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THE IMPACT OF DIVERSE TAX POLICIES ON THE PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN NIGERIA

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ABSTRACT

Despite having clear and specific legislation that contains the list of the fees and taxes to be collected, all tiers of government, including ministries, departments, and agencies, are involved in collecting additional taxes from Small and Medium Enterprises (SMEs) that are not included in this list. These multiple taxes, called by various names, increase the cost of doing business and affect the survival of SMEs in Nigeria. Therefore, this study used a content analysis method to systematically examine the extent and impact of these unlisted taxes on SMEs. By analyzing legislative documents, government reports, interviews with SME owners, and academic publications, the study identifies patterns in tax imposition practices and explores their economic implications. The findings reveal significant discrepancies between the official tax list and actual taxes collected, highlighting transparency issues and additional financial burden on SMEs. This study provides recommendations for policy reforms to streamline tax collection and enhance the business environment for SMEs in Nigeria.

1.0 Introduction

Nigerians pay over 200 unofficial taxes according to Taiwo Oyedele in 2024 who is the Chairman of the Presidential Fiscal Policy and Tax Reforms Committee. Small and Medium Enterprises (SMEs) play a crucial role in the economic development of both developed and developing countries. In developed nations, SMEs are often regarded as the backbone of the economy, accounting for a significant portion of employment and gross domestic product (GDP). For instance, SMEs comprise around 98 percent of all active businesses in Europe, while producing almost 52 percent of total value added in the EU (European Commission, 2022). In developing countries, SMEs are also vital, contributing to job creation, innovation, and economic resilience. However, the World Bank estimates that 90 percent of all businesses in Sub-Saharan Africa small and medium enterprises. In Ghana for instance, more than 85 percent of enterprises are SMEs and they contribute towards 70 percent of the country's GDP (ITC, 2016). In Nigeria, SMEs constitute about 96% of businesses, employ 84% of the workforce, and contribute approximately 48% to the national GDP in accordance with the Small and Medium Enterprise Development Agency (SMEDAN, 2022). These statistics highlight the importance of SMEs in fostering economic growth, reducing unemployment, and promoting equitable distribution of income.

Despite their significance, SMEs face numerous challenges that hinder their growth and sustainability. One of the primary obstacles is the complex and burdensome tax system. In Nigeria, SMEs are subject to various taxes imposed by different tiers of government, including federal, state, and local authorities. These taxes include corporate income tax, value-added tax (VAT), company Income Tax (CIT), Personal Income Tax (PIT), Withholding Tax (WHT), Petroleum Profit Tax (PPT), Capital Gain Tax (CGT), Stamp Duties (SD), Education Tax (ED), National Information Technology Development Levy (NITDL), Tenement Rate and local government levies (Oladipo, 2018). Additionally, SMEs must comply with regulations and fees imposed by specific agencies, such as the National Agency for Food and Drug Administration and Control (NAFDAC) and the Standards Organization of Nigeria (SON). Beyond these official taxes, SMEs often encounter unofficial and unlisted taxes, which further increase the cost of doing business. These multiple and varied taxations create a challenging financial environment, making it difficult for SMEs to thrive (Nwokoye, 2021). Furthermore, the official taxes are multiple and discouraging while the unofficial taxes are also much and called by different names in different parts of the country.

Given the significant impact of taxation on SMEs, there is a pressing need to investigate how these taxes affect their performance and growth in Nigeria. This study aims to fill the gap in the existing literature by examining the extent and implications of unlisted and unofficial taxes on SMEs. Understanding these dynamics is crucial for developing policies that can alleviate the financial burdens on SMEs and promote their sustainability and growth.

The rest of the paper is organized as follows: Section 2 provides a comprehensive literature review, discussing conceptual, theoretical, and empirical perspectives on taxation and SMEs. Section 3 outlines the methodology, detailing the content analysis approach used to investigate the tax-related challenges faced by SMEs. Section 4 presents the findings, highlighting the discrepancies between official tax lists and actual taxes collected, and their impact on SMEs. Finally, Section 5 concludes the study and offers recommendations for policy reforms to support the growth and development of SMEs in Nigeria.

2.0 Literature Review

This section reviews the literature on the impact of taxation on Small and Medium Enterprises (SMEs) from conceptual, theoretical, and empirical perspectives.

2.1 Conceptual Review

The concept of taxation and its impact on Small and Medium Enterprises (SMEs) is multifaceted, encompassing various dimensions such as legislative frameworks, administrative practices, and economic implications.

Taxation

Taxation refers to the process by which a government imposes financial charges or levies on individuals, businesses, and other entities to generate revenue for public expenditures. These taxes can take various forms, including income taxes, corporate taxes, value-added taxes (VAT), and property taxes, among others. The primary purpose of taxation is to fund government activities and public services such as healthcare, education, infrastructure, and national defense (Oladipo, 2018). Effective tax systems are designed to be fair, efficient, and transparent, ensuring that all taxpayers contribute their fair share to the development and maintenance of the state (Adeoye, 2019).

Multiple taxes refer to the imposition of more than one tax on the same income, asset, or financial transaction by different taxing authorities. This can occur at various levels of government, including federal, state, and local levels. Multiple taxes can create a significant financial burden on taxpayers, particularly on Small and Medium

Enterprises (SMEs), by increasing their overall tax liability and reducing their profitability. It also leads to inefficiencies in tax administration and compliance, as businesses must navigate a complex web of tax obligations (Eze & Okafor, 2020). The phenomenon of multiple taxes often arises from overlapping jurisdictions and lack of coordination among different levels of government.

Unlisted taxes are taxes that are not explicitly mentioned in the official legislative framework or tax code but are nevertheless imposed by various government agencies or authorities. These taxes may be introduced under different names or guises, such as fees, levies, or charges, and are often collected without clear legal backing. Unlisted taxes can be particularly problematic for businesses, especially SMEs, as they create uncertainty and unpredictability in the tax environment (Nwokoye, 2021). The imposition of unlisted taxes undermines the principles of transparency and fairness in taxation, as businesses are forced to pay additional, unforeseen costs that are not accounted for in their financial planning. This practice can discourage investment, hinder business growth, and ultimately affect the overall economic development of a country (Agbo & Usman, 2017).

2.1.1 Small and Medium Enterprise (SMEs)

Small and Medium Enterprises (SMEs) are businesses whose personnel numbers or financial assets fall below certain limits. The definition of SMEs varies by country and industry, but they are generally characterized by a relatively small number of employees and lower revenue compared to larger corporations. In Nigeria, SMEs play a crucial role in the economy, contributing significantly to employment, innovation, and economic diversification. They are often seen as the backbone of the economy due to their ability to generate employment and contribute to GDP growth (Adeoye, 2019).

SMEs are typically classified based on criteria such as the number of employees, annual turnover, and balance sheet total. For example, the Central Bank of Nigeria defines an SME as an enterprise with fewer than 200 employees and an annual turnover not exceeding NGN 100 million (Central Bank of Nigeria, CBN, 2017). Despite their size, SMEs are pivotal in fostering economic growth, reducing poverty, and promoting equitable development. They are also instrumental in driving innovation and competition within various sectors of the economy (Eze & Okafor, 2020).

One of the significant challenges faced by SMEs in Nigeria is the complex and burdensome tax environment. Multiple taxation and unlisted taxes can create significant financial and administrative pressures on these enterprises. High tax burdens reduce the resources available for reinvestment and growth, while administrative complexities divert time and effort away from productive activities (Nwokoye, 2021). These challenges are exacerbated by the lack of transparency and coordination among various tax authorities, leading to uncertainty and increased compliance costs.

SMEs often lack the resources to effectively navigate complex tax regulations and may struggle with compliance. This can lead to penalties and additional financial burdens, further hindering their growth and sustainability (Agbo & Usman, 2017). Additionally, the inconsistent application of tax policies and the prevalence of unlisted taxes can create an uneven playing field, disadvantaging SMEs compared to larger businesses that may have more resources to manage their tax obligations.

2.1.2 Tax System in Nigeria

The tax system in Nigeria is designed to generate revenue for the government to fund public services and infrastructure. It comprises various types of taxes, including income tax, value-added tax (VAT), corporate tax, and customs duties. The system is governed by several laws and regulations, which outline the obligations of taxpayers and the responsibilities of tax authorities. Key legislative instruments include the Companies Income Tax Act, the Personal Income Tax Act, the Value Added Tax Act, and the Customs and Excise Management Act (Federal Inland Revenue Service, FIRS, 2020).

Income tax in Nigeria is divided into personal income tax and corporate income tax. Personal income tax is levied on the income of individuals, including wages, salaries, and business profits. It is administered by the State Internal Revenue Services (SIRS) for residents of each state and by the Federal Inland Revenue Service (FIRS) for non-residents and members of the armed forces, police, and external affairs officers. Corporate income tax is imposed on the profits of companies operating in Nigeria and is administered by the FIRS.

Value-added tax (VAT) is a consumption tax levied on the supply of goods and services. It is charged at each stage of the production and distribution process, with the final burden borne by the consumer. The standard VAT rate in Nigeria is 7.5%, and it is administered by the FIRS. Customs duties are taxes on imports and exports and are administered by the Nigeria Customs Service. These duties are intended to protect domestic industries, control the flow of goods, and generate revenue (Nigeria Customs Service, NCS, 2019).

Despite the comprehensive legal framework, the tax system in Nigeria faces significant challenges. One major issue is the prevalence of multiple taxation, where businesses are subjected to various taxes by different tiers of government, including federal, state, and local authorities. This can result in an excessive tax burden on businesses, particularly small and medium enterprises (SMEs), and can stifle economic growth (Eze & Okafor, 2020).

Another critical issue is the imposition of unlisted taxes. These are taxes that are not specified in the official tax legislation but are nonetheless collected by various government agencies. These unlisted taxes often come in the form of levies, fees, and charges imposed under different pretexts. This practice undermines the transparency and predictability of the tax system, creating uncertainty and additional financial burdens for businesses (Nwokoye, 2021).

2.2 Theoretical Review

The theoretical framework for understanding the impact of taxation on Small and Medium Enterprises (SMEs) in Nigeria can be effectively analysed using Lindahl's Model, also known as the Benefit Theory of taxation. This theory, proposed by Swedish economist Erik Lindahl, posits that taxes should be levied in accordance with the benefits received by taxpayers from public goods and services. Lindahl's model suggests an equitable distribution of tax burdens, where each taxpayer pays an amount proportional to the benefits, they derive from government expenditures (Musgrave, 1959).

Lindahl's model operates on the premise that public goods are non-excludable and non-rivalrous, meaning they are available to all members of society without diminishing their availability to others. According to the Benefit Theory, an efficient tax system should ensure that individuals or entities contribute to the financing of public goods in proportion to the benefits they receive. This creates a situation where the marginal cost of providing the public good equals the marginal benefit derived by the taxpayer, leading to a Pareto optimal allocation of resources (Musgrave, 1959).

In the context of SMEs in Nigeria, applying Lindahl's model would imply that the tax burden on these enterprises should be commensurate with the benefits they receive from public infrastructure, security, education, and other governmental services.

However, the reality is often quite different. SMEs frequently face multiple and unlisted taxes that do not necessarily correlate with the benefits received. This misalignment leads to inefficiencies and places undue financial strain on SMEs, hampering their growth and sustainability (Eze& Okafor, 2020).

2.3 Empirical Review

The relationship between taxation and the performance of Small and Medium Enterprises (SMEs) has been extensively studied across various contexts. This section provides an empirical review of literature from developed countries, developing countries, and Nigeria, identifying key findings and highlighting gaps in the existing research. For example, Cullen and Gordon (2017) conducted a study in the United States examining the effects of tax rates on entrepreneurial activity. Their findings suggested that higher marginal tax rates discourage entrepreneurship due to the increased financial burden on SMEs, reducing their capacity for growth and innovation. Similarly, Djankov et al. (2019) investigated the impact of corporate taxation on investment and entrepreneurship in 85 countries, including several developed nations. They found that higher corporate tax rates significantly reduce both firm entry rates and investment levels, indicating that heavy taxation stifles business activity and economic growth. In the same vein, Feld and Heckemeyer (2021) performed a meta-analysis of studies from OECD countries, exploring the relationship between tax policy and business investment. Their results confirmed that high tax burdens negatively affect investment decisions of SMEs, leading to reduced capital formation and slower economic development.

Atawodi and Ojeka (2016) explored the impact of tax policy on SMEs in the West African region. They reported that high and multiple taxation severely restricts the growth potential of SMEs by diverting funds away from productive uses and discouraging formalization. Olawale and Garwe (2018) analyzed the challenges faced by SMEs in South Africa, emphasizing the role of taxation. Their study concluded that complex and high tax regimes are significant obstacles to SME development, reducing their ability to invest in expansion and innovation.

In the specific context of Nigeria, Adebisi and Gbegi (2019) focused on Nigeria and examined how multiple taxation influences SMEs' performance. They found that excessive tax burdens, including those not officially listed, hinder the growth and profitability of SMEs by increasing operational costs and reducing competitiveness. Similarly, Okoye and Ezejiofor (2021) investigated the effects of tax administration on the performance of SMEs in Nigeria. Their findings indicated that inefficient and corrupt tax administration practices lead to higher operational costs for SMEs, impeding their growth and sustainability. Moreover, Ocheni and Gemade (2015) examined the impact of multiple taxation on SMEs in Nigeria and found that the proliferation of taxes, many of which are not officially listed, significantly hampers business performance by creating an unpredictable financial environment. Furthermore, Fagbemi, et al. (2019) studied the compliance behavior of SMEs in Nigeria in response to various tax policies. They highlighted that unclear and numerous tax demands contribute to low compliance rates, further exacerbating the financial challenges faced by SMEs. In addition, Uzor (2018) analyzed the relationship between tax incentives and SME growth in Nigeria. Although the study found that tax incentives could stimulate growth, it also noted that the benefits are often offset by the burden of unlisted and unofficial taxes imposed on SMEs.

While several studies provide valuable insights into the relationship between taxation and SME performance, they primarily focus on official taxation and largely neglect the impact of unlisted and unofficial taxes. This oversight fails to capture the full extent of the financial burdens faced by SMEs, particularly in the Nigerian context where unofficial taxes are prevalent. Hence, this study aims to fill this gap by systematically examining the extent and impact of these unlisted taxes on SMEs in Nigeria.

3.0 Methodology

3.1 Research Design

Multiple Taxes and their Impact on the Performance of Small and Medium Enterprises in Nigeria are dynamic economic and social phenomenon, which cannot be studied objectively, as provided in the positivism paradigm. Thus, the study largely employed quantitative techniques. The study is a survey, which is designed to analyze multiple taxes and their impacts on the performance of small and medium enterprises in Nigeria.

This study employs a content analysis approach to systematically examine the extent and impact of unlisted taxes on Small and Medium Enterprises (SMEs) in Nigeria. Content analysis is a research technique used to objectively and systematically analyze the content of communication, allowing researchers to identify patterns, themes, and meanings within qualitative data (Kumar *et al.,* 2020 & Chen *et al.,* 2023).

3.2 Data Collection

Data for this study were collected from multiple sources to ensure a comprehensive analysis:

(i) *Legislative Documents:* Official government documents outlining the fees and taxes that should be collected from SMEs were reviewed. This includes laws, regulations, and policy documents that specify the official tax list.

(ii) *Government Reports:* Reports from various levels of government, including ministries, departments, and agencies, were analyzed to understand their tax collection practices and identify any unlisted taxes imposed on SMEs.

(iii) *Interviews:* Semi-structured interviews were conducted with SME owners and managers to gain insights into their experiences with tax imposition. These interviews provided firsthand accounts of the challenges faced by SMEs due to additional taxes. Out of numerous SMEs in Nigeria, the selected ones for this study include: Pure Water Business, Ice Block Production, Block Production, Bike Transportation Business (Okada), Wedding Planning and Decoration, Make Up Artists, Driving Schools, Food Vendors, Real Estate Agencies, Home Delivery Services, Catering Services, Fashion Designing and Tailoring, Mobile Phones Repairs, Provision Stores, Carpentry Businesses, Car Wash Business, Painting Services, Dry Cleaning Services, Printing Services, and flower farming.

(iv) *Academic and Industry Publications:* Relevant academic research and industry reports were reviewed to contextualize the findings and compare them with existing studies on taxation practices and their impacts on SMEs in Nigeria.

3.3 Content Analysis Procedure

The content analysis method involves several steps to ensure a systematic and thorough examination of the data:

(i) *Data Coding:* The collected data were systematically coded to categorize different types of taxes, their names, and their sources. Coding helped identify patterns in tax imposition practices and facilitated the comparison between official and unlisted taxes.

(ii) *Pattern Identification:* Through coding, recurring themes and patterns in the data were identified. This includes the frequency and nature of unlisted taxes, the government entities involved, and the terminology used to describe these additional taxes.

(iii) *Thematic Analysis:* The data were analyzed thematically to understand the broader implications of these patterns. Themes such as the economic impact on SMEs, transparency issues, and the overall business environment were explored.

(iv) *Comparative Analysis:* A comparative analysis was conducted to contrast the official list of taxes with the actual taxes collected from SMEs. This comparison highlighted discrepancies and unauthorized tax practices, providing a clearer picture of the extent of the issue.

(v) *Validation:* The findings from the content analysis were validated through triangulation, cross-referencing data from different sources to ensure reliability and accuracy.

4.0 Findings

The findings of this study provide a comprehensive understanding of the extent and impact of unlisted taxes on Small and Medium Enterprises (SMEs) in Nigeria. Through a content-based analytical method, several key themes and patterns emerged from the data of 20 different SMEs, highlighting critical issues in tax imposition practices across different levels of government.

4.1 Prevalence of Additional Taxes

The study reveals that despite clear and specific legislation outlining the official taxes and fees to be collected from SMEs, there is a widespread practice of imposing additional taxes. These unlisted taxes are often levied by various tiers of government, including ministries, departments, and agencies. This finding is supported by data from legislative documents, government reports, and interviews with SME owners. The additional taxes, which are not part of the official tax list, go by various names and significantly increase the financial burden on SMEs.

4.2 Increased Cost of Doing Business

One of the most significant findings is that these additional taxes substantially increase the cost of doing business for SMEs. The financial strain imposed by these unlisted taxes affects the profitability and sustainability of SMEs, making it challenging for them to thrive. Interview data from SME owners indicate that these extra costs often lead to reduced margins, hindering business growth and expansion. This increased cost burden can deter entrepreneurial activities, discouraging new business ventures and negatively impacting the overall business environment in Nigeria.

4.3 Lack of Transparency

The analysis highlights a significant lack of transparency in the collection of these additional taxes. SMEs often face difficulties in understanding the basis for these taxes and their legal standing. Many SME owners expressed confusion and frustration over the arbitrary nature of these taxes, which are often imposed without clear guidelines or justification. This lack of transparency leads to potential disputes with tax authorities and creates an atmosphere of uncertainty and distrust among business owners.

4.4 Economic Implications

The cumulative effect of unlisted taxes on SMEs has broader economic implications. The increased financial burden can lead to reduced investment in business expansion and innovation, ultimately stifling economic growth. The analysis of government reports and academic publications suggests that the additional taxes discourage SMEs from reinvesting profits into their businesses, which could otherwise contribute to job creation and economic development. Furthermore, the burden of these taxes can lead to decreased productivity and competitiveness of Nigerian SMEs in the regional and global markets.

4.5 Impact on Compliance and Administration

The study found that the imposition of unlisted taxes complicates the tax compliance process for SMEs. The multiplicity of taxes, each with its own regulations and payment schedules, makes it challenging for SMEs to comply fully. This complexity can lead to unintentional non-compliance, resulting in penalties and further financial strain. Additionally, the administrative burden of managing and paying multiple taxes diverts valuable time and resources away from core business activities.

4.6 Government and Institutional Involvement

The data indicate that all tiers of government, including local, state, and federal authorities, as well as various ministries, departments, and agencies, are involved in the practice of imposing additional taxes. This widespread involvement complicates efforts to regulate and standardize tax practices. The lack of coordination among different government entities leads to overlapping and redundant taxes, further exacerbating the burden on SMEs.

4.7 Comparative Analysis with Official Tax List

A comparative analysis between the official list of taxes and the actual taxes collected from SMEs highlights significant discrepancies. The study identified numerous instances where taxes collected were not listed in the official legislative documents. This comparison underscores the extent of unauthorized tax practices and emphasizes the need for stringent enforcement of existing tax laws.

4.8 Validation of Findings

The findings from the content analysis were validated through triangulation, cross-referencing data from different sources to ensure reliability and accuracy. The consistency of themes and patterns across legislative documents, government reports, and interview data reinforces the credibility of the study's conclusions. Almost all the respondents in the semi-structured interviews are faced with various but related problems that affect the performance of their businesses. Some indicated that those unofficial taxes increase the cost of their businesses which on the average, makes their products and services more expensive and thereby impede the successes of such businesses and services.

5.0 Conclusion and Recommendations

This study employed a content analysis method to systematically investigate the extent and impact of unlisted taxes on SMEs in Nigeria. Through an examination of legislative documents, government reports, interviews with SME owners, and academic publications, the study identifies patterns in tax imposition practices and explores their economic consequences. The findings reveal notable discrepancies between the official tax list and the taxes actually collected, underscoring transparency issues and the additional financial strain placed on SMEs. Based on the findings of this study, the following recommendations are suggested to address the issues identified and create a more conducive business environment for SMEs in Nigeria:

(i) *Strict Enforcement of Existing Legislation:* Government should ensure strict enforcement of existing tax legislation to prevent the imposition of unauthorized taxes. All tiers of government must adhere to the official list of taxes and fees.

(ii) *Improved Transparency and Communication:* There should be improved transparency and communication regarding tax policies. Government should provide clear guidelines and information to SMEs about the official taxes and fees to be collected, helping them understand their tax obligations better.

(iii) *Streamlining Tax Collection:* Efforts should be made to streamline tax collection processes to reduce the burden on SMEs. This could involve consolidating various taxes into a single, simplified tax regime to make compliance easier and reduce administrative costs.

(iv) *Support for SMEs:* Government should provide support mechanisms for SMEs to help them navigate the tax system. This could include offering tax advisory services, organizing workshops on tax compliance, and providing financial incentives for compliance.

(v) *Regular Audits and Monitoring:* Conduct regular audits and monitoring of tax collection practices across all levels of government. This will help identify and eliminate unauthorized tax practices, ensuring that only the official taxes and fees are collected.

(vi) *Policy Reforms:* Consider policy reforms that address the root causes of unlisted tax impositions. This could involve revising tax laws to close loopholes, setting up dedicated oversight bodies, and implementing stricter penalties for non-compliance by government entities.

By implementing these recommendations, Nigeria can create a more conducive business environment for SMEs, fostering growth and contributing to the overall economic development of the country.

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