VAT ADMINISTRATION AND THE CONCEPT OF FISCAL FEDERALISM IN NIGERIA

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Abstract
Most Nigerian States' internally generated revenue (IGR) cannot cover their operational costs without federal allocations. The administration of Value-Added Tax (VAT), a consumption tax, is vested in the Federal Government. This paper, therefore, examined how the over-concentration of taxing powers in the federal government affects States' ability to expand their tax base. The research design adopted for the study was an Ex Post Facto Design. The data generated for the study is secondary, and regression and inferential techniques were employed for the analysis. The study is guided by the theories of Tax Assignment and Fiscal Federalism. The theory of Tax Assignment assumes that functions should be distributed between the central government and subnational governments, while the theory of fiscal federalism assumes that powers and responsibilities are shared among the tiers of government. The study revealed that VAT revenue generation has a significant effect on States debts; however, VAT allocation does not have a significant effect on States debts; VAT revenue generation has a significant effect on States IGR; and VAT allocation has a significant effect on States IGR. This implies that improvingthe tax base of the States will be hindered. To enable States to explore other alternative means of improving their revenue generation, it is recommended that true fiscal federalism should be encouraged and given the powers to collect VAT, which is a consumption tax, to the States.

Keywords: Federal government, fiscal federalism, states, subnational governments, vat administration.

1.0 Introduction

Value Added Tax (VAT) has become the centrepiece of tax policy in developing countries (Keen & Lockwood, 2010). The long-term, unsustainable budget deficit financing has led politicians to now propose a VAT to improve federal allocation (Nunns & Toder, 2017). Some six decades ago, VAT was not heard outside of France, but it is now embraced because of its contribution to revenue generation and improvement in tax administration and compliance (Keen & Lockwood, 2010).

VAT contributes to economic growth, hence the increment of VAT rate from 5 per cent to 7.5 per cent to reduce federal deficits in Nigeria (Section 42, Finance Act 2020).

VAT is a consumption tax and is charged at every stage of production (Lukpata, 2013). The sales tax, which came into existence in Nigeria through Decree No.7 of 1986, was replaced by VAT because of the narrow tax base (FIRS, 2021). It is noted that the change from sales tax to VAT in Nigeria is to improve tax administration and increase revenue allocation to the States and the Local Governments (LGs) (Oyedokun, 2016). The author opines that VAT is administered rather than sales tax because of the latter's cascading effect, while the former has value added at each stage of production. Furthermore, the introduction of VAT in Nigeria was to diversify from an oil-dependent economy and also to replace the sales tax, which had only 9 categories of goods and only targeted manufactured goods (Omokwe, 2021).

In the implementation of VAT in Nigeria, little attention was paid to which tier of government was saddled with the administration of the VAT; however, the policy was that where the incidence of tax is high should benefit more from the revenue allocation (Ajaja, 2021). To achieve the benefits has been largely unsuccessful because of a lot of challenges faced (Umenweke & Nwoke, 2023); one of these problems of VAT in Nigeria is the fiscal structure, thereby making it controversial (Olika et al., 2024).Despite different reforms to improve states' autonomy, there are challenges of VAT implementation and acceptability by different stakeholders (Muhammad, 2025).

Federalism is a system of government whereby power is shared between the central government and the subnational governments (Ukachikara & Okoroafor, 2019). Also, federalism is a government with levels of decision-making between the central government and the subnational governments (Okwesili *et al*., 2013). Many countries are changing their economic policies by decentralising their fiscal system to reduce inequality among the federating units (Agrawal et al., 2024). Also, implementation of fiscal federalism enhances responsiveness and accountability by the government (Vilela & Oplotnik, 2026).

In addition, for efficiency in the economy and to achieve better public policy, fiscal federalism shares responsibilities, including finances, among all tiers of government (Driessen & Hughes, 2020). The power to collect VAT should be with the States, but in Nigeria, the power is vested in the Federal Government (Section 3a, Nigeria Tax Administration Act, 2025). It is on this basis that this paper aims to investigate the effect the federal government's VAT administration has on the federating units' ability to improve revenue in their States.

Functions ought to be shared between the federal and the States, and this includes taxing power to give them autonomy (Ukachikara & Okoroafor, 2019). However, in Nigeria, there is an extreme concentration of power at the centre, and this causes financial imbalance (Ewetan, 2012),which has been a source of conflict (Ikechukwu & Emeka, 2018; Adesanmi, 2023). This has equally affected the ability of the States in Nigeria to explore other alternative sources of income, like VAT, to expand their tax base. The lop-sidedness and financial imbalance in Nigeria, the taxes and royalties that were collected by the subnational governments, now centralised has affected the States form exploiting other resources (Olulu & Udeorah, 2018). Consequently, the internally generated revenue (IGR) of the States is profoundly affected. There is, therefore, a wide financial gap between the federal government and the States.

Also, in Nigeria, the constitution allows the States to legislate on capital gain tax, stamp duties, incomes or profits of a person other than companies (Part II (7)(a), Second Schedule, 1999

Constitution). There is an omission of VAT from the exclusive list, which causes a constitutional conflict in Nigeria. It is on these bases that this study discussed how these affect the revenue generation of the States and suggests reforms that can improve the States' tax base.

This paper, therefore, examines how the administration of VAT by the federal government affects the revenue generation efforts and accumulation of debt portfolioof the States in Nigeria, where fiscal federalism is practised.Specifically, the study aims to:

i. Examine the effect of VAT generated on the state's debts.
ii. Examine the effect of VAT allocation on the State's debts.
iii. assess the effect of VAT generation on the States IGR; and
iv. Evaluate the effect of VAT allocation on the State's IGR.

To achieve the objective of the study, the study tested the following hypotheses:

i. VAT revenue generated does not have a significant effect on the states' debts.
ii. VAT revenue allocation does not have a significant effect on the states' debts.
iii. VAT revenue generation does not have a significant effect on the States' IGR; and
iv. VAT revenue allocation does not have a significant effect on the States' IGR.

2.0 Literature Review

This section reviews publications that are of interest to this study. It is discussed under conceptual review, theoretical framework and the review of related literature.

Conceptual Review

Value Added Tax

VAT is an acronym for value-added tax, which is a consumption tax and is charged at every stage of production (Lukpata, 2013). Sales tax was introduced to the Nigerian tax system in 1986 through Decree No.7 of 1986 (Agbo & Nwadiolor, 2020). The authors state that a committee was set up to address the challenges of sales tax in 1991, and it was recommended that the sales tax should be replaced with VAT. In January 1994, VAT implementation commenced in Nigeria through the enactment of Decree No.102 of 1993. There have been several amendments to the VAT Decree and subsequently consolidated into the VAT Act Cap V1 Law of the Federation of Nigeria, 2004 (Oyedokun, 2016), and by this, the Sales Tax Act has been repealed (Section 45, VAT 2004).

There shall be the imposition of VAT per the provision of the Act (Section144, Nigeria Tax Act, 2025). To reduce the incidence of VAT on the taxpayers, some basic food items, some medical items and some goods and services are exempt from VAT (Part IV, Nigeria Tax Act, 2025). The VAT rate is 7.5 per cent (Section148, Nigeria Tax Act, 2025). VAT might be a consumption tax widely seen as a local tax; however, in Nigeria, VAT is administered by the federal government (Section 155 (4), Nigeria Tax Act, 2025). The Act also provides for the revenue-sharing formula for revenue accruing under the operation of this Act. The federal government is allocated 10 per cent; the State Governments and the federal capital territory, Abuja, are allocated 55 per cent; and LGs are allocated 35 per cent (Section 81(1), Nigeria Tax Administration Act, 2025). The revenue to the States and the LGs is distributed equally (50%), population (20%), and consumption (30%).

Fiscal Federalism

Fiscal federalism is a system where powers of revenue and expenditure functions are shared. According to Jha (2012), fiscal federalism is the principle that necessitates the division of power of revenue generation to the vertical levels of government to achieve the objectives of equity and efficiency (Jha, 2012).

Overview of VAT Administration in Other Jurisdictions

Australia uses the goods and services tax (GST), and it is administered by the Australian Taxation Office (ATO) on behalf of the federal government (Brunn & Houseman, 2026). The government collects the VAT in a pool, similar to the system in Nigeria, and then distributes it to the States and Councils. VAT operates in 160 countries; however, the USA does not impose federal VAT; it is the duty of the subnationalgovernments to impose state and local sales taxes (Collins, 2025).
Further, in the UK, VAT is administered by the UK government His Majesty's Revenue and Customs (Scottish Government, 2026). Similarly, the Ghana Revenue Authority (GRA) administers VAT for the federal government (PwC Ghana, 2025).

Theoretical Framework

Theory of Tax Assignment

Tax assignment theory is about Musgrave's 1983 framework that believes in the distribution of functions by both the central and local governments (Bahl & Cyan, 2011). To enable local authorities to cover local costs, the 'Musgrave rule' advocates for tax assignment, believing taxing power should be delegated to the subnational governments. It is believed that taxing power between the central and subnational governments should be guided by the principles of decentralisation (Norregaard, 1997).

Tax assignment suits this study and can be applicable as the core component of fiscal federalism. This principle believes that taxes with high mobility, taxes that help in macroeconomic stabilisation, should be administered by the central government, and taxes that do not have high mobility and provide direct benefits like VAT should be administered by the local governments.

Theory of Fiscal Federalism

This study is also guided by the theory of fiscal federalism. In fiscal federalism, it is assumed that, whether in a unitary system, the expenditure and tax distribution power is shared between different vertical levels of government (Jha, 2012). The author further states that in theoretical terms, fiscal federalism helps in understanding: First, the factors that help in achieving the optimal level of fiscal decentralisation; Second, the principles that necessitate the division of power of revenue generation to the vertical levels of government; and finally, achieving the objectives of equity and efficiency by developing appropriate schemes for intergovernmental transfers.

The theory of fiscal federalism was initially laid by Kenneth Arrow, Richard Musgrave and Paul Sadweh Samuelson (Ewetan, 2012). The theory of fiscal federalism is classified into two: the first-generation theory (FGT) and the second-generation theory (SGT) (Jha, 2012). The author further expatriates that the FGT advocates for decentralisation of expenditure responsibilities, but revenue responsibilities are centralised, while SGT, on the other hand, is in favour of decentralisation of both revenue and expenditure responsibilities. SGT, therefore, does not support intergovernmental transfer to mitigate vertical and horizontal imbalances. The purpose of fiscal federalism is for the government to provide maximum services and collective well-being of the residents (Driessen & Hughes, 2020). The maximum services provided by the government are done under two assumption models: the basic assumption model and the extended basic assumption model.

Under the basic model, it is assumed that there are three economic actors government, individuals and firms. The objective of providing maximum well-being to the residents can only be achieved when the assumptions of all three economic actors are met.

Government Assumptions: The spending programme and tax collection of the government are equal, and there are no differences in administrative costs. The financial statement of the government is balanced, that is, the receipts and spending are equal. The government aims to achieve the collective well-being of all residents, and it has information about other economic actors.

The Assumptions of Individuals and Firms: All preferences (utility functions) of individuals and firms are identical. Individuals can only change their consumption, and firms can change their production in response to changes in government policies. In addition, public services and tax assumptions state that all residents have access to the services provided by the government, and taxes are non-distorting so as not to affect individual choices; Taxes should only benefit those that paid them. The basic model assumption is not realistic, and therefore, the model is extended to take care of the different preferences of residents.

Extended Basic Model: Under this model, more realistic assumptions are used. Government policies are influenced by economic conditions, which help in achieving the residents' well-being. To attain this, responsibilities must be split among tiers of government to provide for individuals' and firms' preferences. This theory applies to this study because the federal government and the States have different needs and preferences, and such should also share the power to administer VAT in the best way to improve the citizens' well-being.

Empirical Review

To determine the appropriate formula for revenue sharing in Nigeria, Salami (2011) found that the revenue allocation in Nigeria is disproportionately in favour of the central government. The focus of the paper was on economic diversification, and it suggested that taxation rather than oil should be embraced. This study focused on VAT and the need to implement fiscal federalism.Similarly, in the analysis of the challenges of the tax system to fiscal federalism in Nigeria, Ewetan (2012) found that there is a concentration of taxing powers in the federal government, which has affected true fiscal federalism. The study focused on different reforms and their implementation in Nigeria. This paper is different from the study because this study equally found the causal effect of the variables.Also, to find the effect of politics on revenue allocation in Nigeria, Lukpata (2013) concluded that the meddling of politics in the tax system has negatively affected the revenue-sharing formula in Nigeria.

Okwesili *et al* (2013) revealed that in Nigeria, there is a mismatch between responsibility functions and revenue functions among the levels of government. The study stressed on States having commiserate amount of resources to match their responsibilities. This study further measured the effect of VAT on the revenue generation of States.In a study to measure the effect of federal VAT on States and LGs, Nunns and Toder (2017) revealed that federal VAT significantly affects the State and LG budget balances through changes to tax bases and changes to public services because of compensation. The study, however, used hypothetical bases and, therefore, is limited.

Further, Ukachikara and Okoroafor (2019) in their study tried to determine factors that enhance nation-building, and they concluded that for better development, nationhood building and unity, the country must implement true fiscal federalism. The scope of the study is different from that of this study. This study used VAT to measure two dependent variables. In continuation, Richards (2019) found that there isa failure to implement fiscal federalism in Nigeria. The study stated that despite identifying the challenges, the national tax policy failed to truly implement fiscal

federalism in Nigeria. This also led to tax duplication in Nigeria. An effort was not made to find a causal relationship, and this makes it different from this study.

In the same vein, Tom and Ataide (2021), in their study, revealed that to resolve challenges faced by the VAT allocation to States, the power to collect the VAT should be shared between the federal government and the States. The student employed historical and descriptive methods of analysis, while this study adopted regression and inferential tools of analysis.To determine the level of government legally empowered to administer VAT, Richards (2022) argued that there is no clarity in the constitution as to the level of government that has the power to administer VAT. The study, however, suggested a constitutional amendment to avoid ambiguity. This study not only determines the level responsible for VAT administration but alsofinds the causality of the relationship among the variables.

To investigate the relationship between VAT and the tiers of government, the federal government, States and the LGs, Ordu and Omesi (2022) found that there is a positive and significant relationship among these tiers of government. The study adopted trend analysis, descriptive and regression techniques for analysis. This study employed regression and inferential tools. In a study, Ilemona and Nwite (2022) investigate the effect of a decentralised VAT collection on States in Nigeria. The study revealed that a few States advocated for power sharing while the majority are averse to it. The study, therefore, recommended a partial power sharing between the federal government and the States. The authors employed econometrics for their analysis, which is different from the method adopted for this study.

Also, Adedeji (2023) in a study highlighted challenges affecting true federalism in Nigeria and revealed that overconcentration of power at the federal level hampers the fiscal relation between the federal and the federating units. The study does not focus on VAT, while this paper focuses on VAT. Anifowose (2023) opined that the nomenclature used to describe VAT does not matter; what matters is that the tax is a consumption tax, and thus there is a legal basis for the States to make such laws. The study focused on the legal implications of overconcentration of taxing power at the centre; however, this study focused on the substance and the effect this has on subnational governments' finances.

Owolabi (2025) argued that the financial imbalances of the VAT sharing formula have impacted more on States without natural resources. The study recommended a suitable sharing formula where the effect could be reduced. This study viewed the VAT generation and allocation from an Islamic angle. This study, however, does not focus on the morality of the allocation, but rather on the need to improve subnational governments' autonomy.From the literature reviewed, little effort is placed on measuring the causal effect of these variables in addition to determining the level that ought to administer VAT in Nigeria. It is on this basis that this study investigated how VAT administration affects fiscal imbalances in Nigeria.

3.0 Methodology

Research Design

The research design for the study is Ex Post Facto Design, and the data for the study were generated through secondary; journals, periodicals, the internet, reports from some government agencies and some non-governmental organisations like Nigeria Revenue Service (NRS), National Bureau of Statistics (NBS) and Budgit. The techniques employed for the analysis were regression and inferential statistics. The study adopted a simple regression for the analysis. Two independent variables were used to measure two dependent variables.

The simple regression has the following model: $Y= \beta_0 + \beta_1 X+\varepsilon$

Where:
Y = dependent variable of the study, that is, the variable being explained;

X = independent variable of the study; it is the predictor and potential explanatory variable of the dependent variable.
β_0 and β_1 = the regression coefficient; and
ε = unobservable error.

Variable Measurement

The study employed four variables: two dependent variables (States' debts and States IGR), and two independent variables (VAT revenue generated and VAT revenue allocated). The VAT revenue generated is revenue from both the imported and the non-imported components. VAT allocated is the figure distributed to the States. The State's debts are domestic debts outstanding at the end of every year owed by the States, while IGR comprises PAYE, direct assessment, road taxes and other taxes. The data generated is from 2011 to 2024. This is because the data on domestic debts for the States accessed from the Debt Management Office (DMO) is from 2011.The study focuses on States in Nigeria with VAT as the unit of analysis.

4.0 Data Presentation and Discussion

Data Presentation

This section analyses and discusses the data generated for this study.In Nigeria, VAT collected is paid into a pool where it is distributed among the federal government, States and LGs. Table 1 shows VAT collected and distributed, State IGR and State debts.

Table 1:
VAT Generation1, Distribution, State IGR and Domestic Debts from 2011 to 2024

Year	VAT Generation	VAT Distribution/Allocation	State IGR	State Domestic Debt
	₦'B	₦'B	₦'B	₦'B
2011	659.15	312.90	486.40	1,233.29
2012	710.56	340.87	547.95	1,551.65
2013	802.68	381.89	671.43	1,537.47
2014	802.96	384.20	707.86	1,655.18
2015	767.33	373.79	682.67	2,503.26
2016	828.20	389.28	823.16	2,958.52
2017	972.35	579.93	936.47	3,348.77
2018	1,108.04	490.52	1,103.42	3,853.44
2019	1,188.58	527.19	1,635.80	4,106.31
2020	1,531.17	673.66	1,559.77	4,186.01
2021	2,107.50	938.40	1,895.79	4,458.24
2022	2,511.51	1,133.43	1,925.61	5,337.75
2023	3,639.32	1,457.21	2,426.92	5,862.85
2024	6,721.35	2,964.33	3,653.58	3,968.06

Sources: NRS (2026), OAGF (2026), NBS (2026), DMO (2026).

Hypotheses Testing

Before testing for the hypotheses, regression assumptions such as linearity, normality, and multicollinearity were tested and they did not violate the assumptions.

$H0_1$: VAT revenue generation does not have a significant effect on the state's debts.

The hypothesis tested whether VAT revenue generation has a significant effect on the States' IGR in Nigeria. The regression result showed that VAT revenue generation has a significant effect on States' IGR in Nigeria, $F(1, 13) = 5.002$, $p = 0.045$. With a $p < 0.05$, VAT revenue generation does have a significant effect on states' debts. Having a statistically significant model means hypothesis one is rejected. Also, the Standardised Coefficient Beta is positive, meaning an increase in VAT allocation increases State debts. The f-value is 5.002, which means it is low, and that means the model is not a good fit and the variability in the dependent variable that was accounted for by the model is 29%.

Table 2:

Effect of VAT Revenue Generation on States Debts

Variable	Unstandardized Coefficient B	t-value	R^2	R Adjusted	F-value	p-value
Constant	2.54	5.168				
VG	0.466	2.236	0.294	0.235	5.002	0.45

Source: Authors' Computation, 2026.

$H0_2$: VAT revenue allocation does not have a significant effect on the States debts.

The hypothesis tested whether VAT allocation has a significant effect on the debts of States in Nigeria. The regression result showed thatVAT allocation does not have a significant effect on states' debts in Nigeria, $F(1, 13) = 4.577$, $p = 0.054$. With a $p > 0.05$,VAT allocation does not significantly affect States debts. Having a statistically insignificant model means hypothesis two is accepted. Also, there is a positive Standardised Coefficient Beta, which means there is a positive relationship between the predictor variable and the outcome variable. However, the variability in the dependent variable was not accounted for by the model because the R^2 is 27.6%, and the small f-value showed that the model is not a good fit.

Table 3:

Effect of VAT Revenue Allocation on States Debts

Variable	Unstandardized Coefficient B	t-value	R^2	R^2 Adjusted	F-value	p-value
Constant	2.48	4.702				
VA	1.08	2.139	0.276	0.216	4.577	0.54

Source: Authors' Computation, 2026.

$H0_3$: VAT revenue generation does not have a significant effect on the State's IGR.

The hypothesis tested whether VAT allocation has a significant effect on the IGR of States in Nigeria. The regression result showed that VAT allocation has a significant effect on States' IGR in Nigeria, $F(1, 13) = 112.93$, $p = 0.000$. The $p < 0.05$, and that tells us that VAT allocation is statistically significant and has an effect on States' IGR. Having a statistically significant model means hypothesis three is rejected. Also, the Standardised Coefficient Beta is positive,meaning an increase in VAT revenue generation increases State IGR. Also, the f-value is high, and that means

the model is a good fit and the variability in the dependent variable was accounted for by the model.

Table 4:
Effect of VAT Revenue Generation on States IGR

Variable	Unstandardized Coefficient B	t-value	R^2	R Adjusted	F-value	p-value
Constant	5.22	4.731				
VG	0.497	10.627	0.904	0.896	112.93	0.000

Source: Authors' Computation, 2026.

H0$_4$: VAT revenue allocation does not have a significant effect on the States IGR.

The hypothesis tested whether VAT allocation has a significant effect on the IGR of States in Nigeria. The regression result showed thatVAT allocation has a significant effect on States' IGR in Nigeria, $F(1, 13) = 102.8$, $p = 0.000$. With a $p < 0.05$,VAT allocation does have a significant effect on State IGR. Having a statistically significant model means hypothesis four is rejected. Also, the Standardised Coefficient Beta is positive, meaning an increase in VAT allocation increases State IGR.The f-value is high, and that means the model is a good fit and the variability in the dependent variable was accounted for by the model because of the high R^2.

Table 5:
Effect of VAT allocated on States IGR

Variable	Unstandardized Coefficient B	t-value	R^2	R Adjusted	F-value	p-value
Constant	4.32	3.543				
VA	1.188	10.139	0.895	0.887	102.8	0.000

Source: Authors' Computation, 2026.

Discussion

The analysis has shown that VAT revenue generation has a significant effect on both the States' IGR and States debts to enable them cover their operational expenses. In addition, the revenue allocation influences States' IGR; however, it does not have a significant effect on the States debts.VAT, being a consumption tax,is widely seen as a local tax; however, in Nigeria, VAT is administered by the federal government (Section 3a, Nigeria Tax Administration Act, 2025). One of the reasons put forward to justify this system of VAT allocation to States is equity and balance.

The results of the analysis have shown that if the States are allowed to administer VAT,this will encourage them to improve and create a conducive environment for ease of doing business in their States to attract businesses and, as a result, generate more VAT revenue. Excerpt from VAT collection and distribution in 2024, as shown in Table 6, shows that Lagos and Rivers States collected 16.74% and 22.42%, respectively, of what was generated from their States. Table 6 also shows that only Lagos and Rivers States generated more VAT than allocated in the period under review. Conversely, other States such as Zamfara, Katsina, Bauchi, and Imo States collected more percentages of what they contributed to the pool.

Table 6:
VAT Generated and Allocated in Nigeria, 2024

	STATE	GENERATION	ALLOCATION	ALLOCATION TO GENERATION
		₦	₦	%
1	LAGOS	2,748,665,069,782.76	460,114,236,434.33	16.74
2	RIVERS	832,688,064,654.31	186,656,071,024.28	22.42
3	ZAMFARA	17,827,344,518.62	67,871,376,495.76	380.72
4	KATSINA	22,080,740,524.48	85,587,835,727.97	387.61
5	BAUCHI	19,597,766,555.00	77,472,243,211.90	395.31
6	ENUGU	15,396,554,017.72	67,538,962,223.54	438.66
7	OSUN	14,794,902,567.80	68,619,532,407.63	463.81
8	ONDO	13,802,062,592.84	68,570,293,215.49	496.81
9	CROSS RIVER	9,358,220,471.69	64,248,333,841.31	686.54
10	ABIA	8,680,963,229.26	63,783,987,557.73	734.76
11	KEBBI	8,773,869,718.68	66,553,295,316.50	758.54
12	IMO	4,383,557,406.46	70,700,422,604.48	1,612.85

Source: The Cable, 2025.

This is why Olumede (2021) advised States to make an effort to develop their environment by enacting tax laws to improve revenue generation rather than remain dependent on the federal government. States should make VAT laws and structure them according to the commercial activities of the States (Omojoye, 2021). Failure to put this into consideration puts the States in a difficult position. The States' ability to expand their tax base and improve revenue generation is hindered. Therefore, the IGR of most of the States do not match the operational expenses. This has caused many States difficulties to conveniently cover their operational expenses without the Federation Account Allocation Committee (FAAC) allocation.

Table 7 shows that the operating expenses of the States are not the same, nor is the IGR. The different States have different preferences, and therefore, the realistic option should be for the government to split the taxing power to enable the States use VAT revenue from their regions to charter for the different needs of the residents.

Table 7:
2025 Revenue and Expenses of States in Nigeria

SN	State	IGR		Operating Expenses		Surplus/Deficit	
		2023	2024	2023	2024	2023	2024
		₦'BN	₦'BN	₦'BN	₦'BN	₦'BN	₦'BN
1	Lagos	840.45	1262.43	709.89	1044.44	130.56	217.99
2	Imo	18.23	20.23	97.7	119.89	-79.47	-99.66
3	Kogi	23.59	27.76	113.08	176.03	-89.49	-148.27
4	Jigawa	11.68	19.01	159.5	142.23	-147.82	-123.22
5	Benue	19.2	20.92	85.3	197.74	-66.1	-176.82
6	Yobe	11.2	11.08	89.24	122.32	-78.04	-111.24

Source: Budgit, 2025.

From Table 7, without FAAC, except Lagos State, the remaining States cannot cover their operating expenses. Most governments that practice federalism cede the powers to administer and collect VAT to the States because the States have varying responsibility functions from one another. To correct this anomaly, proper tax administration is important.

There is no clarity in the constitution as to the tier of government with the jurisdiction to administer VAT. The constitution is supreme, and any other law that is contrary to its provisions is void (Section 1(3), 1999 Constitution). Another reason for vesting the power to administer VAT in the then Federal Board of Inland Revenue (FBIR) was because of doubts on the competence and sufficient expertise to effectively administer VAT; and the subnational governments' overreaching power of enacting laws beyond their powers, and to reduce tax collection costs (Joseph, 2023).

Given the introduction of technology in collecting tax, Akinyemi (2021) stated that the cost of VAT collection at 4% is high compared to the costs of tax collection in other jurisdictions. The author stated that between the 2013 and 2017 financial years, ₦146 billion out of the ₦171.7 billion costs of VAT collection were borne by the States, which represent 85 per cent of the costs of collection. With the huge VAT collection costs, the States may as well administer the VAT themselves.

More so, the omission of sales tax in the exclusive list of the 1979 constitution meant the regions could legislate on it (Joseph, 2023). The study made this conclusion based on the 1959 constitution, which gave powers to the regions to legislate on sales tax despite the fact that it was omitted from the exclusive list. This omission is recommended by the 1979 Constitution Drafting Committee to enable the States collect consumption tax (Joseph, 2023). Therefore, the non-inclusion of VAT or sales tax in the 1979 and 1999 constitutions could not have been an omission; rather, the framers of the constitution never envisaged VAT to be a federal tax (Babalola, 2021; Omojoye, 2021; PwC Nigeria, 2021). Also, despite the widespread use of VAT in Europe and other parts of the world, National VAT has never been adopted in the US (Caspersen & Metcalf, 1994). There is no empirical evidence to support the assertion that given subnational governments' taxing power leads to a crowding out of revenue (Bahl & Cyan, 2011).

Interestingly, there are different preferences by individuals and firms residing in different States in Nigeria. State Governments produce goods and provide services based on varying preferences of the residents, for example, population and environmental pollution put pressure on States like Lagos and Rivers, while States like Borno and Yobe are faced with the challenges of desertification. Therefore, the importance of giving powers to the States to legislate cannot be overemphasised. Besides, shortly before the military takeover of 1984, the Supreme Court gave powers to legislate on sales tax to the States (Joseph, 2023). Also, the ruling by the FHC in favour of the States showed that VAT is important to the States. Furthermore, the judges considered the concept of fiscal federalism. It is in this light that it is stressed that the implementation of true fiscal federalism will make States in Nigeria more productive and that States, rather than fighting for a revenue-sharing formula, should discuss how to generate more revenue (Ukpe, 2021). The ultimate aim of any policy is to improve citizens' well-being.

To determine the optimal allocation of responsibilities is difficult; policymakers should adopt theories of fiscal federalism (Driessen & Hughes, 2020). This is so because, to correct fiscal imbalances, the theory of fiscal federalism has a normative framework to assign both revenue and

expenditure responsibilities to vertical levels of government (Jha, 2012). The centralised method of VAT collection in Nigeria has clearly hindered the States' ability to improve alternative means of improving their IGR. The federal government administering VAT implies that the States will explore other sources of revenue by borrowing more, hence expanding their debt portfolio and consequently affecting the delivery of welfare. Table 8 shows the accumulated debts of the States. Hypothesis one confirms the effect of VAT generation on states' debts.

The subnational governments have accumulated huge debt, both domestic and foreign, and this accumulation is a result of poor IGR to cover their operational costs. The States are faced with the challenge of sustainable development as a result of poor revenue (Ogune et al., 2024), and this has caused huge debts for the States (Egboboh, 2022; James, 2025). It is inevitable to grant the subnational governments the power to collect VAT to enable them improve their revenue generation ability. However, VAT from companies that transact business across States and import tax collections may prove to be problematic to collect, and also, there will be duplication of duties.

5.0 Conclusion and Recommendations

Most countries now embrace VAT because it improves the revenue generation of the government. The VAT administration is by the federal government, then shared among the federal, States and LGs. The vesting of taxing powers on the federal government over the States means the powers to share revenue and responsibility functions in terms of VAT are not implemented, and this has affected the concept of fiscal federalism.

The results of the study showed that VAT revenue generation has a significant effect on States' debts; however, VAT allocation does not have a significant effect on States debts; VAT revenue generation has a significant effect on States IGR; and VAT allocation has a significant effect on States IGR. This has made the States not harness the alternative source of income, hence affecting their ability to expand the tax base. This is a confirmation of earlier publications by Okwesili *et al* (2013); Nunns and Toder (2017); Ukachikara and Okoroafor (2019).

It is, therefore, recommended that the federal government ensure that the responsibility functions of States are matched with equal revenue functions by giving them the powers to administer VAT and then adopt an equitable revenue sharing formula to share the interstate VAT and VAT from import and international transactions. To achieve this, there must be a robust framework that will take care of VAT from interstate transactions like the telecommunication and banking sectors, the problem of duplication of tax, and ensure qualified personnel are employed to administer tax.

The scope of the study only focused on the domestic debts of the States. Therefore, for further study, it is recommended that the foreign debt component of the States debts should be incorporated.

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