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Tax Reforms in Nigeria: Case against Tax Incentives

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Abstract

This paper examined tax reforms with respect to tax incentives. Theoretical framework and conceptual framework of the subject matter were discussed. The paper also empirically reviewed the subject matter. The paper revealed that huge sums of tax revenue are being lost annually by the Nigerian Customs service due to under assessment of payable duties, unauthorized transfer of funds, abuse of waivers, concessions, exemptions and non-remittance of government revenue. Based on these revelations, the paper suggests that tax incentive packages such as concessionary duty

rate. Concessions to manufactures in bond schemes and export processing/exercise factory levy should be discontinued.

Key words: Tax Reforms, Tax incentives, concessionary duty rate, waivers.

Introduction

Tax Reforms are operationalized in this paper to mean deliberate changes made by the government in the tax policies, tax laws and administration to enhance the revenue base of the nation by bridging the gap between the national development needs and funding of the needs. They are reviews that are made from time to time in the Nigerian Tax System including the annual budget speeches by the President of the Federal Republic of Nigeria in respect to taxation, considering its importance in the administration of every nation in the world. Tax Reform is the process of changing the way taxes collected or managed by the government, (en.wikipedia.org/wiki/taxreform). Tax reforms have different goals: Some seek to reduce the level of taxation of all people by the government. Some seek to make the tax system more progressive or less progressive while others seek to simplify the tax system and make them more understandable or make accountable.

A common feature of the structure of the tax structure in most emerging economics is that they are complex inelastic, inefficient, inequitable and unfair, therefore it is imperative to review them from time to time in line with the current economic realities especially at this time of global drop in the price of oil in the international market.

Tax incentive encompasses the whole measures adopted by the government to motivate taxpayers to respond favourably to their tax obligations. They are fiscal measures by the government to attract local or foreign investment capital to certain economic units to improve desired sectors of the economy to improve on the productivity level, expand existing ones, invest in new businesses, save more as well as encourage compliance to the tax laws of the nation.

Somorin (2015) defines a tax incentive as “a deliberate reduction in (or total elimination of) tax liability granted by government in order to encourage particular units (e.g. corporate bodies) to act in desirable ways such as to invest more, save more, consume less, import less, pollute less, etc. The reduction in tax liability which a tax incentive constitutes can be achieved through reduction in tax rate, reduction in tax base, outright tax exemption, tax deferment and so on (Dotun, 1966). Some of the features of tax incentives are that: developing countries use tax incentives to attract foreign investments, they are revenue costs to the government and; tax incentives may be drains on the revenue of the government if not properly managed. This paper is designed to adduce the reasons why incentive package to tax payers should be discontinued especially those found to be ineffective or exorbitant.

Conceptual Framework

Tax Reforms

The Nigerian tax system is dynamic and continuously changing to meet the needs of the constituents of the society, hence the need for tax reforms in Nigeria. Other reasons for tax reforms in Nigeria include weak financial position because of the global drop in the price of oil in the international market, diversification of the revenue base of the nation, the mono stream nature of the national income as well as corruption which has eaten deep in the life of most Nigerians that has affected the growth of the economy. Tax is dynamic, so reforms are necessary to effect the required changes in the national economy, (Ola, 2001). Azubuike (2009) observes that tax reform is an ongoing process with tax policy makers and tax administrators continually adopting the tax system to reflect changing economic, social and political circumstances in the economy. The Nigerian tax system has undergone several tax reforms geared at enhancing tax collection, and administration with minimal cost, (Asuquo, 2012).

Tax reform in Nigeria dates back to 1978 with the inauguration of a tax force on tax administration (Somorin, 2015; and <http://olajideassociate.com/olajide/news604.htm>). The outcome of the thrust of this reform included:

- i. Introduction of the withholding tax regime.
- ii. Imposition of 10 percent special levy on bank's excess profit.
- iii. Imposition of 2.5 percent turnover tax on building construction composition.
- iv. Promulgation of decree No. 28 of 1979 popularly known to as CITA 1979. It remained in operation till later amendments known as CITA 2004 and 2007.
- v. Introduction of tax clearance certificate as a collection tool. These earlier tax reforms were proceeded by two study groups: The first study group was inaugurated on the 9th of January 1991 with respect to direct taxation. It was assigned to examine Nigeria's tax system and since independence, evaluate possible changes to be made and proffer necessary recommendation, (http://olajideassociates.com/olajide/news_604.htm). The second study group on indirect taxation headed by Sylvester Ugoh whose task force thrust of the policy was a shift from direct taxation to indirect/consumption taxation. This second phase of tax reforms in Nigeria brought the introduction of value added tax (VAT) in 1993 by decree 102, but was implemented on 1st January, 1994.

Another important tax reform was the introduction of decree No. 21 of 1998. This decree assigned eight, eleven and twenty specific taxes respectively to the Federal, State and Local Governments. The essence of this decree is to stop duplication of taxes at the state and local government levels and discourage the incidence of multiple taxation, (Orikhi & Ahuru, 2014 and Somorin, 2010).

Besides the above tax reforms, the tax reform of 2004 was the outcome of the recommendations made by the study group of (2002) and the working group (2003) which reviewed the work of the former. Both groups after their wide and meticulous consultations came out with nine (9) bills that were presented to the National Assembly. They are:

A Bill for an Act to amend the Companies Income Tax Act;

A Bill for an Act to amend the petroleum profits Tax Act;

A bill for an Act to amend personal Income Tax Act;

A bill for an Act to amend the Value Added Tax Act;

A bill for an Act to amend the customs, Excise Tariffs etc. (Consolidated) Act;

A bill for an Act to amend the National Sugar Development Council Act;

A bill for an Act to amend the National Automotive Council Act; and Bill for an Act to amend the education Act; This Bill was later withdrawn (Somorin, 2010). On the 16th of April, 2007, four (4) of these Bills were passed and signed into laws as follows:

- (a) The Federal Inland Revenue Service (establishment) Act, 2007, covered by Gazette No. 64, volume 94 of 18th June 2007; Companies Income Tax (Amendment) Act, 2007, covered by Gazette No. 62, volume 94 of 13th June, 2007; Value Added Tax (Amendment) Act, 2007 covered by Gazette No. 63, volume 94 of 15th June, 2007; and National Automotive Council (Amendment) Act 2007; covered by Gazette No. 61, volume 94 of June, 2007, (Somorin, 2010). In 2011, the Personal Income Tax Act was amended as Personal Income Tax (Amendment) Act 2011.
- (b) One of the most important recommendations of the (2003) study group was National Tax policy. According to FIRS Handbook (2012), such National policy will constitute means of attracting foreign direct investment, provide direction and focus on general practices, blending various opinions on taxes of different kinds as well as the issues surrounding these opinions, consolidation of several policy documents into a single document for reference.

Another landmark in tax reforms in Nigeria was the establishment of a new Federal Inland Revenue Service and Tax Appeal Tribunal (TAT) in 2007 by the Federal Inland Revenue Service (Establishment) Act 2007. By this Act, the revenue authority became autonomous in the same year. Areas of autonomy granted to it include financial autonomy (funding), administrative and capacity building. According to Oriakhi & Ahuru, (2014) some of the newly created departments due to its new status are Risk

Management, Process operations and Audit. Others include Tax policy, research and development, regional coordination and Modernization departments.

Tax incentive is something packaged or designed by government to encourage some sectors or units of the economy to improve on the level of their productivity. It is designed to encourage economic growth and development which by extension should increase the gross domestic product of the nation. Tax incentives can be described as incentives designed to encourage investments in certain preferred sectors of the economy, sometimes they are geared towards attracting inflow of foreign exchange to complement domestic supplies for rapid economic development. Generally, those incentives are in the sectors of manufacturing, agriculture, export, soil minerals, individuals and others, (Soyode & Kajola, 2006). According to Bassey (2013), tax incentives are those special exclusion, exemptions or deductions from income or tax liability offered to tax payers by the government as an encouragement to engage in specified activities. Government offer different types of incentives to encourage them to behave in certain ways. Examples of tax incentives include; capital allowances, investment allowances, investment tax credit, tax free dividend, loss relief, tax holidays, low tax rate, exemption from interest on certain loans, etc. (Agrogundade, 2005).

Tax incentives are granted on sector basic-agriculture, mining, oil and gas, etc. and are reviewed regularly especially during tax reforms and amendments to tax legislation. In 1996 alone, the Federal Government released over 80 tax incentives, (Somorin, 2015). Tax incentive is a prominent feature of developing countries. Strategies for attracting foreign direct investment (FDI) are popular policy measures used in many countries whether low or high-income countries. Tax incentives are basically designed to attract new investment into the entry and to expand existing ones in priority industries which is based on the country development plan capable of stimulating economic growth. The broadening of a country's taxable capacity is often linked in economic literature to the generous incentives prevalent in a tax system, (Oriakhi & Osemwengie, 2013).

Tax incentives are not always for direct investors. This relates to real investment in productive activities rather than investment in financial assets and often directed to foreign investors on the ground that there is insufficient domestic capital for desired level of economic development and that international investment brings with it modern technology and management techniques, (Olabisi, 2009). Kwenumi (1996) argues that tax incentives by their nature represent revenue cost to the government if not well focused. This is in line with Somorin (2015) who asserts that one of the features of tax incentives may be drains on the revenue of government if not properly harnessed.

Granting of tax incentives is one of the essence of sustainable macroeconomic on arrangement and administration. These are usually in form of tax holiday, tax credit, accelerated depreciation, or interest subsidy. In whatever form they are granted, they ultimately attract more investment towards higher future production in an economy. Consequently the least discriminatory form of incentive is the one that is so designed to increase the rate of return on investment (ROI) by reducing corporate and personal tax rates, (Ohaka & Agundu, 2012).

Theoretical Framework

The theoretical foundation of tax reform is gotten from the supply-siders. Those are sets of economists and who had their hay days between 1970 and early 1980s. The supply-siders believed in the use of economic incentives to encourage production. They positioned that higher marginal tax rate will not create disincentive to works, investment and saving but encourages tax avoidance and evasion, that reduces public generated revenue (Oriakhi & Ahuru, 2014). The leader of the group Author B. Laffer, using what is today known as the Laffer curve showed that there is an optimum tax rate that both encourages savings, investments and labour supply, and at the same time motivate tax payment obligation, (Oriakhi & Ahuru, 2014). The implication of this revelation is that tax rate in excess of the optimum rate will be harmful to economic activities.

Another dimension to theory of tax reforms is the optimal tax reform theory. The theories of optimal taxation are analogous to the examination of the principles of taxation, where lump-sum taxes are impossible, (Kusi, 1998). The general principles of optimal taxation can be summarized as follows: (1) tax revenue is raised most efficiently by taxing goods or factors with inelastic demand or supply (this abstracts from distributional questions where inelasticity refers to compensated demands and supplies); and (2) taxation concerned with distribution and with externalities or market failures should so much as possible go to the root of the problem. Thus for distribution, one should look for the sources of inequality and should concentrate taxation there. In the case of externalities, one should attempt to tax or to subsidize directly the good or activity that produces the externality (Stern, 1988a).

The theoretical exposition of optimal taxation normally begins with a set of fundamental assumptions (Stern, 1987). One of these assumptions is that production takes place in firms under competitive conditions, with profits distributed to consumers. The other fundamental assumptions are that there are no externalities, and that the price-taking consumers maximize utility. Yet another assumption that is of importance relates to the tax instrument under consideration. In case it is commodity tax, it is assured that all goods can be taxed while under income tax it is assured that income can be observed perfectly.

Review of Empirical Literature

Many empirical studies have been conducted on tax reform and its effects on the economy generally. The empirical studies of Holmoy & Vennems (1995), Ajakaiye 1996, Walters (2004), Okafor (2012), Aderenti, Sami & Adesina (2011) and Ogbonna & Ebimmobowei (2012) provided different revelations and explanations on the impact of tax reforms on the economy.

Holmoy & Vennemo (1995) in their study of tax reform examined tax reform on capital formation in Norway. The aim of their study was to ascertain the impact of welfare gain induced by tax reform and its distribution between different groups of households. They adopted a dynamic general equilibrium model for the study. The main aspects of the reform considered were that corporate tax on factors, debts, retention and dividends were to be equal, and depreciation allowances were to be reduced in an effort to approach a system of true economic depreciation. Findings show that it is the households with longer number of members that gain most in absolute terms. The percentage was found to be fairly distributed. Findings further revealed that wage income did not contribute to increase in welfare. It was also found that households without children suffered the most lowered wages while the elderly merely (Non-working) are the least affected.

Ajakaiye (1996) investigated the macroeconomic effects of value-added tax in Nigeria. He adopted a computable general equilibrium model to accomplish the task. The model had 29 production sectors, each which was characterized by a Leotief-type production function in which output was determined by the availability of intermediate inputs due to his assumptions of excess capacity in the nation's production sectors. The policy issues addressed were the effects of VAT under different treatment by taxpayers, and under different fiscal policy stance. Findings revealed that majority of the VAT payers treated the tax as part of cost, therefore result obtained best approximates the Nigerian situation. His argument was that it was necessary to consider strategies for ensuring appropriate treatment of VAT by VAT paying organizations while taking steps to ensure that VAT revenue is targeted of sectors most likely to ameliorate the inadvertent adverse effects of VAT on consumer, welfare, employment and income.

Another interesting tax policy study on emerging economics is the one undertaken by Walters, (2004). The focus of his study was on marginal cost fund for 28 countries (including Nigeria) in the sub-Saharan Africa. He made use of a computable general equilibrium approach in the study. Each country's model had two producing sectors and three goods. The goods were domestic goods, exports and imports. The model had provision for an informal good and four factors of production. The factors were formal capital, informal capital, formal labour and informal labour. According to him, informal good or factor was one on which no tax was paid. He examined five (5) tax instruments such as export tariff, import tariff, domestic tax,

capital and labour taxes. Findings show that the marginal cost of fund (of the taxes) ranges from 193.74 to 214 percent while the average marginal cost of fund for the entire tax system was 117 percent in the 28 African countries thereby implies required rate of return of 117 percent for African public project.

Okafor (2012) investigated the impact of tax return on Nigeria's economic growth. He made use of ordinary least square where he measured economic growth with Gross Domestic Product (GDP) and tax reform with petroleum profits tax (PPT), custom and exercise duties (CEO) and companies' income tax (UT). Findings showed that goodness of fit and all the income taxes have positive coefficients implying that tax reform can stimulate economic growth. A related study was undertaken by Aderati, Sanni & Adesina (2011) in an empirical work titled "value-added and economic growth of Nigeria". They employed the ordinary least square techniques. The result shared that a substantial proportion at the variation in economic growth proxied by the variation of VAT revenue earnings. Ogbanna & Ebinobowei (2012) in their study of the impact of tax reforms: a time frame (198-2007), used a time series variables that were not stationery, employed co-integration and error correction instating. The result revealed that changes in all the income taxes have positive coefficient. The implication is that tax reform will stimulate economic growth.

Case against Tax Incentives in Nigeria

Taxation is the life wire of every nation and if properly managed, helps to sustain a nation's growth and development. The essence of tax incentives is to attract new investments into a country as well as help in the expansion of existing ones which is expected to translate to higher future production in the economy, which by extension more employment opportunities, increases gross domestic product (GDP), more food and savings.

But a meticulous examination of various tax incentive packages granted so far by the government revealed that large sums of tax revenue are being lost annually. Adegbe & Fakile (2011) in *BusinessDay* of 26th August (2015) observed in a study conducted on Nigerian customs Service (NCS) that there is under assessment of payable duties, unauthorized transfer of funds, abuse of waivers, concessions and exemptions, as well as non-remittance of government revenues. Findings showed that a revenue loss to all concessions between January 2004 and November 2006. According to them, revenue loss in 2004 was 56.8 billion which increased to N712 billion in 2005 and reduced to N54.9 billion in 2006. This find reveals that government is losing large sums of revenue annually which is affecting the economy negatively. This finding also corroborates Oriakhi & Osemwengie (2013) who observed that another factor that affects the effective use of tax incentive to encourage business decision is corruption. They also noted that corruption is one of the common features of the emerging countries and manifests in several ways.

Table 1: Revenue loss by Nigerian customs services from 2004 to 2006.

(a)	Revenue loss due to exemptions/waivers
	(2006) N18,237,049,659.54
	(2005) N41,636, 157, 785.94
	(2004) N33,970,745,310.37
(b)	Revenue loss due to ETLS
	(2006) N1,494, 223, 772.13
	(2005) N2,548,734,595.82
	(2004) N2,104,089,331.98
(c)	Revenue loss due to concessionary duty rate granted bonafide manufacture/assemblies.
	(2006) N564,956, 189.29
	(2005) N10,001,804,163.24
	(2004) N6,982,047,350.65
(d)	Revenue loss due to export processing/exercise factory.
	(2006) N256, 055, 157.07
	(2005) N248, 545, 281. 21
	(2004) N146,279,457.67
(e)	Revenue loss due to concessions to manufacture-in-bond-schemes (MIBS).
	(2006) N3,819,378.39
	(2005) N820, 147, 347.45
	(2004) N1,115,233,719.64
(f)	NDCC
	(2006) N34,365,839,307.46
	(2005) N15,989,292,537.74
	(2004) N11,478,137,655.38
	TOTAL (SUMMARY)
	(2006) N54,921,943,464.88
	(2005) N71,244,681,711.40
	(2004) N56,796,532,825.67 (Somorin, 2015)

Another revelation about the state of economy with respect to some forms of tax incentive was made by the former minister of finance, Ngozi Okonjo-Iweala who disclosed that “the Federal Government lost about N170.74 billion to waivers and tax concessions granted to various government and private business in different sectors of

the economy between 2011 and 2013” She revealed that about N627.07 billion was lost by the Nigerian Customs Service, (NCS) alone, as shortfall in budgeted revenue projections for the three years. She disclosed furthermore that a total of N55.97 billion made up of N23,422 billion (import duty exemptions) and N33.543 billion (waivers), was lost in 2011, while about N55.345 billion consisting N46.789 billion (exemptions) and N8.556 billion (waivers) was lost in 2012. A total of N59,417 billion, composed of N33,319 billion (exemptions) and N26,097 billion (waivers) was lost in 2012. A total of N59.417 billion, composed of N33.319 billion (exemptions) and N26,097 billion (waivers) was lost in 2013 (Somorin, 2015)

Apart from these billions of Naira lost to tax incentives which could have been channelled into the building of schools, education sector development, youth and social development, environmental development, health service development, agricultural sector development, road, water management and provision of other people oriented social infrastructure in Nigeria. It is observed that this magnitude loss of billions of revenue to tax incentives is also found in other African countries. For instance, \$2.6 billion is lost each year due to tax incentives in four countries members of the East African Community (EAC) namely, Kenya, Rwanda, Tanzania and Uganda, (*Businessday* of second of September, 2015). The revelations so far regarding the magnitude of revenue loss due to various incentive packages granted by government justifies a serious call for the discontinuation or drastic reduction of tax incentives granted to both individuals and corporate organizations.

However, we are aware that effective use of tax incentives to encourage investment decision is hindered by some factors which may be political or economical. This is because a country characterized by social insecurity and dysfunctional legal system may respond poorly to the effective use of tax incentives to facilitate investment decision.

The case against tax incentive packages in Nigeria is that concessionary duty rate, concessions to manufacture-in-bond schemes and export processing/exercise factory levy should be discontinued because the essence and beauty of these tax incentive packages has been defeated. Besides, the Nigerian Customs Service should be reformed in line with transformation (change) agenda of the present administration in order to reduce the number of corrupt officers in the system. The use of the tax system for special tax references should be carefully examined. This is because tax incentives as tax expenditures cause serious drain on national income by conferring windfall gains on existing activities or by shifting resources to desired sectors or units of the economy.

Conclusion and Recommendations

Tax incentives in Nigeria dates back to the beginning of colonial administration when all sorts of allowances, exemptions, tax holidays and reliefs were granted to

British companies and individuals which became a strategy to establish trade links with the country. However, the school of thought that claims that, the revenue sacrificed through tax incentives will pay off in the long run through growth in the capacity of the favoured tax base will always be possible in a less competitive society, unlike in Nigeria where the level of corruption is alarming. In a less corruption society, tax cuts will reduce taxpayers to be more tax compliant through reduced tax rates which will make tax evasion and avoidance unattractive.

Base on the revelations made in this paper, the following recommendations are made.

1. Government should discontinue discretionary method of granting of concessions and waivers to individual businesses and corporate bodies which has not paid off but has resulted in various abuses of tax incentive packages. Instead, tax rate should be lowered from 30 percent to 25 percent.
2. A meticulous review of the entire tax incentive packages granted by the government to enable her resort to sector-wide exemptions policy to provide specific incentives for some strategic job creating sectors in order to increase the nation's gross domestics product (GDP).
3. Effort should be made by government to fight corruption especially in the public sector without being selective in this fight and introduce capital punishment depending on the magnitude of embezzlement or mismanagement of public funds.
4. Government should diversify the economy. This can be achieved by shifting its traditional reliance on oil money to taxes in the face of plummeting oil prices in the international market.

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