

## ASSESSMENT OF VOLUNTARY TAX COMPLIANCE AMONG INFORMAL ECONOMY IN NIGERIA

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**Abstract:** This study investigated the level and challenges of voluntary tax compliance of businesses within the informal economy of Ifako-Ijaiye local council development area (LCDA) of Lagos state, Nigeria. The population of the study is the entire businesses in the (LCDA) that fall within the category of the informal economy. A sample of 100 business owners comprising of traders, artisans, shop owners and 17 tax officials were selected using convenience sampling method. The responses were obtained through the aid of structured questionnaire. Descriptive statistics such as mean score and frequencies were used to analyse the data. Findings showed that the level of voluntary tax compliance in the informal economy is low and the business owners who are the expected tax payers were of the opinion that non-utilisation of tax revenue by the government and the excessive high tax rate account for their non-voluntary compliance. In addition, empirical evidence as provided by the tax officials had it that the nature of the businesses of the informal economy and the unavailability of adequate records make it hard to tax the informal economy. The study therefore recommends that government should seek to be accountable with good governance in place, and that tax laws should regulate the tax rate applied to businesses in the informal economy.

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**Keywords:** Taxation, Voluntary, Informal economy, Compliance, Nigeria.

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### I. INTRODUCTION

Many developing countries including Nigeria are faced with the problem of raising revenue to meet government expenditure. Oil revenue has been the main stay of the Nigerian economy for decades. However, with the recent crash in the price of crude oil at the global market the quest for alternative sources of revenue has become a major challenge. Revenue generated from individuals and businesses is therefore seen as an important stream of income to the government (Amanamah, 2016). One major sector of every developing economy that should have contributed immensely to this revenue generation drive is the informal sector given its enormous size. But, on the contrary, incomes generated from this sector, in many cases, are not officially captured into the tax net of the States or Nation (Somuah, 2011; Udoh, 2015). It is therefore noted that the informal sector forms a greater percentage of tax defaulters, increasing cases of tax evasions leading to leakages in government revenue.

Over the years, almost every efforts aimed at improving the tax collection among this sector has not yielded expected outcome (Somuah, 2011). Since the informal sector consists of firms and individuals who are not fully registered and regulated, and therefore not in the standard tax net, it is often difficult to ensure voluntary tax compliance among this group. Studies have shown that challenges ranging from tax administration such as poor knowledge of tax matters, inadequate accounting record, failure on the parts of governments to utilise tax revenue, high tax rate, the nature of the business, the large size of the informal sector, account for this

low level of compliance (Somuah, 2011; Nguyen, 2013).

There is a global awakening to the new thinking about how to strengthen the taxation of the informal economy. For instance, in Nigeria, a number of studies have been conducted and many of them focused on the eastern and northern part of the country (Okoye, Akenbor&Obara, 2012; Udoh, 2013, Ohaka&Zubkee, 2015, Obara&Nangih, 2017, Henshaw, 2017). But Lagos, being the economy capital of West Africa with a growing population of more than 20 million people, coupled with the existence of variety of small scale businesses making up the informal economy, the state stands a chance of improved tax revenue generation if this opportunity is utilised. The objectives of this study are therefore to examine the level of voluntary tax compliance among informal sector businesses and identify the challenges hindering such compliance in Lagos State, taking Ifako-Ijaiye local government as a case study..

The next section of this paper provides a brief review of literature. This is followed by a discussion of the research methodology and then the data analysis and results. The final section provides the discussion and conclusion of the study.

### II. LITERATURE REVIEW

#### 2.1 Concept of Taxation

Abdulahi (2012) defined tax as “a charge on income of individuals and corporate bodies by the government. Generally, it is referred to as a compulsory levy that the government of a country or its appropriate agency imposes on taxable persons, individuals, businesses and other bodies to allow the

government provide money needed for the running of government and to achieve other macro-economic objectives and fiscal policies of the government. The process by which this is achieved is known as Taxation. Even though tax payers may receive nothing identifiable in return for their contributions, they nevertheless have the benefit of living in a relatively safe, healthy and solidified society with modern amenities.

In the past, taxation of the informal sector has attracted little attention (Ohaka&Zubkee, 2015). Critics of the view to tax the informal economy were of the opinion that the potential revenue yields from the informal sector are low, administrative cost for tax collection is high and that tax incidence is likely to be regressive (Keen, 2012). However, of recent the issue of taxation of the informal sector has received increased attention. Joshi *et al.*, (2014) noted that this stems from the reality that in many countries the informal sector forms a large growing share of the Gross Domestic Product (GDP), and thus represents potentially significant sources of revenue for the government.

### 2.2 Informal Sectors Business operators

Several authors have used different criteria to define the characteristics of the informal sector. According to (ILO, 1972), it identified the sector as being characterised by ease of entry, small scale operation, unregulated and competitive market. La Porta&Shleifar (2008) categorised businesses that are unregistered and the ones that are registered but hide their tax liability from the government. In essence, tax evasion is a key feature of the informal sector. In line with this, Gerxhani, 2004; Routh, 2011) in addition to identifying tax evasion as a key feature of the informal sector also highlighted lack of social coverage for employees and illegality as characterising this sector. The consensus emanating from other studies provides more criteria for identifying businesses in the informal sector. This includes high mobility of the business, small size, invisibility and irregularity, cash transaction and lack of business records, unstructured and self-employed persons (Udoh, 2013; Ekpo&Umoh, 2014).

The aforementioned criteria show that there is no single generally accepted definition of informal sector. Benjamin &Mbaye (2014) asserted that informality is better described as a continuum and as such, the criteria be narrowed down to registration with the relevant tax authority, size of the business which is often small and improper record keeping.

### 2.3 Tax compliance among Informal sectors

Apparently, since the informal sector consists of firms and individuals who are not fully registered and regulated, and therefore not in the standard tax net, it is often difficult to ensure voluntary tax compliance among this group. Voluntary tax compliance in this case entails; registration of business for tax purpose,

filing of tax returns on time, making full disclosure of income for tax purpose, correctly reporting their tax liability, maintaining all relevant records for tax purpose (OECD, 2004, 2012; Anyaduba, 2012). A number of challenges have been perceived to account for this non-voluntary compliance ranging from tax administration-related barriers such as poor knowledge of tax matters, improper accounting record, failure on the parts of governments to utilise tax revenue, high tax rate, the nature of the business, the large size of the informal sector, (Somuah, 2011; Nguyen, 2013).

## III. RESEARCH METHODOLOGY

The study adopts a survey method by utilising primary data obtained through the aid of a structured questionnaire. The entire informal sector operators within Ifako-Ijaiye local council development area is the population for this study. Although this figure is not infinite, but is large and as such the figure cannot be ascertained for the purpose of this study. Samples of 100 informal sector operators were selected through convenience sampling techniques. Also, 17 tax officials provided data for this study. Data obtained were analysed using descriptive statistics (mean score) through the aid of SPSS 20.0.

### 3.1 Measurement of variables

This study utilised the existing variables as used in previous studies. Measurement of variables for voluntary tax compliance was as used in (OECD, 2004, 2012; Anyaduba, 2012) while measurement of variables for the challenges of tax compliance among informal sector operators were derived by adopting the information as listed in (IMF, 2012 and OECD, 2004). A checklist was used in the questionnaire to gather data on this parameter by measuring on a scale of 1(Strongly Disagree) to 5 (Strongly Agree).

Variable	Number of item	Cronbach's Alpha
Voluntary Tax Compliance	5	0.944

Table 1: Reliability test result for Tax Compliance

Source: Field Survey (2017)

To ensure the relevance of the research instrument in measuring tax compliance internal validity was ensured through the use of widely accepted variables for measuring the data. Cronbach's Alpha estimates for measuring tax compliance was computed to ensure reliability as indicated in Table 1

## IV. ANALYSIS AND RESULTS

### 4.1 Demographic information

The result in Table 2 presents the analysis of respondents from the tax payers' group. As regards the age of the business of the tax payers, majority of them (91%) have been in business from 1 to 10 years

while 5 of them have spent over 10 years in the business. A clear indication of why these businesses are referred to as informal sector economy is the small level of income from this business and the level of staff strength. This is confirmed as (76%) of the businesses make a sales of N250, 000 and below per month and (61%) of them are one man businesses.

	N	Minimum	Maximum	Mean	Std. Deviation
Voluntary Tax Compliance	100	1.00	5.00	1.6880	1.35983
Valid N (listwise)	100				

**Table 2: Demographic Summary of Tax Payers Respondents**  
Source: Field Survey (2017)

Similarly, further analysis showed that 7 (41.2%) of the respondents from the tax officials are well experienced on the job having spent between 6 to 10 years on the job.

#### 4.2 Level of voluntary Tax compliance

The result in Table 3 is the response from the tax payers showing the level of voluntary tax compliance among the informal sectors.

	Category	Freq.	%
Sex	Male	43	43
	Female	57	57
	Total	100	100
Age of Business	Less than 1 year	4	4
	1-5 years	59	59
	6- 10 years	32	32
	Over 10 years	5	5
	Total	100	100
Turnover monthly	Less than N100,000	35	35
	N100,000- N250,000	41	41
	Above N250,000	21	21
	Invalid	4	4
	Total	100	100
Staff Strength	1	61	61
	2-5	36	36
	6-10	2	2
	Above 10	1	1
	Total	100	100

**Table 3: Descriptive Statistics of level of Voluntary Tax Compliance**  
Sources: Field Survey (2017).

Voluntary tax compliance is measured through the assessment of tax payers in the area of registration of their business for tax purpose, filing of tax returns on time, making full disclosure of income for tax purpose, correctly reporting their tax liability and maintenance of all relevant records for tax purpose. The result indicates that the level of voluntary tax compliance among this informal economy is low (1.6880). This is just a little above the minimum value. It can be inferred that the characteristic nature of the informal sector does not encourage registration of business neither does it motivate these

businesses to voluntarily file their tax returns on time, disclose and report tax liability correctly.

#### 4.3 Challenges of voluntary tax compliance among informal sector operators

From the responses of the informal sector businesses as presented in Table 4, high tax rate (5.00) and perceived idea that government do not utilise tax for the purposes they are meant (5.00) are the major challenges inhibiting voluntary tax compliance. They also admit that the nature of their business (4.98) and poor knowledge of tax matters (4.96) do not encourage them to see the necessity of paying tax.

	Mean	Std. Deviation	Minimum	Maximum
Tax Administration- Poor knowledge	4.96	.000	1	5
Economic- High tax rate	5.00	.000	1	5
Accounting No proper record	4.76	.818	1	5
Industry Nature of business	4.98	.200	3	5
Psychosocial- Tax not utilised	5.00	.000	5	5

**Table 4: Descriptive Statistics of level of Voluntary Tax Compliance (Tax payers)**  
Sources: Field Survey (2017)

The tax officials are of the opinion that the nature of business of the informal sector economy (5.00) is the major challenge hindering voluntary tax compliance. This attest to this difficulty encountered in taxing an unstructured business characterised by high level of invisibility and irregularity.

They also confirm truly that the nature of these business does not enhance proper record keeping, thereby posing additional challenge to taxation of the informal sector.

	Mean	Std. Deviation	Minimum	Maximum
Tax Administration- Poor knowledge	3.00	.000	5	5
Economic- High tax rate	2.47	.000	1	5
Accounting No proper record	4.00	.818	1	5
Industry Nature of business	5.00	.200	5	5
Psychosocial- Tax not utilised	1.59	.000	1	5

**Table 5: Descriptive Statistics of level of Voluntary Tax Compliance (Tax Officials)**

*Sources: Field Survey (2017)*

Interestingly, the high point of these challenges as indicated by the tax payers which are high tax rate and perceived idea that government does not utilise the tax are not seen as challenge to voluntary tax compliance. In the opinion of the tax authority, the tax rates (2.47) levied on these businesses are not high and that it is not true that government does not utilise the tax for the purposes it is meant for (1.59).

## DISCUSSION AND CONCLUSION

The result of this study indicates that voluntary tax compliance among informal economy is low. This is because the characteristic nature of the sector makes them to be excluded from the tax net and as such they will not comply voluntarily except when compelled to. However, with the increasing need by government to meet its financial obligations and the potentials of this sector to contribute to the revenue generation drive of the government, the taxation of the informal economy stands to be harnessed.

In addition to the features of the informal economy which pose barriers to the taxation of this sector, if in the opinion of informal economy businesses, factors such as perceived non-utilisation of tax revenue by the government, excessively high tax rate, poor knowledge of tax matters due to the failure of tax officials to provide the requisite enlightenment are not there, perhaps, these businesses would have taken more delight in fulfilling their tax obligation. The tax officials are of the opinion that the nature of the business engaged in by players in this sector makes it difficult to assess them to tax, particularly when they do not keep proper records of their activities.

Accountability and good governance should be the prime concern of the government in order to build trust in the tax payers. Skilled tax officials should be enlisted to orientate the tax payers. Tax law should be favourably disposed to the informal economy in the area of tax rate in order to enhance voluntary tax compliance.

Attempts to tax businesses while they remain informal calls for efforts towards enhancing tax compliance in this sector and this opens up topic for further research.

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