

## **Effect Assessment of Value Added Tax (VAT) on Small and Medium Enterprises in Nigeria**

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| <i>*This Work is sponsored by Tertiary Education Trust Fund (Tetfund)</i> |
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### **ABSTRACT**

*This study investigates the multi-faceted impact of Value Added Tax (VAT) on Small and Medium Enterprises (SMEs) within the Nigerian context, with a significant emphasis on both the revenue-generating advantages that it offers and the myriad challenges that it creates for the operational activities of these enterprises. As much as VAT is an important and essential source of income for the government, it must be noted that SMEs are confronted with excessive compliance expenses, complicated and laborious filing procedures, and the burden of multiple taxation systems. All these factors serve as significant obstacles that limit their growth prospects and create a threat to their overall financial sustainability in a competitive business environment. The study employs mixed-method research, analyzing secondary data and contrasting Nigeria's VAT regime with international best practices in the United Kingdom, New Zealand, and the European Union. The study finds that streamlining VAT processes, broadening the tax base, and leveraging digital tax administration can minimize SME tax burdens without compromising fiscal effectiveness. Policy recommendations include tax education programs, small business exemption programs, and gradual VAT modification to balance between revenue needs and economic feasibility. A VAT system that is streamlined to reduce the cost of compliance and enhance administration effectiveness can pave the way to a more SME-friendly environment and encourage business and national economic expansion.*

**Keywords:** *Value Added Tax (VAT), small and medium enterprises (SMEs), tax compliance, revenue generation, economic growth.*

## 1. INTRODUCTION

Value Added Tax (VAT) is an important source of revenue and a means of economic development in Nigeria. It is a consumption tax applied at each point along the value-added chain of supply, which was introduced in 1993 to replace the Sales Tax.<sup>1</sup> VAT contributes immensely to the total revenue collection and economic growth of the country.<sup>2</sup> VAT has been shown to positively impact resource mobilization and capital formation in Nigeria.<sup>3</sup> Taxation plays a vital role in generating revenue for governments worldwide, enabling the provision of public goods, infrastructure, and social services. In this regard, VAT has emerged as one of the key forms of indirect taxation among various taxing systems and finds widespread acceptance because it works efficiently in raising revenue and is neutral in business transactions. While VAT revenue increased over time, some researchers indicated that increasing VAT collection could further improve tax revenue. This can be done not by raising the current 5 percent rate but by addressing revenue leakages, improving awareness among company managers, and improving training for tax collection staff.<sup>4</sup> Overall, VAT is considered to be an ideal form of taxation in the Nigerian system due to its relative ease of administration and difficulty to evade.<sup>5</sup>

SMEs are an integral part of the economic framework in Nigeria, having a high contribution to the country's GDP and employment. According to the National Bureau of Statistics, it is reported that about 48% of the GDP is contributed by SMEs and about 84% of the workforce is employed by them.<sup>6</sup> These are enterprises that are important in driving innovation, creating entrepreneurship, and reducing unemployment and poverty. Despite these contributions, SMEs in Nigeria face some

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<sup>1</sup> Federal Inland Revenue Service. *Value Added Tax (VAT) Overview*. 1993.

<https://old.firs.gov.ng/wp-content/uploads/2021/06/VALUE-ADDED-TAX-VAT-9304.pdf> (Accessed 28th January 2025)

<sup>2</sup> Juliana, Manukaji Ijeoma, and Nwadiakor Eugene Okoye. "Assessment of the contribution of value added tax to the Nigerian economy." *International Journal of Social Sciences and Management Research* 2.1 (2016): 45-56.

<sup>3</sup> O. Izedonmi, F., and J. A. Okunbor. "The Roles of Value Added Tax in the Economic Growth of Nigeria". *Journal of Economics, Management and Trade*, vol. 4, no. 12, Aug. 2014, pp. 1999-07, doi:10.9734/BJEMT/2014/11013.

<sup>4</sup> Juliana (n2) 1

<sup>5</sup> Federal Inland Revenue Service (n1) 1

<sup>6</sup> National Bureau of Statistics. *Micro, Small and Medium Enterprises (MSMEs) Survey Report 2021*. Federal Government of Nigeria, 2021, <https://www.nigerianstat.gov.ng/pdfuploads/MSMES.pdf?> (Accessed 28th January 2025)

challenges that affect their growth and sustainability. Among these is limited access to finance, thereby limiting their potential for expansion of operations and investment in new technologies. According to the World Bank, most SMEs in developing countries, including Nigeria, experience huge financing gaps that seem to be one of the main barriers to their growth.<sup>7</sup> These operational challenges are further exacerbated by infrastructural deficiencies in the form of inadequate and unreliable power supply, among other issues related to transportation networks. These infrastructural inadequacies make production costs high and reduce the efficiency of service delivery, thus affecting the competitiveness of SMEs in both local and international markets.<sup>8</sup> Furthermore, complicated regulatory frameworks and onerous compliance requirements pose major obstacles. While the VAT system is important to generate revenue, it often adds more financial and administrative burdens on SMEs. High tax rates, complicated filing procedures may increase compliance costs and take away from the core business activities.<sup>9</sup> A study on VAT compliance among Nigerian SMEs indicated that high tax rates and complicated filing procedures are one of the main reasons for non-compliance.<sup>10</sup> This would definitely help improve SMEs' performances and sustainability in Nigeria. Supportive policies, access to finance, infrastructure upgrade, and simplification of tax compliance procedures are key areas that will help boost the SME sector and, consequently, economic growth and development.<sup>11</sup>

The relationship existing between VAT and SMEs in Nigeria is very complex. On one hand, VAT compliance may lead to increased operational costs, cash flow constraints, and administrative challenges related to tax filings. On the other hand, adherence to VAT regulations can facilitate the formalization of businesses, thus providing SMEs with access to benefits accruing from input tax credits and competitiveness in wider markets. This duality underlines the need for

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<sup>7</sup> World Bank. *Small and Medium Enterprise Finance: Bridging the Gap*. World Bank Group, 2022, [www.worldbank.org/en/topic/sme/finance](http://www.worldbank.org/en/topic/sme/finance). (Accessed 28<sup>th</sup> January 2025)

<sup>8</sup> Etuk, Reuben Ufot, Etuk Grace Reuben & Baghebo Michael. "Small And Medium Scale Enterprises (SMEs) And Nigeria's Economic Development." *Mediterranean journal of social sciences* 5 (2014): 656.

<sup>9</sup> PwC Nigeria. *MSME Survey Report 2024*. 2024. <https://www.pwc.com/ng/en/assets/pdf/msme-survey-report-july-2024.pdf> (Accessed 28<sup>th</sup> January 2025)

<sup>10</sup> Kadiri, Ismaila Bolarinwa. "Small and medium scale enterprises and employment generation in Nigeria: The role of finance." *Arabian Journal of Business and Management Review (Kuwait Chapter)* 1.9 (2012): 79-93.

<sup>11</sup> Egbiremolen, Godstime Osekhebhen and Francis Illeloa Igberaese. "Small and Medium Enterprises Financing and Economic Growth in Nigeria: An Econometric Analysis." *Journal of economics and sustainable development* 4 (2013): 52-58.

critical assessment of the impact of VAT on SMEs and how avenues can be created to make the tax environment more supportive.<sup>12</sup>

The research combines mixed quantitative and qualitative methods to study VAT's consequences for Nigerian SMEs and their operational capacity and financial prospects with growth potential. A combination of quantitative and qualitative research methods helps produce an extensive understanding of VAT's effect on SMEs operating under the present tax regulations. The research depends on secondary information obtained from government reports and academic journals, as well as industry surveys. The Federal Inland Revenue Service (FIRS), together with the National Bureau of Statistics (NBS) and Central Bank of Nigeria (CBN), releases government reports that expose VAT revenue patterns and explain compliance expenses as well as regulatory standards. The current study uses peer-reviewed academic publications to understand VAT administrative challenges for SMEs, together with industry survey data, which shows first-hand information about business implications and operational difficulties.

Policy frameworks, as well as administrative issues and global best practices, are analyzed using legislative documents combined with tax policy reports and expert opinions in this qualitative segment of research. Case studies together with interviews will be used as supporting evidence to show how Nigerian SME businesses have experienced the VAT system. Statistical methods evaluate how VAT affects SMEs from a financial perspective to determine their profitability and pricing strategies as well as economic performance. A mixed-methods research design allows complete analysis to evaluate fundamental challenges to shape meaningful policy recommendations. The study intends to direct tax policy changes that combine revenue objectives for Nigeria with efforts to support small and medium enterprise growth necessary for both economic transformation and economic system stability.<sup>13</sup> More importantly, it would make policy recommendations to balance the need for revenue generation with that of fostering the development of SMEs as a major factor in the economic resilience and diversification of the Nigerian economy.

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<sup>12</sup> Aikor, Shirgba Timothy. "Small and Medium Enterprises (SMEs): Key to Socio-Economic Development of Nigeria." *International Journal of Research and Innovation in Social Science* 5.12 (2021): 866-872.

<sup>13</sup> Adhikari, Ramesh, and Tatwa Prasad Timsina. "An Educational Study Focused on the Application of Mixed Method Approach as a Research Method." *OCEM Journal of Management, Technology & Social Sciences* 3.1 (2024): 94-109. <https://doi.org/10.3126/ocemjmtss.v3i1.62229> (accessed 29th )

## **2. Understanding Value Added Tax (VAT)**

Value-added tax is a type of consumption tax leveled along the chain of production and distribution. It should be a very good guide to ascertain the value that is produced by any country through production and is applied to every business in relation to production and the distribution of goods and services. VAT is collected fractionally through a system of deductions, allowing businesses to deduct their VAT liability from the tax paid on purchases. Though businesses collect and remit the tax, it is borne by the final consumer and is therefore an indirect tax. VAT has become the most popular sales tax globally, capable of raising substantial revenue of 5-10% of GDP without creating economic distortions.<sup>14</sup> Its adoption differs among countries; some have used it to replace multiple sales tax laws. In Nigeria, VAT was introduced in 1993 through the Value Added Tax Decree No. 102 of 1993, replacing the previous sales tax system to enhance revenue generation and tax administration efficiency.<sup>15</sup>

Decree Number 102 of 1993 was thus the legal foundation for VAT in Nigeria. Through the years, this decree went through several amendments to meet the changing economic realities and to make the tax regime work effectively. The VAT Act spells out the goods and services that are taxable, those exempted from tax, the rates of tax, and the administrative arrangements.<sup>16</sup> The following are the critical elements of VAT in Nigeria:

**1. Taxable Items:** VAT is charged on all goods and services, unless it is specifically exempted under the VAT Act. Exemptions normally include, but are not limited to, food items, medical and pharmaceutical products, and educational materials.

**2. Current Rate:** The current VAT rate in Nigeria is 7.5%, increased from 5% in 2020 due to measures that were needed to increase government revenue.

**3. Collection Mechanism:** VAT works on an input-output mechanism. It is collected on sales, that is, output VAT by the business entity, which is set off against the input VAT, the amount paid for purchases, and the balance is paid to the government.

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<sup>14</sup> Federal Inland Revenue Service (n1) 1

<sup>15</sup> Federal Republic of Nigeria. *Value Added Tax Decree No. 102 of 1993*. Available at [https://www.icnl.org/wp-content/uploads/Nigeria\\_9\\_NigeriaVAT1993.pdf](https://www.icnl.org/wp-content/uploads/Nigeria_9_NigeriaVAT1993.pdf) (accessed on 28th January 2025)

<sup>16</sup> Ibid

**4. Filing and Compliance:** Businesses registered for VAT are under an obligation to file their monthly VAT returns, remit collected tax by the 21st day of the following month, failure of which is susceptible to a series of fines and interest payments on the accrued amount owed (Federal Inland Revenue Service).<sup>17</sup>

VAT is a significant source of income for the Nigerian government, while making huge contributions to non-oil revenues. According to statistics from the Central Bank of Nigeria, the collections from VAT have been growing upwards in an unbroken fashion, with the receipts rising from ₦1.19 trillion in 2019 to over ₦2.07 trillion in 2022. This growth demonstrates VAT's contribution toward funding key sectors like education, health, and infrastructure development.<sup>18</sup> Value-added tax has come to be a very important source of generating revenue for the government of Nigeria. The share of VAT within the total tax revenue in Nigeria was approximately 27.0% in the previous years. The high contribution determines the great role of the VAT in funding public services and infrastructure development.<sup>19</sup>

### **3. The Relationship between VAT and SMEs**

#### ***Compliance Requirement***

The relationship between VAT and compliance requirements for SMEs in Nigeria is very complex, with many factors playing their role. While the size, profit, and turnover of SMEs have a significant positive impact on VAT compliance, the number of employees and customers has an insignificant effect.<sup>20</sup> In Nigeria, the requirement for registration for Value Added Tax with the Federal Inland Revenue Service is imposed on SMEs when their annual turnover exceeds ₦25 million. Any registered SME shall maintain proper records of all taxable transactions; issue VAT-compliant invoices; and file monthly VAT returns on or before the 21st day of the

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<sup>17</sup> Ibid

<sup>18</sup> Central Bank of Nigeria. *2022 Annual Economic Report*. Available at <https://www.cbn.gov.ng/Out/2024/RSD/2022%20ANNUAL%20REPORT.pdf> (accessed 29<sup>th</sup> January 2025)

<sup>19</sup> Organisation for Economic Co-operation and Development (OECD). *Revenue Statistics in Africa 2024*. Available at <<https://www.oecd.org/tax/tax-policy/revenue-statistics-africa-nigeria.pdf>> (accessed on 28th January 2025)

<sup>20</sup> Ojo, Azeez Olasunkanmi, and Saheed Akande Shittu. "Value Added Tax compliance, and Small and Medium Enterprises (SMEs): Analysis of influential factors in Nigeria." (2023) 10(2) *Cogent Business & Management*. Available at <https://doi.org/10.1080/23311975.2023.2228553> (accessed 28th January 2025)

month following that for which the value-added tax is payable. These include obligations of keeping proper records and accounting for taxes accurately to avoid fines and remain compliant.<sup>21</sup>

Research on VAT compliance among Nigerian SMEs reveals several influential factors. SME characteristics like business age, turnover, and industry class have a negative but insignificant effect on VAT compliance costs.<sup>22</sup> Taxpayer perception, organizational characteristics, compliance costs, and VAT implementation efficacy significantly impact compliance, with SME size and profit level having positive effects.<sup>23</sup> Penalty magnitude, subjective norms and perceived behavioral control are positively related to VAT compliance intention while attitude towards compliance is negatively related, as evidenced by Gimba & Ibrahim 2017.<sup>24</sup> VAT has the highest tax compliance cost among SMEs. The manufacturing SMEs have the highest compliance cost. SMEs engaged in export face higher burdens than those not exporting as Eragbhe & Modugu 2014 stated.<sup>25</sup> These findings point to a need for simplified compliance processes and targeted incentives to reduce the burden on SMEs.

### **Impact on Financial Performance**

Studies have shown that compliance with Value Added Tax is costly for Small and Medium Enterprises and, therefore, impacts their financial performance. Compliance costs depend on the factors of turnover, complexity of regulations, and business characteristics. These costs can be particularly burdensome for SMEs, potentially

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<sup>21</sup> Avalara. "Nigerian VAT Rates and VAT Compliance." *Avalara VATlive*, Avalara, <https://www.avalara.com/vatlive/en/country-guides/africa-and-middle-east/nigeria/nigerian-vat-rates-and-vat-compliance.html>. Accessed 29 Jan. 2025.

<sup>22</sup> Eragbhe, Emmanuel and Alade Sule Omoye. "SME Characteristics and Value Added Tax Compliance Costs In Nigeria." (2024) 5(20) *Mediterranean journal of social sciences*: 614. Available at <https://www.richtmann.org/journal/index.php/mjss/article/view/3772> (accessed 28th January 2025)

<sup>23</sup> Ojo, A. I.O and Saheed Akande Shittu. "Value Added Tax compliance, and Small and Medium Enterprises (SMEs): Analysis of influential factors in Nigeria." [2023] 10(2) *Cogent Business & Management*: Available at < <https://doi.org/10.1080/23311975.2023.2228553>> (accessed on 28<sup>th</sup> January 2025)

<sup>24</sup> Gimba, Hannatu Yohanna and Idawati Ibrahim. "SMEs' View on the Theory of Planned Behaviour and Penalty Magnitude: Preliminary Findings from Nigeria." (2018) 4(1) *Journal of Business and Social Review in Emerging Economies* : 61-72. Available at < <https://www.semanticscholar.org/reader/f0c2e180f5d4a2a835d44a4313499357418dad6b>> (accessed 28<sup>th</sup> January 2025)

<sup>25</sup> Eragbhe & Modugu (n21)

hindering their growth and development.<sup>26</sup> For example, studies show that VAT complexity and compliance costs are some of the significant factors contributing to SMEs' non-compliance.<sup>27</sup> High costs of implementing VAT systems threaten the survival of small businesses. A study that examined VAT compliance among Nigerian SMEs established that high tax rates and complicated filing procedures are among the major causes of non-compliance.<sup>28</sup> The administrative burden arising from compliance with the VAT may shift resources away from core business activities and, therefore, affect profitability and growth.

SMEs often face administrative challenges in meeting their VAT obligations. The complexity of the filing procedures, frequent changes in tax laws, and the requirement for specialized knowledge in tax matters make compliance difficult. Besides, the multiplicity of taxes at the federal, state, and local levels adds to the burden of compliance. These challenges can lead to unintentional non-compliance, exposing SMEs to penalties and interest charges.<sup>29</sup>

#### **4. Challenges of VAT for SMEs in Nigeria**

##### **High Compliance Costs:**

The cost of compliance with VAT in Nigeria is high for Small and Medium Enterprises. A study by Eragbhe and Omoye found that the average compliance cost of tax for SMEs is about ₦108,594 annually, while VAT was about 33% of the total cost. Such costs involve record-keeping costs, tax filing costs, and professional costs that may overstretch the usually limited financial resources of SMEs.<sup>30</sup> Studies have also shown that VAT compliance is particularly burdensome to SMEs, taking away valuable resources from the business. Various studies have also shown that compliance costs of VAT are high, regressive, and have not reduced over time despite several reforms. For example, Lignier and Evans found that tax compliance

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<sup>26</sup> Faridy, Nahida et al. "Complexity, Compliance Costs and Non Compliance with VAT by Small and Medium Enterprises in Bangladesh: Is There a Relationship?" *Emerging Markets Economics: Firm Behavior & Microeconomic Issues eJournal* (2014): Available at <<https://dx.doi.org/10.2139/ssrn.2479146>> (accessed 27<sup>th</sup> January 2025)

<sup>27</sup> Ibid

<sup>28</sup> Ibid

<sup>29</sup> Omodero, Cordelia Onome. "Value Added Tax Compliance and Small and Medium Enterprises in Nigeria." *Cogent Business & Management*, vol. 10, no. 1, 2023, pp. 1-15.  
<https://www.tandfonline.com/doi/full/10.1080/23311975.2023.2228553> (accessed 29 January 2025)

<sup>30</sup> Eragbhe & Modugu (n21)

costs for Australian SMEs have increased, attributing this rise to the introduction of sales taxes, which necessitated extensive accounting records.<sup>31</sup>

SMEs are mostly characterized by a lack of understanding of the complex VAT regulations coupled with a lack of appropriate books and records. Wadesango commented that the complexity of tax legislation results in SMEs being uninformed and thus non-compliant due to ignorance. This complexity dictates that SMEs seek the services of tax experts, which also increases compliance costs.<sup>32</sup> High VAT systems collection costs can always jeopardize the very existence of small businesses. Wadesango indicated that the stress of compliance might lead to diminished profitability and, in the worst case, may bring them to a complete closure when the SME is not able to manage the administrative demands of complying with it.<sup>33</sup>

The few studies conducted on VAT compliance costs estimated high VAT compliance costs in relation to tax revenue for both developed and developing countries. Vishnuhadevi<sup>34</sup> reviewed literature on VAT compliance costs and found that compliance costs were higher and more significant both in absolute terms and with regard to their relationship to tax revenue in developed and developing countries. The study estimated that compliance costs are highly regressive, thus falling most heavily on small businesses.<sup>35</sup> These challenges, therefore, need targeted policy interventions that focus on simplifying the tax environment and reducing compliance costs to enable the sustainability and growth of SMEs.

### **Limited Awareness:**

In practice, many operators of SMEs are not knowledgeable about the many laws and regulations regarding VAT to avoid unintentional non-compliance. The implications of this can be incorrect submissions, miscalculations in the VAT charged, and deadlines missed, putting the business into a vulnerable position

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<sup>31</sup> Lignier, Phil, Chris Evans, and Binh Tran-Nam. "Tangled up in tape: The continuing tax compliance plight of the small and medium enterprise business sector." (2014) 29(2) *Austl. Tax F.* : 217-247. Available at < <https://dx.doi.org/10.2139/ssrn.2479153> > (accessed 29 January 2025)

<sup>32</sup> Wadesango, Newman, and Gift Chirebvu. "The impact of Value Added Tax (VAT) on small and medium enterprises in a developing country." *Academy of Accounting and Financial Studies Journal* 24.Special Issue 2 (2020): 1-12.

<sup>33</sup> Ibid

<sup>34</sup> Vishnuhadevi, S.. "Administrative and Compliance Costs of Value Added Tax (VAT): A Review." *Review of Development and Change* 26(2) (2021): 179 - 206. Available at <https://doi.org/10.1177/09722661211058807> (accessed 29 January 2025)

<sup>35</sup> Ibid

regarding penalties and interest charges. This is worsened by complexities in tax legislations, thereby making it more difficult for the SMEs to keep themselves informed and compliant.<sup>36</sup>

### **Multiple Taxation:**

Multiplicity of taxes levied on SMEs by the three tiers of government-federal, state, and local-is quite burdensome on the SMEs, which in turn reflects adversely on their financial performance. According to Alfred et al.<sup>37</sup>, multiple taxes have impacted negatively on the growth of SMEs in Nigeria, as many operators were unwilling to venture into new enterprises or expand existing ones due to the fear that multiple taxes may consume a greater proportion of their earnings. Addressing these challenges is, therefore, critical in the creation of an enabling environment for SMEs in Nigeria. Such policy interventions as simplifying tax procedures, conducting tax education programs, and streamlining the tax system to reduce multiple taxation burdens would improve compliance and hence contribute to the sustainability and growth of SMEs.

## **5. Comparative Analysis and Case Studies**

A comparative analysis of Nigeria's Value Added Tax (VAT) system with those of other countries can provide valuable insights into best practices and potential areas for reform. This analysis will focus on key aspects such as VAT rates, base broadness, compliance mechanisms, and administrative efficiency.

### **VAT Rates and Revenue Generation**

Comparable to its Economic Community of West African States (ECOWAS) average the Value Added Tax (VAT) rate in Nigeria stands at 7.5%. The relatively low 7.5% VAT rate minimizes Nigeria's VAT revenue generation despite the problems caused by both a restricted tax base and multiple exemptions. South Africa keeps its Value Added Tax rate at 15% while adopting policies which extended tax base contributions to generate higher tax revenue streams. The International Monetary Fund (IMF) recommends that Nigeria would receive increased revenue

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<sup>36</sup> Omodero, Cordelia Onome. "Value Added Tax Compliance and Small and Medium Enterprises in Nigeria." *Cogent Business & Management*, vol. 10, no. 1, 2023, pp. 1–15.  
<https://www.tandfonline.com/doi/full/10.1080/23311975.2023.2228553> (accessed 29 January 2025)

<sup>37</sup> Alfred, Sani Ilemona, et al. "Effects of Multiple Taxation on the Growth of Small and Medium Enterprises in Nigeria." *Journal of Taxation and Economic Development*, vol. 18, no. 2, 2019, pp. 1–8.  
<https://ideas.repec.org/a/ris/jotaed/0012.html> (accessed 29th January 2025)

benefits from raising VAT rates to domestic market standards and simplifying exception rules to expand taxable revenue sources.<sup>38</sup> According to IMF guidelines Nigeria will gradually increase its Value Added Tax from 7.5 percent up to 10 percent in 2025 and eventually reaching 15 percent in 2026.<sup>39</sup> This phased rate rise targets higher revenue flows by accommodating businesses and consumers throughout the transition. Support from IMF highlights that Nigeria must enlarge its tax base through two strategies: first eliminate tax exemptions and second improve overall taxpayer compliance. Enhancing the number of taxable properties while incrementing the VAT rate would elevate Nigeria's total revenue and enable crucial financial allocations to social services and infrastructure development.<sup>40</sup>

### **Compliance Mechanisms and Administrative Efficiency**

The characteristics that define effective VAT systems include regimes of compliance that are efficient, as well as strong administrative frameworks. HMRC in the UK uses only one tax administration system, which makes tax processes both simple and compliant. HMRC has given very elaborate guidelines on how businesses can manage accounting and compliance processes of VAT, including risk and control design considerations.<sup>41</sup> The UK VAT system is well known for administrative efficiency, simplicity, and clarity, thus ensuring that it is easy for the taxpayers to comply. HMRC's Guidelines for Compliance (GfC8) emphasize that it is essential to adopt technology in managing complex and novel risks across tax regimes, including VAT. This approach underlines the UK's commitment to using technology to simplify tax administration and enhance compliance.<sup>42</sup> On the other hand, it is said that Nigeria's tax administration is very complex and less efficient, as there are several tax authorities both at federal and state levels. Such compliance and enforcement challenges blame these reasons. A value-added tax system in Nigeria

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<sup>38</sup> International Monetary Fund. *Nigeria: Selected Issues*. IMF Country Report No. 22/34, 2022. <https://www.imf.org/-/media/Files/Publications/CR/2022/English/1NGAEA2022002.ashx> (accessed 29th January 2025)

<sup>39</sup> Ibid

<sup>40</sup> Ibid

<sup>41</sup> HM Revenue & Customs. *General Approach to VAT Compliance Controls (GfC8)*. UK Government, 2023. <https://www.gov.uk/government/publications/help-with-vat-compliance-controls-guidelines-for-compliance-gfc8/general-approach-to-vat-compliance-controls-part-2> (accessed 29th January 2025)

<sup>42</sup> Vertex Inc. *UK's VAT Guidance Highlights Urgent Need for Tech Adoption*. 2023. <https://www.vertexinc.com/resources/resource-library/uks-vat-guidance-highlights-urgent-need-tech-adoption> (accessed 29th 2025)

was established by the Value Added Tax Act of 1993; this has over time been criticized as being complicated and ineffacious. A study by PwC Nigeria listed some of the key challenges that have made doing business and complying with taxes difficult in the country to include multiple VAT compliance requirements and a largely fragmented tax administration system.<sup>43</sup> As such, the consideration of Nigeria toward a unified tax administration system will improve compliance mechanisms and administrative efficiency, drawing from the UK's HMRC model. It would also require the inclusion of full guidelines on VAT compliance, encouraging technology adoption in tax processes, and defining clear limits on the role of different tax authorities in streamlining tax processes to ease compliance by taxpayers.

### **Broadness of Tax Base**

In developing an effective system of Value Added Tax, its broad base minimizes exemptions, which is common in most standard models. One of the unique features of this system is demonstrated by New Zealand's Goods and Services Tax Act, which requires a single GST rate of 15% in respect of many goods and services with few cases of exemption. This simplicity minimizes administrative complex issues and gives maximum revenue.<sup>44</sup> Contrastingly, Nigeria's VAT is saddled with numerous exemptions and a narrow base, hence the low revenue realizations. The International Monetary Fund has argued that Nigeria has to rationalize the list of VAT exemptions in order to basically reduce it to commodities that take up a wide share of the consumption basket of the poor, and therefore widen the tax base at the same time as maintaining equity.<sup>45</sup> A broad-based tax with limited exemptions would provide a better revenue outcome for Nigeria's VAT and also improve compliance, learning from the New Zealand model of GST.

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<sup>43</sup> PwC Nigeria. *How to Fix Nigeria's Broken VAT System*. 2021.

[https://pwc-nigeria.typepad.com/tax\\_matters\\_nigeria/2021/09/how-to-fix-nigerias-broken-vat-system.html](https://pwc-nigeria.typepad.com/tax_matters_nigeria/2021/09/how-to-fix-nigerias-broken-vat-system.html) (accessed 29th January 2025)

<sup>44</sup> Tax Working Group. *GST: Background Paper*. New Zealand Government, 2018.

<https://taxworkinggroup.govt.nz/sites/default/files/2018-09/twg-bg-gst.pdf>. (accessed 29<sup>th</sup> January 2025)

<sup>45</sup> International Monetary Fund. *Nigeria: Selected Issues Paper*. IMF, 2023.

<https://www.elibrary.imf.org/view/journals/018/2023/019/article-A001-en.xml> (accessed 29th January 2025)

## **6. Policy Recommendation**

In order to build a more friendly and supportive environment for Nigeria's Small and Medium-sized Enterprises (SMEs), it is most critical to prioritize a range of key policy recommendations. These must include simplifying Value Added Tax (VAT) compliance processes, strengthening current tax education programs, and a careful review of current VAT rates.<sup>46</sup> By simplifying VAT registration and filing processes, a significant opportunity is presented to ease the administration burden that is most often placed on SMEs. This practice has been effectively proven through the European Union's SME scheme, for example, exempting smaller companies from many VAT requirements and simplifying reporting requirements, according to information presented in a report shared by the European Commission.<sup>47</sup> Also, having strong tax education programs in place is also important in an attempt to enhance overall awareness amongst SMEs about VAT laws. This improvement would, in fact, contribute towards a lessening in cases of unintended VAT non-compliance, particularly amongst small and medium-sized companies. Notable programs, such as VAT School and VAT Symposium, both of which are run through the Institute for Professionals in Taxation (IPT), contribute towards providing professionals with in-depth training in VAT compliance.

In addition, such programs include utilizing modern technology in tax administration, according to information shared through the Institute for Professionals in Taxation.<sup>48</sup> In addition, revising Nigeria's current VAT rate could have a significant contribution towards lessening financial burdens placed on SMEs and could even stimulate national economic growth. Several studies reveal that such a review could boost disposable incomes, promote increased consumption, and stimulate expansion in businesses.<sup>49</sup> Nevertheless, it is important to remember that any such actions in such a direction must be balanced with the continued necessity

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<sup>46</sup> Inim, Victor E., Francis Sylvanus Udoh, and Uzoma Samuel Ede. "Taxation and the Growth of Small and Medium Enterprises in Nigeria." *Asian Journal of Social Sciences and Management Studies* 7.3 (2020): 229-235. Available at <https://doi.org/10.20448/journal.500.2020.73.229.235> (accessed 29th January 2025)

<sup>47</sup> European Commission. "Simplified VAT Rules for Small Businesses." *EU VAT Rules*, European Union, 2025, [https://sme-vat-rules.ec.europa.eu/index\\_en](https://sme-vat-rules.ec.europa.eu/index_en). (accessed 29th January 2025)

<sup>48</sup> Institute for Professionals in Taxation. "Value Added Taxation (VAT)." *IPT Programs and Schools*, IPT, <https://www.ipt.org/site/content/programs-and-schools/Value-Added-Taxation-VAT.aspx>. (accessed 29th January 2025)

<sup>49</sup> Agu, E. E., et al. "A model for VAT standardization in Nigeria: Enhancing collection and compliance." *Finance & Accounting Research Journal* 6.9 (2024): 1677-1693. Available at <https://doi.org/10.51594/farj.v6i9.1594> (accessed 29th January 2025)

of generating enough revenue, according to information shared through the Brookings Institution. By taking such proactive actions, Nigeria can strive towards creating a VAT system that is not only efficient but fair, and in doing so, promote SME development at the same time, and a secure and reliable source of tax revenue base.<sup>50</sup>

### **Implications of the Policy Recommendations in Nigeria's Economic Trends**

Against Nigeria's current economic background, characterized by high inflation, a volatile foreign exchange environment, reduced government incomes, and a sharp increase in the cost of doing business, proposed VAT policy recommendations stand to have significant implications for SMEs and for the overall range of economic growth.<sup>51</sup> VAT compliance simplification through simplification of registration processes and filing requirements could have a significant impact in terms of ease of doing business, particularly for SMEs, whose operations have been hindered by complications in dealing with requirements for taxes.<sup>52</sup>

Nigeria's tax system is often criticized for its inefficient bureaucracies, compounded by the presence of several layers of taxes levied at several layers of government, creating cumbersome compliance requirements.<sup>53</sup> Adopting a less complex VAT scheme, similar to SME scheme adopted in the European Union, could have a significant impact in terms of persuading a larger proportion of SMEs to register and become formally compliant with taxes. Transitioning towards such a scheme, in addition to widening the base, could instill a compliance culture in companies. That being said, one must appreciate that successful rollout of such a reform will require significant investments in enhancing Nigeria's information and communications technology infrastructure and in coordination between disparate tax administration departments, particularly in view of Nigeria's current disorganized

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<sup>50</sup> William G. Gale, Hilary Gelfond & Aaron Krupkin (2016). Entrepreneurship and Small Business under a Value-Added Tax. *Brookings Institution*, Brookings, <https://www.brookings.edu/articles/entrepreneurship-and-small-business-under-a-value-added-tax/>. (accessed 29<sup>th</sup> Janu 2025)

<sup>51</sup> Oluremi, Deborah Oluwadunmininu and Owen Affor Maku. "Small and Medium Scale Enterprises and Nigeria Economic Growth." (2024)12 (5) *International Journal of Small Business and Entrepreneurship Research*: 71-89. Available at <https://doi.org/10.37745/ijbsber.2013/vol12n590106> (accessed 29th January 2025)

<sup>52</sup> Ibid

<sup>53</sup> Ewim, C. P. M., et al. "A policy model for standardizing Nigeria's tax systems through international collaboration." (2024) 6(9) *Finance & Accounting Research Journal*. Available at <https://doi.org/10.51594/farj.v6i9.1595> (accessed 29th January 2025)

system.<sup>54</sup> Second, strengthening tax educational programs is a must and will represent a critical intervention in terms of curbing cases of accidental non-compliance.

Many SMEs in Nigeria lack proper awareness about applicable VAT legislation at present. In a competitive environment in a marketplace with high incidences of informal operations, institution of widespread educational programs, similar to ones adopted in IPT's VAT training programs, could have a critical role in raising compliance at a will level, at the same time curbing evasion cases. That being said, with high illiterate cases in Nigeria, one must make a case for having educational programs for taxes designed in a manner that addresses diversity in terms of segments in a marketplace and incorporates vernacular language and use of information and communications technology for dissemination in a manner that maximizes impact and covers a larger base.<sup>55</sup>

A downward VAT review opens a scenario with both opportunity and challenge that must be considered with care. With Nigeria's VAT at 7.5%, one of the lowest in all of West Africa, any additional drop could result in increased liquidity for business, increased consumption, and, in turn, a stimulation of activity in many sectors of the economy.<sup>56</sup> Yet, it must be considered that Nigeria's economy is particularly reliant on VAT for non-oil sources of revenue, particularly in a background of ongoing budget deficits and growing debt, with which Nigeria is confronted.<sup>57</sup> Were VATs reduced and no alternative sources of funding developed, then government finance could suffer and funding for key public goods and services, such as infrastructure and healthcare, could fall, with a knock-on impact for key sectors of society and economy alike. Policymakers must, therefore, tread with care, balancing any cutting of taxes with overall strategies for widening the base of taxes collected, including a drive towards a larger proportion of companies becoming formally incorporated and taking actions to curtail leakages in taxes collected. While proposed policy options have potential to stimulate development in SMEs, it must be that such takes careful consideration in relation to overall economic realities in

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<sup>54</sup> Ibid

<sup>55</sup> Ibid

<sup>56</sup> Oto, Theresa Ekpe, and Solomon Wayas. "Value Added Tax and Economic Growth of Nigeria (2003-2022)." *FUDMA Journal of Accounting and Finance Research [FUJAfr]* 2.1 (2024): 16-30. Available at <https://doi.org/10.33003/fujafr-2024.v2i1.74.16-30> (accessed 29th January 2025)

<sup>57</sup> Chinonso Success, Azuka et al. "An Extensive Examination of Taxation as an Accelerator for Economic Growth in Nigeria." (2024) 9(5) *International Journal of Innovative Science and Research Technology (IJISRT)* (2024): Available on <https://doi.org/10.38124/ijisrt/IJISRT24MAY1091> (accessed 29th January 2025)

Nigeria. That a phased review, with a simplification and educational drive towards compliance first, and in parallel and with care, a review of VATs, is a wise move, one that will serve to maintain strong sources of revenue and not have them eroded, and one that will promote development in a SME-friendlier environment, one conducive to entrepreneurship and overall stimulation in economy and society alike.

## **7. Conclusion**

Value-added tax has remained a very vital source of government revenue in Nigeria, given its contribution to non-oil tax collections. Still, careful implementation is important to avoid placing unjustified burdens on the SMEs-the backbone of the economy of Nigeria. The challenge here, then, is how best to optimize tax revenue without defeating the goal of an enabling business environment that could see SMEs grow and prosper. High compliance costs for Value Added Tax, administrative complexities, and multiple layers of taxation continue to constrain the growth of SMEs. International good practices, such as the exemption scheme in the European Union on SMEs from VAT and the broad-based system in New Zealand, have suggested that reforms must be centered on simplification, efficiency, and equity. A well-structured VAT system would minimize compliance cost and enhance administrative efficiency in order to facilitate voluntary compliance, widen the base, and hence support sustainable growth.

Policymakers should appreciate the peculiar challenges SMEs face in VAT administration and introduce targeted reforms to address them. Simplification of VAT registration and filing procedures, investment in digital tax administration, and comprehensive tax education programs for small businesses would go a long way in improving compliance levels. Additionally, the review of VAT rates, while being considerate of Nigeria's fiscal realities, can ease the financial burden on SMEs without affecting the revenue generation for the government. A prudent VAT regime, which is business-friendly and fiscally responsible, has to be jointly developed by the government, tax authorities, business associations, and financial institutions. With a phased and strategic approach to reforming VAT, Nigeria has the potential to further improve its revenue mobilization while creating an enabling environment for growth and sustainability of its SME sector, and ultimately long-term economic prosperity.

## Acknowledgement

We would like to express our profound gratitude and deep regards, especially to the Tertiary Education Trust Fund (TETFUND) for the provision of the grant (funding) for this research project and Isaac Jasper Boro College of Education, Sagbama, Bayelsa State, Nigeria, for the enabling environment to conduct and complete the study.

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