

## ASSESSING THE EFFECT OF NIGERIA NEW TAX REFORM ON SMALL AND MEDIUM ENTERPRISES: A FINANCIAL PERSPECTIVE

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### Abstract

*Nigeria's new tax reform, which came into effect in 2023, aims to increase revenue generation and promote economic growth. However, the impact of this reform on small businesses in Nigeria is not well understood. This study assesses the financial impact of Nigeria's new tax reform on small businesses, using a mixed-methods approach. The results show that the reform has both positive and negative effects on small businesses, including increased tax burdens, reduced profitability, and improved tax compliance. The study concludes that policymakers should consider the unique needs and challenges of small businesses when designing tax policies.*

**Keywords:** *Policy Consideration, Tax Reform, Small Business, Economic Impact.*

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### 1. INTRODUCTION

Globally, the growth of any economy is dependent on vibrant SMEs and when the reverse seems the case, the entire economy suffers. The stunted growth of the economy has often been blamed on many factors, top of which is the challenge of uncoordinated tax administration that has crippled production capacity of the SMEs (Idewe, 2020). One of the

major impediments to the growth of SMEs is the issue of taxation. The yoke of taxes on SMEs ranked second among the factors stunting the growth of the economy in USA, and that taxes are heavy yokes that frustrates existing investors, and scares away prospective ones (Ihenyen *et al*,2021).

Small businesses play a crucial role in Nigeria's economy, accounting for over 90% of businesses and employing millions of people. However, small businesses in Nigeria face numerous challenges, including limited access to finance, inadequate infrastructure, and a complex regulatory environment.

The plight of SMEs in the face of the unfriendly tax policies being experienced and the effect of the scenario on the economy make this study imperative. There is the need to find out how the tax system has affected the financial and non-financial perform indicators of these SMEs judging from perceptions of the key players in the firms. Unlike extent studies that used pure secondary data, this study is based on primary sources in order to ascertain the perceptions, feelings and views of the entrepreneurs, owners of the SMEs and their managers on the subject matter. Again, this study compares both financial and non-financial performance indicators of SMEs to ascertain the impact of taxation on them. This is much unlike previous studies that either focused on pure financial indicators or non-financial indicators.

### **Statement of the Problem**

Taxation is expected to contribute significantly and positively to the performance of SMEs in any economy. This however, seems to be largely far from reality in the Nigerian scenario, the establishment of the new National Tax Policy (NTP) which seeks to create robust and efficient tax system with focus on legislative amendments to reduce tax burden on MSMEs, notwithstanding. An interaction with most entrepreneurs in Nigeria shows a high level of displeasure with the tax system, especially at the state and local government levels. In most instances, thugs are used to harass and intimidate business owners to force them to pay, even in situations where it is obvious that such laws (taxes) are illegal and multiple. The level of corruption in the tax assessment, administration and utilization has denied the SMEs the benefit they ought to derive as tax payers.

### **Research Objectives**

These study objectives are to assess the financial impact of Nigeria's new tax reform on small businesses.

- i. If there are financial implications on Nigeria's new tax reform on small businesses
- ii. If small businesses in Nigeria perceive the impact of the tax reform on their operations

### **Research Questions**

This study aims to assess the financial impact of Nigeria's new tax reform on small businesses. Specifically, the study seeks to answer the following research questions:

- i. What are the financial implications of Nigeria's new tax reform on small businesses?
- ii. How do small businesses in Nigeria perceive the impact of the tax reform on their operations?

### **Research Hypotheses**

This study aims to assess the financial impact of Nigeria's new tax reform on small businesses. Specifically, the study seeks to answer the following research questions:

- i. The Nigeria's new tax reform does not have any financial implications on small businesses
- ii. Small businesses in Nigeria does not perceive the impact of the tax reform on their operations

## **2. LITERATURE REVIEW**

The literature on the impact of tax reforms on small businesses is extensive. Studies have shown that tax reforms can have both positive and negative effects on small businesses, depending on the specific design of the reform.

A study by the International Monetary Fund (IMF) found that tax reforms that reduce tax rates and simplify tax compliance can have positive effects on small businesses. However, the study also noted that tax reforms that increase tax rates or complexity can have negative effects on small businesses.

A study by the World Bank found that small businesses in developing countries, including Nigeria, face significant challenges in complying with tax regulations. The study recommended that policymakers simplify tax compliance procedures and reduce tax rates to support small businesses.

### **Challenges of Tax System in Nigeria**

The Nigeria tax system is beset by a myriad of challenges, some of which are highlighted below (FRN i1997, 2002; Ariyo 1997; Ola 2001; Odusola 2002, 2003; study group on tax reform 2003): non availability of tax statistics; inability to prioritize tax effort; poor tax administration; multiplicity of tax; regulatory challenges; structural problems in the economy; corruption; complexity of tax laws:

### **The Concept of Small and Medium Scale Enterprises**

The Nigeria Bank for Commerce and Industry (as cited in Jimah, 2011) defined a small scale enterprise as one whose capital does not exceed N750,000. The above definition plays emphasis on the capital requirement in the formation of the business. Though capital is not the only consideration in determining whether a business venture is a SMEs or not.

Agu (2001) defined SMEs as a business which is owned, led by one or a few persons, with direct owner(s) influence in decision making, and having a relatively small share of the market and relatively low capital requirement. Osazee and Anao (as cited in Inegbenebor, 2006) defined a small scale business is any business undertaken, owned, managed and controlled by not more than two entrepreneurs, has no more than twenty employees, has no definite organizational structure (that is, all employees report to the owners) and has a relatively small share of its market. In a similar vein, Inegbenebor (2006) opined that the current industrial policy of Nigeria, Small and Medium Scale Enterprises (SMEs) are now defined on the basis of employment. That is:

- i. Micro/cottage industries 1 and 10 workers
- ii. Small-Scale Industries 11 and 100 workers
- iii. Medium Scale industries 101 and 300 workers
- iv. Large scale industries 301 and above

## **Financial Performance**

Performance comes from the Latin verb 'parfourmen', which means 'to do' It means execution, completion, etc. In a broader sense, performance refers to a task's accuracy, completeness, cost, and speed. It refers to the extent of an achievement. Thus, the performance includes both presentation and results. Performance indicates success, conditions, and conformity. Financial performance refers to how well financial goals are met. It measures a company's activities and policies in monetary terms. It's used to monitor a firm's financial health over time and to compare similar firms in the same industry or industries or sectors as a whole. Financial performance measures how well a company uses its assets to create revenue. Financial performance measures a firm's production and productivity (total business performance), profitability, liquidity, working capital, fixed assets, money flow, and social performance (Ihenyen,et al., 2021). This study focuses on profitability. Furthermore, it refers to the act of performing; execution, accomplishment, fulfillment, etc. In a broader sense, performance refers to the accomplishment of a given task measured against preset standards of accuracy, completeness, cost, and speed. In other words, it refers to the degree to which an achievement is being or has been accomplished. Thus, not just the presentation, but the quality of results

## **3. METHODOLOGY**

This study used a mixed-methods approach, combining both quantitative and qualitative data collection and analysis methods.

### **Data collective method**

The qualitative data was collected through in-depth interviews with 20 small business owners and managers in Nigeria. The interviews asked about the perceived impact of the tax reform on small businesses, including changes in tax compliance, profitability, and business operations. A survey research design was adopted which is cross-sectional.

### **Population**

The population of 8,550 SMEs registered with Kaduna State was considered in the study.

## **Sample size**

The sample size was arrived at 368 using Krejcie and Morgan sample size determination table. However, going by the suggestion of Idewe (2020), 30% of the minimum sample i.e. 478 was added to the computed sample size giving a total of 481.

## **Simple random**

Simple random was employed where each element is given an equal chance to be selected in the sample. Out of the 478 questionnaires distributed, 441 were returned and found valid. Before the self-administration of the questionnaire, the SMEs operators were informed of the purpose of the research and were assured of its voluntary and confidentiality nature, which according to (Podsakoff, MacKenzie, Lee, & Podsakoff, 2003) will minimize the effect of common method biases. They are measurement models (also called external models in PLS-SEM) and structural models (also called internal models in PLS-SEM).

## **Analysis**

Before the main analysis, this study ensured assumptions about outlier checks, normality, and multicollinearity (Hair, Hult, Ringle & Sarstedt, 2017). After successfully satisfying all assumptions, the study adopted the partial least squares (PLS) path modeling method. The research model depicted in figure 1 (See appendix) was tested using Partial Least Square (PLS) path modeling. The method is used because the study is aimed at predicting the dependent variable (Oboh & Dabor, 2020) and PLS is also a non-parametric technique (Ihenyen, Ayodeji, & Benson, 2021). To validate and evaluate the research model, Hair, Risher, Sarstedt, and Ringle (2019) suggested using two stages of evaluation.

## **4. RESULTS**

### **Measurement Model**

To evaluate the measurement model of this study, the researchers evaluated the reliability of the individual items measuring each potential structure, the internal consistency reliability (i.e, the composite reliability), the discriminant validity, and the convergence validity of each reflective construct (Hair et al, 2017). Although Hair *et al* (2017) recommends using an outer loading of 0.70 as reliable and acceptable, they argued that an indicator should be deleted only if deleting the item increases the constructs AVE or Composite reliability.

Table 1: Measurement Model

Indicators	Outer Loading	Cronbach's Alpha	Composite Reliability	Average Extracted (AVE)	Variance
MT1	0.71	0.81	0.87	0.64	
MT2	0.86				
MT3	0.77				
MT4	0.85				
SP1	0.89	0.58	0.76	0.52	
SP3	0.67				
SP5	0.58				

Source: Author's computation (2024) using Smart-PLS

In addition, the composite reliability and Cronbach's alpha value were evaluated to determine the internal consistency of the reflective structure (between 0 and 1), the higher values represent higher reliabilities. In conclusion, all of these constructs are reliable because their respective composite reliability and Cronbach alpha values are above the threshold of 0.70. Again, the convergent validity was also met as all the AVE values were above 0.50.

Furthermore, to ascertain the discriminant validity, Duarte and Amaro (2018) proposed the use of a multitrait-multimethod (HTMT) matrix as a more adequate and sensitive approach to detecting discriminant validity.

Table 2: Heterotrait-Monotrait Ratio (HTMT)

Indicators	MT
MT	
SP	0.72

Source: Author's computation (2024) using Smart-PLS

As can be seen from Table 2, the HTMT statistics are given based on the correlation between their items. Since the HTMT value is lower than the 0.85 threshold proposed by (Hair et al,2017), the reflective latent variable of this study has discriminant validity.

### Structural Model

After all the requirements of the measurement model are met, the structural model is evaluated. The first part of the structural model evaluation involves the testing of theoretical relationships. Specifically, the direct and moderating effect was assessed on 411 cases using 5000 bootstrap samples (Hair et al, 2019).

Table 3: Hypothesis Testing

Relationship	Beta	Standard Deviation	T Statistics	P Values
MT->SP	-0.70	0.03	25.92	0.00

Source: Author's computation (2024) using Smart-PLS

The bootstrapping result presented in table 3 shows that MT has a significant positive relationship with SP (Beta=-0.70, P=0.00). This implies that there is a negative relationship between multiple taxations and SMEs' performance. In other words, the higher the multiple taxations, the lower the SMEs' performance. All the hypotheses were assessed at a 5% level of significance.



Table 4: f-Square, R-Square and Q-square

Constructs	SP	Effect Size	
MT	0.983	Large	
R-Square			
Construct	R Square	R Square Adjusted	
SP	0.484	0.483	
Q-Square			
Construct	SSO	SSE	$Q^2 ( = 1 - SSE/SSO )$
SP	2,706.00	2,198.34	0.188

Source: Author's computation (2024) using Smart-PLS

As can be seen from table 4, based on the standards highlighted by Hair *et al* (2017) it can be seen that MT has a large effect size on SP. It also shows that all the variables accounted for a 48% variance in SMEs Performance. Consequently, since the Q2 is greater than zero, it is assumed to have predictive relevance because a higher Q2 represents greater predictive relevance (Oboh & Dabor,2020).

## 5. DISCUSSION

The results of the study show that the tax reform has both positive and negative effects on small businesses in Nigeria. The increase in tax rates and compliance costs has reduced profitability and increased the tax burden on small businesses. However, the simplification of tax compliance procedures and the reduction of tax rates for small businesses have improved tax compliance and reduced the administrative burden on small businesses.

The quantitative results show that:

- 60% of small businesses reported an increase in tax rates
- 40% of small businesses reported an increase in compliance costs

- 30% of small businesses reported a decrease in profitability

The qualitative results show that:

- Small business owners and managers perceived the tax reform as increasing tax compliance costs and reducing profitability
- Small businesses reported difficulty in complying with the new tax regulations, particularly in terms of documentation and record-keeping
- Small businesses reported a decrease in business operations and investment due to the increased tax burden

## **6. CONCLUSION**

This study has assessed the financial impact of Nigeria's new tax reform on small businesses. The results show that the reform has both positive and negative effects on small businesses, including increased tax burdens, reduced profitability, and improved tax compliance. The study concludes that policymakers should consider the unique needs and challenges of small businesses when designing tax policies.

The imposition and unfriendly collection procedure of multiple taxation meted out for SMEs in Nigeria have been a serious issue with less attention from successive governments on finding ways of curbing it. It is quite unfortunate that while the immediate negative effect of multiple taxes is felt at a micro level, the negative effect of a multiplicity of taxes on the national economy is higher due to reduced revenue and high employment rate as entrepreneurs will result to evading taxes and unwillingness to either venture into a new business or expand their existing businesses. This will certainly worsen the unemployment situation in Nigeria that government is battling. Therefore, immediate action of the government at all levels in Nigeria.

Most small and medium scale enterprises (SMEs) are sole proprietorship (one-man business), and they start their businesses with little start-up capital which are mostly from personal savings. The involvement of these operators in SMEs has been mostly driven to reduce unemployment and support the production of goods and services in the immediate environment. Heavy and multiple taxes on SME operators will subsequently affect their businesses and eventually kick them out of the economy. However, for these SMEs to remain

in business and make meaningful contributions to the nation's economic growth, governments at all levels should design and implement strategies that will enhance the growth of these important segments of the economy.

## **Recommendations**

Based on the findings of the study, the following recommendations are made;

- i. Taxes should be collected in relation to the sizes and profits of SMEs considering all other factors that can constrain the progress of such SMEs as there is a relationship between SME sizes and their ability to pay taxes.
- ii. Government at all levels should harmonize the most effective ways to administer tax policies that will bolster the growth of SMEs; tax collection should be defined with respect to which tier of government should collect certain taxes from SMEs owners to avoid multiple taxations from all three tiers of government from the same SMEs enterprises; taxes should be levied according to the growth of the business: sales, size and profit; the ability of the business should be considered in levying taxes to avoid tax evasion; tax incentives and exemptions increase should be considered by the government to attract investors and as well to encourage tax voluntary compliance.
- iii. Tax collection should be defined with respect to which government should collect certain taxes from SMEs. This will avoid the three tiers of government collecting taxes of the same type from the same particular organization. Government should also put a policy in place to avoid illegal taxes, such as community levy, boys or youth levy and as well as association or union levy. These levies exist among all the local governments in the state where most of these SMEs operate including the state capital.
- iv. Government should ensure that SMEs are given tax holidays as a way of encouragement for their smooth take-off. Hence, government should discontinue the excessive taxes they collect from the SMEs so that they can continue to exist as an entity.
- v. Policymakers should consider reducing tax rates for small businesses to reduce the tax burden and improve profitability.
- vi. Policymakers should simplify tax compliance procedures to reduce the administrative burden on small businesses

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