

# An Examination of the Implication of Tax Audit on Revenue Generation in Enugu State of Nigeria

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## ABSTRACT

Tax audit was adopted to evaluate tax computations and remittances in the self-assessment regime. The system of self-assessment provides the taxpayer with the responsibility of assessing his economic activities for taxation, adopting the recommended template or form to render the gross income, allowable deductions, etc. emanating from the economic activities engaged in. The implication of tax audit on tax revenue was undertaken to determine the effectiveness of tax audit on the self-assessment tax policy alongside their contributions to taxation revenue. The survey research design was adopted for the study. Chi-square statistics tool was used to test hypotheses generated for the study. The study revealed that, self-assessment scheme affects revenue generation positively and has contributed greatly in the success of the self-assessment tax policy. The policy is still relevant in today's business world. It should be upheld.

**Keywords:** Tax Administration, Tax Audit, Revenue, Self-Assessment System, Back Duty Assessment

## Introduction

Government interest in direct assessment of taxation on her populace is to get adequate revenue for the carrying out of her constitutional given responsibilities. However, the revenue generated during the use direct assessment system of taxation is said to be insufficient consequence [1]. Improving the insufficient revenue necessitated the enactment and introduction of the self-assessment taxation policy or scheme in Nigeria in 1991, which became effective in 1992. However, it was made mandatory for every taxpayer to self-assess their economic activities for taxation in 1998 [2].

Self-assessment is a method whereby a taxpayer is required to correctly compute his or her own tax liability, properly complete the tax return, pay the self-assessed tax and submit the tax returns together with the accompanying documents on or before the due date according to the relevant tax law [3]. The reason for the enforcement of self-assessment scheme is to ensure steady inflow of revenue to the government without waiting till when tax authorities reach every taxpayer, easing the process of paying tax, supporting taxpayers to comply voluntarily.

The self-assessment policy of taxation came up with tax audit as a means of checking tax practices during the self-assessment system. This exercise is carried out periodically to compliment and support the self-assessment scheme [3]. A tax audit is said to be an examination of whether a taxpayer has correctly assessed and reported their tax liability and fulfilled other obligations [4]. In line with foregoing, this study: (i) examined the effect of self-assessment on tax revenue generation, (ii) ascertained the contribution of tax audit in the self-assessment policy, and (iii) determined the effect of taxation on the Nigerian revenue system in Nigeria. The problem stated in the study includes the inefficiency of the relevant tax authorities in their internal processes, particularly in processing tax refund and tax correspondence, the insufficient access channel for taxpayers to obtain tax guidance and advice and also the relevant tax authority's non-responsiveness to complexities and problems faced by taxpayers.

## Literature Review

Revenue generation is that inflow of cash and cash equivalent that accrues to the economy from the sources approved by the constitution - in this case, taxation. Taxation is a mandatory contribution to state revenue imposed by the government on employee's earnings and company profits, or applied to the cost

of such products, services and transactions (Oxford dictionary). Tax audits are said to be a procedure implemented to improve tax administration and ensure effective tax revenue generation and distribution. Tax audits can be difficult for taxpayers, as poor process management can result in lengthy reconciliation meetings and increased tax liabilities. As a result, active management of the exercise is critical.

An audit is an independent examination of the financial information of any entity whether profit oriented or not; irrespective of its size or legal form when such an examination is concluded with a view to express an opinion thereon. Also, it is as an independent examination of the financial statement of a system or organization with a view of making a report that the financial statement shows a true and fair view. Adedioran, Alade & Oshode added that tax audit, like financial statement audit involves the gathering of information and processing it for determining the level of compliance of an organization with tax laws of the territory. For a successful audit, it is necessary that the auditor organizes his work in such a way that the assignment is accomplished completely and effectively. Sokenu added that by tax audit the relevant tax authority ascertain that the audited organization complied with the applicable tax laws and regulations of the state.

Meanwhile, James identified tax audit objectives to be inclusive of the followings: (i) put non-compliant taxpayers into the tax avoidance net; (ii) to lessen the chances of tax evasion; (iii) to prove the completeness, accuracy and timely filing of tax returns submitted by the taxpayers; (iv) to put strategies in place in order to resolve dispute between the tax authority and the liable taxpayers; and (v) to maintain a strong mechanism to deal with tax avoidance techniques which are available to various organizations. Adediran et al (2013) noted some conditions for a good audit, which appears as follows: (i) the tax auditor must be familiar with his working atmosphere, (ii) tax officials should be motivated to conduct audits, and they should be well-trained and experienced in their field, and (iii) the tax audit should be properly supervised by those who are professional and when new tax inspectors are sent to carry out the audit, they should be monitored by older ones so as to make sure that the right thing is done.

Taxation is the primary source of revenue in Enugu State in Nigeria. Effective and efficient utilization of the collected revenue from the taxes will allow the government to provide adequate infrastructure that may boost and improve the life quality of its citizen. In the self-assessment system, a taxpayer is required to assess his tax liability using a tax return form in which he declares his gross income, allowable deductions, disallowable deduction, statutory deduction, etc. This tax return must then be filed with the tax authority together with a payment for the tax liability computed on the said return. The basic feature of a self-assessment Scheme (SAS) is that it is the taxpayer rather than the tax authority is responsible for the assessment of tax liability. Sarker, identified that the SAS has a unique merits compared to an official assessment system and the merits include: (i) it is more cost effective as it only selects exceptional cases for further scrutiny; (ii) it eliminates the administrative nature of assessment work; (iii) it supports an early and timely collection of taxes; and (iv) it reduces corruption by reducing contacts with taxpayers.

The self-assessment system requires every taxpayer to provide full information about his or her income, calculate the tax payable, and make payment to the tax office in accordance with the tax laws. The concept of self-assessment is a core to the recommended strategy for implementing tax audit. Tax administration should be designed with the aim of increasing voluntary compliance, such that the following conditions are achieved: (i) Simple tax laws - difficult laws can drastically increase obedience costs, reducing tax compliance. A simple tax law would provide for limited exemptions, a single positive rate, a zero-rate limited to exports, and a high threshold etc. (ii) Services to taxpayers - the tax administration should assist taxpayers in meeting their obligations. Taxpayers need to be supplied with the essential information on what is expected of them, changes in procedures and improvements and withdrawal in taxations as and when they fall due. (iii) Simple registration, filing, payment, and refund procedures - tax forms should be readily available to taxpayers and procedures easy to comply with. (iv) Collection enforcement - prompt detection of taxpayers who fail to submit tax returns, and/or pay tax due, are critical to improving tax compliance, especially regarding large taxpayers. Notwithstanding the seeming benefits attributable to the self-assessment policy, the system is faced with peculiar challenges which include: (i) small traders may be illiterate, (ii) most businesses underreport their tax liabilities, and (iii) the conditions for implementing self-assessment are not met.

The back duty assessment or case is another prominent offshoot of the self-service policy. It is said to occur when a source of income has been completely excluded from a tax return or when the amount of business profits has been understated. If an inspector of taxes believes that back duty is payable, an enquiry will be instigated. If back duty is found to be payable, it is likely to come with an interest and penalties added to the tax charge. Adediran et al, corroborated that back duty audit may be instituted when the following is observed: (i) Failure to disclose or include in full any income or earning in the return made available to the tax office. (ii) Uncertain claim of capital allowance in respect of current or previous year. (iii) Reduction in the profit in the returns files in tax office. And (iv) Tax charged or assessed that is less than what it ought to be.

Owing to the classical theory of tax compliance, any "rational" individuals purposefully compare the expected monetary costs and benefits of gaming the tax system, and that compliance can be increased by increasing audits, increasing penalties, or a combination of the two [5]. Any strategy to prevent tax evasion should begin with theory of why many people cheat on their taxes. Naturally, much of it is unconvincing and ambiguous. Nonetheless, to give an indication of the full range of variables that social scientists have studied in an attempt to answer their questions. There are a large number of literatures on the potential moderating influence of government regulation on tax audit and government tax revenue generation.

Economics of Crime and Expected Utility Theory: the taxpayer compliance literature is a broad and developing body of knowledge and encompasses many disciplines, including economics and psychology. Klepper & Nagin noted that its foundations lie in the economics of crime and expected utility literature, in which it is assumed that taxpayers are amoral

economic evaders who would assess the likely costs and benefits of evasion behaviour compared to those of compliance [6]. They identified these costs and benefits to be associated with the tax rate, audit rate (i.e., percentage of returns subject to audit) the probability of returns of detection and the penalties for non-compliance.

In a bid to respond to the tax determinants in achieving optimality in self-assessment policy, Yahaya examined the tax determinants towards self-assessment system with concentration on the corporate taxpayers [7]. The study found out that the corporate taxpayers in Nigeria have knowledge about self-assessment system and the also the responsibilities of Federal Inland Revenue Service (FIRS), it also confirmed that there is a significant influence between awareness of self-assessment system, self-assessment responsibilities, compliance responsibility, payment compliance and audit function and compliance behaviour. Meanwhile, Onuoha and Dada examined the tax audit and investigation as imperatives for efficient tax administration in Nigeria [8]. The findings of this study revealed that tax audit and investigation are inevitable to improve on the collection of tax revenues in Nigeria. It also confirmed that there was a high prevalence of non-compliance currently among individuals and companies in the country.

The study of Onoja and Iwarere, evaluated the effect of tax audit on revenue generation of Nigeria [9]. Their study was carried out in Abuja the federal capital territory (FCT) of Nigeria. The study revealed that tax audit has significant effect on revenue generation. It also portrays that effective tax compliance can enhance revenue generation. It is important to emphasize that the Abuja being a Federal Capital Territory is operated with the Federal Laws, oversight by the Federal Inland Revenue Service (FIRS). Similarly, the study of Adediran, Alade and Oshode explored the impact of tax audit and investigation on revenue generation in Nigeria. Their study revealed that tax audit and investigation can increase the revenue base of the government and can also stamp out the incidents of tax evasion in the country.

A study on how tax audit would affect compliance was done by Kennedy and John [10]. They examined the impact of tax audit and other qualitative attributes on tax compliance level in Nigeria, and It was revealed that there is significant positive relationship between tax audit and tax compliance, the probability of being audited, perception on government spending, penalties and enforcement [11-13]. That the joint effect of tax audit and penalties have a tendency to significantly influence tax compliance in Nigeria. Still on compliance but with self-assessment this time around, Appah and Ogbonna found out that self-assessment compliance rate significantly affects revenue generation in Nigeria [10]. It confirms that self-assessment scheme influences revenue generation [14]. It points out that insufficient access channel for tax payers to obtain tax guidance and advice would not help the FIRS to achieve greater voluntary compliance.

Finally, on the use of electronic tax payment systems to improve tax revenue in Benue State of Nigeria, Amos, John and Eric found out that the use of electronic tax payment system has tremendously improved tax accountability and revenue generation in Benue state [15]. It also revealed that to broaden

the tax bracket and lessening one-time payment can equally; also improve the revenue generated in the state. This study concludes that tax administration significantly affects revenue generation.

**Methodology**

A cross-sectional survey research design was adopted in this study to examine the implication of tax audit on revenue generation in Enugu State of Nigeria. This study employed the categorical data and qualitative data. Data was collected primarily from surveys and inquiries. The population of the study comprise of managers and accounting or finance staff of small and medium sized enterprise (SMEs), accounting, auditing or tax consultancy firms, and the staff of Enugu State Board of Internal Revenue (ESBIR) in Enugu State of Nigeria [16]. The choice of the various sectors is to allow for differing opinions from different sectors. The population is estimated to 360. The non – probability stratified convenience sampling technique was used, to allow for the participation of all sectors. The sampled population was 72, distributed thus 18, 18, 18, and 18 respectively. Studies have shown that 20% of a finite population is considered apt for sample under a finite population [17]. The technique used for analysis is the Chi-square test. This is used when there is categorical data for one independent variable, with intention to compare an observed frequency distribution to a theoretical expected frequency distribution. Thus Chi-square formula is:

$$X^2 = \sum \frac{(Fo - Fe)^2}{Fe}$$

Where:  $\sum$  = Summation of the frequency  
 $X^2$  = Chi-square distribution  
 Fo = Observed frequency  
 Fe = Expected frequency

**Data Analysis and Presentation**

The data below shows the information gathered from distributed questionnaire. The observed frequencies are represented in the cells or box, while the expected frequencies are the represented in brackets (). The expected frequencies were derived from the formula:

$$\frac{\text{Row Total observed frequency} \times \text{column total of observed frequency}}{\text{Total number (of row and column)}}$$

**Table 1: Represent the Observed and Expected Frequencies**

QUESTIONS	SA	A	UN	D	SD
Q1	9(5.4)	53(34.6)	0(15.4)	8(13)	0(1.6)
Q2	6(5.4)	28(34.6)	25(15.4)	11(13)	0(1.6)
Q3	3(5.4)	36(34.6)	23(15.4)	1(13)	7(1.6)
Q4	6(5.4)	0(34.6)	20(15.4)	43(13)	1(1.6)
Q5	3(5.4)	56(34.6)	9(15.4)	2(13)	0(1.6)
Q6	28(15.2)	36(35.4)	5(8.6)	1(8.8)	0(2)
Q7	3(15.2)	30(35.4)	1(8.6)	28(8.8)	8(2)
Q8	8(15.2)	31(35.4)	17(8.6)	12(8.8)	2(2)
Q9	21(15.2)	30(35.4)	18(8.6)	1(8.8)	0(2)
Q10	16(15.2)	50(35.4)	2(8.6)	2(8.8)	0(2)
Q11	12(7.4)	36(40.4)	21(14)	0(6.6)	1(1.6)
Q12	16(7.4)	54(40.4)	0(14)	0(6.6)	0(1.6)

Q13	3(7.4)	22(40.4)	20(14)	20(6.6)	5(1.6)
Q14	2(7.4)	47(40.4)	16(14)	4(6.6)	1(1.6)
Q15	4(7.4)	43(40.4)	13(14)	9(6.6)	1(1.6)

**Source:** information mined from the questionnaire distributed

From the test of hypotheses one, the chi square score (X<sup>2</sup>C) is 155.45 while the chi-critical (X<sup>2</sup>t) is 26.30 at 0.05 level of significance and a degree of freedom (DF) of 16. Since the value of X<sup>2</sup>C is greater than the critical value or tabulated X<sup>2</sup>t of 26.30, the alternate hypotheses which says that self-assessment does affect revenue generation is accepted. The test of hypotheses two shows the p value of 26.30 and the chi square score of 124.25 at 0.05 level of significance and DF of 16, therefore we accept the alternative hypotheses that tax audit and investigation has contributed greatly in self-assessment [18]. From the test of hypotheses three, the p value is 26.30 and the chi square score is 78.87 at 0.05 level of significance and DF of 16, we accept the alternative hypotheses and conclude that Taxation has positive effect in the Nigeria revenue system.

The outcome of the finding in hypothesis one shows the relationship between self-assessment and revenue generation. This is similar to the findings of Appah and Ogbonna and Kennedy and John [2,10]. They discovered that self-assessment compliance rate significantly affects revenue generation.

The result of hypothesis two tested shows a significant relationship between tax audit and investigation and self-assessment [19]. Although, there is no study with similar findings yet, this discovery clears that tax audit and investigation has contributed greatly in self-assessment system [20,21]. Most studies conducted in this area are focused on tax compliance determinant and self-assessment just like Yahaya and Onuoha and Dada, which studied the tax determinant toward self-assessment system and Palil which studied tax knowledge and tax compliance determinant in self-assessment in Malaysia [7,8]. Their findings show that there is a significant influence between self-assessment responsibilities and tax compliance.

The result of hypothesis three tested shows significant evidence of relationship between taxation and the Nigeria revenue system [22]. This is similar to the findings of Amos, John and Eric. Even though their study was focused on tax administration and revenue generation, they discovered that electronic tax payment system has tremendously improved tax accountability and revenue generation [23].

**Conclusion and Recommendation**

The findings of this study have shown that the existence of self-assessment has increased revenue and also ensure voluntary compliance. Based on the findings, it is revealed that self-assessment affect revenue generation in a positive way, tax audit has contributed greatly in self-assessment policy of taxation in Enugu State of Nigeria revenue systems. It is therefore, concluded that Tax audit has strong impact on revenue generation in Nigeria.

Based on the findings of this project, the following recommendations were made on the implication of tax audit

on revenue generation: (i) the relevant tax authorities must try and ensure that firms are taxed and their tax returns are properly accounted for. Firms should also ensure that they pay their tax returns, and the documents are kept for proper audit to enhance revenue generation. The relevant tax authority should ensure that tax audit are taken seriously and they are properly carried out by experts so as to ensure good accounts of revenue generated.

**Questionnaire**

**Section A: Demography**

**Instruction:** please, fill in the option best appropriate to you.

- Employment status
  - Employed
  - Employer of labor
- Please state your job function and where you work?

**Section B: Relevant Research Questions**

Please tick [√] in the appropriate box  
 SA= Strongly Agree. A= Agree. UN= Undecided. D= Disagree. SD= Strongly Disagree.

S/N	Questions	SA	A	UN	D	SD
1	The establishment of self-assessment has yielded desired revenue.					
2	The dishonesty of taxpayers in the computation of tax returns has degraded self-assessment.					
3	Self-assessment has enhanced voluntary compliance thereby increasing revenue.					
4	The existence of self-assessment has worsened tax avoidance thereby decreasing revenue.					
5	Tax simplicity, tax fairness under self-assessment system has remained achievable.					
6	Efficient monitoring and checks of tax returns of the taxpayers by tax auditors under self-assessment has helped in revenue generation.					
7	Tax audit and investigation carried out during self-assessment is not a guarantee on revenue increase.					
8	The use of specific methods introduced by tax auditors to assess tax returns under self-assessment has increased compliance.					
9	Practical investigation and audit of individual tax returns has internally generated revenue.					
10	Adequate education of self-assessment to the taxpayers by the tax auditors has produced great result in the tax system.					

11	The introduction of taxation has raised revenue enough to meet government expenditure.					
12	Taxation has contributed significantly on revenue generation in Nigeria from the point of view of certainty and consistency.					
13						
	The tax collection mechanism used by tax officials is free from embezzlement and contribution thereby developing the Nigerian revenue system.					
14	The non-judicious use and zero accountability of tax paid have increased tax evasion and reduce revenue.					
15	Taxation is regarded as a tool of fiscal policy used by government to increase the rate of economic growth and per capital income.					

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