 years respectively. 32 respondents which is 44.4% work in the finance/accounts department while 23 representing 31.9% are deployed in the administration department. Only 17, producing 23.6% belong to the marketing department. The number of respondents at the management and senior cadre, finance/accounts and administration department as well as the length of service in the companies confirms the quality and sufficiency of data collected.

Table 1. Profile of Respondents

	Frequency	Percentage (%)
Employee Cadre		
Management	37	51.4
Senior	25	34.7
Supervisory	10	13.9
Total	72	100.0
Length of Service		
5 years	3	4.2
5 – 10 years	12	16.7
10 – 15 years	28	38.9
Above 15 years	29	40.3
Total	**72**	**100.0**
Department		
Finance/Accounts	32	44.3
Administration	23	31.9
Marketing	17	23.6
Total	72	100.0

Source: Survey data, September 2014.

Profile of respondents, their lengths of service and departments in the organisation.

4.2 Univariate Analysis

Table 2 presents the descriptive statistics on the variables. On the average, 2.4722 on a four point scale representing 61.81% accept that some of their sales are on credit, while 2.9306 or 73.27% confirm that some invoices are irrecoverable. On the other hand, VAT compliance is 40.63% or 1.6250 which approximates to a “fair” score of 2 on a 4 point scale.

Table 2. Descriptive statistics

	Mean	Standard Deviation	N
VAT Compliance	1.6250	0.84642	72
Irrecoverable Invoices	2.9306	1.01157	72
Sales on credit	2.4722	0.60450	72

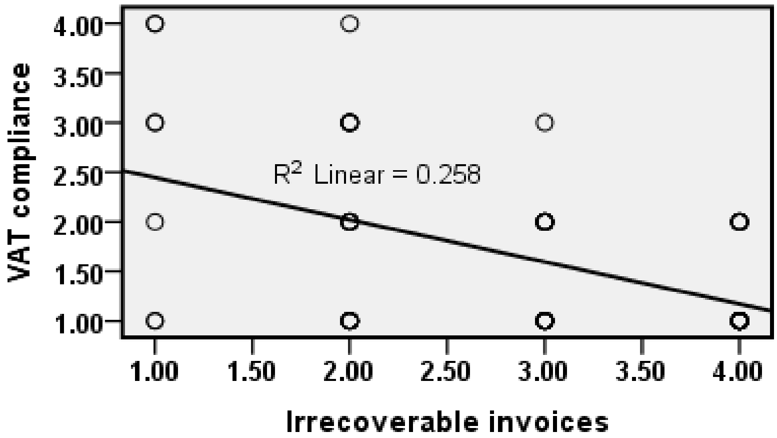
Scale: VAT Compliance – poor = 1, fair = 2, good = 3, very good = 4. Irrecoverable invoices and sales on credit – no extent = 1, some extent = 2, great extent = 3, very great extent =4.

Descriptive statistics of VAT compliance, irrecoverable invoices and sales on credit.

4.3 Bivariate Analysis

The pattern of the association between the explanatory and response variables (irrecoverable invoice [INV] and VAT compliance [VC]) is demonstrated by the scatter diagram. Scatter diagrams, otherwise known as scatter plots are essential for understanding the relationship between variables. They provide a means for visual inspection of data that a list of values for two variables cannot. Both the direction and the shape of a relationship are conveyed in a plot (Cooper and Schindler, 2001).

The slope of the diagram is downwards, from the top left hand side to the right hand side; portraying a negative relationship. As irrecoverable invoices increase, VAT compliance decreases, showing that irrecoverable invoices withhold cash inflow and subsequently disrupt the ability of the tax payer to fully make VAT returns.



Scatter diagram showing relationship between irrecoverable invoices and VAT compliance.

The strength of the relationship between these variables is shown by the correlation analysis in table 3.

Table 3. Correlation analysis between VAT Compliance and Irrecoverable Invoices.

		Irrecoverable Invoices	VAT Compliance
Irrecoverable Invoices	Pearson Correlation	1	-0.508**
	Sig. (2-tailed)		0.000
	N		72
VAT Compliance	Pearson Correlation	-0.508**	1
	Sig. (2-tailed)	0.000	
	N	72	

** Correlation is significant at the 0.01 level (2-tailed).

Correlation analysis between VAT compliance and irrecoverable invoices.

The coefficient of correlation (r) is -0.508 implying a moderate negative relationship which is significant at the 0.01 level. This analysis rejects the null hypothesis and confirms the existence of significant relationship between irrecoverable invoices (INV) and VAT compliance (VC). From the calculated correlation coefficient, the coefficient of determination (r^2) is 0.258 or 25.8%. Statistically, irrecoverable invoices account for reduction in VAT compliance by 25.8%. Other factors aside irrecoverable invoices explain changes in VAT compliance by 74.2%.

5. Discussion of Findings

Results of the descriptive statistics approximately reflect fair compliance by tax payers in making VAT returns. On the average, the response is 1.6250 or 40.63% on a 4 point scale. Similarly, irrecoverable invoices as part of credit transactions are confirmed to be 2.9306 or 73.27% on the average. By this rating, some invoices are approximately irrecoverable to a great extent. Also, the mean score for sales on credit is 2.4722. Based on the scale, this confirms credit sales by 61.81%.

The correlation analysis performed to measure the strength of relationship between the variables indicates a significantly moderate negative relationship between irrecoverable invoices and VAT compliance. The coefficient of correlation is -0.508 at a significance level of 0.01. Alternatively, there is 99% confidence level that the outcome of the analysis is correct. Furthermore, irrecoverable invoices explain delay in VAT compliance in the SMEs sampled by 25.8%. Other factors outside the explanatory variable (irrecoverable invoice) account for changes in VAT compliance by 74.2%.

In addition, the slope of the scatter diagram indicates that increases in irrecoverable invoices are associated with decreases in VAT compliance. This association is moderately negative from the top left hand side to the lower right hand side. The foregoing analyses imply reduction in cash inflow which negatively impact VAT compliance. Respondents opinions in which 73.27% maintain that some sales on credit (61.81%) are irrecoverable provide empirical evidence

6. Conclusion and Recommendation

Irrecoverable invoices arising from credit transactions negatively impact VAT compliance. Empirical findings indicate a statistically significantly moderate negative relationship between irrecoverable invoices and VAT compliance. With a correlation coefficient of -0.508, irrecoverable invoices account for decreases in VAT compliance by 25.8%. This is further corroborated by the result of descriptive statistics in which 73.27% accept that some sales on credit are irrecoverable.

This study is significant as it provides literature on VAT administration in the context of SMEs highlighting irrecoverable invoices factor in VAT compliance. It is also important as it provides data on VAT administration to investors, particularly, those entering the Nigerian business environment for the first time. Enforcing VAT compliance without recognising the intricacies of trade, especially those on credit may create bottlenecks towards the success of the VAT Act.

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