

Tax Risk and Tax Revenue Generation in the Informal Sector of South-West Nigeria

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DOI: <https://doi.org/10.47772/IJRISS.2026.100900007>

Received: 14 September 2026; Accepted: 19 September 2026; Published: 28 September 2026

ABSTRACT

This study examined tax risk and tax revenue generation in the informal sector of South-West Nigeria, focusing specifically on tax leakages risk, tax planning risk and tax non-compliance risk. The broad objective was to investigate how these dimensions of tax risk affect the capacity of State Internal Revenue Services (SIRS) to generate tax revenue from informal sector operators. Specifically, the study examined the effect of tax leakages risk on tax revenue generation, investigated the effect of tax planning risk on tax revenue generation, and assessed the effect of tax non-compliance risk on tax revenue generation.

The study was anchored on the Economic Deterrence Theory, complemented by the Benefit Received Theory and the Planning Behaviour Theory. A survey research design was adopted, relying on primary data obtained through a structured questionnaire administered to tax officers in the informal sector departments of the SIRS across the six South-Western states of Nigeria. The study population comprised 5,193 staff of the SIRS in Lagos, Ogun, Oyo, Ondo, Osun and Ekiti States. A sample of 371 respondents was determined using the Taro Yamane (1967) formula and allocated proportionately across the states using a stratified sampling technique; 368 valid responses were retrieved and analysed. Data were analysed using descriptive statistics (mean and standard deviation) and simple linear regression at the 5% level of significance.

Tax leakages risk had a positive and statistically significant effect on tax revenue generation ($\beta = 0.748$, $R^2 = 0.560$, $p = 0.000$). Tax planning risk also exhibited a positive and statistically significant effect ($\beta = 0.781$, $R^2 = 0.610$, $p = 0.000$), while tax non-compliance risk recorded the strongest effect of the three ($\beta = 0.823$, $R^2 = 0.678$, $p = 0.000$). Consequently, all three null hypotheses were rejected.

The study recommends that State Internal Revenue Services strengthen digital monitoring and internal control mechanisms, simplify tax regulations and intensify taxpayer education, enforce tax laws and penalties consistently, and promote transparency alongside an integrated tax database. The study concludes that effective management of tax leakages, tax planning and non-compliance risks is fundamental to broadening the tax base and improving tax revenue generation from the informal sector in South-West Nigeria.

Keywords: Tax Risk, Tax Leakages, Tax Planning, Tax Non-Compliance, Tax Revenue Generation, Informal Sector.

INTRODUCTION

Governance is an enormous responsibility that gulps substantial funds as government seeks to meet the expectations of the people it represents. A reliable and sustainable source of revenue is therefore needed to finance public expenditure (Olaoye & Ekundayo, 2018). However, government often does not receive the expected support from taxpayers because of failure to fulfil the civic responsibility of remitting tax, thereby limiting the capacity of government to improve its revenue generation (Ayuba et al., 2018). Globally, tax

remains one of the major sources of government revenue, yet not every government has been able to exploit this avenue effectively, owing to risks associated with the tax system, tax administration, tax policy, and over-reliance on other sources of revenue such as foreign aid and grants.

In developing countries, particularly Nigeria, tax non-compliance in the informal sector is one of the main limitations to efficient revenue generation. This is driven by a partial misunderstanding of tax requirements, the lack of formal business structures, limited enforcement mechanisms and general wariness toward officialdom (Oladele et al., 2024). Despite Nigeria's vast natural and human resources, the country's tax-to-GDP ratio remains relatively low compared with other developing nations (Aluko et al., 2022), while poor record-keeping and incomplete disclosure by informal operators continue to widen the tax gap (Isenmila et al., 2019; Oladele et al., 2019; Ige et al., 2023). The consequences include constrained public spending on education, healthcare and infrastructure, and an erosion of social capital (Ayuba et al., 2018; World Bank, 2021).

Three risk dimensions are central to this problem. Tax leakages occur where businesses partially declare income, use fake invoices, or otherwise divert revenue that should accrue to government (Amahalu et al., 2019); tax risk management responds to this through stronger audit capacity and improved coordination between tax authorities and financial institutions to detect irregular transactions. Aggressive tax planning — structuring financial affairs to minimise tax liability — erodes revenue even though tax planning itself is legal, and risk-based directives and monitoring mechanisms are needed to curb the exploitation of loopholes (Saadi & Lahcen, 2022). Tax non-compliance, fuelled by weak enforcement, inadequate taxpayer education and a culture of evasion (Clement & Ayobowale, 2018), remains one of the most persistent obstacles to revenue mobilisation.

Various interventions, including the Voluntary Assets and Income Declaration Scheme and the digitalisation of tax processes, have recorded mixed success (Nwamgbebu et al., 2019). Nevertheless, most tax systems in Nigeria remain reactive — enforcing compliance after infractions occur rather than proactively managing the risks that promote evasion, leakage and non-compliance (Isenmila et al., 2021). Existing studies have rarely examined tax leakages, tax planning and tax non-compliance jointly as dimensions of an integrated tax risk framework, particularly within the informal sector, which contributes substantially to economic activity in developing economies yet remains largely outside formal tax systems. This study addresses this gap by investigating tax risk and tax revenue generation in the informal sector of South-West Nigeria.

Nigeria's low tax-to-GDP ratio, relative to peer economies, constrains the government's capacity to finance infrastructure, social welfare and poverty-alleviation programmes despite the country's vast resource base (Awotomilusi et al., 2023). The informal sector remains largely outside the reach of tax authorities because of weak record-keeping, cash-based transactions and limited enforcement capacity. Although tax authorities have introduced various reforms, the extent to which tax leakages, tax planning behaviour and tax non-compliance jointly constrain tax revenue generation in the informal sector of South-West Nigeria remains empirically under-examined. It is against this background that the study raises the following research questions.

Research Questions

1. What is the effect of tax leakages risk on tax revenue generation in the informal sector of South-West Nigeria?
2. How does tax planning risk affect tax revenue generation in the informal sector of South-West Nigeria?
3. To what extent does tax non-compliance risk affect tax revenue generation in the informal sector of South-West Nigeria?

Objectives of the Study

The broad objective of this study is to investigate tax risk and tax revenue generation in the informal sector of South-Western Nigeria. The specific objectives are to:

1. examine the effect of tax leakages risk on tax revenue generation in the informal sector of South-West Nigeria;
2. investigate how tax planning risk affects tax revenue generation in the informal sector of South-West Nigeria; and
3. assess the extent to which tax non-compliance risk affects tax revenue generation in the informal sector of South-West Nigeria.

Research Hypotheses

H01: Tax leakages risk does not have a significant effect on tax revenue generation in the informal sector of South-West Nigeria.

H02: Tax planning risk does not have a significant effect on tax revenue generation in the informal sector of South-West Nigeria.

H03: There is no significant effect of tax non-compliance risk on tax revenue generation in the informal sector of South-West Nigeria.

LITERATURE REVIEW

Conceptual Review

Tax Revenue Generation. Tax revenue generation refers to the process by which governments secure income from taxes and other sources to finance public services, infrastructure and social programmes (Khan & Jain, 2020; OECD, 2021). In this study, it is defined as the process by which tax authorities increase and expand their financial resources through the effective implementation and enforcement of tax laws, ensuring that individuals and businesses fulfil their tax obligations and thereby contribute to government revenue (World Bank, 2020).

Tax Risk. Tax risk refers to the potential for financial loss arising from non-compliance with tax laws and regulations, which may result from complexities in tax legislation, changes in tax policy, or misinterpretation of tax rules (OECD, 2022). It also encompasses the likelihood that a taxpayer may face significant penalties or increased liabilities due to errors, omissions or disputes with tax authorities (IMF, 2023), as well as the uncertainties associated with audits, reassessments and legislative change (European Commission, 2024).

Tax Leakages Risk. Tax leakages, also known as revenue leakages, refer to capital or income that exits an economy or system rather than remaining within it, arising from loopholes in tax laws, weak monitoring and corruption (Victor et al., 2022; Okoye et al., 2018). In this study, tax leakages risk is examined through tax law loopholes, tax data leakages and tax audit lags — respectively, ambiguities in tax legislation that allow avoidance, breaches in the handling of taxpayer records, and delays between the filing of returns and the commencement of audits (OECD, 2022; AICPA).

Tax Planning Risk. Tax planning is the process of arranging financial affairs to legally minimise tax liability by taking advantage of allowances, exemptions and incentives within the law (Burke, 2019; Stewart, 2018; Temitope et al., 2019). Tax planning risk arises where aggressive, ineffective or inappropriate tax planning strategies reduce expected tax revenue and create compliance challenges for tax authorities. It is examined in this study through tax collection methods, tax incentives and tax law amendments (OECD, 2022; IMF).

Tax Non-Compliance Risk. Tax non-compliance is the failure to obey tax laws, whether by not paying taxes owed, not filing returns, or underreporting income, and may be intentional or unintentional (Rick, 2024; Robert, 2022). It is distinguished from tax evasion, which involves illegal and intentional acts to reduce tax liability, and tax avoidance, which involves the legal minimisation of tax within the law (Suleiman, 2018). In

this study, tax non-compliance risk is examined through tax evasion, late filing of tax returns and inadequate disclosure.

THEORETICAL FRAMEWORK

Three theories underpin this study. The Benefit Received Theory, propounded by Wicksell (1896) and Lindahl (1919), holds that taxpayers should be taxed in proportion to the benefits they derive from government activity; its relevance lies in the argument that efficient use of tax revenue for public goods motivates voluntary compliance and, in turn, enhances revenue generation. The Planning Behaviour Theory, propounded by Ajzen (1985, 1991), holds that behaviour is driven by intentions shaped by attitudes, subjective norms and perceived behavioural control, and is relevant to understanding how taxpayers' beliefs and perceptions shape tax planning decisions. The Economic Deterrence Theory, propounded by Beccaria (1764) and Bentham (1781), holds that individuals may be deterred from non-compliance where the consequences of detection outweigh the perceived benefits of evasion; effective deterrence requires sanctions that are swift, certain and proportionate (Swistak, 2016).

This study is anchored on the Economic Deterrence Theory because it best explains the most potent strategies for curbing tax leakages, aggressive tax planning and non-compliance, and it has been widely applied in tax administration research (Oghuma, 2018; Umar, 2018). Where the perceived gains from non-compliance exceed the expected costs of detection and punishment, taxpayers — particularly within the informal sector — are less likely to comply (Parajawatti & Zainol, 2017), underscoring the importance of credible enforcement alongside taxpayer education.

EMPIRICAL REVIEW

Tax Leakages Risk and Tax Revenue Generation. Folayan and Adeniyi (2018) examined the effect of tax evasion on government revenue generation in Oyo State using primary and secondary data (2011–2016) and found that tax evasion resulted in revenue shortfalls relative to projections. Amahalu et al. (2019) found that tax leakages had a significant negative effect on economic development in Nigeria between 2008 and 2017. Chijioke et al. (2018) found that the implementation of electronic taxation had not, on its own, improved tax revenue or the tax-to-GDP ratio in Nigeria. Basil et al. (2018), studying Cross River State, found a significant negative relationship between tax evasion/avoidance and government tax revenue, while Adegbe et al. (2022) found that electronic tax management significantly improved the ease of filing returns across three states. Most of these studies were restricted to single states or focused narrowly on tax evasion, underscoring the need for a broader, multi-state examination within South-West Nigeria.

Tax Planning Risk and Tax Revenue Generation. Fatile and Ejalonibu (2018) found that persistent shortfalls in internally generated revenue estimates affected sustainable budget implementation in Lagos and Oyo States. Abubakar et al. (2019) found that the self-assessment tax system had a significant positive effect on revenue generation in Kwara State, while the effect of tax professionals' services was not significant. Citra (2019) found that tax planning could significantly influence tax revenue in Padang, Indonesia, noting that outcomes depend on whether planning strategies remain within the law. Aliyu and Mustapha (2020) found that petroleum profit tax, value added tax and government domestic debt were significantly and positively related to economic growth, and recommended blocking loopholes in tax laws while widening the tax net, especially within the informal sector. These studies collectively point to the revenue implications of how tax planning behaviour is structured and monitored.

Tax Non-Compliance Risk and Tax Revenue Generation. Suleiman (2018) found that audit intensity, complexity, fairness perception and compliance costs significantly affected tax non-compliance among small corporate taxpayers in Kano State. Adekoya et al. (2020) concluded that taxing the informal sector is critical for revenue, growth and governance, and that continued neglect of the sector could undermine the morale of compliant formal-sector taxpayers. Hassan et al. (2021) found that taxpayers responded positively to a mix of deterrence and accommodative compliance strategies in Malaysia. Abdulaziz et al. (2022) found a significant effect of tax evasion and avoidance on internally generated revenue in Borno State, while Mary et al. (2023)

found that corruption among tax officials and high compliance costs were major determinants of non-compliance among SMEs in Oyo State, whereas tax knowledge, audits, penalties and amnesty reduced it. Nkurunziza and Mugisha (2023) found that intensified audits and penalties positively affected revenue performance in Rwanda.

Overall, the reviewed studies confirm that tax leakages, tax planning behaviour and tax non-compliance each have material implications for revenue generation, but most have examined these risk dimensions in isolation, relied heavily on secondary data, or been restricted to single states outside the South-West. Few studies have jointly examined the three risk dimensions using primary data obtained directly from tax administrators across an entire geopolitical zone. This study addresses that gap.

METHODOLOGY

This study adopted a survey research design, relying on primary data collected directly from tax officers in the informal sector departments of the State Internal Revenue Service (SIRS) across the six South-Western states of Nigeria, using a structured questionnaire. The questionnaire comprised two sections: Section A captured respondents' bio-data, while Section B used a five-point Likert scale (strongly agree to strongly disagree) to measure tax leakages risk, tax planning risk, tax non-compliance risk and tax revenue generation. Content validity was established through supervisor review, and reliability was assessed through a test-retest approach with a target correlation of 0.70 or higher.

The study population comprised 5,193 staff of the SIRS across Lagos (2,684), Ogun (863), Ondo (620), Ekiti (507), Oyo (269) and Osun (250) as at 31st March 2025. A sample of 371 respondents was determined using the Taro Yamane (1967) formula at a 5% margin of error, and allocated proportionately across the states using a stratified sampling technique. A total of 368 valid, correctly completed questionnaires were retrieved and used for analysis.

Table 1: Population and Sample Size Distribution

State (SIRS)	Population	Sample Size
Lagos (LIRS)	2,684	192
Ogun (OGIRS)	863	62
Ondo (ODIRS)	620	44
Ekiti (EKIRS)	507	36
Oyo (OYIRS)	269	19
Osun (OSIRS)	250	18
Total	5,193	371

Source: Human Resources Departments Data as at 31st March, 2025.

Model Specification

To achieve the objectives of the study, the following functional models were estimated using simple linear regression:

$$\text{Model I: } TRG = \beta_0 + \beta_1 TLR + \varepsilon \quad \dots\dots\dots (1)$$

$$\text{Model II: } TRG = \beta_0 + \beta_1 TPR + \varepsilon \quad \dots\dots\dots (2)$$

$$\text{Model III: } TRG = \beta_0 + \beta_1 TNCR + \varepsilon \quad \dots\dots\dots (3)$$

Where TRG = Tax Revenue Generation; TLR = Tax Leakages Risk; TPR = Tax Planning Risk; TNCR = Tax Non-Compliance Risk; β_0 = constant; β_1 = coefficient of the explanatory variable; ε = error term. The dependent variable, tax revenue generation, was proxied by respondents' assessment of tax revenue outcomes, while the independent variables — tax leakages risk, tax planning risk and tax non-compliance risk — were

each measured using structured questionnaire responses. Data were analysed using descriptive statistics (mean and standard deviation) to answer the research questions, and simple linear regression to test the hypotheses at the 5% level of significance.

RESULTS AND DISCUSSION

Respondents' Profile

Of the 371 questionnaires administered, 368 were correctly completed and returned, representing a 99.2% response rate. Male respondents constituted 58.2% of the sample and females 41.8%. Most respondents (61.9%) fell within the 26–45 age bracket, and 76.7% held at least a secondary-level education, with 40.6% holding OND/NCE or HND/B.Sc. qualifications, suggesting that respondents were well positioned to understand and respond meaningfully to the taxation issues raised in the questionnaire. Respondents were drawn from all six South-Western states, with Lagos (23.9%) and Oyo (21.2%) recording the highest representation, reflecting adequate geographical coverage of the zone.

Descriptive Statistics

Table 2 presents the grand mean and standard deviation of respondents' assessment of each study construct. All four constructs recorded grand means above the 3.00 benchmark, indicating general agreement that tax leakages, tax planning weaknesses and tax non-compliance are significant challenges to tax revenue generation in the informal sector, and that strengthening tax administration would improve revenue outcomes.

Construct	Grand Mean	Std. Dev.	Remark
Tax Leakages Risk (TLR)	4.11	0.97	Agreed
Tax Planning Risk (TPR)	4.13	0.97	Agreed
Tax Non-Compliance Risk (TNCR)	4.14	0.96	Agreed
Tax Revenue Generation (TRG)	4.22	0.94	Agreed

Source: Field Survey, 2026.

Among the tax leakages risk items, respondents most strongly agreed that improving transparency in tax administration would reduce revenue leakages (Mean = 4.23), and that corrupt practices among some tax officials heighten leakage risk (Mean = 4.19). For tax planning risk, inadequate understanding of tax laws (Mean = 4.14) and poor tax planning leading to incorrect assessments (Mean = 4.12) recorded the highest agreement. For tax non-compliance risk, respondents most strongly agreed that strengthening tax education and enforcement would reduce non-compliance (Mean = 4.20 approx.), alongside weak enforcement of tax laws (Mean = 4.19) and the absence of effective penalties (Mean = 4.17). On tax revenue generation, respondents most strongly agreed that reducing tax leakages (Mean = 4.27) and increasing tax compliance (Mean = 4.25) would raise government revenue.

Test of Hypotheses

Hypothesis One: H01 — Tax leakages risk does not have a significant effect on tax revenue generation in the informal sector of South-West Nigeria.

R	R ²	F	β	t	Sig.
0.748	0.560	463.812	0.748	21.536	0.000

Source: Field Survey, 2026.

The correlation coefficient ($R = 0.748$) indicates a strong positive relationship between tax leakages risk and tax revenue generation, and the coefficient of determination ($R^2 = 0.560$) shows that tax leakages risk explains 56.0% of the variation in tax revenue generation. The regression is statistically significant ($F = 463.812$, $p < 0.001$; $\beta = 0.748$, $t = 21.536$, $p = 0.000 < 0.05$). The null hypothesis is therefore rejected: tax leakages risk has

a positive and statistically significant effect on tax revenue generation in the informal sector of South-West Nigeria.

Hypothesis Two: H02 — Tax planning risk does not have a significant effect on tax revenue generation in the informal sector of South-West Nigeria.

R	R ²	F	β	t	Sig.
0.781	0.610	572.338	0.781	23.924	0.000

Source: Field Survey, 2026.

The correlation coefficient ($R = 0.781$) indicates a strong positive relationship between tax planning risk and tax revenue generation, with tax planning risk explaining 61.0% of the variation in tax revenue generation ($R^2 = 0.610$). The regression is statistically significant ($F = 572.338$, $p < 0.001$; $\beta = 0.781$, $t = 23.924$, $p = 0.000 < 0.05$). The null hypothesis is therefore rejected: tax planning risk has a positive and statistically significant effect on tax revenue generation in the informal sector of South-West Nigeria.

Hypothesis Three: H03 — There is no significant effect of tax non-compliance risk on tax revenue generation in the informal sector of South-West Nigeria.

R	R ²	F	β	t	Sig.
0.823	0.678	771.214	0.823	27.771	0.000

Source: Field Survey, 2026.

The correlation coefficient ($R = 0.823$) indicates a very strong positive relationship between tax non-compliance risk and tax revenue generation, with tax non-compliance risk explaining 67.8% of the variation in tax revenue generation ($R^2 = 0.678$) — the highest explanatory power of the three constructs. The regression is statistically significant ($F = 771.214$, $p < 0.001$; $\beta = 0.823$, $t = 27.771$, $p = 0.000 < 0.05$). The null hypothesis is therefore rejected: tax non-compliance risk has a positive and statistically significant effect on tax revenue generation in the informal sector of South-West Nigeria.

DISCUSSION OF FINDINGS

The finding that tax leakages risk positively and significantly predicts tax revenue generation ($\beta = 0.748$, $p < 0.05$) implies that addressing leakages through improved monitoring, transparency, record-keeping and internal controls would meaningfully enhance revenue from the informal sector. This is consistent with Abadiere and Yikarebogha (2025), who found that tax avoidance and non-remittance significantly reduced tax revenue generation in Nigeria between 2004 and 2024, and with Femi-Ayegbo and Omodero (2025), who found that tax evasion and revenue leakages significantly undermined non-oil revenue administration and emphasised the role of enforcement, institutional accountability and anti-corruption measures.

The finding that tax planning risk positively and significantly predicts tax revenue generation ($\beta = 0.781$, $p < 0.05$) suggests that clearer tax regulations, effective tax planning frameworks and improved taxpayer education can reduce planning-related risk and enhance revenue outcomes. This aligns with Aina (2025), who found that weak enforcement, poor record-keeping and limited tax awareness hinder compliance in Nigeria's informal economy, and with Hudu (2025), who found that FinTech-enabled tax administration tools improved compliance behaviour and reduced planning errors among informal enterprises.

The finding that tax non-compliance risk has the strongest positive and significant effect on tax revenue generation ($\beta = 0.823$, $p < 0.05$) indicates that stronger enforcement, taxpayer education, simplified procedures and improved public trust in government would substantially raise revenue collected from the informal sector. This corroborates Kazum (2026), who found that low institutional trust, complex tax systems and perceived corruption encourage non-compliance, and Abdullahi (2026), who found that simplified procedures, financial inclusion and administrative efficiency significantly enhance compliance and revenue generation in Nigeria's informal economy.

Taken together, the results show that all three dimensions of tax risk are positively associated with revenue outcomes as assessed by tax administrators, with tax non-compliance risk exerting the strongest influence, followed by tax planning risk and then tax leakages risk. This ordering suggests that, while all three risk dimensions matter, strengthening compliance behaviour and enforcement offers the greatest marginal potential for improving tax revenue generation in the informal sector of South-West Nigeria.

CONCLUSION AND RECOMMENDATIONS

Conclusion

This study concludes that tax risk is a significant determinant of tax revenue generation in the informal sector of South-West Nigeria. Tax leakages, ineffective tax planning and tax non-compliance each constitute major impediments to optimal revenue mobilisation by State Internal Revenue Services, with tax non-compliance representing the most potent of the three risk dimensions examined. Minimising tax leakages through improved monitoring, transparency and stronger institutional controls, supporting effective tax planning through simplified regulations and taxpayer education, and strengthening enforcement and public trust to curb non-compliance together provide a viable strategy for broadening the tax base, improving voluntary compliance, and ensuring sustainable internally generated revenue across the South-West states of Nigeria.

Recommendations

1. State Internal Revenue Services (SIRS) should strengthen tax monitoring and internal control mechanisms by deploying digital monitoring systems capable of detecting tax leakages and improving accountability throughout the tax collection process.
2. Tax authorities should simplify tax regulations and provide continuous taxpayer education programmes for informal sector operators to reduce tax planning risks arising from inadequate knowledge of tax laws and frequent policy changes.
3. Government should intensify enforcement of tax laws while ensuring that penalties for tax non-compliance are consistently applied to discourage deliberate tax evasion among informal business operators.
4. Tax authorities should promote transparency and accountability in tax administration to increase taxpayers' confidence in government and encourage voluntary compliance.
5. State governments should expand the adoption of digital tax administration platforms that simplify tax assessment, payment, monitoring and record management for informal sector businesses.
6. Professional tax advisory services should be made more accessible to informal business operators through regular workshops, outreach programmes and partnerships with professional accounting bodies.
7. Government should establish an integrated tax database that enhances information sharing among tax authorities and minimises opportunities for multiple taxation, leakages and administrative inefficiencies.

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