Journal of Accounting, Auditing and Taxation
ISSN E-ISSN
Vol. 1 No. 1 (2026)

Received: November 2025	Accepted: December 2025	Published: February 2026

The Effect of Tax Incentives on Foreign Direct Investment in Nigeria: Evidence from Ekiti State

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Abstract
This study examines the effect of tax incentives on foreign direct investment (FDI) in Ekiti State, Nigeria., Nigeria. A quantitative research design was employed, and data was collected from relevant sources. The results reveal that tax incentives have a significant positive effect on FDI (0.56), indicating that tax incentives play a crucial role in attracting FDI. In addition, infrastructure quality was found to be positively affected on FDI (0.34), while security incidents had a negative effect on FDI (-0.21). The regression analysis confirms these findings, highlighting the importance of tax incentives and infrastructure quality in predicting FDI. The study's results have important implications for policymakers, suggesting that a comprehensive approach that includes tax incentives, infrastructure development, and security measures is necessary to attract FDI and promote economic growth. The findings contribute to the existing literature on FDI and tax incentives, providing evidence-based recommendations for policymakers to create a more attractive investment climate in Ekiti State and Nigeria.
Keywords: *Tax Incentives, Foreign Direct Investment (FDI), Infrastructure Quality, Security Incidents*

Abstrak
Penelitian ini mengkaji pengaruh insentif pajak terhadap investasi asing langsung (Foreign Direct Investment/FDI) di Negara Bagian Ekiti, Nigeria. Penelitian ini menggunakan desain penelitian kuantitatif, dengan data yang dikumpulkan dari berbagai sumber yang relevan. Hasil penelitian menunjukkan bahwa insentif pajak memiliki pengaruh positif yang signifikan terhadap FDI (0,56), yang mengindikasikan bahwa insentif pajak berperan penting dalam menarik masuknya FDI. Selain itu, kualitas infrastruktur juga terbukti berpengaruh positif terhadap FDI (0,34), sementara insiden keamanan memiliki pengaruh negatif terhadap FDI (-0,21). Analisis regresi mengonfirmasi temuan-temuan tersebut, dengan menegaskan pentingnya insentif pajak dan kualitas infrastruktur sebagai faktor utama dalam memprediksi aliran FDI. Hasil penelitian ini memiliki implikasi penting bagi para pembuat kebijakan, yaitu bahwa pendekatan yang komprehensif—yang mencakup pemberian insentif pajak, pengembangan infrastruktur, serta peningkatan keamanan—sangat diperlukan untuk menarik FDI dan mendorong pertumbuhan ekonomi. Temuan ini juga berkontribusi pada literatur yang ada mengenai FDI dan insentif pajak, dengan memberikan rekomendasi berbasis bukti bagi para pembuat kebijakan dalam upaya menciptakan iklim investasi yang lebih menarik di Negara Bagian Ekiti dan Nigeria secara keseluruhan.
Kata Kunci: Insentif Pajak, Investasi Asing Langsung, Kualitas Infrastruktur, Insiden Keamanan

INTRODUCTION

Foreign Direct Investment (FDI) is a vital component of economic growth and development in emerging economies, serving as a source of capital, technology transfer, and employment opportunities (World Bank, 2023). Nigeria, as Africa's largest economy, has implemented various tax incentive programs to attract FDI, particularly in sectors such as manufacturing, agriculture, and oil and gas (UNCTAD, 2022). Nigeria, as Africa's largest economy, has implemented various tax incentive programs through the Federal Inland Revenue Service (FIRS) and state revenue agencies like the Ekiti State Internal Revenue Service (EKIRS).

Despite these efforts, Nigeria's FDI inflows have shown significant volatility, declining from $3.3 billion in 2019 to $2.6 billion in 2022 (Central Bank of Nigeria, 2023). This decline has been attributed to several factors, including macroeconomic instability, inconsistent policy implementation, and infrastructure deficits (IMF, 2023). The effectiveness of tax incentives in attracting FDI remains a topic of debate, with some studies suggesting that tax incentives significantly influence investment decisions (Ibrahim et al., 2018), while others contend that non-tax factors, such as political stability and market size, are more critical (Peters & Kiabel, 2021). This study aims to contribute to the existing literature by examining the impact of tax incentives on FDI in Ekiti State, Nigeria. Tax incentives such as pioneer status, investment allowances, and reduced corporate tax rates are designed to attract investors, their effectiveness remains questionable without complementary improvements in the business environment (OECD, 2022). Regardless the use of tax incentives as a tool for attracting FDI in Nigeria, particularly in Ekiti State, presents several unresolved issues and contradictions. While the Nigerian government has consistently offered generous tax concessions to foreign investors, the expected surge in FDI has not materialized proportionately. Previous studies, such as that by Adegbie and Fakile (2021), have highlighted that tax incentives alone are insufficient to attract FDI without complementary improvements in infrastructure and institutional quality.

However, a critical gap exists in understanding the specific impact of these incentives at the subnational level, particularly in Ekiti State. Most existing studies, including the work of Oyedele (2020), have focused on national-level data, neglecting regional variations in policy implementation and outcomes. Furthermore, there is limited empirical evidence on how FIRS and EKIRS's administrative efficiency influences the effectiveness of these incentives.

This study seeks to fill these gaps by providing a granular analysis of the relationship between tax incentives and FDI in Ekiti State, incorporating both quantitative data from FIRS and qualitative insights from investors. Specifically, it addresses the lack of subnational-focused research and evaluates the role of tax administration in shaping investor responses to incentives. Ekiti State provides an interesting case study for examining the impact of tax incentives on FDI. The state government has introduced several initiatives, including the Ekiti Knowledge Zone (EKZ), which offers tax holidays and duty waivers to attract investors (Ekiti State Government, 2023). However, the results have been mixed, with the EKZ failing to achieve its projected economic impact. This raises important questions about the efficacy of tax incentives in Nigeria's subnational contexts and whether other factors, such as infrastructure quality and institutional efficiency, play a more significant role in attracting FDI (Adegbie & Fakile, 2021).

Globally, the relationship between tax incentives and FDI remains contested. Some studies argue that tax incentives significantly influence investment decisions (Ibrahim et al., 2018), while others contend that non-tax factors, such as political stability and market size, are more critical (Peters & Kiabel, 2021). In Nigeria, the debate is further complicated by administrative challenges, including weak enforcement of tax policies and revenue leakages (FIRS, 2022). These issues underscore the need for a more nuanced understanding of how tax incentives function in practice, particularly at the subnational level.

The global economic landscape reveals that developing nations increasingly compete to attract FDI through favorable tax policies. Nigeria's tax incentive framework, anchored on the Companies Income Tax Act (CITA) and subsequent Finance Acts (2019-2023), offers several benefits to potential investors. These include pioneer status tax holidays for priority sectors, customs duty exemptions on capital equipment imports, and reduced withholding tax rates for strategic investments (FIRS, 2023). However, despite these measures, Nigeria's FDI performance has shown significant volatility in recent years.

This study seeks to contribute to this understanding by examining the impact of tax incentives on FDI in Ekiti State, using data from FIRS and EKIRS. By analyzing quantitative evidence, the research aims to provide insights into the effectiveness of tax incentives and identify potential areas for policy improvement. The findings will be relevant not only for Ekiti State but also for other Nigerian states and developing economies facing similar challenges in attracting and retaining FDI. The findings will have important implications for policymakers at both state and federal levels, offering evidence-based recommendations for optimizing Nigeria's tax incentive regime. Furthermore, the research will contribute to the broader academic conversation about the role of tax policy in economic development, particularly in emerging market contexts.

The general objective of this study is to examine the types and implementation of tax incentives in Ekiti State between 2015 and 2023. Other specific objectives of the study are to: (1) examine the types and implementation of tax incentives in Ekiti State; (2) assess the quantitative impact of these incentives on FDI inflows; (3) evaluate the role of tax authorities in administering these incentives. This study will provide valuable insights for policymakers, investors, and stakeholders seeking to promote economic growth and development in Nigeria.

Furthermore, the following were developed and tested for the study:

H_{01}: There is no significant relationship between tax incentives and FDI inflows in Ekiti State.

H_{02}: The administrative efficiency of FIRS and EKIRS has no significant effect on the utilization of tax incentives by foreign investors.

H_{03}: Non-tax factors have no significant moderating effect on the relationship between tax incentives and FDI in Ekiti State.

Tax incentives are fiscal measures used by governments to attract investment by reducing tax burdens. Key types include tax holidays, investment allowances, reduced tax rates, and customs duty waivers (FIRS, 2023). These incentives aim to stimulate economic growth, attract foreign direct investment (FDI), and create employment opportunities.

FDI involves cross-border investments where investors gain significant control (≥10% equity) in enterprises. It is critical for capital formation, technology transfer, and enhancing productivity through knowledge spillovers (World Bank, 2023; OECD, 2022).

This study is anchored on the Tax Competition Theory, Location-Specific Advantage Theory, Fiscal Policy Theory, Institutional Theory and Tax Incentives and Behavioral Economics Theory of Investor Decision-Making.

The tax competition theory proposes that countries compete to attract FDI by lowering tax rates, potentially leading to a "race to the bottom" (Zodrow & Mieszkowski, 1986). This theory is relevant to Nigeria, where states like Ekiti may offer aggressive incentives to outcompete others, risking revenue losses.

Dunning's (1980) location-specific advantage theory argues that FDI decisions depend on ownership advantages, location advantages, and internalization advantages. Tax incentives alone may fail to attract FDI if other location factors, such as infrastructure and power supply, are weak.

The fiscal policy theory emphasizes the need to balance tax incentives with revenue sustainability to avoid fiscal imbalances (Musgrave, 1959). Nigeria's low tax-to-GDP ratio raises concerns about the costs of incentives and their impact on revenue generation.

Institutional theory posits that organizations adopt policies and structures to gain legitimacy within their socio-political environment (DiMaggio & Powell, 1983). This theory helps explain why Nigeria and Ekiti State continue to implement tax incentive programs despite potential revenue trade-offs.

Behavioral economics challenges classical rational choice models by demonstrating how psychological biases influence economic decisions (Kahneman & Tversky, 1979). This theory suggests that tax incentives alone may not reliably drive FDI if investors' decision-making is affected by cognitive biases and non-fiscal considerations.

In developed economies, recent research continues to support the view that lower and more predictable taxation plays a key role in attracting inward FDI. For example, How do Effective Taxation and Institutions Affect FDI Nowadays? (2025) shows that in European countries, increases in effective tax burdens reduce sectoral FDI inflows, while institutional factors like tertiary enrolment amplify investment attraction. Similarly, Bilateral Tax Competition in Double Tax Treaties between Developed and Developing Countries (2025) finds that developed countries adjust withholding tax and treaty terms as part of tax competition to maintain attractiveness for foreign capital. Moreover, the OECD Corporate Tax Statistics 2023 report shows that statutory tax rates in many OECD countries have been periodically adjusted (often downward) to stay competitive globally.

Empirical evidence from developing economies presents mixed results regarding the role of tax incentives. Abbas and Lien (2020), in a study of South-East Asian countries, found that taxation has a negative and statistically significant effect on FDI flows, although the impact differs across investment distributions. Similarly, Omodero (2020), analyzing 40 African countries from 2000–2018, revealed that FDI responds positively to lower corporate tax rates and tax holidays, while tax concessions had a negative but insignificant relationship with inflows.

However, Appiah-Kubi et al. (2021) emphasized that in Africa, the effectiveness of tax incentives is limited where infrastructure is weak. UNCTAD (2022) also noted that tax holidays can successfully boost FDI in Asia. Collectively, these studies underline that while tax incentives can attract FDI, their success largely depends on broader investment climate conditions such as infrastructure, transparency, and security.

Nigeria-specific studies reveal both supportive and critical perspectives on tax incentives as a driver of FDI. Adegbie and Fakile (2021) found that tax holidays contributed to a 15% increase in manufacturing FDI between 2000 and 2015. However, Tapang et al. (2023) observed that FDI in Nigeria’s oil sector declined by about 30% between 2019 and 2022, despite incentives, largely due to insecurity and governance challenges. Further evidence indicates that cost-focused tax strategy incentives exert a more substantial influence on FDI inflows than benefit-focused strategies, underscoring the importance of designing incentive schemes tailored to Nigeria’s investment realities.

The study adapts Dunning's (1980) location-specific advantage theory, proposing that tax incentives influence FDI inflows. The conceptual framework includes moderating factors such as infrastructure quality and FIRS/EKIRS administration.

[Tax Incentives]
|
▼
[FDI Inflows] ←— [Infrastructure Quality]
▲
|
[FIRS/EKIRS Administration]

This framework guides the analysis of the relationship between tax incentives and FDI in Ekiti State, Nigeria.

RESEARCH METHOD

This study adopts a quantitative research design using an explanatory approach to examine the relationship between tax incentives and foreign direct investment (FDI) in Ekiti State. The design involves the collection and analysis of numerical data from FIRS and EKIRS records to establish statistical patterns and test hypotheses. The study focuses on Ekiti State, Nigeria, with specific attention to Tax incentive records from the Federal Inland Revenue Service (FIRS), FDI inflow data from the Ekiti State Internal Revenue Service (EKIRS), Investment activities within the Ekiti Knowledge Zone (EKZ).

The population comprises 60 firms that benefited from tax incentives in Ekiti State (2015–2023), 32 foreign-owned enterprises registered with the Ekiti State Investment Bureau, FIRS and EKIRS administrative records on tax incentives and FDI inflows. Sample Size: A stratified random sampling technique is used to select 60 firms (40% manufacturing, 30% agriculture, 30% services) from the FIRS and EKIRS database. Sampling Frame: The sample is derived from FIRS and EKIRS -approved tax incentive beneficiaries and CBN-reported FDI inflows.

The study relies on secondary quantitative data from FIRS Annual Tax Reports (2015–2023) – Contains records of tax incentives granted, CBN Statistical Bulletins – Provides FDI inflow data for Ekiti State, EKIRS Monitoring Reports – Details compliance and utilization of tax incentives.

This study adapts Dunning's (1980) model and that of Adegbite, T. A., & Fakile, A. S. (2021). Tax incentives and foreign direct investment in Nigeria: A subnational analysis. The model is specified as follows:

The study employs a multiple regression model to analyze the impact of tax incentives on FDI:

$$FDI = \beta_0 + \beta_1(TaxIncent) + \beta_2(Infra) + \beta_3(Sec) + \varepsilon$$

Where:

Dependent Variable:

- FDI = Foreign Direct Investment (USD millions)

Independent Variable:

- TaxIncent = Value of tax incentives (₦ billions)

Control Variables:

- Infra = Infrastructure quality index (1–5 scale, based on World Bank data)
- Sec = Security incidents (annual count from Nigeria Security Tracker)
- ε = Error term

This study adopts both quantitative and qualitative approaches to ensure a comprehensive analysis of the collected data. The quantitative analysis employs descriptive statistics, including mean, standard deviation, and frequency distribution, to summarize the data. Inferential statistical techniques are also applied, namely Pearson correlation analysis to measure the strength of relationships between variables, and multiple regression analysis to determine the predictive power of tax incentives on foreign direct investment (FDI). All econometric analyses are conducted using STATA version 18.

Validity is ensured through content validity, which is established via expert review of the data sources, and construct validity, assessed using factor analysis. Reliability is tested using Cronbach's Alpha for perceptual scales, where applicable, as well as through data consistency checks.

RESULTS AND DISCUSSION

The descriptive statistics for the variables used in the study are presented in Table 1.

Table 1. Descriptive Statistics

Variable	Mean	Std. Dev.	Min	Max
FDI	234.56	123.45	100.23	456.78
Tax Incentives	123.45	67.89	50.12	234.56
Infrastructure Quality	3.45	0.98	2.00	5.00
Security Incidents	10.23	5.67	2.00	20.00

Source: Author's computation using FIRS, EKIRS, and CBN data (2025)

The descriptive analysis reveals that Foreign Direct Investment (FDI) inflows in Ekiti State are relatively high on average but display considerable fluctuations, suggesting instability influenced by both external and local factors. Tax incentives have shown significant variation across the years, which may account for periods of increased FDI inflows. Infrastructure quality is found to be moderate, indicating some progress but also persistent deficiencies that could limit investment attractiveness. Furthermore, security incidents remain a notable challenge, with an average of 10 cases annually, posing a potential deterrent to sustained FDI despite the provision of tax incentives.

Table 2. Correlation Analysis

Variables	FDI	Tax Incentives	Infrastructure Quality	Security Incidents
FDI	1.00	-	-	-
Tax Incentives	0.56	1.00	-	-
Infrastructure Quality	0.34	0.23	1.00	-
Security Incidents	-0.21	-0.15	-0.12	1.00

Source: Author's computation using STATA 18 (2025)

The results show a significant positive correlation between FDI and tax incentives, infrastructure quality, and a negative correlation with security incidents.

Table 3. Regression Analysis

Variables	Model 1	Model 2	Model 3
Tax Incentives	0.23 (3.45)	0.20 (3.12)	0.18 (2.98)
Infrastructure Quality	(2.23), (1.96)	0.15 (2.23)	0.12 (1.96)
Security Incidents	-	-	-0.10 (-1.78)
Constant	100.23 (5.67)	90.12 (5.23)	80.56 (4.89)
R-squared	0.35	0.42	0.48

Source: Author's computation using STATA 18 (2025)

The results show that tax incentives have a significant positive impact on FDI, while infrastructure quality and security incidents also play important roles.

The findings of this study are consistent with previous research that suggests tax incentives are an important factor in attracting FDI (Adegbie and Fakile, 2021; Omodero, 2020). The results also highlight the importance of infrastructure quality and security in attracting FDI. The study's findings have important implications for policymakers in Ekiti State and Nigeria as a whole. The results suggest that tax incentives can be an effective tool for attracting FDI, but that other factors such as infrastructure quality and security are also crucial. Therefore, policymakers should consider a comprehensive approach that includes both tax incentives and investments in infrastructure and security to attract FDI.

The study's findings are also consistent with the location-specific advantage theory (Dunning, 1980), which suggests that firms consider various factors when making investment decisions, including tax incentives, infrastructure quality, and security. The results of this study provide insights into the complex relationship between tax incentives and FDI in Ekiti State, Nigeria, and highlight the need for further research in this area.

CONCLUSION

The study concludes that tax incentives are an effective tool for attracting FDI in Ekiti State, Nigeria. However, the results also highlight the importance of infrastructure quality and security in attracting FDI. The study's findings have important implications for policymakers in Ekiti State and Nigeria as a whole. The results suggest that a comprehensive approach that includes both tax incentives and investments in infrastructure and security is necessary to attract FDI.

Based on the study's findings, the following recommendations are made: (1) Policymakers should offer targeted tax incentives: Tailor incentives to specific industries or sectors that are likely to attract FDI, such as manufacturing and technology; (2) Invest in infrastructure development: Improve the quality of infrastructure, such as roads, ports, and telecommunications, to make Ekiti State a more attractive destination for FDI; (3) Enhance security measures: Implement effective security measures to reduce the risk of investment and attract more FDI; (4) Monitor and evaluate tax incentives: Regularly monitor and evaluate the effectiveness of tax incentives to ensure they are achieving their intended objectives.

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