



The Financial Effects of Nigeria's Tax Reform on Small Businesses: Opportunities and Challenges

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Abstract

Nigeria's tax reform, which came into effect in 2023, aims to increase revenue generation and promote economic growth. However, the financial effects of this reform on small businesses in Nigeria are not well understood. This study examines the financial effects of Nigeria's tax reform on small businesses, using a mixed-methods approach. The results show that the reform has both positive and negative effects on small businesses, including increased tax burdens, reduced profitability, and improved tax compliance.

Keywords: Small Business, Tax, Tax Reform and Tax Compliance

I. Introduction

Nigeria's tax reform, which was signed into law in 2023, is a comprehensive overhaul of the country's tax system (Adeyeye, 2020). The reform aims to increase revenue generation, promote economic growth, and improve tax compliance (Oyedele, 2020). Small businesses are a crucial sector of the Nigerian economy, accounting for over 90% of businesses and employing millions of people (World Bank, 2020). However, small businesses in Nigeria face numerous challenges, including limited access to finance, inadequate infrastructure, and a complex regulatory environment (Kwakye, 2017). Nigeria's new tax regime, which was signed into law in 2023, is a comprehensive overhaul of the country's tax system (Adeyeye, 2020). The regime aims to increase revenue generation, promote economic growth, and improve tax compliance (Oyedele, 2020). Small businesses are a crucial

sector of the Nigerian economy, accounting for over 90% of businesses and employing millions of people (World Bank, 2020). However, small businesses in Nigeria face numerous challenges, including limited access to finance, inadequate infrastructure, and a complex regulatory environment (Kwakye, 2017). Sound and efficient financial performance is the fundamental and desirable objective of every corporate entity including small and medium enterprises for survival in this highly competitive business world. Financial performance showcases the monetary measurement of policies and operations of firms at a given period. Similarly, financial performance can be defined as the monetary measurement of how a business utilizes the resources to generate revenues from its daily operations over a period of time. Basically, financial performance is usually published in the annual financial reports and presented to the users of financial statements. This implies that financial performance is very vital as the life-blood of all businesses particularly small and medium enterprises (SMEs) whose activities have been accorded global recognition and attention in recent time. University of Rochester Medical Center (2014) asserts that as the white blood cells in the blood help the blood to fight against diseases and illnesses, so is the same with efficient financial performance of business entity; money is used to cater for unforeseen risk which may pose a financial shock to the business entity. The import is that good financial performance enhances the growth and survival of small and medium enterprises. In recent decades, there has been significant global attention on the unique economic contributions of Small and



Medium Enterprises (SMEs), with their development becoming a central focus for economies worldwide. SMEs have long been recognized as a vital force for economic growth and industrialization, particularly in smaller economies (Aryeetey & Ohene, 2004; Oludele & Emilie, 2012). These enterprises are increasingly acknowledged for their substantial role in job creation, economic development, and poverty alleviation in Africa. According to the World Development Report, fostering sustainable employment and supporting small entrepreneurs are critical strategies for lifting people out of poverty. This recognition stems from their immense contributions to national economic growth and development. SMEs drive economic activity through the utilization of local raw materials, job creation, promotion of rural development, and entrepreneurship growth (Muritala, Awolaja & Bako, 2012). Representing the largest share of businesses globally, SMEs play a pivotal role in employment generation, the supply of goods and services, improving living standards, and significantly contributing to the gross domestic product (GDP) of numerous countries.

II. Literature Review

The literature on the impact of tax reforms on small businesses is extensive. Studies have shown that tax reforms can have both positive and negative effects on small businesses, depending on the specific design of the reform (IMF, 2019). A study by the World Bank found that tax reforms that reduce tax rates and simplify tax compliance can have positive effects on small businesses (World Bank, 2019). However, the study also noted that tax reforms that increase tax rates or complexity can have negative effects on small businesses.

The impact of tax reforms on small businesses has been widely studied, with research highlighting both positive and negative outcomes depending on the specific nature of the reforms (Kwakye, 2017). A study conducted by the International Monetary Fund (IMF) emphasized that tax reforms aimed at reducing tax rates and simplifying compliance can benefit small businesses (IMF, 2019). Conversely, reforms that increase tax rates or introduce complexities may adversely affect these businesses.

Taxation

Taxation serves as an essential tool for economic development, providing the financial foundation for public goods and services. It is often described as a double-edged sword, influenced by the objectives of the government in power. While it can drive economic growth, taxation can also be

used to promote or discourage activities based on their social implications. Udabah (2002) refers to taxation as a necessary evil, required to fund services desired by society and enforced as an obligatory transfer to public authorities. Attama (2004) describes taxation as a mandatory contribution levied on individuals and businesses by public authorities to meet governmental expenses. He emphasizes its critical role in supporting a nation's economic growth and development, noting that taxes are often imposed annually or as deemed necessary by the government. Taxation involves a compulsory levy on citizens' income, wealth, or property, often without a direct benefit in return. It is instrumental in providing security, social amenities, and economic well-being for society (Appah, 2004). Ogbonna and Ebimobowei (2012) identify taxation as a primary source of government revenue globally. Similarly, Azubuike (2009) notes that tax revenues enable governments to fulfill traditional functions such as the provision of public goods, law enforcement, defense, and regulation of trade to ensure socio-economic stability. Musgrave and Musgrave (2006) highlight the economic effects of taxation, including micro level impacts on income distribution and resource efficiency and macro-level effects on output capacity, employment, prices, and economic growth. Ogbonna (2010) defines taxation as a compulsory payment imposed on individuals and corporate entities, covering income, profits, wealth, estates, property, goods, and services. This payment sustains government functions, though it does not guarantee direct benefits for taxpayers. Taxes play a pivotal role in fiscal policy, enabling governments to manage economic development and stability. They are a cornerstone of the macroeconomic framework, serving as a powerful instrument for economic reform and a critical factor in the functioning of economies worldwide (Ogbonna & Ebimobowei, 2012).

Relationship between Taxation, Financial Performance and Small & Medium Enterprises

High tax rates, as argued by Gordon (2010), disrupt the balance between labor demand and supply, ultimately reducing productivity as individuals may opt for increased leisure time. In some countries, tax systems are designed solely for revenue generation, negatively impacting economic growth. People generally resist tax payments due to their adverse effects on disposable income. Owens (2006) emphasized that tax policies must be broadly acceptable to the public to ensure compliance. Consequently, a well-structured tax system should



align with Adam Smith's (1776) principles of taxation, which include equity, neutrality, efficiency, flexibility, and simplicity. Rohaya, Nori Azam, and Nur Syazwani (2010) investigated the impact of corporate income taxes on the profitability of firms. Their study examined variables such as gross profit, cost of sales, and expenses across 7,306 companies in the hospitality sector, 6,594 in business services, and 1,484 in the transportation manufacturing sector from 1995 to 2000. The findings revealed that corporate income taxes negatively affect profitability. Many small taxpayers, frustrated by complex tax codes, often resort to creative accounting to evade taxes. Additionally, tax multiplicity enables taxpayers to shift between tax types or marginal rates to minimize liabilities. The primary purpose of taxation is to generate government revenue for developmental purposes. According to Musgrave and Musgrave (2004), taxes have both microeconomic effects, such as income distribution and resource efficiency, and macroeconomic effects, including capacity output, prices, employment, and growth. High taxation rates can hinder growth by limiting entrepreneurs' ability to fund rapid expansion.

Economists, including Tomlin (2008), argue that the resources small businesses allocate to taxes could instead be used for reinvestment, fostering growth. He suggested that reforming small business taxation could eliminate incentives for firms to remain small, encourage growth, and enhance overall economic competitiveness. Musgrave and Musgrave (2004) also noted that taxation levels influence public savings and the resources available for capital formation. In Nigeria, improving the investment climate is essential for boosting economic growth and increasing tax contributions from all sectors. While industrialists often view taxes as detrimental to small business success, the extent of this impact remains ambiguous. Government fiscal policies are not intended to stifle small business development through taxation, yet the high failure rate of SMEs raises concerns about the business environment. With supportive tax and regulatory policies, small businesses have the potential to grow into large, competitive companies, comparable to those in the United States (Tomlin, 2008). Amidst global economic crises, including those affecting Nigeria, it is critical to strike a balance between generating government revenue through taxes and creating an enabling environment for business growth.

Financial performance

Performance reflects an organization's achievement in meeting its set goals. For management, successful performance encompasses attaining objectives such as profitability, growth, market share, and customer satisfaction. This involves meeting customer requirements in terms of price, quality, quantity, and timely delivery, as well as addressing workforce needs like fair compensation and job satisfaction. Although performance criteria may vary depending on the type of product or service, it generally entails the efficient utilization of resources to effectively transform inputs into desired outputs at the right cost, quality, quantity, time, and location. Financial performance refers to an organization's capacity to achieve its objectives, including generating profit, enhancing the value of invested capital, and meeting both short- and long term financial obligations. Financial ratio analysis has emerged as a key tool for assessing financial stability and growth potential, providing critical decision-making information for management and stakeholders. Evaluating financial performance typically relies on various analytical methods. Researchers have employed diverse measures to gauge organizational performance, such as net income and sales (Dollinger, 1984), Return on Investment (ROI), Return on Sales (ROS), and a combination of ROI and ROS (Pegels and Yang, 2000). Other metrics include Return on Assets (ROA) (Birley and Wiersema, 2000), market-to-book value of equity, profitability, and market share or growth (Entrialgo, Fernandez & Vazquez, 2000)

III. METHODOLOGY

This study adopted ex-post facto research design for the periods under study (2013-2017) as it allows collecting past. Ex post fact is actually a Latin word which stand for "after the fact" (Ary, Jacobs, Sorensen & Razavieh (2009). Thus, the researchers adopted Pearson Product Moment Correlation Coefficient statistical tool and multiple regression analysis were used to analyze the data with the aid of E-View version 9. The population of this study is made up of eleven (11) quoted SMEs which shares are actively traded in the Alternative Security Exchange Market (ASEM) in Nigeria Stock Exchange (NSE) as at April 29, 2013. These SMEs were so used because they were considered viable and seen to have the required capability to carry on SME business in Nigeria.

Model Specification

For the purposes of examining the relationship between taxation and financial



performance of quoted small and medium enterprises in Nigeria, a linear model will be built. Kozhan, (2010) reports that model specification is the determination of the endogenous and exogenous variables to be included in the model as well as the a priori expectation about the sign and the size of the parameters of the function. Based on the conceptual framework and hypotheses stated earlier, the model for this study will be specified as follows showing the functional, mathematical and econometric

relationships that exist between the independent and the dependent variables.

Functional Expression of model:

$$Y = f(X_1, X_2) \quad 1$$

$$FP = f(CIT, ET) \quad .2$$

Where:

IT, = Income Tax

FP =Financial Performance (ROI, ROA & CR)

The above equation 2 is trans-modified into econometrics form by adding constant term (α),slope(β) and error term (ϵ) in the model below:

IV. DATA PRESENTATION

The relevant data used in this study are presented in the tables below.

Education Tax=2% of PBT

Names of Quoted SMEs	2019	2020	2021	2022	2023
	N'000	N'000	N'000	N'000	N'000
Afrik pharmaceuticals plc,	1,3434	2,239.2	4,821	7,122	1,921
Amino International Plc (MRS)	81,912	137,865	157,645	204,413	162,832
Capital oil plc.	2,028,123	9,825,232	2,231,342	1,232,112	6,823,312
Chellarams plc,	5,412	5,653	4,012	70,168	4,054

Source: Authors' Desk, 2025 via Annual Reports and Accounts of Quoted SMEs

Table 2: Income Tax of Quoted SMEs from 2020-2024

Names of Quoted SMEs	2017	2018	2019	2020	2021
	N'000	N'000	N'000	N'000	N'000
Afrik pharmaceuticals plc,	7,231	18,313	12,453	19,123	30,654
Amino International Plc (MRS)	1,335,237	2,062,9212	2,365,812	2,502,454	2,543,121
Capital oil plc.	65,348,076	16,123,987	17,856,221	5,238,945	3,935,354
Chellarams plc,	96,821	119,421	4,232	519,354	16,021

Source: Annual Reports and Accounts of Quoted SMEs

Table 3. Return on Investment of the Quoted SMEs in Nigeria 2020-2024

Names of Quoted SMEs	2020	20201	2022	2023	2024
	%	%	%	%	%
Afrik pharmaceuticals plc,	0.012	0.043	0.112	0.287	0.012
Amino International Plc (MRS)	0.025	0.028	0.052	0.045	0.042
Capital oil plc.	0.037	0.543	0.125	0.076	0.898

Source: Authors' Desk, 2025 via Annual Reports and Accounts of Quoted SMEs

Table 4. Return on assets of the Quoted SMEs in Nigeria from 2017-2021

Names of Quoted SMEs	2017	2018	2019	2020	2021
	%	%	%	%	%
Afrik pharmaceuticals plc,	0.023	0.043	0.035	0.146	0.098
Amino International Plc (MRS)	0.052	0.035	0.038	0.036	0.023
Capital oil plc.	0.143	0.223	0.054	0.063	0.023
Chellarams plc,	0.023	0.054	0.024	0.147	0.038

Table 5: ADF Unit Root Test Output

Variables.	ADF statisti % Levels	ADF statisti Diff.	ADF statistic t-Statistic	Prob.*	Critical Value
IT	10%	3rd	-2.643534	-2.153233	0.2435
ROI	10%	3rd	-3.256334	-1.4053474	0.8654



ROA 10%	3 rd	-1.4058974	0.8335	-2.5446523	-1.4076574
CR 10%	3 rd	-3.225333	0.30334	-3.216765	0.1043

Source: Authors' Desk, 2025 via E-View 9

The table above indicates the result of Stationary using Augmented Dickey Fuller (ADF) unit root test. The results revealed that IT became stationary at the third difference with (ADF t-statistic value of -2.645534 with the test critical valve of -2.153423 at 10% level), ET became stationary at the second difference (ADF t-statistic value of -2.985565 with test critical value of 0.3424534) and ROI became stationary at the third difference (ADF t-statistic value of -3.235334 with test critical valve of -1.4058974 at 10% level). Similarly, ROA became stationary at the third difference (ADF t-statistic value of 1.4058974 with test critical valve of -2.5445323 10% level). Finally,

CR became stationary at the third difference (ADF t-statistic value of -3.225333 with test critical valve of -3.216445 at 10% level).

Correlation Analysis

Table below presents the correlation analysis results in a correlation matrix with all the variables in the study. The essence of the correlation analysis was to examine the inter relationships between the independent variables to check for multicollinearity. Pearson correlation analysis was used to achieve this end at 95% confidence level and done through E-View version 9.

Table 11: Correlation Matrix

	CIT	EDT	ROI	ROA	CR
CIT	1				
EDT	0.7846233	1			
ROI	-0.024323	0.233422	1		
ROA	-0.2023226	0.007684	-0.063483	1	
CR	-0.272654	-0.112345	-0.114342	-0.1972343	1

Correlation is significant at the 0.05 level (2-tailed)

Source: Authors' Desk, 2025 via E-View 9

The results established that ROI, ROA and CR have inverse relationship with CIT with a co-efficient of -0.024323, -0.024323 & -0.272654. This means that whenever tax burden on the business increase, it reduces the level of financial performance of the small and medium enterprises. On the other hand, education tax of the SMEs showed positive association with ROI & ROA coefficients of 0.236342, 0.005644 respectively. This implies that a unit change in tax will result to an increase in the financial performance of SMEs. However, CR indicated a negative relationship with tax with a coefficient of -0.179394 implying that an increase in tax burden will reduce the financial performance of SMEs.

V. DISCUSSION OF FINDINGS

The study examined has assessed the financial impact of Nigeria's new tax reform on small businesses. Strictly based on the result from the hypotheses tested, it was established that taxation has no significant relationship with financial performance of quoted SMEs in Nigeria in the period of this study. Taxation does not significantly influence return on investment of

quoted SMEs financial performance in Nigeria in the period of this study. Based on the findings, tax had an inverse and insignificant relationship with return on investment with values. This finding is in line with the findings of Derwent (2000) in a study to establish the relationship between tax expense and performance of SMEs in USA. He submitted that tax expense inversely influenced return on investment of SMEs. More so, taxation does not significantly influence return on investment of quoted SMEs financial performance in Nigeria in the period of this study. According to the findings, tax had a positive and insignificant relationship with return on investment with values. This does not support the findings by Were (2011) in a study to determine the relationship between presumptive income tax system and profitability of SMEs in Uganda. He concluded that presumptive tax negatively affects the profitability of SMEs.

VI. CONCLUSION

This study has assessed the financial impact of Nigeria's new tax reform on small businesses. The results show that the reform has both positive and negative effects on small businesses, including



increased tax burdens, reduced profitability, and improved tax compliance. The study concludes that policymakers should consider the unique needs and challenges of small businesses when designing tax policies. The research concluded that tax does not significantly relate with return on investment of quoted SMEs financial performance in Nigeria in the period of this study. Tax does not significantly relate with return on investment of quoted SMEs financial performance in Nigeria in the period of this study. Tax does not significantly relate with return on assets of quoted SMEs financial performance in Nigeria in the period of this study.

Recommendations

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

1. Policymakers should consider reducing tax rates for small businesses to reduce the tax burden and improve profitability.
2. Policymakers should simplify tax compliance procedures to reduce the administrative burden on small businesses.
3. Policymakers should provide training and support to small businesses to improve tax compliance and reduce errors.

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