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EMERGING LEGAL ISSUES IN THE TAXATION OF PERSONAL INCOMES IN NIGERIA

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Abstract

The legal framework for personal income taxation in Nigeria is the Personal Income Tax Act, 2004 (as amended in 2011). However, the taxation of personal incomes in Nigeria as provided under the Personal Income Tax Act presents a lot of practical and conceptual legal issues ranging from the legal implications and justifications for the exemption of certain personal incomes from tax liability under the Act, the tax rates, and the issue as to whether the taxation of dividends constitute double taxation. Through the doctrinal research method, this paper has established that apart from equity considerations, the exemption of incomes of registered friendly societies, ecclesiastical and charitable societies from tax has eroded the tax base by creating opportunities for tax avoidance and evasion since incomes of their members or leadership may be concealed as incomes of those organizations, that the legal basis for the exemption of profits of cooperative societies has collapsed and no longer in tune with modern commercial realities, and that the graduated tax rates as provided under the Act is bound to serve as disincentive to work and also encourage labour agitations for better working conditions. It is therefore recommended that the Personal Income Tax Act be amended to clearly draw a difference between incomes of the exempted bodies and their members so as to subject incomes of members to tax, and that the taxation of dividends, though not double taxation be imposed at a low rate, while the graduated tax rates be lowered so that taxpayers may voluntarily comply with their tax obligation with the smallest amount of hissing while government revenue improves significantly.

1.0 INTRODUCTION

Taxation simply means a compulsory levy imposed by government on a person, his income, property or goods purchased pursuant to legislative authority for support of government or social and economic development. The taxation of personal incomes is not new in Nigeria. A direct system of taxation had been known and practiced in some traditional societies before the advent of colonialism.[1] However, the taxation of personal incomes in its modern form dates back to the enactment of the Direct Taxation Ordinance 1940.[2]Even with this 1940 enactment which separated personal income tax from company taxation, the administration of the personal income tax in Nigeria was done with lack of uniformity among the regions. This, among other reasons necessitated the setting up of the Raisman Commission charged with making recommendations for the introduction of uniform basic principles of taxation of personal incomes throughout Nigeria and sharing of taxing powers between the regional and central government[3].

The recommendations of the Raisman Commission were accepted and embodied in the Nigerian (Constitution) Order-In-Council 1960 and formed the basis of the Income Tax Management Act, 1961. This Act has been severally amended and consolidated into the Income Tax Management Act (ITMA)[4], the Personal Income Tax Decree 1993 which repealed the Income Tax Management Act 1990 and the Personal Income Act, 2004[5] which repealed the 1993 Decree. The Act now has 2011 amendment.[6]

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1 I.A. Ayua, The Nigerian Tax Law (1996) Spectrum Law Publishing, Lagos, p. 22.
2 No. 4 of 1940 Cap. 54.
3 I.A. Ayua, Nigerian Tax Law, (Spectrum Publishers Ibadan, 1996), P.24.
4 Cap. 173 LFN, 2004.
5 Cap. P8 LFN, 2004 (as amended in 2011).
6 Personal Income Tax (Amendment) Act, 2011.

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The taxation of personal incomes in Nigeria presents a lot of legal issues which form the major theme for this discourse. These legal issues include the legal implications for exemption of certain personal incomes from tax liability under the Act, the tax rate as provided by the Act and the issue of whether the taxation of dividends distributed to shareholders constitute double taxation. In doing so, ancillary issues in personal income taxation in Nigeria like liability to personal income tax under the Act, and methods of taxing personal incomes in Nigeria, have been examined. The paper thereafter concludes by making recommendations to overcome the major legal issues in personal income taxation in Nigeria.

2.0 CONCEPTUAL CLARIFICATIONS

In the course of this discourse, certain concepts, words or phrases which are very central to the understanding of the theme call for definition or at least explanation.

2.1 TAXABLE PERSON

The word 'person' as defined in Section 18(1) of the Interpretation Act[7] includes anybody or persons, corporate or incorporated. This same definition was adopted by the Court in *D.S.A. Agricultural Machiner Manufacturing Company Limited V. Lagos State Internal Revenue Board*.[8] The Personal Income Tax Act[9] on the other hand defines 'person' to include an executor, trustee, company, partnership, community, family and individuals.[10] Consequently, the Act goes further to define a 'taxable person' to mean any individual or body of individuals (including a family, any corporation, sole, trustee or executor) having any income which is chargeable with tax under the Act. In other words, any person, natural or artificial who earns an income

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7 PITA, ibid.

8 (2013) 11 TLRN 115. See also *Attorney-General, Bendel State V. Agbodofah* (1990) 2 NWLR (pt. 592) 476.

9 Section 108, Personal Income Tax Act Cap.P8, 2004 (with 2011 Amendment).

10 Ibid.

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that is taxable under the Personal Income Tax Act[11] qualifies as a taxable person.

For our present purposes however, the phrase 'taxable person' shall be restricted to individuals, body of individuals, families, trustees, partnership, communities or executors. Companies are not within this scope since they are taxable under the Companies Income Tax Act.[12]

2.2 INCOME

The need to define the word 'income' has been trailed with controversies. A prominent position taken is that there is no need for a statutory definition of 'income' for tax purposes. Ayua[13] therefore submits that:

> To reduce income into a more precise definition is therefore to unwittingly prevent the Nigeria Tax Law from meeting the demand and challenges of modern society with its complexities and worse still to deny the judges with initiative and a creative approach the opportunity to handle tax law problems.

The view appears good since with the emerging global economy, a statutory definition of 'income' may not be wide enough to cover all gains from emerging economic activities not anticipated by the Legislature.

Futile attempts have however be made to define income. For instance, the Personal Income Tax Act[14] has simply defined income in the following words: "Income includes any amount deemed to be income under this Act". This definition is too casual, same having not broken any grounds. In *Coltness Iron Co. V. Black*, Lord President attempted a definition of income as:

[11] PITA, ibid.
[12] Cap. C12 LFN, 2004.
[13] I.A. Ayua, ibid, p. 17.
[14] (1881) 9 TC 287.

> The general principle of the property and income tax which effect is given by the statutes is that everything of the nature of income shall be assessed from invested capital, or from skill and labour or from a combination of both and whether temporary or permanent, steady or fluctuating, precarious or secure.

This definition though more helpful, has also failed to define income but rather outlined the forms of income. The Nigerian tax law[15] has consequently classified income based on its sources of derivation like profits from trade, business, profession or vocation. The classification also includessalary, wage, fee, any gain, dividend, and interest or discount. The implication for tax purposes is that all gains arising from the above are taxable as incomes.[16]

Income chargeable to the personal income tax which is called 'assessable income' covers income both in money or money's value. Therefore, any benefits provided by an employer or other persons, such as rent-free accommodation or the amount of tax paid by the employer on behalf of the employee, are also treated as assessable income of the employee for the purpose of personal income taxation in Nigeria. Assessable income is divided into eight categories as follows:[17]

i) Income from personal services rendered by employees;
ii) Income from goodwill, copyright, annuity or income in the nature of yearly payments derived from a will or any other juristic act or judgment of a court;
iii) Income by virtue of jobs, positions or services rendered;

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15 Section 3(a), (b), (c), (d), (e) and (f) of the PITA, ibid.
16 See *I.D. Sam Nig. Ltd V. Lagos State Revenue Service* (2011) 5 TLRN 41 at 50.
17 Section 3(1) of the PITA (with 2011 amendments), ibid.

iv) Income in the nature of dividends, interest on deposits with bank in Nigeria, shares or profits or other benefits from a juristic partnership, or mutual fund, payments received as a result of reduction of capital, a bonus, an increased capital holdings, gains from amalgamation, acquisition or dissolution of juristic companies or partnership, or gains from transferring of shares or partnership holdings;

v) Income from letting property and from breaches of contracts, installment sales or hire-purchase;

vi) Income from liberal practices;

vii) Income from construction and other work;

viii) Income from business, commerce, agriculture, industry, transport or any other activity not specified earlier.

3.0 LIABILITY TO PERSONAL INCOME TAX IN NIGERIA

The Personal Income Tax Act subjects to tax the total income of an individual from all sources for that year less any deductions to be made or allowed[18]. All assessable income from a source within Nigeria is therefore chargeable to personal income tax in Nigeria. The Personal Income Tax Act[19] therefore subjects to tax the assessable income of an individual to tax if it arises in Nigeria or to a Nigerian citizen wherever it has been made, whether or not it is brought into or received in Nigeria.

Consequently, Section 6 of the Personal Income Tax Act provides that where an individual, an executor, or a trustee, outside Nigeria carries on a trade or business of which only part of the operations are carried out in Nigeria, the gains or profits of the trade or business shall be deemed to be derived from Nigeria to the extent to which such gains or profits are not attributable to that part of the operations carried on outside Nigeria; provide that –

18 Personal Income Tax Act Cap P8 LFN 2004 (as amended in 2011).
19 Section 36 of the PITA,ibid.

a) the individual, executor or trustee, does not have a fixed base in Nigeria from which he carries on such trade or business;
b) the individual, executor or trustee does not habitually operate a trade or business through a person in Nigeria authorised to conclude contracts on his behalf or on behalf of some other persons related to him or both of whom are controlled by some other person or does not habitually maintain a stock of goods or merchandise in Nigeria from which deliveries are regularly made on his behalf;
c) the trade or business in Nigeria does not involve a single contract for surveys, deliveries, installations or construction;
d) the trade or business is not between persons both of whom are controlled by some other person and such that conditions are made or imposed between such persons in their commercial or financial relations which in the opinion of the relevant tax authority is deemed to be artificial or fictitious.

It therefore follows that where an individual performs certain services in Nigeria and derives income from the performance of such services, the individual will be subjected to Nigerian tax irrespective of the fact that the individual does not reside in Nigeria.[20]In both *G.N. Everitt V. Federal Board of Inland Revenue*[21] and *Western Sudan Exporters V. Federal Board of Inland Revenue*[22], the Nigerian courts further held that income generated

[20] See *G.N. Everitt V. Federal Board of Inland Revenue* (2010) 3 TLRN 158 at 167, and *Western Sudan Exporters V. Federal Board of Inland Revenue* (2010) 3 TLRN 139.
[21] Supra.
[22] Supra.

from services rendered outside Nigeria by a non-resident is liable to tax in Nigeria where obligation imposed on the partnership contract cannot be divided so as to make it possible for the partnership to perform that part of the obligation which relates to outside the country only without also performing its obligation in Nigeria.

The ‘universality’ principle adopted in Nigeria charges to tax the worldwide income of a Nigerian even if not remitted or brought into the country, except the income is covered by double taxation agreement. Thus, this position has amended the Income Tax Management Act, 1961 which subjected to tax only income of a Nigerian which arose in, was received in, or accrued in Nigeria. This amendment is in conformity with the position in the United Kingdom where the worldwide incomes of residents are subjected to the United Kingdom tax.[23]

This position is slightly different from that of Germany where the universality principle also operates. In Germany, persons living abroad all or most of the time (more than six months per year) are known as ‘tax foreigners’ and have limited tax obligations with regard to their domestic income. For this class of people, the ‘territoriality principle’ operates to subject only income, including capital gains generated in Germany to German personal income tax.[24]

The ‘universality’ principle is however bedeviled by some problems in Nigeria, the most visible being that of identification of incomes earned by Nigerians abroad. Nigeria has double taxation agreements with few countries.[25] An essential part of double taxation agreements is the supply of information on the incomes of citizens of the contracting states. The fact that Nigerians may even earn incomes in countries with which Nigeria has no double

[23] Sumption: Taxation of Overseas Income and Gains, Butterworths, London (1973), p. 419.
[24] Invest in Germany – Taxation of Individuals on <www.housegov/jec/fiscal+x-grwoth/cap.gainhtm> (Accessed on 25/06/2019), P.10.
[25] These include Belgium, Canada, France, the Netherlands, the UK, China, Czech, Pakistan, Romania, South Africa, Slovakia, Philippines, Spain and Sweden.

taxation agreement is bound to negatively impact on the available information of citizens that earn incomes abroad.

In Nigeria, where an income receipt is subject to Nigerian personal income tax on the basis that it is earned in Nigeria, it is necessary to determine the tax authority that can collect the tax. The Personal Income Tax Act stipulates that once an income is chargeable to personal income tax, collection can be done by or in the territory in which the individual is deemed resident.[26] Thus, in terms of taxation of foreign income, source is the main determinant of liability to tax in Nigeria while locally, residence is the main consideration as to which tax authority to collect tax on personal incomes of citizens.

4.0 METHODS OF TAXING PERSONAL INCOMES IN NIGERIA

When a person's income is liable to the Nigerian tax, there are basically two methods of charging such incomes to tax. These are the Pay-As-You-Earn and Direct Assessment methods.

The Pay-As-You-Earn method otherwise called PAYE is a system of tax payment by taxpayers engaged in formal employment. The term PAYE is used to describe the system whereby the employee pays tax on whatever income he earned from the employment in any particular month at the end of that month. The employer deducts the tax from the employee's earning. The total amount deducted by the employer from the employee's earnings at the end of every month is then remitted to the relevant tax authority.[27]

The PAYE is administered through what is known as withholding tax system where tax is deducted at source by the employer who is under obligation to deduct and remit same to the tax authority.[28] In *Exclusive Stores Ltd V. Edo State Board of*

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26 Section 2(2) of the Personal Income Tax Act, ibid.

27 See *Lagos State Board of Internal Revenue V. Jenkins Investment Limited* (2013) 10 TLRN 148 at 159.

28 See Section 81 of the PITA, ibid.

Internal Revenue[29], it was held that withholding tax is an advance payment to bring the taxpayer within the tax net immediately.

The application of the PAYE Scheme is provided for by the operation of the Pay-As-You-Earn (PAYE) Scheme Regulations 1997 which is an appendage to the Act. Regulation I of the PAYE Scheme Regulations compels the employer to register with the relevant tax authority for the purpose of deducting income from his employees with or without notification or direction by the relevant tax authority.

The second method of collection of the personal income tax is the Direct Assessment of the taxpayer. This form of personal income tax administration is used for collection of tax from those employed in the informal sectors, mostly the self employed. Private legal practitioners, accountants, property agents, and partnerships, among others are among the category of taxpayers that are directly assessed. The various tax authorities have organised processes for performance of their duties. The chain of processes was set out by Lord Dunedin in *Whitney V. IRC*[30]as follows:

> Now, there are 3 stages in the imposition of tax, there is the declaration of liability, that is the part of the statute which determines what person in respect of which property are liable. Next, there is assessment. That ex-hypothesis has been fixed. But assessment particularises that exact sum which a person liable has to pay. Lastly, come the method of recovery; if the person taxed does pay voluntarily.

Under this system, the taxpayer is under obligation to make a return based on which he can be assessed to tax. Under Section 44 of the Personal Income Tax Act, a taxable person is also required to make a self-assessment by calculating the amount of

[29] (2005) All FWLR (pt. 279) 1829 at 1841.
[30] 1925 AC. 37 at 52.

tax payable. However, where the taxpayer refuse to remit the documents requested for the purpose of a final and conclusive assessment, the tax authority can proceed to assess the amount to be paid and notify the taxpayer of same.[31] Where such an assessment is impossible, the tax authority can bring an application to the court to compel the surrender of the relevant facts, records and documents.[32]

Where the taxpayer is dissatisfied with an assessment raised, he or she has the right to object or appeal against the assessment[33]within 30 days of the service of Notice of Assessment on him, and if he fails to object, and the assessment is in accordance with the provisions of the law, it shall be final and conclusive for all purposes.[34]

5.0 EMERGING LEGAL ISSUES

In the course of subjecting personal incomes to tax liability in Nigeria, many legal issues emerge ranging from the legal justification for the exemption of certain incomes from tax liability under the Personal Income Tax Act, to tax rates and the issue of whether the taxation of company profits and dividends in the hands of shareholders as personal incomes amount to double taxation. The foregoing therefore form the subject of the ensuring discourse.

5.1 EXEMPTED INCOMES UNDER THE ACT

The Act[35] does not define 'exempt income'. However, in *Northern Nigeria Investment Limited V. Federal Board for Inland Revenue*[36],Belgore, J (as he then was) defined the phrase as income

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31 See 55(1) PITA and *Guarantee Trust Bank Plc V. Ekiti State Board of Internal Revenue* (2019) 40 TLRN 53 at 77.

32 A combined reading of Sections 55 and 104 of the PITA is to that effect.

33 See *Lagos State Board of Internal Revenue V. Jenkins Investment Ltd* (Supra).

34 See *Star Deep Water Petroleum Limited V. Lagos State Internal Revenue Service* (2016) 23 TLRN 14 at 18.

35 PITA, ibid.

36 (1962) AC. 125.

that is primarily subject to tax but exempt under another provision of the law.

Section 19 of the Personal Income Tax Act[37] provides that there shall be exempted from tax all incomes specified in the Third Schedule to the Act. Under the Third Schedule, the following incomes are listed for exemption:

a) all consular fees received on behalf of a foreign state and all income of consular officers or employees except income from trade, business, profession or vocation carried on by such officers;
b) gains or profits from the business of operating ships or aircrafts carried on by anyone not resident in Nigeria in so far as in the case of ships the business is not carried on in inland waters;
c) interest accruing to any person not resident in Nigeria in respect of:
    i. interest on loan charged on the public revenue of the federation and raised in the United Kingdom;
    ii. interest on bonus issued by the government to secure repayment of loans raised from the International Bank for Reconstruction and Development;
    iii. interest on any money borrowed by the government;
    iv. income of any Local Authority, Native Authority or Government Institutions;
    v. income of any ecclesiastical, charitable or educational institution of a public character provided such is not derived from a trade or business carried on by such institution;
    vi. pensions granted to any person under the provision of the Pension's Act relating to widows and orphans;
    vii. income of any trade union registered under the Trade Union Act, provided such income is not derived from a trade or business carried on by such trade union;

[37] Ibid.

viii. interest from post office savings bank or from any Nigerian savings certificate;

d) income of any statutory or Registered Friendly Society in so far as such income is not derived from trade or business carried on by such society;

e) income and profits of co-operative societies;

f) sums received by way of gratuities or as consolidated compensation for death injuries;

g) dividends incorporated in Nigeria provided the equity participation is either wholly paid for in foreign currency or by assets brought into Nigeria between January 1, 1978 and December 31, 1992 and the person to whom the individuals are paid owns not less than 10 percent of the equity share capital of the company.

This provision is commendable particularly on two significant fronts. First, that it has brought the emoluments of the President, Vice President, Governors and their Deputies within the tax net. That is, the emoluments of the above mentioned public servants are no longer exempt from tax but now taxable. This is in sharp contrast with the 1990 Act which exempted those incomes from tax. Secondly, most of the exemptions can be justified on the ground of public policy, the need to stimulate investment and the desire to ensure social welfare.

However, the exemption of certain incomes from personal income tax is bound to erode the tax base, promote inequality and completely neglect both the redistribution of wealth and revenue generating functions of taxation. The exemption of incomes of ecclesiastical, charitable or statutory or registered friendly society appears to be vague.Section 19 of the Act[38] has not clearly made a distinction between the incomes of those bodies and incomes of their members. The incomes accruing to members from the operations or activities of these bodies are not considered for purposes of personal income tax in the Act. This lack of a clear distinction between the incomes of the exempted bodies and

[38] The PITA, ibid.

incomes of their members is bound to create opportunities for tax evasion and avoidance where incomes of members or business activities may be concealed as exempted incomes. An example worthy of mention here is the case of *Rev. M.F. Shodipo&Ors V. Federal Board of Inland Revenue*. In this case, the first and second plaintiffs were Trustees of Methodist Church Mission. They formed the Development Trust (Nigeria) Limited which developed land on Marina Road, Lagos. The defendant then proceeded to assess to tax the rents collected from the landed properties. However, the plaintiff sought a declaration that the income arising from the properties was that of a religious body and therefore not subject to tax. The Court rejected this contention on the ground that the Development Trust was simply a going concern and nothing more. In the words of the Court:

> I cannot say that there is left in my mind, any doubt the company is doing what it was formed to do, namely carrying on business of a company dealing in real estate. As such it is assessable to income tax on its profits.

This attempt to conceal trading income as income of the church and therefore successfully carry out tax avoidance was rightly tracked down by the court which prevented the loss of government revenue.

Again, the legal basis for the exemption of profits of Co-operative Societies no longer exists. The exemption of profits of Co-operative Societies from tax is on the basis that a man cannot make profits by selling to himself. However, this exemption no longer accords with modern commercial realities. It is in conflict with the rule in *Sharkey V. Wernhner*.[39] The rule is to the effect that where a taxpayer consumes his own stocks, the market value of such stocks should be entered into the books of accounts, thus imputing a notional profit to the taxpayer and therefore taxable. If a taxpayer is taxed for consuming his stock, then the justification for

[39] (1959) AC. 135.

exempting profits of co-operative societies from tax can no longer stand. It has now been firmly established that a man can make profit by selling to himself.

5.2 TAXATION OF DIVIDENDS

Dividend has been defined as a share of profits, whether at fixed rate or otherwise, allocated to holders of shares in a company.[40] In other words, dividend refers to the profits of a company distributable to members or shareholders as their shares of the profits. Taxation of dividends when distributed to shareholders is provided for under Section 12(1) of the Personal Income Tax Act.[41] According to the Section;

> The income from a dividend distributed by a Nigerian Company shall be deemed to be derived from Nigeria, and shall be the gross amount of that dividend before deduction of any tax which the company is required to deduct on payment thereof under the provisions of any law in force in Nigeria at the relevant time imposing taxation on the profits of companies.

In other words, companies are under the obligation to deduct tax on dividends and remit same to the tax authority.

The issue of whether or not the taxation of dividend amount to double taxation has been a controversial one. In the United States of America[42], and Nigeria income that is earned by corporations is subject to two levels of tax. Corporate profits are subject to corporate tax. When these profits are distributed to the shareholders they are taxed as personal incomes in the hands of the shareholders. According to Cordes[43], this amount to double taxation of corporate earnings and is bound to affect the corporate

40 Halsbury's Laws of England, 4th edition Vol. 7, Para. 596.
41 PITA, ibid.
42 Joseph J. Cordes, 'Dividends, Double Taxation of <https:/www.urban.org>, p. 95. (Accessed 15/07/2019).
43 Ibid.

decision as to how much to pay out to shareholders in dividends. Cato[44] therefore submits that:

> First, high dividend taxes add to the income tax code's general bias against savings and investment, second, high dividend taxes cause corporations to rely too much on debt rather than equity financing. Highly indebted firms are more vulnerable to bankruptcy in economic downturns. Third, high dividend taxes reduce the incentive to pay out dividends in favour of retained earnings. That may cause corporate executives to invest in wasteful or unprofitable projects.

These arguments can be justified in view of the fact that instead of paying out dividends to shareholders which is subject to further taxation, the company may choose to reinvest most of her profits.

Conversely, arguments do suggest that the company is a separate legal personality or entity so that the profits of a company and the dividends paid to shareholders are separate subjects of tax, and that the privileges conferred by incorporation justify the tax on company profits and on dividends as incomes accruing to shareholders.[45] In other words, the taxation of company profits and dividends when distributed to shareholders does not amount to double taxation as both constitute incomes to different entities. Prof. Amadi[46] therefore argues that:

> The greatest advantage of the corporate form of business organisation is the limited liability protection accorded its owners. Taxation of corporate income is the price of that protection.

[44] 'Archived copy', https://web.archive.org/web/20040204191706/http://www.cato.org/research/articles/edwards-030108.html.

[45] 'Dividend Tax', https://portal.bsum.edu.ng/viewReceiptByPayid,jsp?payid=2017..., p. 2, accessed on 5th September 2019.

[46] Confidence W. Amadi,quoted from 'Dividend Tax', ibid.

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> This price must be worth the benefits since, according to the Internal Revenue Service (1996), corporations account for less than 20 percent of all U.S. business firms, but about 90 percent of U.S. business revenues and approximately 70 percent of U.S. business profits. The benefits of limited liability independent of those enjoyed by shareholders, the flexibility of change in ownership, and the immense ability to raise capital are all derived from the legal entity status accorded corporations by the law. This equal status required that corporations pay income taxes.

These views are strengthened by the decision in *Global Marine International Drilling Corporation V. Federal Inland Revenue Service*[47]where the court considered the issue of whether or not taxation of payments made by the appellant to their subsidiary subcontractors can rightly be subjected to tax in the hands of the subcontractor who for all purposes is not different from employers of the appellant. In holding that the transaction does not amount to double taxation, the Tribunal held that "Double taxation can only happen where the same amount of income is taxed more than once in the hands of the same taxpayers"[48].

It is instructive to note however that though justified on the basis of being income in the hands of different legal entities, the taxation of dividends has the capacity to discourage investment and must be pursued with caution. Dividends should be subjected to tax at an affordable rate in order to reduce its trickle down effect on investment decisions.

47 (2013) 12 TLRN 1 at 23.
48 Ibid. P.24

5.3 PERSONAL INCOME TAX RATES

The Personal Income Tax Act[49] has provided for graduated tax rates on incomes as follows:

1. First ₦300,000 at 7 percent
2. Next ₦300,000 at 11 percent
3. Next ₦500,000 at 15 percent
4. Next ₦500,000 at 19 percent
5. Next ₦1,600,000 at 21 percent
6. Above ₦3,200,000 at 24 percent

The graduated nature of the tax rates for personal income taxation shows that the Nigerian tax regime is progressive. That is, the percentage of income an individual pays in taxes tends to increase with increasing income. Not only do taxes increase with higher income, as income increases, the taxpayer pays higher rates of taxes.

The most important issue for present purposes is whether a progressive tax regime has disincentive effect on the taxpayer. A high marginal tax rate, a product of the progressive tax regime has the tendency to produce the disincentive effect which makes the worker take to leisure rather than to extra work. It has been shown that disincentive effects are indications of economic inefficiency and waste.[50]

Ayua is of the view that disincentive effects can take different forms including emigration to countries of low tax rates, and involvement in 'black economic' activities.[51] The United States of America's experience in particular has shown that an extremely high rate of income tax for regulatory purposes has frequently clashed.[52] The situation is even worse in developing economies which are experiencing economic imperialism where transnationals or multinational corporations usually move their

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[49] Sixth Schedule to the Personal Income Tax Act, ibid.

[50] W.B. Elliott, 'Historical Perspectives on U.S. Tax Policy Towards the Rich', in Joel B. Slemrod ed. Does Atlas Shung? The Economic Consequences of Taxing the Rich, 2000 London, Sweet & Maxwell, p. 60.

[51] I.A. Ayua, ibid.

[52] Reuven S. Avi-Yonah, The Three Goals of Taxation, Harvard Law Review, February, 2005, p. 15.

capital out of peripheral economies when the legal environment is no longer conducive for optimum profit maximisation. A high tax rate as much as 21-24 percent as in the case in Nigeria may lead to workers' agitations for increase in wages and better conditions of work in order to improve on the disposable income of labour. Such agitations certainly do not encourage investment destinations.

6.0 CONCLUSION

The paper has examined some legal issues in the taxation of personal incomes under the Personal Income Tax Act. In particular, it examined the legal basis for the exemption of certain incomes under the Act, whether taxation of dividends constitutes double taxation, and the legal implications for the graduated tax rates under the Act.

In respect of the exemption of incomes of Registered Friendly Societies, and ecclesiastical and charitable societies, the paper has demonstrated the need for a clear separation of incomes of these bodies and incomes of their membership or leaders since the present situation encourages tax avoidance and evasion as it is possible for personal incomes to be concealed under the guise of the organisations.

The paper has also established that the legal basis for the exemption of the profits of co-operative societies from tax no longer exist as the decision in *Sharkey V. Wernhner*[53]has shown that a man can make profit by selling to himself. It is therefore more equitable to expunge this exemption from the list of exempted incomes under the Act.

It has further been shown in this paper that taxation of dividends, though legally not double taxation, practically, it has the potentials to serve as disincentive to investment, particularly in limited liability companies. It is therefore advocated here that, though legally justified, the taxation of dividend should be at a minimal rate. That is, dividends should be taxed with the smallest

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[53] Supra.

amount of hissing from the investor. Only then will the disincentive effect be eroded.

In considering the interaction between graduated tax rate regime as provided under the Personal Income Tax Act, and incentive to work, it is clear that as income increases, the marginal tax rate of a worker also increases. This is bound to impact negatively on the workers' willingness to work hard as his increased income will be taken away in the name of tax. In alternative, there may be sustained increase in labour agitations for increased wages which may consequently discourage investment. These tendencies may be curtailed if the gap in the graduated tax rates is not so much widened. This will enable the worker benefit significantly from his increased income arising from hard work.

In all, there is the urgent need to amend the Personal Income Tax Act to address the emerging legal issues therein that are not in tune with modern economic realities. Only then will the taxpayervoluntarily comply with his tax obligation with the smallest amount of hissing, while government revenue improves significantly due to increment in tax compliance.