



TAX INCENTIVES AND INCLUSIVE GROWTH IN THE NIGERIAN ECONOMY

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Abstract: Tax incentives in addition to infrastructural development have been used by most countries to attract investment to different sectors of the economy. Thus, the study investigated tax incentives as it affects inclusive growth in Nigeria from 1999-2019. The objective of the study is to examine both investment and pioneer tax allowances on inclusive growth in Nigeria. Time series data was collected from the publications of the Central Bank of Nigeria (CBN) statistical bulletin and Nigerian Investment Promotion Council Publications of various issues. This study adopted the technique of Fully Modified Ordinary Least Square (FMOLS) to analyze the time series data. The empirical result revealed that pioneer tax allowance is positively related to inclusive growth. Also, investment allowance has a direct and significant impact on inclusive growth in Nigeria during the period of study. Based on the findings, it was therefore recommended that tax authority should consider proportionately, increase of both pioneer and investment allowances, as this will attract more investors, and bring about inclusive growth in the economy. Also, government should strengthen the tax administration system to broaden the tax income, and embark on tax education to ensure voluntary tax compliance.

Keywords: FMOLS, Tax, Incentive, Inclusive growth, Pioneer allowance.

1. Introduction

Tax as an indispensable instrument of fiscal policy, play vital role as tool for resources mobilization, reduction in inequalities of income, and improvement in social welfare of both the developed and developing countries, sometimes as a way to inspire inclusive growth of an economy. By way of definition, tax is a mandatory levy by law and payable by an economic unit of the government to finance the activities of the government (George-Anokwuru & Obayori, 2020). Taxes could be classified into direct or indirect. “A direct tax such as personal income tax is levied on individuals and factors of productions and thus is not transferable; while indirect tax

such as import tax is the one that can be transferred to another individual or business that owes it and thereby the consumers bear the ultimate burden” (Obayori & Omekwe, 2019). Thus, to ease the burden of tax on business agents and as well attract inflow of investment, government must encourage the policy of tax incentive or tax relief in some critical sectors such as the industrial sector that drives the economy.

Meanwhile, a tax incentive is a basic term for all the procedures adopted by the government to consciously influence the tax system to the benefit of potential taxpayer. Put differently, tax incentive is a careful discount in or total removal of tax liability granted by the government



in order to inspire a particular economic unit to act in some desired ways. One of the importance of incentives is to ease off the burden of tax on tax payers and encourage investors, which in turn will enhance inclusive growth. Essentially, tax incentives are intended to boost investment in certain desired sectors of the economy, and as well designed towards attracting foreign investment inflow to compliment domestic production for rapid growth. These incentives include, but not limited to: personal allowances, pioneer tax allowance, capital allowances, investment allowances, loss relief, annual allowances, tax free dividends, export processing zones reliefs, research and development and tax free holidays.

Over the years in Nigeria, it has been perceived that income tax revenue has been obviously understated as a result of unsuitable tax administration arising from under assessment and inefficient machinery for collection (Adegbe & Fakile, 2011). The Nigeria law of Companies and Allies Matter Act of 1990 as amended, incorporating all legal provision has made provision for certain tax incentives for corporate bodies and individuals (Nnubia & Obiora, 2018).

In the meantime, the increasing outflow of investors, and the poor performance of local industries as a result of inadequate finance, increasing cost of production occasioned by volatility in Naira exchange rate and recent economic recession have returned the attention of managers of the nation's economy to the importance and sustainability of taxes, especially tax incentive to both local industries and foreign investors in order to grow the economy (Obayori & Omekwe, 2019; Afolayan & Okoli, 2015). Moreover, the incidence of tax evasion and avoidance by tax payers is high, leading to low level of government revenue which further reduces the level of government expenditure, culminating into a reduction in the income savings and expenditure of households and firms, leading to low level of economic activities and economic growth. Thus, the need for tax incentive became imperative in the face of tax avoidance and tax evasion.

Moreover, various empirical studies have been carried out on tax incentives and economic variables. Such studies include; Ogbonna and Appah (2012); Yaya (2013) and Akwe (2014) which indicated positive relationship between tax and economic growth; others such as Saibu (2015) as well as Bonu and Pedro (2009), showed negative relationship. In view of these different findings, this study seeks to further investigate the relationship between tax incentives and inclusive growth in Nigeria, with particular focus on the effect of pioneer tax allowance and investment allowance on Nigeria's inclusive growth period 1999–2019.

2. Conceptual Clarification of Tax Incentive

Incentives is reduction in the effective tax burden on the favoured activity as against that normally imposed upon it, in the hope that the reduction in government revenue will be compensated by an expected expansion of the national economy and ultimately by resulting increases in total revenue from such broadened economic basis. According to Sanni (2002), tax incentive is a deliberate reduction in or total elimination of tax liability granted by the government in order to encourage a particular economic unit to act in some desirable ways. The desirable ways maybe to invest more, employ more, export more and import less. Tax incentive is a generic term for all the measures adopted by the government to deliberately manipulate the tax system to the advantage of potential taxpayer (Dotun, 1996).

Tax incentive could be in the form of investment allowance, annual allowance, research and development and free trade/export processing zones. All these forms of incentives are operationalized to encourage investment and increase the level of employment, reduction in poverty and increased the growth of the economy.

2.1 Investment Allowance

As an incentive for investments, an investment allowance of 10% was granted to companies in the business of agricultural production (other than in marketing and process). This allowance is given in addition to the initial



allowance granted on such assets. The allowance, like the initial allowance, is granted once on an asset and is not affected by the length of the basis period during which the asset was first put to use. But unlike the initial allowance, it is not deducted from the cost of the asset in arriving at the tax written down value of the asset.

Also, investment allowance is claimable and hence deductible from profit only in respect of production machinery in the year of expenditure and cannot be carried forward if not claimed or not relieved. Therefore if a business sustains a loss in a year that investment allowance is claimable for tax purposes, the allowance will be lost even when a claim is made as it cannot be relieved from a loss.

In order to encourage investment in the manufacturing industry, the 1996 finance miscellaneous Decree increased the rate of investment allowance from 10 % to 15% on plant and machineries used in manufacturing business. Thus, the rate of investment allowance is now 15% effective from 1st January 1996. Investment allowance is also granted on qualifying capital expenditure incurred on new assets on or after 1st April 1969 as a replacement of an asset of a business destroyed or damaged in any part of Nigeria during the period commencing 16th July, 1967 and ending 15th January, 1970 as a direct result of any military operation or other operation connected with civil war. The amount of investment allowance is increased to 25% of the capital expenditure incurred. Industrial plant and machinery bought in replacement of old ones are granted a once and for all 95% capital allowance in the first year with 5% retention as the book value until the final disposal of the assets.

2.2 Tax Relief for Research and Development

Industrial establishments are expected to engage in research and development for the improvement of their processes and products. Up to 120 per cent of expenses on (R&D) are tax deductible, provided that such (R&D) activities are carried out in Nigeria and related with the businesses from which income is derived. Also, 140 per

cent is allowed as R&D on local raw materials. However, where the research is long-term, the expenses on R&D is taken as capital expenditure and written off against profit. The results of such research would be patented and protected according to international property rights (NIPC, 2009).

2.3 Free Trade/Export Processing Zones

In order to create a business friendly environment, the Federal Government in 1991 passed an aggressive free zone law which allows interested parties to set up industries and businesses within the designated zones. This is with the objectives of exporting the goods and services manufactured or produced within the zones. Incentives include, tax holiday; unrestricted remittance of profits and dividends earned by foreign investors; no import or export licenses required; up to 100 per cent foreign ownership of enterprises; permission to sell up to 25 per cent of production in the domestic market, etc.

The Oil and Gas Export Free Zone was established by Decree No. 8 of 1996. The Decree provides for an incentive-driven and attractive environment for business in the oil and gas sector. The objective of the zone is to motivate both foreign and local investors for increased investments in the oil and gas sector, so as to increase the nation's oil reserves, enhance government take and provide basis for technological transfer. There are currently three oil and gas free zones in Nigeria with enhanced stacking and warehousing facilities for investors. They comprise, the Onne, Calabar, and Warri Oil and Gas Free Zones. Thus, fiscal incentives in the zone include:

- All companies operating in the zones are exempted from payment of all Federal, State and Local Governments taxes, including rates and levies;
- All goods imported into the zones are duty free;
- There is 100 per cent guarantee on foreign capital, profits and dividends repatriation;
- There is no expatriate quota and foreign exchange regulation;



- There is no pre-shipment inspection for goods imported into the free zones;
- The operators in the zone are not required to process import or export License;
- Companies are to enjoy rent free land at the construction stage;
- There is no restriction on profits and dividend remittances by foreign investors;
- There would be no strike and lock-out for ten-years after the commencement of operations in a zone;
- There is 100% foreign ownership of company investment

2.4 Annual Allowance

As the name implies, the annual allowance is granted every year to a business owning an asset that was used for the purpose of the business. The allowance is granted in the first year applying the relevant percentage on the cost of the asset, less any initial allowance granted. In the second and subsequent year, the same amount as was given in the first year is also given. Thus the annual amount is given on straight line basis. Where an initial allowance had been given both initial and annual allowances may be claimed in the first year. Where the basis period for a year of assessment is a period of less than one year, the annual allowance are not proportionately reduced. However, annual allowances are not proportionately increased if the period for a year of assessment happens to be a period of more than one year. It shall be limited to a period of 12 months. This situation is applicable when the commencement provisions are involved and when qualifying capital expenditure is incurred in the middle of a basis period. It should be noted that the tax laws, by prescribing the straight lines basis for calculating the annual allowance, implicitly fixes the life span of the asset. Thus, if the annual allowances rate for an asset is given as 20%, this implies that the asset will be written-off for tax purposes in 5 years (i.e., 100/20). If the rate is given as

10%, the asset is to be written –off in 10 years. The implication of this is that an asset could be written off for tax purposes, yet the business could be using the asset to earn income. To avert abuse and misapplication, the tax laws provide that the annual allowance is to be granted such that a nominal sum ₦10 is left in the books for each asset, until is eventually sold or otherwise disposed of by the business.

Clearly, what this means is that the business continues to use the asset after the end of the asset's useful life. It should be noted that the straight –line method of arriving at the annual allowance was introduced with effect from the 1985 year of assessment. Before then, annual allowance was calculated using the Reducing Balance Method.

3. Theoretical and Empirical Evidence on Taxation

Theoretically, the role of taxation on the economy can be examined from two foremost schools of thought – the traditional economic school and the modern school. Accordingly, the traditional economic school of thought, averred that if other factors affecting growth are held constant, low tax rates and low government spending will bring about higher growth (Barro (1991; Slemrod, 1995). This means that the higher the marginal tax rate, the greater the chances of higher income tax payers diverting extra time from productive operations to leisure activities. On the other hand, the modern school of thought revealed that higher marginal tax rates leads to greater economic development in the long-run because government would secure a greater revenue which when invested in the country's education and infrastructure development will boost the growth of the economy.

From the point of view of economic theory, marginal tax rates are particularly important because they affect the incentives of individuals to earn more income. Consequently, as marginal tax rates increase, individuals will keep less of their additional earnings. While economic theory predicts a negative relationship between marginal tax rates and economic growth.



Empirically, Saidu (2014) examined the impact of tax incentives on economic growth and industrial development of companies in Nigeria. Survey method and content analysis was used for the analysis. The findings showed that, there is a significant relationship between tax incentive and economic growth. Uwuigbe, Uwuigbe, Adeyemo and Anowai (2016) examined tax incentives and the growth of manufacturing firm in Nigeria. By employing a judgmental sampling technique to generate data from 20 small and medium scale manufacturing companies in Ogun State, they concluded that tax incentives affect funds for capital of the 20 small and medium scale manufacturing companies in Ogun State. The study concluded that increase in tax incentives increases the performance and creation of new manufacturing companies in Nigeria.

Uwaoma and Ordu (2016) used correlation method of analysis to examine the impact of tax incentives on industrial growth in Nigeria from 2004 to 2014. Using probability method, a sample size of 45 respondents in 30 companies were studied. Twenty eight (28) correctly-responded set of study questionnaire were obtained for the analysis; and the findings revealed that sufficient tax incentives enhances industrial growth and economy. Ramaswamy (2016) examined the size dependent tax incentives, threshold effects and horizontal subcontracting in Indian manufacturing, using a panel data set from 5 firms listed on Indian stock exchange from 1999 to 2010. Results from the fixed effect model showed that there is a positive relationship between manufacturing performance of the firm and tax incentives in India.

Manukaji (2018) examined the effect of tax structure on economic growth in Nigeria from 1994 to 2016. The result of the OLS study showed that company income tax revenue as well as other two components of tax breaks have significant effect on economic growth in Nigeria. The study contends that tax administrative loopholes should be plugged for tax revenue to contribute immensely to the development of the economy. Also, Okeke, Mbonu and

Ndubuisi (2018) used OLS multiple regression analysis to examine tax revenue and economic development in Nigeria between 1994 and 2016. The findings showed that tax revenue has significant impact on life expectancy, labour force and gross fixed capital formation.

Obayori and Omekwe (2019) used Auto Regressive Distributed Lag (ARDL) model to examine the impact of indirect tax on economic growth in Nigeria from 1994–2018. The ARDL co-integration test showed that there is a long run association amongst the variables. The ARDL short run result showed that the value of VAT has a positive relationship with economic growth in Nigeria. Also, custom and excise duties revenue positively impacted on economic growth in Nigeria. Also, George-Anukwuru and Obayori (2020) used dynamic ordinary least square (DOLS) to examine direct tax and the growth of the Nigerian economy. The empirical results showed that a direct and significant relationship exists between petroleum profit tax and economic growth, while an indirect relationship exists between oil rent and economic growth.

3. METHODOLOGY

Since the study is quantitative based, quasi -experimental research design was used in collecting the various data. This is because the study demanded the use of time series variables to determine the relationship between the economic variables under consideration. The data range is from the period of 1999 to 2019. This data was primarily sourced from various issues of the publications of the Central Bank of Nigeria (CBN) statistical bulletin, and the Nigerian Investment Promotion Council Publications. This study adopted descriptive statistics to test the reliability of data via mean, median skewness and standard deviation. While, the fully modified ordinary least square (FMOLS) is the main econometrics method for analyzing the data. “The FMOLS method was developed for estimating a single co-integrating relationship that has a combination of I (1) and also deal with serial correlation problem and as well produce reliable estimates for small



sample size and provide a check for robustness of the results” (Philips & Hansen, 1990)”.

Model Specification

The FMOLS model was specified in the linear form in the equation below;

$$IEG_t = \beta_0 + \beta_1 PAA_t + \sum_{i=1}^n \Delta \beta_1 PAA_{t-i} + \beta_2 IVA_t + \sum_{i=1}^n \Delta \beta_2 IVA_{t-i} + \varepsilon_t \quad (1)$$

Where; IEG is inclusive growth (proxy by GDP per capita); PAA is pioneer tax allowance, IVA is investment allowance, ε is error term, t is time frame; $t-1$ is time lag; β_0 is intercept parameter; β_1 and β_2 are the slope parameters and $\sum$ is summation

4. RESULTS AND DISCUSSION

Table 1: Descriptive Statistics Results

	IEG	PAA	IVA
Mean	4511.768	1759369.	1039159.
Median	4747.715	630100.0	971543.8
Maximum	6218.821	8270667.	2216470.
Minimum	2148.968	11480.00	92792.50
Std. Dev.	1477.236	2335641.	695057.5
Skewness	-0.382507	1.240867	-0.018252
Kurtosis	1.706091	3.693863	1.569191
Jarque-Bera	1.977015	5.810393	1.792479
Probability	0.372132	0.054738	0.408102
Sum	94747.12	36946758	21822342

Table 2: Unit Root Test at Level and First Difference

Variables	ADF Test @ Level	Critical Value @ 5% (level)	Order of Integration	ADF Test Statistic @ 1 st Difference	Critical Value @ 5% (1 st Diff.)	Order of Integration
IEG	--1.742089	-3.040391	Not Stationary	-7.408060	-3.040391	1(1)
PAA	-1.934973	-3.040391	Not Stationary	-7.258020	-3.040391	1(1)

Sum Sq. Dev.	43644533	1.09E+14	9.66E+12
Observations	21	21	21

Source: *Extracted from E-view 12.0*

The descriptive statistics reported in Table 1 indicated that inclusive growth (IEG) has an approximate average of ₦4512billion with the corresponding standard deviation of ₦1477billion. Similarly, pioneer tax allowance has an approximate average of ₦1759369billion with the corresponding standard deviation of ₦2335641billion. Also, investment allowance has approximate average of ₦1039159billion with the corresponding standard deviation of ₦695058billion. Thus, it can be inferred from the analysis that the standard deviation of all the variables were not higher than their averages or means. Therefore, they converged around their respective mean. Meanwhile, the skewness test showed that the variables are negatively sloped except PAA which has a positive slope. Moreover, inclusive growth (IEG) and investment allowance (IVA) are platykurtic relative to normal, since the approximate values for kurtosis 1.70 and 1.56 are less than 3. Meaning that the two variables have thin tails, and their central peaks are lower and broader. But pioneer tax allowance (PAA) has leptokurtic distributions relative to normal, since the approximate values for kurtosis 3.6 is more than 3. This indicated a flatter than normal distribution and the variables have large tails. Meanwhile, the probability of Jarque-Bera statistics showed that the null hypothesis of all the variables were accepted. Thus, the variables were not normally distributed.



IVA	-1.040387	-3.040391	Not Stationar	-5.566972	-3.040391	1(1)
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Source: *Extracted from E-view 12.0*

The order of each of the series as presented in Table 2 using the ADF tests, showed that both the dependent and independent variables were not stationary at level. Thus, the variables were differenced once and they became stationary at first difference, I (1). Given the stationarity of the variables, the best regression results were obtained when estimating the FMOLS.

Table 3: Fully Modified Ordinary Least Square Regression Result

Dependent Variable: Real Gross Domestic Product per Capita (IEG)			
Variables	Coefficients	t-statistics	Probability
C	2355.009	11.44688	0.0000
Pioneer Tax Allowance (PAA)	0.0000613	0.987629	0.3372
Investment Allowance (IVA)	0.001977	9.138034	0.0000
R-Squared	0.89487	f-statistics	Prob(F-statistic)
		91.17424	(0.0000)

Source: *Extracted from E-view 12.0*

The results of the estimated model as presented in Table 3 showed that pioneer tax allowance (PAA) has positive value of 0.0000613 in the model. This implies that increase in pioneer tax allowance increases inclusive economic growth (IEG) by 0.00613% in Nigeria during the period of study. But the variable is not statistically significant with inclusive growth, given the p-value of 0.337 which is greater than the critical value at 5%. The result conforms to the finding of Uwuigbe, Uwuigbe, Adeyemo and Anowai (2016) on tax incentives and the growth of manufacturing firm in Nigeria. Moreover, investment allowance (IVA) has positive value, and is statistically significant at 5% level of significance. Thus, a unit increase in investment allowance significantly increases inclusive growth by 0.1977%. The result conforms to the finding of Nnubia and Obiora (2018) who examined the effect of tax incentives on economic growth in Nigeria, and concluded that tax incentives in the form of investment allowance and pioneer income tax relief are directly related with economic growth in Nigeria.

Meanwhile, the R-squared which measure the goodness of fit of the model, has an approximate value of 89%. Based

on the result, the explanatory variables can impact up to 89% out of the expected 100%, leaving the remaining 11% which was captured by the error term. Similarly, the f-statistics which measures the overall significance of the explanatory variables in the model, showed that the two independent variables are significant in explaining the level of inclusive growth in Nigeria. This is because the probability value of 0.0000 is less than 0.05. Also, the model is free from the problem of autocorrelation because the Durbin-Watson value is 2.2 which is approximated as 2.0. This means that the model can be used for policy implementation.

5. Concluding Remark

Tax incentive is a deliberate reduction in or total elimination of tax liability granted by the government in order to encourage a particular economic unit to act in some desirable ways. The desirable ways maybe to invest more, employ more, export more, sell more, consume less, import less and pollute less and so on. Tax incentives in addition to infrastructural development have been used by most countries to attract investment to different sectors of the economy. Thus, the study investigated the effect of tax



incentives on inclusive growth in Nigeria and revealed that incentive in the form of pioneer tax allowance and investment allowance will potentially bring about inclusive growth in Nigeria during the studied period. Based on the finding from the study, it was recommended that tax authority should consider proportionately, increase of both pioneer tax allowance and investment allowance, within the operational period of investors, as will attract more investors, thereby improving the growth of the economy. Also, government should strengthen the tax administration system to broaden the tax income base, and embark on tax education to ensure voluntary tax compliance.

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