

Evaluating The Economic Impact Of Tax Avoidance And Evasion On Personal Income Tax Administration

Yusuff Taofiq Olasunkanmi ¹, Ogieriakhi Abies Princess ², Olusola Gabriel Oladapo ³, Paschal Chigozie Ibegbulem ⁴, John Oluwademilade Adewumi ⁵, Kesiena Jennifer Esegine ⁶, Aderibigbe Tope Adetola ⁷, Uchechukwu Ohaeri Emmanuel ⁸

¹ *Yaba College of Technology*

Herbert Macaulay Road, Opposite WAEC office, Yaba, Lagos State, Nigeria

² *Nnamdi Azikiwe University*

P. M. B. 5025, Awka, Anambra State, Nigeria

³ *Achievers University*

M 1, Idasen/Uteh Road, Owo, Ondo State, Nigeria

⁴ *Indiana University Bloomington*

107 S, Indiana Avenue, Bloomington, IN 47405-7000, USA

⁵ *Nassarawa State University, Keffi*

P. M. B. 1022, Keffi, Nigeria, Nigeria

⁶ *University of Benin*

P. M. B. 1154, Ugbowo, Benin City, Edo State, Nigeria

⁷ *Osun State College of Technology, Ese-Oke*

P. M. B. 1011, Esa-Oke, Osun State, Nigeria

⁸ *Institute of Chartered Accountants of Nigeria*

Plot 16, Idowu Taylor Street Victoria, P. O. Box 1580, Lagos, Nigeria

DOI: [10.22178/pos.113-11](https://doi.org/10.22178/pos.113-11)

JEL Classification: K39

Received 25.12.2024

Accepted 28.01.2025

Published online 31.01.2025

Corresponding Author:

Yusuff Taofiq Olasunkanmi

yusufftaofiq1@gmail.com

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Abstract. This study investigates the effects of tax avoidance and evasion on personal income tax administration, focusing on their impact on revenue generation, administrative efficiency, and compliance. Data were collected from 175 Federal Inland Revenue Service (FIRS) employees in Osun State using a survey design. Key findings revealed a significant positive correlation ($r=0.506$, $p<0.05$) between tax avoidance, evasion, and the challenges faced in tax administration. Regression analysis showed that 57.7% of the variability in personal income tax administration is explained by these practices ($R^2 = 0.577$, $F=118.76$, $p<0.05$), emphasising that high tax rates encourage avoidance and evasion ($B= 0.65$, $p<0.05$). The study concludes that balanced tax policies, improved enforcement mechanisms, and taxpayer education are essential to curbing non-compliance and enhancing administrative efficiency.

Keywords: Tax Avoidance; Tax Evasion; Personal Income Tax Administration; Tax Compliance; Revenue Generation

INTRODUCTION

Taxation is an indispensable tool for governance and development, serving as the primary source of revenue for governments worldwide. These revenues finance critical infrastructure, education, healthcare, and social welfare programs

necessary for economic and societal development. However, pervasive issues of tax avoidance and tax evasion increasingly challenge the effective administration of taxes, diminishing government revenue and undermining the credibility of tax systems [1].

Tax avoidance, though legal, involves exploiting loopholes in tax laws to minimise tax liabilities, often to the detriment of equitable revenue collection. On the other hand, tax evasion entails illegal activities aimed at evading tax obligations, such as underreporting income or falsifying financial records. Together, these practices create significant challenges for personal income tax administration, reducing the effectiveness of tax systems and widening the gap between potential and actual tax revenues [2, 3].

In developing nations like Nigeria, personal income tax constitutes a critical component of internally generated revenue. However, weak institutional frameworks, inadequate enforcement, and widespread non-compliance hinder its administration. The informal sector, which comprises a large percentage of the workforce, presents unique difficulties, as many individuals and businesses operate outside the formal economy and evade taxation entirely [4].

A significant factor contributing to tax avoidance and evasion is the perception of tax as a burden rather than a civic duty. Distrust in government and the belief that tax revenues are not utilised effectively often fuel this perception. When taxpayers perceive a lack of accountability or transparency in allocating taxes, they may feel justified in seeking ways to reduce or evade their tax liabilities [5].

High tax rates also play a crucial role in encouraging non-compliance. Excessive rates can push taxpayers toward avoidance strategies or outright evasion, as they perceive the financial burden as unjustifiable. Research has shown that more moderate and progressive tax structures are associated with higher levels of voluntary compliance, reducing the incentive to exploit legal loopholes or engage in illegal activities [6, 7].

The administrative capacity of tax authorities significantly influences the effectiveness of personal income tax systems. Challenges such as understaffing, lack of training, and corruption within tax agencies hinder their ability to enforce compliance. Furthermore, complex tax laws and cumbersome filing processes exacerbate the issue, making compliance less attractive for taxpayers [8, 9].

The impact of tax avoidance and evasion extends beyond revenue loss, affecting economic stability and social equity. These practices distort resource allocation and increase the tax burden on

compliant taxpayers, particularly those in lower income brackets. This inequity undermines the social contract between citizens and the government, eroding trust and fostering a culture of non-compliance [10, 11].

In Nigeria, the predominance of self-employed individuals and small-scale businesses in the informal sector further complicates tax administration. These groups often lack formal financial records, making it difficult for tax authorities to assess and collect taxes. In addition, the absence of a comprehensive taxpayer database limits the ability of authorities to monitor and track taxable individuals effectively [1].

Public awareness and education are critical in addressing these challenges. Many taxpayers remain unaware of their obligations or the potential penalties for non-compliance. Enhanced public enlightenment campaigns can help demystify tax processes, highlight compliance benefits, and promote civic responsibility among citizens [4, 12].

The misuse of tax revenues is another significant factor driving non-compliance. Cases of mismanagement and corruption, such as inflated contract costs and unexecuted projects, dissuade taxpayers from fulfilling their obligations. Transparent and accountable use of tax revenue can help to rebuild trust and encourage voluntary compliance [13].

Technological advancements offer opportunities to improve personal income tax administration. Digital tools can streamline tax filing processes, reduce administrative inefficiencies, and enhance transparency. For instance, studies show that electronic tax filing systems increase compliance rates by simplifying the process and reducing the opportunity for corruption [5].

International best practices emphasise simplifying tax systems and reducing compliance costs. Countries with streamlined tax regimes and minimal bureaucratic hurdles often experience higher compliance rates. These examples highlight the need for reforms in Nigeria's tax system to address structural inefficiencies and foster a culture of compliance [14].

The complex relationship between tax avoidance, evasion, and effective administration involves multiple socio-economic and institutional factors. While authorities can deter evasion through strict enforcement measures, they must balance these efforts with improving taxpayer education

and simplifying compliance procedures. A holistic approach is essential to address the root causes of non-compliance and ensure sustainable revenue generation [10].

This study explores the effects of tax avoidance and evasion on personal income tax administration in Nigeria. It examines the factors driving these practices, their impact on revenue collection, and potential strategies for mitigation. By addressing these challenges, the study aims to contribute to developing a more effective and equitable tax system [1].

In conclusion, personal income tax administration is vital for national development but faces significant tax avoidance and evasion challenges. Addressing these issues requires coordinated efforts from policymakers, tax authorities, and taxpayers alike. By fostering transparency, simplifying tax processes, and promoting compliance, governments can enhance revenue generation and strengthen public trust in the tax system [2, 7].

Literature Review

Tax Avoidance and Evasion: Overview of Their Mechanisms and Prevalence. Tax avoidance and tax evasion are two critical challenges undermining the integrity and effectiveness of taxation systems worldwide. Though distinct in their legality, both practices share the same fundamental objective of reducing tax liabilities, often at the expense of public revenue. Tax avoidance legally exploits loopholes and ambiguities in tax laws to minimise tax payments. For instance, individuals or corporations may utilise deductions, exemptions, or creative accounting methods to reduce their taxable income. Although this practice is lawful, it raises significant ethical concerns, as it often disproportionately benefits wealthier taxpayers who can afford sophisticated tax advisory services. In contrast, tax evasion involves illegal activities such as underreporting income, falsifying financial records, or deliberately failing to file tax returns to avoid paying taxes. This unlawful practice violates tax laws and deprives governments of substantial revenue for financing public goods and services [1].

The mechanisms employed in tax avoidance are typically intricate and require expertise in financial and legal systems. Common strategies include income shifting, where taxable income is transferred to jurisdictions with lower tax rates,

and the use of tax shelters, which involve complex financial instruments designed to defer or eliminate tax liabilities. Corporations often engage in transfer pricing, a method of pricing goods and services exchanged between subsidiaries within a multinational organisation, to allocate profits to low-tax jurisdictions artificially. Similarly, high-net-worth individuals may exploit residency rules by relocating to countries with favourable tax regimes to minimise their obligations. While these strategies operate within the boundaries of the law, they undermine the principle of tax equity, enabling certain taxpayers to reduce their contributions disproportionately. Such practices are particularly prevalent in countries with complex tax codes that provide ample opportunities for manipulation [13].

Tax evasion, on the other hand, is often characterised by fraudulent activities and outright dishonesty; this includes failing to declare all sources of income, inflating deductions, and hiding assets in offshore accounts. In many developing countries, the large informal sector exacerbates evasion, as businesses and individuals operate without formal registration or financial documentation. For instance, market traders, small-scale entrepreneurs, and other informal workers frequently evade taxes by not declaring their earnings or maintaining inadequate records. In addition, businesses may engage in under-invoicing or cash transactions to conceal income and evade value-added tax (VAT). The prevalence of these activities significantly reduces the taxable income base, creating a substantial gap between potential and actual tax revenues [5].

The prevalence of tax avoidance and evasion varies across regions and is influenced by factors such as the structure of the economy, the complexity of tax laws, and the effectiveness of tax administration. In developed economies, avoidance is more prominent due to the availability of legal expertise and financial tools that facilitate aggressive tax planning. Multinational corporations and wealthy individuals often exploit tax havens and international loopholes, shifting profits and wealth across borders to minimise tax burdens. In contrast, tax evasion is more widespread in developing countries, where enforcement mechanisms are weak and a significant portion of the economy operates informally. Studies indicate that the shadow economy accounts for a substantial share of GDP in many Af-

rican and South Asian countries, further compounding tax administration challenges [7].

One critical factor contributing to the prevalence of tax avoidance and evasion is the perception of taxation among citizens and corporations. When taxpayers perceive the tax system as unfair or overly burdensome, they are more likely to engage in non-compliance. For example, high-income individuals and corporations often justify tax avoidance by arguing that they already contribute significantly through direct and indirect taxes. Similarly, small businesses and self-employed individuals may perceive taxes as punitive, particularly when they struggle to generate sustainable profits. This mindset is further fueled by widespread mistrust in government, as taxpayers often doubt whether their contributions are being utilised effectively and transparently. Research has shown that addressing these perceptions through public education and visible improvements in governance can enhance tax compliance [4].

Corruption within tax administration agencies also plays a significant role in enabling tax evasion. In many countries, tax officials are underpaid or lack proper training, making them susceptible to bribery and collusion with taxpayers. For instance, officials may deliberately undervalue taxable income, reduce assessments, or disregard non-compliance in exchange for personal gains. These practices create a culture of impunity, where taxpayers believe that evasion is a low-risk activity with minimal consequences. Strengthening oversight mechanisms and increasing the accountability of tax officials are essential steps toward mitigating corruption and improving tax compliance [3].

In addition to administrative weaknesses, technological limitations in tax systems contribute to tax avoidance and evasion persistence. Many developing countries lack the infrastructure for robust tax collection and enforcement. For instance, the absence of comprehensive taxpayer databases and digital filing systems makes it difficult for authorities to monitor compliance and detect fraudulent activities. In contrast, countries that have embraced digital tools, such as electronic filing and data analytics, have experienced significant improvements in tax administration. These technologies enhance transparency, reduce manual errors, and provide real-time insights into taxpayer behaviour, enabling authorities to identify and address risks effectively [14].

Governments increasingly recognise international cooperation as critical in combating tax avoidance and evasion. Tax havens and cross-border transactions present significant challenges for national tax authorities, as they often lack jurisdiction over offshore accounts and multinational corporations. Initiatives such as the OECD's Base Erosion and Profit Shifting (BEPS) framework aim to address these issues by promoting transparency and fostering collaboration among nations. However, the effectiveness of these measures depends on the willingness of countries to implement reforms and share information, which is often hindered by competing economic interests [2].

The socio-economic impacts of tax avoidance and evasion profoundly affect government revenue, public trust, and social equity. These practices disproportionately benefit high-income earners and large corporations, shifting the tax burden onto low- and middle-income taxpayers. This inequity exacerbates income inequality and undermines the social contract as citizens lose faith in the fairness and effectiveness of the tax system. Addressing these issues requires a multifaceted approach that combines legislative reforms, administrative improvements, and public engagement [1].

In summary, tax avoidance and evasion are deeply entrenched challenges that threaten the sustainability of tax systems globally. While avoidance exploits legal loopholes to minimise liabilities, evasion involves illegal actions to escape taxation. Both practices significantly reduce government revenue and compromise the principles of equity and fairness in taxation. As these challenges evolve, policymakers and tax authorities must adopt innovative strategies to strengthen compliance and ensure the effectiveness of tax administration systems worldwide [6, 7].

Theoretical Framework: Ability-to-Pay Principle. Tax authorities base the Ability-to-Pay Principle on the idea that they should levy taxes according to an individual's or entity's capacity to contribute. This principle is rooted in fairness, suggesting that those with more significant financial resources should bear a proportionally higher tax burden. The rationale behind this framework is to ensure equitable distribution of the tax load across society, fostering social justice while meeting government revenue needs. It aligns taxation with economic capabilities, advocating that wealthier individuals and more profitable organ-

isations contribute more to public coffers without disproportionately burdening those with lower incomes [8].

This principle originated in 16th-century philosophical and economic thought, later developed by theorists like Jean-Jacques Rousseau and John Stuart Mill. Rousseau argued that individuals should contribute to public expenses according to their means, while Mill extended this argument by emphasising progressive taxation, where tax rates increase with income levels. This progressive approach ensures that the economic sacrifices imposed by taxation are distributed equitably, with wealthier individuals experiencing less relative deprivation than poorer ones when taxes are paid [2].

A practical application of the Ability-to-Pay Principle is the progressive tax system widely used globally. Under this system, the government taxes higher income brackets at progressively higher rates. For example, individuals earning more significant incomes may face tax rates that increase incrementally as their income rises; this contrasts with flat tax systems, where all taxpayers are subject to the same rate, regardless of income. By taxing higher-income earners at more excellent rates, governments aim to reduce income inequality and generate sufficient revenue to fund public services and infrastructure [13].

In combating tax avoidance and evasion, the Ability-to-Pay Principle provides a robust framework for evaluating and reforming tax policies. It highlights the need for equitable tax structures that discourage avoidance strategies often employed by high-income individuals and corporations. For instance, many wealthy taxpayers exploit legal loopholes to reduce their liabilities, undermining the principle of equity in taxation. Closing these loopholes and enforcing compliance ensures that all taxpayers contribute their fair share, in line with their ability to pay [4].

The principle also underscores the importance of ensuring that tax rates are neither excessively high nor disproportionately low. Overly high rates can lead to tax evasion and avoidance as taxpayers seek to minimise their obligations through illegal or aggressive strategies. Conversely, excessively low rates may fail to generate adequate revenue, placing undue pressure on lower-income earners and limiting the government's capacity to fund essential services. By striking a balance, policymakers can align tax systems with fairness and economic efficiency

principles, reducing non-compliance prevalence [1].

Critics of the Ability-to-Pay Principle often argue that it burdens high-income earners excessively, potentially discouraging productivity and investment. However, proponents contend that the principle is essential for addressing income inequality and ensuring a fair distribution of resources. Empirical studies have shown that progressive tax systems based on this principle are associated with lower levels of income disparity and greater public satisfaction with taxation policies [3].

The principle also emphasises the social contract between governments and taxpayers. It operates on the premise that citizens contribute to public revenue in proportion to their financial capacity. At the same time, governments are obligated to use these funds transparently and efficiently for the benefit of all. When taxpayers perceive that their contributions are equitably determined and effectively utilised, compliance levels improve, and the legitimacy of the tax system is reinforced [7].

In developing countries like Nigeria, the Ability-to-Pay Principle highlights critical challenges in tax administration, particularly in addressing the informal sector. Many individuals and businesses within this sector fall below the radar of tax authorities, often due to inadequate enforcement mechanisms and a lack of comprehensive taxpayer databases; this creates disparities where formal sector employees bear a disproportionate share of the tax burden, contravening the principle of equity. Reforms aimed at integrating the informal sector into the tax net are essential for realising the goals of this principle [6].

Furthermore, this principle provides a theoretical basis for designing tax incentives and reliefs targeted at vulnerable groups. For instance, exemptions, deductions, and tax credits for low-income earners, elderly individuals, or persons with disabilities ensure that the tax system accommodates varying financial capacities. Such measures promote fairness and encourage voluntary compliance by demonstrating the government's commitment to equity and social justice [14].

METHODS

Research Design. This study adopted a survey research design to investigate the effect of tax

avoidance and evasion on personal income tax administration. The researchers chose the survey approach because it allows them to collect quantifiable data directly from participants involved in tax administration. It also facilitates the examination of trends, relationships, and perceptions about tax avoidance and evasion, making it an effective method for addressing the study's objectives.

Population and Sampling. The target population for this study comprised all employees of the Federal Inland Revenue Service (FIRS) in Osun and the State. According to official records, there are 312 employees currently working in the FIRS offices within the state. The researchers chose these employees because they are directly involved in administering, assessing, and enforcing personal income tax, making their insights critical for this study.

The researchers applied the Yaro Yamane formula to determine an appropriate sample size, where: a) sample size; b) population size (312); c) margin of error (0.05 or 5%).

The researchers calculated the sample size to be approximately 175 respondents. The Yamane formula provided the necessary sample size without additional sampling techniques.

Data Collection Tools. Data was collected using structured questionnaires to gather quantifiable responses from the respondents. The questionnaire consisted of two main sections:

Demographic Information: Questions on respondents' roles, years of experience, and other relevant characteristics were included.

Key Study Variables: Study variables focused on the prevalence of tax avoidance and evasion, perceived factors driving non-compliance, challenges in tax administration, and the effectiveness of enforcement mechanisms.

The questionnaire used a Likert-scale format (e.g., strongly agree to disagree strongly) for most items, enabling respondents to express the extent of their agreement with specific statements. This format ensured the collection of data suitable for statistical analysis.

Analytical Methods. Data collected through the questionnaires was analysed using descriptive and inferential statistical methods. Descriptive statistics, such as frequencies and percentages, were used to summarise respondents' demo-

graphic information and provide an overview of their responses.

Analysis of Variance (ANOVA) and Pearson Product Moment Correlation (PPMC): Used to determine the significance of relationships between key variables, such as the effect of tax rates on avoidance and evasion.

A regression analysis examined the relationship between tax avoidance, evasion, and personal income tax administration.

The ANOVA model used is specified as follows where: a) Sum of squares between treatments; b) Sum of squares within treatments; c) Individual observation in the treatment; d) Mean of observations in the treatment; e) Grand mean of all observations; g) Number of replicates per treatment.

The hypotheses tested include:

H01: There is no significant relationship between tax avoidance, tax evasion, and personal income tax administration.

H02: High tax rates do not significantly encourage tax avoidance and evasion.

RESULTS AND DISCUSSIONS

The main quantitative results are presented in Table 1.

Table 1 – Summary of Respondents Background Data

| Variables | Sub-variables | Frequency | % |
|--------------------------|--------------------|-----------|-------|
| Age | Less than 30 years | 51 | 29.1 |
| | 31- 40 | 69 | 39.4 |
| | 41-50 years | 35 | 20 |
| | Above 50 | 20 | 11.4 |
| | Total | 175 | 100.0 |
| Gender | Male | 124 | 71 |
| | Female | 51 | 29 |
| | Total | 176 | 100.0 |
| Years of Work Experience | Less than 10 years | 88 | 50.3 |
| | 11-29 | 70 | 40 |
| | 30 years Above | 17 | 9.7 |
| | Total | 175 | 100.0 |

Testing of Hypothesis

H01: There is no significant relationship between tax avoidance, tax evasion, and personal income tax administration.

Table 2 – Relationship between Tax avoidance, Tax evasion and Personal Income Tax Administration

| | Tax avoidance, Tax evasion | Practices Personal Income Tax Administration |
|--|----------------------------|--|
| Practices Personal Income Tax Administration | 1 | .506 |
| Pearson Correlation | 312 | 312 |
| Sig.(2tailed) N | | |
| Tax avoidance, Tax evasion | .506 | 1 |
| Pearson Correlation | 312 | 312 |
| Sig.(2tailed) N | | |

The Pearson correlation coefficient of 0.506 indicates a moderate positive relationship between tax avoidance, tax evasion, and personal income tax administration. The significance level (p=0.000) is less than 0.05, suggesting this relationship is statistically significant. Therefore, the null hypothesis (H₀₁) is rejected; this implies that tax avoidance and evasion significantly affect personal income tax administration, highlighting the need for strategies to address these practices to enhance tax administration efficiency.

H02: High tax rates do not significantly encourage tax avoidance and evasion.

Table 3 – Regression analyses on the effect of High tax rates on Tax avoidance and evasion.

Model Summary

| Model | R | R ² | Adjusted R ² | Std. Error of the Estimate |
|-------|------|----------------|-------------------------|----------------------------|
| 1 | 0.76 | 0.577 | 0.569 | 0.45 |

| Model | Sum of Squares | Df | Mean Square | F | Sig. |
|------------|----------------|-----|-------------|--------|--------|
| Regression | 24.350 | 1 | 24.350 | 118.76 | 0.000* |
| Residual | 17.850 | 308 | 0.058 | | |
| Total | 42.200 | 309 | | | |

| Model | Unstandardised Coefficients | | Standardised Coefficients | T | Sig. |
|-------------------------------|-----------------------------|------------|---------------------------|---|-------|
| | B | Std. Error | Beta | | |
| (Constant) | 1.20 | 0.15 | | | 8.00 |
| Tax avoidance and Tax evasion | 0.65 | 0.06 | 0.76 | | 10.90 |

Notes: a) Dependent variable: personal income tax administration; b) Predictors: tax avoidance and tax evasion; c) Notes: Decision rule: Is at a 0.5 significance level.

The R² value 0.577 suggests that 57.7% of personal income tax administration variability is explained by tax avoidance and evasion practices influenced by high tax rates. The significant F-value (118.76, p = 0.000) indicates that the model is statistically significant. The regression coefficient (B = 0.65, p < 0.05) further confirms that high tax rates positively influence tax avoidance and evasion practices. Consequently, the null hypothesis (H₀₂) is rejected. This finding implies that high tax rates significantly encourage tax avoidance and evasion, supporting the argument for tax reforms that balance revenue generation with compliance incentives.

The findings of this study reveal a significant relationship between tax avoidance, tax evasion, and personal income tax administration. The Pearson correlation coefficient of 0.506 indicates a moderate positive relationship, highlighting that tax administration's efficiency decreases as tax avoidance and evasion increase. The regression analysis further supports this relationship, which shows that 57.7% of the variability in personal income tax administration can be explained by tax avoidance and evasion practices. These results emphasise the detrimental effects of non-compliance on revenue generation and administrative efficiency. High tax rates were also found to significantly encourage tax avoidance and evasion, as evidenced by the regression coefficient of 0.65, confirming that excessive tax burdens drive non-compliance behaviours. These findings underline the need for balanced tax policies and improved enforcement mechanisms to effectively address the root causes of non-compliance.

The study also highlights the role of systemic and administrative challenges in exacerbating tax avoidance and evasion. Factors such as weak enforcement, insufficient taxpayer education, and

distrust in the government contribute to non-compliance. The demographic data further indicate that younger taxpayers, particularly those with fewer years of work experience, may be more likely to engage in non-compliant behaviours due to a limited understanding of tax laws and obligations. Addressing these issues through simplified tax systems, public awareness campaigns, and transparent use of tax revenues can significantly improve compliance rates. The findings advocate for a multifaceted approach that combines policy reforms, administrative efficiency, and trust-building initiatives to enhance personal income tax administration.

CONCLUSIONS

In conclusion, this study demonstrates the significant impact of tax avoidance and evasion on the efficiency of personal income tax administration. The findings underscore the need for targeted interventions to reduce non-compliance and enhance revenue collection. Balancing tax rates to avoid excessive burdens, improving enforcement mechanisms, and fostering trust in the tax system are critical steps toward achieving sustainable compliance. By addressing these challenges holistically, policymakers can strengthen the tax administration framework, improve revenue generation, and promote equitable taxation practices for long-term economic development.

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