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Issue of Income Inequality in Nigeria: the role of Indirect Taxes

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Abstract

The main objective of this study is to conceptually examine the effect of indirect taxes on income inequality in Nigeria. To achieve this, prior literature on the concept of indirect taxes and income inequality were carefully reviewed. The methodology employed in this study is purely exploratory. From the review of prior studies, it was observed that there is no consensus as to the effect of indirect taxes on income inequality. Some studies revealed that indirect taxes are negatively related to income inequality because it helps increase government revenue which is used to alleviate poverty and enhance redistribution of income. Other studies found that indirect taxes contribute significantly to income inequality. From the review, the study revealed that indirect taxes are basically imposed on consumption and are regressive which implies that an increase in its rate will further widen the income gap to varying degrees. As indirect taxes increase the price of goods and services also increase which then makes it difficult for income inequality to be reduced because all taxpayers pay the same tax rate irrespective of their income level. Going by the outcome of the reviews, the paper takes a position that, the indirect tax does not reduce income inequality. This paper recommends that government should reconsider the recent increase in VAT, as this increase in VAT rate would further increase the price of commodities and services in the nation which therefore implies that the low-income earners will have less of their income to spend on more commodities. Also, the Federal Government should remove the recent amendment to CETA, to allow the average low-income earners to be able to afford the listed imported goods in the fifth schedule of CETA.

***Keywords**: Taxes. Taxation, indirect taxes, Value added tax, Custom and excise duties, income Inequality*

1 Introduction

Equal distribution of income is important for the stability of any economy but income is not distributed equally in any country and the governments try to provide the fairest distribution of income by intervening with various instruments. The government of any country is the one responsible for income redistribution, promoting fairness and equity, economic stabilization, provision of public goods and services, fiscal responsibility and accountability, facilitating economic growth and development (World Development Report, 2017).

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Income inequality is one of the most challenging economic trends facing most developing countries, particularly Nigeria. The income disparity between the rich and the poor continues to widen despite efforts to address it by implementing different public policies like social expenditure and taxation. The gap that exists between the rich and the poor is a major concern for governments all over the world. One of the tools at the disposal of the government in addressing this gap is taxation. As an economic instrument, taxation is one of the most direct ways to keep inequality in check and reduce poverty in the short term. A well-structured tax system is capable of generating enough income to fund the infrastructural development that will promote policy reforms (Action Aid, 2013).

Taxation is imposed on the income of individuals, corporate bodies, goods and services. According to Bhartia (2009) and Ola (2001), tax is imposed on taxpayers to generate revenue that government can use to meet the needs of the society, ensure income redistribution and properly run the affairs of a country or economy.

Government can either impose a tax directly or indirectly. When tax is imposed directly, each taxpayer pays the same tax rate on their income, so that means a high-income earner will pay a higher tax than a low-income earner. On the contrary, when tax is imposed indirectly, all taxpayer pays the same amount of tax irrespective of the income earned. The implication of this is that a low-income earner and a high-income earner will pay the same amount of money as tax.

Barnard (2010) argued that indirect taxes are regressive, every taxpayer pays the same rate of tax irrespective of his/her financial status (whether rich or poor). This means a greater burden (relative to income) is imposed on the poor than on the rich, this has widened the disparity in societal wellbeing, this is because the poor ends up paying a larger proportion of income as tax compared to the rich. Indirect taxes unlike direct taxes do not take into consideration the fact that different individuals earn different incomes, hence a flat rate is charged not based on the income. There is an inverse relationship between the tax rate and the taxpayer's ability to pay, this means the tax burden of the taxpayer with a higher ability to pay is reduced compared to that of taxpayers with a lower ability to pay.

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The Federal government of Nigeria increased the rate of Value Added Tax (VAT) by an additional 2.5% (formerly 5%) to 7.5% in 2020 (Finance Act, 2019). The increase in VAT is one of the main issues that necessitated this study. With all taxpayers paying the same rate of VAT, regardless of their income status. There is a need to ascertain whether the income inequality between the rich and the poor has either reduced or increased. This raises one of the questions that constitute this paper, does VAT reduce income inequality?

Also the Amendment of Part III, Section 21 of the Customs and Excise Tariff, Etc. (Consolidation) Act (CETA) is another reason for conducting this study. Excise Duty used to be imposed only on specific locally manufactured goods in Nigeria as specified in the fifth schedule to CETA but now it has been extended to apply to all foreign goods listed on the fifth schedule to CETA (Finance Act, 2020). Another question this study seeks to answer is, what is the effect of the amendment to CETA on the inequality of income in Nigeria?

In assessing these questions, a look at extant literature showed that while some researchers (Oboh & Eromonsele, 2018; Saez, 2004; Sameti & Rafie, 2010) argued that indirect tax helps to increase government revenue, can be used for income distribution in the economy, alleviate poverty and contribute to sustainable economic growth, others (Ardanaz & Scartascini, 2013; Martinez-Vazquez, Vulovic, & Moreno-Dodson, 2012) claim that Indirect tax is not a good tool for redistribution of income and is potentially harmful to growth and that an increase in VAT will lead to an interest rate hike, higher inflation, more unemployment and generally make people poorer. Stating further that any increase in Indirect tax leads to an increase in the prices of goods and services which will, in turn, make it difficult for income inequality to be reduced.

A further check on available literature suggests that while there is ample empirical research (Oboh & Eromonsele, 2018; Saez, 2004; Sameti & Rafie, 2010) on the correlation between indirect taxes and inequality of income; conceptual papers discussing the issues of the impact of indirect taxes on income inequality are sparse in Nigeria. Oboh and Eromonsele (2018) attested that issues surrounding taxation and income inequality are still not resolved in literature and as such provides

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abundant opportunity for further enquiries. To the best of our knowledge, this paper is among the few that have conceptually discussed indirect taxes and income inequality in Nigeria.
In a bid to take a position as to whether indirect taxes decrease income inequality in Nigeria, this paper examined the concept of indirect taxes, VAT and CET, their impact on income inequality, and also discusses the issue of income inequality in Nigeria.

It is expected that the recommendations of this paper will be of significance to Government because they will highlight how indirect taxes influence income inequality. It will also be important to Federal Inland Revenue Service by providing insight into how taxation can affect income inequality in Nigeria. It may serve as reference content for upcoming research on the subject matter, especially in the aftermath of the increase in the VAT rate and amendment to CETA in Nigeria.

The remaining part of the paper is structured as follows: Section two presents an overview of the concept of income inequality; Section three is on the Concept of indirect Taxes; Value Added Tax (VAT) and Custom and Excise Duty (CED); Section four reviews relevant literature to the study and Section five concludes the study with necessary suggestions made.

2. The concept of Income inequality

The term income inequality has been defined by different authors. However, the underlining idea in the definitions shows the same direction-persistent widening of the gap between the income of the rich and the poor. Income inequality is a summary of the distribution of individual income, that symbolizes sharing of income or wealth measurement among households (Okatch, Siddique & Rammohan, 2013). In the view of Bradley (2013) inequality of income is a way of examining the gap that exists in the income of the different households in a given region, nation or country.

Kopp (2019) defines income inequality as "an extreme disparity of income distribution with a high concentration of income usually in the hands of a small percentage of a population". When income inequality thus occurs, there is a large gap between the wealth of one population segment in comparison to another. Obaretin, Akhor, and Oseghale (2017) opined that income inequality is an

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uneven distribution of individual and household incomes over the different parts of an economy. Income disparity is calculated as the rate of income divided by the number of the populace. The reasons for the income disparity can be because of education, sex, religion and social status. For this paper, however, income inequality can be loosely defined as the unequal distribution of income in any economy.

Oxfam (2017) particularly noted that the paradox of growth in Nigeria is such that as the country gets richer, only a few benefit, while the majority continue to suffer from poverty and deprivation. According to the Multidimensional Poverty Measure (PMP), as many as 47.3% of Nigerians (98 million people) live in multidimensional poverty (Lain & Vishwanath, 2021). The Multidimensional Poverty Measure (PMP) is a poverty indicator of the World Bank that captures dimensions of education, basic infrastructure and monetary poverty. It revealed that Nigeria is the largest contributor with the highest levels of deprivation in multidimensional poverty in Sub-Saharan Africa (Lain & Vishwanath, 2021). Furthermore, the Oxfam (2019) report of ranking of African nations by their commitment to tackling inequality ranked Nigeria as the 45th out of 45 countries, stating that Nigeria has the unenviable distinction of being at the bottom of the African ranking, as well as its global ranking for two years running.

In the perspective of Ilaboya and Ohonba (2013) public policies such as social expenditure, taxation, good governance represented by transparency and accountability, public expenditure on health, housing and education, and policies of more comprehensive growth, are used to address the issue of income disparity.

Igbuzor (2017) identified that the reasons for inequality and poverty in Nigeria are regressive taxation, poor allocation and budgetary system, mismanagement of resources, weak implementation of policy, and the prohibitive cost of governance, cronyism and favouritism. These drivers have made it difficult for the government to reduce income inequality.

The coefficient of variation of income, the logarithm of income, generalised entropy class of inequality indices, the Gini coefficient and the Atkinson index are different techniques that can be

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used to measure inequality in a population (Okatch *et al*., 2013). The most widely used technique is the Gini coefficient that calculates the distinction between the actual and equal distribution of income among the populace. It measures the extent to which income or consumption among individuals or households within an economy differs from a perfectly equal distribution (Gylfason & Zoega, 2002). Individuals or households within an economy have equal income when the Gini coefficient is zero (0) while a Gini coefficient of one (1) indicates that all income goes to only one person. Hence, when the Gini coefficient is high that means there is high inequality. Gini coefficient has been used by some researchers (Awe & Rufus, 2012; Ilaboya & Ohonba, 2013) as a measure for inequality in their studies.

There are so many reasons why studying income inequality is considered important. It is apparently because it is important to the state of the economy and a wide range of stakeholders. Appergis (2005) suggest different factors that lead to income inequality, some of which are changes in skilled-based technology, increase in labour force participation by low skilled workers, globalization, and increasing share of high income in couples and single-parent households and the declining top marginal income tax rates of high earners.

Nyenke and Amadi (2019) asserted that despite the huge amount of money generated by the Nigerian government through tax revenue, economic development seems to be a mirage as poverty, low standard of living and income inequality remain widespread and at a growing trend. They went further to say that no remarkable change has been recorded in the area of growing income inequality even with the numerous tax reforms in Nigeria (such as the Federal Inland Revenue Service Act 2007, Personal Income Tax Act 2011, Petroleum Profit Tax Act 2004, Value-Added Tax Act 2007, Tertiary Education Tax Act 2011, among others.)"

3. The Concept of Indirect Taxes

Tax revenue is an important instrument for addressing social and economic issues and promoting equality (Johansson, Heady, Arnold, Brys & Vartia, 2008). The main purpose for imposing tax has always been to fund the activities of government, redistribute income, and encourage economic activities among others (Obaretin, Akhor, & Oseghale, 2017). In the opinion of Anyaduba (2000)

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tax is a compulsory levy imposed on an individual, household and corporate entity's income by the government to raise revenue. Oladiran (2009) defined taxation as a tool for societal development and an avenue through which the rewards of development are redistributed. Ariwodola (2008) described taxation as a method by which a nation implements decisions to transfer resources from the private to the public sector. While Ogbonna and Appah (2012) asserted that the main reason for taxation is the raising of income to finance government expenditures, redistribute riches, and for the management of the economy.

According to Micah, Ebere and Umobong (2012) taxation in Nigeria is enforced by the Federal, State and Local Government. The major taxes operational in Nigeria currently include Personal Income Tax, Petroleum Profit Tax, Companies Income Tax, Value Added Tax (VAT), Tertiary Education Tax, Capital Gains Tax, Custom and Excise Duties, and Stamp Duties; all can be grouped under two main categories of direct taxes and indirect taxes.

Direct Taxes are taxes levied directly on personal or corporate income, these taxes include Personal Income Tax, Petroleum Profit Tax and Companies Income Tax while indirect taxes are levied on goods and services these include Value Added Tax (VAT), Stamp Duties and Custom and Excise Duties (CED).

Indirect tax is a type of tax usually imposed on a manufacturer or supplier who then passes on the tax to the consumer. Indirect taxes are not levied directly on the income of the taxpayer but are placed on goods and services. The burden of an indirect tax can be shifted by the taxpayer to someone else. Value Added Tax (VAT) and Custom and Excise Duties (CED) are the major taxes used as proxies for indirect tax in this study

3.1 Value Added Tax (VAT)

Agaji and Ogakwu (2020) defined Value Added Tax (VAT) as a levy imposed on the purchase and consumption of goods and services in Nigeria by the Federal Government. It is charged on the value derived from the purchases of goods and services. VAT is a consumption tax paid when goods are purchased and services are rendered, it is a multi-stage tax borne by the final consumer

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(FIRS, 2020). For the study, however, VAT is defined as an indirect tax paid by a consumer on the consumption of goods and services.

Value Added Tax (VAT) was introduced by the Value Added Tax (VAT) decree No. 2 of 1993 in Nigeria, which has now been repealed and replaced with the VAT Act 2007. Collection of VAT commenced on January 1, 1994, and it replaced the Sales Tax (Ochei, 2010). At inception, VAT was charged at 5% on all invoiced amounts of taxable goods and services borne by the final consumer, payable upon registering with the Federal Board of Inland Revenue (Akhor & Ekundayor, 2016; Ojo & Oladipo, 2017; VAT Act, 2004). The scope and coverage of VAT apply to all goods and services manufactured or imported in Nigeria, except those that are exempted e.g. services rendered outside the country, pharmaceuticals products, medical supplies, educational materials and equipment. Goods and services in export processing zones (EPZs) or free port zones are also not liable to VAT on the basis that these zones are outside the scope of Nigerian VAT rules (VAT modification order, 2020).

Foreign companies running a business in Nigeria need to register to be able to charge VAT on all their taxable supplies in the country. VAT is aimed at increasing government revenue and ensuring funds are available for development. Indirect tax such as VAT has over time, provided a more consistent revenue inflow for the government because it is easier for tax authorities to collect and administer and more difficult for tax payable to evade (National Tax Policy, 2017).

The Nigerian VAT Act was part of the amended tax laws by the Finance Act 2019. The Finance Act 2019, signed into law on 13 January 2020, increased the Value Added Tax rate by an additional 2.5% (initially 5%) to 7.5% effective as from 1st February 2020 (Ameh, 2019; Finance Act, 2019; VAT Modification Order, 2020). The list of goods and services exempted from VAT were also extended to include products used by most Nigerians across all industries such as essential food items, medical supplies, pharmaceutical products, petroleum products as well as renewable energy equipment (Finance Act, 2019).

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While the government hopes to generate more revenue from the revised VAT rate to stimulate economic growth, there has been an inflationary impact on the prices of taxable goods and services. It is this inflationary impact of VAT that is assumed to further contribute to the increase in income inequality. This is premised on the assumption that indirect tax has the effect of raising the price of the products on which they are imposed, once this happens the poor end up paying more of their income as tax compared to the rich and this further widens the income between the rich and the poor.

3.2 Custom and Excise Tariffs

Custom and excise tariffs are administered by the Nigerian Customs Services (NCS). Customs duties are taxes imposed on commodities imported from foreign countries. Import duties are taxes on imports from foreign countries, charged either as a percentage of the value of the imports or as a fixed amount depending on quality (Akhor & Ekundayo, 2016; CET Act, 2004). Sometimes, the government may want to protect certain domestic products from foreign competition. One way of doing so is by imposing import duty, which makes foreign products more expensive, thus keeping the same domestic products more competitive (Ilaboya, 2012).

Export Duty is a tax imposed on goods sold to foreign countries from Nigeria. Olurotimi, (2013) asserted that export duty is levied on the goods passing through a customs area with a route to another area or country. Export Duty is charged from the date of export or from the movement of transferring goods from one country to another (Okoye & Gbegi, 2013). Ugochukwu and Azubike (2015) argued that export duties are no longer used to the best of their knowledge, except for certain mineral, petroleum, and agricultural products. Export duty is an income-generating means for several resource-rich countries. The burden of export duties falls on the foreign country in that the prices of commodities are increased while that of import duties falls on the consumers of the goods and services (Ikeokwu & Micah, 2019). According to Ayodele (2006), customs duties are the highest yielding indirect tax."

The tax levied on goods manufactured within a country is called Excise duties. Excise duties are charged as a percentage of import value or as a fixed amount on a specific quantity (Akhor &

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Ekundayo, 2016). Ekeocha (2010) described excise duty as an ad-valorem tax on the output of manufactured goods and administered by the country's customs services. Inyiama and Ubesie (2016) affirmed that excise duty is the type of tax charged on goods produced within the country (as opposed to customs duties, charged on goods from outside the country). Though the collection of excise duty augments revenue generated by the government to provide public goods and services, however, over the years it has been used as an instrument of fiscal policy to stimulate economic growth (Olurotimi, 2013).

In Section 21 of Customs and Excise Tariff, Etc. (Consolidation) Act (CETA) provision was made for imposing excise duty on only certain goods manufactured in Nigeria while the imported version was exempted, as specified in the fifth schedule to CETA. In the Finance Act 2019, an amendment was made to this section of CETA by extending the imposition of excise duty to foreign goods listed on the fifth schedule of CETA thus creating equal opportunity for both the locally manufactured goods and imported goods to compete (Finance Act, 2019). However, a provision was introduced as part of the amendment which suggests that foreign goods and raw materials are exempted from excise duties. The provision was later expunged in the Finance Act 2020 because it nullified the intended purpose of imposing excise duties on foreign goods (Finance Act, 2020; Nwofia & Egege, 2021). This means all imported goods on the Fifth schedule to CETA now attract excise duty.

The effect Custom and excise duties have on income inequality can be examined in this light, when the tariff on foreign products is very high, it's the end-users of such products that bear the tax burden. This is because the high rate of custom and excise duties will eventually lead to an increase in the price of imported products. The poor might not be able to afford these products because of the increased price. At the end of the day, the amendment to CETA further contributes to an increase in income inequality as all users regardless of their income level will pay the same amount for the imported products.

3.3 Theoretical Review

The study focused on two theories Ability to Pay Theory and Expediency Theory

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3.2.1 Ability to Pay Theory

Ability to Pay Theory was first introduced by Arthur Cecil Pigou (1877-1959) (Anyaduba & Otulugbu, 2019). The theory sees tax liability as a compulsory levy imposed by the state quid pro quo benefits (Chigbu, Akujuobi & Appah, 2012). Also referred to as the equality of sacrifice theory, the ability-to-pay theory states that taxes should be paid in proportion to an individual's capacity. This means that the more an individual earns the more tax he pays; a high-income earner would therefore pay more than a low-income earner. The theory says the tax should be imposed according to an assessment of the taxable capacity and the ability to pay taxpayers primarily based on tax payer's income and property (Chigbu, Eze & Ebimobowei, 2011). There should be equity in tax applications such that those with the financial resources and the ability to pay should make the payment. A major criticism of the theory is that it might discourage people from expanding their business since it will translate to paying more tax. The tax increase is a major deterrent to taxpayer expanding business as this will automatically mean more tax will be paid as a consequence and there is no incentive. As income increases, the ratio of tax also increases. The theory applies to this study because as one's ability to pay increases more tax would be paid.

3.2.2 Expediency Theory

The Expediency theory is embedded in the cannon of economy, it explains the economy, effectiveness and efficiency of tax collection instruments (Ibadin & Oladipupo, 2015). With taxation, tax authorities have at their disposal a strong policy tool that can be used to overcome economic and social shortcomings in the society such as inequality in income, disparities in regions, unemployment and so on (Chigbu, Eze & Ebimobowei, 2011). The theory according to Bhartia (2004), Musgrave and Musgrave (2004) is based on a relationship between state activities and tax liability, the reason being that it substantiates the reason for distributing tax burden between the members of the society and using tax paid for financing state activities. This theory is used since it sees taxation as a system that provides a set of policy instruments governments can use to overcome fiscal and social evils in the nation. The theory also captures all taxes and inequality.

4. Empirical Review

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To ascertain the correlation between taxation and income inequality in Nigeria, Ilaboya and Ohonba (2013) employed multivariate econometric techniques. Data for their study were collected from CBN Statistical Bulletin, World Bank Index Mundi and Federal Inland Revenue Service from 1980 to 2011. The data were analyzed using both co-integration and error correction models. "The result from their study reveals a negative and robust relationship between total tax revenue, total tax revenue to GDP ratio and income inequality in Nigeria. From the study, it was established that the Nigerian tax system has helped to enhance the redistribution of wealth within the period under review. The study also revealed that the ratio of direct to indirect tax increase inequality even though the impact was insignificant at the 5% level of significance. From the study, it was discovered that tax burden, can help to reduce the level of inequality arguing from the fact that the result reveals a negative impact on income inequality in Nigeria. Flowing from their results, they recommended that there is an urgent need for effective computerization of all tax activities in Nigeria, starting with the registration of all taxpayers with emphasis on the private sector.

Obaretin, Akhor and Oseghale (2017) studied taxation and effective tool for income redistribution in Nigeria from 1981 to 2014 (34 years), using the Ordinary Least Squares statistical tool to analyse their data. From their review, they found that all tax variants do not exert a significant impact on income disparity in Nigeria as observed by GNI at a 5% level. They further suggested that taxation has not been fulfilling its role as a standard tool of income redistribution in Nigeria."

Anyaduba and Otulugbu (2019) investigated taxation and Inequality of income in Nigeria. Tax variables such as Company Income Tax (CIT), Petroleum Profit Tax (PPT), Valued Added Tax (VAT) and Custom and Excise Duties (CED) were used as proxies for taxation while the GINI coefficient was used to proxy income inequality. "The results from their study shows a positive relationship between VAT, CED and PPT with GINI when measured at 5% critical level, though VAT and Custom and Excise Duties (CED) were not significant, while CIT had a negative but significant impact on GINI. Flowing from their results, the study concluded that only Company Income Tax tends to reduce income inequality in Nigeria. The study recommended that VAT should be imposed on goods and services consumed by high-income earners. In respect of CED,

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the government should address the level of tariffs; for PPT, there is need for adequate diversification of the economy; and for CIT, tax authority should harness corporate taxes to its fullness."

Martinez-Vazquez, Vulovic and Liu (2011) examined direct versus indirect taxation, they considered the trends, theory and economic significance. Their study showed that the tax mix of developed, developing and transitional nations (a total of 116 nations) from 1972 to 2005 had a negative effect on inequality in nations with a share of total tax to Gross Domestic Product (GDP) larger than (0.29) thus reducing income inequality meanwhile for the sub-sample two of developing nations, the result of tax mix on income inequality was found not to be statistically significant. These findings confirm the low impact of the developing nation's tax systems on income distribution. Between 1970 and 2009, Martinez-Vazquez, Vulovic and Moreno-Dodson (2012) investigated the relationship between tax and expenditure policy on income distribution. Their result revealed that there is a negative effect on general consumption taxes, custom and excise duties and income redistribution. Office of the National Statistics (ONS) (2016) reviewed the effects of taxes and benefits on income inequality from 1977 to 2015 in the United Kingdom (UK). Inequality was reduced by direct taxes with 3.2% points in 2014/2015 and since 1977, the average proportion of direct taxes to income households pay has generally fallen, from 22.9% of gross income in 2007/2008 to 18.8% in 2014/2015. Direct taxes have generally been progressive regardless of variations while indirect taxes were found to be regressive, having increasing income inequality to GNI index of 3.5% in 2013/14.

To determine the impact of taxation on income inequality in Nigeria, Oboh and Eromonsele (2018) examined a period of 34 years ranging from 1980 to 2014 using time series data. Data for their study were analysed using Error Correction Model (ECM). The results from their study revealed that the relationship between indirect tax and income inequality in Nigeria is negative. This result simply implies that income is effectively redistributed by indirect taxes thereby reducing income inequality. Direct tax, on the other hand, was found to have a positive impact on income inequality in Nigeria. This means as direct tax is increasing income inequality is also increasing. The study,

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therefore, concludes that the gap between the rich and the poor in Nigeria is widened by the direct tax. They recommended that the government must take serious measures to ensure compliance to tax payments since indirect taxes helps to reduce income inequality in Nigeria.

The research of Kaisa and Jukka (2015) also discovered that indirect taxes reduce income inequality. Their study focused on developing countries examining the effect of the introduction of Value Added Tax on Government revenue and inequality using high-quality macro data. Their findings revealed that VAT has reduced income inequality and that VAT's impact differs across countries.

On the other hand, the study of Fu (2016) had a different finding. Fu (2016) investigated research titled "Does indirect tax increase the income gap between Urban and Rural areas?" The study showed that as Value Added Tax (VAT) is increasing the income gap between urban and rural areas is also increasing. It is, therefore, necessary to reduce the tax burden of indirect taxes so that they can have the function of reducing the income gap between urban and rural income.

The work of Liu (2011) also supports this, his study was on the regressive and resident income of indirect tax incidence and the economic management of the inequality of residents' income. The data analysis revealed that the regressivity of VAT and consumption tax is reasonably strong. Hence it justifies the reason the income gap is widening to varying degrees.

The work of Liu and Nie (2004) also revealed that indirect tax increases the income distribution gap. They examined the impact of the indirect tax burden on income distribution. Urban household survey data was used to show that the burden of Value Added Tax (VAT) and consumption tax of low-income families is greater than that of high-income families.

The study of Okatch, Siddique and Rammohan (2013) was carried out in Botswana to investigate the determinants of income inequality. The elements increasing income inequality at the household level in Botswana were analysed using the ordinary least square (OLS) regression method. The study revealed that VAT increases income

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inequality significantly. One of the recommendations of the study was that VAT on goods and services should either be zero rates or exempted, especially those heavily consumed by low-income households, like food items while high-income households should pay VAT on goods they heavily consume.

Klazar and Slintakova (2010) analyzed the effect of harmonization on the distribution of VAT in the Czech Republic. They used the entropy measures (GE) and Gini index under the framework of both annual and lifetime incidence given a time frame of 2003 to 2005. Their result showed that the Czech VAT is regressive when analyzed for annual income while the lifetime income analysis indicated that VAT is progressive and that the distribution of income both annual and lifetime after taxation was more equal before the harmonization. They suggested that shifting from income taxation towards consumption taxation would lead to improved economic efficiency and that the design of VAT can affect the rate of progressiveness as it can be a tool for efficient redistribution.

The interaction between income redistribution, economic growth and taxes was carried out by Sameti and Rafie (2010), who examined the correlation between income redistribution, economic growth and taxes. The study was carried out between 1990 to 2006 and it used random effect estimation and panel data regression for data analysis. The result from their study revealed that there exists an insignificant relationship between VAT and income inequality.

In a similar study by Alavuotunki and Pirttila (2015) when they investigated the effect of the Value Added Tax (VAT) on income inequality. The results from their study revealed that the consequences of VAT had no positive relationship with income inequality, thereby conflicting with prior studies.

Olaoye and Ayeni (2018) conducted a study on the effects of Value Added Tax and Customs Duties on Revenue Generation in Nigeria (2000-2016). “Secondary data were sourced from Federal Inland Revenue Service (FIRS) ranging from 2000 to 2016. Autoregressive Distributed

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Lag (ARDL) and Granger causality tests were used as the estimation techniques. The findings of the study revealed that the F-statistics value was 2.883868 which is lesser than both the lower bound and the upper bound values of 3.79 and 4.85 respectively at the 5percent level of significance which implies that there is no long-run relationship among value-added tax, customs duties and revenue generation. It was equally revealed that there is no causality among value-added tax, customs duties, and revenue generation. The study concluded that value-added tax and customs duties have no significant effect on revenue generation and there is no long-run relationship among value-added tax, customs duties and revenue generation in Nigeria during the study period. Thus, it is recommended that the fiscal policy should discourage tax avoidance by emulating measures for compliance with value-added tax and customs duties.

Iris, Martinez-Vazquez and Vulovic (2012) studied the government fiscal policies' impact on income inequality in Asia. Panel estimation for 150 companies between the periods of 1970 and 2009 was used. Their variables include company tax, personal income tax; payroll taxes and social security contribution; taxes on goods and services including VAT and customs and excises duties. From their empirical results, they found the general taxes on goods and services including VAT and custom and excise duties to be regressive in Asia. They, therefore, opined that a 1% increase in goods and services tax in Asia increases inequality of income by 0.666% compared to 0.768% points in the rest of the world.

Erero (2015) analysed the effects of value-added tax increment using a dynamic general equilibrium model of the national treasury in South Africa. The model comprises a social accounting matrix (SAM) for the year 2010 and all-important South African taxes. Five different simulations examined range from 1% to 5% VAT increase between the periods 2012 and 2018. The empirical result showed that an increase in VAT rate resulted in a marginal increase in GDP for the period between 2013 by 0.022% and 2018 by 0.115% respectively. The result also revealed a slight increase in the government revenue which could be used for distribution and alleviation of poverty. The researcher suggests that any policy measures aimed at stimulating growth, employment

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and redistribution of income can consider an increase in VAT rate as well as evaluating the trade-offs between a VAT and other taxes for future research."

Ukpabi (2019) examined the Impact of Indirect Taxation on Economic Growth in Nigeria. The result showed that customs and excise duties had a negative relationship but were tested and found to be insignificant. He recommended that the burden of customs duties should be lessened on infant industries.

The numerous researches on the relationship between Indirect taxes and income equality have not been able to reach the same conclusion. Some studies found that indirect taxes reduce income inequality while others state otherwise. The review of extant literature shows that an increase in Indirect taxes will lead to an increase in government revenue which will eventually reduce inequality of income. There was varying opinion to this; some studies found that Indirect taxes do not reduce income inequality. They believe since Indirect tax is regressive, the same rate will be paid by all income earners, the only issue is low-income earners will be paying a larger part of their income as tax compared to other taxpayers.

5. Conclusion

This study aimed to review the extant literature on the impact of indirect taxes on income inequality in Nigeria. The motivation for the study was the recent increase in VAT rate by the Federal Government of Nigeria and the amendment of Part III Section 21 of CETA. The study examined the literature to determine whether indirect taxes increase, decrease or are of no effect on the inequality of income in Nigeria.

The review of prior studies showed that some of the empirical studies carried out on the relationship between indirect taxes and income inequality revealed that indirect tax is negatively related to income inequality. This means as indirect taxes increases income inequality reduces; hence indirect taxes effectively reduce income inequality. According to these scholars, indirect tax increases the revenue of the government. These revenues generated from VAT charges on expensive and luxurious goods and services can be used by the government to provide schools,

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hospitals, social services and other infrastructure for the entire society, both the rich and the poor, thereby reducing income inequality. Another important merit of indirect taxes is that governments do not have to spend so much administering and collecting these taxes, the administrative overhead costs are low.

While some studies showed that indirect tax contributes significantly to income inequality. Indirect tax is regressive which means an increase in its rate will lead to a further increase in the disparity between the poor and the rich because the same rate will be paid by all, the regressiveness of indirect tax widens the income gap on varying degrees."

Going by the outcome of the reviews, the paper takes the position that indirect tax does not reduce income inequality. The literature revealed that VAT is imposed on consumption and CET is imposed on goods and services. This means that as indirect taxes increase the prices of goods and services also increases making it difficult for income inequality to be reduced. The VAT increase will lead to interest rate hikes, higher inflation, more unemployment and generally make people poorer. This increase will violate a fundamental principle of taxation that people should pay according to their abilities. Any increase in VAT will be counterintuitive to the goals of reducing poverty and inequality, although the increase will affect everybody the poor will bear the brunt more.

Also, the recent amendment to CETA does not reduce income inequality this is because the imposition of excise duties on imported products leads to an increase in the price of the imported goods, which means it's the end-users of such products that bear the tax burden. Hence income inequality will increase as all users regardless of their income level will pay the same amount for the imported product.

5.1.Suggestions

This paper sees the need for government to reconsider the recent increase in VAT, as it would reduce the price hike in commodities and services in the nation, and low-income earners will have more of their income to spend on other commodities.

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The Federal Government should remove the recent amendment to CETA, to allow the average low-income earners to be able to afford the listed imported goods in the fifth schedule of CETA. If removed the prices of such goods will become affordable for all.

Government should focus more on direct tax since the tax rate is charged on the income of the taxpayer, which means the high-income earner pays a higher portion of his income as tax compared to the low-income earner. There is a need for empirical validation of the nexus between VAT and income inequality, especially with the recent increase in the Nigerian VAT rate. Also an empirical study on the effect of the recent amendment to CETA on income inequality.

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