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TAXATION AND ITS IMPLICATION ON SMALL AND MEDIUM SCALE ENTREPRISES IN NIGERIA

BY

ABDULSALAM IDOWU SULAIMAN
DEPARTMENT OF ECONOMICS,
OYO STATE COLLEGE OF EDUCATION,
LANLATE, OYO STATE
08054225558
abdulsalamidowu12@gmail.com

AND

LAWAL NASIRU ALAYO
DEPARTMENT OF ECONOMICS,
FEDERAL COLLEGE OF EDUCATION (SPECIAL),
OYO, OYO STATE
08064979300
Lawal.nasiru@fcesoyo.edu.ng

Abstract

Small and medium scale businesses have increasingly been recognized as enterprises that contribute considerably to the creation of jobs, increasing the GDP and promoting entrepreneurship, henceforth contribute to poverty reduction and boosting the economies. Ideally too, taxes are necessary as they are being raised by the government to generate funds used to provide services to the public. Despite the benefits of taxes, the state of small businesses performance in Nigeria is still not encouraging. Hence, this study aimed to investigate the effect of taxation on small and medium scale enterprises in Nigeria. The study adopted the descriptive survey design. A well guided questionnaire was used as the instrument of data collection. Chi-square statistical analysis was used to analyze the result. The findings revealed that tax system in the country has negative impact on small businesses. Also, small businesses cannot compete with big industries. The study concludes that government should create a conducive environment to enhance the survival and sustainability of small enterprises and thereby recommended that small businesses be levied a lower percentage of taxes, increase tax incentives such as tax holidays to the micro enterprises, these will encourage the small enterprises and attract investors that are potential taxpayers.

KEYWORDS: Challenges, Nigeria, Oyo State, Small-scale Business, Taxation

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Introduction

Small and medium scale enterprises play a crucial role in Nigeria's economic growth and development by fostering job creation, boosting GDP and promoting entrepreneurship. They contribute significantly to poverty reduction and overall economic stability. Small and Medium Enterprises (SMEs) have been described as essential agents for delivering more inclusive globalization and growth, and key contributors to economic and social wellbeing (Organization for Economic Cooperation and Development OECD, 2022). SMEs make a significant contribution to the national and global economies.Small and medium enterprises are mostly private enterprises, and they face difficulties when dealing with the government in general and the tax administration in particular, most especially,in the developing countries. The concept of Taxation is to create incentives for governments to level up the key societal institutions for nation building, making the idea of taxes one that has virtually been existing as long as we have been having organized governments.

According to Manasseh (2018), a tax is generally referred to as a compulsory levy imposed by government upon various categories of assets for public purposes. The mobilization of tax revenue as a means of financing developmental activities in Nigeria has been hindered by various forms of resistance, including tax evasion, avoidance, and other corrupt practices, which are detrimental to the economy and contribute to the current state of underdevelopment in the country. Additionally, the over-reliance of the Nigerian economy on crude oil has undermined the crucial role of taxation as a reliable means of revenue generation. Government imperatively, are to create an environment that makes it attractive for entrepreneurs to set up small companies as well as one that is conducive to the success of SMEs in the long run. Small and Medium Enterprises have always been considered an important force for economic development and industrialization in smaller economies (Aryeetey & Ohene, 2014 and Oludele & Emilie, 2022). These small enterprises have increasingly been recognized as enterprises that contribute considerably to the creation of jobs, henceforth boosting the economies.

Ideally too, taxes are necessary as they are being raised by the government to generate revenue used to provide services such as: health centers, telecommunication, roads, schools, electricity et cetera to the public.Despite what tax revenues are used for, the state of small and medium scale business enterprises performance in Nigeria is still poor and it is also a concern that these firms find it a hurdle to keep up to making profits and then remitting taxes. This could be due to several reasons confronting different firms. This and other factors prompted this study.

The general objective of the study is to investigate the effects of taxation on small businesses in Nigeria.

The specific objectives are to:

i. To determine whether tax revenue has impacted the level of small businesses in Nigeria.
ii. To evaluate the effects of taxation policies on small businesses in Nigeria.
iii. To investigate the challenges of taxation confronting small businesses in Nigeria.

The hypotheses to be tested by this study are stated below.

i. Taxation has no significant impact on small businesses in Nigeria.
ii. Taxation policies have no significant effect in Nigeria.

iii. Small businesses facing significant challenges of taxation in Nigeria.

Conceptualization

Taxation

Taxation is a mandatory non-repayable remittance made to the government for products and services intermittently. Its normally paid by private businesses and consumers to the government. Agunbiade andIdebi, (2020). Taxes can be classified into direct and indirect taxes. Direct tax is a type of tax that is levied on individual or an organization which are remitted directly to the government by companies and individuals. Capital gains tax, withholding tax, petroleum profit tax, company income tax and stamp duties are categorized under this tax. Omodero et al (2021). While indirect tax are taxes that the burden are not borne by the individuals or organization imposed upon but are transferred to other individuals who will then bear the tax burdens as a result of consuming certain commodity or service. Types of indirect taxes include value added tax, custom duties and excise duties. Taxes can also be classified as progressive, regressive and proportional taxes. Progressive tax is the type of taxation that the tax rate grows in proportion to the amount subject to the tax. Under the progressive tax, as the income increases, the tax rates equally rise accordingly, the objective of this is to redistribute income in the economy. Berens and Gelepithis (2019). Also, a regressive tax is the sales tax where the lower income households spend a larger portion of their income on consumption and therefore pay a larger proportion of their income on taxes (Davies et al (2019).A system of taxation where the same percentage of tax rate is levied on all the taxpayers irrespective of their income level is refers to as proportion tax. Jacob (2018). A tax is a mandatory payment collected by the government from individuals or businesses to cover the costs associated with providing for public welfare. Nguyen and Darsono (2022).

Abomoye Nimenibo (2017). Taxation is a process established by the government to exert control over the tax and tax collectors. It is considered as the distribution of wealth from private to public sectors of the economy in order to assist the nation in achieving social economic objectives. According to Abomoye-Nimenibo et al (2018), it is the art of charging citizens with taxes, while the tax itself is seen as a mandatory payment to be made by every citizen of a state. This payment of a tax is called a civic duty. A famous economist, Adam Smith in his book “The Wealth of Nation” published in 1776 outlined the fundamental principle of taxation which any government must adhere to in order to guarantee an efficient, effective and equitable tax system. These principles include:

Canon of Equity: this principle states that those in the same income bracket should pay the same tax. This can be horizontal equity or vertical equity. While the former refers to the people in the same income group paying the same amount of tax, the later refers to people with different incomes paying different taxes.

Canon of Certainty: this principle states that the scope of the tax must be apparent and ascertainable, actual amount to be paid as tax, how the amount was computed and when and where to pay the tax.

Canon of Flexibility: this principle state that the tax system must not be static but it should be subject to change to suit the prevailing circumstances.

Canon of Neutrality: this principle states that the tax system must be neutral and not negative to affect work, savings and investment of the tax payers.

Canon of Convenience: the principle states that the timing and modality of tax payment must be convenient to the taxpayer.

Canon of Economy: this principle states that the administrative costs of collecting tax should be reasonable enough to contribute meaningfully to the revenue pool of the government. This implies that the expenses incurred to collect tax should not be higher than the amount generated as tax.

The term small and medium scale enterprises (SMEs) has no generally established definition. The criteria for classification of an enterprise vary from one country to another, depending on whether it's a developed or developing country. In developed nations, a small firm is characterized by its yearly revenue and number of paid employees. While in Nigeria and other developing countries, a small scale enterprise is a business that is not big in terms of its size, the number of people it employs, the capital for doing business or the nature of work it embarks on. For instance, in the United Kingdom, a small business is viewed as an industry with an annual income of fewer than 2 million pounds and fewer than 200 paid employees. While in Nigeria, the central bank of Nigeria defined small and medium enterprise as a business with a turnover of less than N 100 million per annum and/or less than 300 employees.

According to Agu (2021), small and medium scale enterprises is view as businesses owned by one or a few persons, with direct owner(s) influencing in decision making and having a relatively small share of the market and relatively low capital requirement. Osazee and Anao as cited in Ineghenbor, (2022) defined SMEs as any business undertaken, owned, manage and control by not more than two entrepreneurs, with employee not more than twenty, no definite organizational structure and has a relatively small share of its market.Small and medium enterprises contribute significantly to the Gross Domestic Product (GDP) of every nation and provide the majority of employment opportunities. Bello, Dandago and Samaila (2023); Bello, et al (2024), Bello et al (2021); OECD (2022). In Nigeria, SMEs account for over 90% of businesses and contribute around 48% to the national GDP. Bello, et al (2021); SMEDAN and NBS, (2021).

Roles and Challenges of SMEs in Nigeria

Globally, small and medium scale enterprises play a significant role especially in developing countries where it create job for the rising population by employing a larger percentage of the work force.SMEs can be summarized by their substantial contribution to job creation, innovation and economic diversification. World Bank (2023) reported that globally, small and medium scale enterprises represent over 90% of businesses and account for approximately 50-60% of total employment. In many developing economies, SMEs play more prominent role as they serve as the backbone of both informal and formal economies. It contribute significantly to the grow of GDP in most economies with the estimates being suggested that they provide up to 60% of total employment in high-income countries and as much as 90% in low-income and developing countries. Also, SMEs can play a crucial role in developing countries in term of poverty alleviation by providing income-generating opportunities for disadvantages groups including women and youth. According to a report by UNDP (2023), SMEs through informal sector growth are crucial in lifting millions of people out of poverty by offering labour and entrepreneurial opportunities. SMEs also create a significant role in the context of globalization, digitalization and sustainable development.

Despite several contributions to the economy, small and medium scale enterprises equally face significant challenges that can hinder their growth and sustainability which include access to finance, market competition, government policies, infrastructural decay, burdensome tax policies, technological gaps among others.

One of the strategies adopted by the government of various nations to support the SMEs is the provision of tax incentives such as tax holidays, reduced tax rate and investment allowances with the aim of reducing the financial burden on these enterprises and encouraging reinvestment and expansion. UNCTAD (2021). This has not exempted the Nigerian government where various tax incentive policies have been introduced under the Companies Income Tax Act (CITA), the Industrial Development Income Tax Relief Act, the Finance Acts of 2019-2023 and most recently, the proposed New tax bill currently in progress all aimed at fostering small and medium scale businesses in the country. The studies of Adebisi and Gbagi, (2021); Bello et al. (2021; Okonkwo et al., (2022) have all revealed that many SMEs are either unaware of these incentivesor unable to accessthem as a result of administrative bottlenecks, corruption or lack of capacity.

Empirical Review

Ocheni and Gemade (2015) investigated the impact of multiple taxation on the performance of SMEs in Benue state. The study was conducted using a questionnaire of 74 respondents who were small and medium scale businesses owners in the state. Adopting a basic non-parametric statistical percentages for the research, the findings revealed that SMEs ability to survive is negatively impacted by several taxes and in order to support the growth of SMEs in Nigeria, the government should create a standard tax laws.

Adebisi and Gbagi (2021) carried out a research on tax incentives and SMEs performance in Nigeria. There findings revealed that while incentives theoretically encourage SMEs growth, poor awareness, bureaucratic hurdles and informal sector dominance dilute their effectiveness. Agu, Onwuka and Aruomah (2019) carried out a research on the impact of taxes on the performances of small and medium-sized enterprises (SMEs) in Abia State. Questionnaire was employed as the instrument for data collection and survey technique was utilized to obtain the data. 162 workers and owners of 40 SMEs who were chosen at random as the participants. Using the multiple regression analysis and the one sample t-tests, it was discovered that there is a statistically significant and positive relationship between taxes and the performance of SMEs in Abia State.

Segun and Osazee (2018) investigated the impact of numerous tax burdens on small scale businesses performance, specifically on Lagos Island. The study sought to determine the impact of multiple tax burdens on SMEs performance. Collecting information from small business owners in Lagos Island Local Government Area through primary sources. Using basic percentages of inferential statistics, the study revealed that there is a statistically significant relationship between the burden of many taxes and the performance of small scale businesses in the area. The researchers suggested that the government should create an agency to deal with the problem of double taxes in Nigeria. Onwuchekwa and Aruwa (2022) assessed tax reliefs under Nigeria's Finance Acts and observed that many SMEs especially in the North-East are unaware or incapable of accessing these benefits due to low literacy and poor record-keeping.

Hassan and Adesina (2023) carried out research on tax policy and SMEs sustainability in Northern Nigeria. The findings revealed that most SMEs in Gombe State operate outside formal tax systems, making them ineligible for many incentive schemes. Also, they highlighted a gap in government outreach and monitoring. Olatunji and Adegbite (2020) investigated the impact of tax on SMEs in Lagos State. The results of the findings showed that there is a significant positive relationship between tax incentives and SME capital investmentin Lagos State. They suggested that effectiveness may vary by region and institutional strength.

Methodology

This study adopted a descriptive survey design to analyze the effects of taxation on small and medium scale businesses in three local government area of Oyo state. The targeted population comprises of two hundred and ten (210) small and medium scale businesses randomly selected. The local governments are Ibadan North, Ibadan North East and Ibadan North West local government. A Four- point Likert scale of Agreed, Strongly Agreed, Disagreed and Strongly Disagreed was explored to establish the reliability of the instrument to analyze the effects of taxation on small and medium scale businesses. Collected data were analyzed and Chi-square statistical analysis was used to analyze the result using a significance level of 5% (0.05)

Data Presentation

Table 1: Targeted Population of the study

Local Government Area	**Frequency**	**Percentage**
Ibadan North	70	33.33
Ibadan North East	70	33.33
Ibadan North West	70	33.33
Total	210	100.00
Years of Service		
2-5 years	28	13.33
6-10 years	51	24.29
11-15 years	57	27.14
16 years and above	74	35.24
Total	**210**	**100.00**

Table 2: Responses of Respondent to Questionnaire

S/N	**Items**	**Strongly Agreed**	**Agreed**	**Strongly Disagreed**	**Disagreed**
1	Tax burden on SMEs is high	53	65	33	27
2	Tax administration on SMEs is inefficient	50	58	37	33
3	SMEs do receive tax education and training periodically	30	35	60	53
4	Tax rate are reasonable for SMEs	40	47	45	46
5	Knowledge of the basic or entire concept of taxation and SMEs is insufficient.	51	55	34	38
6	There is full awareness of the applicable tax obligations and policies for SMEs	35	42	52	49
7	SMEs is aware and takes opportunity of tax planning	42	43	48	45
8	The tax policies need to be designed to make the tax rate appropriate and beneficial	58	63	29	28

9	Tax does not facilitate the SME's all-round growth	59	50	38	31
10	Tax remunerated affects the financial performances of the SME	56	61	35	26
11	Tax penalties, fines and other related serves as burden on SMEs	61	64	29	24
12	Tax affect cash-flow of SMEs	51	58	37	32

Ho1: Taxation has no significant impact on small businesses in Nigeria.

Table 3: To determine whether tax revenue has impacted the level of small businesses in Nigeria.

Response	Observed Frequency	Expected Frequency	x^2Cal Value	x^2Table Value	Degree of Freedom	Level of Significance	Remarks
SA	53		20.91	7.81	3	0.05	Significant
A	65	44.5					
D	33	44.5					
SD	27	44.5					
Total	178	178					

Degree of Freedom = (R – 1) (C – 1)

= (4 – 1) (2 – 1) = 3

The analysis of the responses from the respondents shows that x2 chi-square calculated 20.91 is greater than chi-square table value of 7.81 at 5% level of significance with a 3 degree of freedom. The null hypothesis is hereby rejected and the alternative hypothesis accepted. Therefore, it is concluded that tax revenues has significant impact on small businesses in Nigeria.

Ho2: Taxation policies have no significant effect in Nigeria.

Table 4: To evaluate the effects of taxation policies on small businesses in Nigeria.

Response	Observed Frequency	Expected Frequency	x^2Cal Value	x^2Table Value	Degree of Freedom	Level of Significance	Remarks
SA	58	44.5	23.31	7.81	3	0.05	Significant
A	63	44.5					
D	29	44.5					
SD	28	44.5					
Total	178	178					

The analysis of the responses from the above table shows that x2 chi-square calculated value 23.32 is greater than chi-square table value of 7.81 at 5% level of significance with a 3 degree of freedom. The null hypothesis is hereby rejected and the alternative hypothesis is accepted. Therefore, it is concluded that tax policies has effect on small businesses in Nigeria.

Ho3: Small businesses facing significant challenge of taxation in Nigeria.

Table 5: To investigate the challenges of taxation confronting small businesses in Nigeria.

Response	Observed Frequency	Expected Frequency	x^2Cal Value	x^2Table Value	Degree of Freedom	Level of Significance	Remarks
SA	59	44.5	10.46	7.81	3	0.05	Significant
A	50	44.5					
D	38	44.5					
SD	31	44.5					
Total	178	178					

From the above table, the analysis of the responses reveals that x2 chi-square calculated value 10.46 is greater than chi-square table value of 7.81 at 5% level of significance with a 3 degree of freedom. The null hypothesis is hereby rejected and the alternative hypothesis is accepted. Therefore, it is concluded that small businesses are facing a lot of challenges in Nigeria.

Conclusion

The results of the findings revealed that tax system in the country has negative impact on small businesses. The chi-square calculated values for the three hypotheses tested were greater than their correspondence chi-square table values. This led to the rejection of the null hypotheses and the acceptance of the alternative hypotheses. The results further showed that small businesses cannot compete with big industries and there is a need for government to encourage them by creating an enabling environment through appropriate tax incentives to enable their sustenance and growth. It is concluded that the tax system should be design in such a way to promote the sustainability and growth of both small businesses and the larger firms.

Recommendations

Based on the findings made from the above, it is therefore recommend that

- Government should ensure that corrupt tax officials are not allowed to carry out assessment and collection in other to discourage the imposition of multiple taxes on small businesses.
- Small businesses should be levied a lower percentage of taxes to enable them have enough funds for survival and development of their businesses.
- Government should increase tax incentives such as tax holidays, these will encourage voluntary compliance and attract investors that are potential viable taxpayers.
- Tax administrators should improve their support services towards small businesses, by enlighten them on issues related tax payment and benefits
- Government at all levels should utilize all money drive from taxes and other related income judiciously in order to encourage the citizens and promote small businesses.

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