

# Reconceptualising Horizontal Fiscal Federalism in Nigeria: A Critical Appraisal of the Place of Consumption Standard under the 2025 Tax Acts

Chioma Bernadine Nwankwo, BL, LL.B, LLM, PhD,

Senior Lecturer, Faculty of Law  
Nnamdi Azikiwe University, Awka, Anambra State, Nigeria  
+2348036727930

Email: [cbe.nwankwo@unizik.edu.ng](mailto:cbe.nwankwo@unizik.edu.ng); [dr.chiomanwankwo1@gmail.com](mailto:dr.chiomanwankwo1@gmail.com)

**Abstract:** *The enactment of the Nigeria Tax Act (NTA) 2025 and the Nigeria Tax Administration Act (NTAA) 2025 represents the most significant paradigm shift in Nigeria's fiscal landscape since the return to democratic rule. Central to this reform is the reconfiguration of the Value Added Tax (VAT) sharing formula, designed to mitigate the "Headquarters Effect", a phenomenon in which revenue was disproportionately credited to states that housed corporate headquarters rather than to states where actual economic consumption occurred. This article provides a doctrinal and critical analysis of the transition from a production-based derivation model to a "Place of Consumption" framework. Drawing on the provisions of Chapter Six of the NTA 2025 and the administrative enforcement mechanisms established under Section 106 of the NTAA 2025, the study evaluates how the new 30% consumption-based sharing ratio reshapes horizontal fiscal federalism in Nigeria. The findings suggest that while the reform promotes fiscal equity by rewarding states with high consumer activity, it introduces significant administrative complexities regarding geographical tax attribution. The study concludes that the success of this "Consumption Tax" regime hinges on the Nigeria Revenue Service's (NRS) ability to leverage the newly introduced Electronic Fiscal System to prevent revenue leakage and inter-state tax disputes.*

**Keywords:** Fiscal Federalism; VAT Derivation; Nigeria Tax Act 2025; Place of Consumption;

## 1. Introduction

### 1.1 Background: The Evolution of VAT in Nigeria

The introduction of Value Added Tax (VAT) in Nigeria via the Value Added Tax 1993<sup>1</sup> (which took effect on January 1, 1994) marked a fundamental transition from a fragmented state-administered sales tax regime to a centralised consumption tax model. Originally set at a flat rate of 5%, VAT was designed to broaden the non-oil revenue base and harmonise the tax burden across the Federation. For over three decades, the administration of this tax remained under the purview of the Federal Inland Revenue Service (FIRS), with proceeds shared among the three tiers of government according to a formula that balanced derivation, population, and equality. However, the "centralised" nature of VAT has been a perennial source of constitutional friction. While the Finance Act 2019 successfully increased the rate to 7.5%, it failed to resolve deep-seated grievances regarding horizontal fiscal imbalance. These tensions culminated in the landmark legal battle *Attorney General of Rivers State v. Federal Inland Revenue Service & Anor*<sup>2</sup>, in which the Federal High Court challenged the National Assembly's constitutional power to legislate on VAT, sparking a race among sub-national governments to enact independent state VAT laws.

### 1.2 The Reform Catalyst: From Fragmentation to the 2025 Consolidation

The 2025 Tax Reforms, signed into law by President Bola Ahmed Tinubu on June 26, 2025, were enacted to harmonise Nigeria's "broken" tax system and establish a constitutionally coherent framework that addresses calls for "true federalism." This reform package, consisting of the Nigeria Tax Act (NTA), 2025, and the Nigeria Tax Administration Act (NTAA), 2025, repealed and merged over a dozen outdated statutes to produce a unified code. The main driver for this change was the realisation that, politically and economically, the current revenue-sharing model disincentivised regional economic development by not properly rewarding states according to their actual economic output and consumption levels.

### 1.3. Problem Statement: The "Headquarters Effect" and Revenue Injustice

Before the 2025 reforms, Nigeria's VAT administration experienced what economists term the "Headquarters Effect." Since corporate entities were permitted to file returns and remit taxes centrally at their head office locations, primarily in Lagos, Rivers, and the FCT, revenue generated from transactions in other states was mistakenly attributed to these "Headquarter States."

---

Chioma Bernadine Nwankwo, BL, LL.B, LLM, PhD, Senior Lecturer, Faculty of Law, Nnamdi Azikiwe University, Awka, Anambra State, Nigeria, +2348036727930, Email: [cbe.nwankwo@unizik.edu.ng](mailto:cbe.nwankwo@unizik.edu.ng); [dr.chiomanwankwo1@gmail.com](mailto:dr.chiomanwankwo1@gmail.com)

<sup>1</sup> Decree No. 102 of 1993

<sup>2</sup> (2021) 15 NWLR (Pt 1799) 303.

This lack of geographical attribution led to profound revenue injustice. For example, VAT paid on telecommunications services or fast-moving consumer goods in rural or northern states would often be remitted and credited to Lagos simply because the service providers were headquartered there. This systemic flaw undermined the principle of derivation. It exacerbated horizontal fiscal imbalances, leaving consumer-heavy states with a deficit in their Internally Generated Revenue (IGR) relative to their actual market size.

#### 1.4. Research Questions

To assess the effectiveness of the 2025 legal framework in resolving these dilemmas, this study examines the following questions:

1. To what extent does the Nigeria Tax Act 2025 redefine the derivation principle to promote fiscal equity among the federating units?
2. What specific administrative mechanisms within the Nigeria Tax Administration Act 2025, particularly the attribution requirements under Section 106, ensure compliance with the new location-based filing system?
3. What are the potential constitutional and socio-economic obstacles to the successful implementation of the "Place of Consumption" rule within Nigeria's distinctive federal structure?

## 2. Theoretical Framework: Fiscal Federalism and Tax Assignment

### 2.1. Theories of Fiscal Federalism

The conceptual foundation of this study is rooted in the "Decentralisation Theorem" posited by Wallace Oates, which suggests that in a federal system, the provision of public services should be aligned with the specific jurisdictions that benefit from them to ensure economic efficiency. In the Nigerian context, this theorem intersects with Richard Musgrave's "Three-Function Framework," particularly the Distribution Function, which dictates how tax revenues should be allocated among different tiers of government to ensure horizontal equity, which is the principle that states with similar economic profiles should have access to similar levels of revenue.

### 2.2 The Derivation Principle vs the Principle of Need

A significant conflict in Nigerian fiscal history is the tension between the Derivation Principle (which allows a state to keep a portion of the revenue generated within its territory) and the Principle of Need (which redistributes revenue based on population or social factors).

Historically, the derivation principle was the cornerstone of the 1960 and 1963 Constitutions. However, the centralisation of revenue during military regimes shifted the focus toward a "Distributable Pool Account" (now the Federation Account). The Nigeria Tax Act (NTA), 2025, attempts a modern reconciliation of these principles by explicitly recognising "Place of Consumption" as a legitimate metric for derivation, shifting the focus from the point of production to the point of economic utility.

### 2.3 Tax Assignment and the "Consumption Tax" Dilemma

Tax assignment refers to the constitutional distribution of the power to tax specific activities. In *Attorney General of Lagos State v. Eko Hotels Ltd & Ors*, the Supreme Court emphasised the complexities of overlapping jurisdictions between Federal VAT and State Sales Tax. The theoretical dilemma examined in this study is whether VAT, as a multi-stage tax, can be effectively localised. Standard fiscal theory proposes that VAT should be centralised to uphold a single internal market. However, the Nigeria Tax Administration Act (NTAA), 2025, introduces a hybrid model. By utilising Section 106 to enforce "geographical attribution," the law strives to satisfy the sub-national demand for derivation while maintaining the administrative efficiency of a federally-collected tax.

### 2.4 The "Leviathan" Hypothesis in the 2025 Reform

This study further utilises the "Leviathan Hypothesis",<sup>3</sup> which argues that central governments have an inherent tendency to maximise revenue at the expense of sub-nationals. The transition to the Nigeria Revenue Service (NRS) and the implementation of a 10% Federal preference in the VAT pool (NTA 2025, Chapter 6) are analysed through this lens to determine if the reform truly decentralises fiscal power or merely rebrands federal dominance under the guise of "Consumption-based" sharing.

## 3. Legal Analysis of the 2025 Reform Framework

---

<sup>3</sup> Geoffrey Brennan and James M Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (Cambridge University Press 1980).

The shift to a consumption-based tax system is not just a policy change but a targeted legislative overhaul. This section examines the cooperation between the Nigeria Tax Act (NTA) 2025 and the Nigeria Tax Administration Act (NTAA) 2025 in redefining the derivation principle.

### 3.1 Substantive Provisions: Chapter 6 of the NTA 2025

The substantive authority for Value Added Tax (VAT) is consolidated under Chapter 6 of the NTA 2025.<sup>4</sup> Unlike the repealed VAT Act (as amended), the NTA 2025 codifies the revenue-sharing ratio with greater emphasis on sub-national equity. Under this framework, the Federation Account receives 10%, while 55% is allocated to the States and 35% to Local Government Areas. The "tropical" innovation here is the legislative directive that at least 60% of the States' share must be distributed based on the "principle of derivation." In a departure from previous practice, the NTA 2025 redefines derivation to mean the "Place of Consumption."<sup>5</sup> This effectively shifts the tax credit from the supplier's headquarters' jurisdiction to the final consumer's jurisdiction.

### 3.2 Administrative Enforceability: Section 106 of the NTAA 2025

While the NTA 2025 provides the formula, the NTAA 2025 provides the "teeth" for its enforcement.<sup>6</sup> The most critical provision in this regard is s 106, which addresses the "Failure to make attribution."

Historically, VAT was filed as a global sum, making it impossible for the tax authority to determine the specific state where a transaction occurred. Section 106 of the NTAA 2025 imposes a mandatory obligation on taxable persons to attribute taxes collected to the specific location, State, or Local Government of the transaction. By criminalising the failure to attribute, the law ensures that the data required to calculate the 60% derivation share is captured at the point of filing. This is further supported by s 22, which mandates detailed VAT returns that break down taxable supplies by location.<sup>7</sup>

### 3.3 The Role of the Nigeria Revenue Service (NRS)

The institutional transition from the Federal Inland Revenue Service (FIRS) to the Nigeria Revenue Service (NRS) under the NTAA 2025 is central to this analysis. The NRS is empowered to deploy an Electronic Fiscal System (EFS) to track transactions in real time. This technological mandate is the procedural bridge that allows s. 106 to function. Without the automated attribution enabled by the EFS, the "Place of Consumption" rule would likely remain a "paper law," unimplementable in Nigeria's vast and largely informal retail market.

### 3.4. Resolving the "Headquarters Effect"

The combined effect of Chapter 6 of the NTA and s 106 of the NTAA is the legislative neutralisation of the "Headquarters Effect." By requiring location-based attribution, the Acts prevent "Revenue Gazumping", that is, where states like Lagos or the FCT benefit from consumption occurring in states like Sokoto or Akwa Ibom. This legal mechanism provides a statutory solution to the grievances raised in *Attorney General of Rivers State v Federal Inland Revenue Service & Anor*.<sup>8</sup>

## 4. Socio-Economic Implications: A Critical Impact Analysis

The statutory reconfiguration of the Value Added Tax (VAT) derivation architecture under the 2025 fiscal regime extends beyond mere legislative amendment; it represents a fundamental recalibration of horizontal fiscal equalisation among Nigeria's federating units. By transitioning from an origin-based attribution model to a destination-based consumption framework, the Nigeria Tax Act (NTA) 2025 establishes a novel economic hierarchy with significant implications for sub-national revenue autonomy.

### 4.1 The Erosion of the 'Headquarters Advantage'

Historically, jurisdictions such as Lagos, Rivers, and the Federal Capital Territory (FCT) benefited from a disproportionate allocation of the VAT pool due to the 'Headquarters Effect,' a systemic artefact of administrative centralisation.<sup>9</sup> This advantage was arguably a product of procedural convenience rather than substantive economic equity. Through the rigorous enforcement of s 106 of the Nigeria Tax Administration Act (NTAA) 2025, which mandates precise geographical attribution, these established 'Production Hubs' may experience a relative diminution in their derivation credits. This shift seeks to address longstanding contentions that Headquarters States were effectively capturing fiscal value generated by consumption across disparate regions.<sup>10</sup>

<sup>4</sup> Nigeria Tax Act 2025 (Act No 7, Gazette Vol 112, No 117) ch 6

<sup>5</sup> *ibid*.

<sup>6</sup> Nigeria Tax Administration Act 2025 (Act No 5, Gazette Vol 112, No 117).

<sup>7</sup> Nigeria Tax Administration Act 2025, s 22.

<sup>8</sup> N.6

<sup>9</sup> Nigeria Tax Administration Act 2025 (Act No 5, Gazette Vol 112, No 117) s 106.

<sup>10</sup> *Attorney General of Rivers State v Federal Inland Revenue Service & Anor* (2021) 15 NWLR (Pt 1799) 303.

## 4.2 The Ascendance of Consumer-Dense Jurisdictions

The primary beneficiaries of the 2025 reforms appear to be states characterised by high demographic density and robust retail activity, often categorised as 'Consumption Hubs.' Jurisdictions such as Kano, Oyo, and Anambra, which maintain extensive consumer markets despite a lower density of corporate headquarters, are projected to realise a substantial appreciation in the derivation component of their Internally Generated Revenue (IGR) profiles. Pursuant to the 60% derivation threshold stipulated in Chapter 6 of the NTA 2025, revenue accrued from the consumption of telecommunications services, energy, and fast-moving consumer goods (FMCG) will henceforth be attributed to the specific jurisdiction in which the transaction was consummated.

### 4.3 Fiscal Vulnerabilities for Industrial and Logistics Hubs

Conversely, states with economies predicated on industrial manufacturing or logistics may encounter a significant 'fiscal cliff.' In scenarios where commodities are manufactured in one jurisdiction (e.g., Ogun State) but consumed exclusively in another (e.g., Kaduna State), the producing state, which bears the externalities of infrastructure maintenance and security provision, may receive no derivation credit for the VAT generated. This introduces a theoretical tension within Nigerian fiscal federalism: a purely consumption-based model may disincentivise sub-national investment in industrial capacity.<sup>11</sup>

Furthermore, the operationalisation of the Electronic Fiscal System (EFS) mandated by the NTAA 2025 poses technical challenges for states with prominent informal sectors. In jurisdictions where digital penetration remains nascent and e-invoice compliance is low, the geographical attribution required by s 106 may be prone to under-reporting. This potentially results in Revenue Flight, a phenomenon in which tax generated in peripheral or informal markets is not effectively captured in the state's formal revenue data.<sup>12</sup>

### 4.4 Inter-Jurisdictional Contestation and the Sales Tax Conflict

A paramount socio-economic risk involves the potential for intensified inter-jurisdictional conflict. Despite the consolidation sought by the NTA 2025, certain sub-national governments may continue to impose autonomous 'Sales' or 'Consumption' taxes, contending that the federal VAT allocation is insufficient to offset the administrative costs of state-level governance. Such a trajectory could precipitate a Tax-on-Tax environment, potentially invoking the constitutional doctrine of covering the field, while simultaneously inflating the cost of living and circumventing the simplification objectives of the 2025 reforms.<sup>13</sup>

## 5. Implementation Challenges and Critiques

While the 2025 tax reforms provide a robust legal architecture for fiscal equity, the practical realisation of these objectives encounters significant structural and institutional impediments. The transition from a centralised collection model to a destination-based attribution system necessitates a level of administrative precision and digital integration that remains largely unprecedented in Nigeria's fiscal space.

### 5.1 The Informality Constraint and 'Attribution Deficit'

The most pervasive challenge to the enforcement of s 106 of the NTAA 2025 is the sheer scale of the informal economy, which, by some estimates, accounts for over 60% of Nigeria's GDP.<sup>14</sup> In a retail landscape dominated by open-market transactions and fragmented supply chains, the ability of taxable persons to accurately attribute supplies to specific locations is severely compromised.

This 'Attribution Deficit' is particularly acute in inter-state commerce conducted through informal intermediaries. When goods are transported from a regional hub to multiple local government areas via non-formalised logistics networks, the digital footprint required for compliance under the Electronic Fiscal System (EFS) is often severed. Consequently, there is a risk that VAT revenue generated in rural or peripheral jurisdictions will be defaulted to the point of dispatch, thereby inadvertently preserving the 'origin-based' inequities the Act seeks to abolish.

### 5.2. Digital Readiness and the Institutional Capacity of the NRS

The institutional metamorphosis of the Federal Inland Revenue Service (FIRS) into the Nigeria Revenue Service (NRS) under the NTAA 2025 places an immense premium on technological capability.<sup>15</sup> The Act mandates the deployment of an EFS for real-time transaction monitoring; however, the systemic readiness for such a large-scale digital overhaul remains a subject of critical debate.

---

<sup>11</sup> Wallace E Oates, *Fiscal Federalism* (Harcourt Brace Jovanovich 1972) 45.

<sup>12</sup> Nigeria Tax Administration Act 2025, s 22.

<sup>13</sup> *Attorney General of Lagos State v Eko Hotels Ltd & Ors* (2017) 16 NWLR (Pt 1591) 222.

<sup>14</sup> International Monetary Fund, 'Nigeria: Selected Issues' (IMF Country Report No 24/12, 2024).

<sup>15</sup> Nigeria Tax Administration Act 2025, s 3.

The efficacy of geographical attribution hinges on the NRS's ability to integrate its servers with the diverse Point-of-Sale (PoS) and Enterprise Resource Planning (ERP) systems of millions of registered businesses. Institutional friction, exacerbated by inconsistent power infrastructure and varying levels of digital literacy among SMEs, suggests that the full implementation of s 106 may face a protracted gestation period. Furthermore, the reliance on a single-window digital system introduces a 'Single Point of Failure' risk, where technical outages could paralyse revenue reporting across the Federation.

### 5.3 Data Integrity and Inter-State Dispute Potential

The shift to a consumption-based sharing formula introduces a new dimension of interstate rivalry predicated on data integrity. Given that 60% of the State share of VAT is now contingent on the accuracy of 'Place of Consumption' reporting, states may increasingly challenge the attribution data provided by the NRS.<sup>16</sup>

Without a transparent and independent audit mechanism to verify the location-based returns filed under s 22 of the NTAA, the Federation risks a surge in litigation. Sub-national governments may allege that the NRS or the taxable persons themselves are misattributing consumption to specific favoured jurisdictions. This potential for 'Data Contestation' highlights a critical omission in the 2025 reforms: the lack of a robust, inter-tier revenue reconciliation board specifically empowered to adjudicate derivation-based data disputes.

## 6. Conclusion and Policy Recommendations

### 6.1 Summary of Findings

The enactment of the Nigeria Tax Act (NTA) 2025 and the Nigeria Tax Administration Act (NTAA) 2025 marks a watershed moment in Nigeria's quest for fiscal justice. This study has demonstrated that the transition to a destination-based VAT model, underpinned by s 106 of the NTAA 2025 and Chapter 6 of the NTA 2025, provides a statutory remedy for the 'Headquarters Effect' that long disadvantaged consumer-dense jurisdictions. However, as this analysis reveals, the legal resolution of horizontal fiscal imbalance is merely the first step; the substantive success of the reform is inextricably linked to the administrative efficacy of geographical attribution and the digital resilience of the Nigeria Revenue Service.

### 6.2 Recommendations for Implementation

To ensure that the 2025 reforms achieve their intended socio-economic outcomes, the following policy interventions are recommended:

1. **Establishment of an Inter-Tier Revenue Reconciliation Board (IRRB):** To mitigate the risk of 'Data Contestation' identified in Section 6.3, the Federal Government should establish an independent board comprising representatives from all 36 states and the NRS. This body would be empowered to audit attribution data and adjudicate disputes arising from location-based filings.
2. **Implementation of SME Digital Inclusivity Programs:** Recognising the 'Attribution Deficit' in the informal sector, the NRS should provide subsidised digital e-invoicing tools to small and medium enterprises. This would reduce the compliance burden of s 106 while ensuring that consumption in rural areas is accurately captured.
3. **Phased Enforcement of Section 106 Penalties:** Given the technical complexities of real-time geographical attribution, a moratorium on the punitive aspects of s 106 should be considered for the first 24 months of the implementation cycle. This would allow taxable persons to synchronise their ERP systems with the Electronic Fiscal System without the immediate threat of criminal prosecution.
4. **Constitutional Harmonisation:** To prevent the 'Tax-on-Tax' scenarios discussed in Section 5.4, the National Assembly should initiate a constitutional amendment that clearly delineates the boundaries of VAT as a federal consumption tax, thereby pre-empting the imposition of overlapping state-level sales taxes.

### 6.3 Concluding Remarks

The 2025 tax regime is an ambitious attempt to align Nigeria's fiscal architecture with the principles of true federalism. By prioritising 'Place of Consumption' over 'Point of Production,' the law acknowledges the economic contribution of every Nigerian consumer, regardless of their proximity to corporate headquarters. If the implementation challenges regarding informality and digital readiness are addressed with institutional transparency, the Nigeria Tax Act 2025 could serve as a model for fiscal horizontal equalisation across the African continent.

---

<sup>16</sup> Nigeria Tax Act 2025 (Act No 7, Gazette Vol 112, No 117) ch 6.