

AN EXAMINATION OF THE EFFECTIVENESS OF TAX PENALTIES IN COMBATING TAX OFFENCES IN NIGERIA

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ABSTRACT: Taxation is a critical engine for socio-economic growth and development, serving as a primary revenue source for governments worldwide. However, tax offences, including evasion, avoidance, and non-compliance, significantly frustrate revenue generation efforts. This article examines the effectiveness of tax penalties as a mechanism for combating tax offences and improving tax compliance within the Nigerian tax system. It provides a detailed analysis of the legal framework, outlining both criminal sanctions (fines and imprisonment) and civil sanctions (distrain of goods, sealing of premises, and imposed interests) as provided for in key statutes like the Personal Income Tax Act (PITA), Companies Income Tax Act (CITA), and the Federal Inland Revenue Service (Establishment) Act (FIRSEA). The study argues that while a structured penalty regime exists, its deterrent effect is undermined by significant challenges. These include the technical nature of tax laws leading to procedural failures in court, difficulties in tracking a highly mobile populace and informal sector, inadequate prosecution of defaulters, low levels of tax awareness, and the pervasive issue of multiple taxation. The article concludes that the current penalties are underutilized and, in some cases, archaic. To enhance effectiveness, a multiple approach combination is

recommended, encompassing stricter enforcement and prosecution, increased taxpayer education, harmonization of taxes to eliminate duplication, and a revision of penalty structures to reflect modern economic realities, thereby fostering voluntary compliance and boosting national revenue.

Keywords: *Tax Penalties, Tax Compliance, Revenue Generation, Nigerian Tax System, Criminal Sanctions, Tax Awareness, Federal Inland Revenue Service (FIRS)*

Introduction

Taxation, being the compulsory financial contribution by citizens (individuals and corporations) to government from their incomes strongly assist in running the affairs of government. It enables government to finance both administrative duties of state and the provision of basic infrastructure for development and welfare, defence and security of the citizens.

Sanctions in form of penalties are usually imposed on tax defaulters as a means of punishment and as deterrence against future occurrence of anti-tax activities or omissions in form of tax evasion. This article therefore seeks to examine the effectiveness of tax penalties as provided in the various tax enactments in Nigeria in combating tax offences and encouraging tax compliance for the sake of improving tax revenue generation.

1. Tax Penalties in Nigeria

Tax penalties are amongst the instruments employed by the government in promoting tax compliance. Where tax evasion or non-compliance is seen to spread and succeed, erstwhile law-abiding tax-paying citizens may be tempted to venture into tax default too. Recent studies have shown that penalties levied in consequence of tax offences are important in deterring tax evasion. The behavior of taxpayers can often be defined by penalties more clearly than by tax laws. Consequently, there are different types of tax offences and penalties in the Nigeria tax regime. The foundational principles and practices governing these penalties are extensively documented in authoritative texts such as Abdulrazaq (2015), who provides a comprehensive overview of revenue law in Nigeria.

1.1 Criminal Sanctions

The various tax legislations in Nigeria provide for specific sanctions for tax offences stipulated therein. Such sanctions range from fines to imprisonment, and these may be enforced by way of criminal prosecution of the tax offenders. The available criminal sanctions for tax offences in Nigeria, like in other jurisdictions, can be found in the express provisions of tax statutes, and others are found in non-tax statutes, such as the Criminal Code and the Penal Code. The court with jurisdiction over actions relating to government revenue are stated under Section 251(a) of the Constitution of the Federal Republic of Nigeria 1999, is the Federal High Court. Hence, prosecution of offences for recovery of Tax shall be instituted and heard before the Federal High Court in Nigeria.

The two major elements of every criminal offence include the *actus reus* and *mens rea*, that is, the blamable act and the mental condition respectively. It has been argued, however, that the doctrine of *mens rea* may not apply in holding an offender liable for certain tax offences, particularly an offence committed under the Personal Income Tax Act. Nevertheless, one must examine the object and terms of the law creating an offence before deciding whether or not *mens rea* is an essential element in determining liability for the offence. In the Nigerian Tax statutes, one may note the use of words such as “willful”, “knowingly”, and “unlawfully” to qualify prohibited acts. This suggests that the prosecution must prove guilty knowledge in respect of offences where the law stipulates or uses words such as “knowingly”.

In respect of tax offences committed by a company under the relevant Act, questions may arise as to whether the directing minds and limbs of the company should be made culpable for each offence or whether the company itself must bear its own liability, being a legal person. It is under the old common law position that corporate criminal liability was impossible. The current position of the law is as set out in the case of **H.L Boton (Engineering) Co. Ltd v. T.J Grahams & Sons**, wherein the Court per Lord Denning, observed that there are certain persons in the management of the company who are more than mere servants of the company, and who represent the directing mind and will of the company. In the case of **FRN v. Nwaoboshi & Ors**

the Court of Appeal applied the doctrine of the alter ego as expounded in the H.L Bolton's case, and held as follows:

The law is settled that the minds of companies are the minds of their Managers, Directors or alter egos. Lord Denning, in the case of H.L., Bolton Engineering Co. Ltd vs. T.J Graham & Sons (1957) 1 QB 159 decided that: "The state of mind of these managers is the state of mind of the company and its treated by the law as such.

In criminal proceedings, the burden of proof is beyond reasonable doubt. This applies in equal measure to cases bordering on tax offences. The onus usually lies on prosecution, which in this case is the tax authority. The position of the law regarding the duty on the prosecution in criminal case, which is not of strict liability, is that the burden remains on the prosecution throughout the trial to prove all the elements/ingredients of the offence or offences with which an accused person is charged. This position which is a presumption of innocence in respect of an accused is recognized in law not to have "universal" application in all offences.

It is trite law that prior to the institution of any action be it civil or criminal, the claimant or prosecution (complainant) as the case may be, must first satisfy itself of certain pre-conditions. These include the parties to the action, the laws under which the action shall be brought or levied, the jurisdiction and venue of court, amongst other things. The case of *Unipetroal Nig. Plc v. Edo State Board of Internal Revenue* properly illustrates this. In this case, unipetrol Plc, the Appellant was charged before the Revenue Court of Edo State for an offence bordering on refusal to pay outstanding withholding tax contrary to Section 5(2) (b) of the Income Tax Law Cap 71, Law of Bendel States (now Edo State).

Sequel to the charge, the appellant filed a preliminary objection challenging the jurisdiction of the Court to entertain the matter, on the grounds that the prosecuting authority who is the proper party to bring the action is the Attorney General Edo State on behalf of the Board. The trial Court dismissed the preliminary objection, and the decision of the trial Court was upheld on appeal. Hence, the appellant appealed to the Supreme Court where it was held that the Board can institute actions in its corporate name, and that the Attorney General can delegate his power to prosecute,

as stipulated under section 174(1)(b) and (c) of the 1999 Constitution of the Federal Republic of Nigeria (CFRN), as amended.

1.2 Civil Sanction

Subject to the power of the Attorney General of the Federation, the Federal Inland Revenue Service is empowered to prosecute offences through its legal officer. In addition to criminal sanctions imposed for breach of Nigerian tax statutes, provisions are equally made for civil sanctions. The law provides for penalties and interests in certain circumstances as sanction for breaches committed under the relevant statutes. The imposition of these civil sanctions may require the assistance of Courts in certain circumstances. Section 34(1) of the Federal Inland Revenue Service (Establishment) Act provides as follows:

Without prejudice to any provision of this Act or any other law listed in the first schedule to this Act, any amount due by way of tax shall constitute a debt due to the service and may be recovered by a civil action brought by the Service.

By this provision, the FIRS is empowered to institute civil actions to recover tax debt from taxpayers and enforce overdue taxes. It has been observed that the FIRS favour the levying of civil actions against willful tax defaulters as against criminal prosecution, despite their authority to employ either in tax compliance enforcement. It must be noted that the finding of guilt or acquittal in respect of a criminal charge levied against a person who has committed tax fraud, does not preclude the imposition of civil sanctions/penalties in respect of tax fraud.

2. Effectiveness of Tax Penalties in combating Tax Offences in Nigeria.

Tax penalties are critical tools for enforcing tax compliance and deterring offences such as tax evasion, late payment, non-filing of tax returns, and falsification of tax records. To ensure the effectiveness of tax enforcement, Nigeria has implemented a structured penalty system that has undergone several revisions over time. These penalties are designed to promote compliance among taxpayers, discourage fraudulent practices, and enhance revenue generation for national development.

In Nigeria, taxation hardly constitute a center piece in economic development as a result of the menace of tax offenders many of which manifests in the form of tax evasion and tax avoidance. The prevalence of tax offences in Nigeria has been identified as a consequence of weak tax administration, amongst other things. This is a challenge noted across various levels of government, as studies like Coker et al. (2015) have highlighted the difficulties in expanding internally generated revenue (IGR) at the local government level. Hence, the various tax legislations and statutes in Nigeria makes provisions for sanctions for breach of the tax laws. The amendments to the Finance Acts equally contain innovative provisions such as the provision for mandatory use of Tax Identification Number (TIN) by taxpayers, in order to curb the menace of tax offences. In addition to the mandatory use of Tax Identification Numbers (TIN) by taxpayers, the Act expands the definition of chargeable assets to include digital assets, such as cryptocurrencies, subjecting gains from their disposal to a 10% Capital Gains Tax (CGT). This inclusion aims to capture revenue from the digital economy and reduce tax evasion in this rapidly growing sector. Taxpayers can now offset capital losses against gains from the same class of assets, with unutilized losses carried forward for up to five years. This provision ensures a fairer tax system and encourages accurate reporting of gains and losses.

The Act introduces excise duties on all services provided in Nigeria, including telecommunications, at rates to be prescribed by the President. This measure broadens the tax base and aims to capture revenue from the service sector, reducing opportunities for tax avoidance. The distribution formula for EMTL proceeds has been amended to allocate 15% to the Federal Government, 50% to State Government, and 35% to Local Government. This relocation aims at enhancing transparency and accountability in the use of these funds, thereby improving compliance. The Act empowers the FIRS to appoint any person to withhold or collect Value Added Tax (VAT) and mandates that such VAT be remitted in the currency of the transaction by the 14th day of the following month. This provision strengthens VAT collection mechanisms and ensures timely remittance, thereby reducing tax evasion.

As earlier established in this study, Nigerian tax laws are satiated with sanctions and penalties to be imposed on tax defaulters by tax authorities, and equally for the purpose of ensuring voluntary compliance. The offences highlighted in this study include, amongst others, fraudulent declaration of income, false representation, false statement, and refusal to pay tax. The various sanctions render the evasion of tax unprofitable to taxpayers and equally recover and safeguards tax revenue for government. In the same vein, criminal sanctions are significant in punishing tax offences and deterring other taxpayers from future offences.

Tax authorities in Nigeria are vested with the power to distrain the goods or other chattels belonging to defaulting taxpayers, and such distrained goods or securities may be sold for the purpose of recovering the tax owed by the defaulter. This is provided in the Personal Income Tax Act (PITA) particularly Section 104, Companies Income Tax Act (CITA) particularly Section 86, and the Federal Inland Revenue Service (Establishment) Act (FIRSEA) particularly Section 33, amongst others. This power has been exercised on different occasion by tax authorities in Nigeria, and the procedure for same has been decided upon before the Court.

The Appellant in the case of **Independent Television/Radio vs. Edo State Board of Internal Revenue** argued that the use of ex-parte application under Section 104 of the Personal Income Tax Act Cap P8 of 2004 (a amended in 2011) is unconstitutional on the basis of lack of fair hearing. In deciding on the matter, the Court of Appeal noted that due to the nature of certain preliminary steps that have to be taken before the commencement of the substantive matter, the rules of the Court have made provision for ex-parte applications and there is nothing unconstitutional about it.

The Court noted further that the question as to whether an ex-parte order offends the principles of fair hearing depends wholly on the circumstance of the case and the statute in question. This is no doubt that ex-parte applications are only used in situations where a Statute permits it. The Court outlined the process that should proceed with and follow ex-parte Order under the Act as stated in Section 44 of PITA, from allowing a taxpayer to do self-assessment of tax to knowing his tax liability. If he does not do so, S.54 empowers the tax authority to do the assessment of the taxpayer's income tax. After the tax authority completes that tax assessment, it

serves the assessment on the taxpayer as provided for in S. 57. The taxpayer, upon receipt of the assessment from the tax authorities, is empowered under S. 58 to revise the assessment and raise objections(s) if any. In fact, such taxpayers are entitled to write to the tax authority stating his objections and the tax authority is under obligation to look into the matter and arrange meeting(s) with the affected taxpayer to resolve the discrepancies in figures.

Also, S. 59 provides for how both the taxpayer and the tax authority can handle errors and defects in assessment and notice. Where after all the above processes, the taxpayer refuses to pay and/or the parties are not able to agree on a definite amount or other issues raised, S.60 in establishing Tax Appeal Tribunal allows an aggrieved party to approach the Tribunal on cases arising from the operation of the Act. Where all the efforts at resolving disputes and affecting tax payments above have failed, S. 104 gives the tax authority the power to distrain the tax defaulter's property pursuant to an ex-part application to a High Court Judge. In addition, the PITA equally offers the taxpayer an opportunity to be heard following the service of the notice of assessment on him. Upon the examination of these preconditions, the Court of Appeal held inter alia that:

“Thus, looking at the antecedents of acts to be done by the tax authority intended at putting the tax payer on notice, allowing him to object if he wants, and the different provisions allowing the tax payer air his views, I am of the humble opinion that the ex parte provision in S. 104 of the PITA is constitutional and does not offend his right to fair hearing”.

Prior to it being sold, the goods and chattels distained may be kept by the tax authorities at the cost of the defaulter, and where all outstanding of the defaulter are not paid up, the said goods and chattels may be sold.

In addition to the forgoing sanction, the law also provides fines, power to seal up premises, power to access all buildings, lands and documents of defaulters for the purpose of tax collection, and imprisonment.

It is questionable, however, whether these sanctions and penalties are adequate in dealing with the menace of tax non-compliance and tax offences in Nigeria. Both

civil and criminal sanctions have been developed in response to the needs of the Nigerian tax system, but neither seems to adequately deal with the problem of tax non-compliance in Nigeria. We must therefore determine whether the sanctions serve as deterrent enough or whether there is need to increase the severity of the sanctions to better ensure compliance with our tax laws. The fact remains that many of the sanctions provided in the statutes are archaic and not reflective of modern realities. Also, the existing sanctions and penalties remain underutilized and underenforced.

Nonetheless, the threat of punishments in the form of tax penalties is employed by countries as a form of deterrence to non-compliance with tax obligation by taxpayers. Studies have shown that a significant positive relationship exists between tax penalties and tax compliance. In the study on tax audit, penalty and tax compliance in Nigeria, it was found that the penalties prescribed by various tax laws in Nigeria influence the behavior of corporate taxpayers. Hence, the study recommended that tax penalties should be increased for the purpose of achieving effective tax compliance.

Similar findings have been made in other studies and tax laws which also found that increasing prescribed fines and sanctions have equally received commendations. This is reflective of the cost-benefit model which posits that tax compliance is increased and tax offences effectively combated where the penalties levied on defaulters are high. When penalties are increased or introduced, taxpayers generally become more observant of the enacted laws.

However, there are conflicting findings in other jurisdictions on the impact of tax penalties on tax compliance. Devos, (2014) posited that where penalties for non-compliance are not inconsequential in terms of the benefits accruing to a particular taxpayer, such penalties have insignificant influence on the behavior of taxpayers. While severe tax penalties may deter tax offences and compel compliance, it may equally discourage them from declaring their true income. Tax authorities in Nigeria do not adequately utilize the criminal sanctions provided for in the Acts. The number of tax offenders prosecuted is very negligible. The tax authorities favour the use of such sanctions as distraint of property and sealing up of premises, notwithstanding the fact that there are criminal elements in the said cases.

It is the civic duty of every citizen to pay tax, and taxation offers a means for the government to generate revenue for the purpose of executing its functions and providing amenities for the citizenry. Tax non-compliance and tax evasion amounts to a wrong against society. Enforcement agencies must better enforce the provision of the Statutes and extend their focus and application to all class of individuals liable to pay tax.

3. Challenges Undermining the Effectiveness of Tax Penalties in the Nigerian Tax System

While Nigeria has established a structured penalty system, its effectiveness in combating tax offences remains a subject of debate, largely due to issues like enforcement challenges, corruption, and taxpayer resistance. The following are the identifiable problems of the enforcement of tax penalties in Nigeria.

3.1 Technical Nature of Tax Cases

A proper understanding of tax laws is crucial for the effectiveness of the laws and their application to defaulters. The technical nature of tax laws has resulted in the failure of a number of cases instituted to enforce tax obligations. The case of **the Nigeria breweries Plc v. State Internal Revenue Board** was defeated at the Court of Appeal on the ground that the originating process used in instituting the suit was Originating Summons. In the case of *Wilbros Nig. Ltd v. Attorney General of Akwa Ibom & Anor* the Court of Appeal held that the Federal High Court has no jurisdiction to entertain an action relating to Personal Income Tax of an individual. The Court noted that Federal High Court would have had jurisdiction if the matter was in respect of Personal Income Tax collected by the FIRS from individuals in the FCT, Armed Forces, and Diplomats as stipulated in the VAT Act. Like these cases, many other tax cases have been slaughtered at the altar of technicalities. Hence, it is germane for tax authorities to have a proper understanding of tax legislations so that the technicalities involved would not clog the wheel of enforcement efforts of the tax authorities.

3.2 Difficulty in Tracking Tax Defaulters

One of the major challenges faced by tax authorities in their enforcement efforts is the lack of proper tracking system for tax defaulters. The influx of many of the labour force in Nigeria and their migrant nature makes it difficult for tax authorities to assess and collect personal income tax from this highly migrant group. Similarly, a lot of businesses and business owners in Nigeria adopt different antics in evading tax, amongst which include the concealment of their business or place of business from the relevant tax authorities.

It is for the purpose of better tracking of taxpayers that the FIRS introduced the Taxpayers Identification Numbers (TIN), which would afford the authorities the opportunity to properly track taxpayers for tax purposes. It provides a database for all taxpayers, and this helps reduce the incidences of tax evasion and tax avoidance in Nigeria.

3.3 Inadequate Prosecution of Tax Defaulters

The low prosecution of tax defaulters encourages the popular perception that tax non-compliance is not a serious offence. Many do not appreciate the seriousness of the offence or the importance of their tax obligations. This perception has been further promoted by the sheer unwillingness of tax authorities to prosecute tax defaulters, as the tax authorities are rather willing to employ other means of settlement of tax liability rather than venturing into the prosecution of the tax offenders in Court.

3.4 Tax Knowledge and Tax Awareness

Tax knowledge and tax awareness have extensive impacts on taxpayers' compliance with tax obligations. The voluntary compliance level of taxpayers is influenced by their knowledge of the country's tax system and tax policy. Research by Edogbanya and Ja'afaru (2013) on local councils in Kogi State underscores the direct impact of revenue generation, which is fueled by compliance, on government development efforts. In Nigeria, the rate of voluntary tax compliance is low, particularly among individuals taxpayers and small businesses. The more the tax system is understood

by taxpayers, the more the compliance level of taxpayers are likely to increase and vice versa. Studies on tax awareness and voluntary compliance with tax obligations have revealed that the willingness to pay tax stems not only from the fear of sanction or promise of rewards or incentives, but include taxpayers' trust in the government provision of essential amenities and infrastructures, government's tax accountability, tax rate, and the system of tax payment.³⁷ This aligns with the findings of Ezugwu and Agbaji (2014), who assessed the contribution of IGR in Kogi State, emphasizing the role of taxpayer identification systems.

Tax awareness relates to the efforts undertaken by the tax authorities to provide property information on tax, furnish the general public with better knowledge on tax laws and the importance of taxation as well as aiding their understanding and offering guidance, in order to improve the level of compliance by taxpayers. Tax awareness has been recognized as a major tool for improving tax compliance. Multiple taxation and lack of adequate knowledge of the tax system in Nigeria poses serious problem with the Nigerian tax system and this consequently affects the level of tax compliance. Taxpayer education is therefore necessary to encourage voluntary compliance with tax obligations, as well as reduce the cost expended on tax collection.

Studies on tax awareness and voluntary compliance with tax obligations have revealed that the willingness to pay tax stems not only from the fear of sanction or promise of rewards or incentives but include taxpayers' trust in the government provision of essential amenities and infrastructures, government's tax accountability, tax rate, and the system of tax payment. Tax awareness and tax education are equally important in reaching the informal sector and effecting tax collection in Nigerian informal economy. Operators in the informal economy include all categories of entrepreneurs who operate unprotected, unregulated, and untraceable businesses which although legal, are impossible for tax authorities to track or monitor. They include businesses that are unofficially operated outside established rules, government regulations, and taxes. Tax awareness and tax education provide the recipe for tax compliance. The Low level of tax awareness of many taxpayers

translates into low tax compliance level, and this applies to taxpayers across all sectors.

3.5 Multiplicity and Duplication of Taxes

One of the major identifiable factors which has always negatively impacted the Nigerian tax system is the problem of multiplicity of taxes. This issue has been a long-standing concern, as earlier identified by Ogbonna (2010) in an analysis of the Nigerian tax system. In the 2012 National Tax Policy, multiple taxation refers to “the imposition of the same or similar taxes on the same income base, transaction or person by one or more levels of government, in one or more jurisdiction”. In the 2017 National Tax Policy, multiple taxation is defined as a situation whereby similar taxes collected by a particular level of government are being introduced or levied by the same or another level of government.

The negative effects of such policies are evident in studies like Nwanne (2015), which analyzed the effect of tax policy on local government expenditure in Imo State. Furthermore, the strategic importance of managing this revenue effectively is a critical success factor for local governments, a point reinforced by Alao and Alao (2013) in their work using the Balanced Scorecard framework.

In Nigeria, new taxes are introduced and implemented at different levels of government on already overburdened taxpayers and on the same tax base. Easy reference can be made to the Finance Act 2023 which imposed exercise on non-alcoholic beverages, as well as an increase in the rate of Tertiary Educate Tax. Also, the Tertiary Hospital Development Fund Bill, 2021 which seeks to inaugurate a Tertiary Hospital Development Fund to be financed in part by the imposition of Tertiary Hospital Development Tax, comprising of 1% of Petroleum Profit Tax paid on all barrels of petroleum produced every year, 1 % mobile phone service providers tax remitted on data and airtime sold in every year, and 1% of beverages and breweries in Companies Income Tax remitted on profits declared yearly, amongst others.

To curb multiple taxation, taxes levied at all levels must be harmonized. The Nigerian tax system is not optimally or effectively operating, and it is important to

take all available measures in ensuring that our fiscal strategy sufficiently supports the economy. Multiple taxation has direct impacts on the costs of business and this results in inflation, an increase in the price of goods and services, and negatively impacts the ease of doing business in Nigeria. Harmonization of direct taxes would reduce the tax burden on taxpayers and would solve the problems posed by multiple taxation. Tax harmonization requires different taxing authorities to align the taxes respectively levied in the jurisdictions for the purpose of creating a common tax regime.

Conclusion

The foregoing discussions above have examined the effectiveness of tax penalties in combating tax offences in Nigeria, the relationship existing between tax penalties and tax compliance, as well as the factor influencing the effectiveness of the Nigerian tax system. Also examined were the regime of sanctions and penalties provided in the various tax statutes, both civil and criminal, and their deterrence level in the light of the current rate of tax compliance in Nigeria. Tax offences have been shown to amount to serious acts of sabotage, the resultant effect of which is usually felt by both the State and its citizens alike. It deprives the State of the necessary revenue required for the effective discharge of government's electoral promises and denies the public the necessary socio-economic facilities which may vicariously impact on the people's standard of living.

Experience has also shown that the deterrence level of tax penalties is more effective on corporate taxpayers than against natural people. Since registered corporate entities are more easily tracked by tax authorities, the probability of discovery and sanction in the event of default is higher compared to natural people, particularly persons operating in the informal sectors who are more mobile and evasive. The challenge of tracking and integrating the informal sector and small businesses into the tax net is a significant hurdle, as acknowledged in works by Okeke, Chidi, and Eme (2017) on strategies for enhancing IGR. Trackable taxpayers already in the tax net are most likely to be more compliant with their tax obligations. The problem, therefore, is difficulty in tracking tax defaulters, lack of tax knowledge, and inadequate prosecution of defaulters amongst others. If defaulters are more adequately

prosecuted, it would increase the effectiveness of tax penalties in ensuring better tax compliance, resulting in more revenue generation. Ultimately, as argued by scholars like Kiabel and Nwokah (2009), boosting revenue generation requires exploring all viable options, including effective penalty regimes, to ensure states can meet their infrastructural and developmental obligations, a link also established by Michael and Sunday (2013) in their study on Akwa Ibom State.

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