

## Tax Compliance Costs of Small and Medium Scale Enterprises in Nigeria

Emmanuel Eragbhe<sup>1</sup> and Kennedy Prince Modugu<sup>2</sup>

### Abstract

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This study investigates the estimated cost of tax compliance for SMEs in Nigeria. The sum of internal compliance cost, external compliance cost and incidental cost; including bribery/psychological cost related to the different taxes paid by SMEs in Nigeria was utilized in estimating the tax compliance costs. Our analyses revealed that on the average the SMEs overall tax compliance cost in Nigeria is about ₦ 108,594 per annum and the values range from ₦14, 500 to ₦725, 000 per annum. Smaller SMEs were found to have an average TCC of N219,601 per annum as against N123,047 TCC per annum for larger SMEs which implies the existence of tax compliance costs regressivity in Nigeria. It was also discovered that Value Added Tax (VAT) has the highest TCC accounting for about 33% of the total average tax compliance costs. Furthermore, the study shows that SMEs in manufacturing industry have the highest relative average tax compliance cost while those in business services have the lowest average tax compliance cost. Exporting SMEs in Nigeria bear higher tax compliance cost burden than non-exporting SMEs. We recommend tax compliance simplification and incentives that would assist in reducing SMEs tax compliance costs in Nigeria.

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**Keywords:** Tax compliance cost, Small and Medium scale enterprises and Taxation

### 1. Introduction

Tax compliance cost is that aspect of tax burden that is not often discussed in textbooks and most literature. When one thinks about a tax burden, what readily comes to mind is the amount of tax paid by the tax payer.

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<sup>1</sup> PhD, Department of Accounting, University of Benin, Benin City, Nigeria

<sup>2</sup> Department of Accounting, University of Benin, Benin City, Nigeria

People hardly consider the extra burden or costs besides the tax liability which the taxpayer incurs in the process of complying with the provisions of the tax legislation and requirements by tax authorities. Tax compliance costs refer to all costs, besides the actual tax liability, born by taxpayers and third parties in the process of ensuring that they comply with the provisions of the relevant tax laws and the requirements laid on them by the relevant taxing authorities, including the inconveniences encountered in the process of becoming and remaining tax compliant.

Several researches on this study have been conducted in different countries around the world. The public interest in reducing the compliance costs has resulted in publications in the U.S., Australia, UK, Singapore, Hong Kong, Croatia, South Africa, Canada, Malaysia, The Netherlands, India and New Zealand and Belgium (Evans, 2003, PWC, 2008; PWC, 2009; PWC, 2010) but no specific interest has been given to this issue in Nigeria. According to Blazic (2004) this kind of research is still very rare among transition countries either because it requires investigation involving the collection of large amounts of data not available from published sources, or because there has been a general apathy towards the problem. These compliance costs as far as we are aware, are yet to be studied in Nigeria. For this reason it seems appropriate to conduct research on compliance cost for Nigerian Small and Medium-scale Enterprises (SMEs) that probably make relatively high efforts to comply with the Nigerian tax system which has been described as complex in several discourses. The primary objective of this study is therefore to conduct a survey research to establish what the average estimated cost of tax compliance is for SMEs in Nigeria.

SMEs have been given due recognitions especially in the developed nations for playing very important roles towards fostering accelerated economic growth, development and stability within several economies. While it is widely accepted today that SMEs are indispensable catalysts to the economic development of any country, there is a growing concern among researchers on the impact of tax compliance costs on the growth of SMEs. According to Price Waterhouse Coopers (2008), SMEs consistently report that complying with taxation regulation is a constraint on their growth and development due to the cost they have to incur to become and remain tax compliant.

The results of this study should help Nigerian SMEs to be informed about these costs and make efforts to minimize them.

It is assumed that businesses in Nigeria are not aware that tax compliance cost can be a significant cost of operations and could decrease their profitability. The results can also be used as documentation to convince the authorities to review the complexity of the tax system in Nigeria in order to lower the compliance costs for SMEs'.

## **2. Literature Review**

### **2.1 Concept of Tax Compliance Costs**

The term 'tax compliance cost' has different definitions, a consensus as to the precise meaning of compliance costs only began to emerge in the literature about 30 years ago when researches on tax compliance cost left its hitherto state of obscurity to a familiar terrain. Evans (2003) observed that there is now an extensive and varied literature available that deals with issues relating to tax compliance cost. Sapiei and Kasipillai (2009) argued that the challenges faced in tax compliance cost research particularly in the definition and measurement of compliance cost remains a critical issue. The absence of well-built consensus to the extra connotation of compliance cost remains a puzzle. However, a preponderance of definitions still abounds in the tax compliance costs literature. Sandford (1995), defined the concept of tax compliance costs, as follows:

Tax compliance costs are the costs incurred by taxpayers in meeting the requirements laid on them by the tax law and the revenue authorities. These are costs over and above the actual payment of tax and over and above any distortion costs inherent in the nature of the tax. These costs would disappear if the tax was abolished. They include the costs of collecting, remitting and accounting for tax on the products and profits of the business and on the wages and salaries of its employees, and also the costs of acquiring and updating the knowledge to enable this work to be done, including knowledge or legal obligations and penalties. (Sandford, 1995, p 1)

Americans For Fair Taxation (2007) sees tax compliance cost as the total time and money spent on filling out tax forms, keeping records, learning tax rules, and other tax-related matters.

Compliance costs of taxation are amount of resources expended by taxpayers, in addition to the amount of tax they are required to pay, in conforming to the requirements of the relevant tax legislation. Compliance costs are not only incurred by taxpayers but by all the agents/parties involved in making possible the transfer of funds from the private sector to the government department that controls public money.

For individuals, compliance costs include the costs of acquiring sufficient knowledge to meet legal requirements; of compiling the necessary receipts and other data; making the relevant calculations and completing tax returns; paying professional advisors for tax advice; and paying incidental costs of postage, telephone, and travel to communicate with tax advisors or the tax office. For a business, the compliance costs include the costs of collecting, remitting, and accounting for tax on the products or profits of the business, and on the wages and salaries of its employees. Tax Compliance costs for a business also includes the costs of acquiring the knowledge to enable this work to be done including the knowledge of their legal obligations and penalties. (Sandford, Godwin & Hardwick 1989).

While there have been some attempt to clearly define tax compliance cost, there are also debate on the appropriateness of tax compliance cost definitions. The most frequently cited definition of tax compliance cost proffered by Standford (1995) has been regarded by Yesegat (2009) as inconsistent. By extension, Sapiei, and Kasipillai,(2009) noted that the first sentence of the definition confines compliance cost to cost incurred in complying with the requirement of the tax system, while the next sentence opened up the scope of tax compliance cost to include all cost except for the tax liability and the distortion cost. However, Sandford, Godwin and Hardwick (1989) offers a justification for their definition of tax compliance cost in which the paper argues that complexities and interrelationships make it difficult if not impossible to define the various cost within absolute precision or in a neat mutually exclusive way.

In this study we define compliance costs as all costs, besides the actual tax liability, born by taxpayers and third parties in the process of ensuring that they comply with the provisions of the relevant tax laws and the requirements laid on them by the relevant taxing authorities, including the inconveniences encountered in the process of becoming and remaining tax compliant.

They would include both genuine compliance costs and avoidance costs and costs of non-compliance, including costs associated with tax evasion, psychology and bribery costs.

## 2.2 Types of Tax Compliance Costs

In this section, we shall examine the various types of tax compliance cost as identified by extant literature.

### 2.2.1 Administrative Costs

Tax compliance cost from the administrative costs perspectives, are the costs that exist besides the occurrence of compliance costs that are borne by the companies. These costs are cited as those that the government must also take into account as a public cost to ensure that the tax legislation is obeyed. These are to some extent substitutable, for example when a country transfers from a system where the tax office calculates the tax owed, to a self-assessment system as was the case in Nigeria in 1993. The consequence is usually an increased burden on the companies. Together, the compliance costs and administrative costs are defined as the operating cost of taxation (Sandford, 1998; Evans, 2001).

### 2.2.2 Time Spent, Cash Expenses and Psychological Costs

Another dimension of tax compliance cost definition is the division of tax compliance cost into three parts: time spent, cash expenses and psychological costs. The total time spent contains employee costs (in-house staff) and external costs (fees paid to outside accountants and other advisors). Hours by internal staff can be converted in expenses by means of an average hour rate. The psychological costs refer to the effects upon a taxpayer having to deal with tax affairs, for example mental stress. However, these costs are difficult to measure. Therefore, they are disregarded in most investigations. These compliance costs include costs that are incurred by a company, but are beyond the control of its management (Bhatnagar et al., 2002; Hijattulah & Pope, 2008).

### 2.2.3 Internal and External Costs

In describing tax compliance cost a distinction is often made between internal and external costs (Blumenthal & Slemrod, 1996).

Internal costs are generated by the accounting and administration department of the company. Internal staff will prepare all information and documents for the fiscal authorities and consult external advisors when necessary. External costs are generated by the services from lawyers, consultants and other advisors. These external costs are much easier to identify and quantify. Internal costs are more difficult to quantify since they involve subjective estimations of the time spent on different tax activities. Some studies have revealed that in most companies the internal compliance costs are substantially more important than the external (Tran-Nam, Evans, Walpole & Ritchie 2000; Hijattulah & Pope, 2008).

### 2.2.4 Computational Costs and Tax Planning Costs

In describing tax compliance cost there is also the need to distinguish between computation costs and planning costs. The first are inevitable as for example the costs necessary to have a proper accounting system that already prepares the necessary information and calculates the amounts due for tax purposes. They are considered as recurrent administrative costs which cannot be avoided by the company, but which management can only try to fulfill their administrative duty as efficient as possible (Hanfah et al., 2002). Planning costs on the other hand occur when a company tries to lower or avoid tax payments in a legal manner. This activity is part of good management practices designed to optimize the profitability of the company (as long as the avoidable planning costs are less than the obtained tax savings) (Tran-Nam et al., 2000). According to Bhatnagar et al (2002), these avoidance costs contain planning and research costs and are considered as voluntary costs. They are considered as additional expenditures to increase the opportunities for avoidance. Mills (1996) proves the hypothesis that firms who are spending more on tax research and planning, pay less tax than other firms.

### 2.2.5 Commencement and Recurrent Costs

The compliance costs of taxation can be viewed from commencement and recurrent costs perspectives. The former may arise as a result of both legislative change and changes in the taxpayer population while the latter are the regular costs.

Generally, studies tend to note this distinction and recognize that the frequency of legislative and population change makes disentanglement difficult if not impossible to integrate the two in the measurement of tax compliance costs (Kirsten, 2007).

### 2.2.6 Accounting Costs and Tax Costs

Another perspective in describing tax compliance cost is the problem of disentangling accounting costs from tax costs. This problem is referred to by Evans (2006) as “joint cost problems”. Despite careful attempts in most recent studies to separate tax compliance costs from the underlying costs of being in business referred to by Sandford (1995) in Evans (2006) as “core accounting costs”, there is almost certainly some overlap between business or accounting costs and tax compliance costs. There is uncertainty about the extent of overlap and therefore most estimates of taxation compliance costs can only be indicative at best (Kirsten, 2007).

### 2.3 Measurement of Tax Compliance Costs

There is uncertainty about what should be included in the measurement of taxation compliance costs (Evans, 2006). Whilst this is an area in which there will always be theoretical debate, it is possible to identify a “hard core” of costs that are indisputably part of the costs of complying with taxation requirements.

Typically these will include: (i) the time taken in compiling receipts and recording data in order to be able to complete a tax return; (ii) the costs of labour/time consumed in completion of tax activities, for example, the time taken by a business person to make the necessary calculations, fill in the tax returns, acquire appropriate knowledge to deal with tax obligations such as Pay As You Earn (“PAYE”), VAT, education tax, company income tax, custom and excise duties etc (iii) the costs of expertise purchased to assist with completion of tax activities

(typically, the fees paid to professional tax advisers); and (iv) incidental expenses incurred in completion of tax activities, including computer software, postage, travel etc.

Turner, Smith and Gurd (1998) summarized tax compliance cost into the following categories of compliance costs:

**TCC** = taxpayer's and unpaid helper's time + tax agent fees + incidental expenses.

This method of measuring tax compliance cost is subjected to the problem of quantifying taxpayer's and unpaid helper's time in monetary terms. However, for small businesses that can monetarily quantify time spent on tax matters, the method might be appropriate since most SMEs tax compliance costs include the cost of collecting, paying and accounting for tax on products or profits of the business, and on the wages and salaries of employees together with the costs of acquiring the knowledge to enable this work to be done. Using professional tax advisors is one of the main costs contributing to the cost of complying with taxation legislation.

Sandford (1995) in his measurement distinguished between gross and net compliance costs; where net compliance costs are equal to gross compliance costs minus the value of tax compliance benefits. The main quantifiable form of tax compliance benefit, according to the study is the cash flow advantage which arises when businesses use tax revenues for a period before they are remitted to tax authorities. Net Compliance Costs may thus be written as:

**Net compliance costs** = Gross compliance costs – Cash flow benefits

This approach of measuring tax compliance cost is however subject to debate, especially in the areas of distinguishing between gross compliance costs and net compliance costs (Sandford, 1995; Tran-Nam et al., 2000; Tran-Nam & Glover, 2005; Lignier, 2006; Lignier, 2009). The net compliance costs are obtained by the following calculation:

**Net tax compliance costs** = gross tax compliance cost- (tax deductibility benefits + cash flow benefits + managerial benefits)



Sapiei (2009) has argued that the above approach to tax compliance cost measurements is complex and hence he provided a simple tax compliance cost approach with three major theoretical components (*Internal cost, external cost and incidental cost*).

Internal costs refer to time spent by the business staff on tax matters, External cost are fees paid to tax agents while incidental costs, sometime referred to as overhead cost include travel, stationary, computer, telephone, court litigation cost and Psychological cost – which are negative experience of taxpayers such as anxiety and frustration caused by tax compliance. Thus, according to Sapiei (2009), total tax compliance (TTC) cost is measured as;

$$\text{TCC} = \text{Internal cost} + \text{external cost} + \text{incidental cost}$$

In response to the simplicity of the above approach, Tran – Nam et al (2000) developed a rather sufficiently robust model to capture tax compliance cost. The model is stated as follows:

**Taxpayer compliance costs (TCC)**= Direct monetary outgoings incurred by taxpayers + Imputed costs of time and resources spent by taxpayers on their tax affairs – (Managerial benefits to taxpayers + Cash flow benefits to taxpayers + Tax deductibility benefits to taxpayers) – Reduction in tax liabilities due to tax planning.

Despite the robust nature of the above method, it is not widely used due to the measurement and computational problems that are associated with its application.

#### 2.4 SME's and Tax Compliance Cost in Nigeria

Small and medium scale enterprises (SMEs) taxpayers under the Nigerian system of taxation are subjected to high tax compliance burden. Reducing the compliance costs and tax rate increases the small enterprises profit margin. It also increases the Government's tax revenue, since the simplified provisions for a micro enterprise historically reduce the size of the shadow economy and the number of non-complying registered taxpayers (Vasak, 2008).

In Nigeria, SMEs usually have to operate in an overbearing regulatory environment with the plethora of regulatory agencies, multiple taxes, cumbersome importation procedure and high port charges that constantly exert serious burden on their operations. Many SMEs have to deal with myriad of agencies at great cost. SME's in Nigeria are heterogeneous and these differences in size and structure may in turn carry differing obligations for record-keeping that affect the costs to the enterprises of complying with (and to the revenue authorities of administering) alternative possible tax obligations.

An overly complex regulatory system and tax regime like that of Nigeria makes tax compliance unduly burdensome and often has a distortionary effect on the growth of SMEs (Masato, 2009). Among the factors militating against SME tax compliance are: high tax rates, Low efficiency, high collection charges, waste of time for taxpayers and the staff, and the low amounts of received taxes and the deviation of optimum allocation of resources are double taxation, no professional tax consultancy, weak tax planning, high taxation cost. (Farzbod, 2000 and Yaobin, 2007).

SMEs in Nigeria are subjected to different types of taxes. The following are types of taxes that they are expected to comply with (1) Company Income Tax (2) Value-Added Tax (3) Education Tax (4) Customs and Excise duties and (5) Employee Tax (PAYE) /Personal Income Tax and Withholding tax. In agreement with Ariyo (2007), we admit that SMEs tax administration and the associated compliance cost in Nigeria is particularly hard because tax literacy level is low and record keeping for tax purpose is not yet a popular culture. There are not enough tax officials to cover the field. Most of the officials are little trained, ill equipped, badly remunerated and corrupt. Governments in Nigeria are perceived as a corrupt and selfish lot, to whom money should not ever be voluntarily given. Taxes paid are expected to end up in private pockets, not in public utilities. The foregoing not only makes SMEs tax compliance difficult, but also enforcement problematic.

## 2. 5 Empirical Evidence of SME's Tax Compliance Cost

Slemrod and Venkatesh (2002) in their study of Small and Mid-size companies and tax preparers for the year 2000, used internal personnel cost, non-personnel costs and external costs as components of tax compliance costs. Tax preparers were asked to estimate Compliance Cost (CC) for hypothetical firms.

All respondents were asked about high CC provision activities avoided due to tax complexity, tax shelters and also to provide suggestions for simplification. Separate estimates were provided for pre-filing, filing and post-filing costs by activity. The results show that CCs are Regressive and that CC was 58.7% of internal personnel compliance cost; 16.5% of other internal costs; 68.5% for federal taxes; 25.5% for state/local taxes and 6.05% for foreign taxes.

The mean CC was \$254,455 (adjusted for bias; \$134,995); median CC \$114,705; Total CC \$29.9bn (26.9%-28% of tax paid).

It was found that Compliance Costs are 10-11 times the CC estimates in Slemrod and Blumenthal (1996) for large firms.

Blažić (2004), examined the measurement of tax compliance costs of business units that pay personal income tax in Croatia for the period 2001/2002. They comprise all taxes, except custom duties. The regressive effect is proven, measured by different size measures. In the cost structure the cost of time, predominantly the owner's time, is paramount. Concerning the type of tax, personal income tax and VAT are, in aggregate, of almost the same importance. As a percentage of GDP the tax compliance costs come to around 0.8%. The share of personal income tax compliance costs in the relevant tax revenues is extremely high (almost 100%), which calls for the substitution of self-assessment by lump sum (estimated) tax. Psychological cost of that tax does not seem to be significant. The share of VAT is also considerable (25% or at least 16%), calling for a higher exemption threshold.

Smulders and Stiglingh (2007) in their study provided a baseline measurement for annual tax compliance costs for small businesses.

Their work focuses on an empirical study amongst tax practitioners to identify and measure the annual tax compliance costs for small businesses throughout South African and their results revealed that R7 030 per annum is the average fee that tax practitioners charge their small business clients to ensure that their tax returns (for four key taxes – income tax, provisional tax, value added tax and employees' tax) are prepared, completed and submitted as South African Revenue Service requires.

From a time and cost perspective, preparing, completing and submitting VAT returns takes the longest and costs the most. It is evident that, overall, the compliance costs are regressive the smaller the business, the heavier the burden.

Eichfelder and Schorn (2008), using survey data from 2003 and analysing the correlation between tax compliance costs and other attributes of German businesses by regression methods found that tax compliance costs are an important part of the total bureaucratic burden of private businesses resulting from public regulations. The regression confirms the widely accepted result that small businesses bear a higher compliance burden due to economies of scale.

Furthermore the study verifies the close connection between countable tax compliance costs and psychic costs.

Even more important, it does not provide empirical evidence for a significant cost reduction by electronic data interchange or by a simplified cash accounting method but emphasizes the role of tax advisers and administrative authorities in reducing the bureaucratic cost burden of private businesses.

Schoonjans, Van Cauwenberge, Reekmans and Simoens (2011), in their study presents survey evidence on the magnitude and determinants of tax compliance costs in Flemish small and medium-sized enterprises (SMEs). Data were obtained from an internet questionnaire among members of a professional network of Flemish entrepreneurs called VOKA. Analyzing a sample of 151 Flemish SMEs, the study finds that the tax compliance costs – exceeding over seven percent of gross added value – are relatively high. VAT, labor taxes and corporate taxes are the main components of tax compliance costs. In addition, the paper confirms the regressivity hypothesis, according to which smaller companies face relatively higher compliance costs. Furthermore, industry, age and the proportion of blue-collar workers prove to be determining factors of relative compliance costs.

### 3. Methodology

The research design for this study is the survey research design. The population for this study is all SMEs in Nigeria with a history of paying taxes. A recent study undertaken by the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) and the National Bureau of Statistics (NBS) put micro, small and medium businesses across the country in the region of 17.3 million (Ndumanya, 2013). But considering the cost of conducting a survey for all the SMEs and the non-availability of reliable data on the total number of taxpaying SMEs in Nigeria, we adopted the Yamane (1967) sample size calculation formulae based on the number of SMEs in Nigeria. The sample size is derived using the statistical formula stated, thus:

$$n = N / (1 + N(e^2))$$

Where:

n= sample size

N= Population size (finite population)

e= 95 % Level of significance desired

Using the above formulae and the total number of estimated SMEs of 17.3 million at 5% level of significance, we arrived at a sample of 400 SMEs as the minimum for this study. However, we used a reasonably large sample of 750 taxpaying SMEs across the country instead of the 400 arrived at using the Yamane (1967) sample size calculation formulae stated above. This became necessary in order to ensure adequate representation and reliable generalization and also because of the anticipated low response rate. This approach of taking a sample beyond the minimum sample size is referred to as over-sampling and is recommended by Salkind (1997) and Fink (1995) for most questionnaire survey based research. To avoid regional bias, we ensured that at least a minimum of 50 SMEs that pay taxes from each of the six geopolitical zones in Nigeria is included in the sample. The sampling frame was drawn from states tax authorities' and SMEs trade association's directory of SMEs tax payers.

Non-profit oriented SMEs and SMEs that have no tax records or history were not taken into account because tax compliance cost cannot be ascertained for such businesses. The exclusions of some SMEs are accepted since similar studies, see Blumenthal and Slemrod, (1996) have followed the same approach in computing tax compliance costs.

The study therefore adopts a cluster and purposive sampling technique and the justification is based on the need to avoid selection and representativeness bias.

The research instrument used for the study is divided into several sections. The first section (Section A) of the questionnaire gathered data relating to the characteristics of the SME's such as geographical location, ownership type, sector of operation, number of employees, average turnover, years operational, whether the business exports or not and how business tax is computed. The second section (Section B) of the questionnaire collected data on internal tax compliance costs for the following taxes; VAT, education tax, business/company income tax, withholding tax, employee tax and custom and excise duties tax. Respondents were asked to give their best estimate on how much time they spend on each tax and the cost they have to make to comply with these taxes. Although most studies ask a direct estimation of the tax compliance cost, the pre-research showed that SME's in Nigerian have difficulties in correctly estimating these costs.

Therefore, providing a range of estimates was adopted as a control procedure. To compute internal tax compliance costs for the various taxes, estimates were sought for the following; (i) average time taken per year by internal staff in filling and keeping records relating to the various categories of taxes. (ii) Average cost per year spent internally in filling and keeping records relating to the types of taxes. (iii) Average cost per year spent on internal staff in research and planning (R&D) in respect of the different types of taxes. (iv) Average time taken per annum by internal staff in addressing audits, appeals and litigations issues in respect of the different types of taxes. (v) Average overhead/incidental cost per annum (i.e. travel, stationary, computer, telephone etc) spent internally in addressing tax issues in respect of the types of taxes.

The third section (Section C) of the questionnaire collected data on external compliance cost for VAT, education tax, business/company income tax, withholding tax, employee tax and custom and excise duties tax.

Specifically, respondents were asked if they seek the assistance of tax professionals in understanding and complying with the types of taxes. For the purpose of analysis, respondents were asked to give their best estimate of the average fees per year spent on professional charges on these types of taxes.

The fourth section (Section D) of the questionnaire collected data on bribery and psychological costs associated with tax compliance external compliance cost for VAT, education tax, business/company income tax, withholding tax, employee tax and custom and excise duties. Respondents were asked if they experience stress, anxiety or frustration when complying with the various taxes. Specifically, in estimating psychological tax compliance cost, we requested information on what the business may be willing to pay to avoid the stress and anxiety that arise from complying with a specific tax or from a tax-related activity, and to avoid the frustration resulting from harassment from tax officials. This approach for measuring psychic cost of tax compliance is similar to the approach adopted in a survey of large corporations in India by Bhatnagar, Chattopadhyay, Mohanty, Mykhopadhyay, Das-Gupta & Singh (2002).

Consequently, the measurements of the tax compliance cost for VAT, education tax, company income tax, withholding tax, employee tax and custom and excise duties tax is presented below;

CVAT = The sum of Internal compliance costs, external compliance costs, bribery and psychological costs related to value added tax.

CCIT = The sum of Internal compliance costs, external compliance costs, bribery and psychological costs related to business/company income tax.

CETAX = The sum of Internal compliance costs, external compliance costs, bribery and psychological costs related to employee tax.

CWPTAX = The sum of Internal compliance costs, external compliance costs, bribery and psychological costs related to withholding tax.

CETAX = The sum of Internal compliance costs, external compliance costs and bribery and psychological costs related to Education tax.

CEXDUT = The sum of Internal compliance cost, external compliance cost, bribery and psychological costs related to Excise and custom duties.

TTAXCP = The Aggregate tax compliance costs (VAT compliance costs + Employee tax compliance costs + Withholding tax compliance costs + business/company income tax compliance costs + educational tax compliance costs + custom and excise duties tax compliance costs). These costs include internal staff costs, external tax fees, incidental costs such as bribery costs and psychological costs. Where; CVAT= Compliance cost of VAT

CCIT = Compliance Cost of Business/Company Income Tax.

CETAX= Compliance Cost of Employee Tax.

CWPTAX= Compliance Cost of withholding tax.

CETAX = Compliance Cost of Education tax.

CEXDUT= Compliance Cost of Excise and custom duties.

TTAXCP= Total Tax compliance cost.

#### 4. Presentation and Analysis of Result

Table 4.1: SMEs Based on Region Classification

Region	Sample	Percentage (%)
North-Central	47	8.2
North-East	91	15.9
North-West	66	11.3
South-East	99	17.2
South-South	143	24.9
South-West	128	22.3
Sampled SMEs	574	100

Source: Survey (2012)

Table 4.1 shows a breakdown of the SMEs sampled according to the various geopolitical zones in Nigeria. It seems evident from the results that, to some extent, there exist a fair representation of SMEs in Nigeria across the six geopolitical zones. The dominance of SMEs from the South East (11.5%), South South (24.9%) and South West (22.3%) is of relevance to this study since most organized and registered small and medium scale business in Nigeria are often located in these regions.



The results also confirm that registered and active SMEs that belong to well-known small and medium scale trade associations in the Northern regions are relatively small compared to other regions in Nigeria.

Table 4.2 Smes Based on Industry Classification and Overall Average Tax Compliance Cost

Industry	Sample	Percentage	Overall Average Tax Compliance Cost
Agriculture	35	6.1	123,157.1
Business services	113	19.7	93,345.1
Computer	82	14.3	101,963.4
Construction	59	10.3	108,135.6
Hotel & restaurant	57	10	124,131.6
Manufacturing	68	11.8	128,332.9
Real estate	53	9.2	110,434
Transport & storage	26	4.5	100,519.2
Wholesale & retailing	51	8.9	102,666.7
Others	30	5.2	107,583.3
Sampled SMEs	574	100	108,594.1

Source: Survey (2012)

Table 4.2, shows the sampled SMEs industry classification for this study according to their participation in the survey and average total tax compliance cost. The results indicate that there was at least a fair representation of SMEs of different industries and even those outside our industry classification. As seen in the results above, there is some difference in the average tax compliance cost for SMEs in different industries in Nigeria. SMEs in manufacturing industry have the highest relative average tax compliance cost (N128, 332.9 per annum) while SMEs in business services has the lowest average tax compliance cost (N93, 345. Per annum).

Table 4.3 Smes Based on Business Life Classification

<b>Business Life (Age)</b>	<b>Sample</b>	<b>Percentage (%)</b>	<b>Overall Average Tax Compliance Cost (₦)</b>
15 years and above	104	18.1	126,716.3
6 to 14 years	180	31.4	108,958.3
3 to 5 years	185	32.2	98,605.41
0 to 2 years	105	18.3	108,594.1
Sampled SMEs	574	100	442,874.11

Source: Survey (2012)

Table 4.3 provides another distinction in the sampled SMEs according to their business age, participation in the survey and average total tax compliance cost. The results indicate that there was at least a fair representation of SMEs of different business age. The results in table 4.3 indicates that the group of SMEs (young SMEs) that falls under the business age bracket of less than 3 years of operations have an average tax compliance cost of ₦108,594 while those with 15 years and above have an average tax compliance cost of ₦126,716. The lowest average tax compliance cost was found in SMEs categories with 3 to 5 years (₦ 98,605.41) while the largest average tax compliance cost burden was found with SMEs that have operated for 15 years and above (₦ 126,716.3). This finding implies that older SMEs are likely to bear's larger tax compliance cost burden than younger SMEs in Nigeria.

Table 4.4 Smes Based on Foreign Activities Classification

<b>Foreign</b>	<b>Sample</b>	<b>Percentage (%)</b>	<b>Overall Average Tax Compliance Cost</b>
Export across the globe	8	1.4	191,625
Export within Africa	29	5.1	168,896.6
No export	537	93.5	104,100.6
Sampled SMEs	574	100	464,622.2

Source: Survey (2012)

Table 4.4 provides analysis on our sampled SMEs based on their exports status and average tax compliance cost. As shown in the table, over 94 % of the sampled SMEs in this study did not engage in export while 1.4% export across the globe and 5.1 % export within Africa.

This finding indicated that a majority of Nigerian SMEs provide services and goods for Nigerian domestic market. This implies that SMEs in Nigeria appear relatively unable to compete in the international export market. In this same table, we observed that non-exporting SMEs in Nigeria have an average tax compliance cost of ₦104, 100.6 per annum while exporting SMEs have an average tax compliance cost of ₦360, 522 per annum. This means that exporting SMEs in Nigeria bear higher tax compliance cost burden than non-exporting SMEs. The relative large difference can be attributed to the legal documentation and tax clearance that is required from exporting SMEs.

In our regression analysis we also tested whether SMEs engagement in export increases their average tax compliance cost in Nigeria.

Table 4.5 SMEs Based on Outsourcing Classification

<b>Outsourcing</b>	<b>Sample</b>	<b>Percentage (%)</b>	<b>Overall Average Tax Compliance Cost</b>
Both Internal and External tax personnel	165	28.7	121,481.8
External Tax expert	190	33.1	109,828.9
Internal staff	219	38.2	99,547.95
Sampled SMEs	574	100	221,525.75

Source: Survey (2012)

Table 4.5 shows that about 28.7% of the sampled SMEs use both internal and external personnel in addressing their tax problems while 38.2% of them use internal staff and 33% use external tax expert only. This implies that a large number of SMEs in Nigeria still address their tax compliance problems without seeking external tax expert services. In terms of the average tax compliance cost for SMEs in Nigeria, we observed that SMEs that have a lower average tax compliance cost was found in cases where SMEs use internal staff only (₦99, 547.95) while a larger average tax compliance cost was found in cases where SMEs use both internal and external personnel in complying to tax (₦121, 481.8). This finding clearly shows that the use of external tax expert along with internal staff increases the tax compliance cost burdens of SMEs.

Table 4.6 Smes Based on Turnover Classification

Turnover	Sample	Percentage (%)	Overall Average Tax Compliance Cost
Above 20 million	48	8.4	136,395.8
10 to 20 million	117	20.4	97,931.62
5 to less than 10 million	117	20.4	114,859
1 to less than 5 million	117	20.4	105,529.9
500 to less than 1 million	115	20	109,913
Less than 500 thousand	60	10.4	98,375
Sampled SMEs	574	100	110,500

Source: Survey (2012)

Table 4.6 shows the sampled SMEs turnover categories for this study according to their participation in the survey and average total tax compliance cost. The results indicate that there was a fair representation of SMEs of different turnover categories except in the case of SMEs with above 20 million naira (8.4%) and SMEs with less than 500 thousand naira turnover (10.4%). In comparing the average tax compliance cost we re-group the SMEs into Large (10 Million naira and above), Medium (1 million to less than 10 million naira) and Small (Less than 1 million naira), our calculation shows that the average tax compliance cost for large, medium and small SMEs stood at  $\text{N}117, 163.4$   $(136,395.8+97,931.6/2)$ ,  $\text{N}110, 194$   $(114,859+105,529.9/2)$  and  $\text{N}104, 144$   $(109,913 +98,375/2)$  respectively. The turnover survey results could not identify regressivity in tax compliance cost. In previous studies regressivity in SMEs tax compliance cost is often best tested using employee size rather than turnover since the use of revenue as a proxy of size is subjected to different revenue recognition and measurement problems. In this study regressivity of tax compliance cost for SMEs was tested using employee numbers.

Table 4.7: Smes Based on Work Size or Employee Number Classification

Work size	Sample	Percentage	Overall Average Tax Compliance Cost
Less than 10 employee	174	30.3	107,523
10 to 49 employees	166	28.9	112,078.3
50 to 99 employees	131	22.8	109,725.2
100 employees and above	103	18	103,349.5
Sampled SMEs	574	100	342,676

Source: Survey (2012)

Table 4.7 shows the sampled SMEs workforce size categories for this study according to their participation in the survey and average total tax compliance cost. The results indicate that there was an adequate representation of SMEs of different workforce size categories. In comparing the average tax compliance cost we regrouped the SMEs into Large (50 employees and above) and Small (Less than 50 employees), our calculation shows that the average tax compliance cost for large and small SMEs stood at ₦123,074.7  $(109725.2+103349.5/2)$  and ₦219,601.3  $(107,523+112,078.3/2)$  respectively. This result indicates that small SMEs are associated with higher tax compliance cost burden than larger SMEs.

This in other word means that tax regressivity hypotheses also hold in Nigeria. The regressivity in tax compliance of cost as found in this study is in line with previous studies (see Blumenthal and Slemrod, 1992; Hanefah, Ariff & Kaipillail, 2002; Pope, 1993; Sandford, Michael & Peter, 1989; Slemrod & Venkatesh, 2002; Vaillancourt, 1986). This therefore leads to our conclusion that Small SMEs bears higher tax compliance cost burden than larger SMEs in Nigeria.

Table 4.8: Descriptive Statistics for Overall and Types of Tax Compliance Costs

Tax compliance cost	Obs	Mean ₦	Min ₦	Max ₦
SME Tax compliance cost (TTAXCP)	574	108,594	14,500	725,000
SME withholding tax (CWPTAX)	170	40,670	500	219,000
SME Payee (CETAX)	317	47,667	500	219,000
SME company income tax (CCIT)	315	50,025	500	218,500
SME Value added tax (CVAT)	249	67,995	500	178,000

Source: Survey (2012) and STATA results

The table 4.8 provides the overall average tax compliance cost for the responded SMEs in our study. From the results, we observe that on the average the SMEs overall tax compliance cost in Nigeria based on the 574 respondent SMEs is about ₦ 108,594 per annum and the value varies from ₦14, 500 to ₦725, 000. In the case of withholding tax we found that 170 SMEs accepted that they comply with withholding tax out of the 574 SMEs and their average tax compliance cost was ₦40,670 and it varies from a minimum of ₦ 500 to a maximum of ₦ 219,000. In the same table we observed that 317 from the 574 sampled SMEs accepted that they comply with PAYE. The average tax compliance cost in the case of PAYE was ₦ 47,667 and this varies from a minimum of ₦ 500 to a maximum of ₦219,000. In the case of business/companies income tax (CIT), 315 SMEs from the 574 responded that they comply with this tax and the average tax compliance cost for CIT stood at ₦ 50,025 and this varies from a minimum of ₦ 500 to a maximum of ₦ 218,000.

Finally, VAT which is a major concern for SMEs in Nigeria that are engaged in VAT based transaction had an average tax compliance cost of ₦ 67,995 and varies from a minimum of ₦ 500 to a maximum of ₦ 178,000. A careful look at the mean tax compliance cost indicates that for the sampled SMEs, VAT compliance cost burden is higher than that of other types of taxes.

## **5. Conclusion and Recommendation**

Our survey results indicate that Nigerian SMEs bear considerably high tax compliance cost. Furthermore, it has been established that these compliance costs are regressive in nature. Our results clearly indicate that tax compliance costs are relatively high for small SMEs in Nigeria and this vary across SMEs. Since high tax compliance costs might impede SMEs innovation and growth, it is necessary that policy makers continuously strive to further reduce them. It is our opinion that reducing the compliance costs of taxpaying SMEs by simplification or otherwise will increase their profit margin and also increases the Government's tax revenue because, as earlier discussed, this will reduce the size of the shadow economy and the number of non-complying registered SME taxpayers.

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