



**EFFECT OF TAX AUDIT ON GOVERNMENT REVENUE GENERATION IN
LAGOS STATE**

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Abstract

This study investigates the impact of tax audits on revenue generation in Lagos State, Nigeria, focusing specifically on the revenue from Pay-As-You-Earn (PAYE) and Direct Assessment (DA) over a 12-year period (2012-2023). Utilizing a longitudinal research design, data was sourced from the Lagos State Internal Revenue Service (LIRS) audit division. The methodology involved descriptive and inferential analysis, including ordinary least squares regression analysis, to explore the relationships between tax audits and revenue outcomes. Results indicate that tax audits positively and significantly influence both PAYE and DA revenues, with coefficients of 0.557 and 0.580, respectively. The study further highlights the significance of time as a variable influencing direct assessments, underscoring the cumulative effect of taxpayer compliance over years. The findings contribute to existing literature by elucidating the role of tax audits in enhancing revenue collection, providing valuable insights for tax authorities and policymakers. Recommendations for periodic tax audits to optimize revenue generation are offered, along with suggestions for future research to broaden the scope of inquiry in the field of taxation.

Keywords: Tax avoidance, Tax Audits, Tax Compliance, Tax Evasion, Government Revenue, Public Finance, Taxation Policy, Economic Impact.

JEL Codes: H21, H25, H26, H29, H71, H73

INTRODUCTION

Lagos, a crucial economic and financial hub in Nigeria, plays a significant role in the country's fiscal landscape. Effective revenue generation strategies are vital for maintaining public services, building infrastructure, and supporting social programs. Taxation, a long-standing practice in Nigeria dating back before colonial times, is a key source of income for all levels of government (Clement et al., 2021). However, maximizing its potential requires ensuring tax compliance and minimizing evasion. Tax audits are essential in this context, as they support efforts to increase revenue (Onoja and Iwarere, 2015).

A fundamental element of tax administration is the Tax Audit, which involves a comprehensive review of tax records and financial activities to identify any discrepancies and ensure compliance with fiscal obligations (Adediran et al., 2013). This process includes various techniques such as desk audits, field investigations, and comprehensive audits, all designed to verify the accuracy of tax returns and address potential issues. According to the Internal Revenue Service (IRS 2024), audits help ensure that tax returns are accurate and that the appropriate taxes are paid. Similarly, According to Geektonight, n.d. Tax audits not only enforce compliance but also promote taxpayer education and fairness within the tax system.

Overall, tax audits play a critical role in maintaining the integrity of tax systems and enhancing revenue collection for governments.

Statement of the Problem

In Lagos State, effectively administering tax policies and generating revenue are essential for fostering economic growth and delivering critical public services. However, the state faces significant challenges with tax compliance, which leads to substantial annual revenue losses due to tax evasion. Previous efforts, such as implementing tax audits and digitalization initiatives, have not yielded the desired results. For instance, while tax audits aim to enforce compliance, they can be resource-intensive and often meet resistance from taxpayers, particularly small and medium-sized businesses, which may distrust tax administration practices (Ogundajo & Onakoya, 2016; Anyaduba & Modugu, 2021). Digital initiatives like the e-tax portal, designed to simplify compliance, have encountered issues related to reliability and accessibility, hampering their effectiveness (Oladele et al., 2019). Furthermore, aggressive enforcement measures can lead to strained relationships with the business community, reducing voluntary compliance. Empirical studies show mixed results regarding tax audits; while some research indicates a positive correlation between regular audits and improved compliance, others highlight that the costs and administrative burdens may outweigh the benefits, especially in sectors with lower tax bases (Ademola & Olaniyi, 2022). Thus, the combination of audits and educational initiatives tends to yield better outcomes, suggesting that fostering taxpayer trust through transparent and supportive measures may enhance overall compliance (Aigbokhaevbolo et al., 2022). A more balanced approach that includes digital engagement and taxpayer education alongside audits could be crucial for improving compliance and revenue generation in Lagos State.

Research Hypotheses

To guide the study, the following hypotheses are formulated:

H₀₁: Tax Audit has no significant effect on Revenue from Pay-As-You-Earn (PAYE) in Lagos State.

H₀₂: Tax Audit has no significant effect on effects on Revenue from Direct Assessment (DA) in Lagos State.

LITERATURE REVIEW

The literature review provides a comprehensive examination of existing research, conceptual frameworks, theoretical frameworks, and empirical studies related to the effect of Tax Audit on government revenue generation. This section aims to contextualize the current study within the broader academic discourse, identifying key themes, gaps, and methodologies employed by previous researchers.

Conceptual Review

Tax Audit, often called tax examination, involves a systematic and thorough review conducted by tax authorities to assess the accuracy, completeness, and compliance of taxpayers with relevant tax laws and regulations (Kircher, 2008). The main goal of a tax audit is to ensure that taxpayers fulfill their obligations by accurately reporting income and paying the correct amount of taxes. This process seeks to identify discrepancies, errors, or cases of tax evasion, thereby promoting a fair and efficient tax system. Tax Investigation, on the other hand, focuses on verifying a company's accounts to detect any unpaid taxes due to taxpayer omissions, which lead to under-assessment (Nurebo et al., 2019). Previous studies by Gaaya et al. (2018) and

Martins and Sa (2018) indicate that tax investigations usually begin when there are allegations of fraud, intentional default, or negligence by taxpayers, with the primary aim of recovering unpaid taxes. The effectiveness of tax investigations relies on unbiased evaluations and decisions based on credible evidence, as some taxpayers might use illegal means to avoid paying taxes. The primary purpose of a Tax Audit is to evaluate the extent of compliance with tax laws and regulations. Tax authorities examine whether taxpayers have followed the rules when reporting their income, claiming deductions, and meeting other tax responsibilities. Recovering additional taxes through investigations boosts the financial resources available to the government.

Desk Audit

Bassey (2013) established a framework that categorizes tax audits into two main types: desk audits and field audits. A desk audit, also known as an office audit, is conducted within the tax office, where tax officials carefully examine the taxpayer's financial records and books. During this process, tax officials may request additional documents from the taxpayer to resolve any issues or concerns with the submitted returns. Notifications for desk audits are typically sent via letters requesting specific documents or information, rather than through formal notices. The primary aim of a desk audit is to ensure adherence to tax laws, rules, and regulations, and to perform administrative reviews of filed returns. Smith et al. (2021) highlight the growing significance of desk audits in modern tax administration. Their research points out that advancements in technology have allowed tax authorities to perform desk audits more efficiently by utilizing digital platforms for data analysis and risk assessment. This study emphasizes the evolving role and ongoing importance of desk audits in current tax audit practices.

Field Audit

Tax authorities conduct field audits to ensure taxpayer compliance and improve tax adherence by carrying out audits directly at the taxpayer's premises. This process involves formally notifying taxpayers of the auditor's upcoming visit and requesting the necessary documents to be audited beforehand. Field audits include an in-person examination of documentary evidence and materials at the taxpayer's location to verify the accuracy of their tax filings. The scope of verification depends on the findings from the auditor's desk audit and the identified risk factors. Areas with a high potential for tax revenue are typically given more attention. Field audits are often used for conducting comprehensive tax audits. Ojo and Adewale (2023) emphasize the significance of field audits in enhancing tax compliance and increasing revenue collection. Their research highlights the effectiveness of proactive field audit strategies in detecting tax discrepancies and fostering taxpayer accountability.

Pay as You Earn

Withholding taxes are designed to collect income tax at the time it is earned, with the Pay-As-You-Earn (PAYE) system being a common example where taxes are withheld from wages. This mechanism is vital in most national tax systems, as PAYE represents a crucial and easily collectible revenue source. It demands minimal resources from tax administration, especially when employee return filing is limited to those with substantial additional income or significant special deductions. A straightforward PAYE system simplifies wage administration for employers, allowing compliance efforts to focus more on employers rather than individual employees. The system is more manageable when other income is also subject to withholding taxation (Uwaoma & George, 2015). PAYE is a highly productive revenue source in many states. Okoye and Adekunle (2022) emphasize the importance of PAYE in effective revenue collection and tax administration. Their research highlights how efficient PAYE systems can

simplify tax compliance for both employers and employees, while making a significant contribution to government revenue.

Direct Assessment

Direct Assessment, also known as direct tax assessment, involves tax authorities determining a taxpayer's taxable income or tax liability directly, rather than relying solely on the taxpayer's self-reported income or tax returns. This method is commonly used in tax laws and regulations around the world. Tax laws generally outline the conditions, procedures, and criteria under which authorities can carry out direct assessments. As outlined in Section 55 of the Nigerian Personal Income Tax Act (PITA) 2011 (as amended), if a taxpayer fails to submit a tax return as required by the Act, the tax authority can assess the taxpayer's income based on available information and other relevant sources. The tax authority then issues a notice of direct assessment to the taxpayer, specifying the assessed income and the resulting tax liability. The taxpayer can provide additional information or evidence within a set timeframe. If the tax authority considers the supplementary information relevant, adjustments may be made to the direct assessment. The tax liability must be settled by the taxpayer within the period specified in the notice. However, the taxpayer can appeal the direct assessment to the Tax Appeal Tribunal or other relevant appellate bodies within the prescribed timeframe and according to the Act's provisions. Adeyemi and Olaniyan (2023) explore the importance of direct assessment in improving tax compliance and revenue collection in Nigeria. Their study highlights the procedural details and legal frameworks associated with direct assessment, emphasizing its role in ensuring taxpayer accountability and supporting effective tax administration.

Theoretical Framework

The theoretical framework of this study draws upon several theoretical perspectives, providing a lens through which to understand the relationships and dynamics involved. One pertinent theoretical framework is Compliance Theory, encompassing various sub-theories applicable to the study. Compliance theory, as articulated by Robert (1984), delves into factors influencing individuals' and businesses' decisions to comply with tax laws. The theories within this framework elucidate the motivations for compliance and the role of enforcement mechanisms, such as Tax Audit, in shaping compliance behavior. Taxpayers are believed to weigh the benefits of successful tax evasion against the risks of detection and penalties, maximizing expected utilities (Sandmo, 2005).

Johnson and Smith (2023) offer insights into the application of **Compliance Theory** in understanding taxpayer compliance behavior. The research highlights the multifaceted factors that influence tax compliance decisions, emphasizing the role of enforcement mechanisms in promoting adherence to tax regulations. The study also draws on elements of Compliance Theory to investigate taxpayer compliance with tax obligations in Lagos State. Understanding these factors is essential for assessing the efficacy of Tax Audit in fostering compliance.

Empirical Review

In their 2021 study, Anyaduba and Modugu proposed that tax audits strongly discourage tax evasion by raising the perceived risk of detection and penalty enforcement. They argued that regular audits, paired with strict penalties, could foster a culture of compliance among taxpayers. Utilizing an ordered logistic regression model, they analyzed survey data from corporate tax departments across Lagos, focusing specifically on taxpayer perceptions about government spending, penalty severity, and audit likelihood as motivators for compliance. Their results highlighted a positive correlation between frequent tax audits and increased

compliance, ultimately benefiting revenue collection. The authors concluded that consistent audits and well-enforced penalties are effective tools for boosting compliance and curbing evasion, recommending increased audit frequency as a strategic measure to support revenue growth.

Aigbokhaevbolo and colleagues (2022) assumed that transparent, high-quality tax administration combined with technological integration would enhance both taxpayer trust and compliance. They further hypothesized that digital systems would reduce human error in revenue collection. Using a mixed-method approach—quantitatively analyzing Lagos State’s tax records and conducting interviews with tax auditors—they applied a productivity model to examine the elasticity of various tax sources relative to GDP and taxpayer income, focusing on the impact of audits on revenue productivity. The study concluded that tax audits, especially when implemented alongside digital payment systems, increased accountability and reduced fraud, as digitalization streamlined revenue collection processes, enhancing the effectiveness of audits. The authors recommended increased investment in digital infrastructure to sustain and expand these revenue gains.

The Research Square study from 2023 assumed that digital tax systems and transparent auditing practices improve compliance by clarifying and simplifying tax processes for taxpayers. This study used the Pearson Product-Moment Correlation Coefficient to evaluate survey data on taxpayer satisfaction with tax administration reforms in Lagos, including electronic payment systems and the Tax Identification Number (TIN) system. Findings showed a strong positive relationship between digital systems and increased revenue: the TIN, along with electronic payment and POS systems, improved accountability, reduced tax evasion, and significantly boosted revenue. The study advocated for further digital integration to enhance compliance and revenue collection in Lagos State.

Nwaiwu and Macgregor (2018) conducted a study in Nigeria focusing on the webometric indices of tax audit and tax revenue generation. The primary aim of this research was to empirically analyze the impact of these webometric indices on tax revenue in Nigeria. They collected primary and time series data on various tax audit and revenue variables from sources including the Federal Inland Revenue Service, the Auditor General’s office, and the Chartered Institute of Taxation of Nigeria, as well as through questionnaires. The study concluded that tax audits could significantly contribute to tax revenue generation and recommended regular tax audits by tax authorities to boost government revenue.

Amah and Nwaiwu (2018) empirically investigated the effect of tax audit practices on tax revenue generation in southern Nigeria. They used both primary and secondary data sources, analyzing them with linear and multiple regression techniques using SPSS version 21.0. Their findings indicated a positive effect of tax audit practices on tax revenue in Nigeria, highlighting a significant positive impact of desk audits on personal income tax.

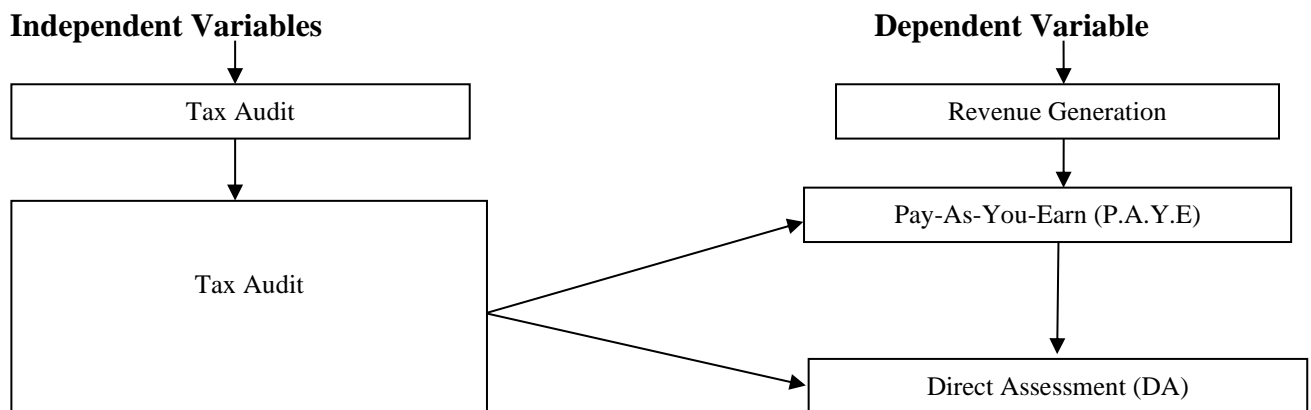
Beredugo et al. (2019) explored tax evasion and avoidance through effective tax audits in Cross Rivers State. Their research demonstrated that tax audits had a significant impact on reducing tax avoidance and evasion. They concluded that thorough tax audits would encourage timely tax return filings by taxpayers and that a more robust audit and investigation system would decrease tax evasion and avoidance in the state.

Dada and Taiwo (2020) examined the effect of tax audits on revenue generation in Ekiti State. Data was collected through structured questionnaires administered to 312 staff members of the Ekiti State Internal Revenue Service. Using regression analysis, they found that a notable portion of revenue generation in Ekiti State could be attributed to tax audits. They also

identified factors such as auditing access, officials, effectiveness, non-compliance, fieldwork, control, and corruption as influencing revenue generation. The study concluded that embracing tax audits could enhance revenue collection, support government developmental projects, and strengthen taxpayer businesses.

Alemu (2020) used both primary and secondary data to address significant challenges faced by tax authorities. He found that tax audits, fines, penalties, and knowledge affect tax compliance both positively and negatively. Olaoye and Ekundayo (2019) also found a positive effect of tax audits on tax compliance in their study, "Effects of Tax Audit on Tax Compliance and Remittance of Tax Revenue in Ekiti State," recommending routine tax audits to ensure proper tax payments.

Conceptual Frameworks



Source: Research's Conceptual Model, 2024

METHODOLOGY

This section outlines the methodology used in conducting the research, including the research design, data collection methods, variable measurement, data analysis techniques, and model specification. The study adopted a longitudinal research design, as it involved observing data over an extended period. The population for this study consists of the taxpayer register from the Lagos Internal Revenue Service (LIRS) over the past 12 years, covering the period from 2012 to 2023. Data was obtained from the LIRS audit division of Lagos State, as it was secondary data rather than firsthand information. The variables in the study were measured and proxied as detailed in Table 3.0.

Model Specification

The collected data underwent descriptive analysis, presenting the observed data's characteristics. This included estimating minimum, maximum, mean, standard deviation, kurtosis, skewness, and Jarque-Bera statistics. Additionally, inferential analysis was conducted, employing ordinary least squares regression analysis to estimate the data.

For each specific objective of the study, functional models are structured within the econometric framework commonly used to analyze time series data in fields like economics and social sciences. The model employed in this study is built based on the modification of the model of Endalew et al. (2020). The modified model is specified as follows:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + e$$

Where: Y= Tax Revenue generation X1= Objective of tax audit, X2= Adequacy of tax audit resource X3 = Provision of training to taxpayers X4 = Illegal practice of taxpayers

B0 – β4 are co-efficient each variable including the constant

The structure of this model separately analyzing the effect of a tax audit on revenue generated from two sources, Pay-As-You-Earn (PAYE) and Direct Assessment (DA) is a dynamic model, meaning it incorporates past values of the dependent variable (e.g., lagged values of PAYE and DA) and independent variables to predict current outcomes.

The approach used here involves log-linear models, where the dependent and independent variables are transformed using natural logarithms. Log-linear models are typically applied to:

- Normalize data and stabilize variance,
- Allow for elasticity interpretation of parameters, and
- Address potential exponential growth trends over time in economic data.

Functional Model:

$$y_t = f(x)_t \dots \dots \dots \text{Eq.(3.0.1)}$$

$$y_t = \alpha_0 + \alpha_1 x_t + \varepsilon_t \dots \dots \dots \text{Eq.(3.0.2)}$$

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$$\text{PAYE}_t = f(\text{TA})_t \dots \dots \dots \text{Eq.(3.0.3)}$$

$$\text{LogPAYE}_t = \beta_0 + \delta_1 \text{LogPAYE}_{t-1} + \beta_1 \text{LogTA}_t + \varepsilon_t \dots \dots \dots \text{Eq.(3.0.4)}$$

LogTA_t means the natural log of tax audit measured over some time.

LogPAYE_t means the natural log of Pay-As-You-Earn measured over some time.

LogPAYE_{t-1} means the natural log of differencing of Pay-As-You-Earn by one year.

ε_t = stochastic error

β₀ = intercept

δ₁ = parameter of differenced In PAYE_t

β₁ = parameter of In TA_t

A priori expectation from the model; δ₁, β₁ > 0.

Effect of Tax Audit on Direct Assessment

$$\text{DA}_t = f(\text{TA})_t \dots \dots \dots \text{Eq.(3.0.5)}$$

$$\text{LogDA}_t = \mu_0 + \alpha_1 \text{LogDA}_{t-1} + \mu_1 \text{LogTA}_t + \mu_2 \text{TM} + \varepsilon_t \dots \dots \dots \text{Eq.(3.0.6)}$$

LogDA_t means the natural log of direct assessment measured over some time.

LogDA_{t-1} means the natural log of differencing of direct assessment by one year.

LogTA_t means the natural log tax audit measured over some time.

TM = means time i.e. the number of years.

ε_t = stochastic error

μ₀ = intercept

α₁ = parameter of differenced In DA_t

μ₁ = parameter of In TA_t

μ₂ = parameter of Time

A priori expectation from the model; α₁, μ₁, μ₂ > 0.pp

Table 1 Measurement of Variables

Variables	Form	Proxies	Measurements	Previous Studies
Revenue Generation	Dependent Variable	PAYE	Total amount of revenue generated through Pay-As-You-Earn	Oladele and Wale (2019) Ogundajo and Onakoya (2016)
		DA	Total amount of revenue generated through direct assessment	
Tax Audit	Independent Variable	TA	Proceeds that accrue from engaging on tax audit	Anyaduba and Modugu (2021) Aigbokhaevbolo et al. (2022)
		TM	Number of years observed	

Source: Researcher’s compilation 2024

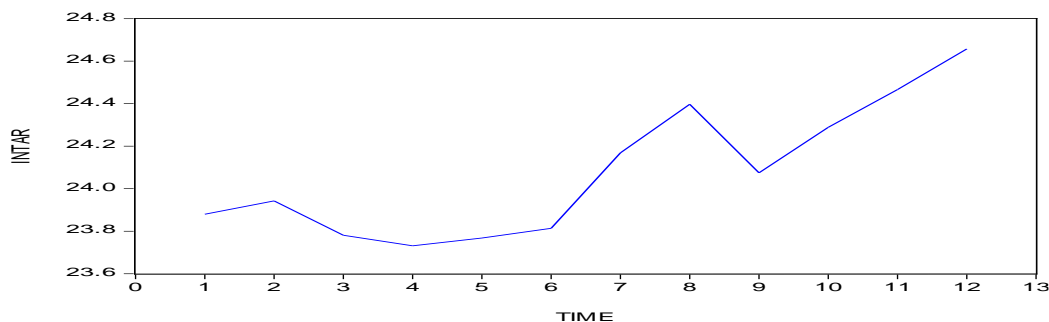
RESULTS AND DISCUSSIONS

In this section, the collected data underwent analysis using various analytical tools to address the research questions. The results obtained were interpreted and discussed to enhance the comprehension of the research findings.

Trend Analysis

Figure 4.1.1 illustrates the trend of tax audits, displaying the fluctuations in revenue generated through tax audits from 2012 to 2023. The revenue increased steadily from 2012 to 2013, followed by a decline in 2014 and 2015. Subsequently, there was an upward trend observed from 2016 to 2019, with a subsequent drop in 2020. However, there were upward trends again from 2021 to 2023. The depicted trends highlight the fluctuating nature of revenue generated through tax audits over the specified periods. This variability could potentially be attributed to the involvement of human factors in the process, which can introduce unpredictability.

FIGURE 4.1.1: Trend of Tax Audit.

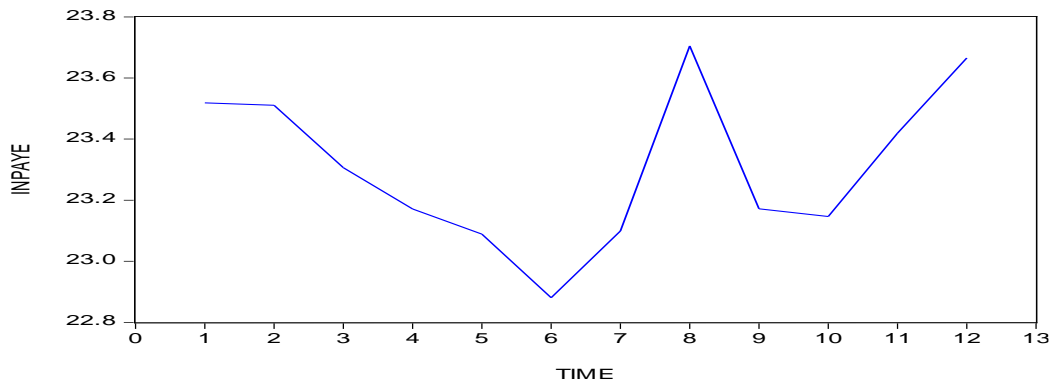


Source: Researcher’s compilation 2024

Figure 4.1.2 depicts the trend of Pay-As-You-Earn in Lagos State over the specified periods. The revenue raised from pay-as-you-earn remained constant from 2012 to 2013. Subsequently, there were alternating movements observed from 2014 to 2017. The trend exhibited an increase

in 2018 and 2019, followed by a decline in 2020 and stability until 2021. However, there was a rise in the trend of Pay-As-You-Earn in both 2022 and 2023. This pattern suggests that the revenue generated by Lagos State varied from year to year, with periods of stability interspersed with fluctuations.

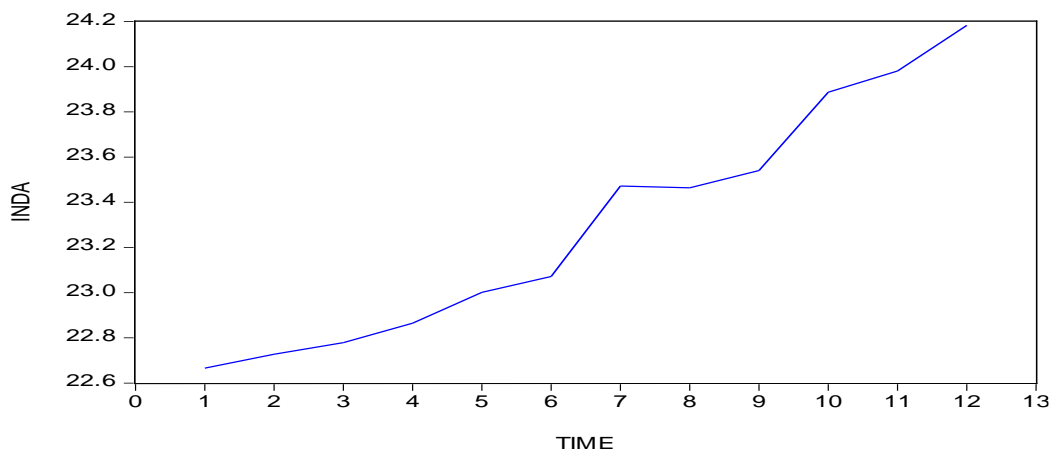
FIGURE 4.1.2: Trend of Pay-As-You-Earn



Source: Researcher’s compilation 2024

Figure 4.1.3 illustrates the trend of revenue realized from direct assessment in Lagos State. The revenue from direct assessment exhibited a steady increase from 2012 to 2018, remaining constant until 2019. Subsequently, there was an upward trend observed from 2020 to 2023. This figure demonstrates that the revenue from direct assessment increased annually, except for maintaining constancy in 2019.

FIGURE 4.1.3: Trend of Direct Assessment



Source: Researcher’s compilation 2024

Descriptive Statistics

The results presented in Table 2 stem from a descriptive analysis of the variables under scrutiny. Mean, maximum, minimum, and the normal distributions of the variables were determined. For tax audit, the mean was calculated to be 24.081, indicating that the average annual revenue from tax audit amounted to N24.081 billion. The maximum revenue realized through tax audit was N24.658 billion, while the minimum was N23.731 billion. Skewness was

computed as 0.4999, close to zero, indicating near-normal distribution. The kurtosis value was 1.9211, less than the threshold of 3, suggesting that tax audit is leptokurtic. The Jarque-Bera statistic was 1.0817 with a probability of 0.5822, indicating a normal distribution ($p > 0.05$).

For Pay-As-You-Earn, the mean was 23.307, signifying that the average annual revenue from Pay-As-You-Earn amounted to N23.307 billion. The maximum revenue realized from pay as you earn was N23.705 billion, while the minimum was N22.881 billion. Skewness was computed as 0.1278, close to zero, indicating near-normal distribution. The kurtosis value was 1.9409, less than the threshold of 3, indicating leptokurtic distribution. The Jarque-Bera statistic was 0.5935 with a probability of 0.7432, indicating a normal distribution ($p > 0.05$).

For direct assessment, the mean was 23.303, indicating that the average annual revenue from direct assessment amounted to N23.303 billion. The maximum revenue realized from direct assessment was N24.183 billion, while the minimum was N22.666 billion. Skewness was computed as 0.3259, close to zero, indicating near-normal distribution. The kurtosis value was 1.7333, less than the threshold of 3, indicating leptokurtic distribution. The Jarque-Bera statistic was 1.0146 with a probability of 0.6021, indicating a normal distribution ($p > 0.05$).

TABLE 2: Descriptive Analysis of Observed variables

	InDA	InPAYE	InTA
Mean	23.303	23.307	24.081
Maximum	24.183	23.705	24.658
Minimum	22.666	22.881	23.731
Skewness	0.3259	0.1278	0.4999
Kurtosis	1.7333	1.9409	1.9211
Jarque-Bera	1.0146	0.5935	1.0817
Probability	0.6021	0.7432	0.5822
Observations	12	12	12

Source: Research’s compilation 2024

Correlation Analysis

The results presented in Table 3 unveiled the extent of the relationship between the independent variable and dependent variables observed in this research. It was found that tax audit exhibited a strong relationship with direct assessment ($r = 0.90$). Conversely, the relationship between tax audit and pay as you earn was moderate ($r = 0.55$). Overall, the relationship between tax audit and either direct assessment or pay as you earn was positive.

TABLE 3: Correlation of Observed Variables

	InDA	InPAYE	InTA
InDA	1.000	0.181	0.903
InPAYE	-	1.000	0.551
InTA	-	-	1.000

Source: Researcher’s compilation 2024

Unit Root Test

The findings presented in Table 4 demonstrated the assessment of stationarity for the observed variables in the study. The Augmented Dickey-Fuller (ADF) t-statistic was utilized to evaluate stationarity through the unit root test.

For the natural log of tax audit, the ADF t-statistic yielded a value of -2.712 with a probability of 0.012. With a critical value of ($p < 0.05$) at -1.982, the null hypothesis is rejected when the ADF coefficient is less than the critical value. Consequently, it was concluded that the natural log of tax audit is stationary at the first level difference (I1) without the inclusion of time.

Similarly, for the natural log of Pay-As-You-Earn, the ADF t-statistic produced a value of -3.235 with a probability of 0.005. With a critical value of ($p < 0.05$) at -1.988, the null hypothesis is rejected when the ADF coefficient is less than the critical value. Hence, it was concluded that the natural log of Pay-As-You-Earn is stationary at the first level difference (I1) without the inclusion of time.

Furthermore, for the natural log of direct assessment, the ADF t-statistic yielded a value of -4.121 with a probability of 0.049. With a critical value of ($p < 0.05$) at -4.108, the null hypothesis is rejected when the ADF coefficient is less than the critical value. Consequently, it was concluded that the natural log of direct assessment is stationary over time at the first level difference (I1).

TABLE 4: Stationarity of Observed Variables

Variables	InDA	InPAYE	InTA	Order of Stationarity at first difference
Augmented Dickey-Fuller: t- statistic	-4.121	-3.235	-2.712	I ₁
Prob *	0.049	0.005	0.012	I ₁
Critical value@ 5%	-4.108	-1.988	-1.982	I ₁

Source: Researcher’s compilation 2024

Regression Analysis

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The findings presented in Table 5 show the relationship between the explanatory variable and the dependent variable, along with the level of significance. Additionally, it highlights the predictive power concerning the dependent variable. The intercept value, recorded as 1.117, signifies that the average value of PAYE when tax audit equals zero is 1.117. This implies that the Lagos State Internal Revenue Service would still generate N1.117 billion from PAYE even without conducting tax audits. With a coefficient of 0.557, tax audit demonstrates a positive relationship with pay as you earn. Specifically, a 1 percent increase in tax audit leads to a 55.7% increase in pay as you earn. The t-Stat value is 2.804 with a probability value of 0.023, indicating that at a 5% level of significance, tax audit has a positive and statistically significant effect on Pay-As-You-Earn .

Furthermore, the coefficient of determination (R²) is 0.527, suggesting that 52.7% of the variation in Pay-As-You-Earn can be attributed to tax audit. The Prob(F-statistic) is 0.050,

indicating that this regression analysis model has explanatory power for the dependent variable, i.e., pay as you earn.

TABLE 5: Result of Effect of Tax Audit on Pay-As-You-Earn

Variables	Coefficients	t-stat	Prob.
C	1.117	0.134	0.897
InPAYE(-1)	0.376	1.420	0.194
InTAR	0.557	2.804	0.023
R-squared	0.527		
Adjusted R-squared	0.408		
F-statistic	4.451	Durbin-Watson stat	1.885
Prob(F-statistic)	0.050		

Source: Researcher's compilation 2024

H₀₁: p > 0.05: Tax audit has no significant effect on Pay-As-You-Earn

Decision Rule: The null hypothesis is rejected since $p < 0.05$. Tax audit has a statistically significant effect on Pay-As-You-Earn.

Effect of Tax Audit on Direct Assessment

The intercept value is 19.157, indicating that the average value of DA when tax audit equals zero is 19.157. This implies that the Lagos State Internal Revenue Service would still generate N19.157 billion from DA even without carrying out tax audits. With a coefficient of 0.580, tax audit exhibits a positive relationship with direct assessment. Specifically, a 1 percent increase in tax audit leads to a 58% increase in direct assessment. The t-Stat value of direct assessment is 3.429 with a probability value of 0.011, indicating that at a 5% level of significance, tax audit has a positive and statistically significant effect on direct assessment.

Additionally, the t-Stat value of time is 5.416 with a probability value of 0.001, suggesting that the number of years also impacts the amount of realization from direct assessment. The coefficient of determination (R²) is 0.989, indicating that 98.9% of the variation in direct assessment can be attributed to tax audit. Moreover, the Prob(F-statistic) is 0.000, implying that this regression analysis model has explanatory power for the dependent variable, i.e., direct assessment.

TABLE 6: Result of Effect of Tax Audit on Direct Assessment

Variables	Coefficients	t-Stat	Prob.
C	19.157	4.228	0.004
InDA(-1)	-0.471	-1.707	0.132
InTA	0.580	3.429	0.011
TM	0.168	5.416	0.001
R-squared	0.989		
Adjusted R-squared	0.984		

F-statistic	209.898	Durbin-Watson stat	1.417
Prob(F-statistic)	0.0000		

Source: Researcher's compilation 2024

H₀₂: p > 0.05: Tax audit has no significant effect on direct assessment.

Decision Rule: The null hypothesis is rejected since $p < 0.05$.

Tax audit has a statistically significant effect on direct assessment.

Discussion of Findings

This research indicates that tax audits have a positive and statistically significant effect on Pay-As-You-Earn (PAYE) revenue in Lagos State, demonstrating a direct relationship between PAYE revenue and tax audits. The findings indicate a strong connection between tax audits and compliance, demonstrating that tax audits have a statistically significant positive effect on PAYE revenue in Lagos State. This aligns with Compliance Theory, which posits that increased enforcement actions—such as audits—enhance taxpayer compliance by raising the perceived risk of penalties for non-compliance. The effectiveness of audit personnel and the integration of advanced technology in taxpayer management further bolster this compliance incentive, as indicated in your results. This perspective echoes the findings of Clement et al. (2021), who reported similar compliance trends, while contrasting with the findings of Nurebo and Lakew (2019), which suggest that taxpayer responses can vary based on context and individual circumstances.

Moreover, your research highlights a positive correlation between tax audits and revenue from direct assessments, illustrating how effective methodologies and procedures in audits can cultivate a compliant tax culture. This is consistent with the work of Amah and Nwaiwu (2018), who noted the role of rigorous audit practices in enhancing taxpayer trust and compliance. Conversely, the findings from Dada and Taiwo (2020) raise important considerations about the variability in audit effectiveness, indicating that different approaches may lead to differing compliance outcomes.

Finally, the study reveals that as time progresses, compliance levels in direct assessments improve, suggesting that taxpayers may become more accustomed to their obligations over time. This temporal aspect aligns with the learning components of Compliance Theory, which assert that continuous engagement with the tax system leads to greater compliance. Overall, your findings contribute significantly to the understanding of tax compliance dynamics in Lagos State, highlighting the multifaceted relationship between tax audits, taxpayer behavior, and revenue generation.

CONCLUSION AND RECOMMENDATIONS

In this section, the study draws conclusions based on the analysis outcomes and provides recommendations. The contributions of this research to existing knowledge are highlighted, along with suggestions for future research. Acknowledgments are also extended to direct and indirect contributors to the successful completion of this empirical study.

Conclusion

The taxpayers' perception of taxation in Lagos State, whether as individuals or organizations, was predominantly negative. They exhibited reluctance towards tax payment while simultaneously expecting significant services from the government. This negative sentiment

raised concerns among tax authorities regarding the accuracy and appropriateness of the tax returns filed by taxpayers. Consequently, tax regulators in Lagos State initiated tax audits to ascertain the adequacy and accuracy of tax liabilities. These tax audit initiatives yielded various impacts on Lagos State's revenue generation. In conclusion, this study determined that tax audits in Lagos State exhibit a positive relationship and statistically significant effect on revenue generation.

Recommendations

Based on the discovery that tax audit significantly impacts Pay-As-You-Earn in Lagos State, it is suggested that tax authorities conduct periodic tax audits. This practice can bolster the revenue potential derived from PAYE.

Regarding the second finding that tax audit has a notable influence on direct assessment, it is recommended that the Lagos State Internal Revenue Service (LSIRS) undertake tax audit initiatives to facilitate increased revenue generation through direct assessment.

Contributions to Knowledge

The study has enriched existing literature by augmenting the available body of knowledge. Its findings are poised to enlighten tax authorities in other states, serving as a valuable reference point. Additionally, this research addresses a gap in empirical studies within the field, thereby enhancing understanding and contributing to knowledge in this area of interest.

Suggestions for Further Studies

Future researchers are encouraged to incorporate national values into their investigations. This entails broadening the study's scope to analyze the research problem within the jurisdiction of the Federal Inland Revenue Service. Furthermore, researchers may explore the possibility of introducing a moderating or intervening variable into the model alongside tax audit to assess its impact on revenue generation more comprehensively. Additionally, it is recommended that future researchers expand the duration of observation, while also considering the possibility of scaling it back slightly.

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