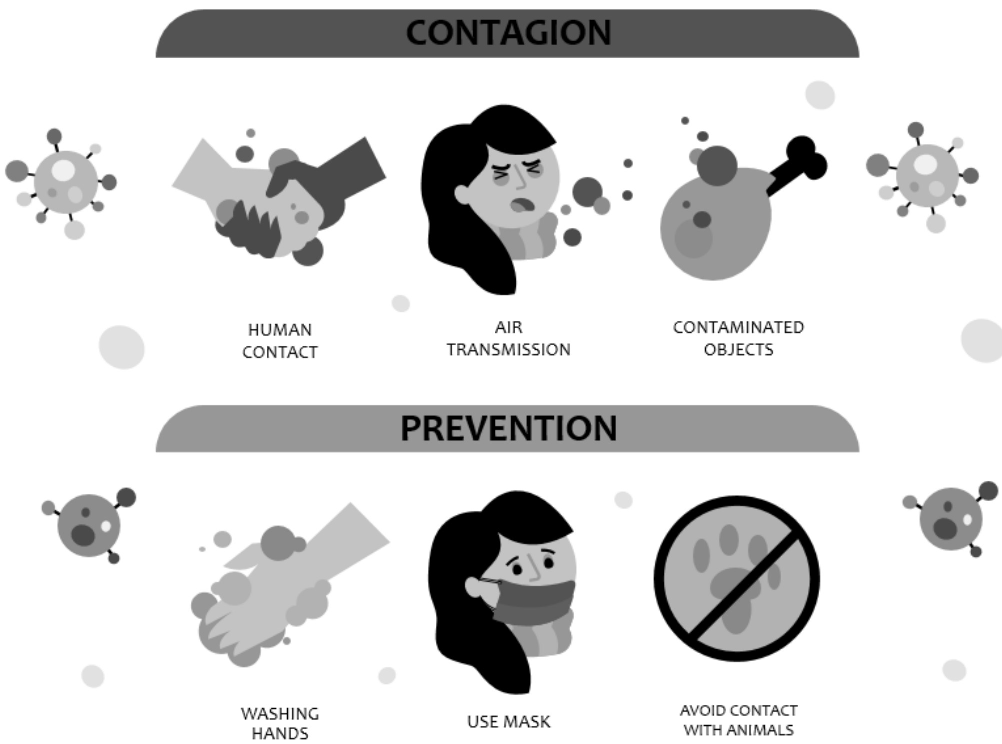
COVID-19: Impact on State Taxes



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This policy note is part of a three-part series on the impact of COVID-19 on State governments in Nigeria. This is the second title, focusing on how tax revenues are affected in States and the opportunity tax data provides to inform broader responses to the pandemic.

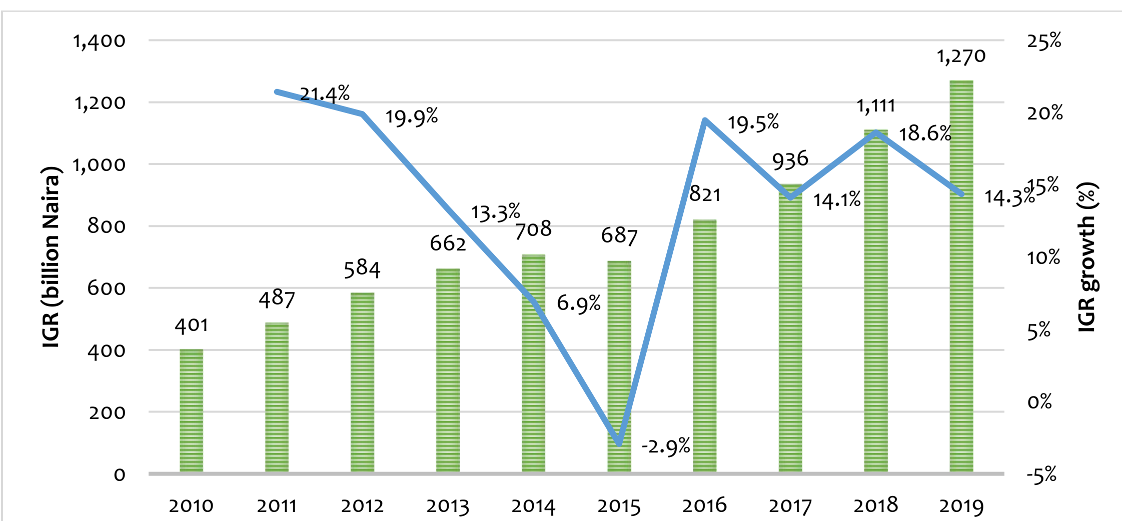
The tax environment was already undergoing significant transformation before COVID-19

Tax revenues are essential for State governments to maintain fiscal sustainability given the boom and bust cycles the Nigerian economy experiences[2]. Unlike the federal government, most States do not have fiscal buffers to help smoothen the impact of volatility cycles on their budgets. The phenomenon has been more pronounced in governments that previously responded to temporary windfalls by expanding their permanent expenditures (including the scope of public employment and infrastructure spending which they were unable to complete before the "good" years ended).

The tax environment at the State level has recorded a significant level of transformation over the last decade. Total internally generated revenue (IGR) for the 36 States grew three-fold from N401 billion in 2010 to N1.27 trillion in 2019 (see figure 1). Except in 2015 when the country faced an oil-led fiscal crisis which eventually set off a recession, growth in IGR averaged 13.7% annually. Behind the steady growth were reforms to consolidate revenue accounts, expand informal sector tax collection, increase the use of technology in tax collection, revise outdated tax laws and professionalise tax authorities.

Data shows that much of this growth is accounted for by about 14 States annually, with mixed performances in other States due to the varied level of reform implementation. In the long run, success will be dependent on other factors such as the capacity of tax administrations, the government's choice in adapting and adopting tax laws, tax education, tax morale, the implicit social contract between the government and citizens, and the quality of institutions in the State (including bureaucracy and corruption).

Figure 1: Growth in internally generated revenues for the 36 States of Nigeria, 2010 - 19



Source: Data based on Joint Tax Board reports, 2020

[2] Nabena D. (2019) Managing Volatility in Nigeria. Nigeria Governors' Forum. Available at: https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID3384488_code3519620.pdf?abstractid=3384488&mirid=1

The pandemic is rapidly expanding the scope of government's action.

Since 27th February 2020 when the first case of COVID-19 was reported in Nigeria, governments at both the federal and State level have taken several actions – including a series of lockdown measures[3] which forced businesses and households to give up work, school, trade and events. According to an April-May 2020 survey conducted by the National Bureau of Statistics, 42% of Nigerians stopped working during the period mainly for reasons related to COVID-19, particularly those in farming or family businesses [4]. The labour-force impact was particularly high in the commerce and service sectors. Coupled with the shutdown in business activities and value chains, there were general increases in the price of inputs and goods and services. By June 2020, inflation had reached 12.8% from 12% during the start of the year while unemployment reached 27.1% in the first quarter of 2020 from 23.1% recorded back in the third quarter of 2018 according to reports from the National Bureau of Statistics.

Governments have responded by expanding the scope of social investment programmes, tax relief, loans, grants and subsidies to mitigate the economic impact on citizens and businesses, including food supply to vulnerable households. At the federal level, the government designed a N2.3 trillion stimulus plan while the Central Bank released an unprecedented level of financing to businesses including a newly approved N15 trillion CBN-led Infrastructure Development Company to leverage and build critical infrastructure across the country over an initial 5-year period. The entity, which will be wholly focused on Nigeria will be co-owned by the CBN, the Africa Finance Corporation (AFC) and the Nigeria Sovereign Investment Authority (NSIA), but exclusively managed by an Independent Infrastructure Fund Manager (IIFM) that will mobilize local and foreign capital to support the federal government in building the transport infrastructure required to move agriculture and other products to processors, raw materials to factories, and finished goods to markets [5]. The pandemic is transforming the role of government in the economy. Unlike the 2008/09 and mid-2014 crises which were triggered by the financial and oil sectors respectively, the 2020 pandemic has the human cost at its epicentre.

Tax reform before the pandemic

The Lagos tax case is generally cited as the symbol of urban disorder transformed into a representation of effective tax governance. But unlike Lagos that was triggered by political and electoral pressures as well as elite ambitions to build a prosperous megacity[6], for many other States,

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[3]Nigeria Governors' Forum (2020) COVID-19 – What it Means for State Economies. Retrieved August 17, 2020 from https://nggovernorsforum.org/phocadownload/IGR_Dashboard_Tools/COVID-19%20-%20What%20it%20means%20for%20State%20economies.pdf

[4] Lain, J. W, et al. (2020) COVID-19 From the Ground Up: What the Crisis Means for Nigerians (English). Monitoring COVID-19 Impacts on Households in Nigeria Washington, D.C.: World Bank Group. Retrieved August 17, 2020 from http://documents.worldbank.org/curated/en/757201593465025800/COVID-19-From-the-Ground-Up-What-the-Crisis-Means-for-Nigerians

[5] Central Bank of Nigeria (2020, July 20) Central Bank of Nigeria Communiqué No. 131 of the 274th Monetary Policy Committee Meeting held on Monday 20th July 2020. Retrieved August 17, 2020 from https://www.cbn.gov.ng/Out/2020/CCD/Central%20Bank%20of%20Nigeria%20Communique%20No.%20131%20of%20the%20Monetary%20Policy%20Committee%20of%20July%2020,%202020,%20with%20Personal%20Statements%20of%20Members.pdf

[6] De Gramont, D. (2015). Governing Lagos: unlocking the politics of reform (Vol. 12). Carnegie Endowment for International Peace.

tax reform has been triggered by the boom and bust oil cycles recorded in recent years, especially following the aftermath of the mid-2014 fiscal crisis which saw government revenues (percent of GDP) fall by nearly half from 11% in 2013 to 6% in 2016. The crisis triggered a set of changes in government policy and action, including the 2016 resolutions of the National Economic Council (NEC), the Fiscal Sustainability Plan (2016), the Economic Recovery and Growth Plan (2017 – 2020), the new National Tax Policy (2017), and the Voluntary Assets and Income Declaration Scheme (2017).

The Finance Act 2019 was also passed with amendments in key tax legislations, including the Company Income Tax (CIT) Act (as amended) CAP C21 2004, Value Added Tax (VAT) Act Cap VI LFN 2007, Customs and Exercise Duty etc. (Consolidation Act, Cap C49, 2004), Personal Income Tax (PIT) Cap P8 LFN 2007 (as amended), Capital Gains Tax (CGT) Act Cap CI LFN 2007, Stamp Duties (STD) Act Cap S8 LFN and the PPT Tax Act with implications on revenues due to the federal and State governments. One of the biggest changes of the Finance Act 2019 was the increase in the VAT rate by 50% from 5% to 7.5% and the inclusion of electronic and online transactions as liable STD items.

A stronger collaboration also emerged since 2016 between the Federal Inland Revenue Service (FIRS) and State Internal Revenue Services (SIRS) through the Joint Tax Board (JTB). JTB steered a set of reforms which led to the revitalisation of the Taxpayer Identification Number (TIN) system; the introduction of a system to allow for the immediate issuance of value added tax/withholding tax certificates on payment of invoices for government contracts; collaboration on joint audits to share information on unremitted taxes in States; and additional training programmes for tax officers. In 2017, an IGR Dashboard and a HelpDesk technical programme for States were also instituted with the support of the Bill and Melinda Gates Foundation to increase the use of evidence in policy making, decision maker engagement and the capacity of tax authorities through training sessions and technical advisory. The increasing knowledge in the tax space since 2017 helped bridge the gap in political commitment, capacity and reform implementation across all 36 States in the country.

In practice, tax authorities were granted administrative and financial autonomy as the gateway to professionalise their workforce and sustain reforms. This administrative transition which took place in Adamawa, Bauchi, Cross River, Edo, Kaduna, Kano, Kwara, Plateau and Zamfara among others has become a necessary condition to raise tax revenues sustainably and it features among the top qualities of the top performing States. In Kwara and Delta State, initiatives also emerged to reward taxpayers with better social services with the aim of improving taxpayer compliance in the informal sector. Kaduna, Kogi and Plateau States on the other hand, were among those that established a consolidated revenue code (CRC) to exhaustively cover the system of their tax laws. Today, the CRC has become an important legislation to end the proliferation of arbitrary and duplicative taxes which damage the business environment.

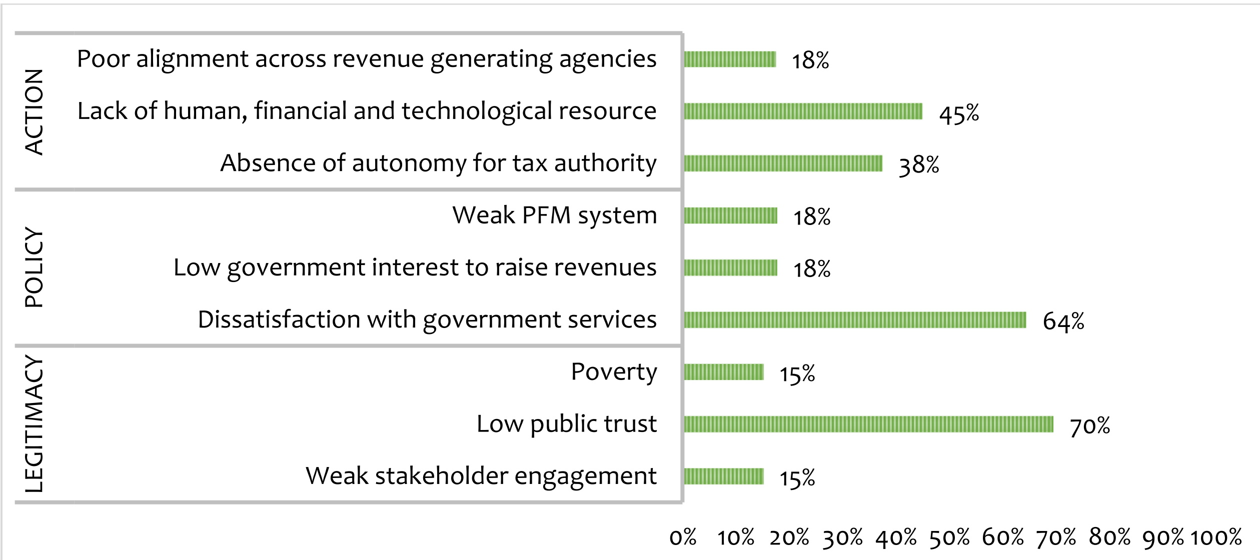
Box 1: Frontrunner States in domestic revenue growth

- **2019:** Yobe (93%), Zamfara (88%), Osun (73%)
- **2018**: Ondo (127%), Bauchi (122%), Imo (117%), Sokoto (108%)
- **2017:** Sokoto (98.4%), Jigawa (88%), Borno (86%)
- **2016**: Kwara (140%), Kano (127%), Ogun (111%)
- **2015**: Ogun (98%), Anambra (42%), Borno (28%)

Source: Underlying data from the Joint Tax Board, 2020

Amidst these reforms, the fiscal social contract between governments and citizens still remained the key challenge to effective taxation in the country. Separate studies conducted by the Nigeria Economic Summit Group (NESG)[7] and the NGF Secretariat[8] showed that low public trust and dissatisfaction with government services are the biggest risks to taxation in the country. Public dissatisfaction with government services outweigh other challenges such as lack of human, financial and technological resources for tax authorities (figure 2). These risks continue to weaken governments' legitimacy and capacity to collect additional taxes. Over time, the vicious cycle of poor government services and the public's willingness to evade taxes has depressed tax revenues and in turn limited governments' capacity to provide quality services.

Figure 2: Risks of Taxation



Source: Survey conducted by the Nigeria Governors' Forum Secretariat, 2019

In October 2019, a State Revenue Action Plan (SRAP)[9] was signed between State governments under the auspices of the Nigeria Governors' Forum (NGF) and tax authorities. The plan was aimed at promoting a structured approach for tax reform implementation in all 36 States given the lessons from frontier States. The plan covered five (5) broad objectives and twelve (12) detailed actions to raise domestic revenues sustainably. The objectives of the plan include the following:

i. Making the most of State Internal Revenue Services (SIRS);
ii. Ending double/multiple taxation;
iii. Improving tax compliance;
iv. Blocking revenue leakages; and
v. Unlocking new revenue sources.

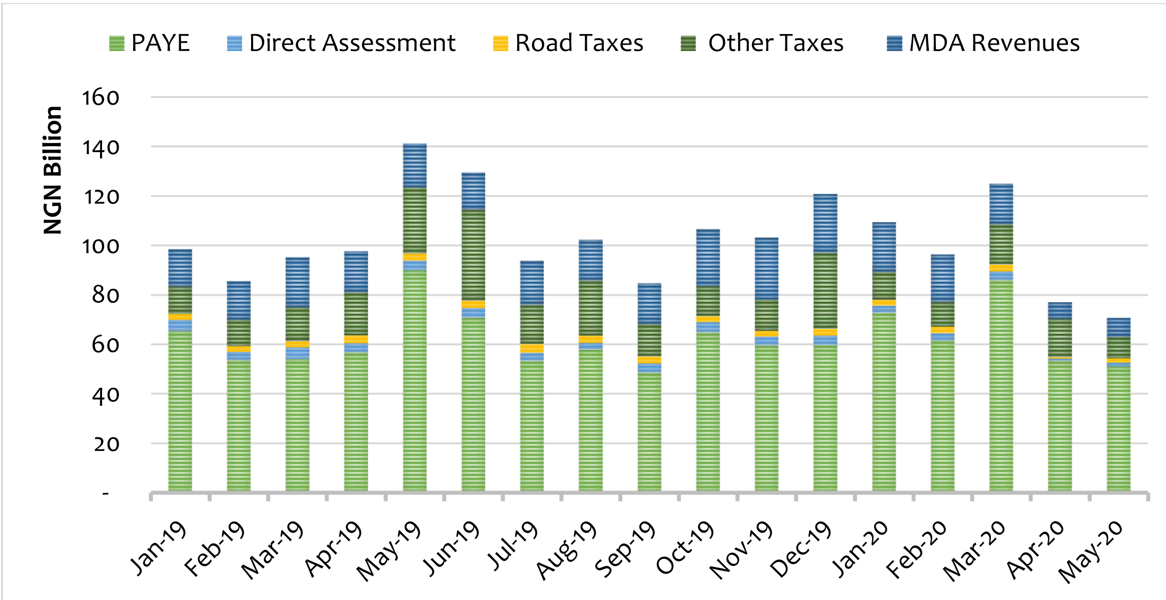
[7] McCulloch N. & Moerenhout T. (2019, March 25). What Nigerians really think about tax. International Centre for Tax and Development. Retrieved August 17, 2020, from https://www.ictd.ac/blog/what-nigerians-really-think-about-tax/

[8] Nigeria Governors' Forum (2019) Sub-National Risks of Taxation, Retrieved August 17, 2020, from https://nggovernorsforum.org/phocadownload/Sub%20-%20National%20Risks%20of%20Taxation.pdf and https://nggovernorsforum.org/phocadownload/November%20IGR%20brief.pdf

[9] Nigeria Governors' Forum & Joint Tax Board (2019) State Action Plan on Revenue Generation. Retrieved August 17, 2020, from https://nggovernorsforum.org/phocadownload/State%20Action%20Plan%20on%20Revenue%20Generation_.pdf

While the SRAP kickstarted a uniform tax reform strategy in all States, the emergence of the COVID-19 pandemic presented new challenges with the need for relief for businesses and taxpayers who were facing serious financial difficulties.

Figure 3: Decline in State government internally generated revenue due to COVID-19



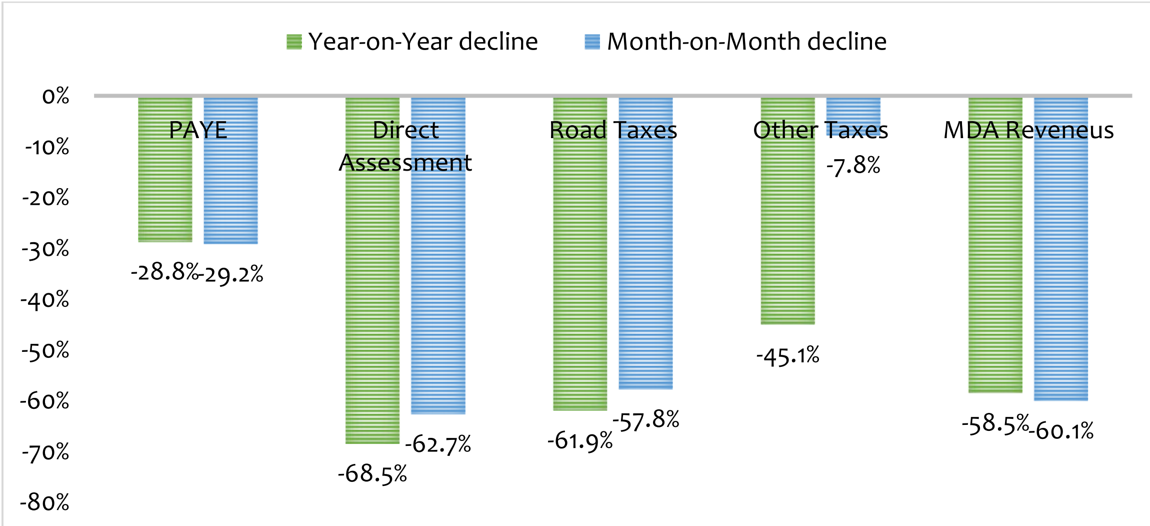
Source: State Internal Revenue Services, provisional, July 2020

Impact of COVID-19 on the IGR of States

In April 2020, the NGF Secretariat developed an advisory[10] for tax authorities to help State government's maintain some level of revenue sustainably, improve business confidence, and protect businesses and the tax community during the COVID-19 period. State governments had to quickly formulate response plans that took account of the negative impact of the pandemic on taxes while at the same time securing the tax environment. Between the start of the year and April – May 2020 when lockdown measures where strictly in place, States' tax revenues declined by 40% from pre-pandemic collections (figure 3). Road taxes, taxes paid by self-employed persons and service charges from government ministries, departments and agencies fell even higher by up to 60% (figure 4). In Lagos and Ogun where lockdown measures were centrally enforced, and where tax authorities and taxpayers operated under stricter guidelines, taxes paid by self-employed persons declined by over 70% and 85% respectively. Ironically, the States where lockdown measures were federally enforced were also the frontier States in revenue generation.

[10] Nigeria Governors' Forum (2020) COVID-19 Response for tax Authorities. Retrieved August 17, 2020, from https://nggovernorsforum.org/phocadownload/NGF%20COVID-19%20Response%20for%20Tax%20Authorities.pdf

Figure 4: Highest decline recorded for taxes paid by self-employed persons

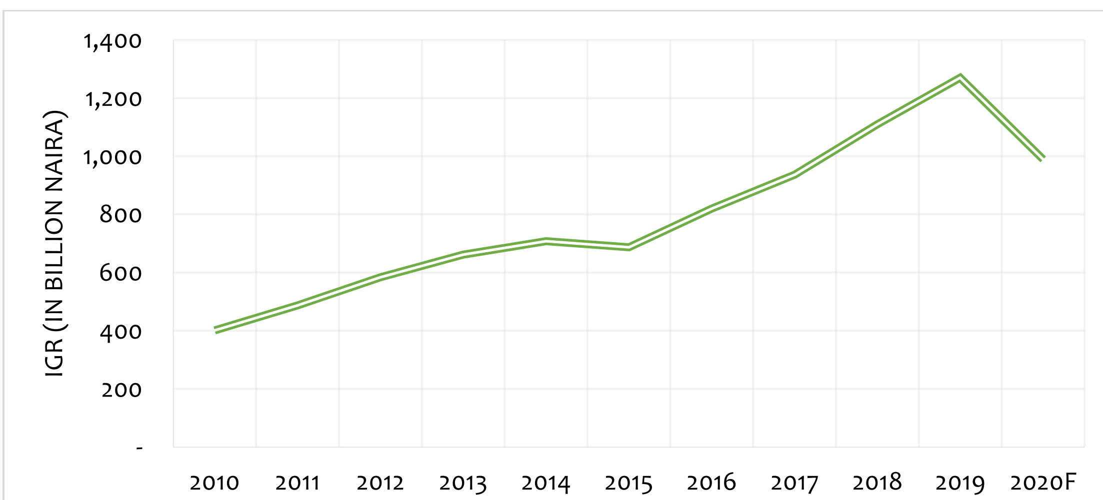


Source: State Internal Revenue Services, provisional, July 2020

Note: Yearly change compares April – May 2019 vs April – May 2020; monthly change compares February – March 2020 and April – May 2020

The COVID-19 pandemic is expected to lead to a decline in IGR for the 36 States by over 20% to N1 trillion in 2020 from N1.27 trillion recorded in 2019. The fiscal impact on budgets will be significant, with their total budget size around N6.1 trillion. Although a rebound is expected post 2020, we project that domestic revenues will reach just N2.7 trillion by 2025 and N5.1 trillion by 2030. The low tax to GDP across States averaging below 3% except in Lagos, Ogun and Rivers, indicates an outsized gap between the tax potential and tax effort of States.

Figure 5: IGR of States 2010 - 20F



Source: Underlying data from JTB and SIRS, July 2020

Tax environments that are highly digitalised stand to cope better during the pandemic

Digital access in States varies greatly by location, with wide disparities across gender and sectors. As the COVID-19 crisis weighs on the country, payment of taxes will be harder to administer. But it presents new opportunities that tax authorities can be part of – the pandemic has made digitalization more relevant to services and businesses. The service industry is transitioning from physical transactions to online services – and as far as compliance strategies are concerned, priority should be given to this transition. The expansion in the number and scope of electronic tax payment channels have accounted for a large percentage of the revenue growth in States like Kwara, Sokoto and Zamfara. Most States have a central platform for collecting taxes but much of the taxable public are not integrated in the digital economy, especially informal sector taxpayers.

To close the tax gap created by social distancing guidelines, tax authorities may have to leverage partnerships with digital platforms and retail and distribution networks to maintain tax compliance during the pandemic. This includes equipping and training local retailer networks to go digital, collaborating with digital payment platforms to waive fees on transactions and building USSD-based platforms. Paga, a mobile phone-based payment platform for remittance, bill payment and ecommerce services has taken steps to make its services more accessible during the COVID-19 period. They adjusted their fees so that merchants can accept payments for zero fees while customers can send money for free if they use the recipient's phone number or email address versus a bank account. Mobile payments company PalmPay also waived transfer charges from its e-wallet to other PalmPay users and Nigerian banks. Banks such as FCMB have a USSD banking service to perform all transactions without data. The bank is encouraging customers to use this service during the pandemic.

State governments are implementing tax relief programmes to mitigate the impact of the pandemic on businesses and individual taxpayers

Tax relief programmes are optional but they have become an essential part of governments' responses for businesses that are facing a liquidity crisis. Many businesses will need a combination of incentives to stabilise and mobilise back to work. Given that State governments are facing a serious liquidity crisis as well, and with limited capacity to borrow, tax, trade and regulatory programmes may be the most feasible response to support business continuity.

State governments have scaled down their revenue projections for 2020 on account of the pandemic. They have also taken an interventionist approach to mitigate the impact of the pandemic on businesses and individual taxpayers. By July 2020, all tax authorities across the 36 States and the Federal Capital Territory had published a tax relief package, focusing on 4 (four) main areas:

i. Extension of the date of filing for 2019 annual returns;
ii. Waiver or reduction on penalties and interests on tax liabilities;
iii. Rebate/discount on taxes paid by new taxpayers;
iv. Installmental payment of taxes; and
v. Online issuance of tax clearance certificates to minimise human interaction.

These responses have been aimed at providing targeted support especially to small and medium scale enterprises in the hospitality and agriculture sectors who are among those worst hit by the crisis. In addition to other policy responses, these short-term tax measures will influence corporate and financial behaviour and the economic recovery of States.

Some States have provided very generous tax relief programmes such as in Jigawa where the government issued a one-year tax holiday for all existing small and medium enterprises in the State effective 1st July 2020 to 30th June 2021, and an 18-months tax holiday for all new enterprises and individual business that come up after the COVID-19 pandemic from 1st July 2020 to December 2021. In Katsina State, a 20% rebate will be issued to new taxpayers from 1st October 2020 to 31st March 2021 while a 10% rebate on personal income taxes will be granted to businesses in Anambra State until year end 2020. Some have played an active role in the public health response – in Ondo State, the IRS donated N1.36 million to the COVID-19 response and 1,800 units of personal protective equipment (PPE) to all revenue generating MDAs in the State.

The impact of tax relief programmes will depend on the scope of the packages and the size of the State's tax base

Tax relief programmes should typically be developed based on a reliable taxpayer management system. The impact of these relief programmes on businesses, including the 41.5 million micro, small and medium entreprises (MSMEs) in Nigeria is not yet clear but their survival will depend on how well these programmes are implemented, especially in States like Lagos and Oyo that together account for nearly 20% of MSMEs in the country[11]. The effectiveness of these measures depends on the tax effort of the States, including enforcement guidelines issued to their tax officers and collecting agents and the size of the taxable population in their tax net.

New administrative measures required include the development and issuance of COVID-19 operational guidance and advisories to staff and taxpayers, creation of feedback and redress systems via calls, emails and social media platforms, suspension of in person meetings and large gatherings, and regular updates to taxpayers. Measuring the impact on State revenues is also vital, given that tax relief programmes are essentially a form of tax expenditure that will reduce government revenues.

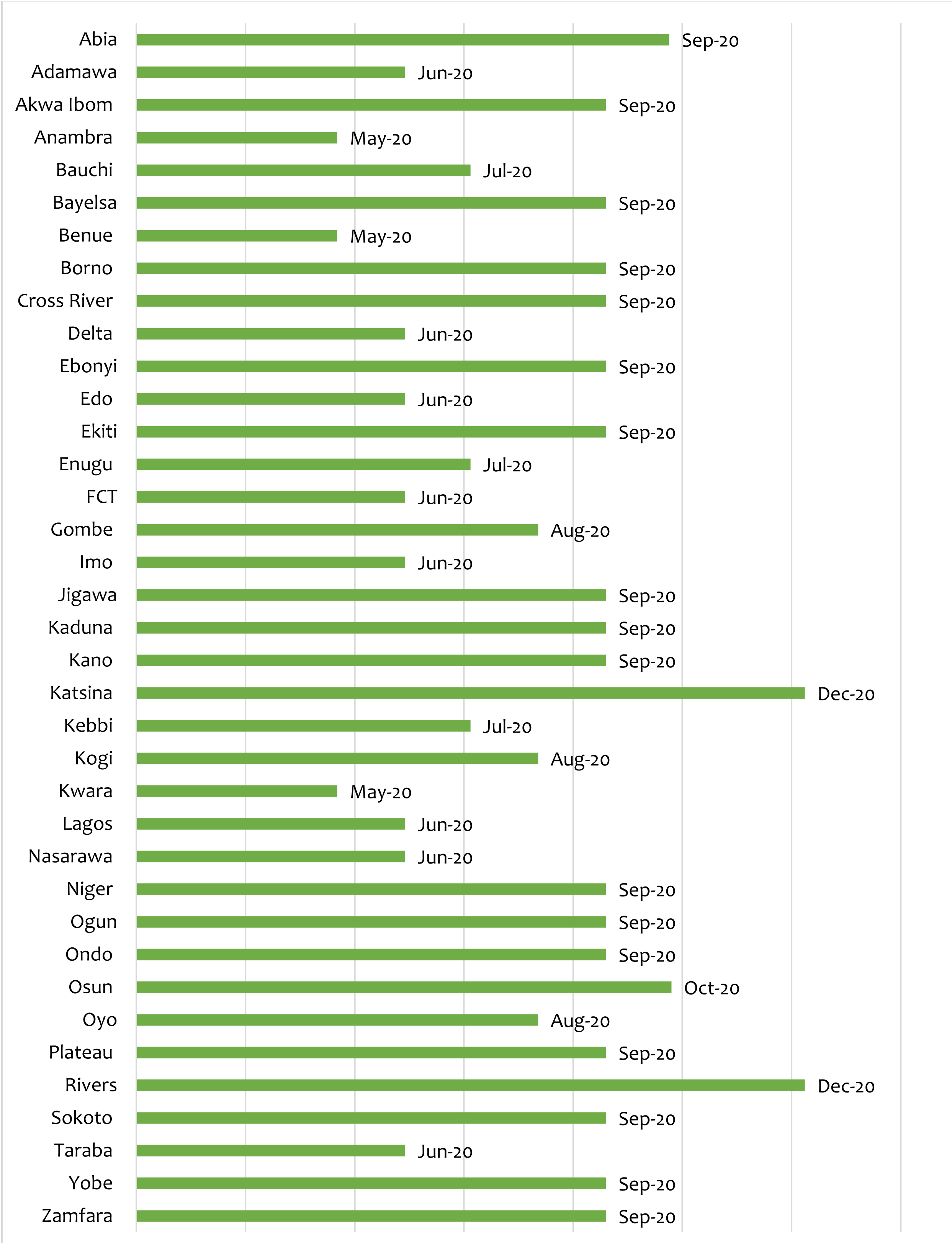
Tax data provides a measure of the economic and social cost of the COVID-19 pandemic

As the world changes and as economies adapt, governments will require real-time data and high-level capacity to use available information to guide recovery for many individuals who continue to face loss of livelihoods, businesses that are recording depleted savings, and financial networks that have collapsed. Unlike economic data which experience lags and are mostly unavailable at the subnational level, tax data provide real time insights into the impact of the pandemic that can be analysed daily, weekly or monthly. The impact of the new interventionist approach may not be easily measured in the short run, but available tax data provides important insights into the cost on the society. Evidence has shown that total tax revenues declined by 40% in the two-month period post lockdown, while taxes paid by self-employed persons declined by 60% – in lockdown States, this reached over 80%.

Combined with value added and corporate income taxes collected centrally, sub-national tax information can inform broad-based initiatives to sustain the impact of tax relief programmes.

[11] National Bureau of Statistics (2019) Micro, Small, and Medium Enterprises (MSME) National Survey 2017 Report. Retrieved August 17, 2020, from http://www.nigerianstat.gov.ng/download/967

Appendix 1: Extension granted by States and the FCT for filing 2019 annual tax returns



Source: Internal Revenue Service of States, as at July 2020

Note: Some States have expanded the scope of their tax relief programmes due to rapidly changing conditions within their jurisdictions

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