

## STATES &amp; 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*

**T**HE PROGRESSIVE TAX system, based on taxpayers' ability to pay, imposes higher tax rates on those with higher incomes. The Nigerian tax system is quite progressive, with gradatory rates increasing with income and wealth. Lower-income earners and those who spend a sizeable proportion of their income on necessities ideally should benefit more from progressive taxation. Progressive taxation also presupposes higher revenue yield as those with more significant income pay much more. But how progressive is progressive taxation in Nigeria, where a considerable share of high-net-worth individuals (HNIs) and very important personalities (VIPs) evade tax payments almost without consequences? Progressivity in taxation conveys the notion of fairness and equity and facilitates narrowing the income inequality gap. The 2021 Africa Wealth Report, published by South Africa's AfrAsia Bank and New World Wealth, reported that Nigeria had about 9100 high net worth individuals with a combined wealth of approximately \$207 billion as of December 2020. But 70 percent of Nigeria's over 200 million people live in poverty, with an average per capita income of \$2,085. Yet, as of 2018, the federal government identified more than 130,000 high-net-worth individuals and companies dodging tax payments. The fact that the rich easily evade taxes more than ordinary and lower-income people induces questions on the integrity and legitimacy of the tax system.

In countries with severe socio-economic inequality, like Nigeria, HNIs often account for less than one percent of the population but control between 15 percent and 30 percent of the total wealth. Knight Frank's 2021 Wealth Report estimated that Nigerian ultra-HNIs (\$30+ million) were approximately 1000 people. Most high-net-worth individuals are indeed considered VIPs. Some VIPs may not, income-wise, fall into the high-net-worth individual category but usually have access to enormous political power. Besides the massive wealth and potentially high demand impacts, HNIs and ultra-HNIs usually drive tremendous employment opportunities because of their significant investments. Fortunately, this class of people is growing reasonably well in the country. However, although the HNI population fell by 23 percent between 2015 and 2020, the 2021 Wealth Report predicts a 19 percent increase between 2020 and 2025. For the ultra-high-net-worth individuals, the report estimated that they grew by six percent between 2015 and 2020 and could grow by 14 percent between 2020 and 2025. It is evident, however, that this increasing expansion in the HNI population does not cor-

respondingly reflect in the revenue yield to the government.

High net worth individuals and VIPs default on their tax obligations through several channels, namely the under-declaration and non-declaration of earned income. Although this is not peculiar to the ultrarich and VIPs, theirs creates a much bigger hole than the defaults of lower income earners would. For instance, under-declaration or outright non-declaration of incomes earned on government contracts and overseas trading, which people with much higher incomes primarily handle, can be significant. Again, since the ultrarich own the big firms with a complex transactional relationship with non-resident companies within the country, they can easily dodge the declaration and remittance of some value-added tax collections. Usually, the complexity of such a network of relationships with foreign organisations not physically on the ground in the country makes it markedly easy to hide them. In general, there are usually sizable levels of inconsistency between their declared incomes supporting their tax computations and the actual worth of their assets.

Several reasons account for the ultrarich and VIPs' successes in underpaying their tax obligations. The first is the elevated level of informality and the dearth of information on potential taxpayers. Micro and unregistered businesses largely dominate the informal sector, making obtaining information for their tax assessments quite challenging. However, many high-net-worth individuals stack their operations on a well-coordinated network of micro and small businesses operating within the informal sector. An example is an informally operating big-time aggregator of agricultural commodities in the northern parts of the country with privately registered trucks and a network of unregistered wholesalers from the southern parts of the country making payments directly into his private or dedicated private personal account. Even though this high-net-worth individual has expansive operations with a massive income, there is ample room for underpayments as all the individual activities within the ecosystem operate informally and, at best, qualify for presumptive tax rates.

Secondly, while the tax law allows capital gains upon value realisation, it does not provide for taxing income growth differences (income appreciation) except for salaried income earners. For instance, if the income of the agricultural produce aggregator in the personal bank accounts doubles each year, it is unlikely that he would pay an increased tax. The only exception is capital gains upon selling statutorily registered assets such as equities

## Enhancing the tax compliance of HNIs and VIPs



and real estate. In the latter's case, some ultrarich individuals merely hand them over to their children as they age. Thirdly, wealthy persons are attractive to virtually all countries because of the attendant investment inflows. Many countries waive the applicable taxes on these investments to attract and retain them. Such tax havens are veritable wealth-hiding places for high-net-worth individuals. The Panama and Paradise papers show how the wealthy and VIPs utilise these tax havens to avoid and evade the payment of taxes on their wealth. Many Nigerian HNIs surely make use of this window.

Fourth, the ultrarich and VIPs take up substantial proportions of the campaign financing of many politicians. Some of them that do not make direct financial contributions support the emergence of the candidate through various other ways. In our substantially corrupt society, these levels of backing equal future payments for political favours, including cover from tax payments. For instance, more than 60 percent of government officials, who also own businesses; the so-called royal fathers, traditional rulers, and well-known financiers of political parties within a state rarely pay their fair share of taxes.

Fifth, the rich and VIPs in Nigeria have tremendous bribing capacity and can easily influence auditors and tax collection officers to make assessments in their favour, resulting in substantial underpayments. A wealthy person in a business whose tax liability is N40 million may end up paying only N15 million into government coffers after successfully bribing the auditor and the tax officer with N5 million each. Many tax auditors, assessors and officers look forward to this bribe-collecting opportunity to influence the underpayment.

The sixth factor is that billionaires usually do not receive salary payments. Most of their bills are naturally taken care of by their corporate organisations, mostly under opaque headings melting into general corporate operating costs. Therefore, while mid-level and executive-level employees pay commensurate taxes, the personal income tax of the ultrarich is often a mockery of their actual income. Part of the reason for this is that in the eyes of most tax officers, the rich are usually synonymous with their organisations and scarcely treated as individuals. As a result, if the organisation regularly com-

plies with its corporate income tax obligations and other associated tax regulations, there is usually little incentive to pry further into the owners' personal wealth size and corresponding tax payments.

The seventh factor pertains to the ease of accessing high-net-worth individuals and VIPs to demand tax compliance. While reaching out to the middle class is much easier, usually in average-income districts, the rich reside in well-guarded and out-of-reach areas. This access challenge makes it doubly frustrating for tax officers and may lead to successful tax evasion by the rich.

Voluntary assets and income declaration schemes (VAIDS) came into existence as a response to this anomaly. VAIDS is a programme designed to encourage the voluntary disclosure of previously unknown assets and income, regularise and remediate their tax status and pay all outstanding tax liabilities. The programme is a response to the tax authority's discovery of significant disparities in the asset values and tax returns of many HNIs and VIPs by utilising data from sources such as Bank Verification Number (BVN), foreign exchange application, land registry, company dividends, car registration, Corporate Affairs Commission, and foreign property ownership. VAIDS was an amnesty window by the government to voluntarily enable defaulters to remediate their arrears of non-compliance from 2010 to 2018. The window has closed, and it is unclear whether it was impactful in entrapping the HNIs and VIPs.

In addition to asset and tax payment matching, leveraging the previously mentioned databases, several other steps are worth exploring to catch more taxpayers in this socioeconomic demographic. The first relates to the more effective utilisation of the databases through active integration. Active integration enables real-time assessment and intelligence regarding the taxpayer's assets, income, and tax obligations. Making reliance on this approach more robust requires incorporating more databases and mandatory disclosure on the purchases of ostentatious

items beyond a specified value threshold. A variant of this measure is the naive targeting of affluent taxpayers through graduated value-added tax (VAT) payments. VAT payments, for instance, can be as high as 60 percent on such luxury goods as diamonds, expensive jewellery, luxury cars, furniture, and wristwatches.

The second approach is the SNG assessment, audit, and reporting. Most rich people in Nigeria primarily have two operational bases: state and local government, where their businesses are and, to some extent, their state and local governments of origin. A matching of asset audit reports from the two locations can give a more authentic picture of the wealth status and provide an excellent foundation for additional investigation. For instance, most wealthy people of Southeast Nigerian descent own good houses in their towns and villages. Appropriate matching of the databases containing the quality and size of the property at home would usually help unveil such hidden wealthy tax defaulters. The success of this approach would depend substantially on the level of asset audit cooperation among subnational governments.

Demanding tax clearance for typical activities performed by the rich, VIPs, and high-net-worth individuals can be an excellent starting point in this exercise. Some areas worth focusing on include, standing for critical national elections, membership in elite clubs such as the Ikoyi Club in Lagos, taking traditional and other high-profile professional titles, and building mansions and edifices anywhere in the country. Again, criminalising defaults, creating a dedicated unit within the Economic and Financial Crimes Commission (EFCC), and complementary special tax courts across the thirty-six states and the federal capital territory would likely deliver more optimal results.

Finally, it is essential to note that the rich can be as ignorant as any other citizen concerning tax matters. In part, much of the defaults by high-net-worth individuals and VIPs can result from such a knowledge gap. Tax education designed exclusively for the wealthy can help close this gap and enhance their accountability, responsibility, and willingness to disclose their income sources in their tax returns fully.

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## The Nexus between...

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The corporate governance best practices of conducting periodic board and workers evaluations and retreats have recently been adopted by many boards. Board evaluations and retreats are most effectively designed and administered by external corporate governance experts. There are organisations that are specialists in corporate governance training. They organise annual or periodic retreat for strategic planning of organisations goals and also evaluate the performance of boards and workers so as to ensure that boards and workers are on track towards achieving the set goals. The goals and objectives of board

evaluations typically include an assessment of directors' knowledge, skills and competencies, including business and financial acumen, industry knowledge, socio-political knowledge and fundamental legal knowledge and understanding, which will typically vary by a particular company's type and its board's organisational maturity.

In a competitive economy, strategic communication of corporate governance goals of organisations is very important and can only be handled by experts who are specialists in this field. The results will be noticed in organisations' performances using goodwill, sales turnover, profit, employees' satisfaction and increase in share value as indices.