

## Taxing informal sector and revenue generation in Nigeria

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### Abstract

The financial difficulties faced by many developing countries causes retardation to economic development and standardized well-being of their citizens. One major sector of every developing economy that should have contributed immensely to their revenue generation drive is the informal sector given its enormous size. The effect of informal economy on generation of tax revenue in Nigeria was examined in this paper. It was a field survey research design, 73 structured questionnaires were administered to the sampled respondents while 68 were retrieved representing 97.1% retrieved/completed usable copies. Cronbach Alpha test shows that the research instrument has a value of 0.988 which is greater than 0.70, which implies that the research instrument is reliable. The study adopted purposive sampling technique for sample size estimation of descriptive and inferential statistics employing regression analysis were used for data analysis. The findings revealed that informal sector (tax assessment and collection technique, tax compliance level, informal sector financial acquisition and economic activities of informal sector) significantly affected revenue generation through tax in Nigeria ( $Adj.R^2 = 0.935$ ,  $F_{(63,4)} = 241.364$ ,  $p < 0.05$ ); The study concluded that informal sector significantly influence revenue generation through tax in Nigeria. Therefore, this paper recommended that Nigerian government should boost the tax assessment and collection technique of informal sector in order to increase revenue and also give room for tax incentive given to the sector to allow for more informal business to be registered with the CAC.

**Keywords:** Tax system, Tax compliance, financial acquisition, Economic activities, Informal sector, Tax revenue.

### 1 Introduction

Across the globe, governments' civic responsibility is to provide all the necessary and basic amenities for well-being and betterment of its citizens; irrespective of the sectors they belong whether formal or informal. Some of the obligations from the government to her citizens and to those who own one or two businesses include economy stability, income reallocation, and availability of public goods and services (Aina, Adebayo & Adigun, 2017) <sup>[3]</sup>. This can be financed through generated revenue. From time immemorial, tax income has been the main source of income for the government, the income generated through taxes paid by the citizens are utilized by the government in executing its civic responsibilities all over the world. According to Obara and Nangib (2016) <sup>[23]</sup>, government of any nation are expected to provide worthy roads, maintain law and order, build a defense against external aggression, regulate trade and commerce to attain a peaceful living standard for its citizens (Obara & Nangib, 2017) <sup>[24]</sup>.

In Nigeria, taxes are compulsory levy and collectible by the three tiers of government depending on the nature of the tax. Every individual, businesses and corporate bodies are expected to pay tax as their civic responsibility to the government. The main focus of tax system and administration is to ensure that government generated sufficient fund in financing all public expenditures (Okoye & Raymond, 2014) <sup>[28]</sup>. In recent time, the curiosity and difficulties faced by government of many nations in generating sufficient fund to effectively carried out their civic role has widened their search for alternative means of revenue of which Nigeria is not an exception. The tax system and administration in Nigeria suffered lots of deficiencies ranging from outdated facilities and

incompetent personnel; hence tax evasion and avoidance are on rampage as majority of taxable person and businesses are not captured in to the tax net for proper assessment (Amanamah, 2016) <sup>[6]</sup>.

One major sector of every developing economy that should have contributed immensely to this revenue generation drive is the informal sector given its enormous size. But, on the contrary, incomes generated from this sector are rarely subjected to appropriate tax because this sector of the economy are not captured into the tax net, thus difficult to assess (Udoh, 2015) <sup>[32]</sup>. It is therefore noted that the informal sector of the economy constitute the larger proportion of the tax defaulters, evading and avoiding tax payments by all means, thus resulting to leakages in revenue to have accrued to the government. Over the years, almost every efforts aimed at improving the tax collection among this sector has not yielded expected outcome (Obara & Nangih, 2017) <sup>[24]</sup>. Since the informal sector consists of firms and individuals who are not fully registered and regulated, and therefore not in the standard tax net, it is often difficult to ensure voluntary tax compliance among this group. Studies have shown that challenges ranging from tax administration such as poor knowledge of tax matters, inadequate accounting record, failure on the parts of governments to utilise tax revenue, high tax rate, the nature of the business, the large size of the informal sector, account for this low level of compliance (Ohaka & Zubkee, 2015) <sup>[27]</sup>.

The role of the informal sector to local economic development has been discussed by many authors (Rachmawati, 2014) <sup>[29]</sup>. According to Torado (2000) informal sector in Nigeria refers to economic activities in all sectors of the economy that are operated outside the preview

of government regulation. The features and characteristics of this very critical sector include among others, their mobile nature, small scale operation, cash transaction and unwillingness to keep business records make it very hard to tax the sectors actors, since the taxation of this commonly referred to as hard-to-tax sector“ requires enormous effort and seeming tasking. This sector may also be invisible, irregular, parallel, non-structured, backyard, underground, subterranean, unobserved, or residual (Ekpo and Umoh, 2014) <sup>[10]</sup>. Ohaka and Zubkee (2015) <sup>[27]</sup> stated that the operators of this sector mostly lack adequate financial resources to import more advanced technology so the sector heavily relies on labor-intensive mode; for its production. Ekpo and Umoh (2014) <sup>[10]</sup> further summarized that “activities in the informal sector in Nigeria are difficult to measure; they are highly dynamic and contribute substantially to the general growth of the economy and personal or household income”. Obara and Nangih, (2017) <sup>[24]</sup> argued that an informal economy are broadly low income earners, coupled with instability return on investment and unable to access legal protections of business and services, thus inhibits steady and rapid growth of such economy.

Iredele, Ogunleye & Obe, (2018) <sup>[16]</sup> opined that Nigeria is often times faced with the problem of raising revenues to meet up with the government’s spending. The bane of taxation in Nigeria lack transparency and proper accountability which made Nigerian government not been able to generate the revenue it supposed to towards the aid of the entire economy and the growth of the informal sector (Bird, 2015) <sup>[8]</sup>; however, tax administration according to Eze, Iorwuese and Abba (2016) <sup>[312]</sup> in Nigeria is said to be deplorable in nature. All these and many more are the issues this study considered imperative in examining the nexus between informal sector and tax revenue in Nigeria.

The Socio-Political theory of taxation was presented by Wagner (1883) <sup>[33]</sup> which stated that social and political objectives should be the major factors in selecting taxes. Ogbonna and Appah (2012) <sup>[26]</sup> affirmed this reasoning justifies the imposition of taxes for financing state activities and for the provision of a basis for apportioning the tax burden between members of the society. The advocates of this theory believed that tax system is not designed to serve individuals but to cures the ills of the society as a whole. The society is made up of individuals but is more than the sum total of its individual members; consequently, the tax system should be directed towards the health of the society as a whole, since individuals are integral part of the broader society.

### Empirical Review

Akinyele and Ogunmakin (2016) <sup>[4]</sup> investigated the impact of tax avoidance on government budget implementation in Southwest Nigeria for the period 1999-2014. The result of the analysis revealed that on the average, 61 percent of the anticipated ax revenue of the states were restrained due to tax avoidance. The study reported that tax avoidance occurred as a result of low compliance level of the citizens with collection and remittances especially among the informal economy, and inefficient implementation of tax laws and policies by the tax administrators in Southwest Nigeria negatively impacted on the performance of government budget implementation and thus affected the development of the economies of sampled states.

Almustapha and Hamza (2016) <sup>[5]</sup> carried out a study on the determinants of informal sector tax evasion in Sokoto Metropolis using a field survey research design. The study administered 317 questionnaires to respondents within Sokoto Metropolis while 300 questionnaires were returned and analyzed using regression analysis. It was reported that taxation and fiscal factors, economic factors and administrative factors, among other factors statistically influenced individuals’ tax-evasion behavior. It was recommended that tax authorities should design policies to help increase the income level of taxpayers rather than increasing administrative as this may lead to higher tax compliance in the long run.

Ibadin and Eiya (2013) <sup>[15]</sup> examined tax evasion and tax avoidance behavior of the self-employed, using some selected states in Nigerian geo-political zone. The responses of the respondents showed that tax evasion has been seen has norm in the society and become ethical. The result of the analysis also revealed thee exist a significant relationship between the ethical view, tax administration system and cultural practices of the self-engaged citizens and tax evasion and avoidance. Similar study was carried out by Obafemi (2014) <sup>[22]</sup>, it was discovered that tax evasion and avoidance has become a practice among the informal sector of the economy and adversely affected economic growth and development in Nigeria.

Iredele, Ogunleye and Obe (2017) <sup>[16]</sup> in their study on voluntary tax compliance among the informal economy using Ifako-Ijaiye local council development area (LCDA) of Lagos state, Nigeria as case study. Structured questionnaire was administered to a sample of 100 business owners comprising of traders, artisans, shop owners and 17 tax officials were selected using convenience sampling method. It was reported that the compliance level among the informal economy is low and business owners who are the expected tax payers were of the opinion that tax injustice on the path of the government is the major cause of high non-voluntary compliance rate. The study also evidenced that tax officials agreed to the assertion that due to the nature of the businesses of the informal economy and the inadequacy of records, taxing the informal sector of the economy has been a major challenge.

Obara and Nangib (2017) <sup>[24]</sup> examined effects of taxing the informal sector in Nigeria using field survey research method. A total of 110 questionnaires were administered to respondents within Port Harcourt metropolis and its environs. The result of the Kruskal Wallis and Chi square tests showed that taxing the informal sector would boost revenue generation and also impact positively on the economic development of developing countries. It was recommended that effective tax monitoring and audit of the informal sector operators, enhanced capacity building of staff of the Revenue Authorities, immediate establishment of revenue courts to try offenders where necessary, reduction of multiple taxes, etc. as some of the steps to be taken to ensure compliance to tax payments by informal sector operators.

Spatial and featured database was developed for the informal sector businesses as a basis for efficient tax generation from the informal sector using a Global Positioning System for data acquisition form different informal businesses location and geographic Information System for data capturing and analysis by Odubo, Mieye and Odubo (2016) <sup>[25]</sup>. They also carried out a field survey

on the level of compliance of small businesses with the registration; it was observed that owners of small businesses are unwilling to get their businesses registered, they agreed that they are enlightened on tax through the media and the tax authorities, but majority of the respondents declared that they haven't paid taxes. It was concluded that the compliance level of informal sector business to tax administration and system is very low resulting to dwindling in tax revenue generated by the government.

A field survey research conducted by Enahoro and Olabisi (2012)<sup>[11]</sup> on tax administration system in Lagos State using Kendall analytical technique; 130 filled and returned structured questionnaire were used for the analysis and it was found that there are still lapses in tax administration system of Lagos State. The study recommended that consultants or private organisations should be engaged in Lagos State tax system to ensure effectiveness and block leakages in revenue generation.

**Methods and Materials**

This study is a field research, targeting the entire seventy-three (73) staff of Federal Inland Revenue Service (FIRS), Ikeja, Lagos as the population and as well the sample subjects using total enumeration sampling techniques. The staff of FIRS was chosen as sample frame using purposive sampling technique as they are considered to be knowledgeable and experienced on tax matters. Five-point Likert-type scale structured questionnaire was used as data collection instrument with options ranging from Strongly Agree; Agree, Undecided, Disagree, and Strongly Disagree and coded as SA (5), A (4), UD (3), D (2), SD (1). The questionnaire was subjected to reliability test using Cronbach Alpha Coefficient Technique and the result of 0.988 being greater than 0.70 thresholds implied that the questions formulated in the questionnaire standing as the

research instrument is consistent in generating relevant information for the analysis.

The data obtained from the administration of structured questionnaire were analysed using descriptive and regression analysis. Multivariate regression (Pooled Ordinary Least Square) analysis was carried out in testing the hypothesis, while Statistical Package for Social Sciences software was used in carrying out the regression analysis (SPSS).

**The regression model of the study is formulated thus:**

$$ISR = f(TACT, TCL, TFA, EAS)$$

$$ISR = \alpha_0 + \alpha_1TACT + \alpha_2TCL + \alpha_3TFA + \alpha_4EAS + \mu_6$$

Where: Tax Assessment and Collection Technique (TACT), Tax compliance level (TCL), financial acquisition (FA), Economic Activities (EAS)

$\alpha_0$  represents Intercept and  $\alpha_1, \alpha_2, \alpha_3, \alpha_4,$  and  $\alpha_5$  represent the Coefficient of the independent variables (IS);  $\mu_1$  is the error term

**Results and Discussion of Findings**

**Questionnaire Returned Rate**

Sevety-three (73) structured questionnaires were administered to the staff of Federal Inland Revenue Service (FIRS), Ikeja, Lagos State as respondents, while sixty-eight (68) were duely filled, returned and analyzed to achieve the stated objective in this study. The proportion of the returned questionnaire to the total number administered was 93.15%, which was considered adequate for the analysis as it was above 80% expected returned rate.

**Demographic Characteristics of Respondents and Research Based Questions**

The bio-data of the respondents as obtained from the filled questionnaire were presented and analysed I Table 4.2.

**Table 1:** Demographic Data

Characteristics	Group	No of Respondents	Percentage %
Sex	Male	40	58.8%
	Female	28	41.2%
Age of the Respondents	21-30 Years	10	14.7%
	31-40 Years	33	48.5%
	41-50 Years	23	33.8%
	51 Years and Above	2	2.9%
Marital Status of the Respondent	Single	29	42.6%
	Married	39	57.4%
Educational Qualification of the Respondent	ND/NCE	5	7.4%
	HND/B.sc	35	51.5%
	M.Sc.	25	36.8%
	PhD	3	4.4%
Civil Service Experience of the Respondent	1-5 years	9	13.2%
	6-10 Years	32	47.1%
	11-15 Years	19	27.9%
	16-20 Years	8	11.8%

Source: Field Work, (2019)

**Interpretation**

As shown in Table 4.1.2, the demographics data of the respondents in relation to: gender of the respondents are male 40 (58.8%) while 28 (41.2%) the least happens to be

female. Majority of the respondents' age fall within 31 - 40 years (33respondents, 48.5%); followed by for age brackets 41 – 50 years, (23respondents, 33.8%); age 21 - 30 years (10 respondents, 13.7%) while the respondents between age

51 years and above are just 2 (2.9%). 39 (57.4%) of the respondents are married while 29 (42.6%) are single. The highest educational respondents' qualifications is HND/B.Sc 35 (51.5%), followed by M.Sc with 25 (36.8%), followed by ND/NCE 5 (7.4%) and the least happens to be Phd with 3 (4.4%) Majority of the respondents have a cognate work experience of 6-10 years 32 (47.1%) followed by 11-15 years 19(27.0%), 1-5 years 9 (13.2%) and the least is 16-20 years 8 (11.8%).

This implies that majority of the respondents are male and majority fall between the age brackets of 31-40 years, most of the respondents are married. The highest educational qualification for them is HND/B.Sc, majority of them have a work experience of 6-10 years.

**Analysis of General Questions**

This is the presentation and analysis of questions relating to the research topic according to the questionnaire distributed

**Table 2:** Tax assessment and collection technique

S/N	Tax assessment and collection technique	SA (%)	A (%)	UD (%)	D (%)	SD (%)	$\bar{X}$	STD
1	Tax authorities adopt different types of technique in tax collection	40 58.8%	24 35.3%	3 4.4%	- -	1 1.5%	4.50	.723
2	Informal sector tax administration templates in relation to assessment, collection and remittances has not been fully automated	35 51.5%	30 44.1%	2 2.9%	1.0 1.5%	- -	4.46	.633
3	Tax collection techniques reduces the level of tax evasion in the informal sector	28 41.2%	30 44.1%	8 11.7%	1 1.5%	1 1.5%	4.22	.826
4	Tax assessment method allows for transparency and efficiency in tax collection in the informal sector.	31 45.6%	29 42.6%	4 5.9%	3 4.4%	1 1.5%	4.26	.874
5	Presumptive tax is a new invention in Nigeria tax system and has not been fully implemented nor appropriately captured in the existing tax laws and policy.	30 44.2%	29 42.6%	3 4.4%	4 5.9%	2 2.9%	4.19	.981
6	Inadequate knowledge of the tax authorities personnel is one of the major challenge of full implementation of presumptive tax, thus creating conflict with taxpayers	30 44.2%	29 42.6%	3 4.4%	4 5.9%	2 2.9%	4.19	.981
							4.30	

Source: Field Survey (2019)

**Discussion**

The responses given by respondents in respect to tax assessment and collection technique with an aggregated mean of 4.30 reflected that on the average, the respondents agreed that tax authorities adopt different types of technique in tax collection; informal sector tax administration templates in relation to assessment, collection and

remittances has not been fully automated; tax collection techniques reduces the level of tax evasion in the informal sector, tax assessment method allows for transparency and efficiency in tax collection in the informal sector, the invention of presumptive tax has not been fully implemented; and lastly, tax authorities personnel lack required knowledge for presumptive tax implementation.

**Table 3:** Tax compliance level

S/N	Tax compliance level	SA (%)	A (%)	UD (%)	D (%)	SD (%)	$\bar{X}$	STD
1	Citizens in the informal economy do not have adequate knowledge of tax compliance strategy	21 30.9%	35 51.5%	5 7.4%	4 5.9%	3 4.4%	3.99	1.015
2	High tax rate is an economic burden on citizens in the informal sector	30 44.1%	30 44.1%	8 11.8%	- -	- -	4.32	.679
3	Citizens in the informal sector do not keep good accounting records for tax assessment	37 54.4%	25 36.8%	6 8.8%	- -	- -	4.46	.656
4	Businesses in the informal sector have not been properly registered for tax purpose	20 29.4%	30 44.1%	6 8.8%	8 11.8%	4 5.9%	3.79	1.166
5	Government do not utilize tax for the purpose they are meant	25 36.8%	25 36.8%	10 14.7%	5 7.4%	3 4.4%	3.94	1.105
							4.1	

Source: Field Survey (2019)

**Discussion**

The responses given by respondents in respect to tax compliance level with an aggregated mean of 4.10 reflected that on the average, the respondents agreed that: Citizens in the informal sector do not have adequate knowledge of tax compliance strategy, high tax rate is an economic burden on

Citizens in the informal sector, Citizens in the informal sector do not keep good accounting records for tax assessment, businesses in the informal sector have not been properly registered for tax purpose. Lastly, government do not utilize tax for the purpose they are meant.

**Table 4:** Tax financial acquisition

S/N	Tax financial acquisition	SA (%)	A (%)	UD (%)	D (%)	SD (%)	$\bar{X}$	STD
1	Government carry out financial acquisition with the informal sector revenue	20 29.4%	10 14.7%	20 29.4%	10 14.7%	8 11.8%	3.35	1.358
2	Government gives full disclosure to informal sector on how their finances are used for asset acquisition	15 22.1%	16 23.5%	11 16.2%	15 22.1%	11 16.1%	3.13	1.413
3	Government improves the informal sector through financial acquisition to improve economic development.	20 29.4%	20 29.4%	10 14.7%	10 14.7%	8 11.8%	3.50	1.366
4	Informal sector carries out financial acquisition to increase and also contribute to the economy.	20 29.4%	25 36.8%	10 14.7%	10 14.7%	3 4.4%	3.72	1.170
							3.425	

Source: Field Survey (2019)

**Discussion**

The responses given by respondents in respect to tax financial acquisition with an aggregated mean of 3.425 reflected that on the average, the respondents partially agree and partially indifferent on the points that: government carry out financial acquisition with the informal sector revenue,

government gives full disclosure to informal sector on how their finances are used for asset acquisition, government improve the informal sector through financial acquisition to improve economic development. Lastly, informal sector carries out financial acquisition to increase and also contribute to the economy.

**Table 5:** Economic activities of informal sector

S/N	Economic activities of informal sector	SA (%)	A (%)	UD (%)	D (%)	SD (%)	$\bar{X}$	STD
1	Informal sector represents a substantial sector in the economy.	40 58.8%	20 29.4%	4 5.9%	2 2.9%	2 2.9%	4.38	.947
2	Government taxes the informal sector revenue	20 29.4%	10 14.7%	5 7.4%	18 26.5%	15 22.1%	3.03	1.583
3	Informal sector contributes a large part of tax revenue in Nigeria.	6 8.8%	20 29.4%	20 29.4%	10 14.7%	12 17.6%	2.97	1.233
4	Informal sector is only marginally productive.	20 29.4%	30 44.1%	9 13.2%	7 10.3%	2 2.9%	3.87	1.050
5	Most of those in the sector are entrepreneurs of unregistered enterprises with no knowledge of the basics of taxation.	20 29.4%	30 44.1%	10 14.7%	7 10.3%	1 1.5%	3.90	.995
							3.63	

Source: Field Survey (2019)

**Discussion**

The responses given by respondents in respect to economic activities of informal sector with an aggregated mean of 3.63 reflected that on the average, the respondents agreed that: informal sector represents a substantial sector in the economy, government taxes the informal sector revenue,

informal sector contributes a large part of tax revenue in Nigeria, informal sector is only marginally productive. Lastly, most of those in the sector are entrepreneurs of unregistered enterprises with no knowledge of the basics of taxation.

**Table 6:** Informal Sector Revenue

S/N	Informal Sector Revenue	SA (%)	A (%)	UD (%)	D (%)	SD (%)	$\bar{Y}$	STD
1	Government apply policies that can spur informal sector revenue in Nigeria.	10 14.7%	19 27.9%	17 25.1%	12 17.6%	10 14.7%	3.10	1.283
2	Nigeria optimizes the collection of informal sector revenue.	17 25.0%	18 26.5%	10 14.7%	14 20.6%	9 13.2%	3.29	1.394
3	Informal sector revenue contributes majorly to the revenue component of the federal government.	13 19.1%	19 27.9%	11 16.2%	17 25.0%	8 11.8%	3.18	1.326
4	Each level of government plays a pivotal role in the efficient collection of informal sector revenue.	18 26.5%	22 32.4%	18 26.5%	6 8.8%	4 6.8%	3.65	1.143
5	Government fosters strategies that ensure compliance with the payment of taxes in the informal sector.	14 20.6%	20 29.4%	20 29.4%	9 13.2%	5 7.4%	3.43	1.176



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