

Tax Auditing and Investigation in a Developing Nation: Information Technology Imperative

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Abstract - This research looked at some of the traditional approaches of tax administration and auditing at both the State and Federal Boards of Inland Revenue, with emphasis on corporate and personal income taxes. Several problems are discovered to be plaguing the tax administration in Nigeria ranging from non equitability, complex and inconvenient assessment system, economically dispassionate (non neutral) system and duplicated payments. Using Structured Systems Analysis and Design Methodology (SSADM), this research therefore designed a cost-effective and less problematic corporate system that will enable both taxpayers and tax administrators carry out their civic responsibilities effectively. Equitable, just and fair tax system, which will eliminate rigidities and severities of manual administration, is achieved when taxpayers can file, assess, audit, pay and obtain tax clearance certificate from any part of the country. This will in turn create a globally acceptable means to form an opinion on the truth and fairness of the financial statement of every taxpayer. Both federal and state government revenue will increase while companies' income tax can be paid at any location and accessible at any other location.

Keywords - Tax, Income, Revenue, Audit, Equitable, Taxation, Distributed Database.

I. Introduction

Tax is described as a ratable portion of the produce of the property and labour of the individual citizens and residents, taken by the nation, in the exercise of its sovereign rights, for the support of government, for the administration of laws and as the means for continuing in operation the various functions of the state (Adam Smith, 1776). Tax is a compulsory levy, it is imposed by the government, the money raised should be used for public purposes, or, if the purpose of the tax is not to raise money, it is to encourage social justice within the community. The Black's Law Dictionary (2012) describes a "Tax" as a compulsory levy which every citizen in any nation must pay as a contribution for the nation's sustenance.

In lay man's term, Adeniyi (2004) said auditing means a certified professional going through an organization's financial records to ascertain its correctness and appropriateness. It is the independent examination of/and expression of opinion on the financial statement of an enterprise by an appointed auditor in pursuance of that appointment and in compliance with any relevant statutory obligation. The primary and basic objective of auditing is to form an opinion on the truth and fairness of the financial statements of the organization.

According to Chinex (2010), taxes are presumably collected for the sake of the welfare of taxpayers as a whole the liability of the individual taxpayer is independent of any benefit received. There are important exceptions to this characterization. The Nigerian Constitution (1999) states that payroll taxes are commonly levied on labour income in order to finance retirement benefits, medical payments, and other social security programs.

Taxes are used to control the microeconomic variable such as interest rates, inflation rates, employment level and capacity utilization in the economy. If according to Arias (2012), tax is so important to the nation's economy, it means truth and fairness of the financial statements of all taxable persons and organizations must be established. It is for this reason that tax investigations become synonymous with auditing in internal revenue circles.

This research is aimed at:

1. Designing a cost-effective and less problematic corporate system that will enable an equitable, unbiased, simple to understand and convenient tax auditing.
2. Implementing and achieving an economically dispassionate assessment and auditing system for all levels of tax payers (at the designated office).
3. Revolutionizing the traditional approaches of tax auditing and investigations with emphasis on corporate taxes – Personal Income tax (royalty, rents, dividends, interests, etc.); companies income tax; income tax relief; petroleum profits tax; education tax; value added tax; capital gains tax; and several others.

II. Statement of the Problem

A good tax system according to Adam Smith in his book *Wealth of Nations* (1776), should be equitable, simple, certain, convenient and administratively efficient and economic. Yerokun (2012) discovered in a recent study that several employees of the same agencies receive the same income but pay different taxes. Looking critically at the Nigerian tax situation, the authors arrived at the following as the first general problem: ***Inequitable Tax*** where two taxpayers are of the same financial status and conditions but do not pay the same tax.

III. An Overview of the Nigerian Tax System

The overview of the Nigerian tax system is presented in the table below.

Table 1: Payment Schedule for Withholding Tax. Source: Chinex (2010): nigerianelitesforum.com/ng

<i>Payment</i>	<i>% Corporate</i>	<i>% Individual/Partnership</i>
Rent	10	10
Construction	5	5
Dividend	10	10
Royalties	10	5
Commission	10	5
Professional fees	10	5
Technical	10	5
Director's fees	10	10

A. Personal Income Tax

This tax is on the basis of Pay-As-You-Earn. It is the tax payable by personal individuals based on the income earned by every citizen. Every adult citizen in Nigeria is liable to pay tax on the aggregate amount of his income whether derived within or outside Nigeria (Omoigu-Okairu, 2010). The salaries, wages, fees, allowances, and other gains and benefits, given or granted to an employee are chargeable to tax. The employers of labour are deemed to be agents of the tax authority for the purposes of remitting taxes deducted from salaries due to employees. The Personal Income Tax is most easy to collect among civil servants (government workers) only as it is deducted from the source by the appropriate authorities. But in the private sector of the economy, the employer has to file returns of each tax payer which in most cases in Nigeria, is not done.

The tax is regulated by the Personal Income Tax Act 2004. Residency of the taxpayer determines the extent of a taxpayer liability in Nigeria. A person is deemed resident in Nigeria if he resides in Nigeria for 183 (one hundred and eighty three) days in any 12-month period. The following are however exempted from tax:

- a. Medical or dental expenses incurred by the employee.
- b. Retirement gratuities and compensation for loss of office.
- c. The cost of passage to or from Nigeria incurred by the employee.
- d. Interest on loans for developing an owner-occupied residential house.
- e. Leave allowance, which is computed as 10% (ten percent) of annual basic salary

(subject to some further conditions such as maximum limit).

B. Administration of Tax - Board of Internal Revenue

Upon registration and incorporation, every company is mandated to submit a financial report at the end of every financial year. This financial report must bear the seal of registered accounting firm, mostly chartered. The financial report includes the following:

1. Balance sheet
2. Profit and loss account
3. Fixed Asset Schedule
4. Depreciation

It is with the financial account that the Board of Inland Revenue makes an assessment and computation of tax liabilities for the assessment year using the table above. The manual calculations involved in the assessment and determination of tax payable for a personal income is done in stages. The employee is expected to have completed an Income Tax form, Return of Income and Claims for Allowances; and Relief form immediately after employment. This form is subject to annual review and assessment, but the truth is that most taxpayers have not seen this form in their entire working career. The question is how are employees' taxes determined? The answer is: thousands of taxpayers are at the whims and caprices of the accounting staff of their organizations. Some taxpayers do not even know about any tax relief or the ones they are entitled to.

The Income and Claims for Allowances and Relief contain particulars such as:

1. Personal particulars
2. Statement of Income of the year ended

3. Deductions and contributions claimed/paid from income (e.g. NHIS, Penfund, Mortgage, etc.)
4. Claims for capital allowances
5. Claims for personal reliefs by reference to circumstances
6. Allowances for children
7. Allowances for dependent relatives
8. Allowances for Life Assurance, etc.

government employee's sample pay advice for a month as shown below.

PAY ADVICE FOR THE MONTH OF MAY, 1999.									
STAFF NAME :									
BANK NAME :									
PAYMENTS	AMOUNT	ALLOWANCES	AMOUNT	DEDUCTIONS	AMOUNT	AMOUNT			
BASIC PAY	3619.00	TRANS-ALL	1030.53	RENT-DEDU.	0.00	HOU-DED.	0.00		
SHIFT-ALL.	0.00	HOUSE-ALL	2433.33	MONTHLY-TAX	723.50	CAR-DED.	0.00		
SEC-ALL.	0.00	MEAL-ALL	405.00	SMS-DEDU.	0.00	BIC-DED.	0.00		
OVERTIME	0.00	UTILITY-AL	310.00	SAS/NASU/COASU	150.00	FUR-DED.	0.00		
ACTING ALL	0.00	RESPON-ALL	0.00	SECR-DEDU.	0.00	SUR-DED.	0.00		
APPEARS	0.00	ENTERT-ALL	0.00	SALARY-ADV	0.00	OTHERS-DE	0.00		
ALL-APPEARS	7892.30	TOTAL ALL.	12165.60	MORTG	90.47				
MONTH-GROSS	3619.00	TOTAL GROSS	15784.60	TOTAL-DED		964.27			
			X 10	NET PAY	14820.33				

Fig 1 Government Employee Pay Advice

Annual Gross Income (N15,784.60 X 12) = N189,415.20

Annual Gross Income (multiplied by 10 for convenience) =
N1,894,152.00

Less: Consolidated Relief /Allowance [200,000 + (20% of Gross Income)]

$$[200,000 + (20\% \text{ of } 1,894,152)] = \text{N}578,830.40$$

N1,315,321.60

Less: Statutory Deductions

Pension	60,000.00
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NHF	60.000.00
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NHIS20.000.00

Life Assurance Policy 80,000.00

= N220,000.00

Taxable Income	N1,095,321.60
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According to Omogui-Okauru (2012), based on the information from the form, the designated officer then proceeds to calculate the tax payable as follows:

- a. Remove the consolidated Relief Allowance of [200,000 + (20% of Gross Income)] from the gross income;
- b. Add up all statutory deductions and subtract from gross income;
- c. Calculate a 7% tax for the first remaining N300,000
- d. Calculate an 11% tax for the next remaining N300,000
- e. Calculate a 15% tax for the next N500,000
- f. Calculate a 19% tax for the next N500,000
- g. For the remaining N1,600,000, calculate tax of 21%; and
- h. From N2,400,000 and above, it is a tax of 24%.
- i. Add up all calculated tax to make up the tax payable.

There is however a minimum tax payable - the tax which is charged on an income of the taxpayer after all allowable deductions granted, there is no taxable income, or where the tax payable is less than 1% (one percent) of his gross income. Therefore, 1% (one percent) of his gross income will be taken as tax payable. An example is shown below using a

Tax payable

First N300,000.00 X 7%
= N21,000.00

Second N300,000 X 11%
= N33,000.00

Next (remaining) N495,321.60 X 15%
= N74,298.24

N128,298.24

Tax payable per month N128,298.24 / 12 months
= N10,691.52

Divided by 10 =. N1,069.15

From the above calculations, it can be seen that the employee is paying less than is expected, N723.80 instead of N1069.15, a whopping shortage of N343.35. Imagine the sum of multiplying this amount by one million taxpayers under-taxed by the government presently (Yerokun, 2012).

The various taxation problems in the nation can be summarized as follows:

- 1) ***Inequitable Tax:*** Two taxpayers of the same financial status and conditions but not paying the same tax.
- 2) ***Complex and Biased system:*** Every taxpayer is entitled to know what he/she is paying for, the rates with respect to incomes.
- 3) ***Administrative inefficiency:*** long, tedious and porous, Loss of audit trails giving room for fraud, evasion and avoidance.
- 4) ***No distributed database:*** No database connecting all the states of the federation, giving room for incoherent tax assessments.

IV. The Proposed System

The new system will include the following:

1) ***Automatic Assessment:*** The system will be integrated into the State Board of Internal Revenue and installed at every bursary or accounting department of every government parastatal. This will ensure an automatic computation of taxes on every salary and wages. Every Government employee will be assessed based on the same criteria, there will be no room for biased and passionate evaluation.

2) ***Simple and Easy-to-Use system:*** Just like the Automatic Teller Machines, taxpayers are assigned PINs to process, evaluate and assess their financial reports automatically. Every taxpayer can feed the data required and obtain a report by them, easy to understand and very balanced (dispassionate).

3) ***Distributed Database:*** The National Identification Management Commission (NIMC) has commenced its nationwide registration exercise. This is an enrolment exercise for every citizen and legal residents from 16years and above. The database generated can be made accessible to the federal and state

revenue agencies. The proposed system is designed to work with such distributed database to identify every taxpayer, the location of business and residential premises, tax exemptions and assess the taxpayer accordingly. This will prevent fraudsters from using falsified data to evade tax, and this will justify honest businessmen that are being unjustly made to pay at every location.

4) *Economic and administrative efficiency:*

so much of the paper work required to audit, investigate and process or manage tax will be totally removed. With a click, taxes can be assessed and monitored to the last kobo at the minimum cost. Wastage of human resources and time will also be removed.

5) *Procedure for Recovering Excess Taxation:*

In the event of over-payment which can be due to human error in the assessment and computation of tax, the system is designed to follow a step by step procedure in ensuring a refund to the taxpayer.

The system will be supported by appropriate TCP/IP connection and ensure the connection between the components provided in the various domains and the other systems that need to interface to the Boards of Inland Revenue System.

V. Security and Confidentiality Issues

One major limitation encountered in the process of this research is restricted access to documents, especially company records. This calls for a major consideration in accessing, processing and producing tax certificates or clearances for users. Login parameters are automatically generated by the administrator and sent to the GSM number provided at registration point, this obviously ensures that

only the user/applicant has the codes and can further have access to the taxpayer's record.

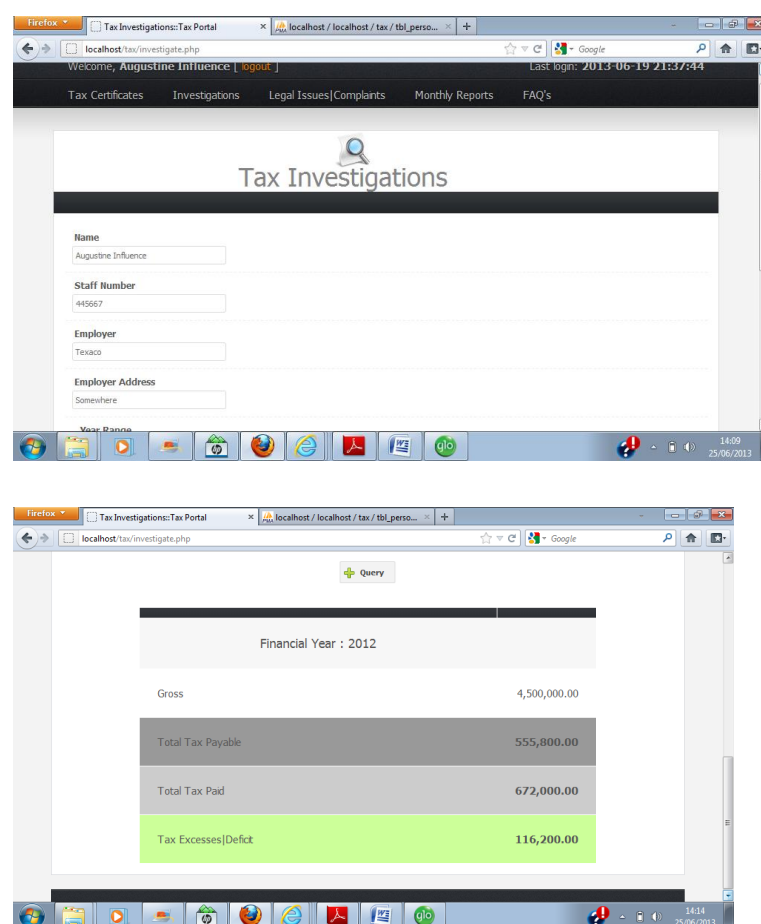


Fig 2 Investigation/Result of Tax Payable versus Tax Paid

VI. Conclusion

Adam Smith (1776) rightly said that every nation's tax system should be equitable, simple and convenient before it can be universally acceptable as fair. This study has shown that the tax system in Nigeria does not possess any of the qualities necessary for it to be globally acceptable. Secondly, if other countries can develop with tax incomes, Nigeria can also do so, only if the system is automated.

Automated tax audit and investigations system is designed to make administration of tax easier for the government at all levels. Government employees can finally know exactly what they are paying, the rates they are paying and of course how much the government is generating from tax. It will also be gratifying for taxpayers to know that what they are paying is what their colleagues are paying without favour to one. The case of multiple payment of tax due to varying contract locations is also handled decisively in this work by making it web based such that it can be assessed anywhere in the country and accepted as a final authority. Finally, in the case of overpayment, the process of refund has been made very easy by this software thereby building a trust for the government system generally.

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