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Tax Audit And Company Paying Its Fair Share of Income Taxes: Evidence from Nigeria

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Abstract: The purpose of this study was to investigate the link between tax audits and tax compliance among Nigerian firms. Using a cluster sampling strategy, three hundred (300) questionnaires were sent to companies taxpayers in the South-West zone (comprising the states of Ekiti, Osun, Oyo, and Lagos). A total of one hundred (100) questionnaires were distributed in each state. Ordinary Least Squares was used to examine the hypotheses stated (OLS). Compliance with Nigeria's corporate income tax laws was shown to have a positive relationship with the independent variable (tax audit). Tax audits were shown to have a statistically and positively favorable association with corporate income tax compliance in Nigeria, suggesting that they are helpful in encouraging compliance. According to the findings, the best strategy to promote compliance with corporate income taxes is to use a mix of persuasive (tax justice and tax education) and deterrent (tax audit) tactics.

Keywords: Hoffman theory; Tax audit; Tax compliance; Tax fairness

JEL Classification: H21

1. Introduction

As a general rule, it is the duty of each given government to ensure the safety of its citizens. To participate in economic life, people rely on their government to provide them with the resources they need. As Egwaikhide and Udoh put it, “the quantity of revenue gained for the supply of infrastructure in that specific country is crucial to the political, economic, and social advancement of that country,” and only the government, with a substantial commitment of resources, can meet the constitutional mandate to care for the “general welfare” (2012). It also relies on people being law-abiding and paying their taxes on time. Having a thriving economy, they went on to explain, is crucial to a nation's development since it improves people's standard of living and quality of life generally. As the cost of running the government rises and revenue continues to diminish, as stated by Kiabel and Nwokah, all levels of government in Nigeria have been compelled to adopt steps to improve the basis of income generation (2013). Promoting truthful tax reporting is one such method.

Taxes are a primary source of revenue for governments across the globe, allowing them to fulfill their constitutional mandates in areas such as caring for their population, upholding law and order, securing their borders, and regulating business (Edame & Okoi, 2014).

Given the significance of tax revenue to national development, the issue of tax noncompliance has received considerable attention. While some developed countries have made strides in addressing tax

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compliance issues, many developing countries have not (Umar, Derashid, & Ibrahim, 2016). People in the shadow economy sometimes have incorrect ideas regarding tax exemptions (Abiola & Asiweh, 2012).

Since it is impossible to make someone obey the laws, we need to find other ways to motivate them to do so voluntarily. In order to address the problems produced by taxpayers not paying their fair share, tax authorities must get a thorough understanding of the factors that affect taxpayer compliance. There is a dearth of empirical studies on tax audits and tax compliance in Nigeria's informal sector, thus we deemed it important to fill that gap. The purpose of this study was to fill a gap in the current literature by examining the effects of income tax audits on businesses' compliance with legal requirements in Nigeria's South-west area. Among the goals of this study was to perform an audit of Nigerian businesses to check for compliance with income tax regulations. The study aims to contribute to the growing literature on tax compliance. Conducting financial audits to verify that companies are paying their fair share of taxes in accordance with Nigerian law. As a result, we were able to articulate our study's driving research question, primary objective, and provisional hypothesis.

- To what extent does tax audits discourage Nigerian firms from paying their fair share?;
- To examine the impact of tax audit on firms from paying their fair share in Nigeria;
- Tax audits has no effect on the compliance with business income tax regulations in Nigeria.

2. Review of Related Literature

Concept of Tax

Taxes, although an annoyance for the person or business forking over the cash, are essential to the government's ability to function. It seems to reason that citizens would like to pay as little as possible in taxes, while governments would prefer to collect as much as possible. The government's intention to increase tax revenue went against the views of the individuals who would be paying that increase. The administration of taxes has as one of its primary goals the maximization of taxpayer compliance with those duties. Inadequate tax administration is a problem in many poor countries, including Nigeria. This leads to widespread tax evasion, corruption, and coercion (Loveday & Eiya, 2016). Nigeria's government has made a number of changes to the tax system in an effort to enhance tax collection, although data shows that income taxes contribute just a small amount to the country's overall tax take (Abdulsalam et al, 2014 and Ahmed & Kedir, 2015).

Tax Compliance

To "comply" is to behave in accordance with and to fulfill one's tax duties in a manner consistent with all applicable tax rules and regulations. Responding immediately to information requests and providing the needed information in the relevant forms may help taxpayers' status with the tax authorities. Assuming the return is complete and correct, and the assessed tax is paid, the taxpayer is in compliance with the law (Sitardja &Dwimulyani, 2016). Often considered the progenitors of modern tax compliance research, Allingham and Sandmo (1972) are notable for being the first to apply Becker's (1968) economics of crime method to the study of taxpayer behavior. Various scholars have presented their own definitions of tax compliance. According to Ahmed and Kadir, "the degree to which taxpayers comply with government-enacted tax laws and regulations" is what is meant by "taxpayer compliance" (2015). As defined by Thiga and Muturi (2015), "tax compliance" refers to the practice of making monetary contributions to the government in a way that complies with the government's established tax rules and policies.

Independent contractors and employees alike must file a business tax return each year, says Eiya (2012). Businesses don't pay tax on their earnings, but people do. The amount of an individual's income remaining after applying all applicable exemptions and credits is their taxable income. One's income includes gains and losses from any endeavor, whether it a job, an investment, or the selling of a product or service (Ogbonna & Appah, 2016).

A taxpayer must file a statutory income earned return with the relevant tax authority in the taxpayer's country of residence in the prescribed form in order to be assessed by the government (government assessment) or to assess oneself (self-assessment), take into account one's reliefs, calculate the amount expected to be paid as tax at the current rate, and then make payments (Igbeng, Tapang, & Usang, 2012). By "compliance," we mean the taxpayer has filed all necessary tax forms and made all necessary tax payments based on correct and truthful information, as well as complied with all other relevant rules and regulations.

In Nigeria, "pay as you earn" (PAYE) tax withholding is required by law for all businesses (Loveday & Eiya, 2016). Employers that fail to properly register their workers and make timely tax payments are a persistent issue for companies that must pay PAYE tax. Humans from the Anyaduba region (2012). Author of study defines "company income tax compliance" as "the full and voluntary conformity by taxpayers and tax authorities with all applicable business income tax rules and regulations."

An audit of a company's financial records is performed to verify the accuracy of the company's tax return (Ojo, 2016). Profitability analysis helps with this process, since it reveals whether or not the firm is operating legally in terms of taxation. Auditing taxpayers' returns ensures compliance with tax laws, which in turn increases the amount of money the government receives in revenue. Tax returns are a possible way for authorities to check a person's compliance with the law and regulations (Madjid, 2015).

In 1972, Allingham and Sandmo published a model of tax evasion based on the assumption that taxpayers may either I report their true income and pay the correct amount of tax, or (ii) claim a lower income and pay a lesser amount of tax. The likelihood of being audited, detected, and penalised influences your decision between the two possibilities. A wise taxpayer would choose for the former option since the latter increases the risk of audit, identification, and penalty. The absence of sanctions for perpetrators exacerbates the problem. It would seem that Nigeria's efforts to enforce compliance with tax laws via audits, penalties, and fines have been ineffective. Several studies, including those by Appah and Eze (2013), Lateef et al. (2015), and Modugu and Anyaduba (2016), find that tax audits raise compliance rates (2014). A more recent study, however, by Eiya et al. (2016), found no correlation between tax audits and increased compliance.

The presence of a tax audit program was linked by Appah and Eze to increased levels of voluntary tax compliance in Nigeria (2013). Findings from a study by Lateef et al. suggest that tax audits may be a useful tool for encouraging compliant behavior (2015). Consequently, Modugu and Anyaduba (2014) looked on how tax audits affect taxpayer compliance in Nigeria. The available data suggests that tax audits significantly and generally positively impact tax compliance.

Eiya et al. found that religious pressure and tax audits had no effect on Nigeria's notoriously lax attitude to corporation tax payments (2016). Results from studies examining the link between tax audits and greater tax compliance have been mixed..

Theoretical Framework

These theoretical foundations include both Robert Hoffman's tax planning theory and the concept of agency. Empirical studies have confirmed the validity of both of these theories. The Hoffman tax planning hypothesis places more scrutiny on corporations having a track of of diverting profits to private investors rather than to local, state, or federal governments (Hoffman, 1961). Due to the complexity of tax systems and processes, tax loopholes (also known as tax escapes) will always exist. These exemptions and deductions may help taxpayers financially. The goal of tax planning, according to Hoffman (1961), is to prevent revenue from being paid to the government. In certain cases, with careful preparation, you may significantly lower your taxable income while keeping the same or even increasing your total revenue. It is the taxable income of the firm, which is equivalent to its adjusted profits, which is used to calculate the tax bill in this case. One solution put out to address this issue is for businesses to devote a larger share of their efforts to initiatives that result in a lower taxable profit figure.

According to agency theory, however, stockholders are the principals and managers are the agents in any business. The shareholders have delegated authority to the management to make decisions, yet the managers are often going against the shareholders' wishes. There must be corporate governance mechanisms in place to combat the agent's behavior. However, if management takes advantage of their position and steals money or other assets from the firm, tensions between the shareholders and the management might rise (Jensen and Meckling, 1976; Desai and Dharmapala, 2006). This is supported by the agency theory and the Hoffman tax planning theory.

Empirical Evidence

Due to the high social status associated with honest tax filing, several research have been undertaken on the issue. These kinds of inquiries are performed with the expectation that they would shed light on the reasons people actually pay their taxes. This is supported by research from a variety of sources, including Anyaduba et al. (2012), Eiya et al. (2016), Helhel & Ahmed (2014), and Umar et al (2016).

In their study of what factors influence tax attitudes and tax compliance in Yemen, Helhel and Ahmed (2014) utilized tax rate, an unfair tax system, and tax audits as independent variables. Research shows that a high tax rate is related with an unfair tax system. Worse, they found that the more the number of audits a taxpayer confronts, the less likely they are to comply. Umar et al. (2016) looked at the impact of public governance quality on aspects including tax awareness, perceived audit probability, and tax compliance in order to better understand the causes of income tax noncompliance in Nigeria. Unexpectedly, they found a positive correlation between tax compliance and sound administration. The researchers also found that people's compliance with their tax obligations was inversely proportional to their degree of audit anxiety.

Anyaduba et al. (2012) used these indicators in their research of the factors that contribute to tax compliance in Nigeria. Currently available tax incentives in Nigeria are inadequate, according to the authors' findings. The authors draw the conclusion that encouraging taxpayers to comply with tax rules voluntarily may increase both taxpayer morale and compliance. Eiya et al. (2016) analyzed religious incentives and disincentives to tax compliance to learn more about the correlation between religious piety and tax compliance. They argue that a person's religious convictions have no place in deciding whether or not they will pay their taxes. Similar findings were made on Nigerian taxpayers, showing that the use of disincentive measures did not improve taxpayer honesty.

3. Methodology

To gather data for the study, a survey was sent to all of the participants. This approach was selected above others because of the exploratory character of the study and the high dependability with which it tends to generate more honest responses than other research techniques.

The sheer number of Nigerians makes it impossible to collect information from all of those who file tax forms. Despite the fact that not every single Nigerian files a personal income tax return, we should still be able to derive some important insights from the information we gather. As a result, cluster sampling was used to choose the South-West geo-political zone from the six existing geo-political zones in Nigeria. The South-West geopolitical zone of Nigeria is a more practical location, and it also has a large number of educated people working in civil and public service. The six states that make up Nigeria's South-West region are: Lagos, Oyo, Osun, Ogun, Ondo, and Ekit.

The magnitude of the study's target population necessitated the use of a selective sampling method, which led to the selection of our sample. Out of the six that make up the South-West zone, four were arbitrarily chosen. These states are: Lagos State, Oyo State, Osun State, Ogun State, Ondo State, and Ekit State (Osun State, Ogun State, Ondo State and Ekit State State). Four hundred questionnaires were returned, one hundred from each of the four states.

Since it was expected that a higher rate of tax audits would increase corporate income tax compliance, this study drew on Oseni's (2021) findings on tax audits and individual income tax compliance in Nigeria. It follows that there must be some connection between tax audits and the punctuality with which businesses report their taxable revenue.

Company income tax compliance = f(Tax audit) (i)

This is expressed in code form as

$$CITC = f\,(TA) \quad \text{(ii)}$$

This equation is transformed into econometric form as follow

$$CITC=\beta 0+BTA+ \mathcal{E} \quad \text{(iii)}$$

CITC=Company income tax Compliance

TA = Tax Audit

β =Unknown Coefficient of the Variables

Ɛ= Error Term

The study instrument was a survey with ten (10) questions, five (5) of which were designed to probe the relationship between tax compliance and reporting, payment, and the cost of compliance. Client perspectives on tax audits are presented. The Likert scale questionnaire has five response options, labeled “Strongly Agree” (SA), “Agree,” “Neutral,” “Disagree,” and “Strongly Disagree,” with corresponding values of 5, 4, 3, 2, and 1 for each. This means that replies of Strongly Agree (5) and Agree (4), ambiguity for a Neutral (3) response, and disagreement for a Disagree (2) and Strongly Disagree (1) response will be deemed to have a high level of compliance.

Spearman's rho determined how strongly the hypothesis variable was correlated with filing income tax returns (R). We speculate that there is a link between the two. We examined whether or not there was a connection between the averages of the variables and tax compliance using an Ordinary Least Squares (OLS) model. The major goal in using these methods was to explain why taxpayers choose to choose a higher compliance level when they are subject to tax audits. The focus of this study was to disentangle the impact of tax audit as an independent variable on taxpayer compliance. The researchers set up their labs in the southwest of Nigeria.

Descriptive Statistics

4. Data Presentation and Analyses

Tax Audit	SA	A	N	D	SD	MEAN
	5	4	3	2	1	
In light of the tax authority's limited capacity to verify all claimed income, I might choose not to disclose my true earnings.	66	103	58	92	68	3.01
Under the PAYEE Deduction Scheme, company income tax is deducted monthly by the employer, hence, it is okay not to declare any additional income that could be subjected to tax.	98	119	63	71	36	3.44
Low probability of detection encourages tax noncompliance.	120	137	53	49	28	3.70
I think it is worthwhile not to comply with tax payment if the benefits derived from noncompliance are greater than fines if caught later.	76	118	47	87	59	3.17
Awareness of tax audit encourages tax compliance.	198	125	30	18	16	4.22
						3.51

Source: Researchers Computation (E-views 8) 2022

Keep in mind that SA indicates very strong agreement, A indicates agreement, N indicates neutrality, D indicates disagreement, and SD indicates very strong disagreement. Calculating the mean value uses a five-point scale: SA(5), A(4), N(3), D(2), and SD(2) (1). With this many people, the mean is obviously 3. A frequency distribution was used to describe the sample. The formula used to calculate the mean of the sample population was as follows: (1/387)(5(66))+(4(103))+(3(58))+(2(92))+(1(68))=3.01. The competing hypothesis, Ho = o = 3, is in opposition to the null hypothesis, Ho = 1 3. Preliminary data are shown in Table 2, where the mean of the predictor variable "Tax audit as a predictor of tax compliance" is 3.51 (above the population mean of 3.25). (3.00). This leads to the first conclusion that tax audits are useful in gauging the extent to which Nigerian firms pay their fair share of income tax.*

Table 2 Summary of Unit Root Test Result

	PP-Fisher Chi Square	
VARIABLE	**At Level**	**I(d)**
CITC	0.0187**	I(0)
TA	0.0015**	I(0)

*Source: Authors' Extracts from Table 4**5% level of Significance*

In order to determine the possible sequence of integration among the relevant variables, this study used the Phillips-Perron Chi Test (CITC,TA). Non-stationarity was tested for using the unit root test, with the occurrence of the test (i.e. non-stationarity) serving as the null hypothesis and the alternative hypothesis being that the series is stationary. If the absolute probability value is larger than the threshold probability value (0.05), the null hypothesis is accepted and the series is termed stationary.

Table 2 displays the results of a PP-Fisher Chi-square unit root test, which reveals that all variables are stationary at the level form indicated by the letter I. (0). In light of this, it may be inferred that there is no co-integration between the variables under consideration.

Table 3 Regression results

Dependent Variable: CITC
Method: Panel EGLS (Period random effects)
Date: 09/13/22 Time: 11:53
Sample: 2012 2021
Periods included: 10
Cross-sections included: 64
Total panel (balanced) observations: 640

Variable	Coefficient	Std. Error	t-Statistic	Prob.
FSIZE	0.012690	0.005011	2.532598	0.0122
LEV	0.000361	6.92E-05	5.219215	0.0000
ROA	0.078636	0.000101	-0.299884	0.7646
C	0.089422	0.086178	1.037649	0.3009

R-squared	0.161405	Mean dependent var	0.314157
Adjusted R-squared	0.146778	S.D. dependent var	0.176937
S.E. of regression	0.163437	Sum squared resid	4.594398
F-statistic	11.03497	Durbin-Watson stat	0.474144
Prob(F-statistic)	0.000001		

Source: Authors' Computation, (2022)

The findings of a panel data regression analysis using a random effect model indicated that the r2 for the sample of company income tax was 0.161. Based on the coefficient of determination (R-squared), we find that the model is only partially successful at explaining the systematic variation in the value of the dependent variable that can be attributed to the independent variables; the remaining 84.9% of the variations in tax audit of the sampled firms can be attributed to factors outside the scope of the model. Adjusted R-squared, which evaluates how much of the overall variation can be attributed to the model, is 14.7%, which is in line with this conclusion. The study's Durbin-Watson test yielded an intriguing result: 0.4741. Time series regression residuals can be tested for autocorrelation with the durbin-watson statistic. As a result, the result (0.4741) proved that there was a positive autocorrelation between the independent variables.

A p-value of (0.000) less than 0.05 for the Fishers ratio (i.e. the F-Statistic) shown in Table 4.6, demonstrating the robustness of the estimated model, indicates that the independent variables were jointly and strongly associated with the dependent variable. This is equivalent to rejecting the null hypothesis in favor of the alternative hypothesis in practice. Since this is the case of tax audit, tax compliance was used as the dependent variable in this study. Nigeria's South-West zone served as the site of the research project.

5. Discussion of Findings

The purpose of this study was to determine whether and how tax audits impact a company's propensity to pay its full share of federal, state, and local income taxes. Tax audits have been shown to have a positive and statistically significant relationship with income tax compliance among Nigerian enterprises, according to both multiple regression and simple regression analysis. The results indicate a causal relationship between the frequency of tax audits and taxpayer compliance. The increased likelihood of discovery afforded by the use of technology in Nigeria's tax system, together with the correspondingly substantial penalty, may account for the positive link between tax audits and company income tax compliance in that nation. The percentage of income tax compliance among enterprises may benefit significantly from tax audits, according to several studies (Appah & Eze, 2013; lateef et al, 2012 and Liucija, 2013). However, this conclusion is at odds with another body of literature that found no connection between tax audits and corporations' real income tax compliance (Eiya et al, 2016). Taxpayers' perspectives are impacted by factors including tax audits, tax rates, the value of tax evasion, the chance of getting detected, and the severity of penalties for doing so, as predicted by the economic deterrent theory (Allingham & Sandmo, 1972).

6. Conclusion and Recommendations

The study's objective is to examine the effect of tax audits on the rate of company income tax compliance among Nigerian enterprises. This study set out to answer the question, “How can tax audits affect the timing of a company's payment of income taxes?” Audits of tax returns were shown to have a positive and statistically significant link with income tax compliance among Nigerian enterprises. This shows that there is a direct correlation between tax audits and companies' compliance with their income tax responsibilities. This evidence supports the hypothesis that tax audits help raise levels of tax compliance. The study found that taxpayers' mental health has to be considered while developing tax audits and other “deterrent” tax processes. As a result, tax collectors need to know when and how to utilize incentives as well as punishments (tax fairness and tax education).

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