

## **ARE TAX INCENTIVES STIMULATING SMEs' COMPETITIVENESS IN NIGERIA? A CRITICAL EXAMINATION**

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### **Abstract**

*A major objective of tax incentives is to stimulate the competitiveness of small and medium-scale enterprises (SMEs) to contribute meaningfully to economic development. However, it appears this objective has not been achieved as many SMEs in Nigeria struggle for their survival. Are the tax incentives given by the government actually meeting the objective? This study therefore investigated the extent of utilisation of various tax incentives by SMEs in Nigeria and examined the impact of these incentives on the competitiveness of SMEs. Data were collected through the administration of structured questionnaire to purposively selected respondents who are knowledgeable in tax incentives. Data collected were subjected to psychometric tests, and were analysed using Pearson correlation analysis and OLS multiple linear regression technique. The results showed that SMEs in Nigeria enjoy tax incentives such as capital allowance, reinvestment allowance, investment tax credit, reduced company income tax, tax holiday, and free trade zones and export incentives to a moderate extent. The study also revealed that tax incentives have fairly stimulated the competitiveness of SMEs in the areas of employment creation, investment opportunities, and production capability amongst others.*

**Key words:** Tax incentives, small and medium-scale enterprises, competitiveness, economic development

### **Introduction**

The goal of a tax system is to achieve specific economic objectives of government and encourage individuals and corporate in taxable activities (Asaolu et al., 2015). This is generally done through the introduction of effective and flexible instruments such as tax incentives. Tax incentives have been a good aid to reducing increased tax avoidance and evasion schemes adopted by taxpayers. Government introduced tax incentives in order to reduce the perceived exploitative nature of the tax system, thereby encouraging taxpayers to participate in taxable activities. Tax incentives are special exclusions, exemptions or deductions granted by the government to businesses to encourage them to carry out their responsibilities and contribute meaning to economic development. Adedotun (2001) and Dopemu and Monday (2018) describe tax incentive as a deliberate reduction in (or total elimination of) tax liability in order to encourage a particular economic unit or corporate bodies to act in some desirable way.

Tax incentives make sectors like oil and gas, agriculture, solid minerals, tourism, energy, telecommunications more attractive. Incentives attract, retain and increase investment in these sectors, and assist companies or individuals carrying on identified activities. Tax

incentives according to Auerbach and Hines (1988), can take the form of a taxpayers' right of election, capital allowance, tax holiday, re-investment allowance, investment tax credit proportionate to the amount of capital investment, accelerated depreciation among many others. The intentions of the government for establishing tax incentives remains widely accepted and there is no dispute to the fact that many listed benefits will be derived from granting such incentives.

Tax incentives result in a number of advantages which includes among many; establishing a favorable investment climate, providing the desired assurance against confiscation and non-convertibility, and increasing the profit prospect of a new venture thereby enabling a firm to recover its capital cost faster so that the risk of investment is reduced considerably. Tax incentives make available tax-free incomes which are re-invested to increase profitability. Government grants tax incentives to businesses so as to promote regional investment, sectoral investment, performance enhancement, and transfer of technology (Summers & Delong, 1991 cited in Oghoghomeh, 2014). These incentives also draw attention to the profit prospects of investing in certain types of businesses, especially the small and medium-scale enterprises (SMEs), that a country seeks to promote. Tax incentives is a viable tool for stimulating the competitiveness of the SME sector in many economies.

SMEs, on the other hand, are widely acknowledged as the major drivers of sustainable economic growth and development. SME sector constitutes the largest proportion of businesses in both developed and developing economies (Monday et al., 2015; Sriram & Mersha, 2010). SMEs promote industrial development through the utilization of local resources, production of intermediate goods and the transformation of rural technology. They create employment for the teeming masses, help to diversify the economy through exports and international trade, and are able to implement new ideas and form new partnerships more easily than large-scale companies.

Despite these remarkable roles, SMEs in Nigeria are finding it pretty tough to survive and remain competitive. Multiple taxation has been identified as a major constraint inhibiting the growth of SMEs in the country (National Policy for MSME, 2013). It thus appears that the tax incentives provided by the government has no significant impact on the competitiveness of Nigerian SMEs. There is the need to investigate whether or not the tax incentives stimulate SME competitiveness in Nigeria. Besides, few studies (Chukwumerije & Akinyomi, 2011; Jiakponna, 2012; Saidu, 2014; Uwuigbe et al., 2016; Feyitimi et al., 2016) have examined the impact of tax incentives on the performance and growth of SMEs in Nigeria, but have failed to investigate the extent to which SMEs utilize the various tax incentives granted by the government. These necessitate the study.

The broad objective of this study was to critically examine the impact of tax incentives on competitiveness of small and medium-scale enterprises in Nigeria. To achieve this objective, this study specifically investigated the extent of utilisation of various tax incentives by SMEs, analysed the relationship between tax incentives and productivity of SMEs, and determined the impact of the incentives on the profitability of SMEs in Nigeria.

Based on the foregoing specific objectives, the following hypotheses were formulated and tested in the study:

H<sub>01</sub>: There is no positive relationship between tax incentives and productivity of SMEs.

H<sub>02</sub>: Tax incentives do not have significant impact on the profitability of SMEs.

## **Literature Review**

### **Taxation**

Tax is a compulsory levy imposed by government through its agencies on the income, consumption and gains of individuals and organizations. These levies are made on personal income such as salaries, business profits, interests, dividends, discounts and royalties (Chukwumerije & Akinyomi, 2011). According to Jiakponna (2012), tax is a major source of public revenue, a compulsory payment for which the government need not offer explanation. It is an obligatory transfer of money from private individuals or groups of individuals to a public authority. Taxes are used by the government to provide security, social amenities and create conditions for the economic well-being of the society (Salawu, 2019).

Amadiogwu (2008) defines taxation as a means through which the generality of the nation (both individuals and organizations) are made to contribute a portion of their incomes and gains for societal administration. Taxation is the demand made by the government of a nation for compulsory payment of money by the citizens of the country with the aim of raising revenue, satisfy collective wants of the people and regulate economic and social policies (Aguolu, 1999). Taxation drives sustainable development and the growth of emerging economies especially where natural resources are relatively scarce (Dickson & Persley, 2013).

Taxation is broadly classified into two:

- i. Direct Taxation:** Any tax in which the burden is borne by an individual or organization directly is referred to as a direct tax. Once the tax is remitted directly by the subject to the relevant tax authority, the tax is said to be direct. In Nigeria, various direct taxes exist including: personal income tax, company income tax, capital gain tax among others.
- ii. Indirect Taxation:** This tax is levied on goods and services consumed by individuals. This is tax levied on one part of the economy with the intention that it be passed on to another (Simon, 1998). The tax is usually not remitted to the relevant tax authority by those who bear the final burden of the tax. Indirect tax includes among many others: Value Added Tax (VAT), Export duties and Excise duties.

### **Tax Incentives**

Incentive refers to anything that encourages one to do something. According to Holland and Vann (1996) and Saidu (2014) many developing and transitional countries in the world offer incentives for investment, the incentives are not meant for direct investors, but it relates to real investment in financial assets and often directed to foreign investors,

in a situation where there is insufficient domestic capital for desired level of development and that international investment brings with it modern technology and management techniques.

Tax incentives are deductions, exemptions or exclusions from tax liabilities, offered as encouragement to engage in special activities such as investment in manufacturing sector for a specific period (Olaleye et al., 2016). It is the use of government spending and tax policies to influence the level of national income (Saidu, 2014). Tax incentives refer to reduction in the effective tax burden on the favored activity as against that currently imposed upon it in the hope that the reduction in government revenue due to tax foregone will be compensated by a resulting increase in total revenue from such broaden economic basis (Adedotun, 2001; Ohaka, 2010). According to Abdulrahman and Kabir (2017), tax incentives encourage the springing up and gradual growth of new enterprises by the reduction of profit tax, which in turn encourages production, influences the production level and curbs unemployment in the society, thereby contributing significantly to economic development.

Tax incentives can be classified as both the general and specific incentives. The general incentives are applied to stimulate and attract both foreign and domestic investments in all sectors of the economy, and they include re-investment allowance, capital allowance investment tax credits, and pioneer status. Specific tax incentives are mapped out by government to stimulate the growth in the manufacturing sector and reposition it as the engine of growth in the economy (Dopemu & Monday, 2018). Mustapha (2018) identified two broad classes of tax incentives namely: cost-based tax incentives such as tax credits and accelerated depreciation allowances, and profit-based tax incentives such as tax holidays or reduced tax rates.

There are four costs associated with incentives. They include: revenue cost, compliance cost, resource allocation cost, and corruption cost. Revenue cost refers to lost government tax revenue resulting from the tax incentives. Compliance cost is associated with enforcing the tax incentives and monitoring who is receiving the incentives and ensuring that the conditions for granting the incentives have been fulfilled. Resource allocation cost refers to the situation where the tax incentives lead to too much investment in a certain area of the economy and too little investment in other areas of the economy. Corruption cost relates to the abuse of tax incentives by the people. Corruption cost will occur where there are no guidelines or minimal guidelines for qualification (Easson & Zolit, 2003).

### ***Types of Tax Incentives in Nigeria***

Tax incentives are available to both individuals and organizations in Nigeria. Some of these incentives are listed and explained below:

- i. Pioneer status (Tax holidays)
- ii. Capital Allowance
- iii. Investment Tax Credits
- iv. Reduced company income tax
- v. Reinvestment allowance
- vi. Free trade zones and export incentives

- vii. Loss relief
- viii Rural Investment Allowance

- a. **Pioneer Status (Tax Holiday):** New firms are considered by the tax authorities and exempted from paying specified tax rates. This is often given to encourage investment in certain sectors of the economy and to encourage productivity. The Industrial Development (Income Tax Relief) Act, Cap 17 Laws of the Federation of Nigeria, 2004 grants tax holidays to companies that satisfy the required conditions for being called “Pioneer Industries”. A company holding a pioneer certificate shall be on tax holiday for an initial period of three years, commencing on the production date of the company unless restricted in any manner by the council or cancelled. The council may at the end of the three years extend the tax relief period for an additional two-year period.
- b. **Capital Allowances:** Capital Allowance (CA) is granted for capital expenditure made in relation to assets used for the purpose of trading, profession or vocation. It is a write-off of the capital cost of the asset. CA is granted to encourage investment in capital expenditures. Although firms tend to apply different rates as the normal depreciation, the tax authorities recognize only the given CA rates so as to promote uniformity in the derivation of assessable profits. CA rate is restricted to 75% of assessable profit for the year of assessment for companies in the manufacturing sector and 66% for others, except companies in the agro-allied industries. Companies in the agro-allied industries are granted 100% on leased assets, while an additional investment allowance of 10% is granted on leased assets for agricultural plants and equipment (Dopemu & Monday, 2018).
- c. **Investment Tax Credits:** Investment Tax Credits (ITC) permits companies or individuals to deduct a specific percentage of certain investment cost in addition to CA deducted thereby reducing tax liability (Dopemu & Monday, 2018). ITCs are earned when qualified buildings or equipment's are acquired for use in the firm. Klemm (2009), Ohaka and Agundu (2012), Ohaka and Dagogo (2015) emphasize that ITCs are only earned in the year of purchase and only applies to newly acquired properties. Such properties are qualified for a 10% rate on the capital expenditure to reduce the federal income tax liability in the first year; any unused credits can be extended and used to reduce federal income tax in future years. Unused ITCs can be carried forward 10 years and carried back 3 years (Ohaka & Dagogo, 2015). Auerbach and Hines (1988) submit that 40% of unused ITCs granted in a tax year may be claimed in the year it was actually earns and this grant is for the purpose of enhancing performance of the firm and boosting overall national economic growth.
- d. **Reduced Company Income Tax (RCIT):** This is a tax incentive whereby companies that have turnover of less than ₦1.0 million in the manufacturing sector pay company income tax (CIT) of 20% instead of 30% in the first five years of their operations. Also, dividends from such companies are tax free for the first five years. In addition, dividends from manufacturing companies in the petrochemical and liquefied natural gas sub-sector are tax free (Dopemu & Monday, 2018).

- e. Re-investment Allowance (RIA):** This is an incentive given to already existing manufacturing companies that incur capital expenditure for purposes of approved expansion of production capacity, modernization of production facilities and diversification into related products (Klemm & Stefan, 2012). It is an allowance available to a company which has been in operation for at least 12 months and had incurred capital expenditure on a factory, plant or machinery for the purpose of acquiring or retaining a qualifying project (Ohaka & Agundu, 2012). The allowance is available as a percentage of the expenditure incurred on qualifying projects, and its deduction is restricted to a percentage of the statutory income. The quantum of the deduction varies depending on some pre-conditions like the activity engaged, geographical location where the expenditure is incurred, and whether a certain level of production process efficiency is achieved. According to Dopemu (2017), RIA is in form of an allowance involving 60% of qualifying capital expenditure incurred by the companies for several years. The allowance can be utilized to offset 70 percent of the statutory income in the year of the assessment. Thus, RIA is a means of encouraging manufacturing companies to re-invest profits, expand and contribute to the growth of the economy.
- f. Free Trade Zones and Export Incentives:** According to the Nigerian Investment Promotion Council, NIPC (2009), export incentives and free trade zone consist of the following incentives:
- a. Duty Drawback Scheme:** This provides for refund of duties/charges on raw materials including packing and packaging materials used for the manufacture of products upon effective exportation of final products. The scheme allows for a 60% refund on duties/charges, which is automatically granted to the exporter at the initial screening by the Duty Draw Back Committee (DDBC). The refund amount is liquidated after the final processing of the application, while the Committee is authorized to approve the request for claim of any payment where applicable.
- b. Duty Drawback Facility:** This scheme provides for both fixed and individual drawback facilities. The fixed drawback facility is for those exporters/producers whose export products are listed in the fixed drawback schedule to be issued from time to time by the Committee, while the individual drawback is for exporters/ producers that do not qualify under the fixed drawback facilities. It is therefore a straight forward traditional drawback mechanism under which duty is paid on all inputs. The duties are consequently rebated on inputs used for export production.
- c. Trade Liberalization Scheme:** This is an export liberalization incentive primarily geared towards export activities within the ECOWAS sub-region. The aim is to considerably enlarge intercommunity trade activities in the region through the elimination of tariff and non-tariff barriers in trade emanating from member countries. The scheme offers preferential access to the ECOWAS market from Nigeria.

- g. Rural Investment Allowance:** Companies Income Tax Act (CITA) provides for rural investment allowance in respect of capital expenditures incurred by companies established in rural areas in relation to providing lacking infrastructural facilities such as electricity, water supply and tarred road or communication for at least 20 kilometers away from facilities provided for by the government (Chukwu, 2012). The rates as provided in section 34 (2) of CITA 2009 are as follows:

**Table 1: CITA Rates of Rural Investment Allowance**

Lacking Facilities	Allowance
Areas where there are no facilities at all	100%
No Electricity	50%
No Water	30%
No Tarred road	15%
No Telephone	5%

- h. Loss Relief:** Where a company is faced with losses, such a company can claim a loss relief by setting off such loss from the profit if any of the future accounting periods given that such loss arise from the respective business activity. Where a series of losses occur from year to year, the cumulative loss can be used to reduce the profits in future years of assessment if any. There used to be a restriction of the carry forward of loss to a maximum of 4 years, but currently this restriction has been removed and losses can be carried forward into the foreseeable future until they can be offset against profits.

### Benefits of Tax Incentives

Saidu (2014) and Dopemu and Monday (2018) highlight the benefits of tax incentives in business organisations and the society at large as follows:

- i. Tax incentives improve the commercial profitability of investment by making available tax-free income within the tax holiday period, which are re-invested in assets and the establishment of other industries.
- ii. Tax incentives serve as inducement to invest in certain sectors of the economy.
- iii. They help to establish a favorable investment climate and provide the desired assurance against confiscation and against non-convertibility especially in developing countries including Nigeria where there are different problems like currency restrictions, instability of government and the risk that foreign capital investment may be expropriated.
- iv. Tax incentives generate employment and motivate self-employed to incorporate into limited liability companies.
- v. They also increase the profit prospects of new ventures and enable firms to recover their capital costs much faster, so that the risks of investment are reduced considerably.

### **Small and Medium-scale Enterprises in Nigeria**

The National Policy on MSMEs (2013) in Nigeria adopts a classification for SMEs based on dual criteria, employment and assets. Small-scale enterprises are business organisations whose total assets (excluding land and building) are between ₦5 million and ₦50 million, with a workforce of between 10 and 50 employees. Medium-scale enterprises are those business organisations whose total assets (excluding land and building) are between ₦50 million and ₦500 million, with a total workforce of between 50 and 200 employees. Therefore, SMEs are those enterprises/registered firms whose total assets (excluding land and building) are above five million naira, but not exceeding five hundred million naira, with a total workforce of between 10 and 200 employees.

SMEs contribute to improved standards of living, provide employment for the teeming masses, bring about substantial local capital formation and achieve high level of productivity and capability. They are recognised as the principal means of achieving equitable and sustainable industrial diversification and dispersal (Udechukwu, 2003).

The National Policy on MSME (2013) which was the product of the collaborative research between National Bureau of Statistics (NBS) and Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) identified the main challenges and constraints confronting the operations of SMEs in Nigeria to include:

- i. lack of access to finance
- ii. weak infrastructure
- iii. inconsistency of government policies
- iv. lack of work space,
- v. multiple taxation
- vi. Obsolete technology

### **Empirical Studies in Nigeria**

To have a good understanding of how tax incentives have stimulated business and economic performance in Nigeria, empirical studies carried out in Nigeria were thoroughly reviewed. Olabisi (2009) investigated tax incentives as a catalyst for economic development in Nigeria. The study focused on 12 selected companies in Lagos state using cross-sectional survey design. Structured questionnaires were administered in gathering primary data. Descriptive statistics and Chi-Square analysis were used to the data. The study showed that tax incentives impact investment decisions positively and promotes economic development as well.

Ohaka (2010) investigated the impact of tax Incentives on corporate financial performance of quoted (large-scale) manufacturing firms in Nigeria. The study employed cross-sectional survey design on 58 manufacturing companies. Data were collected using structured questionnaire and analysed using paired samples t-test. The study found that tax incentives made significant difference on each of the financial performance measures such as return on investment (ROI), return on equity (ROE), and profit after tax (PAT).

Chukwumerije and Akinyomi (2011) assessed the impact of tax incentives on the performance of SMEs. The data used for the study were obtained from 11 food and

beverages companies in Rivers state, Nigeria via structured questionnaire. Data analysis was done using frequency distribution and Chi-Square analysis. The study showed that tax incentives have a significant positive effect on the performance of SMEs by helping to improve profit after tax and capital employed of small-scale industries in Nigeria.

Jiakponna (2012) examined the impact of tax incentives on growth and development of small and medium-scale industries in Nigeria. Primary data was obtained through the administration of questionnaires, personal interviews and observation. Correlation coefficient, Chi-Square were used for data analysis. This research revealed that tax incentives increase capital base, level of working capital and reduces the rate of unemployment. Tax incentives expands the scope of business activities thereby increasing the level of employment.

Ohaka and Agundu (2012) examined tax incentives for industrial synergy in Nigeria. Questionnaire were administered to 100 quoted (large-scale) manufacturing companies in Nigeria. Correlation, regression analysis and Z-test were used to determine the relationship between tax incentives and corporate financial performance. The findings revealed that tax incentives positively affect corporate financial performance and boosts manufacturing industry investment in the Nigerian economy.

Azeez (2013) investigated the impact of tax incentives on the contribution of manufacturing sector to economic growth in Nigeria. The study employed a time series data for the period of 1991 to 2000. Data was analysed by ordinary least squares (OLS) multiple linear regression. The results revealed that that tax incentive had a negative impact on manufacturing sector's contribution to GDP. However, with the combined influence of the controlled variables like exchange rate, interest rate, and bank credit facilities, tax incentives had positive and significant impact on the growth of the manufacturing sector.

Oriakhi and Osemwengie (2013) examined the impact of tax incentives on revenue productivity of the Nigerian tax system. A secondary data in the form of time series data for the period of 1981 to 2009 was sourced. The findings showed that well-articulated tax incentives would not only promote economic activity but also stimulate foreign investments into the economy thereby improving revenue productivity and tax base of Nigeria's tax system.

Saidu (2014) examined the impact of tax incentives on economic growth and industrial development in Nigeria. This study employed cross-sectional survey design. Primary data were obtained using structured questionnaire administered to medium-sized companies in the Northeastern Nigeria. Data was analysed by Chi-Square statistic and analysis of variance (ANOVA) methods. The study revealed that tax incentives encourage direct and indirect foreign and local investment which enhances micro and macro-economic growth and development.

Olaleye et al. (2016) examined the effect of reduced company income tax incentives on foreign direct investment in listed (large-scale) Nigerian manufacturing companies. Primary data was obtained using questionnaire. The population of the study comprised 74 quoted manufacturing companies in Nigeria. OLS Linear Regression Model and

Analysis of Variance (ANOVA) were used to analyze the data. The study showed that tax incentives encourage foreign direct investment in Nigeria.

Uwuigbe et al. (2016) investigated the influence of tax incentives on the growth of manufacturing firms in Nigeria. The study employed cross-sectional survey design of 20 small and medium manufacturing companies which gave a study sample size of 100 accountants and tax officers. Data were analysed using descriptive statistics and OLS multiple regression techniques. The findings revealed that manufacturing SMEs in Nigeria are privileged to enjoy certain tax incentives from the government, and the incentives had significant positive effect on the productivity and growth of the SMEs.

Feyitimi et al. (2016) examined the relationship between tax incentives and the growth of SMEs in Nigeria. Data were collected through the administration of questionnaires, interviews and observations in the form of time series data from 2004 to 2011. Percentage and OLS regression model were employed to analyse the data. The study found that there was a positive significant correlation between tax incentives and profitability of SMEs.

Abdulrahman and Kabir (2017) investigated tax incentive as a real modifier for industrial growth and development in Nigeria. Large-sized firms were used for this study. Primary data was gathered using questionnaire, and simple percentage and Chi-Square analysis were used to analyze the data. The study revealed that tax incentives granted by the government is considered as an industrial and economic booster and that industries that benefit from tax incentives will develop better and faster than industries that do not benefit from tax incentives.

Dopemu and Monday (2018) conducted a research on the impact of tax incentives on business growth in Nigeria. The study made use of secondary data obtained from the Nigerian Stock Exchange (NSE) factbook, Federal Inland Revenue Service (FIRS) and financial statements of 55 quoted manufacturing companies for the period 2009 to 2015. Panel regression model was used to express the relationship between tax incentives and growth of the firms. The study revealed that tax incentive (capital allowance) had a positive significant impact on the growth (return on equity) of the listed manufacturing companies.

Ugwu (2018) investigated the contribution of tax incentives towards foreign direct investment (FDI) inflow into Nigeria, Ghana and South Africa as well as the effect of such FDI inflows on those countries' exports after their adoption of IFRS for the period 1999-2015. Secondary data and ex-post- facto research design was used. The study adopted mixed methods in data analysis – descriptive survey approach and time series data of least squares regression approach. The findings revealed a positive association between tax incentives and FDI, and that FDI had no significant effect on the exports of Nigeria, Ghana and South Africa.

From the above previous studies, it is clear that few researches have been conducted on the impact of tax incentives on performance and growth of small and medium-scale enterprises in Nigeria. These few available studies failed to critically examine the extent to which SMEs in Nigeria utilize the various tax incentives provided by the government as well as analyzing the impact of the incentives on SME competitiveness in terms of

profitability of investment, employment ability and efficient use of resources. This study therefore sought to proffer solution to the lacuna.

## Methodology

### Research Design

A cross-sectional survey design was employed and it was descriptive since it attempted to unravel the essential elements of tax incentives and SME competitiveness. The design was considered appropriate in this study because survey research studies the whole population by selecting a sample from which inferences about the population could be drawn. Besides, survey research aids generalization of findings. This study collected data from sample of SMEs in Lagos State which, according to the National Policy on MSMEs (2013), constitutes more than 75% of small and medium enterprises in Nigeria. Lagos State is widely acknowledged as the commercial hub of the nation. In this research, primary source of data collection was used. The aim was to collect detail and factual information from owners/managers of SMEs. This study was carried out between July, 2018 and April, 2019.

### Sample

The target population of this study comprised of registered SMEs in Lagos State which totaled up to 3,864. Using Yamane's formula, 362 SMEs was obtained as the sample size. In order to account for non-response which is often associated with survey research, the sample size of this study was rounded up to 400 SMEs. Judgement sampling technique was used to select the respondents who were owners or managing directors or top management staff of the firms. It is believed that this caliber of respondents have wealth of experience concerning tax activities in the selected firms. From each firm, one respondent was selected giving the sample size of the study as 400 respondents.

### Measurement of Variables and Models

The independent variable was tax incentives and the dependent variable was competitiveness of SMEs. Tax incentives construct was measured with capital allowance, reinvestment allowance, investment tax credit, reduced company income tax, tax holiday, free trade zones and export incentives. Competitiveness which refers to a firm's ability to sustain its long-term performance better than its competitors, was measured using the productivity and profitability of SMEs.

The relationships between tax incentives and SME competitiveness measures are demonstrated in the cross-sectional economic models:

$$PRODTY_i = \alpha + \beta_1 CA_i + \beta_2 RIA_i + \beta_3 ITC_i + \beta_4 RCIT_i + \beta_5 THOL_i + \beta_6 FTZE_i + \varepsilon_i \dots (1)$$

$$PROFIT_i = \alpha + \beta_1 CA_i + \beta_2 RIA_i + \beta_3 ITC_i + \beta_4 RCIT_i + \beta_5 THOL_i + \beta_6 FTZE_i + \varepsilon_i \dots (2)$$

Where:

PROD = Productivity of SMEs; PROF = Profitability of SMEs; CAP = Capital Allowance; RIA = Reinvestment Allowance; RCIT = Reduced Company Income Tax; THOL = Tax Holiday; FTZE = Free Trade Zones and Export Incentives;  $\alpha$  = Constants;  $\beta_i$  = Slopes of estimated parameters; and  $e_i$  = Error term.

Apriori Expectation:  $\beta_1 > \beta_2 > \beta_3 > \beta_4 > \beta_5 > \beta_6 > 0$

### Research Instrument and Validation

The major research instrument used was the structured questionnaire. The questionnaire was administered directly to the owners/managers of the firms. The questionnaire was divided into four Sections; A, B, C and D. Section A provided information on the Social-Demographic characteristics of the respondent such as age, gender, marital status, educational qualification, and years of experience. Section B captured the extent to which SMEs utilize available tax incentives using close ended questions of multiple-choice response and a 5-point rating scale of “Not at all (1)” to “Extensively (5)”. Section C evaluated the relationship between tax incentives and the productivity of SMEs using a 5-Point Likert scale of “Strongly disagree (1)” to “Strongly agree (5)”. Section D evaluated the impact of tax incentives on the profitability of SMEs using 5-Point rating scale of “No impact (1)” to “Great impact (5)”.

The nature of the study was explained to the respondents; hence the respondents' confidentiality of any information provided was assured. Respondents were provided with detailed instructions as to how the questionnaires should be completed and returned. The rationale behind providing clear instructions and assuring confidentiality of information was based on the fact that this significantly reduces the likelihood of obtaining biased responses.

The research instrument (questionnaire) was validated using appropriate validity and reliability tests. The validity test comprised face validity, content validity and construct validity. The reliability test was test-retest and Cronbach's Alpha coefficient. For face validity, the questions in the questionnaire were given to colleagues to view it in accordance with the research objectives. Content validity was conducted by viewing the questionnaire items in the light of adequacy of international and national literature.

After carrying out face and content validity, test-retest reliability was conducted by administering the questionnaire to five SMEs who were not part of the selected firms. This assisted in rephrasing questions that were not well structured in order to generate the right responses. The Cronbach's Alpha Coefficient which measures the internal consistency of the constructs was afterwards carried out. Generally, reliability coefficient ranges between the values of 0.00 and 1.00, and coefficient of at least 0.5 is considered good. From the analysis in Table 2, the results showed that the values of Cronbach's Alpha coefficients ranged between 0.518 and 0.739, indicating high reliability of the measurement scales of the research instrument.

**Table 2: Reliability Analysis (Cronbach's Alpha)**

Construct	Number of Items	Cronbach's Alpha
Tax Incentives	6	$\alpha = .518$
SME Productivity	5	$\alpha = .739$
SME Profitability	4	$\alpha = .702$

Furthermore, construct validity was carried out by conducting a factor analysis. A strong condition of validity is that all scale items load significantly on their variable and have a loading of at least 0.5. As shown in Table 3, the Kaiser-Meyer-Olkin (KMO) test of

sampling adequacy for the various scales presented a value of above 0.5, revealing that the samples were appropriate for the study. All the extracted factors account for more than 50% of the total variance. Results of the factor analysis showed that all the loadings exceed the 0.5 cut-off point. This implies that the loadings can be considered to be significant; thus, indicating that the various questionnaire items loaded correctly in the appropriate construct.

**Table 3: Validity test (Construct Validity)**

<b>Construct</b>	<b>Variable</b>	<b>Factor Loading</b>	<b>Eigen-value</b>	<b>% of variance</b>	<b>KMO test</b>
Tax Incentives	INCV 1	.553	1.817	30.283	.553
	INCV 2	.737	1.135	18.910	
	INCV 3	.578	.977	16.281	
	INCV 4	.697	.870	14.493	
	INCV 5	.669	.715	11.910	
	INCV 6	.770	.487	8.123	
SME Productivity	PROD 1	.533	2.462	49.243	.785
	PROD 2	.677	.826	16.527	
	PROD 3	.768	.687	13.745	
	PROD 4	.753	.559	11.174	
	PROD 5	.750	.466	9.311	
SME Profitability	PROF 1	.761	2.120	53.004	.733
	PROF 2	.686	.736	18.407	
	PROF 3	.665	.641	16.027	
	PROF 4	.792	.502	12.561	

**DATA ANALYSIS AND DISCUSSION**

Data collected were first subjected to thorough editing and coding using the latest SPSS 21.0 supported with EpiData. Afterwards, the data were analyzed using the descriptive and inferential statistics. The descriptive statistics were frequency, percentage, mean, and standard deviation which were used to analyze the research objectives, while the inferential statistics employed in the study include Pearson correlation analysis and multiple linear regression technique which were used to test the hypothesis of the study. Of 400 copies of the questionnaire administered, 270 copies were completely filled and returned. Thus, the response rate was 67.5% which could be adjudged to be reasonably high. The analysis and discussion of data was based on the retrieved copies of the questionnaire.

**Socio-Demographic Characteristics of Respondents**

The analysis in Table 4 shows the respondents’ socio-demographic characteristics which consisted of age, marital status, highest educational qualification, and years of experience in the companies. The age distribution that all the respondents were above 20 years of age. Considering the marital status of the respondents, a high percentage of 68.5% of the respondents were married, 12.6% were single, 13.7% were divorced, and 5.2% were widow/widower. These results showed that the respondents are matured and responsible; so, they could provide information about tax incentives without intimidation.

It can also be seen from the analysis that 28.2% had HND qualification, 54.8% had B.Sc. qualification, and 17% had postgraduate qualification, revealing that a substantial proportion of the respondents have at least a first degree. This is an indication that the firms were composed of highly educated people with sound understanding of the questions. In addition, the analysis showed that 78.9% of the respondents had put in at least 6 years of service in the companies. This shows that the respondents were knowledgeable in the tax operations of the firms. Therefore, data supplied by these respondents were accurate and reliable to a large extent.

**Table 4: Distribution of Firms by Socio-Demographic Characteristics**

Characteristics	Variable	Frequency	Percentage
Age	Below 20 years	0	0
	21-30 years	71	26.3
	31-40 years	86	31.9
	41-50 years	87	32.2
	50 years and above	26	9.6
	Total	270	100.0
Marital Status	Single	34	12.6
	Married	185	68.5
	Divorced	37	13.7
	Widow/Widower	14	5.2
	Total	270	100.0
Educational Qualification	HND	76	28.2
	B.Sc.	148	54.8
	Postgraduate	46	17.0
	Total	270	100.0
Years of Experience	1-5 years	57	21.1
	6-10 years	113	41.9
	11-15 years	73	27.0
	16-20 years	18	6.7
	21 years and above	9	3.3
	Total	270	100.0

**Tax Incentives Available to the Selected SMEs**

The analysis in Table 5 reveals the level of awareness of tax incentives by the SMEs. Multiple response method was used to analyse the data for this sub-section. The results showed that 60.4% of the SMEs are aware of Capital Allowance, 60.4% are also aware of Reinvestment Allowance, 62.2% confirmed that Investment Tax Credit were provided, 65.2% also agreed to Reduced Company Income Tax being made available, and 63% and 49.6% of the SMEs confirmed the availability of Tax Holiday and Free Trade Zones and Export Incentives respectively. This showed that a substantial proportion of the SMEs are aware of the tax incentives provided by the government to enhance business growth and economic development. However, to be aware of the availability of tax incentives is quite different from the utilization of the incentives.

**Table 5: Distribution of SMEs by Level of Awareness of Tax Incentives**

Tax Incentives	Frequency	Percentage
Capital Allowance	163	60.4
Reinvestment Allowance	163	60.4
Investment Tax Credit	168	62.2
Reduced Company Income Tax	176	65.2
Tax Holiday/ Pioneer Status	170	63.0
Free Trade Zones and Export Incentives	134	49.6

\*Multiple response analysis

The analysis in Table 6 shows the extent of to which the SMEs utilize the tax incentives under consideration. The results revealed that to a substantial extent, 51.5% of the SMEs utilized the provisions of Capital Allowance, 44.8% enjoyed Reinvestment Allowance, 51.1% accessed Investment Tax Credit, 51.8% utilized Reduced Company Income Tax, 59.2% utilized the provisions of Tax Holiday, and 53.7% utilized Free Trade Zones and Export Incentives. From this analysis, the tax incentives considered in this study were fairly utilized by the SMEs in the country. This was confirmed by a moderate mean value of 3.402 (std. dev. = 1.204) on a maximum possible scale of 5.00.

**Table 6: Distribution of SMEs (in %) on Utilization of Tax Incentives by SMEs**

Tax Incentives	1	2	3	4	5
Capital Allowance	11.5	14.4	22.6	27.4	24.1
Reinvestment Allowance	15.9	20.7	18.5	27.	17.4
Investment Tax Credit	6.7	12.6	29.6	33.0	18.1
Reduced Company Income Tax	6.3	15.2	26.7	34.4	17.4
Tax Holiday/ Pioneer Status	7.0	6.7	27.0	37.0	22.2
Free Trade Zones and Export Incentives	7.8	13.7	24.8	30.4	23.3
Mean	3.402				
Standard Deviation	1.204				

1 = Not At All, 2 = Little Extent, 3 = Fair Extent, 4 = Large Extent, 5 = Extensively

### **Relationship between Tax Incentives and Productivity of SMEs**

The analysis in Table 7 shows the relationship between tax incentives and productivity of SMEs in terms of job creation, investment expansion, production capacity, and efficient utilisation of asset resources. The results showed that 48.2% of the respondents agreed that tax incentives provided the firms with the ability to employ more personnel/labor, 53.3% attested that tax incentives enable the firms to efficiently use assets, 50.7% agreed that tax incentives has contributed to the expansion of their firms, 54.1% also agreed that tax incentives stimulates their firms to invest in new products, and 47.8% indicated that their firms' production capacity had increased as a result of tax incentives. These results revealed a fair positive relationship between the tax incentives and productivity of the SMEs. This was confirmed by a moderate mean value of 3.254 (Std. dev. = 1.361) on a maximum possible scale of 5.00. This means that the current tax incentives available

have not helped small and medium-scale enterprises to achieve much in the areas of employment opportunities, investments, and production capacity.

**Table 7: Distribution of SMEs (in %) on the Relationship between Tax Incentives and SME Productivity**

Tax incentives aid my...	1	2	3	4	5
company's ability to employ more people	13.7	20.7	17.4	33.0	15.2
firm to efficiently use assets	13.7	11.1	21.9	33.7	19.6
firm's expansion	14.4	16.3	18.5	28.1	22.6
firm to invest in new products	15.2	16.7	14.1	26.7	27.4
firm's production capacity	18.1	18.1	15.9	24.8	23.0
Mean	3.254				
Standard Deviation	1.361				

1 = Strongly Disagree, 2 = Disagree, 3 = Indifferent, 4 = Agree, 5 = Strongly Agree

**Hypothesis One Testing:**

Before testing the hypothesis one ( $H_{01}$ ) of the study, an inferential statistics (Pearson Correlation analysis) was carried out to determine whether or not, a statistically significant linear relationship exists between pairs of tax incentives' variables (capital allowance, reinvestment allowance, investment tax credit, reduced company income tax, tax holiday, and free trade zones and export incentives).

The analysis in Table 8 showed that, at 5% level of significance, Capital Allowance had positive significant relationship with Reinvestment Allowance, Investment Tax Credit, Reduced Company Income Tax, and Tax Holiday with the exception of Free Trade Zones and Export Incentives. Reinvestment Allowance was also found to be positively significant to all other tax incentives except Free Trade Zones and Export Incentives. Investment Tax Credit had positive significant relationship with the other tax incentives with the exception of Free Trade Zones and Export Incentives. In the same vein, Reduced Company Income Tax had positive significant relationship with all of the tax incentives except Tax Holiday. The results showed the absence of multicollinearity, and also there existed statistically significant linear relationship between the pairs of tax incentives' variables. This suggested that SMEs would perform better when each of the tax incentives is adequately utilized.

**Table 8: Correlation Matrix of Variables of Tax Incentives**

	CA	RA	ITC	RCIT	TH	FTZ
CA	1					
RA	.415**	1				
ITC	.145*	.132*	1			
RCIT	.185**	.164**	.133*	1		
TH	.126*	.303**	.261**	.041	1	
FTZ	.117	-.026	-.019	.189**	.079	1

\*\* , \* Correlation is significant at the 0.01 and 0.05 levels (2-tailed) respectively

Having established the linearity among the tax incentives, an ordinary least squares (OLS) multiple linear regression analysis was conducted to examine the relationship between the six types of tax incentives and the productivity of SMEs as depicted in Model 1, and this was used to test hypothesis one (H01) of the study. The analysis in Table 9 shows the multiple regression of the relationship between tax incentives and the productivity of SMEs. The results revealed that each of the tax incentives (capital allowance, reinvestment allowance, investment tax credit, reduced company income tax, tax holiday/ pioneer status, and free trade zones and export incentives) were positively related to productivity of the SMEs. This implies that as the intensity of each of the practice increases, SMEs productivity in terms of employment creation, investment opportunities, production capacity and facility expansion, also increases.

It could also be seen in Table 9 that capital allowance ( $t = 5.545, p < 0.05$ ), tax holiday ( $t = 2.304, p < 0.05$ ) and free trade zones and export incentives ( $t = 4.107, p < 0.05$ ) were statistically significant to SME productivity. This suggested that capital allowance, tax holiday, and free trade zones and export incentives are critical drivers of SME productivity. Moreover, the F-statistic confirmed that the relationship between tax incentives and SME productivity was significant ( $F = 14.534, p < 0.05$ ). The coefficient of correlation (R) of 49.9% depicted a positive relationship between tax incentives and productivity of the SMEs; hence, H01 was rejected. This is consistent with the findings of Jiakponna (2012) and Uwuigbe et al. (2016) who found that SMEs in Nigeria are privileged to enjoy certain tax incentives from the government and such SMEs experienced higher productivity and growth in areas of increase in productive assets, capital investment and working capital formation.

**Table 9: Multiple Regression of Relationship between Tax Incentives and SME Productivity**

Predictor	Coefficient	s.e	t-stat	Sig.	VIF
(Constant)	.213	.422	.506	.614	
CAP	.363	.065	5.545**	.000	1.259
RIA	.074	.065	1.127	.261	1.342
ITC	.031	.071	.430	.667	1.107
RCIT	.007	.070	.105	.917	1.097
THOL	.171	.074	2.304*	.022	1.181
FTZE	.267	.065	4.107**	.000	1.071
<b>Analysis of Variance</b>					
Source	SS	df	MSS	F-stat	Sig
Regression	135.703	6	22.617	14.534**	.000
Residual	409.264	263	1.556		
Total	544.967	269			
<b>Correlational Statistics</b>					
Response	Multiple R	R <sup>2</sup>	Adjusted R <sup>2</sup>	SEE	DW
PRODTY	.499	.249	.232	1.247	1.971

\*\* , \* Significance at the 1% and 5% levels of significance (2 tailed).

### Impact of Tax Incentives on the Profitability of SMEs

The analysis in Table 10 shows the impact of tax incentives on the profitability of SMEs in terms of profit margin, return on investment, return on assets, and market share. With regards to the impact of tax incentives on SME profitability, the results showed that 53.7% of the SMEs indicated significant impact on their profit margin; 45.5% indicated significant impact on return on investment (ROI); 47% indicated significant impact on return on asset (ROA); and 45.2% indicated significant impact on market share. This implies that tax incentives had fair impact on the profitability of the SMEs. A moderate mean value of 3.340 (Std. dev. = 1.300) on a maximum possible scale of 5.00 confirmed that the tax incentives had fair impact on the profitability of the SMEs.

**Table 10: Distribution of SMEs (in %) on the Impact of Tax Incentives on SME Profitability**

Profitability item	1	2	3	4	5
Profit margin	8.5	17.4	20.4	27.0	26.7
Return on investment	7.0	10.7	36.7	17.0	28.5
Return on Assets	11.5	20.7	20.7	22.6	24.4
Market share	17.4	15.9	21.5	26.3	18.9
Mean	3.340				
Standard Deviation	1.300				

1 = No Impact, 2 = Little Impact, 3 = Moderate Impact, 4 = High Impact, 5 = Great Impact

### Hypothesis Two Testing:

Since the linearity of each pair of the independent variables had been established (see Table 8), the OLS multiple linear regression was conducted to show the impact of tax incentives on SME profitability as depicted in Model 2. This also helps to test hypothesis two (H02) of this study. The analysis in Table 11 shows the multiple linear regression analysis of the impact tax incentives on SME profitability. The results revealed that capital allowance ( $t = 3.540, p < 0.05$ ), reinvestment allowance ( $t = 4.508, p < 0.05$ ), and free trade zones and export incentives ( $t = 3.303, p < 0.05$ ) had significant impact on the profitability of the SMEs. This suggested that capital allowance, reinvestment allowance, and free trade zones and export incentives are critical for increased profitability of the SMEs. Also, the overall impact of tax incentives on SME productivity was significant ( $F = 14.667, p < 0.05$ ).

Furthermore, the intensity of tax incentives explained a significant proportion (25%) of the variation in the profitability of the SMEs. These results showed that tax incentives had significant impact on the profitability of the small and medium-scale enterprises in Nigeria. Therefore, H02 was rejected. Although the tax incentives were moderately utilised, they had positive and significant impact on the profitability of the SMEs.

The findings of this study are consistent with those of Chukwumerije and Akinyomi (2011) and Feyitimi et al. (2016) who revealed that the tax incentives provided by the Nigerian government have significant impact on SME profitability which has a resultant

influence on productivity of SMEs. They posited that tax incentives are pivotal to the expansion and sustenance of growth in the SME sector and that well managed SMEs are sources of employment opportunities and wealth creation.

The effect of multicollinearity in Models 1 and 2 was assessed by conducting the Variance Inflation Factor (VIF) of each independent variable. The analysis in Tables 9 and 10 showed that each independent variable was less than 10 which was satisfactory. Also, the value of the Durbin Watson (DW) was approximately 2.00 (satisfactory), indicating no autocorrelation between the residuals from the regression. Therefore, the Models 1 and 2 expressed fitness.

**Table 11: Multiple Regression of Relationship between Tax Incentives and SME Profitability**

Predictor	Coefficient	s.e	t-stat	Sig.	VIF
(Constant)	.439	.397	1.104	.270	-
CAP	.218	.062	3.540**	.000	1.259
RIA	.278	.062	4.508**	.000	1.342
ITC	.003	.067	.044	.965	1.107
RCIT	.064	.066	.958	.339	1.097
THOL	.086	.070	1.233	.219	1.181
FTZE	.202	.061	3.303**	.001	1.071
<b>Analysis of Variance</b>					
Source	SS	df	MSS	F	Sig
Regression	121.447	6	20.241	14.677**	.000
Residual	362.719	263	1.379		
Total	484.167	269			
<b>Correlational Statistics</b>					
Response	Multiple R	R <sup>2</sup>	Adjusted R <sup>2</sup>	SEE	DW
PROFIT	.501	.251	.234	1.174	1.690

\*\* , \* Significance at the 1% and 5% levels of significance (2 tailed).

**CONCLUSION AND RECOMMENDATION**

The study showed that tax incentives (Capital Allowance, Reinvestment Allowance, Investment Tax Credit, Reduced Company Income Tax, Tax Holiday, and Free Trade Zones and Export Incentives) provided by the Nigerian government fairly stimulate SME competitiveness to be able to compete favorably in the global dynamic market. Although a good number of SMEs were aware of government tax incentives, the extent of utilization of the incentives by small and medium-scale enterprises in the country could be described generally as moderate. The study also revealed a positive relationship between the tax incentives and the productivity of the SMEs in Nigeria. With tax incentives provided to SMEs, they would be able to carry out their economic responsibilities such as employment creation, investment opportunities, production capacity and facility expansion, and contribute meaningfully to economic development. More so, the study showed that tax incentives have significant impact on the profitability of SMEs.

Therefore, providing tax incentives to SMEs could serve as catalyst for economic development in Nigeria.

Based on the findings of this study, the following recommendations were made:

1. Government should provide more efficient means of disseminating information about available tax incentives to SMEs.
2. The provisions guiding the utilization of tax incentives should be explained in such a manner that ambiguity and misinterpretation is avoided.
3. Government should provide more tax incentives to encourage startup ventures as well as existing ones. The percentage of the existing incentives should be increased to boost the competitiveness of SMEs.
4. Tax authority should educate SMEs more on the objectives of tax incentives scheme so that they will reconcile their personal objectives with that of the government.

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