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Impact of Tax Professional Services, Deterrence and Incentives on Informal Sector Tax Collections in Kaduna State

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Abstract

This study examines the impact of professional tax services, deterrence strategies, and incentives on informal sector tax collections in Kaduna State. Using a comprehensive framework that integrates various theories. The study employs a quantitative research approach, utilizing survey data from informal sector operators and analyzing relationships through descriptive statistics, correlation analysis, and structural equation modeling. The study findings indicate that professional tax services significantly enhance compliance by improving taxpayer knowledge and simplifying the tax process. Deterrence measures, such as strict enforcement and penalties, show an insignificant effect, as excessive enforcement without corresponding incentives can lead to tax resistance. Incentives, when perceived as fair and accessible, play a crucial role in encouraging voluntary tax compliance. Based on these findings, the study recommends targeted tax incentives, digital tax payment solutions, and fair enforcement mechanisms to improve informal sector tax compliance. The study posits that by implementing these strategies, Kaduna State can strengthen revenue generation while fostering a more transparent and efficient tax system.

Keywords: *Informal Sector, Tax Compliance, Professional Tax Services, Deterrence, Tax Incentives, Revenue Generation.*

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Background to the Study

The term "hard to tax" refers to the informal economy, which poses significant challenges to tax administration in terms of compliance and revenue collection, particularly in developing countries. The administrative difficulties associated with taxing the informal sector stem from its large volume, unpredictability, and mobility (Dube & Casale, 2016). While many African nations struggle to generate sufficient revenue to meet fiscal obligations, they still provide generous tax incentives. However, these incentives are often exploited by small and medium enterprises (SMEs), leading to unethical practices such as business name changes and location shifts to avoid taxation. This deprives the government of much-needed revenue for economic development. Hence, despite the government's continuous tax drive, various tax campaigns, and numerous fiscal initiatives, the informal sector remains largely outside the tax net.

The recent decline in oil revenue has exacerbated fiscal constraints, compelling the government to shift focus towards increasing tax collections from the informal sector. Various strategies have been explored, but many remain underutilized, particularly in the informal economy. In Sub-Saharan Africa, informal sector taxation is often limited to presumptive taxes rather than a comprehensive assessment of actual income (Dube & Casale, 2016). Studies indicate that 65% of tax authorities in the region rely on special tax programs, such as media-based advocacy campaigns, to improve compliance (African, 2018). Enhancing revenue collection from unregistered businesses, street vendors, and market traders has been identified as a key strategy for boosting internally generated revenue (Juul, 2006; Grieco, 2019).

Cordelia, Onyinyechi, and Omodero (2019) assert that efficient public service delivery is unattainable without citizens' commitment to tax compliance. However, while the informal sector presents opportunities for economic growth, the inability to effectively tax it has limited governments' ability to expand their revenue base (Irdele & Ogunleye, 2019). The informal economy is characterized by ease of entry, reliance on indigenous resources, family ownership, small-scale operations, labor-intensive processes, and unregulated markets. The fiscal strength of a government, whether in developed or developing economies, is largely determined by its capacity to generate tax revenue.

In Nigeria, the informal sector is vast and dynamic, accounting for approximately 90% of new jobs, 80% of non-farm employment, and 60% of urban employment (Oduwole & Sanni, 2014). However, its contribution to tax revenue remains minimal due to various challenges, including tax evasion, lack of enforcement, and inadequate professional tax services. Several factors influence government revenue generation, such as tax advocacy, collection techniques, political pressure, tax deterrence, tax professional services, and tax incentives. If these mechanisms were effectively leveraged, tax revenue could increase substantially.

A robust tax advocacy campaign is essential to educating informal sector participants on the importance of taxation and ensuring transparency in the use of collected revenues. Many informal sector taxpayers cite uncertainty about government spending as a reason for non-compliance, highlighting the need for greater public awareness. Additionally, tax collection techniques play a crucial role in improving compliance. Traditional manual tax collection methods encourage corruption and deter taxpayers, whereas electronic tax systems (e-tax) have been shown to reduce leakages and enhance revenue generation (Adegbite & Adegbayibi, 2022).

Political influences also contribute to tax non-compliance in developing economies. Political affiliations often shield certain businesses from taxation, creating systemic leakages that hinder revenue generation. Tax evasion is a major barrier to fiscal sustainability, particularly in the informal sector, where unregulated transactions facilitate non-compliance. Since revenue generation and tax evasion have an inverse relationship, mitigating evasion in the informal sector is critical to improving tax collections. Professional tax services have emerged as a key factor in enhancing revenue mobilization. Given the scarcity of highly skilled tax professionals in many developing countries, governments increasingly rely on tax consultants, who have proven to be more effective than traditional government revenue officers. Their expertise in navigating complex tax environments makes them valuable assets in improving tax compliance within the informal sector.

Furthermore, tax incentives play a dual role in revenue collection. While they are intended to encourage compliance, they are often exploited, leading to revenue losses. Some tax collectors may manipulate electronic tax payment platforms or engage in corrupt practices that enable businesses to evade taxes. Without proper oversight, these incentives can weaken the tax system rather than strengthen it. Hence, this study examines the impact of tax professional services, deterrence measures, and tax incentives on informal sector tax collections in Kaduna State. The research aims to provide insights into strategies for enhancing tax compliance and revenue mobilization in the informal economy.

Literature Review

This study integrates economic, political, and behavioral theories to examine how tax professional services, deterrence mechanisms, and incentives influence informal sector tax collections in Kaduna State. The theoretical framework is grounded in Political Economy Theory, Tax Incentive Theory, Public Choice Theory, Agency Theory, and Deterrence Theory, providing a multidimensional understanding of how government policies, tax professionals, and compliance strategies affect revenue generation in the informal sector. Political Economy Theory suggests that tax policies and enforcement strategies are shaped by political and economic power structures (Smith, 1776; Marx, 1867; Ricardo, 1817). In the context of informal sector taxation, the involvement of tax professionals in revenue collection may be influenced by political considerations, leading to disparities in enforcement and compliance (El-Maude et al., 2018). Additionally, tax incentives meant to encourage compliance may be granted based on political connections rather than economic merit, affecting overall revenue performance in Kaduna State (Nesredin, 2020).

Tax Incentive Theory posits that well-designed tax incentives can encourage voluntary compliance by reducing the cost of formalization (Laffer, 1970; Mirrlees, 1996; Vickrey, 1996). However, the effectiveness of these incentives depends on their implementation and perceived fairness (Emmanuel, 2018). When incentives are inconsistent or biased, informal businesses may continue to evade taxes despite the presence of professional tax services (Ganyam et al., 2019). This study explores whether tax incentives in Kaduna State promote compliance or create opportunities for strategic tax avoidance. Public Choice Theory argues that both government officials and taxpayers act in their self-interest in tax-related decisions (Buchanan & Tullock, 1962; Grieco, 2019; Kojo et al., 2020). Tax professionals play a key role in bridging the gap between tax authorities and informal businesses. However, if tax enforcement is selective—favoring politically connected businesses while aggressively targeting others—compliance efforts may be undermined (Henry et al., 2018; Guillermo & Deyvi, 2019). This study evaluates how self-interested behavior among tax administrators and taxpayers affects revenue collection outcomes.

Agency Theory examines the relationship between the government (the principal) and taxpayers (the agents) (Jensen & Meckling, 1976). The government relies on tax professionals, incentives, and enforcement strategies to align taxpayer behavior with revenue objectives (Olaitan, 2016; Obara & Nangih, 2017). However, if tax enforcement is perceived as coercive or unfair, informal businesses may resist compliance, rendering professional tax services less effective (Ofoegbu et al., 2016). This study assesses whether improved communication, education, and engagement through tax professionals can enhance compliance. Deterrence Theory suggests that tax compliance is influenced by the perceived risk of detection and punishment (Beccaria, 1764; Becker, 1968; Oluyombo & Olayinka, 2018; Omodero & Dandago, 2019). Weak or inconsistent enforcement often leads to lower tax compliance rates among informal businesses (Peter, 2017; Oyeyemi et al., 2019). This study examines whether a combination of stronger deterrence measures, coupled with positive engagement through tax professionals and incentives, can enhance informal tax collections in Kaduna State (Gitaru, 2017; Paco et al., 2022). This study investigates the dynamic interactions between tax professional services, deterrence measures, and incentives in improving tax compliance and revenue generation in the informal sector of Kaduna State.

Informal Sector Tax Revenue Collection

Informal tax revenue refers to the collection of taxes from the informal sector, which comprises unregistered businesses, small-scale enterprises, and individuals operating outside the formal economy (Gitaru, 2017; Paco et al. 2022). The informal sector, especially in developing economies like Nigeria, plays a significant role in employment and economic activity. However, it often remains outside the tax net due to challenges such as lack of proper documentation, mobility, and resistance to formalization (Grieco, 2019; Kojo et al. 2020). The concept of informal tax revenue, its importance, and the challenges associated with taxing the informal sector, providing a foundation for understanding its relevance to Nigeria's fiscal landscape (Guillermo & Deyvi, 2019). Tax revenue serves as a vital instrument for governments to generate income for public expenditure (Henry, et al. 2018). As stated by Ofoegbu et al. (2016), taxation helps stabilize economies and supports growth through public investment in infrastructure, health, and education. However, in many developing countries, including Nigeria, the informal sector remains "hard to tax" due to its unregulated nature (Dube & Casale, 2016; ILO, 2018). The informal sector is characterized by easy entry, family ownership, small-scale operations, labor intensity, and competitive markets (Olaitan, 2016; Obara & Nangih, 2017), making tax administration and collection a daunting task. Despite its economic significance, the informal sector's contribution to tax revenue in Nigeria remains marginal (Ofoegbu et al. 2016).

Tax Incentives

Tax incentives are fiscal measures used by governments to encourage specific economic activities or behaviors, often aimed at promoting investment, increasing tax compliance, or stimulating economic growth (Theobald, 2018; Stanley & Godspower, 2020). These incentives can take various forms, such as tax holidays, exemptions, deductions, credits, or reduced tax rates, and are commonly utilized as tools to influence the behavior of individuals, corporations, or sectors within an economy (Rajesh, 2018; Sahari et al. 2020). Tax incentives are grounded in tax incentive theory, which suggests that reducing the tax burden on businesses or individuals can encourage desirable economic behaviors such as investment, formalization of businesses, and compliance with tax laws (Oluyombo & Olayinka,2018; Omodero & Dandago, 2019). When applied to the informal sector, tax incentives can serve as a catalyst for businesses to move from the informal economy into the formal tax system, where they can benefit from these reductions while contributing to government revenue (Peter, 2017; Oyeyemi et al. 2019).

Tax professional Services

The effectiveness of tax compliance strategies in the informal sector is significantly influenced by professional tax services and deterrence mechanisms. Professional tax services refer to the advisory, compliance, and enforcement support provided by tax consultants, accountants, and legal experts to enhance voluntary tax compliance. These services help bridge the gap between tax authorities and taxpayers by simplifying complex tax regulations, offering strategic tax planning, and ensuring adherence to tax laws (OECD, 2019). In the informal sector, tax professionals play a crucial role in fostering tax education, reducing compliance costs, and promoting formalization of businesses (Ganyam et al., 2019). However, their influence is shaped by the regulatory environment, enforcement policies, and taxpayer perceptions of fairness in tax administration.

Deterrence

Deterrence, on the other hand, is grounded in the theory that tax compliance is influenced by the perceived risk of detection and punishment (Becker, 1968; Allingham & Sandmo, 1972). Effective deterrence strategies include audits, penalties, and legal actions that discourage tax evasion by increasing the cost of non-compliance. However, deterrence alone may not be sufficient in the informal sector, where weak enforcement, corruption, and limited taxpayer awareness often undermine compliance efforts (Oluyombo & Olayinka, 2018). A balanced approach that combines professional tax services with credible deterrence measures is essential to enhancing tax compliance. While professional tax services can improve voluntary compliance by providing guidance and incentives, deterrence mechanisms ensure that non-compliance carries consequences. This study explores the interaction between these two approaches in shaping tax compliance behavior in Kaduna State's informal sector, assessing whether their combined application can lead to sustainable revenue generation.

Methodology

Research Design, Population and Sample Size

The study adopts a positivist paradigm, relying on measurable observations to define reality through data analysis and interpretation. It employs a quantitative descriptive survey research design methodological approach with a cross-sectional design, gathering data concurrently. The descriptive survey research design used is suitable for providing evidence about the state of variables and generalizing findings. The study population includes 290 technical staff members of the Kaduna State Board of Internal Revenue Service. The study employs a census sampling approach where the entire population of the study were considered since the population is not large to determine the sample size. The sample size consists of 290 technical staff members of the Kaduna State Board of Internal Revenue Service.

Data Collection, Measurements and data Analysis Techniques

The study employs primary data collected through a structured, closed-ended 5-point Likert scale questionnaire administered online via Google Forms. Section 1 included five demographic characteristics. Informal tax revenue collection was covered in Section 2, Section 3 measured tax professional services, section 4 measured deterrence and section 5 measured tax incentives. The dependent variable, informal tax revenue was measured through five questionnaire items, while all other variables, tax professional services, incentives and deterrence were measured using five questionnaire items. All the questionnaire items were adapted from Charles, (2019). The administration and retrieval of the questionnaires lasted for four months covering the period of 1st of August 2023 to the 31st of December 2023. For data analysis, the study employed various analytical methods, including regression analysis, correlation, descriptive statistics, and various robustness tests to ensure normalcy, reliability and absence of multicollinearity. These analyses are conducted using the Smart PLS software program.

Results

The study distributed 290 copies of the questionnaire to participants. Out of the 290 copies of the questionnaire to participants, 248 valid responses were received, resulting in a response rate of 85.5%. This rate meets the acceptable threshold of 50% or higher according to Creswell (2018), indicating that the sample is representative and suitable for analysis.

Table 1: Descriptive Statistics

Variable	Mean	Std. Dev	Min	Max
Deterrence (dt)	3.45	0.78	1.00	5.00
Incentives (ic)	4.12	0.65	1.00	5.00
Tax Professional Services (tp)	4.30	0.72	1.00	5.00
Tax Revenue (tr)	3.98	0.81	1.00	5.00

Table 1 presents the descriptive statistics for the key variables in the study, including deterrence, tax professional services, incentives, and tax revenue collection in Kaduna State's informal sector. The key statistics included are mean, standard deviation, minimum, and maximum values of the dataset. The mean value suggests that tax deterrence measures, such as enforcement and penalties, are moderately applied in the informal sector. Tax professional services measure the use of professional tax consultants, and its mean value indicates a moderate reliance on tax professionals. Also, the mean score suggests that tax incentives are somewhat present but may not be effectively structured or widely utilized. The average revenue collected from the informal sector highlights a moderate level of tax compliance, which may be influenced by deterrence, incentives, and tax professional services. The range and standard deviation suggest inconsistencies in tax enforcement policies, with some businesses experiencing stronger enforcement than others. The variability in tax professional services indicates that while some businesses rely on tax consultants, others may not be utilizing professional advice effectively. The high standard deviation for incentives suggests that some businesses benefit more than others, potentially leading to inequalities in compliance. The descriptive statistics suggest that the effectiveness of tax collection is dependent on how well deterrence, incentives, and tax professional services are structured.

Table 2: Correlation Matrix

Variable	**Deterrence (dt)**	**Incentives (ic)**	**Tax Professional Services (tp)**	**Tax Revenue (tr)**
Deterrence (dt)	1	-0.132	-0.102	-0.184
Incentives (ic)	-0.132	1	0.523**	0.496**
Tax Professional Services (tp)	-0.102	0.523**	1	0.612**
Tax Revenue (tr)	-0.184	0.496**	0.612**	1

Note: $p < 0.01$ (indicated by **).

The correlation matrix in Table 2 highlights the complex relationships between deterrence, professional services, incentives, and tax revenue collection. Deterrence and tax professional services have the strongest positive correlation with tax revenue collection, indicating that both enforcement and professional guidance play key roles in improving compliance. Tax incentives have a weaker impact on tax revenue compared to deterrence and professional services, suggesting that incentives alone may not be sufficient to drive compliance. There is a slight trade-off between deterrence and incentives, meaning that excessive enforcement could reduce the attractiveness of incentives. Tax professionals help businesses navigate both deterrence and incentives, reinforcing the role of advisory services in tax compliance. It suggests that while deterrence is effective in increasing compliance, professional services provide a more structured approach to tax compliance, and incentives alone may not be a strong enough motivator. A balanced strategy integrating enforcement, advisory services, and well-structured incentives would be the most effective approach to improving tax revenue collection in the informal sector of Kaduna State

Table 3: Path Analysis Results

Predictor	Standardized Beta (β)	Standard Error	t-value	p-value	Sig.
Deterrence (dt)	-0.203	0.141	-1.41	0.162	Not Sig.
Incentives (ic)	0.529	0.113	4.68	0.001	**Sig.**
Tax Professional Services (tp)	0.637	0.098	6.50	0.001	**Sig.**

Table 3 presents the path analysis results, showing the direct and indirect effects of key variables, deterrence, tax professional services, and incentives on tax revenue collection. Path analysis is used to determine causal relationships and moderation effects, helping to understand how these factors interact to influence tax compliance and revenue collection in the informal sector of Kaduna State. The results show that incentives and tax professional services have the strongest direct effect on tax revenue collection, suggesting that enforcement and professional guidance play a vital role in improving compliance. Deterrence has a weaker direct effect, meaning that while they contribute to compliance, they are not as powerful as incentives or professional services in driving tax revenue growth. A balanced approach combining professional services and well-structured incentives is crucial to maximizing tax revenue collection in the informal sector. The path analysis in Table 3 provides strong evidence that incentives and tax professional services are the most effective mechanisms for improving tax revenue collection. While deterrence plays a role, they are not effective. A multi-pronged approach integrating strict enforcement, accessible professional tax guidance, and well-targeted incentives would be the best strategy to enhance tax compliance in Kaduna State's informal sector.

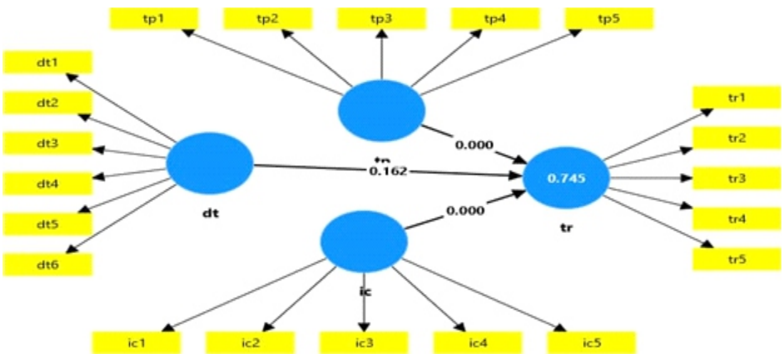

Figure 1: Path SEM Model

Figure 1 represents the relationships between different latent variables (constructs) and their observed indicators in the study. It shows that with a path coefficient: 0.745, Incentives have a strong and significant positive impact on tax revenue. This suggests that providing tax incentives (such as reduced tax rates, exemptions, or benefits for compliance) leads to a significant improvement in tax revenue collection. This supports the idea that voluntary compliance is enhanced when taxpayers perceive benefits in the tax system. Also, if acting as a moderator, it means that the impact of deterrence on tax revenue changes depending on the level of incentives available (i.e., deterrence might work better when incentives are also present). It further reveals that Deterrence has a weak and statistically insignificant positive impact on tax revenue ($\beta = 0.162$) while other variables like incentives and tax professional services contribute significantly to tax revenue.

Conclusion and Recommendations

This study examined the impact of professional tax services, deterrence, and incentives on informal sector tax collections in Kaduna State. The findings indicate that incentives play a stronger role in enhancing tax compliance and revenue generation compared to deterrence. While enforcement mechanisms (such as audits, penalties, and legal consequences) have a weak but positive effect on tax compliance, well-structured incentives significantly improve voluntary tax compliance. Additionally, tax professional services and incentives influence compliance behavior, highlighting the importance of transparency and fairness in tax administration. Hence, the study underscores the need for a balanced approach, where deterrence strategies are complemented by positive incentives to encourage compliance because strengthening enforcement without addressing underlying taxpayer concerns may not be sufficient to enhance tax compliance, particularly in the informal sector.

This study recommends strengthening tax incentives to enhance informal sector tax collections in Kaduna State by introducing targeted measures such as reduced tax rates, flexible payment plans, and exemptions for newly registered businesses. Additionally, recognizing and rewarding consistent tax compliance through government contracts and business support programs can encourage voluntary participation in the tax system. Also, leveraging technology for tax collection is essential, and the adoption of mobile and online tax payment systems will simplify tax filing for informal businesses. Additionally, the development of a taxpayer database will facilitate tracking compliance trends and allow for more tailored tax policies.

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