



Tax Compliance, Informality, and Revenue Leakages in Nigeria: Institutional and Behavioural Perspectives

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ABSTRACT

Tax revenue remains an essential source of government funding for sustainable economic growth. However, Nigeria faces significant revenue losses primarily due to widespread informality and low tax compliance. This study examines taxpayer behavior, the influence of the informal sector, and institutional factors that lead to revenue leakages from both institutional and behavioral perspectives. It employs an exploratory research approach grounded in institutional theory and behavioral tax compliance models to analyze taxpayers' attitudes towards taxation. Findings indicate that low institutional trust, complicated tax systems, perceived corruption, and weak enforcement promote informality and evasion. Behavioral elements such as perceived fairness, social norms, and tax morale also influence individuals' and small businesses' compliance choices. The study suggests that enhancing institutional credibility, streamlining tax processes, and boosting behavioral incentives are vital for reducing revenue loss and broadening Nigeria's tax base. Policy recommendations emphasize digital tax administration, transparency reforms, and taxpayer education initiatives.

Keywords: Tax compliance, Informal sector, Revenue leakage, Tax morale, Institutions, Nigeria.

INTRODUCTION

Taxation enables governments to generate essential funds for economic growth, infrastructure projects, and public services. A robust tax system sustains vital sectors such as education, health, transportation, and security, while also decreasing dependence on external loans or volatile revenue sources like natural resources. In developing nations such as Nigeria, taxes play a crucial role in maintaining fiscal stability and fostering broad-based growth. Nevertheless, Nigeria has long relied heavily on oil revenue, which has reduced the urgency to improve tax collection or broaden the tax base beyond oil (Fjeldstad & Moore, 2020). Despite being Africa's largest economy, Nigeria's tax-to-GDP ratio remains low relative to similar countries, reflecting persistent issues with tax compliance and revenue generation. Recently, Nigeria's tax-to-GDP ratio has hovered around 6 to 7 percent, whereas Kenya's and Ghana's are closer to 15 and 13 percent, respectively. This significant disparity highlights the importance of strengthening Nigeria's tax system to uphold its social contract and fund critical public services. Insufficient tax revenues not only hamper government investment in development but also weaken the effectiveness of monetary policy, as fiscal deficits can lead to inflation, increase public borrowing, and undermine macroeconomic stability.

A major obstacle to effective taxation in Nigeria is the extensive informal sector. Many individuals work in small businesses, are self-employed, or run unregistered companies that do not adhere to official regulations. For instance, on a typical morning in Lagos, hundreds of street traders set up small kiosks or sell goods from trays balanced on their heads, navigating busy markets and traffic to offer snacks, phone cards, or clothing. These traders often lack business licenses or tax identification numbers, and their earnings are seldom recorded officially. Recent estimates indicate that the informal sector accounts for about 57 percent of Nigeria's GDP and employs over 80 percent of the labor force (National Bureau of Statistics and the International Labour Organization [ILO], 2023). Despite its vital role in the economy and in supporting many livelihoods, this sector remains largely outside the tax system due to weak registration, limited monitoring, and insufficient resources for tax administration (Medina & Schneider, 2021). The prevalence of informal businesses complicates tax

collection, leading to tax evasion, underreporting, and nonpayment of dues. This persistent informality limits government revenue and hampers development efforts.

Tax compliance depends on both the effectiveness of institutions and individual motivation. Authorities typically enforce tax laws through audits, penalties, and legal actions. However, willingness to pay taxes also depends on trust in the system, the quality of governance, and perceptions of fairness. Issues such as corruption, slow bureaucracy, policy changes, and a lack of transparency decrease trust and reduce individuals' willingness to pay (OECD, 2022). When people believe public funds are mismanaged, they tend to comply less, perpetuating noncompliance. For example, a recent Nigerian Corruption and Tax Morale Survey found that over 70 percent of respondents believe officials often misuse tax revenues, and high-profile cases such as the 2023 investigation into the misappropriation of state funds in Kaduna State have heightened skepticism of government institutions. This perception damages willingness to comply and widens the social contract gaps between taxpayers and the government. It creates a feedback cycle: weak governance lowers voluntary compliance, which in turn diminishes the resources needed to improve governance and public services. Psychological and social factors also influence tax compliance. Key elements include tax morale, perceptions of fairness, peer behavior, and trust in government. When people perceive the tax system as fair and see tangible benefits from public services, they are more inclined to pay taxes. Conversely, perceptions of unfair taxes, inadequate public services, or unfair enforcement foster resistance and increase informal practices (Torgler, 2021). In Nigeria, factors such as low trust, limited taxpayer education, and governance issues further complicate compliance.

The Nigeria Revenue Service (NRS), formally known as the Federal Inland Revenue Service (FIRS), has implemented several reforms, including the adoption of digital tools, the introduction of taxpayer ID systems, and enhanced VAT enforcement. Digitalization efforts, such as the streamlined online tax filing platform launched in 2021, have already yielded positive early outcomes: FIRS reports indicate an 18 percent rise in online tax payments in 2022 compared to the previous year, and a substantial increase in registered taxpayers following the deployment of digital taxpayer identification channels. Moreover, initial data from the Central Bank of Nigeria reveals a 12 percent growth in VAT revenue in 2022, linked to improved electronic transaction monitoring. Despite these advances, Nigeria continues to face significant gaps in tax collection. Challenges such as inefficient administration, weak enforcement, and ongoing informality lead to financial losses. According to the World Bank (2023), weak tax administration and non-compliance are responsible for an estimated annual revenue shortfall of more than 4 trillion naira, about 3 percent of GDP. These losses hinder government revenue, complicate budget planning, increase public debt, and threaten the country's economic stability.

Given these challenges, it is important to understand how institutions affect people's behavior when designing tax policies. Improving tax compliance in Nigeria requires more than just strict enforcement. Reforms should focus on making the system more transparent, increasing accountability, and building trust with taxpayers, while also encouraging people to pay taxes willingly. For example, the Nigeria Revenue Service (NRS) has recently introduced an electronic receipt verification system that allows taxpayers to instantly confirm the authenticity of payment receipts online or via mobile devices. This initiative not only improves transparency and reduces the risk of fraud but also demonstrates the government's commitment to honest transactions. By giving taxpayers an easy way to verify their payments, NRS has taken a practical step that boosts public confidence and demonstrates how technology can strengthen trust in the tax system.

This study investigates tax compliance, informality, and revenue losses in Nigeria, examining both institutional and behavioral factors. It analyzes how governance, administrative procedures, and taxpayer attitudes affect compliance, offering policy suggestions to boost revenue and reduce losses as Nigeria's economy develops. Recommended actions include enhancing tax administration, expanding digital tools, streamlining small-business registration, and applying behavioral strategies such as taxpayer education and incentive programs. These measures aim to close compliance gaps, encourage voluntary payments, and increase government revenue.

Objectives of the Study

The broad objective of this study is to examine tax compliance, informality, and revenue leakages in Nigeria from institutional and behavioral perspectives.

The specific objectives are to:

1. Examine how institutional and behavioral factors influence tax compliance in Nigeria.
2. Assess the effect of informality and tax compliance behavior on revenue leakages and domestic revenue mobilization in Nigeria.

Research questions

This study seeks to answer these questions

1. How do institutional and behavioral factors influence tax compliance in Nigeria?
2. What is the effect of informality and tax compliance behavior on revenue leakages and domestic revenue mobilization in Nigeria?

LITERATURE REVIEW

Concept of Tax Compliance

Tax compliance is essential for a strong fiscal system because it encourages accurate income reporting, timely filing, and prompt tax payments. Important measures of compliance are the misreporting gap, the timely filing rate, and the payment compliance rate. Alm and Torgler (2021) define tax compliance as the willingness to meet legal obligations by reporting honestly, making payments, and cooperating with audits. As such, understanding the difference between voluntary and enforced tax compliance is important. People comply voluntarily when they trust the system, feel it is fair, or believe it is their duty. Enforced compliance happens when people fear penalties or audits (Kirchler, 2019). In many developing countries, such as Nigeria, enforcement is more common because trust in institutions is low and tax morale is weak.

Contemporary tax compliance theory shows that compliance is about more than avoiding audits or penalties. Earlier theories said taxpayers balance the benefits of evasion against the risk of getting caught, but newer research points to the role of psychological, social, and institutional factors (Alm, 2019). People are more likely to comply when governments are accountable, transparent, and provide good public services. Making tax administration easier through simple procedures, digital filing, taxpayer education, and good complaint systems also helps (OECD, 2022). On the other hand, complexity, corruption, and bureaucracy make compliance harder and increase the tax gap. Informal sectors present significant challenges to tax compliance in developing countries. Informal businesses operate outside official regulations, complicating enforcement efforts. Medina and Schneider (2021) observe that this dynamic reduces the tax base. Institutional reforms are necessary to address these challenges. Research indicates that high tax morale, defined as the motivation to pay taxes, enhances civic participation and trust in government (Torgler, 2021). Conversely, perceived misuse of funds and unfair taxation diminish morale, leading to increased revenue loss and leakage.

Institutional Perspective of Tax Compliance

In Nigeria, the Nigeria Revenue Service (NRS) has made progress by introducing electronic systems and expanding taxpayer registration. Still, more needs to be done to improve compliance. This includes simplifying tax processes, adding more digital tools, and increasing taxpayer education. To address ongoing informality, weak enforcement, and behavioral challenges, a broad approach encompassing economic, institutional, and behavioral factors is needed. Furthermore, Tax compliance helps increase domestic revenue and supports fiscal stability. To achieve this, strong institutions, transparent governance, and policies that focus on taxpayers are needed. However, informality is widespread in Nigeria, making tax administration harder. The informal

economy includes businesses, jobs, and income that are not registered or taxed, often because people want to avoid regulations (Medina & Schneider, 2021).

In Nigeria, informality is caused by unemployment, poverty, limited access to finance, and weak enforcement. Many small businesses are not registered, do not keep proper accounts, or lack tax IDs, which reduces the tax base and non-oil revenue. Complicated registration, many taxes, bureaucracy, and unclear rules make formalization seem expensive. Weak tax administration encourages informality. Enforcement is not only limited in number but also in quality. Poor technology and record-keeping make it difficult to select and follow up on cases, resulting in low audit coverage. Weak follow-up and lack of staff training limit investigations and recovery, while legal delays reduce deterrence. Medina and Schneider (2021) note that weak enforcement increases informality and revenue losses. Overall, weak enforcement lowers compliance and increases informality, which reduces revenue and capacity.

Efforts to formalize the informal sector include adopting simpler tax regulations, implementing digital tools, and conducting taxpayer education initiatives. The Nigeria Revenue Service has implemented electronic filing systems and taxpayer identification numbers. To further enhance formalization, it is recommended to prioritize building taxpayer trust, reducing compliance costs, and clearly communicating the benefits of formal business operations. Strengthening governance, modernizing tax institutions, and increasing oversight are essential to address revenue loss. The effectiveness of these reforms depends on the capacity of agencies, the quality of legal frameworks, and the rigor of enforcement. Addressing challenges such as inadequate record-keeping, reliance on manual processes, political interference, insufficient staff training, and weak internal controls should be prioritized in reform agendas.

In Nigeria, tax authorities at the federal, state, and local levels are poorly coordinated, leading to overlapping roles and inconsistent enforcement. These gaps create loopholes that let taxpayers avoid or reduce their tax obligations. Corruption also diverts public funds for private gain. When enforcement officers are not independent or accountable, rent-seeking increases and revenue losses grow. Institutional credibility plays a key role in shaping taxpayer behavior; as such, Compliance can be improved by strengthening audit systems, increasing transparency, automating processes, and consistently enforcing rules. Digitalization, integrated management, and results-based accountability help with monitoring and revenue collection. Reforms should focus on building trust and discouraging tax evasion.

Behavioral Perspective of Tax Compliance

The behavioral perspective goes beyond deterrence models by looking at psychological, social, and moral factors that influence tax decisions. Traditional theory says people comply mainly out of fear of penalties. Benno Torgler (20) explains that tax morale is about civic duty and the belief that taxes benefit society. Trust in institutions and visible public improvements increases voluntary compliance, whereas misuse, corruption, or unfairness reduces motivation and increases evasion. Perceptions of fairness matter: horizontal fairness means equal taxes for equal incomes, while vertical fairness spreads tax burdens across income levels. Exemptions, selective enforcement, or bias make people view compliance less favorably. Social norms also play a role, as people often follow community expectations and peer behavior. When evasion is common, non-compliance spreads, but strong compliance cultures encourage responsibility and lawfulness. Behavioral insights highlight the importance of communication and taxpayer engagement: simple procedures, respectful officials, transparent dispute resolution, and clear information help. The Federal Inland Revenue Service uses campaigns, digital reminders, and voluntary programs to improve compliance.

The behavioral approach shows that lasting tax compliance needs both enforcement and trust. Policies that improve transparency, ensure fairness, and involve citizens through targeted services and clear communication are more effective at reducing revenue loss than relying solely on enforcement.

Theoretical Framework

The study on Tax Compliance, Informality, and Revenue Leakages in Nigeria: Institutional and Behavioural Perspectives is anchored on the Economic Deterrence Theory and Institutional Theory, which jointly explain

taxpayers' compliance behaviour and the persistence of revenue leakages in developing economies. The Economic Deterrence Theory, developed by Gary Becker (1968) and later extended by Michael Allingham and Agnar Sandmo (1972), posits that taxpayers behave as rational individuals who weigh the benefits of tax evasion against the probability of detection and the associated penalties. Compliance, therefore, increases when enforcement mechanisms such as audits, monitoring systems, and sanctions are strong. In Nigeria, weak enforcement capacity, inadequate taxpayer databases, and limited monitoring systems reduce perceived detection risk, thereby encouraging tax evasion and participation in the informal economy and ultimately contributing to significant revenue leakage.

Institutional Theory, as advanced by Douglass North, holds that the quality of government institutions significantly affects economic behavior and tax compliance. Weak institutions, marked by corruption, inefficiency, inconsistent policies, and lack of transparency, lower public trust, and reduce voluntary compliance. In Nigeria, these problems have led to more informal economic activity and less willingness to pay taxes, widening the tax gap. Other developing countries, such as Ghana and Kenya, face similar issues, but reforms, such as Kenya's digital tax system and Ghana's expanded taxpayer outreach, have improved compliance. Comparing these cases underscores the need to strengthen institutions and adopt successful practices to address tax compliance problems in Nigeria. Together, these theories show that revenue leakages in Nigeria are caused by both weak enforcement and poor institutional credibility. To improve tax compliance, it is important to have strong deterrence measures and better institutions that build trust, ensure accountability, and encourage people to join the formal tax system.

Empirical review

Chuks (2022) investigated company income tax compliance and enforcement behaviors in Nigeria using secondary data from 41 quoted companies listed on the Nigerian Stock Exchange as of 2022. The study employed an Ordinary Least Squares (OLS) regression model to analyze archival data from the Federal Inland Revenue Service and annual company reports. The results showed that enforcement methods significantly influenced companies' tax compliance behavior, suggesting that stronger enforcement incentives could reduce revenue leakage and improve compliance outcomes in corporate tax administration. Obara and Nangih (2017) examined taxation barriers and internal revenue generation among Small and Medium Enterprises (SMEs) in Port Harcourt Metropolis using primary survey data collected via structured questionnaires. Analyzed with SPSS statistical tools, the results demonstrated that lack of reliable tax databases and the prevalence of cash transactions in the informal sector significantly impeded government revenue generation, suggesting that weaknesses in institutional capacity and informal economic behaviour hinder tax compliance and exacerbate revenue leakages.

Oladiran, Festus, and Anaekenwa (2024) explored the relationship between tax justice and tax compliance across South West Nigeria using survey data from 356 eligible taxpayers. With questionnaire responses analyzed through standard statistical validation procedures (KMO, Bartlett's test, and Cronbach's alpha), the study found that perceived tax injustice and lack of transparent utilization of tax revenue significantly reduced tax compliance, affirming the behavioral role of perceived fairness and institutional trust in shaping taxpayers' willingness to comply.

Alkali, Danjuma, and Joseph (2025) examined tax compliance and voluntary disclosure among SMEs in Nigeria using data from 400 SMEs sampled from the SMEDAN register and regression analysis. The findings showed that complex tax laws, poor tax management practices, low trust in government, limited tax education, and a lack of tax amnesty initiatives significantly affected voluntary disclosure and compliance behavior, demonstrating both institutional and behavioral drivers of tax compliance in the SME sector.

Adejuwon and Olasunkanmi (2023) investigated tax digitalization and revenue-collection problems using data from 352 tax administrators in Southwest Nigeria and tested hypotheses using Chi-square and regression analyses. The study found that tax digitalization significantly improved tax revenue and substantially reduced tax evasion, indicating that embracing ICT and digital tax systems can help curb informal-sector evasion and shrink revenue leakages, provided adequate infrastructure and skilled personnel are deployed. Recent empirical evidence confirms that the expansion of digital tax platforms has led to measurable improvements in both

revenue collection and compliance rates. For example, post-digitalization periods in various states have seen percentage increases in tax revenue and declines in reported tax evasion cases, underscoring the tangible impact of digitalization initiatives on strengthening tax administration in Nigeria.

Amahalu, Okoye, and Obi (2019) explored the effects of tax leakages on economic development in Nigeria using time-series data from 2008 to 2017 and applied unit root tests and OLS regression. Results revealed that tax leakages from evasion and avoidance had a significant negative impact on Nigeria's economic development indicators, including GDP per capita and social outcomes, underscoring that revenue losses from non-compliance constrain public service delivery and broader development goals.

Jibir, Abdu, and Muhammad (2020) conducted a firm-level tax compliance study in Sub-Saharan Africa, including Nigerian firms, using World Bank Enterprise Survey longitudinal data and generalized estimating equations models. They found that corruption and perceived weak enforcement encouraged non-compliance, as firms often relied on informal payments to evade taxes, demonstrating the intersection of institutional weaknesses, informal incentives, and behavioral strategies that reduce effective tax compliance and increase revenue leakage.

METHODOLOGY

This study used an exploratory research design. The analysis was based on a review of journals, books, and other literature in accounting, taxation, and finance to draw conclusions and make recommendations.

CONCLUSION AND RECOMMENDATIONS

This study looked at tax compliance, informality, and revenue leakages in Nigeria, focusing on both institutional and behavioral factors. The results show that compliance depends on how institutions work and how individuals behave. Weak institutions, such as those with little transparency, poor enforcement, and limited digitalization, make tax administration less effective. At the same time, behavioral issues such as low tax morale, feelings of unfairness, and reliance on informal activities worsen non-compliance and reduce the effectiveness of revenue collection. Also, the analysis found that informality is a major cause of revenue leakages because businesses outside the formal tax system avoid compliance, thereby reducing domestic revenue. While enforcement is important, evidence shows that punishment alone is not enough. Lasting improvements in tax compliance and revenue collection need a broad strategy that combines institutional reforms, behavioral changes, and incentives for formalization. By addressing both structural and behavioral issues, policymakers can improve compliance, reduce leakages, and strengthen the tax system. The following recommendations aim to improve the taxation of the informal sector and boost overall compliance.

In alignment with the study objectives, the following policy recommendations are proposed:

1. Enhance institutional capacity by improving transparency, accountability, and enforcement, and support these efforts with behavioral strategies like taxpayer education and awareness programs.
2. Reduce informality and revenue leakages by creating incentives for informal businesses to join the formal sector, such as tax holidays, access to credit, and easier registration.
3. Digitalization of Tax Administration: Promote digitalization of tax administration by expanding digital platforms for registration, filing, and payment. This can reduce human interference, improve record-keeping, and strengthen monitoring. Streamlined tax processes, particularly for small businesses and SMEs, can lower compliance costs, reduce bureaucratic barriers, and incentivize voluntary compliance.
4. Maintain ongoing taxpayer education and engagement through continuous programs that help people understand their obligations, the benefits of compliance, and the consequences of not complying.

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