TAX AUDIT AND TAXPAYERS' COMPLIANCE IN SOUTHWEST NIGERIA

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ABSTRACT

This study examines the effect of tax audit on taxpayers' compliance in Southwest Nigeria. The study employs a survey research design. Structured questionnaire were administered to elicit information from 190 randomly selected respondents. Data obtained were analysed using descriptive and inferential statistics. Findings from the study reveals that the effect of tax audit on taxpayers' compliance in Southwest Nigeria is statistically significant. Thus, the study recommends that activities regarding tax audit in the Southwest region of Nigeria should be improved to further reduce tax evasion and significantly improve voluntary compliance with tax laws and regulations that would result to increased revenue. Tax evaders caught through tax audit should face the full wrought of the law to serve as deterrence for prospective evaders.

Keywords
Tax Audit, Taxpayers' Compliance, Desk Audit, Field Audit, Registration Audit, Back Duty Audit

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Introduction

Governance comes with a lot of administrative expenses which necessitates the need for increased revenue generation of which tax is a major source. Government is saddled with the responsibility of providing quality education, security, infrastructural facilities and a stable business environment. Over the years, the revenue of state governments in Nigeria has been impaired due to increased number of tax defaulters. According to the report of The Federal Inland Revenue Service (FIRS, 2018), a tax gap of N861.76 billion and N1.4 trillion was recorded in 2017 and 2018 respectively and this represents about 18% and 21% of targeted revenue indicating the level o non-compliance by taxpayers (Enofe, Embele & Obazee, 2019). Moreover, as of 2020, Nigeria still accounts for a low tax-to-GDP ratio of around 6.1%, signifying that a substantial amount of tax revenue was not reported. Tax is a mandatory levy imposed by the government through its ministries, agencies and departments on the consumption, income and capital of its citizens. According to Ojo (2017), tax is a compulsory contribution levied by the government on taxpayers for the advantage of the whole nation at large. By paying the required tax, the citizens will have the advantage of living in a fairly healthy, educated and safe environment. Hence, the readiness of people and organizations to comply with tax regulations and pay their taxes as and when due should not generate any concern. Nevertheless, it appears that taxpayers in Nigeria, particularly in the informal sector, find it hard to voluntarily comply with tax laws. Tax compliance is the readiness of taxpayers to fully comply with tax regulations, state the exact income in each accounting year and pay the accurate amount of taxes. It is the willful obedience of taxpayers to tax laws. Generally, non-compliance to tax laws is a predominant problem in emerging economies due to high level of unethical practices by tax administrators and taxpayers. In Nigeria, taxpayers, particularly the self-employed, adopts various means of avoidance schemes to reduce or outrightly escape tax liability. This raises question on the effectiveness and efficiency of tax administration. Although, state governments generate most of their revenues via Pay-As-You-Earn (PAYE) yet other sources of revenue seems to have been neglected especially the informal sector.

Recently, the reduction in statutory allocation as well as the inability of some state governments in the Southwest region of Nigeria to generate enough tax revenue has re-kindled the need to work out modalities that will improve internally generated revenue (IGR) so as to augment the current fiscal imbalance. One of the ways to achieve the required compliance by taxpayers is tax audit (Eiya, Alade & Adu, 2016; Olaoye &

Ekundayo, 2019). It is an audit carried out to ensure that taxpayers fully comply with tax laws. It has contributed enormously to create tax consciousness among stakeholders and cause a reasonable increase in tax revenue (Okonkwo, 2014). Several studies have shown that tax audit is better captured with desk audit, field audit, back-duty audit and registration audit (McKerchar, Meyer & Karlinsky, 2016; Enofe, Embele & Obazee, 2019; Olaoye & Ekundayo, 2019). On this basis, the influence of tax audit and investigation on tax compliance and revenue generation has generated a lot of studies (Modugu & Anyaduba, 2014; Ephrem, 2016; Eiya, Alade & Adu, 2016; Harelimana, 2018; Umar & Oyedokun, 2018; Sor-Tin, 2019; Saffay, 2019; Elisa, Felix, Alvin & Soegihono, 2019; Olaoye & Ekundayo, 2019; Ayneshet, 2020; Oghuma, 2020). However, mixed findings were reported. For example, while Modugu and Anyaduba (2014), Ephrem (2016), Eiya, Alade and Adu (2016) reported a positive significant effect of tax audit on tax compliance, Amah and Nwaiwu (2018), Saffay (2019) and Enofe, Embele and Obazee (2019) discovered that tax audit is not effective in improving voluntary tax compliance and revenue generation. This is a gap in literature that this study intends to fill. Moreover, none of the studies conducted in Nigeria cuts across the southwest region of the country, which constitutes the geographical area of this study. Also, only Olaoye and Ekundayo (2019) out of the reviewed previous studies conducted in Nigeria jointly capture tax audit with desk audit, field audit, back duty audit and registration audit, hence, this study. In line with the study objectives, the following hypotheses were formulated to guide this study:

H_{O1}: desk audit has no significant effect on taxpayers' compliance in Southwest, Nigeria;

H_{O2}: field audit has no significant effect on taxpayers' compliance in Southwest, Nigeria;

H_{O3}: back duty has no significant effect on taxpayers' compliance in Southwest, Nigeria;

H_{O4}: registration audit has no significant effect on taxpayers' compliance in Southwest, Nigeria.

This study, therefore, fills the identified gaps by examining the effect of tax audit on taxpayers' compliance in Nigeria, with a focus on the Southwest region of Nigeria. In this regard, it will add to the extant literature on how state governments can better improve their revenue profile to advance their infrastructural development and recurrent operational activities.

2.1 Literature Review

The functionality of the government is dependent on the revenue generated and by extension amount of tax collected. According to Badara (2012), opined that tax is a compulsory charge levied by the government on the profit and income of organizations and individuals. Corroborating this, Harelimana (2018) described tax as a government mandatory levy forced on individuals, organizations, corporate bodies, vocation, etc., in order to provide basic and developmental amenities to every sector of the economy and improve the living standard of the citizenry. This view is similar to that of Umar and Oyedokun (2018). They describe tax as an obligatory exaction of money by the government for public purposes. This is an indication that the benefits of taxation are enjoyed by all as the indispensability of taxes to infrastructural expansion of a country cannot be over emphasized. However, it is noted that some personalities and organizations still evade tax and thereby decrease the resources of the government to advance economic growth. Tax audit was therefore introduced by the government so as to curtail the menace of tax evasion and improve tax compliance. Tax audit revolve around the assessment of the record of taxpayers with the aim of ensuring that the amount of taxes reported are in accordance with tax laws (Okonkwo, 2014). The focus of tax audit is to assess business records for tax purposes and ensures that adequate revenue is generated by the government. McKerchar, Meyer and Karlinsky (2016), Olaoye and Ekundayo (2019), Enofe, Embele and Obazee (2019) noted that tax audit is better captured through desk audit, field audit, back-duty audit and registration audit. Desk audit takes place within the sites of the tax officers. Appropriate and relevant papers are requested and assessed by tax auditors withing the office premises. This is followed by field audit. A field audit is a comprehensive tax audit carried out by tax auditors at either the taxpayer's home or place of business or accountant's office, to examine individual or organizational monetary records to ensure adequate tax return (McKerchar, Meyer & Karlinsky, 2016). Adediran, Alade and Oshode (2013) asserted that back duty audit is initiated when taxpayers failed to disclose any earning in the return submitted to the tax office, or when there is a doubtful claim of capital allowance in respect of the current or previous year. In the registration audit system, the tax authority brings individuals and companies into the tax net (Okonkwo, 2014). This audit is achieved by obtaining information on businesses from the Corporate Affairs Commission (CAC), the Nigerian Customs Service, other third parties and routine visits to premises of suspected non-registered taxpayers in to ensure that the entities are properly taxed. At the end of the exercise, the organizations and persons found to be outside tax net are usually registered and given an identification number and a file. Tax audit is noted to have a direct effect on tax compliance. According to Majed (2019), tax compliance is when taxpayers' willingly obey tax laws regarding the prompt payment of required taxes. It is the capability and readiness of taxpayers to obey tax regulations, state the exact income in each year and pays the precise tax on time (Saffay, 2019).

2.2 Theoretical Framework

This study is theoretically underpinned by deterrence theory. The theory propounds that if the consequences of wrongdoing are greater than the act itself, people might be discouraged from doing it. It is believed by scholars that modern deterrence theories were established as a result of classical criminological theory derived mainly from Cesare Beccaria (1764), an Italian economist and philosopher and from Jeremy Bentham (1781), an English philosopher, jurist, and social reformer (Kelli, 2016). There was a fundamental theory of criminology in their study which claimed that people would make choices as a result of what will give them pleasure and sidestep discomfort, and unless discouraged, they would follow their pleasures, even by committing wrongdoings. According to Sandmo (2005), part of the deterrence theory is that the taxpayer is presumed to exploit the expected accessibility of the tax evasion hazard, by matching the benefits of successful tax deceit against the risky prospect of being caught and reprimanded by tax authorities. Gallupe and Baron (2010) added that this theory postulates that punishments should be rapid, definite, and proportional to the crime to properly discourage individuals from violating the law. Beccaria (1764) argued that laws that were written concerning crimes, with their parallel penalty should be made known to the public. However, the theory has been criticized based on the fact that the assumption that people always carefully weigh the penalties of their criminal conduct early, can be disproven by the observation that some crimes are unplanned (Kevin, 1983). This implies that not all crimes are calculated. Another criticism of deterrence theory is that, even though it is difficult to prove the deterrent effect of punishment, society continues to invoke "deterrence" to validate the imposition of punishment on individuals (Kevin, 1983). The relevance of this theory lies in its emphasis on the certainty and the severity of punishment in deterring the unwillingness of people to comply with tax laws. It can be agreed that if the certainty of tax evaders getting caught and being penalized is high, people would be discouraged from perpetrating the act. Also, if the severity of perpetrating crime matches the gain of perpetrating the crime, or is, even more, people would be deterred from perpetrating crimes.

2.3 Empirical Review

James and Moses (2012) examined the impact of tax administration on revenue generation in a developing economy using Nigeria as a case study. Primary data were collected via questionnaire and analyzed using simple percentages. The study found that inadequate training of personnel, lack of modern information communication tools are some of the challenges facing effective administration of tax in Nigeria. Also, Adediran, Alade and Oshode (2013) examined the impact of tax audit and investigations on revenue generation in Nigeria using Pearson correlation coefficient. The study revealed that tax audit and investigations can increase the revenue base of the government and can also stamp out the incidents of tax evasion in the country. Onuoha and Dada (2016) examined tax audit and investigation as imperatives for the achievement of an efficient tax administration in Nigeria. The study adopted an expository approach using content analysis of existing literature. The study revealed that tax audit and investigation are inevitable to improve on the collection of tax revenues in Nigeria. The study also confirmed that there is a high prevalence of non-compliance currently among individuals and companies in the country. Eiya, Alade and Adu (2016) determined how tax compliance is influenced by tax audit. Data were obtained through administered questionnaire distributed randomly which were analyzed using the simple regression analysis. The result revealed a weak but positively significant relationship between tax audit and tax compliance. The study conducted by Harelimana (2018) was to determine the effects of tax reassessment on Rwanda's revenue collection. Using correlation analysis, the study found that the relationship between tax collected before the reassessment and after the reassessment is significant, which means that tax reassessment increases the collection of revenue in Rwanda. Timgo Dinku and Alamirew (2018) carried out a study in Ethiopia to find out that tax investigation, and penalty together with audit productivity effects tax compliance. The study used secondary data and analysis was done using descriptive and inferential statistics. The study revealed that audit productivity improves voluntary compliance. Saffay (2019) examined the effect of tax audit on tax revenue collection in Afghanistan using paired t-test. The findings revealed that tax audit raises revenue collection but it is not effective in improving voluntary tax compliance. This is because a weak relationship exists between tax audit and revenue collection which could be linked to other factors such as; inappropriate auditing practices, small number of qualified tax auditors, corruption, and lack of adequate tax facilities for the tax audit department, and completely incorrect information provided by taxpayers as not showing their actual company activities. Olaoye and Ekundayo (2019) examined the effects of tax audit on tax compliance in Ekiti State, Nigeria. Multinomial Logistic Regression analysis was employed as the estimation technique. The findings revealed that the multinomial logistic regression model fitting information was significant with the p-value of 0.040 which implies that the tax audit can influence the tax compliance. Also, the likelihood ratio tests of multinomial regression showed that tax accuracy and current returns have not been significantly affecting tax compliance, that tax law has effect on tax compliance while tax procedure has no effect on tax compliance during the study period. Majed (2019) examined the effect of tax auditing using the computer on Palestine tax compliance. The study was qualitative in nature. Based on the review it can be concluded that tax non-compliance is a global phenomenon and all societies and economic systems across developed and developing countries of the world faces this challenge. Although several factors have been presented as responsible for tax non-compliance, the issue of tax audit has been established by logical and several empirical studies as a major important factor relating to tax non-compliance. Sor-Tin (2019) explored the significant factors in the multidimensional construct. The study was conducted with a sample of 250 service tax license holders in Malaysia. Factor Analysis is conducted to examine the possible variables and validate the number of factors. The results obtained show there is inter-relationship or causal relations existing among the factors of taxpayer compliance; and that the Taxpayer Audit Compliance Construct (TACC) is a 4-factor structure. Using Custom Factorial ANOVA and using SPSS software, Elisa, Felix, Alvin and Felix (2019) compared the perception of tax audits between three generations, Millennials, X, and Baby Boomers. The perception of tax audit measures with three indicators, namely audit probability, audit procedures, and auditor behavior. The study examined the different perception of voluntary tax compliance between generations. The method used was a survey in 2019 to four big cities of Jakarta, Surabaya, Semarang, and Denpasar. The outcome of the study revealed that Millennials and X had different perceptions of tax audits regarding audit probability, audit procedures, and auditor's behavior compare to Baby Boomers. Ayneshet (2020) undertook a study on the impact of tax audit on tax compliance with reference to category "A" taxpayers in Ethiopia. The study specifically sought the effect of tax audit, fines and penalties, and tax education and knowledge on tax compliance in Hawassa City, south nations, nationalities and peoples' regional state. Descriptive statistical tools and correlation and multiple regressions analysis were used in analyzing the data collected. The study findings showed that probability of tax audit, and tax knowledge and education have a positive effect on level of tax compliance.

3. Methodology

Survey research design was adopted for this study. The study population covered all the 360 staff in the audit and compliance department of State Board of Internal Revenue (SBIR) and Federal Inland Revenue Services (FIRS) for the six states within the Southwest region of Nigeria. Through Taro Yamane formula of 1967, the sample size of 190 respondents was determined. The study adopted proportionate and convenience sampling techniques. Proportionate sampling technique was used to determine the sample for each state government while convenience sampling technique was used to determine the respondents to the administered copies of questionnaire to promote voluntary participation. The breakdown is given in table 1.

Table 1: **Population and Sample of the Study**

States	Population	Sample Size
Ekiti State	47	$n = \frac{47(190)}{360} = 25$
Lagos State	96	$n = \frac{96(190)}{360} = 51$
Ondo State	46	$n = \frac{46(190)}{360} = 24$
Ogun State	64	$n = \frac{64(190)}{360} = 34$
Osun State	50	$n = \frac{50(190)}{360} = 26$
Oyo State	57	$n = \frac{57(190)}{360} = 30$
Total	**360**	**190**

Source: Authors' computation, 2021

A close ended questionnaire was designed to elicit information for this study. To ensure the validity of the instrument, the instrument was subjected to face and content validity by experts so as to determine the appropriateness of the instruments in measuring what they supposed to measure. Also, items in the instruments represented the content and suitability specified by the concepts to be measured. For the reliability test, a pilot study was conducted where 25 copies of the questionnaire were administered on the staff of Kwara State Internal Revenue Service. Thereafter, Cronbach Alpha which measures internal consistency was used. Table 2 gives the reliability results.

Table 2 Reliability Results

S/N	Variables	Reliability Coefficient
1	Desk Audit	0.862
2	Field Audit	0.797
3	Registration Audit	0.818
4	Back duty Audit	0.823
5	Taxpayers' compliance	0.821

Source: Authors' Computation, 2021

The model used by Eiya, Alade and Adu (2016) to examine tax audit and tax compliance is adapted. The functional and linear representation of the model is given thus:

$TC = \alpha_0 + \alpha_1 TA + U_t$………………...…………………………………………..……. 3.1

TC= Tax Compliance, TA= Tax Audit, α_0………α_1 are parameter estimates and u=Stochastic Error Term. The model was modified to suit the stated objectives of this study by capturing tax audit with desk audit, field audit, registration audit, back duty audit. Thus, the functional and linear representation of the modified model is given thus:

$TC = \alpha_0 + \alpha_1 DA + \alpha_2 FA + + \alpha_3 BA + \alpha_4 RA + Ut$…………………...……. 3.2

Where: TC is Tax Compliance, TA is Tax Audit, DA is Desk Audit, FA is Field Audit, BA is Back Duty Audit, RA is Registration Audit and α_0………α_4 are parameter estimates. Pearson correlation and multiple regression were used to test the hypotheses at 0.05 level of significance. To observe whether the responses of the respondents with respect to both independent and dependent variables fulfill the requirements of linear regression, normality test, linearity test and heteroscedasticity test were carried out.

Results and Discussion of Findings

4.1 Results

Out of the 190 questionnaires that were administered, only 172 constituting 91% were well filled and returned valid. Thus, the analysis of the administered questionnaire was based on 172 copies of retrieved questionnaire. The variables were measured by using standardized instruments of proven reliability and validity.

Normality Test

Table 3: Normality Test Results

Shapiro-Wilk Stat	Probability
0.882	0.067

Source: Authors' computation, 2021

The Shapiro-Wilk statistics and probability values of the error term estimated models, stood at 0.882, and 0.067. The result reveals that there is no enough evidence to reject the null hypothesis that the error term of the estimated model is normally distributed, given the probability value that is greater than 0.05, thus confirming that the error term is normally distributed.

Linearity Test

This is the assumption that the relationship between the variables is linear. The null hypothesis states that the relationship is linear, against the alternative hypothesis that it is not linear.

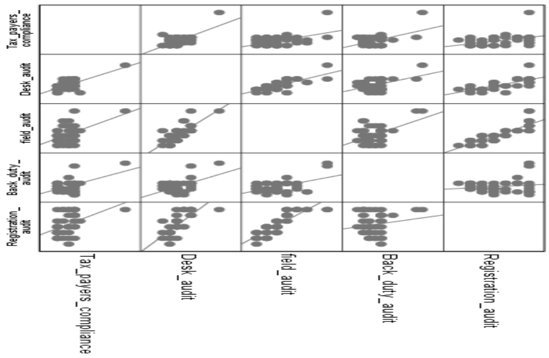

Figure 2: Linearity Test

Figure 2 depicted the matrix scatter plot graph with an inserted line, showing the linear relationship. Deductively, it shows that there is a linear relation between the outcome variable and the predictors. Hence, there is no enough evidence to reject the null hypothesis that the relationship is linear.

Heteroscedasticity Test

Table 4: Breusch-Pagan Godfrey Heteroscedasticity Test Results

F-statistics	Probability
0.767	0.616

Source: Authors' computation, 2021

Table 4 reports f-statistics and probability values of 0.767 and 0.616. Given the probability of the reported f-statistics, it stands that there is no evidence to reject the null hypothesis of constant variance of the error term (homoscedasticity). Hence the test confirmed that there is no problem of heteroscedasticity in the error term of the estimated models.

Table 5: Pearson Correlation Matrix Analysis

Variables	TC	DA	FA	BA	RA
TC	1				
DA	0.694**	1			
FA	0.501**	0.477**	1		
BA	0.496**	0.211**	0.455**	1	
RA	0.417**	0.306**	0.513**	0.233*	1

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

Source: Authors' computation, 2021

Table 5 reveals the correlation results and it showed that the relationship between taxpayers' compliance and all the predictor variables are positive and significant to the tune of 0.694**, 0.501**, 0.496** and 0.417** for desk audit, field audit, registration audit and back duty audit respectively. This indicates that all the predictor variables move in the same direction with taxpayers' compliance in the Southwest region of Nigeria. The inference is that an increase in tax audit will result to increase in the voluntary compliance level of taxpayers. In the same vein, the correlation between all the predictor variables was positive and significant without any presence of collinearity since the highest correlation coefficient stood at 0.513, as against the bench mark of 0.70.

Table 6: Multiple Regression Analysis

Variable	Coefficient	Std Error	t-statistics	Prob.
(Constant)	0.799	0.053	6.379	0.000
Desk Audit	0.984	0.278	3.542	0.001
Field Audit	0.650	0.276	2.400	0.020
Backduty Audit	0.853	0.342	2.756	0.009
Registration Audit	0.191	.173	1.102	0.277

R=0.722, R-Square=0.521, R-Square 0.470, F-statistics=85.322, Prob(F-statistics) = 0.000
Dependent Variable: *Taxpayers' Compliance*
Source: Authors' computation, 2021.

Presented in table 6 is the regression estimation results which reveals that all the predictor variables in terms of desk audit, field audit, back duty audit and registration audit exert a positive effect on taxpayers' compliance in the Southwest region of Nigeria with their respective regression coefficients of 0.984, 0.650, 0.853 and 0.191. However, the positive effect was only significant for desk audit, field audit and back duty audit with their respective P-values of 0.001<0.05, 0.020<0.05 and 0.009<0.05. Adjusted R-square reported stood at 0.470%. This implies that about 47% of the systematic variation in the outcome variable could be explained by the explanatory variables. The F-statistics of 85.322 reveals that the regression model was significant.

4.2 Discussion of Findings

Using the regression estimation, findings from the study shows that tax audit in terms desk audit, field audit, back duty audit and registration audit have a positive effect on taxpayers' compliance in the Southwest region of Nigeria with their respective regression coefficients of 0.984, 0.650, 0.853 and 0.191. This connote that a unit increase in desk audit, field audit, back duty audit and registration audit, would increase taxpayers' compliance by 0.984, 0.650, 0.853 and 0.191 respectively. This indicate that tax audit will stimulate increase in revenue generation in Nigeria. This outcome gives credence to the tenets of deterrence theory. The crux of deterrence theory of tax compliance is to mainly evaluate the association between the possibility of being caught and the possibility of sanction severity that would affect non-compliance. Deterrence theory suggests that the penalty for evading tax should be as severe, or more than the benefit of evading the tax. This purports that deterrence theory depends largely on tax audit and penalties to improve the voluntary compliance level of taxpayers. Significantly, it was gathered from the regression estimation that desk audit, field audit, back duty audit would improve taxpayers' compliance. The significant effect could be attributed to the fact that the tax audit officer is responsible to ensure that the reported amount is correct and that the amount of tax paid corresponds with tax laws and regulations. In the same vein, they ensure voluntary compliance with the tax laws and regulations and ensure that a higher tax compliance rate is achieved. Outcome of this study corroborated the findings of Modugu and Anyaduba (2014), Ephrem (2016), Eiya, Alade and Adu (2016). The studies reported a positive significant effect of tax audit on tax compliance. However, the findings from this study differ from the findings reported by Amah and Nwaiwu (2018), Saffay (2019) and Enofe, Embele and Obazee (2019). The studies noted that tax audit is not effective in improving voluntary tax compliance and revenue generation.

5. Conclusion and Recommendations

This study examines the effect of tax audit on taxpayers' compliance in Southwest Nigeria. Based on the regression estimation, it was established that the effect of tax audit on taxpayers' compliance in Southwest Nigeria is statistically significant. Consequently, while desk audit, field audit and back duty audit could significantly engender increase in taxpayers' compliance, registration audit was not significant in causing a reasonable increase in the compliance level of taxpayers in Southwest, Nigeria. Thus, the study recommends that activities regarding tax audit in the Southwest region of Nigeria should be improved to further reduce tax evasion and avoidance which will significantly improve voluntary compliance with tax laws and regulations through which adequate revenue would be generated. Tax evaders caught through tax audit should face the full wrought of the law to serve as deterrence to others.

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