



## DETERMINANTS OF TAX EVASION WHEN TAX AUTHORITIES ARE NOT TRANSPARENT: EVIDENCE FROM ILORIN METROPOLIS

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### **Abstract**

*This study focused on  
the determinants of tax  
evasion in one of the  
major cities in Nigeria,  
Ilorin in Kwara State. It  
considered how tax  
payers respond to  
their civil*

### **Keywords**

*Transparent,  
Evidence, Evasion,  
Tax, Determination.*

*responsibility of tax  
payment when the tax  
authorities are  
perceived not to be*

### **INTRODUCTION**

Globally, tax is a compulsory responsibility or levy that is expected to be paid by individual or citizen of any country. The payment of tax is an obligatory duty of every citizen whether natural or corporate citizen. As a civic duty, it is expected that citizens should voluntarily comply with such obligation but that is not the case with some citizens. Alm, Martinez-Vazquez and Schneider (2003) acknowledged that majority of the people do not like to pay taxes as a result; it is difficult for tax authority to impose and collect taxes anywhere and anytime. Kirchler, Hoelz and Wahl (2008) opined that

*transparent in their handling of tax revenue. Ordered probit method was used to estimates identified determinants of tax evasion based on established literature. Our result shows that tax evasion will be low* if *punishment for tax evasion is severe in penalty, political capture and tax payers' socialization. The study therefore recommends severe punishments with powerful tax institution as remedy to the high rate of tax evasion in the State.* *However, weak tax institution with low study therefore recommends severe punishments with powerful tax institution as remedy to the high rate of tax evasion in the State.* *Other powerful tax institution as remedy to the high rate of tax evasion in the State.* *tax evasion are evasion in the State.* *powerful institution*

government has primary interest and responsibility in ensuring that citizens follow this civic duty and behave in compliance with provision of tax laws irrespective of their social status.

The need for the government to provide social amenities, embark on developmental projects that would improve living standard of citizenry as well as meet its overhead or recurrent expenses necessitate intensified revenue generation efforts both internally and externally. One of the major sources to generate revenue is by levying taxes on the tax object which could be individuals or corporate entities. For the purpose of clarity, there are three relevant tax authorities in Nigeria with capacity to collect various designated taxes, the Federal Inland Revenue Service (FIRS) collecting taxes on behalf of Federal government, the State Inland Revenue Services (SIRS) collecting State taxes and the Local Government Revenue Committee (LGRC).

As a result of this, if government of any economy, where government must need expenditure towards realizing the goals of the government for the public, it must therefore try to raise or to generate revenue. This revenue therefore form the nucleus or basis for government expenditure and as a result of this, if government expenditure therefore must happen this way then it means we cannot avoid the consideration of fiscal policy measure and since tax is one of the fiscal policy measure, then it becomes important. As a result of this, there has been claims by many economist, that tax is an

important issue as far as the world is concerned and going by this when one look at it from the perspectives of country basis, tax therefore becomes an important source of government revenue in Nigeria. Although there are other sources of government revenue but tax is the most important among all the sources of government revenue. Tax can come in two ways; it may be through direct tax or indirect tax.

Direct taxes as we are all aware, is a compulsory payment, which income earners must pay to the government as far as any nation is concern. Direct taxes are in various types, such as personal income tax, capital gains tax, capital transfer tax, company profit tax and petroleum profit tax. On the other hand, indirect taxes are taxes on the consumption and production of goods and services. Indirect taxes are also in various types, it includes customs duties, excise duties, purchase tax, entertainment tax, and value added tax. At this juncture, government will need to generate revenue or resources from the various identified kinds of taxes from both direct and indirect taxes because it is important for government to raise revenue so that it could maintain the needs of what is expected to do to the public. At this point it is worth noting that total tax revenue generated depends on the economic climates of the nation concerned and whether the tax payers cooperate with the tax authority or not. This therefore leads to the various claims by antagonistic and synergistic propaganda.

The tax climate in a society can vary on a continuum between an antagonistic climate and a synergistic climate. In an antagonistic climate, taxpayers and tax authorities work against each other; in a synergistic climate, they work together. The antagonistic climate can be characterized by a “cops and robbers” – attitude on both sides: tax authorities perceive the taxpayers as “robbers” who try to evade tax payments or levies whenever they can and need to be held in check; taxpayers feel persecuted by the authorities (“cops”) and feel it is right to hide (Braithwaite, 2003a). In such a climate, the social distance is likely to be large, with little respect and little positive feelings towards the regulatory authorities on behalf of individuals and groups (Bogardus, 1928). Voluntary compliance is likely to be negligible, and individuals are likely to resort to “rational” weighing of the costs and benefits of evading. The synergistic climate can be characterized by the idea that tax authorities perform a service for the

community, and are a part of the same community the individual taxpayers belong to. The authorities' approach could be described as a "service and client" – attitude, as it is propagated in New Public Management. Authorities aim for transparent procedures and for respectful and supportive treatment of taxpayers. For example, in Switzerland a friendly and respectful treatment of taxpayers by authorities has been recognized for a long time as an important means to enhance tax compliance (Feld & Frey, 2005). In such a climate, social distance is likely to be low, voluntary compliance is likely to prevail, and individuals are less likely to consider the chances of evading, and more likely to contribute their share out of a sense of obligation. From experience this is in contrast with Nigeria situation.

It is against this background that we therefore try to look at taxes where the people are willing to pay and where of course some are trying to avoid such payment. So as a result of this, non-payment of taxes can come in two ways; one of this is that some people may not pay fully what they are supposed to pay while some people are not willing to pay at all. This has been declared overtime that people who do not know the value of government services are those that are not willing to pay (tax avoidance) while who are not willing to pay fully are known as tax evaders, we therefore speak of tax evasion. Tax evasion is the crime of deliberately not paying all the taxes that a tax payer is expected to pay to the tax authority or tax collector who act on behalf of the government. This is one of those areas where some disadvantages of tax collection in any situation have always been identified. At this juncture tax evasion therefore involves concealment of income or gains or of assets. It is a criminal procedure of manipulating the tax form e.g. declaring lower income or refusing to pay tax altogether. So as a result of this, tax evasion therefore is seen as an offence in any country where people refuse to pay what they are expected to pay to the authority in charge of receiving taxes. Because these set of people or group are expected to be cheaters and corruption can as well lead to this type of problem. Hence, such people must be checked from evading tax, if actually government must generate adequate revenue or commensurate revenue that would guarantee the budget of any country. In Nigeria, like some other developing countries, tax noncompliance is a

serious challenge facing tax income administration and hindering tax revenue performance. In relative term, tax revenue has continued to drop tremendously in Nigeria.

Goradichenko, Martinez-Vanzquez and Peter (2009) and Vela (2007) stated that tax evasion is a universal and a growing phenomenon. Research evidences available have shown that the problems of tax evasion cut across the globe from developing countries to developed countries. For instance, Embaye (2007) also reported that tax evasion is considerable in U.S with about 16% overall noncompliance for individual income tax. The concept related to tax evasion is tax avoidance, which is described as creative compliance in McBarnett (2003). However, according to Arogundade (2005) there is conceptual distinction between tax evasion and tax avoidance. The distinction between these two concepts hinges on the legality of taxpayer's actions. Arogundade (2005) said that the similarity of both concepts is that they lead to leakages in tax revenue. Others distinguished the two concepts from legal perspective. According to them, tax evasion is carried out in violation of the law, therefore is illegal while tax avoidance is carried out within the legal framework of the tax law in order to reduce one's tax liability, therefore tax avoidance is legal.

In order to ensure compliance to tax law and regulation, tax administrative organs are put in place or set up to introduce refined tax system which includes tax rules and regulations, tax laws and tax policy. According to Marti (2000), the existence of tax system forces individuals and organizations to give part of their income to the government as tax payment. Silvani (1992) added that the goal of tax administration is to foster voluntary compliance.

Tax evasion can also be in form of non-compliance by the tax payer. Franzoni (2000) and Chatopadhyay and DasGupta (2002) stated that compliance with tax laws involves true reporting of the tax base; correct computation of the tax liabilities; timely filling of tax returns and timely payment of the amount due as tax. Any behaviour by the taxpayer contrary to the above constitutes non-compliance which results to tax evasion by the tax payer. Despite the arrangement put in place through tax system to ensure compliance with tax rules and regulations, human society is still confronting numerous cases of tax noncompliance as Marti (2000)

submitted, tax noncompliance problem is a phenomenon inherent by the existing tax system.

Moreover, in a country like Nigeria with high ethnical fractionalization, the perception of different ethnic group regarding tax payment may cause variation in compliance behaviour in different part of the country. Nevertheless, the Nigerian tax system has not given adequate consideration to the ethnic and cultural diversity of Nigeria (Osemene, 2004).

In worthwhile, tax institution comprises of the agencies charged with the principal duties of regulating tax system in the country. So, therefore we have tax administration organs in Nigeria. Thus, these organs are in regulatory functions of the Nigerian Tax System which comprises of at least 39 taxes, levies and fees, including 8 Federal, 11 State and 20 Local Government taxes and levies specified in the Taxes and Levies

The problem of tax evasion has also become a very serious issue in Nigeria due to the non-transparency of the tax authority. The non-transparency of the tax authority may be as a result of corruption in the tax authority, it may also come inform of poor administration in the tax authority and mismanagement in the tax authority. The enforcement machinery of the Nigerian tax laws seem so absorbent that taxpayers go against them effortlessly. Those responsible for tax administration seem ill-equipped as they often do not possess the requisite skills and capabilities to perform. Hence, they become cynical, discouraged, exasperated and are therefore unproductive (Ogbonna, 2012) [16]. It is undoubted whether the tax system in Nigeria is characterized by economic agents who often evade taxes. One of the arguments provided in taxation literature is that the Government of Nigeria rarely utilize proceeds of taxation in providing social amenities for the benefits of taxpayers but rather, has its focus mainly on generating revenue. The system has consequently been characterized with high rate of forgery of tax documentations and other official receipts including tax clearance certificates as well as non-accountability for taxes collected on the part of tax officials (Ogbonna, 2012) [16]. An examination into the Nigerian tax system was driven by the Federal Ministry of Finance which inaugurated a study group in July 2003 to make recommendations towards enhancing the Nations' Tax Policy

hitherto characterized by inefficient administration. The aim was to provide a better tax policy blueprint capable of reducing and possibly eliminating tax evasion. (Musgrave and Musgrave, 2004; 2009 and Appah, 2010) have called for the adoption of an efficient and effective taxation system in Nigeria, to help increase the internally generated revenue of a country and to ensure funds for development in a country. To them, an improved tax system would generate funds to provide basic social needs and services which helps to ensure transparency and accountability in governance. Thus, a strong vibrant system would ensure transparency and accountability in taxation that would boost development in the country and also will reduced or alleviates the level of tax evasion in a country. An efficient and effective tax system is capable of ensuring the basic necessities and services in the country, in the areas of healthcare services, infrastructural facilities, security services and redistribution of wealth.

### **The Problem**

Despite the various tax reforms undertaken by Nigerian government to increase tax revenue over the years, prior statistical evidence has proven that the contribution of income taxes to the government's total revenue remained consistently low and is relatively shrinking. However, from all the taxes, personal income tax has remained the most disappointing, inefficient, unproductive and problematic in Nigerian tax system (Nzotta, 2007; Odusola, 2006; Sani, 2005). The statistical data indicated that contributions of non- oil income tax to total revenue of Government in Nigeria dropped from 19.8% in 1999 to 11.7% in 2008 and the tax ratio in 2009 was 11% the lowest in West Africa and below 15% recommended for low income countries. Specifically, the contribution of individual income tax remained marginal and comparatively low in Nigeria's tax revenue. At the state and local government levels, where the major source of internal revenue is expected to be individual income tax, its contribution to the total revenue of these levels dropped from 20.18 and 7.7% in 1999 to 12.4 and 1.6% in 2008 respectively (CBN, 2008). Based on this now, it has shown to us that for some years back, there has been increasingly decrease in tax revenue in Nigeria. Compare to other African countries, Nigeria had been consistently recording lowest income tax ratio and personal income tax

(PIT) ratio. For instance in 2006, Nigeria had 2.5% and 1% respectively as income tax and PIT ratio the second lowest in the group of fifteen countries with South Africa recording the highest with 14.4 % and 7.7% (Volkerink, 2009). This phenomenon remains unexplained even though one tries to apply the basic and extended model of tax compliance. The serious decline in tax revenue may be as a result of high rate of tax evasion and it may also be as a result of non-transparency in administration of tax authority. Thus, for this study, there is need to examined the effect of tax evasion on tax revenue in Nigeria. Hence, this study seeks to proffer answer to questions such as: What are the determinants of tax evasion in Nigeria? Is there any causal relationship between tax evasion and non-transparency of tax authority?

### **Relevancy**

Taxation plays a very crucial role in the advancement of Nigerian economy. Tax been the major sources of government internal revenue has contributed immensely to the growth of the country. Tax is indispensable in the running of any government, be it, military or civilian, democracy or autocracy. Admittedly, government is the biggest employer of labour in developing economies. In addition to promoting various social services, government introduces taxes in some exceptional cases to discourage or encourage certain behaviours thereby serving as a tool of social reengineering. Unfortunately in our society today, it is a sad reality that the level of tax compliance is very low.

Tax evasion is unpatriotic, an economic sabotage. This economic epidemic continues to spread from one person to another, community to community, state to state and sector to sector unabated. Whether we agree with history or not, it is undeniably true that taxes are usually met with resentment and revolt.

The findings from this study would help to highlight the likely problems of tax evasion and non-transparency of the tax authority in Nigeria and need to reduce or eliminate these problems. Furthermore, this study will be of great benefit to policy makers in Nigeria.

### **Model Specification**

In an effort to determine the determinants of tax evasion when tax authorities are not transparent in Nigeria, it becomes important to develop

a model to justify the relationship that exists between the variables. Such that the functional relationships become;

$$TE = f(TSS, ATE, INS, INL, AG, SX, MS, REL, CUL, TK, MR, GP, SOC, EDU, POC)$$

The model to be estimated which incorporated econometric equation is specified thus:

$$TAEASY = \beta_0 + \beta_1 TRSEVERE + \beta_2 WLOW + \beta_3 PLOW + \beta_4 SOCIAL + \beta_5 AGE + \beta_6 GENDER + \beta_7 HNUMBER + \beta_8 RELIGION + \beta_9 INCOME + \beta_{10} CAPTURE + \mu_t$$

Where;

taeasy= Tax Evasion

trsevere = Tax Evasion Punishments is very Severe

wlow = Tax Institution is Weak and Penalty for Tax Evasion is low

plow = Tax institution is Powerful and Penalty for Evasion is low

social = Socialization

age = Age

gender = Gender

hnumber = Household Number

religion = Religion

income = Income

capture = Political Culture

$\beta_0$  = Constant Term

$\beta_1 - \beta_{12}$  = Parameters to be Estimated

$\mu_t$  = Stochastic Error Term

Based on economic theory, the following a-priori expectation relationships are postulated for the estimated results.

$$B_1 < 0 \quad \beta_2 > 0 \quad \beta_3 < 0 \quad \beta_4 > 0 \quad \beta_5 > 0 \quad \beta_6 > 0 \quad \beta_7 > 0 \quad \beta_8 < 0 \quad \beta_9 < 0 \quad \beta_{10} > 0$$

## PRESENTATION, ANALYSIS AND INTERPRETATION OF RESULTS

### Results and Discussion

The objective of this section is to interpret the ordered probit regression result presented in the table below. Also in the course of interpreting the result, effort is made to see if our results satisfy the earlier stated a priori expectation by looking at the sign of the coefficient obtained from the ordered probit regression result against the earlier stated a priori

expectations. It is imperative to state here that the significance or otherwise of explanatory variables will be tested with the use of probability value (p-value) obtained from the regression result.

**Table: 4.2.1**  
**Ordered probit regression**

<b>taeasy</b>	<b>Coef.</b>	<b>Std. Err.</b>	<b>z</b>	<b>P&gt; z </b>	<b>[95% Conf. Interval]</b>	
trsevere	-.0524475	.0196815	-2.66	0.008	-.0910226	-.0138724
wlow	.0991914	.0186677	5.31	0.000	.0626034	.1357795
plow	.0667569	.0204656	3.26	0.001	.026645	.1068687
social	.1133393	.0608734	1.86	0.063	-.0059703	.2326489
age	-.0081354	.0047504	-1.71	0.087	-.017446	.0011751
age2	5.43e-07	3.16e-07	1.72	0.086	-7.67e-08	1.16e-06
gender	-.0868041	.0929502	-0.93	0.350	-.2689831	.0953749
hnumber	-.0376163	.016025	-2.35	0.019	-.0690246	-.0062079
religion	.1119437	.0938183	1.19	0.233	-.0719369	.2958242
income	-.0000135	.0000118	-1.14	0.254	-.0000366	9.67e-06
capture	.0906025	.0181246	5.00	0.000	.055079	.126126
Number of obs = 497				Pseudo R2 = 0.0563		
Lag likelihood = -1086.1599				Prob > chi2 = 0.0000		
LR chi2(11) = 129.51						

**Source; author computation using STATA 11.0 software**

Table 4.1: above show the ordered probit result of the regression analysis that clearly spelt out the achievement of the objectives of the study. From the result, “Trsevere” is a significance determinant of tax evasion with a P-value 0.008 which shows that it is significant at (1% and 5%). The standard error value (.0196815) is less than half of the coefficient which signifies that the variable is a significant determinant of tax evasion in urban Ilorin south. The sign of the coefficient which is negative satisfy our a priori expectation and indicate that has the punishments for tax evasion can be more severe, it will leads to decrease in the level of tax evasion in urban Ilorin south. This variable also proved to be statistically significant with Z-

test of -2.66. This result further shows that 1% increase in the punishment for tax evasion will lead to a 5.2% reduction in tax evasion.

On the other hand "Wlow" has a positive relationship with tax evasion and it also shows that its significant determinant of tax evasion with a p-value 0.000 which shows that it is significant at (1%, 5% and 10%). The standard error value (.0186677) is less than half of the coefficient which signifies that the variable is a significant determinant of tax evasion in urban Ilorin south. The sign of the coefficient which is positive satisfies our a priori expectation and indicates that as the tax institutions are weak and also their punishment is also low will lead to an increase in tax evasion in urban Ilorin south. This variable also proved to be statistically significant with a Z-test of 5.31. This result means that 1% further increase in the weakness of the tax institution and low punishment will lead to  $(0.0991914 \times 100)$  i.e. 9.9% increase in tax evasion.

Furthermore, "plow" is a significant determinant of tax evasion with a p-value 0.001, which shows that it is significant at (1%, 5% and 10%). This sign of the coefficient which is positive also satisfies our a priori expectation and indicates that as the tax institutions are powerful while their punishment is low will also lead to an increase in tax evasion of urban Ilorin south, while this result also proved statistically significant with a Z-test of 3.26. The standard error value (.0204656) is less than half of the coefficient which signifies that the variable is a significant determinant of tax evasion in urban Ilorin south. This result further means that 1% increase in the insufficiency of tax institutions will lead to  $(0.0667569 \times 100)$  i.e. 6.7% increase in the level of tax evasion.

The ordered probit regression result presented in the table above indicates that socialization is a significant determinant of tax evasion at 10% significance level but not at (1% and 5%) with a P-value of 0.063. This sign of coefficient which is positive also satisfies our a priori expectation and indicates that business holders are involved in many social units i.e. socialization, this will lead to an increase in the level of tax evasion. This variable also proved to be statistically significant with a Z-test of 1.86. This result further shows that 1% increase in the socialization level of the individual or business holders will lead to  $(0.1133393 \times 100)$  i.e. 11.3% increase in the level of tax evasion in urban Ilorin south.

The ordered probit regression result presented in the table above indicate that "Age" is a significance determinant with tax evasion with a p-value.0.086, which shows that it is significant at 10% but not at (1% and 5%). The sign of the coefficient which is negative negate our stated apriori expectation and indicate that has the age of individual or business holder in urban Ilorin south increases, it leads to decrease in the level of tax evasion. This variable is also proved to be statistically significant with z-test of -1.71. The standard error value (.0047504) is exactly half of the coefficient which also signifies that the variable is significant determinant of tax evasion. This result further shows that a year increases is the age of individual will lead to  $(0.0081354 \times 100)$  i.e. 0.8% decrease the level of tax evasion.

Moreover, the ordered probit regression result in the table indicates that "gender" is not a significance determinant of tax evasion. With p-value of 0.350, which shows that it is not significant at (1%, 5% and 10%)? The Z-test of the result which is -0.93 also show that it is not statistically significant .The result also shows that there is a negative relationship between gender and tax evasion. This implies that 1% increase either being a female or male will leads to  $(0.0868041 \times 100)$  i.e 8.6% decrease in the level of tax evasion.

The results of the ordered probit regression indicate that "Hnumber" which is the household number is a significance determinant of tax evasion with p-value of 0.019, which shows that it is significant at 1% 5% and 10%. The Z-test of the result which shows -2.35 implies that it is also statistically significant. The result also shows that there is a negative relationship between Hnumber and tax evasion. The standard error value (.016025) is less than half of the coefficient which signifies that the variable is a significant determinant of tax evasion. This result negate our a priori expectation, which implies that as the Hnumber increases, the lower the level of tax evasion.

The ordered probit regression indicates that "Religion" has a positive relationship with the level of tax evasion. This negates our a priori expectation. It also shows that religion is not a significant determinant of tax evasion with p-value of 0.233 which shows that it is not significant at (1%, 5% and 10%). The Z-test of the result which shows 1.19 implies that

it is not statistically significant. The standard error value (.0938183) is greater than half of the coefficient which signifies that the variable is not a significant determinant of tax evasion. The sign of coefficient of the result for religion in this ordered probit regression made us to realize that religion does not matter when it comes to the issue of tax evasion in urban Ilorin centre. i.e. evading tax or not evading tax is not backed up by religion. The ordered probit regression result shows that income has a negative relationship with tax evasion. This implies that as income increases, there will be reduction in the level of tax evasion. This also conforms to our a priori expectation. This also shows that income is not a significant determinant of tax evasion with p-value of 0.233 which shows that it is not significant at 1%, 5% and 10%. The Z-test which is -1.14 also review that it is not statistically significant. The standard error value (.0000118) is greater than half of the coefficient which implies that the variable is not a significant determinant of tax evasion. This further shows that 1% increase in income level will leads to  $(0.0000135 \times 100)$  i.e. 0.0135% decreases in tax evasion. This means that people with higher income that are comfortable will not mind paying their tax.

Finally, the ordered probit regression result shows that political capture i.e. (the interest of few are considered stronger than the interest of the community) has a positive relationship with tax evasion in urban Ilorin centre. This result conforms to our a priori expectation. This also shows that political capture is a significant determinant of tax evasion with p-value of 0.000, which implies that it is significant at 1%, 5% and 10% and this is also reviewed by the Z-test, which shows 5.00, which implies it is statistically significant. The standard error value (.0181246) is less than half of the coefficient which implies that the variable is a significant determinant of tax evasion. This result further shows that 1% increases in this act of political capture by the government will increases the level of tax evasion by  $(0.0906025 \times 100)$  i.e. 9% increase to tax evasion.

The Pseudo R<sup>2</sup> which explained how the independent variable explained the dependent variable shows that 5.63 of the independent variable explained the dependent variable and this is normally small for primary data analysis.

In conclusion, this study focused on the determinants of tax evasion in one of the major cities in Nigeria, Ilorin in Kwara State. It considered how tax payers respond to their civil responsibility of tax payment when the tax authorities are perceived not to be transparent in their handling of tax revenue. Ordered probit regression method was used to estimate the identified determinants of tax evasion based on established literature. Our result shows that tax evasion will be low if punishment for evasion is severe in Ilorin metropolis. However, weak tax institution with low penalty for tax evasion increases probability of tax evasion. Other factors that significantly increase tax evasion are powerful institution with low evasion penalty, political capture and tax payers' socialization. The study therefore recommends severe punishments with powerful tax institution as remedy to the high rate of tax evasion in the State.

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