



STATES & LOCAL FINANCE

The IGR Initiative

MARTIN IKE-MUONSO

Martin Ike-Muonso, a professor of economics with interest in subnational government IGR growth strategies, is managing director/CEO, ValueFrontiera Ltd. He can be reached via email at martinoluba@gmail.com

IN MODERN PUBLIC finance, the role of taxation is primarily four: [a] revenue generation for the provision of public goods, facilitation of production efficiency and the handling of governments operational expenditures, [b] the stabilization of economic growth process, [c] resource redistribution, and [d] other non-economic objectives such as discouraging harmful goods consumption. Tax policy design and implementation always reflect policymakers' views and interests in achieving these four broad areas individually and interactively with other factors. That is why they are ideally concerned about policy effectiveness, even from design points. In contrast, experience with subnational governments in Nigeria has shown meagre consideration of tax policy effectiveness on the IGR expansion during the design phases and, by extension, at their implementation. Accordingly, monitoring the magnitude and interactive chain of burden and relief impacts on variables central to revenue expansion efforts becomes less attractive and nonpriority.

Determining the effectiveness of tax policy and building such understanding into the design always leads to sound public governance. It could be the root of prosperity-creating tax policies. There are at least three reasons why the effectiveness of IGR policy needs prioritization. The first is clarity and attendant accountability. Policy effectiveness understanding clarifies the need for such policies and the size of expected impacts. It also makes it easier to track progress in policy implementation as it logically establishes the connection between the policy and expected outcomes. The second is learning. The focus on the effectiveness of tax policies for IGR expansion promotes learning among tax policy decision-makers. They pay attention to how changes in the policies affect critical individual and corporate welfare indicators. That way, policy fine-tuning becomes even more meaningful and effective. The third is the apparent improvements in decision-making. With an improved understanding of the effects of tax policy changes, it is unarguably easier to improve the overall decision-making process and the provision of justifications for policy changes to stakeholders, citizens and businesses.

The most important role of taxation is to orchestrate development. Therefore, tax policy effectiveness is necessarily viewable from the lens of fulfilling this expectation. Alignment of tax policies with the subnational governments developmental priorities is critical. Misalignment with this goal will either create parallel or contradictory interests. In the former, the design goals and the strategic purposes of the sub-

national government fail to meet each other, and consequently, the supposed contribution of our tax policy effectiveness vanishes. In the latter, designed policies can frustrate the government's developmental objectives. For instance, before many state governments adopted the harmonization codes, multiple taxations by both state and local governments have been significant complaints by businesses. It follows, therefore, that when the effective average tax rates that entrepreneurs pay become considerably burdensome, they may consider non-compliance as an option or even move to a different location. In effect, therefore, if the subnational government's developmental priorities focus on increased employment, such tax policy developments would only frustrate such employment prospects. The relocation of several businesses from Lagos state to Ogun state is not un-connected with this situation.

The sustainability of IGR expansion depends almost entirely on the expansion of entrepreneurs' residual incomes. The prosperity of entrepreneurs delivers more opportunities for employment of human and capital resources and income, both of which provide tax revenue. Therefore, there is a deviation from the mark when tax policy designers do not pay sufficient attention to how tax policy changes and the implementation strategies will affect entrepreneurial success. Virtually all subnational governments rarely consider this in Nigeria. Designers fall into the trap of copying and pasting tax rates, bases, taxable assets, and incentives regardless of the differences in business environments and general contexts across state and local government areas. And therefore, the adaptation of tax policies given those peculiarities, even if copied from other state and local governments, is critical. Forward-looking measures that make robust albeit qualified guesses of the potential profitability performance across industries, sectors, and value chain phases provide a significant guide to tax policy designers in reflecting tax impacts and incidences on such indicators in future design.

Again, the ideal thing is that policy designers should have data on the historical deviations of tax policy impacts from targets. *Ceteris paribus*, there are usually estimates of target tax impacts and actual incidences at the design stages. The idea is to ensure that tax policies are consistent with developmental and entrepreneurial prosperity priorities. Where policies frustrate these goals, they are not worth implementing regardless of how much income resources [formal incidences] that will potentially accrue to the government. However, many governments scarcely set these targets

Tax policy effectiveness for IGR expansion



alongside tax policies and, even when they have such benchmarks in place, they rarely track them. The ideal thing is to re-examine such historical information where they exist to know the extent to which the tax impact and real incidences of existing tax policies are in line with such set targets. With minimal deviation, and given that the set targets are equally consistent with the realities, changes to such policies may not be necessary as they are already effective. In the case of IGR expansion, the design of such impacts and incidents targets gives more weight to business prosperity and critical compliance factors.

It is a fact that adequate cognizance of tax policy effects on business profitability also requires substantial consideration of its impact on investment. However, this is not always the case, as some tax policies may be either selective and favourably skewed to a sector or industry at the point of design or be more beneficial to an industry or sector due to unforeseen events. In cases like these, which always occur, there is a distortion of the investment market that channels investable funds to favoured sectors. In contrast, competing participants may experience some measure of investment drought depending on the intensity of the positively skewed effect. Understanding the potential tax effects on investments across industries and value chains is critical to a successful tax policy design. Policymakers must consider the market-distorting impacts of different tax policies and the flow of investable funds, and the competition generally. For instance, generous concessions offered to Dangote's entrepreneurial operations substantially influence the flow of investable resources to them but have often created severe competition upset that repeatedly threatened the survival of other competitors.

Successfully sustaining an effective tax policy regime also requires rigorously accounting for unintended tax incentive effects where they apply. Although subnational governments in Nigeria do not have a strong history of generous tax incentives, they must nevertheless always consider such consequences at the design and implementation stages. There are

at least four potential sources of abuse of tax incentives and, by implication, loss of government revenue that policy designers need to pay attention to and seriously monitor. While these potential sources of tax incentive abuse are common at the federal level where such incentives apply, they are worth noting as there may be closer semblances at the subnational government level. These include the possibility of existing firms transforming into new entities to qualify for incentives, domestic firms restructuring as foreign investors, over-valuation of assets for depreciation, tax credits or other purposes, and disguising very non-qualifying activities into those that qualify.

The abuse of tax holidays for freshly registered businesses is rampant, particularly among micro and small businesses. In this case, the typical modality of abuse is to incorporate a new company with a name similar to the first one and make it difficult for customers to notice the difference. For example, assume that a company incorporated in 2020 has the name Tino-P limited. After eighteen months, its tax holiday would have expired. The business owner can register a newer company as Tino-Px limited with the same address, logo, telephone, and email address. Whereas customers will rarely notice the difference, the freshly registered company qualifies for another eighteen months of tax holidays in the face of the law. Domestic firms restructuring as foreign investors is also one of such scams or incentive abuses that are well known. Of course, there are several cases of prominent Nigerian entrepreneurs setting up shelf companies overseas to evade taxes. The extended version of such abuse comes as these shelf companies, repackaged as foreign investors to Nigeria. Typically, the process of perfecting this tax evasion fraud is registering the domestic firm as a shelf company or a subsidiary of an existing firm in some of the tax-free havens overseas. After that, these shelf companies are repackaged as prospective corporate investors back into the country to expropriate some tax incentive windows that they ordinarily would not have access to as indigenous companies. Therefore, tax policy designers

should pay attention and make financial and other provisions for substantial background checks and other forms of due diligence on the so-called foreign investors to determine their authenticity.

Beyond the possible abuse of tax policies is a properly defined and clarified goal or set of goals that the policies intend to achieve. Often these goals appear to opaquely exist without a logically definable link between designed tax policies and incentives with such desired outcomes. But that is not where the big challenge lies. Much of the problem is with the legislative involvement in the process. Focusing on the socio-economic outcomes of tax policies will require regular examination. This requirement also means that those responsible for checking, assessing and determining outcome performance possess the data and other necessary resources for such assignments. Unfortunately, this only becomes a mirage without properly defined indicators and a priori mapped out resources for data collection and analysis. An authentic executive and legislative hug should lead to a specialized hearing on such evaluations. Ideally, such legislative hearings should query the absence of alignment between the policies and the expected outcomes and demand reasons for and possibly sanction performance failures.

Finally, when tax policy designers and implementers focus on effectiveness, the impact on internal revenue generation is usually positively outstanding. Unfortunately, tax policy formulation at subnational government levels rarely defines an overarching goal and properly aligns those policies with those goals and, by extension, the government's developmental priorities. Pursuing such worthwhile outcomes usually comprises solid policy attention to business prosperity and employment generation. It also considers the unintended effects and abuses of tax incentives, which mainly undermines the efforts of policymakers to leverage the tax tool for state-wide decision-making.

● *business a.m. commits to publishing a diversity of views, opinions and comments. It, therefore, welcomes your reaction to this and any of our articles via email: comment@businessamlive.com*