Addressing Tax Evasion and Avoidance through Effective Tax Audit and Investigation in Cross River State, Nigeria

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Abstract - The paper addresses tax evasion and avoidance through effective tax audit and investigation in Cross River State. The study adopts survey research design, while data were collated from staff of FIRS and SIRS in Cross River State. The Chi-square ($\chi^2$) statistical tool was employed to analyze respondents’ opinion on the effect of tax audit and investigation in addressing tax evasion and avoidance. The results revealed that, while there is a significant difference in the opinions of respondents on the effect of tax audit on tax evasion and avoidance in Cross River State; there was no significant difference in their perception on the effect of tax investigation on tax evasion and avoidance. Penalty also significantly affected tax evasion and avoidance. Identified also was that the thoroughness of the tax audit will encourage taxpayers to be more prudent in complying with tax returns and that the strengthening of tax audit and investigation will wipe away tax evasion and avoidance in Nigeria. It was therefore recommended that tax payers should be educated during tax audits and penalty should be adequately implemented to serve as a deterrent to tax evader and avoiders so as to increase tax compliance and government revenue.

Keywords: tax evasion, tax avoidance, tax audit, tax investigation, penalty

I. INTRODUCTION

Tax evasion and avoidance is a growing concern in today’s economy. Nigeria is presently confronted with social, political and administrative difficulties in establishing a sound public finance system. As a consequence, the country is vulnerable to tax evasion and avoidance, and to salvage some of these encumbrances, require among other approaches, tax audit and investigation that is aimed at increasing the level of compliance with the relevant tax laws, thus improving tax revenue for the country. In addition, it is quite worrisome that not enough attention has been paid to the system of tax audit and investigation in reducing tax evasion and avoidance in Nigeria.

According to Igbeng, Beredugo, and Adu (2015:1), “the Nigerian tax system has undergone several reforms, yet, it is still lacking in the unifying theme of achieving high tax compliance”.

Torgler (2003) added that the spate of low tax compliance is a matter of serious concern in many developing countries. This is because, it limits the capacity of government to raise revenue for developmental purposes. However, with the dwindling revenue accruing to the Federal and State government as a result of declining returns from sales of crude oil, tax authorities are solidifying their tax auditing drive in order to ensure compliance and to increase tax revenue. This measure is viewed by some citizenry as a point toward the right direction. Deloitte (2016) further added that tax audit and investigation remains the primary tool through which tax and accounting records of tax payers are reviewed to ensure that correct returns have been filed and correct taxes are paid in the relevant year of assessment.

It is quite preposterous that after the federal Inland Revenue service (FIRS) issued a statement in September 2016, disclosing plans to carry out a special audit of all companies operating in the country, some stakeholders took to the media that ‘the President, Muhammadu Buhari is still witch-hunting’. Others regarded the proposed exercise as clueless, and that audit firms and tax consultants will just make money at the expense of the State, after harassing, intimidating and extorting money from companies.

To some, the law-abiding companies are those who often bear the brunt at the end of the day, and that it does not matter how much tax they have been paying before, that the FIRS/SIRS will still conjure up all sorts of reasons to ask for new taxes and make companies or tax payers look like defaulters. It is also worrisome that stakeholders did not look at the capacity of tax audit and investigation to ensure accuracy of tax remittances, enhancement of transparency and tax compliance, expanding the nation’s tax net, information dissemination, building capacity of tax administration as well as sharing information that would promote voluntary compliance and limit tax evasion. It is against this backdrop the study evaluates the perception of respondents on the effect of effective tax audit and investigation on tax evasion and avoidance in Cross River State. To this end, the following objectives were achieved:

- To examine the opinions of respondents on the effect of tax audit on tax evasion and avoidance in Cross River State
- To determine respondents’ opinions on the effect of tax investigation on tax evasion and avoidance in Cross River State.
- To examine respondents’ opinions on the effect of penalty on tax evasion and avoidance in Cross River State.

II. LITERATURE REVIEW

2.1. The effect of Tax audit in addressing tax evasion and avoidance

Tax audit entails the independent examination or verification of tax returns filed by the tax payer. Tax audit exercise is essentially meant to enable the revenue authority to further satisfy itself that audited financial statement and the related tax computation submitted by tax payers agree with the underlying records. It involves the gathering of information and processing for determining the level of compliance of an organization with tax laws of the territory (Adediran, Alade & Oshode, 2013).

According to the OECD (2006), the audit programme of a revenue body is to promote voluntary compliance by taxpayers. It seeks to achieve this by reminding taxpayers of the risks of noncompliance and by engendering confidence in the broader community that serious abuses of the tax law will be detected and appropriately penalized. Tax audits may also bring to light significant understatements of tax liabilities, and can assist to clarify the application of the law for individual taxpayers and to identify improvements required to recordkeeping and thus may contribute to improved compliance by taxpayers in the future.

Ideas surrounding the applicability of tax audit in addressing the tax evasion and avoidance also rest on the theory of tax evasion by Allingham and Sandmo (1972). He established that incomes of taxpayers would appropriately disclose if the probability of detection is high. As such the probability of detection plays a significant role in the taxpayers’ compliance.

According to Iheanyi (2014), the engagement of audit tools such as risk engine tools by the Audit unit of the Federal Inland revenue Service for the identification of tax evaders and to officially carry-out enforcement on defaulters is an action towards the right direction. The risk engine tools are usually used to identify defaulting companies that should be subject to tax audit or tax investigation. It is important to state that this responsibility have been backed up by the “statutory mandate and the provisions of Sections 58 and 60 of the Companies’ Income Tax Act (Cap. 21 LFN 2004) and Sections 26 and 27 of the Federal Inland Revenue Service (Establishment) Act 2007”.

According to Dike (2000), the thrust of a tax audit will be that of verification of the figures and other information submitted by the taxpayer for tax purposes. It helps to improve voluntary compliance by detecting and bringing into account those who do not pay the correct amount of tax. Kim (2008) reiterated that tax audit is a routine exercise and the outcome usually leads to reassessment or referral for special investigation if tax evasion is suspected.

According to Naiyeju (1996), tax audit is not supposed to be a punitive measure by the relevant tax authority, but an exercise to ensure that the amount due to the government has been correctly determined and collected. More so, to maintain and enhance voluntary compliance with the tax law; it is imperative to carry out regular and vigorous tax audit exercise. Tax audit is also exigitent to identify exaggerated refund claims, detect underreported sales figures, detect tax evasion and avoidance, as well as minimize arithmetical inaccuracy.

As a prelude to the study, tax evasion is an illegal reduction of tax payments, for instance by underreporting income or by stating higher deduction rates (Slemrod & Yitzhaki, 2002). Firms can evade tax either by misreporting sales or profits, or by making false declarations about input use (Cremer &Gahvari, 1995). Tax evasion is particularly severe in all countries particularly developing economies like Nigeria. Therefore the government of many countries attempts to invent a tool – tax auditing – to lessen its impacts to the economy (Kim, 2008; Alm & Vazquez, 2001). Tax avoidance, on the other hand, takes place within the legal context of the tax system where taxable persons or companies take advantage of the tax code and exploit “loopholes” by engaging in activities that are legal but run counter to the purpose of the tax law. This action often minimizes tax liabilities and reduces tax revenue (Beredugo,Inah & Edom, 2014).

However, through tax audit, adequate accounting books and records will not only exist for the purpose of determining the taxable profits or loss of the taxpayer and consequently the tax payable, but to also providing an avenue of detecting and correcting accounting and/or arithmetical errors in tax returns; discouraging tax evasion and avoidance as well as educating taxpayers on various provisions of the tax law.

In a similar study, Palil and Mustapha (2011) argued that audits rates and the thoroughness of the audits could encourage taxpayers to be more prudent in completing their tax returns, report all income and claim the correct deductions to ascertain their tax liability. In order words tax audit is a preventive measure of engaging in tax evasion and avoidance. Slemrod, Blumenthal and Christian (1998) investigated the relationship between the tax audit and the taxpayers’ responses. Their result shows that the probability of being audited played a significant role in determining taxpayers’ evasion behaviour.

It is also quite the obvious when Deloitte (2016) added that tax audit remains the primary tool through which the tax and accounting records of tax payers are viewed to ensure that tax returns have been filed and taxes paid in the relevant year of assessment. And off course, the fear and punishment of being
caught evading tax would discourage such non-compliance with relevant tax laws.

2.2. The effect of Tax investigation on addressing tax evasion and avoidance

Tax investigation, is similar to any other form of investigation. It is not carried out on routine basis as that of an audit. Tax investigation could be carried out when there are suspected cases of tax evasion and/or evidence of mismanagement. These could be due to: failure to file tax returns; filing of incomplete or inaccurate returns; failure to register for tax purposes or connivance between tax official and tax payer to defraud revenue authority etc.

The principal aim of investigation is to expose all the circumstances of the fraud or tax evasion and to obtain evidence for possible prosecution. This also rests on the theoretical assumptions of Allingham and Sandmo (1972) who declared that investigations as well as penalties probability have an impact on tax compliance. This goes to shows that the higher the investigation and penalty probability, the greater the discouragement for potential tax evasion and avoidance.

More so, where tax evasion comes to the knowledge of the revenue authority; tax investigation is used to identify the extent to which the tax payer has circumvented the tax authority and the actual amount the commission has lost in the process. Tax investigation is conducted by tax inspectors who have special training and competence in investigation techniques. They might request for assistance of police investigators and enforcers, if necessary.

The principal aim of investigation is to expose all the circumstances of the fraud or tax evasion and to obtain evidence for possible prosecution. Tax investigators have been given greater power than tax auditors. They can seal up a business premises to facilitate their work and obtain all the documents needed to substantiate the evidence of tax evasion and fraud. The tax investigation unit is responsible not to only investigate, but to penalize and recommend prosecution in cases of tax evasion (Akinola 2004).

Adediran, Alade and Oshode (2013) examined the impact of tax audit and investigations on revenue generation in Nigeria and conclude that Tax audit and investigations can increase the revenue base of the government and can also stamp out the incidents of tax evasion in the country. He recommended that Tax audit and investigations should be carried out more often and as thorough as possible to accomplish its task of increasing the revenue base and stamping out tax evasion in the country.

Amawhe (1997) also concluded that the purpose of tax investigation is to promote voluntary compliance and detect and bring into the tax net taxpayer education and enlightenment on various provisions of the tax laws that have been breached ignorantly. Beck, Davis and Jung (1991) in their study found that tax investigation and penalty rates affect tax compliance. Virmani (1989) also discovered that tax investigation is positively associated with evasion, meaning that high rates of tax investigation will discourage concealment of tax liability knowing fully well that it could be dire of the organization when discovered.

III. RESEARCH METHODOLOGY

The study, adopts the survey research design. This was required to elicit information on the opinion of respondents saddled with the responsibility of tax appraisal, collection, and accounting. The justification for the choice of the staff of FIRS and SIRS stemmed from the fact that these staff to a very large extent knows most of the plight of most tax payers, their challenges and in most cases reasons why they evade tax, and the relevancy of tax audit and investigation in circumventing tax evasion.

The instrument used was the research questionnaire developed on a Five-Point Likert Scale of Strongly Agree (4-point); Agree (3-point); disagreed (2-point); strongly disagree (1-point) and Neutral (0 point). The instrument was tested for reliability using test re-test method. This was accomplished using the Spearman Rank Correlation coefficient and the result gave a favorable r-value of 0.802; which indicates that the instrument was reliable. The study judgmentally administered 175 copies of questionnaire to staff of the Federal Inland Revenue Service (FIRS) and State Inland Revenue Service (SIRS) in Cross River State. The sample was taken out of the population size of 423. The data generated was analyzed using the Chi-Square ($X^2$) statistical tool to determine the significance difference in the opinion of respondent on the effect independent variable has on tax evasion and avoidance.

IV. RESULTS

The study used the Chi square ($X^2$) statistical due to the qualitative nature of the data used. The distribution of the statistic $X^2$ was corroborated with ($r-1$) ($c-1$) degrees of freedom, 5 percent level of significance. Table 1 shows the result of the observed and expected variables of the chi-square test of significance of respondents’ opinions on the effect of tax audit on tax evasion and avoidance in Cross River State. The observed variables preceded the expected variables which are presented in brackets. It was discovered that the chi square ($X^2$) result of 37.28 at 8 d.f. was higher than the tabulated value at 0.05 level of significance [$X^2_{cal} = 23.9058 > t_{0.05} = 15.507$] Thus, there is a significant difference on the opinions of respondents on the effect of tax audit on tax evasion and avoidance in Cross River State.
The study examined addressing tax evasion and avoidance through effective tax audit and investigation in Cross River State. It was discovered that tax audit significant affect tax evasion and avoidance in Cross River State. This was corroborated by the study of Palil and Mustapha (2011) who argued that audits rates and the thoroughness of the audits could encourage taxpayers to be more prudent in completing their tax returns, report all income and claim the correct deductions to ascertain their tax liability. The result of the effect of tax investigation on tax evasion and avoidance shows no significant relationship from the perception of respondents. This could be as a result of divergence view from respondents on tax investigation. However, the effect of penalty on tax evasion and avoidance was significant; and the result was supported by Beck, Davis and Jung (1991) in their study found that tax investigation and penalty rates affect tax compliance.

V. CONCLUSION AND RECOMMENDATIONS

Table 2 reveals the result of the observed and expected variables of the chi-square test of significance of the relationship between forensic investigation and audit quality. The observed variables preceded the expected variables which are presented in brackets. It was discovered that the chi square ($X^2$) result of 13.88 at 8 d.f. was less than the tabulated value at 0.05 level of significance $[X^2_{cal} = 13.88 > t_{0.05} = 15.507]$. Thus, there is no significant difference on the opinions of respondents on the on the effect of tax investigation on tax evasion and avoidance in Cross River State.

Table 3 reveals the result of the observed and expected variables of the chi-square test of significance of the relationship between forensic investigation and audit quality. The observed variables preceded the expected variables which are presented in brackets. It was discovered that the chi square ($X^2$) result of 41.88 at 8 d.f. was greater than the tabulated value at 0.05 level of significance $[X^2_{cal} = 41.88 > t_{0.05} = 15.507]$. Thus, there is no significant difference on the opinions of respondents on the on the effect of penalty on tax evasion and avoidance in Cross River State.

### TABLE 1: Chi-square result on the effect of tax audit on tax evasion and avoidance

<table>
<thead>
<tr>
<th>Tax audit</th>
<th>Tax evasion and avoidance</th>
<th>SA</th>
<th>A</th>
<th>D</th>
<th>SD</th>
<th>U</th>
<th>$X^2$</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Audits rates and the thoroughness of the audits could encourage taxpayers to be more prudent in completing their tax returns.</td>
<td>Tax evasion and avoidance</td>
<td>53</td>
<td>72</td>
<td>36</td>
<td>10</td>
<td>1</td>
<td>37.28</td>
<td>P &lt; 0.05 Sig.</td>
</tr>
<tr>
<td>2. Strengthening of tax audit units would wipe away tax evasion and avoidance in Nigeria</td>
<td>Tax evasion and avoidance</td>
<td>46</td>
<td>60</td>
<td>42</td>
<td>18</td>
<td>6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Tax audits can change compliance behaviour from negative to positive</td>
<td>Tax evasion and avoidance</td>
<td>43</td>
<td>41</td>
<td>39</td>
<td>38</td>
<td>11</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Field Survey, 2019

### TABLE 2: Chi-square result on the effect of tax investigation on tax evasion and avoidance

<table>
<thead>
<tr>
<th>Tax Investigation</th>
<th>Tax evasion and avoidance</th>
<th>SA</th>
<th>A</th>
<th>D</th>
<th>SD</th>
<th>U</th>
<th>$X^2$</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Absence of functional Tax Investigating is largely the bane of noncompliance.</td>
<td>Tax evasion and avoidance</td>
<td>61</td>
<td>57</td>
<td>23</td>
<td>21</td>
<td>10</td>
<td>13.88</td>
<td>P &lt; 0.05 Not Sig.</td>
</tr>
<tr>
<td>2. Non-establishment and fortification of tax investigation will result to tax evasion and avoidance</td>
<td>Tax evasion and avoidance</td>
<td>50</td>
<td>51</td>
<td>43</td>
<td>14</td>
<td>14</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Taxpayers awareness of offences through adequate investigation and consequences might reduce their tendency to evade tax</td>
<td>Tax evasion and avoidance</td>
<td>41</td>
<td>59</td>
<td>38</td>
<td>23</td>
<td>11</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Field Survey, 2019

### TABLE 3: Chi-square result on the effect of penalty on tax evasion and avoidance

<table>
<thead>
<tr>
<th>Penalty</th>
<th>Tax evasion and avoidance</th>
<th>SA</th>
<th>A</th>
<th>D</th>
<th>SD</th>
<th>U</th>
<th>$X^2$</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. The awareness of offences was presumed to have a significant influence on tax evasion and avoidance</td>
<td>Tax evasion and avoidance</td>
<td>59</td>
<td>67</td>
<td>33</td>
<td>8</td>
<td>5</td>
<td>41.79</td>
<td>P &lt; 0.05 Sig.</td>
</tr>
<tr>
<td>2. Penalty rates impact upon tax compliance behavior</td>
<td>Tax evasion and avoidance</td>
<td>27</td>
<td>61</td>
<td>44</td>
<td>24</td>
<td>16</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. The higher the penalty and the greater the discouragement for potential tax evasion and avoidance</td>
<td>Tax evasion and avoidance</td>
<td>24</td>
<td>76</td>
<td>30</td>
<td>25</td>
<td>17</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Field Survey, 2019

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www.rsisinternational.org
An attempt was made to address tax evasion and avoidance through tax audit and investigation and it was inferred from the perception of respondents that tax audits rates and the thoroughness of the audit on the could encourage taxpayers to be more prudent in completing their tax returns and that the Strengthening of tax audit would wipe away tax evasion and avoidance in Nigeria. Tax investigation on the other hand does not substantial affect tax evasion and avoidance in Nigeria because of the mischievous character exhibited by some tax investigators. However, the fear of penalty has a significant effect on tax evasion and avoidance, as it was discovered that the awareness of offences and penalty rates impact upon tax compliance behavior.

It was therefore recommended that tax payers should be educated during tax audits. Enforcement of the law should be adequately communicated and penalty should be adequately implemented to serve as a deterrent to tax evader and avoiders so as to increase tax compliance and government revenue.

REFERENCES


