

1 The Effect of Pay as you Earn on Social and Economic 2 Development in Nigeria

3 Osho, Augustine E. Ph.D¹, Ogunyankin Easter O.B² and Fadakinte, Bukola³

4 ¹ EKITI STATE UNIVERSITY,NIGERIA.

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6 **Abstract**

7 This study x-rayed the impact of pay as you earn on social and economic development (proxy
8 by gross domestic products) in Nigeria. Secondary time series panel data was collected for the
9 period 2009 to 2018 from the Statistical Bulletin of the Central Bank of Nigeria (CBN). The
10 study employed Ordinary Least Squares (OLS) technique based on the computer software
11 Eview 10 version for the analysis of data, where gross domestic products (GDP) is the
12 independent variable, proxy for social and economic development, was regressed as a function
13 of personal income tax (PIT) and value-added tax (VAT), the dependent variables.

16 **Index terms**— economic development, direct tax, personal income tax, social development, value added tax.

17 **1 Introduction**

18 Tax is a compulsory levy imposed as an instrument for economic development. Governments use tax proceeds
19 to render their social functions, such as: the provision of goods, maintenance of law and order, defence against
20 external aggression, regulation of trade and business to ensure social and economic maintenance (Edame & Okoi,
21 2014). And also use to reduce or increase flow of cash in circulation during inflation or deflation, as industries can
22 be more easily secured with the use of tax through the means of increasing tariff on imported goods and services.
23 The consumption and production of particular goods and services can also be checked, monitored or reduced
24 with the use of tax (Agbetunde, 2010). Overall, tax is seen as a compulsory levy imposed by the government
25 through its various means on the income, capital, or consumption of its subject (Mustapha, 2010). From these
26 few explanations, it could be seen that the payment of tax is a compulsory exercise on all taxable individuals
27 and corporate bodies.

28 Direct tax is a tax assessable directly on the tax payer who is required to pay tax on his income or profit while
29 indirect tax is imposed on commodities before they reach the final consumer and is paid by them upon, not as
30 taxes, but as part of selling price of the commodity ??ICAN, 2006). Personal income tax (PIT) which forms part
31 of direct tax refers to all taxes or levies imposed on the income, salaries and wages, profit, gratuities, etc., of
32 individuals as well as interest and dividends from companies accruing to them. This tax is further divided into
33 two categories: Pay As You Earn (PAYE) and direct assessment tax (Mohammed, 2017).

34 The PAYE directly on the individual's income as a result of employment and the employee's income are taxed
35 using a graduated scale. The tax calculated is usually deducted from the source and is done by the employer who
36 will remit the amount to the tax authorities. The second category, direct assessment tax, is a tax levied on the
37 individual income as a result of self-employment. This part of income tax covers income from trade, business,
38 profession, or vacation. The payment of this tax, occurs after the individual has collected his/her gross income
39 and filed in a return on the gross income.

40 In a tax system, responsibility is delegated to three key entities: the tax payers whose obligation is payment of
41 the assessed taxes promptly and accurately, tax authorities which ensure the collection of taxes for the government
42 and the government whose duty is the imposition of taxes to finance the activities that ultimately benefit the
43 citizens. Thus, the tripartite constituents of an effective tax system include tax administration, policy and law
44 for effective service delivery (Olaofe, 2008).

4 CONCEPT OF VALUE ADDED TAX (VAT)

45 With the recent reduction in the collection of revenue from the oil; which is the main source of the consolidated
46 federation revenue there is the need for all the three tiers of government to look inwards. This study therefore
47 seeks to examine the Impact of pay as you earn and social, Economic development in Nigeria for the period
48 2009-2018 (10 years).

49 2 T i. Concept of Taxation

50 Taxation is the art or process of being taxed. It is the primary source of governmental revenue. Specifically, it is
51 an instrument for moving resources from the private hands to the public in order to achieve some of the country's
52 economic and social goals (Ekine, 2011). The primary purpose of taxation is to raise revenue to meet huge public
53 expenditure. That is, to generate or create revenue capable of financing the expenditure of government at all
54 levels ??Emmanuel and Charles 2015). Taxation is a powerful tool in the hands of the governments (federal,
55 state or local) to achieve stated economic and social goals among which is economic growth.

56 Furthermore, taxation according to Musgrave and Musgrave (1980) can be used extensively in regulating the
57 pattern of consumption resulting in economic stabilization. Taxes can be used to control anti-social behaviour
58 such as smoking, drinking of alcohol and pool betting or gambling by imposition of higher tax rate on production
59 of such goods (Cornelius, Ogar & Oka, 2016).

60 Moreover, Anyanwu (1993), Nzotta (2007) as well as Onyele & Nwokoacha (2016) submitted that the purposes
61 of taxation include raising revenue for the government for administration purpose and improvement of the society.
62 As such, it is believed that payment of tax is helpful to the person paying and the citizenry, since tax revenue
63 is used to accomplish some economic and social goals of the country. Examples of countries that have used
64 tax revenue to create prosperity include Netherland and Canada. In addition, tax system provides a path for
65 government to bring together additional revenue besides income from other sources, which is needed or required
66 in discharging its imperative obligation. A good system of taxation also presents itself as one of the most effective
67 means of assembling a country's domestic resources and it lends itself to make sustainable environment that will
68 encourage growth and development.

69 Tax revenues are usually used for the provision of public goods including the defense of country against external
70 aggression, maintenance or upholding of law and order, and regulation of trade and business environment to
71 guarantee social and economic justice. Strictly speaking, the entire essence of taxation is to generate revenue
72 to advance the welfare of the inhabitants of a nation with focus on promoting the growth and development of
73 the country's economy through the provision of essential amenities for improved public services through proper
74 managerial system and structures. However, over the years, these benefits in Nigeria have been insignificant
75 and revenue from taxes has been the explanation or cause of a little proportion of total government revenue in
76 Nigeria.

77 3 ii. Concept of Pay As You Earn (PAYE)

78 Although all withholding taxes aim to tax income when it is earned, only withholding on wages is commonly
79 known as pay-as-you-earn (PAYE). This tax plays an important role in nearly all national tax system The
80 PAYE is an important and easy-to-collect revenue item. Its claim on the resources of the tax administration
81 is limited, particularly if return filing by employees is restricted to those who earn substantial other income or
82 are entitled to significant special deductions, or both. A simple PAYE does not complicate the employer's wage
83 administration. Compliance control can focus on employers only, rather than on individual employees. Non
84 consolidation with other income is more acceptable when other income is also subject to withholding taxation
85 ??Uwaoma & George,2015) The PAYE is a high-yielding revenue collector in many countries. It generates a
86 lion's share of the personal income tax and, in industrial countries, usually exceeds the revenue of the general
87 sales tax or valueadded tax (VAT) by an ample margin iii.

88 4 Concept of Value Added Tax (VAT)

89 Value Added Tax (VAT) is a consumption tax levied at each stage of the consumption chain and borne by the
90 final consumer of the product or services. Each person is require to charge and collect VAT at a flat rate of
91 5% on all invoiced amount on all goods and services not exempted from paying VAT, Under Value Added Tax
92 Act 1993,as amended. Where the VAT collected on behalf of the government (output VAT) in a particular
93 month is more than the VAT paid to other persons (input VAT) in the same month, the difference is require
94 to be remitted to the government on monthly basis, by the taxable person (Federal Inland Revenue Services.
95 Information Circular No 9304).Where the reversed is the case, the tax payer is entitled to a refund of the excess
96 VAT paid. All exports are zero rated for VAT, no VAT is payable on exports. Every person, whether resident in
97 Nigeria, who sales goods or render services in Nigeria under the VAT Act as amended is obligated to register for
98 VAT within six months of its commencement of business in Nigeria. The registration is with the Federal Board
99 of Inland Revenue (FBIR).

100 Ajakaiye, (2000) defined VAT as a "multi stage tax imposed on the value added to goods and services as they
101 proceed through various stages of production and distribution and to services as they are rendered" which is
102 eventually borne by the final consumer but collected at each stage of production and distribution chain. Ola

103 (2001), said that, VAT is a tax paid at each stage of value added. It is a multi-stage tax which applies whenever
104 goods and services are supplied by II.

105 **5 Literature Review a) Conceptual Review**

106 the producers. He also said that VAT are levied on the © 20 20 Global Journals government in this case the
107 incidence of tax is borne by either the producer or the final consumer or shared by both.

108 **6 Taxation Principles**

109 Business Dictionary.com defined as basic concepts by which a government is meant to be guided to designing and
110 implementing an equitable taxation regime. These include:

111 1. Board Basing: Taxes should be spread over as wide as a possible section of the population, or sectors of the
112 economy, to minimize the individual tax burden. 2. Compatibility: Taxes should be coordinated to ensure tax
113 neutrality and overall good governance. 3. Convenience: Taxes should be enforced in a manner that facilitates
114 voluntary compliance to the maximum extent possible. Bhartia (2009) noted that the time of payment, the
115 manner of payment, the quality to be paid ought to all be clear and plain to the tax payer and every other
116 person.

117 **7 4.**

118 Earmarking: Tax revenue from a specific source should be dedicated to a specific purpose only when there is a
119 direct cost -and-benefit link between the tax source and the expenditure, such as the use of motor fuel tax for
120 road maintenance and also education tax for buying educational materials. However, what we are experiencing
121 today in Nigeria is fiscal indiscipline, corruption and misappropriation of funds.

122 **8 5.**

123 Efficiency: Tax collection efforts should not cost an inordinately high percentage of tax revenue. This principle
124 seems to be lacking in Nigerian tax system. World Bank Report says that for every N100 that business has to
125 pay in taxes, they pay about N30 in compliance costs. According to the minister of finance Okonjo-Iweala, this
126 is a waste of capital. According to ??nyawu (2007) Personal income tax is a levy imposed by the government of
127 a country on its citizens, individual or entities known as the taxpayers. The levy imposed on the taxpayers is
128 such that it varies with the level of income or profits of the taxpayers. Taxes imposed on the personal income
129 of an individual taxpayer are termed "Personal Income Tax". Thus, personal income tax signifies taxes imposed
130 on the personal income of the individual. These taxes are imposed on the income of the individual on a basis of
131 'Pay as You Earn" (PAYE) and the individual taxpayer must be an employed person and expected to file returns
132 on a yearly basis.

133 **9 vi. Tax Reform in Nigeria**

134 The role of taxation in every economy cannot be over emphasized, that is why every nation is working tirelessly
135 to have a good tax law: ??gbonna

136 **10 vii. Economic Development**

137 Economic development is the sustained, concerted actions of policy makers and communities that promote the
138 standard of living and economic health of a given area. Economic development can also be referred to the
139 quantitative and qualitative changes in the economy.

140 Economic development requires collective action and large-scale, long-horizon investment. Economic development
141 addresses the fundamental conditions necessary for the micro economic functioning of the economy. It is
142 within the purview of government. Though it is certainly possible to have growth without development in the short
143 or even medium-term, economic development creates the conditions that enable long-run economic growth. Jobs
144 are a main concern of policy: for growth what matters is the number of jobs while for economic development the
145 focus is wages, career advancement opportunities, and working conditions ??Feldman & Francis, 2003). economic
146 social, political and environmental terms". In Nigeria, dependency theorists' argument explains the precarious
147 situation we are into. Dependency theorists argue that poor countries have sometimes experienced economic
148 growth with little or no economic development initiatives. Today, Nigeria being the number one economies in
149 Africa cannot boast of a good education system like our sister country Ghana. Nigeria only functions as resource-
150 providers to wealthy industrialized countries. Although opposing argument has it that growth causes development
151 because some of the increase in income gets spent on human development such as education and health. Other
152 theories of economic development are Adam Smith's theory, the Ricardian theory, the Schumpeterian theory,
153 the Keynesian theory e.t.c (Jhingan, 2002).

154 **11 viii. Gross Domestic Product (GDP)**

155 According to Adekunle and Aderemi, (2012), gross domestic product measures the monetary value of final goods
156 and services, that is, those that are bought by the final users produced in a country in a given period of time

157 e.g quarterly or yearly. It counts all the output generated within the borders of a country. GDP is composed
158 of goods and services produced for sale in the market and also include some non market production, such as
159 defence or education services provided by the government. An alternative concept, gross national product, or
160 GNP, counts all the output of the residents of a country. Not all productive activity is included in GDP. For
161 example, unpaid work (such as that performed in the home or by volunteers) and blackmarket activities are not
162 included because they are difficult to measure and value accurately ix. The Effect of VAT on Social Economic
163 Development VAT is a consumption tax levied at each stage of the consumption chain and borne by the final
164 consumer of the product or service. Each person is required to charge and collect VAT at a flat rate of 5% on
165 all invoiced amounts, on all goods and services not exempted from paying VAT, under the Value Added Tax Act
166 1993 as amended. Where the VAT collected on behalf of the government (output VAT) in a particular month
167 is more than the VAT paid to other persons (input VAT) in the same month, the difference is required to be
168 remitted to the government, on a monthly basis, by the taxable person (Oserogho & Associates, 2008). Where
169 the reverse is the case, the taxpayer is entitled to a refund of the excess VAT paid or more practically, to receive
170 a tax credit of the excess VAT from the government. All exports are zero rated for VAT, i.e. no VAT is payable
171 on exports. Also, VAT is payable in the currency of the transaction under which goods or services are exchanged
172 (Umeora, 2013).

173 Value Added Tax (VAT) is one of the most popular taxes around the world. In sub-Saharan Africa for
174 example, VAT has been introduced in Benin republic, Cote d" Ivoire, Guinea, Kenya, Madagascar, Mauritius,
175 Niger republic, Senegal, Togo and Nigeria. Evidence has shown in these countries that VAT has been an important
176 contributor to total government revenue (Ajakaiye 2000). Shalize & Squire (1988) found that VAT accounted for
177 about 30% of total tax revenue in Cote d" Ivoire, Kenya and Senegal in 1982. Tait (1989) showed that VAT has
178 According to Ajakaiye (2000), the impressive performance of VAT in virtually all countries where it has been
179 introduced strongly influenced the decision to introduce it in Nigeria in 1993.

180 The main reason for the popularity of VAT is that it provides a buoyant revenue base that usually yields
181 significantly more revenue than other tax on consumption. It is relatively easy to administer and difficult to
182 avoids. The yield from VAT is a fairly accurate measurement of the growth of an economy since purchasing
183 power increases with economic growth (Paulo 2002).

184 Evidence so far supports the view that VAT revenue is already a significant source of revenue in Nigeria.
185 For example, actual VAT revenue from 1994 was #8.189 billion which is 36.59% higher than the project is #6
186 billion for the year. Similarly actual VAT revenue for 1995 was #21 billion compared with the projected #12
187 billion. In terms of contribution to total federally collected revenue, VAT accounted for about 4.06% in 2004
188 and 5.93% in 2005. As much as #404.5 billion was collected on VAT (5.1%) of total revenue in 2015, VAT
189 revenue of #1.97 trillion was paid to federation account for the first half of the year 2018 (CBN, 2018) So many
190 scholars have investigated on the issue of VAT and its contributions to the nation. Owolabi and Okwu (2011)
191 showed that VAT revenue contributed positively to the development of the respective sectors. Izedonmi and
192 Okunbor (2014) showed that VAT Revenue accounts and total revenue account for as much as 92% significant
193 variations in GDP in Nigeria. A positive and insignificant correlation exists between VAT Revenue and GDP.
194 Both economic variables fluctuated greatly over the period though VAT Revenue was more stable. Umeorah,
195 (2013) that VAT has significant effect on GDP and also on Total Tax Revenue. Though prior Rather, it required
196 consistent efforts on the part of people. Dafionone (2013), noted, "that for the country to lay claim on growth and
197 development through taxation, there must be an improvement of the quality of life of the citizens, as measured
198 by the appropriate indices in The Malthusian theory did not regard the process of economic development as
199 automatic.

200 research revealed that VAT as a tax has contributed This theory asserts that every tax proposal must pass the
201 test of practicability. It must be the only consideration weighing with the authorities in choosing a tax proposal.
202 Economic and social objectives of the state as also the effects of a tax system should be treated as irrelevant.
203 This proposition has a truth in it, since it is useless to have a tax which cannot be levied and collected efficiently
204 (Umeora, 2013). There are pressures from economic, social and political groups. Every group tries to protect
205 and promote its own interests and authorities are often forced to reshape tax structure to accommodate these
206 pressures. In addition, the administrative set up may not be efficient to collect the tax at a reasonable cost of
207 collection. Taxation provides a powerful set of policy tools to the authorities and should be effectively used for
208 remedying economic and social ills of the society such as income inequalities, regional disparities, unemployment,
209 cyclical fluctuations and so on.

210 12 Dependent Variables

211 13 Independent

212 14 Variable

214 15 Conceptual Framework of Pay As You Earn on Social and 215 Economic Development in Nigeria

216 the recent economic recession to an extent has eaten the effect of value added tax (VAT) administration on the
217 economic development in Nigeria. up the economy. This study therefore set up to assess

218 16 iii. The cost of service theory

219 This theory is very similar to the benefitsreceived theory. It emphasis the semi commercial relationship between
220 the state and the citizens to a greater extent. The implication is that the citizens are not entitled to any benefits
221 from the state and if they do receive any, they must pay the cost thereof. In this theory, the state is being asked to
222 give up basic protective and welfare functions. It is to scrupulously recover the cost of the services and therefore
223 this theory unlike the benefits received one, specifically implies a balanced budget policy. (Abata, 2014). In the
224 process, the state is not to be concerned with the problems of income distribution. No effort is to be made to
225 improve income distribution; and no notice is to be taken if the policy of levying taxes according to the cost of
226 service principles deteriorates it further.

227 17 iv. Ability to pay theory

228 This approach considers tax liability in its true form-compulsory payment to the state without quid pro quo. It
229 does not assume any commercial or semicommercial relationship between the state and the citizens. According
230 to ??ohammed, (2007) in this theory, a citizen is to pay taxes just because he can and his relative share in the
231 total tax burden is to be determined by his relative paying capacity. This doctrine has been in vogue for at least
232 as long as the benefits theory. A good account of its history is found in Seligman. This theory was bound to
233 be supported by socialist thinkers because of its conformity with the ideas and concepts of justice and equity.
234 However, the doctrine received an equally strong support from non-socialist thinkers also and became a part of
235 the theory of welfare economics.

236 The basic tenet of this theory is that the burden of taxation should be shared by the members of society
237 on the principles of justice and equity and that these principles necessitates that the tax burden is apportioned
238 according to their relative ability to pay.

239 18 .3.3 A-priori Expectation

240 Paye as you earn measured in terms of Value Added Tax, Personal Income Tax are expected to exert positive
241 relationship with the social and economic development measured in terms of real gross domestic product (GDP).

242 19 IV. esults

243 This study xtrayed the impact of PIT and VAT on GDP, using Ordinary Lease Square technique. The data
244 so far gathered for the study was presented in table 1 below, while the results of the analysis are in table 2.
245 relationship between tax-payers and the state. The state provides certain goods and services to the members
246 of the society and they contribute to the cost of these supplies in proportion to the benefits received. In this
247 quid pro quo set up, there is no place for issues like equitable distribution of income and wealth. Instead, the
248 benefits received are taken to represent the basis for distributing the tax burden in a specific manner. (Uwaoma
249 & George, 2015). This theory overlooks the possible use of the tax policy for bringing about economic growth or
250 economic stabilization in the country.

251 ii. The benefits-received theory This theory proceeds on the assumption that there is basically an exchange or
252 contractual Table 2 above shows the summary of the regression results, that is, the correlation between PIT, VAT
253 and GDP. From the results it is found that all the independent variables are significant and positively related to
254 GDP.

255 20 Global

256 The explanatory power of the model as given by the R^2 0.90 or 90 per cent is statistically significant given the
257 high value of the adjusted R^2 value of 0.85 or 85 per cent. This also means the independent variables jointly
258 and adequately explained or accounted for changes in the dependent variable. The calculated Durbin Watson
259 (DW) value is 3.57339 which is less than 5.0 indicated that there was no autocorrelation between the independent
260 variables and Schwarz criterion is 41.56547 which is below 50 per cent.

261 The regression model revealed a contemporaneous positive and significant impact given that about 85 per cent
262 of the variation of the dependent variable (GDP) is jointly explained by changes in the behaviour of PIT and
263 VAT. The relatively high adjusted shows that Value Added Tax (VAT) has a positive impact on Inflation rate.
264 This is indicated in its positive coefficient of 40402.80. However, Value Added Tax is elastic to Inflation rate
265 since the standard error and tvalues revealed that the coefficient is statistically significant.

266 The F-statistics shows overall significance of the regression model. F-sig. level of .000 is less than 0.1 which
267 suggests that H 0 should be rejected. Therefore, Personal income tax has significant and positive impact on
268 Inflation rate, thus pay as you earn is an instrument for social and economic development in Nigeria. This means

21 CONCLUSION

269 that both PIT and VAT have a contemporaneous positive and significant impact on GDP. The results of the
270 study analysis have shown that Personal Income Tax and Value-Added Tax have a contemporaneous positive and
271 positive impact on economic development V.

272 21 Conclusion

273 The paper has established that the collection of pay as you earn and direct assessment to be weak when compared
274 with the total revenue generated under the period covered in the study. Similarly, gross domestic product
275 has a positive and significant impact on the states' internally generated revenue. Overall, with regard to the
276 overall picture of Federally generated revenues, the findings have depicted the following: inflation has a negative
277 but significant impact on state federally generated revenue; unemployment has a negative though insignificant
278 influence; population has an insignificant positive influence; agriculture has significant positive relationship;
279 manufacturing has significant positive relationship; and the service sector has significant and positive correlation.

280 It is recommended that the government should look inwards and develop strong strategies to enhance their
281 federally generated revenue, most especially with the dwindling prices of oil in the international market. The
282 emphasis should be on enhancing direct assessment through capturing every eligible tax payer in the informal
283 sector. Every government should also know its GDP with the aim of boosting its level. As it is only when you
know the capacity of your people that you could plan successfully. ^{1 2}

Ogbonna & Ebimobowei, 2012)

7. Neutrality: Taxes should not favour any one group or sector over another, and should not be designed to interfere with or influence individual decisions making.

[Note: 8. Predictability: Collection of taxes should reinforce their inevitability and regularity. 9. Restricted Exemptions: Tax exemptions must only be for purposes (such as to encourage investment) and for a limited period. 10. Simplicity:]

Figure 1:

2

Variable	Coefficient	Std. Error	t-statisti	Prob
Const.	86126.40	85980.18	-1.582645	0.7533
VAT	40402.80	9862.714	8.192420	0.0128
PIT	2.283704	6.221690	0.734110	0.0388
R-Squared	0.451075	Mean dependent var	S. D. dependent var	23041.93
Adjusted R-Squared	0.213306			14263.71
S. E. or regression	10929.23	Akaike info criterion		21.72544
Sum squared resid	7.17E+08	Schwarz criterion		41.565468
Log likelihood	-104.6272	Durbin-Watson stat		3.573386

Source: Researchers' E-views Result, (2019).

Figure 2: Table 2 :

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Dependent Variables: GDP
Method: Least Squares
Date: 20/12/19 Time 10:17
Sample (adjusted) 2009-2018
Included Observation: 10

Figure 3: Table 1 :

21 CONCLUSION

fact the Prob. value of PIT is 0.039 and this is less than the critical value of 0.1. Also VAT had statistically positive significant relationship with GDP given the Prob. value of 0.013 and less than critical value of 0.1.

The coefficient of Personal Income Tax is statistically significant as shown by both the corresponding standard error and t-values. Thus, Cumulative Personal Income Tax is elastic to Inflation rate. This positivity of the coefficient of pay as you earn conforms to the economic a priori expectation of a positive impact of personal income tax on Inflation rate. Furthermore, the result obtained from the regression

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[Source: Researchers' E-views Result ()] , *Source: Researchers' E-views Result* 2019.

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