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CHAPTER TEN

The Place of Value Added Tax (VAT) in Revenue Allocation

M.A. Adawo & C.N. Ekong

INTRODUCTION

Since the middle of the 1970s Nigeria has riskily depended on a single commodity for her finances; that is petroleum oil. Although much comes from this resource, Akpakpan (1989) shows that for well over three decades Nigeria was running deficit budgets. In other words, fiscal imbalance dominated Nigeria's fiscal system. Therefore, alternative or additional sources of revenue was necessary. Thus, the federal government in 1991, under the leadership of General Babangida, commissioned two different studies on possible modes and means of mobilizing more revenue through direct and indirect taxes.

One study group was set up by the Federal Ministry of Finance and Economic Development to study and make recommendations on the reforms needed in direct taxes in Nigeria. The indirect tax group, which was set up by the Federal Ministry of Budget and Planning was inaugurated on 26 April, 1991 with the following objectives among others:

(i) shift taxation towards consumption (indirect) rather than savings (direct);
(ii) reduce dependence on (petroleum) oil revenue;
(iii) provide incentives for export production;
(iv) improve the administration of indirect taxes; and
(v) maintain a fairly even tax incidence across various lines, stages and elements of taxation on imported goods.

By this arrangement VAT was introduced in Nigeria.

The indirect tax group came up with value added tax (VAT). Pure VAT is collected only at the retail level in order to ensure that the maximum value has been added to the product on sale and in order to collect the maximum revenue. But Nigeria adopted modified value added tax (MVAT) because of the cumbersomeness of collecting VAT at all stages. Pure VAT involves elaborate record keeping and simmers down to illiterate retailers and the preponderance of the informal sub-sector in the distribution chain. Collecting VAT at all levels in Nigeria would not be cost effective. Therefore, Nigeria collects MVAT at the levels of manufacturing, wholesalers and importers.

The committee on MVAT, inaugurated on June 1 1992, reviewed the terms of reference for the reforms of sales tax thus:

(a) To eliminate or minimize the distortion, by improving its transparency and predictability and shifting its incidence towards expenditure rather than income.

(b) To achieve greater fiscal flexibility in order to develop expenditures that can be maintained in the face of fluctuations in oil revenue by broadening the statutory base for taxation and its effective coverage.

(c) To distribute the burden of taxation more evenly across different goods and services through a broader coverage to avoid multiple taxation.

provide the basis for strong revenue growth and flexible fiscal arrangement in 1994 and beyond.

(e) To shift taxation towards consumption rather than income.

(f) To reduce dependence on oil revenue

(g) To provide incentives for export production, and

(h) To develop an approach to taxing luxury consumption relatively higher and minimizing the impact on essential goods and services used by low-income earners and formulate a programme of work for the accomplishment of the assignment.

Since the introduction of MVAT in the 1994 fiscal year, it has yielded an appreciable amount of naira, and recorded some measure of success, though the VATable list is not comprehensive. But, like any other revenue sharing formula in Nigeria, the formula for sharing VAT is equally an unsettled business. It is against this background that this paper is set to offer suggestions that could lead to a more meaningful and result-oriented formula.

The rest of this paper is arranged in four sections. Section 2 puts forward a brief theoretical discourse on VAT, section 3 examines VAT in Nigeria, VAT and revenue allocation is treated in section 4, while section 5 makes some recommendations and concludes the paper.

2. A Brief Theoretical Discourse

Mobilization of revenue involves the adoption of economicall[illegible] and politically acceptable taxes that would ensure eas[illegible] administration, accounting verification, audition and investigatio[illegible] based on equity, neutrality and other attributes of a good tax (Udo[illegible] [illegible]ona [illegible]nd I[illegible]ng, 1999:437). The value added tax is consumption tax. Therefore, it is difficu[illegible] to eva[illegible] its pa[illegible]me[illegible]

A consumption tax should recognize the consumer as utility-maximizer, while at the same time safeguarding against tax evasion. The adoption of an appropriate consumption tax should follow a critical and objective examination of the tax incidence, base and distribution sequence of such a tax.

According to Udoh et al. (1999),

> the essential consideration in choosing a consumption tax option from other tax options include assessing the administrative feasibility of each tax, determining its relative revenue potentials, its degree of voluntary compliance, its relative neutrality, its equity potential for regressively and the efficiency of data matching.

The above reason(s) might have been responsible for government deciding to replace the existing retail sales tax (RST) with the value added tax (VAT) as a consumption tax. VAT, according to Ogundele (1996, as cited by Udoh et al. (1999), has three major characteristics:

a. It is a consumption tax.

b. It is a multi-stage tax.

c. It is borne by the final consumer.

VAT centres on the value added which is defined by Ogundele (1996) as the amount of value a firm contributes to a good or service by applying its own factors of production. However, a factor of production here could mean transport. Hence value added is simply value of output less value of input.

VAT has been considered to induce inflation and inequality and, regressively. Such claims are disputed in some quarters. For e[illegible]ple, [illegible] (19[illegible], [illegible]s of [illegible] vie[illegible] [illegible]at th[illegible] [illegible]rod[illegible] [illegible]n o[illegible]T, or a change in VAT rate is not inflationary — the change might al. (1999) look at the movement of the consumer price index (CPI), which reflects inflation rate, and note that when VAT was introduced in 1994 inflation rate rose from 54 percent to 57 percent. It (inflation rate) rose to 72 percent in 1995 and dropped to 44.6 percent in 1996. This shows that VAT impacts minimally on inflation. Indeed, one of the reasons for this is the in-built input tax refund that is embodied in VAT.

Provided that the VAT rate is adjusted to reflect differentials on necessities and luxuries, it is a good measure of income distribution. Of course, this must depend on whether or not VAT proceeds are spent in a way that raises the real income of the low-income groups.

2.1 Merits and Demerits of VAT

A basic difference between a sales tax and a VAT, which must be emphasized is that the base of VAT is not the gross value of the retail sale but rather the net value added at each stage of production (Bhatia, 1993:152). This distinguishes VAT from turnover tax where each transaction is taxed on its gross value. There are about four types of VAT:

(i) consumption type :– full investment is deducted from gross value of output,

(ii) production type :– no deduction for fixed investment is made from gross value of output,

(iii) income type :– depreciation of fixed investment is deducted from gross value of output, and

(iv) wage type :– the estimate of income type is further reduce by deducting profit and interest.

..1 ...its ... T

... tax liability of a firm by using credit

Conversely, a turnover tax encourages vertical integration of production so as to avoid intermediary sales and taxes and to acquire a competitive advantage over others.

(ii) VAT avoids cost cascading effect. A conventional sales tax leads to compounding of tax liability, while VAT does not.

(iii) There is less of tax evasion. Also it is in the interest of a firm to account for the taxes paid by earlier firms through whom the inputs have come, otherwise the firm pays the tax itself. Moreover, if any firm understates its output, the firm buying inputs from it will disclose it. This kind of cross-auditing enables the authorities to plug tax leakage.

(iv) It encourages exports. Exportable goods may be zero-rated. It is easy to separate the tax from the cost of production in the case of VAT, but it is not so in the case of other taxes which easily get mixed up with the cost of production (because they are levied at gross value in each case).

(v) It is claimed that VAT is conducive to efficiency since a firm is not exempted from its tax liability even if it suffers a loss — it pays tax not on the profit but on the value produced.

(vi) Multiple rates could be applied to different commodities.

2.1.2 Demerits of VAT

(i) VAT is a complicated system that needs an honest and efficient government machinery to ensure cross checking and linking up of various production activities and the resulting tax liability of each firm. This demands proper record keeping.

(ii) Each firm calculates its tax liability and also finds out the false purchase invoices showing taxes paid by others. This practice brings about tax evasion.

(iii) It is expensive on the part of the taxpayer as he is expected to keep and maintain an elaborate account.

(iv) Critics doubt that VAT induces efficiency. They claim that in an economy with shortages, speculative hoarding, non-competitive price rise and similar practices are common. In a seller's market, producers and sellers have no incentive to increase their efficiency and reduce costs, since goods will sell irrespective of their quality and high price.

3. VAT in Nigeria

The first country to impose VAT in its comprehensive form was France in 1954. The practice was later imported into the French speaking African countries, so that by 1967, almost all the French speaking African countries were operating one form of VAT or the other (Ijewere, 1993:4). In sub-Saharan Africa, VAT has been introduced in several countries including Benin, Cote d' Ivoire, Guinea, Kenya, Madagascar, Mauritius, Niger, Senegal, Togo and, of course, Nigeria in recent times. VAT became operational in Nigeria from the 1994 fiscal year. Prospective VAT payers — manufacturers, wholesalers, importers, and suppliers of VATable commodities were required by Decree No. 102 of 1993 to register with the Federal Inland Revenue Service (FIRS), which centrally administers VAT in Nigeria.

At the moment records show that there are seventeen categories of goods and twenty-four categories of services that are VATable. VATable goods and services include all goods manufactured and assembled in Nigeria; all goods imported into [illegible]geri[illegible] [illegible]sec[illegible] hand [illegible]ds, [illegible] [illegible]eho[illegible] [illegible]nit[illegible] [illegible]nd e[illegible] me[illegible] [illegible] and petroleum products (including engine

rugs, beer, wine, liquor, soft drinks, aerated water, cigarettes and tobacco. Also VATable are all vehicles and spare parts (excluding commercial vehicles and their spare parts), perfumes and cosmetics (including toiletries), soaps and detergents, mining and minerals, office furniture and equipment and electrical materials of any description.

VATable services include all services rendered by financial institutions to their customers (excluding people's and community banks and mortgage institutions), accountancy services, the provision of report, information or similar technical services (UBA, 1994).

Commodities exempted by the decree are purely those that border on people's welfare and whose requirements are necessary for improving human development (Udoh et al, 1999). These include medical and pharmaceutical products, basic food items, educational materials, agricultural services and equipment, etc. Nigeria adopts a general 5% VAT charge on all commodities, whether domestic or imported, and imposes a zero-rate on export commodities, with the hope of encouraging a favourable balance of trade.

The first year of implementing VAT in Nigeria recorded minimal success as the proper foundation for its take-off had not been laid and the level of public awareness was also low. VAT is a self-assessment tax that is paid when returns are rendered. In-built in the VAT system is the refund or credit mechanism, which eliminates the cascading effect that features in the retail sales tax. The input–output tax mechanism in VAT makes it self-policing. In all, it is the output tax less input tax that constitutes the VAT payable. It is the equivalent of the VAT paid by the final consumer of the product that will be collected by the government. Though VAT is a multiple-stage tax, it has a single e[illegible] and [illegible] [illegible] the consumer price, no matter the

VAT Performance in Nigeria

The performance of VAT in Nigeria since its inception in 1994 (See Tables 1–3) is impressive. In 1994 the actual receipts was ₦7260.8 million, representing an increase of ₦1260.8 million or 21.0 percent over the budget estimate for that year. VAT receipts increased further by 185.9 percent to ₦20761.0 million in 1995 and by 49.3 percent to ₦31,000.00 million in 1996. As a proportion of total non-oil revenue, the contribution of the tax was 17.4 percent in 1994, 15.3 percent in 1995 and 20.5 percent in both 1996 and 1997. Its share of total federally collected revenue also increased from 3.6 percent in 1994 to 4.5 percent in 1995 and 5.9 percent in 1996, and declined marginally to 5.8 percent in 1997. As a proportion to the GDP the corresponding percentages were 0.80, 1.1, 1.3 and 1.1 for the years 1994, 1995, 1996 and 1997, respectively. The impressive performance of this source of revenue in its first four years of existence was largely attributable to improvements in administration as well as the relatively low tax rate of 5 percent, which minimized customer resistance. Naiyeju (1997) supports the introduction of VAT in Nigeria as an instrument for the balance of payments engineering by encouraging exports through zero-rating of export goods.

TABLE 1: VAT REVENUE, TOTAL REVENUE AND GDP

Year	Total Revenue ₦'m	VAT (₦'m)	GDP (₦ 'm)
1994	201,910.8	7260.8	911068.0
1995	459,987.3	20761.0	1960685.6
1996	520,190.0	31000.0	2331923.9
1997	582,811.0	34000.0	3127900.0

Source: CBN (1997)

TABLE 2: VAT REVENUE AS A PERCENTAGE OF TOTAL REVENUE AND GDP

Year	% of VAT to Total Revenue	% of VAT to GDP
1994	3.59	0.80
1995	4.51	1.06
1996	5.96	1.33
1997	5.83	1.08

Source: CBN (1997)

TABLE 3: CONTRIBUTION OF VAT TO NON-OIL REVENUE

Year	Non-oil Revenue (₦'m)	VAT Revenue (₦'m)	VAT as a Percentage of Non-oil Revenue
1994	41718.4	7260.8	17.4
1995	135439.7	20761.0	15.3
1996	151000.0	31000.0	20.5
1997	166000.0	34000.0	20.5

Source: CBN (1997)

4. VAT and Revenue Allocation

Revenue allocation is one thing that has dissipated the energies of our rulers, be they military or civilian. VAT has had the "privilege" of having a separate revenue sharing formula each year and sometimes two formulae in a year. Table 4 shows VAT sharing formula right from inception.

At inception, the Federal Inland Revenue Service (FIRS) was to retain 20% of the gross proceeds while the remaining 80% was to be shared among states, since the tax was a replacement of the sales tax that was before then shared among states. From January to March 1995 t[illegible] form[illegible] [illegible] to 5[illegible] [illegible] 25 [illegible] in favour of [illegible] state and local governments, respectively. The

TABLE 4: SHARING FORMULA OF VAT, 1994–1999

Year	FIRS	Fed. Govt. of Nigeria	States*	LGAs
1994 (Jan.	20%	-	80%	-
1995(Jan - March	-	50%	25%	25%
1995 (April-Dec.)	-	40%	35%	25%
1996-1998	-	35%	40%	25%
1999	-	15%	50%	35%

Notes: *The states' share is distributed among them on the basis of 50% equality, 30% population and 20% derivation.

Sources: Udoh et al. (1999:441); *Business Times* (April 26, 1999)

governments, respectively. Between 1996 and 1998 the formula changed again showing rates of 35:40:25 percent in favour of the federal, state and local governments. In 1999, according to *Business Times* (26/4/99), the formula changed again with 15 percent for the federal government and 50 and 35 percent for state and local governments, respectively. One observation here is that, even though the FIRS is a federal government department, and apportioning some share to it and the Federal Government could probably be considered duplicative. The FIRS had no share after 1994.

Consequently, the federal government's share amounted to ₦1452.2 million in 1994, ₦7437.8 million in 1995 and ₦10746.0 million in 1996. VAT revenue for state governments were ₦5026.0 million, ₦6340.3 million and ₦11290.0 million for 1994, 1995 and 1996, respectively.

Equally VAT revenue for local governments were ₦3558.1 million and ₦4581.7 million for 1995 and 1996, respectively.

TABLE 5: SUMMARY OF STATE GOVERNMENTS' AND FEDERAL CAPITAL TERRITORY'S FINANCES, 1994[1] (₦ MILLION).

States	Revenue			Expenditure	Surplus/Deficit
	Statutory2 Allocation	Total	VAT	Total	Overall
Abia	793.8	1173.0	149.2	1175.9	-2.9
Adamawa	878.4	1077.5	127.5	1754.7	-677.2
Akwa Ibom	902.2	1530.8	137.3	1829.2	-298.4
Anambra	736.7	1293.1	113.9	1578.8	-282.7
Bauchi	1028.9	1746.3	173.4	2560.9	-814.6
Benue	857.8	1073.0	120.9	1140.2	-67.2
Borno	857.1	1161.6	141.0	1121.3	40.3
Cross River	794.9	1107.6	117.4	1089.2	18.4
Delta	973.8	1835.2	168.4	1834.2	1.0
Edo	730.2	1014.0	119.8	1150.7	-136.7
Enugu	838.5	1238.2	149.1	1970.0	-731.8
Imo	931.3	1506.3	144.6	1396.6	109.7
Jigawa	832.0	1161.9	156.1	1766.0	-604.1
Kaduna	1154.7	1720.2	228.9	2541.9	-821.7
Kano	1606.2	2415.3	235.2	2134.2	281.1
Katsina	1252.8	1576.5	152.9	1091.2	485.3
Kebbi	951.7	1232.1	120.3	1309.1	-77.0

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Table 5 continued

	Revenue			Expenditure	Surplus/Deficit
States	Statutory2 Allocation	Total	VAT	Total	Overall
Kogi	665.3	990.1	106.1	1004.5	-14.4
Kwara	733.5	2248.7	112.1	1194.6	1054.1
Lagos	931.9	4186.3	649.1	4216.7	-30.4
Niger	826.2	972.4	115.8	868.4	104.0
Ogun	876.6	1626.1	167.1	1830.9	-204.8
Ondo	1030.0	2503.5	155.8	2043.9	459.6
Osun	934.6	1432.7	151.5	1386.9	45.8
Oyo	860.1	1691.2	209.0	2267.3	-576.1
Plateau	1008.3	1540.5	147.3	3014.4	-1473.9
Rivers	1011.2	2420.4	180.1	2484.2	-63.8
Sokoto	1045.0	1379.5	193.3	846.9	532.6
Taraba	1004.6	1424.4	108.4	1513.5	-89.1
Yobe	808.8	1542.5	116.0	1445.9	96.1
FCT Abuja	1149.7	1685.2	58.1	4357.0	-2671.8
Total	29006.8	49506.1	5026.0	55916.4	-6410.3

Notes: 1. Revised, 2. Indicates gross allocation to state governments.
Source: CBN (1997)

TABLE 6: SUMMARY OF STATE GOVERNMENTS' AND FEDERAL CAPITAL TERRITORY'S FINANCES, 1995[1] (₦ MILLION).

	Revenue			Expenditure	Surplus/Deficit
States	Statutory2 Allocation	Total	VAT	Total	Overall
Abia	1106.1	1590.8	200.4	1808.7	-217.9
Adamawa	1188.2	1451.9	158.7	2040.4	-588.5
Akwa Ibom	1510.9	2017.9	187.6	2144.2	-127.1
Anambra	1012.4	1655.8	178.6	3696.6	-2040.8
Bauchi	1413.1	2164.8	207.4	2175.7	-10.9
Benue	1022.8	1730.9	154.5	1731.0	-0.1
Borno	1322.3	1561.7	135.6	1301.0	260.7
Cross River	1248.9	1740.2	146.8	1471.2	269.0
Delta	1347.0	3126.1	209.6	3098.0	28.1
Edo	1360.0	2078.5	206.2	2069.5	9.0
Enugu	1390.1	2135.8	167.0	2838.9	-703.1
Imo	1201.1	1974.7	196.0	2462.2	-487.5
Jigawa	1135.7	1602.8	168.7	3107.8	-1505.0
Kaduna	937.4	1934.0	257.2	2823.5	-889.5
Kano	1587.1	2826.8	288.6	2409.5	417.3
Katsina	1545.4	1959.0	189.4	1493.8	465.2
Kebbi	1045.6	1614.5	156.4	1975.7	-316.2

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Table 6 continued

States	Revenue Statutory2 Allocation	Total	VAT	Expenditure Total	Surplus/Deficit Overall
Kogi	101.8	1451.1	185.5	1495.3	-44.2
Kwara	1019.7	1375.7	150.3	1323.1	52.6
Lagos	1286.3	6802.8	765.6	5999.1	803.7
Niger	1141.7	1328.5	134.9	1143.9	184.6
Ogun	1191.6	2832.7	215.6	3080.8	-248.1
Ondo	1304.6	2670.8	198.6	2794.4	-123.6
Osun	1289.7	2118.0	196.2	1802.8	315.2
Oyo	1290.1	2102.1	260.7	3994.4	-1892.3
Plateau	1344.6	2533.5	191.3	3969.2	-1435.7
Rivers	1511.8	4609.9	245.6	2928.1	1681.8
Sokoto	1503.1	1932.0	223.8	1961.9	-29.9
Taraba	980.3	1456.4	134.7	3113.8	-1657.4
Yobe	1062.2	1896.5	146.3	1987.7	-91.2
FCT Abuja	1375.8	1725.7	73.5	5349.4	-3623.7
Total	38677.4	68001.1	6340.3	79591.6	-11590.5

Notes: 1. Revised, 2. Indicates gross allocation to state governents.
Source: CBN (1997)

TABLE 7: SUMMARY OF STATE GOVERNMENTS' AND FEDERAL CAPITAL TERRITORY'S FINANCES, 1996[1] (₦ MILLION).

States	Revenue Statutory[2] Allocation	Total	VAT	Expenditure Total	Surplus/Deficit Overall
ia	998.7	1518.0	288.5	1595.9	-77.9
Adamawa	1423.6	1829.3	256.7	2529.7	-700.4
wa Ibom	1421.7	2615.0	279.0	2612.0	3.0
ambra	1181.2	1858.9	342.2	2227.7	-368.8
Bayelsa[4]	210.5	290.1	79.2	311.9	-21.8
auchi	1547.4	2378.5	346.5	2152.4	226.1
nue	1379.0	2113.4	308.0	1366.7	746.7
orno	1396.7	1983.8	302.2	2234.0	-250.2
Cross River	1100.1	1765.4	284.3	1708.1	57.3
elta	1378.8	5428.1	401.4	3406.6	2021.5
bonyi[4]	205.3	292.9	87.6	697.7	-404.8
Edo	1174.0	2172.6	301.3	1154.3	1018.3
kiti[4]	216.0	298.6	81.5	242.7	55.9
nugu	1189.5	2352.4	260.0	3102.0	-749.6
Gombe[4]	210.0	326.5	79.0	368.4	-41.9
Imo	1190.2	2193.9	230.0	2568.9	-375.0
gawa	1367.3	1863.3	318.3	3097.2	-1233.9
aduna	1645.2	2806.4	452.1	2804.0	2.4
Kano	1686.7	3957.8	479.9	2662.7	1295.1
atsina	1391.3	1957.1	358.0	2229.4	-272.3

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Table 7 continued

States	Revenue			Expenditure	Surplus/Deficit
	Statutory[2] Allocation	Total	VAT	Total	Overall
Kano	1686.7	3957.8	479.9	2662.7	1295.1
Katsina	1391.3	1957.1	358.0	2229.4	-272.3
Kebbi	1096.7	2093.9	264.9	1656.1	437.8
Kogi	1141.7	1681.6	215.9	1387.6	294.0
Kwara	1075.4	1591.7	271.6	878.7	713.0
Lagos	1704.8	8881.0	1636.3	8057.2	823.8
Nassarawa[4]	226.0	300.1	61.8	128.6	171.5
Niger	1381.6	1736.0	300.8	1750.1	-14.1
Ogun	1184.5	3087.4	297.0	3876.6	-79-89.2
Ondo	1201.1	2826.7	328.1	2902.9	-76.2
Osun	1070.9	1959.5	281.7	2179.8	-220.1
Oyo	1421.3	2245.3	260.7	3273.2	-1027.9
Plateau	1324.8	2206.7	334.0	2206.7	0.0
Rivers	1566.9	6863.5	464.5	6869.0	-5.5
Sokoto	1379.1	2028.0	338.3	1989.9	38.1
Taraba	1136.4	1594.3	262.8	1320.2	274.1
Yobe	1278.1	1751.4	262.8	1765.6	-14.2
Zamfara[4]	195.0	315.0	82.5	368.4	-52.4
FCT Abuja	928.9	8638.4	90.6	4494.4	4144.0
Total	41626.4	89802.4	11290.0	84177.1	5625.3

Notes: 1. Revised, 2. Indicates gross allocation to state governents.
Source: CBN (1997)

TABLE 8: SUMMARY OF STATE GOVERNMENTS' AND FEDERAL CAPITAL TERRITORY'S FINANCES, 1997[1] (₦ MILLION).

States	Revenue			Expenditure	Surplus/Deficit
	Statutory[2] Allocation	Total	VAT	Total	Overall
Abia	1125.2	1690.2.	350.0	1539.0	151.2
Adamawa	1356.7	1864.4	334.4	1959.6	-95.2
Akwa Ibom	1580.6	2916.5	314.5	3017.9	-101.4
Anambra	1097.0	1770.2	240.4	2227.1	-456.9
Bayelsa[4]	1095.6	1827.3	326.6	1827.4	-0.1
Bauchi	1403.8	2006.9	334.3	1611.1	395.8
Benue	1263.9	1997.8	333.9	1419.3	578.5
Borno	1566.5	2139.8	333.6	2397.2	-257.4
Cross River	1305.6	2127.5	266.3	2131.1	-0.3
Delta	1818.7	4925.8	480.0	3989.6	936.2
Ebonyi[4]	1023.1	1405.7	271.9	2160.5	-754.8
Edo	1459.4	2485.9	344.2	2075.1	410.8
Ekiti[4]	1065.3	1825.3	269.9	1024.9	800.4
Enugu	1071.7	2473.5	327.8	2288.0	149.5
Gombe[4]	1341.9	1811.9	370.0	1312.5	499.4
Imo	1290.4	1903.2	332.9	1717.1	186.1
Jigawa	1450.2	2100.4	480.7	3085.4	-985.0
Kaduna	1718.1	3346.7	551.4	4460.9	-1114.2
Kano	1987.8	3544.5	565.4	3120.4	424.1

Continued on the next page

Table 8 continued

States	Revenue			Expenditure	Surplus/Deficit
	Statutory[2] Allocation	Total	VAT	Total	Overall
Katsina	1489.8	2191.1	389.4	2166.4	24.7
Kebbi	1221.2	1932.6	290.4	1314.5	118.1
Kogi	1268.9	1920.7	295.0	1619.5	304.4
Kwara	1283.4	1890.2	278.1	1474.8	415.4
Lagos	2000.0	12802.0	1895.1	10009.2	2792.8
Nassarawa[4]	1078.8	1382.1	255.8	1348.0	34.1
Niger	1538.8	2100.9	328.5	1802.5	298.4
Ogun	1270.9	2625.7	343.7	3146.2	-520.5
Ondo	1580.9	2073.2	274.7	1301.0	772.2
Osun	1277.2	2283.8	306.7	2322.1	-38.3
Oyo	1557.3	3043.2	475.0	4186.8	-1143.6
Plateau	1133.0	1879.4	302.6	2805.3	-925.9
Rivers	1264.3	3705.2	320.1	3922.3	-217
Sokoto	1306.2	1941.1	319.4	1836.5	104.6
Taraba	1211.3	1765.6	260.4	2050.9	-285.3
Yobe	1309.7	1748.9	258.7	1839.9	-91.0
Zamfara[4]	1163.4	1519.0	291.5	1821.8	-302.8
FCT Abuja	1968.1	4769.8	138.3	3816.0	953.8
Total	50962.7	95702.0	13851.6	92647.6	3054.4

Notes: 1. Revised, 2. Indicates gross allocation to state governents.
Source: CBN (1997)

Tables 5 to 8 reveals that the total VAT revenue that went to state governments was ₦36, 507.9 million for the period, 1994–1998, while internally generated revenue within the same period was ₦74668.1 million. Statutory allocation to state governments was ₦160273.3 million for the same period. VAT revenue to state governments was 48.9 percent of the internally generated revenue and 22.8 percent of statutory allocation to state governments for the period, 1994–1998.

Table 9 is an extraction from Tables 5–8 showing percentages of VAT to states' revenue, year by year, from 1994 to 1997

TABLE 9: PERCENTAGES OF VAT TO STATES' REVENUE

	1994	1995	1996	1997
States' Revenue	49506.1	68001.1	89802.4	95702
VAT	5026.0	6340.3	11290.0	13851.6
Percentage	10.2%	9.3%	12.6%	14.5%

Source: Computed by the author.

The percentages of VAT revenue to state governments' statutory allocation were 10.2, 9.3, 12.6 and 14.5 percent for 1994 1995, 1996 and 1997, respectively.

Table 10 contains information on net finances of states whose financial position showed deficits for at least two years between 1994 and 1997 after VAT was introduced. For the period, 1994–1997, Adamawa State had a deficit of ₦2061.3m, Bauchi ₦825.5 million, Enugu ₦2184.5 million, Jigawa ₦4328.0 million and Plateau State ₦3835.5 million. The importance of VAT here is that, without VAT, such deficits would have escalated. For example, Adamawa State would have had a deficit of ₦2938.6m, Bauchi ₦1206.3 million, Enugu ₦2760.6 million, Jigawa ₦5451.6 million and Plateau State ₦44[illegible] million.

TABLE 10: SELECTED STATE GOVERNMENTS FINANCES : DEFICITS (1994–1997).

State	1994	1995	1996	1997	Total
Adamawa	-677.2	-588.5	-700.4	-95.2	-2061.3
Vat	127.5	158.7	256.7	334.4	877.3
Bauchi	-814.6	-10.9	-	-	-825.5
Vat	173.4	207.4	-	-	380.8
Enugu	-731.8	-703.1	-749.6	-	-2184.5
Vat	149.1	167.0	260.0	-	576.1
Jigawa	-604.1	-1505.0	-1233.9	-985.0	-4328.0
Vat	156.7	178.7	318.3	480.7	1123.6
Plateau	-1473.9	-1435.7	-	-925.9	-3835.5
VAT	147.3	191.3	-	302.6	641.2

Source: Extracted from Table 5–8.

Statutory allocation to all local governments for the 19
1997 was ₦54, 511.5 million, internally generated revenue
653.5 million and VAT revenue ₦15, 685.9 million. VAT reve
percentage to statutory allocation was 28.8 percent, while V
revenue percentage to internally generated revenue was 23
percent within the same period.

Table 14 shows selected local governments with def
finances for 1995–1997. The information is extracted from Ta
11, 12 and 13. Consideration was given to states with l
governments whose combined deficits were up to ₦100 mil
and above. It can be seen that local governments in Anan
State had a deficit of ₦352.7 million, those in Benue ₦2
million, in Borno ₦715.6 million, in Ebonyi ₦264.4 million
in Enugu ₦92.7 million. Other local governments with def
are those of Jigawa ₦1133.9 million, Lagos ₦1756.1 mill
Ri[illegible] ₦11[illegible] million and Taraba ₦64.2 million. Obviously,
clear that without adding VAT revenue to the LGAs, such de

TABLE 11: SUMMARY OF LOCAL GOVERNMENTS' FINANCES, 1995 (₦ MILLION).

States	Revenue Expenditure: Statutory Allocations Federal	Statutory Allocations State	VAT	Total	Surplus/Deficit: Overall
Abia	486.4	0.0	131.8	618.2	-13.9
Adamawa	419.5	2.8	103.0	597.3	117.8
Akwa Ibom	806.2	10.7	143.3	960.2	6.5
Anambra	273.7	0.0	109.8	383.5	-456.9
Bauchi	624.0	0.0	151.6	775.6	13.7
Benue	499.7	9.6	103.7	613.0	-234.3
Borno	881.3	10.1	120.1	1011.5	120.0
Cross River	534.7	2.6	79.7	617.0	98.3
Delta	532.3	93.5	76.8	701.8	93.9
Edo	611.7	13.1	123.2	748.0	146.2
Enugu	491.3	7.1	127.5	625.9	-92.7
Imo	478.2	0.0	127.5	605.7	65.8
Jigawa	340.8	0.3	36.3	377.4	42.1
Kaduna	599.6	2.0	102.0	703.6	71.1
Kano	1323.1	0.4	238.1	1561.6	86.6
Katsina	899.5	3.1	130.7	1033.3	169.0
Kebbi	236.0	0.3	30.7	267.0	32.2

Continued on the next page

Table 11 continued

States	Revenue Expenditure				Surplus/ Deficit
	Statutory Allocations Federal	Statutory Allocations State	VAT	Total	Overall
Kogi	352.8	0.7	60.9	414.4	67.4
Kwara	305.5	13.1	8.6	327.2	24.1
Lagos	789.8	249.8	385.7	1425.3	56.0
Niger	483.5	2.0	99.5	585.0	83.8
Ogun	340.7	0.8	25.2	366.7	33.7
Ondo	610.1	0.0	8.1	618.2	25.2
Osun	650.8	26.7	143.3	820.8	193.6
Oyo	551.4	0.0	193.1	744.5	268.9
Plateau	775.6	0.0	138.3	913.9	152.0
Rivers	637.4	0.0	181.4	818.8	-111.0
Sokoto	1405.2	1.8	214.9	1621.9	433.2
Taraba	290.8	2.7	72.4	365.9	-12.8
Yobe	571.9	2.7	82.4	657.0	92.7
FCT Abuja	0.0	169.5	9.3	178.8	-161.8
Total	17875.5	625.4	3558.1	22059.0	1969.4

Source: CBN (1997).

TABLE 12: SUMMARY OF LOCAL GOVERNMENTS' FINANCES, 1995 (₦ MILLION).

	Revenue			Expenditure	Surplus/Deficit
States	Statutory Allocations Federal	Statutory Allocations State	VAT	Total	Overall
Abia	333.5	0.9	61.7	396.1	-19.0
Adamawa	351.1	1.3	65.6	418.0	137.9
Akwa Ibom	625.5	0.0	202.8	828.3	166.4
Anambra	721.7	8.5	180.4	460.8	-352.7
Bayelsa	724.6	0.0	200.0	924.6	69.6
Benue	802.8	0.0	27.6	830.4	276.8
Borno	704.1	10.6	195.3	910.0	-164.0
Cross River	531.3	2.2	47.2	580.7	24.0
Delta	451.5	113.9	235.9	801.3	234.8
Ebonyi	86.1	7.5	33.5	127.1	-264.4
Edo	342.7	6.1	124.5	473.3	-24.6
Ekiti	261.9	0.7	34.3	296.9	11.9
Enugu	373.4	17.2	185.0	575.6	48.1
Gombe	281.4	0.0	53.5	334.9	12.5
Imo	350.9	0.0	191.5	542.4	-371.1
Jigawa	486.1	0.0	86.2	572.3	-868.1
Kaduna	548.7	5.6	179.1	733.4	1.5
Kano	1215.3	14.3	278.8	1508.4	221.2

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Table 12 continued

States	Revenue: Statutory Allocations Federal	Revenue: Statutory Allocations State	Revenue: VAT	Expenditure: Total	Surplus/Deficit: Overall
Katsina	892.7	4.7	162.6	1060.0	-31.6
Kebbi	255.2	7.1	57.5	319.8	-3.3
Kogi	235.6	0.7	53.7	280.0	261.9
Kwara	287.6	0.3	96.3	384.3	55.9
Lagos	537.8	477.0	663.1	1677.9	-472.7
Nassarawa	271.2	0.0	19.2	290.4	16.1
Niger	634.5	0.0	93.9	728.4	88.0
Ogun	259.0	1.1	76.5	336.6	25.4
Ondo	246.1	0.0	29.2	275.3	18.5
Osun	418.8	0.3	121.6	540.7	11.3
Oyo	505.5	0.0	32.3	537.8	81.0
Plateau	475.2	1.1	104.0	580.3	130.8
Rivers	655.6	0.0	305.0	960.6	133.6
Sokoto	766.5	2.0	118.4	886.9	71.3
Taraba	232.2	5.3	10.4	247.9	-64.2
Yobe	269.1	0.6	114.1	383.8	89.0
Zamfara	500.6	2.1	67.1	569.8	78.2
FCT Abuja	129.6	0.0	52.2	181.8	16.9
Total	16569.7	691.1	4581.7	21842.5	-319.6

TABLE 13: SUMMARY OF LOCAL GOVERNMENTS' FINANCES, 1995 (₦ MILLION).

States	Revenue: Statutory Allocations Federal	Revenue: Statutory Allocations State	Revenue: VAT	Expenditure: Total	Surplus/Deficit: Overall
Abia	389.8	1.4	192.0	583.2851.5	123.6
Adamawa	742.0	2.1	107.4	-	310.7
Akwa Ibom	685.1	0.0	246.2	931.3	-77.5
Anambra	404.7	20.5	225.7	650.9	55.7
Bayelsa	856.8	0.1	201.2	1058.1	-103.6
Bauchi	302.7	0.9	123.5	427.1	-37.2
Benue	666.5	6.1	217.6	890.2	150.7
Borno	1041.1	0.6	238.2	1279.9	-151.6
Cross River	638.7	2.2	166.3	807.2	246.1
Delta	606.3	169.2	298.3	1073.8	164.0
Ebonyi	344.3	3.7	122.8	470.8	27.8
Edo	480.5	5.4	194.4	680.3	-103.2
Ekiti	381.1	0.0	138.6	519.7	103.6
Enugu	209.8	0.2	173.2	383.2	0.1
Gombe	450.6	2.1	125.6	578.3	-13.9
Imo	407.3	0.5	231.9	639.7	-25.6
Jigawa	405.6	0.1	100.9	506.6	-565.8
Kaduna	792.5	11.8	184.8	989.1	47.0

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Table 13 continued

States	Revenue			Expenditure	Surplus/Deficit
	Statutory Allocations Federal	Statutory Allocations State	VAT	Total	Overall
Kano	1250.0	18.9	396.4	1665.3	-259.6
Katsina	1181.8	103.4	313.4	1598.6	-48.8
Kebbi	370.4	0.5	64.1	435.0	78.5
Kogi	341.4	1.4	147.1	489.9	-63.6
Kwara	409.3	0.2	118.1	527.6	-24.9
Lagos	524.9	275.4	1175.6	1957.9	-583.4
Nassarawa	396.8	0.0	113.0	509.8	-6.2
Niger	696.2	0.0	192.1	888.3	525.7
Ogun	311.1	0.2	120.4	431.7	-1.0
Ondo	409.5	0.0	175.1	584.6	-45.6
Osun	620.4	0.3	239.3	860.0	30.5
Oyo	704.3	0.0	362.5	1066.8	228.3
Pleteau	482.9	0.0	170.4	653.3	-69.1
Rivers	200.2	0.0	95.8	296.0	21.5
Sokoto	810.4	1.4	208.5	1020.3	38.5
Taraba	347.1	2.8	76.2	426.1	4.1
Yobe	409.8	47.2	82.2	539.2	7.8
Zamfara	548.5	0.5	110.5	659.5	-8.4
FCT Abuja	245.9	9.2	96.8	351.9	150.1
Total	20066.3	688.3	7546.1	28300.7	185.3

Source: CBN (1997).

TABLE 14: SELECTED STATES, LOCAL GOVERNMENTS WITH DEFICIT FINANCES (1995–1997) ₦ MILLION

Year	1995	1996	1997	Total
Anambra	-	-352.7	-	-352.7
VAT		180.4	-	180.4
Benue	-234..3	-	-	-234.3
*Born	-	-164.0	-151.6	-715.6
VAT		195.3	238.2	133.5
Ebonyi	-	-264.4	-	-264.4
VAT		33.5		33.5
Enugu	-92.7	-	-	-92.7
VAT	127.5			127.5
*Jigawa	-	-868.1	-565.8	-1133.9
VAT		86.2	100.9	187.1
*Lagos	-	-472.7	-583.4	-1756.1
VAT		663.1	1175.6	1838.7
Rivers	-11.0	-	-	-111.0
VAT	181.4	-		181.4
Taraba	-	-64.2	-	-64.2
VAT		10.4		10.4

Note: ***States' LGAs with deficits of two years and above.**
Source: Computed from Tables 11, 12 and 13.

had a deficit of ₦533.1 million, Benue LGAs ₦338.0 million, Borno LGAs ₦849.1 million, Ebonyi LGAs ₦297.9 million and Enugu LGAs ₦220.2 million. The deficits of other states LGAs would be ₦1321.0 million for those in Jigawa, ₦3594.8 million for those in Lagos, ₦292.4 million for those in Rivers and ₦74.6 million for those in Taraba.

The new value added tax (VAT) has proved to be a veritable source of revenue in Nigeria, although it is yet to attain its optimal level of performance.

CONCLUSION

Sharing formula for VAT poses two challenges; the vertical sharing among the associated organs — the Federal Inland Revenue Service (FIRS), the federal, state and local governments, and the horizontal sharing which concerns the criteria for sharing the revenue among governments. From Table 4, it is clear how volatile the vertical sharing formula has been. Between 1994 and 1995, five different formulae were applied, and the indication is that some new one was following in the year 2000.

Recommendations

Taking into consideration the role of the FIRS, the federal government, state and local governments, this paper recommends the following vertical formula:

FIRS	—	5%
Federal government	—	10%
State government	—	55%
Local government	—	30%
Total	—	100%

The justifications are thus: since it is the FIRS that centrally administers VAT, it is necessary that it directly shares in VAT, rather than rigmarole through the federal government. This arrangement, the paper believes, will assist the FIRS to be more efficient and more productive. It should be noted that the 5% share this paper recommends for the FIRS and the 10% to the federal government tallies with the 1999 formula for the federal government, even though that it not necessary but just a coincidence. The recommendation that state governments' share should increase by 5 percent is based on the fact of higher responsibilities for states.

For the horizontal sharing criteria among state governments, the paper suggests the following ratios:

Equality	—	40%
Financial efficiency	—	10%
Financial responsibility	—	10%
Education and health	—	10%
Derivation	—	20%
Population	—	10%
Total	—	100%

To discourage waste, which has been endemic in our public life, at least 10% of VAT should be shared on the basis of financial efficiency. This implies that spending will be result-oriented and cost effective, and proper records kept for FIRS inspection. To introduce this into the VAT sharing matrix will encourage accountability. Next to this is the financial responsibility criterion. From Tables 10 and 14 we can observe that some state and local governments have been running deficit budgets. Giving incentives can offer a form of minimal financial improvement to such state and local governments.

Complementarily, 10% of VAT should be made project-specific, notably for education and health services. That these are areas the poor and the low-income groups/spend their income, readily justifies this criterion. For health services, such monies could be paid into the National Health Insurance Scheme in readiness for a relatively free health care delivery system. Education demands more attention now than ever. Buildings and equipment in schools, especially in the older schools, are dilapidating. Schools should be properly equipped both for qualitative education and for the proper implementation of the Universal Basic Education (UBE) scheme.

The weight assigned to population should be reduced from 30% to 10%. Experience has shown that high weights assigned to population in revenue sharing is singularly responsible for inflated

Reducing the weight will play down on distorted population figures that adversely affect purposeful planning. Similarly, there is nothing particularly wrong if same criteria are applied to local governments.

Again if VAT is tc generate more revenue and redistribute income, different rates should be charged for luxury goods and necessities.

VAT has enhanced revenue generation in Nigeria. But its administration needs to be strengthened on a continuous basis of education, public enlightenment, monitoring and enforcement, while genuine efforts should be directed at widening the tax base. More importantly, a result-oriented VAT sharing formula, such as that suggested in this paper, should be adopted, if VAT revenue is to create a positive impact on the taxpayers.

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