

EFFECT OF PRESUMPTIVE INCOME TAX ON MICRO, SMALL AND MEDIUM ENTERPRISES (MSMES) TAX COMPLIANCE IN BAUCHI STATE, NIGERIA

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Abstract

Bauchi State, Nigeria, is faced with the problem of low internally generated revenue. The study, therefore, aimed to investigate the effect of presumptive tax on tax compliance of micro, small and medium enterprises (MSMEs) in the State. The population of the study is 1,167,941, which is the number of MSMEs in Bauchi State, Nigeria. A proportional sampling selection technique was adopted, and Taro Yamane's 1967 formula was employed for the sampling size. The research design for the study is cross-sectional; therefore, a quantitative approach was adopted. A primary data collection method was used, and to collect the data, 400 questionnaires were administered to the participants. Out of the questionnaires administered, 282 were properly filled out and collected, and for the analysis, a regression technique was employed. The result of the study shows that presumptive tax does not have a significant effect on tax compliance of MSMEs in Bauchi State, Nigeria. The study, therefore, found that presumptive tax does not affect MSMEs' tax compliance decisions in Bauchi, Nigeria. This implies that the businesses may choose not to grow beyond the presumptive regulation's eligibility threshold. The government is advised to educate the MSMEs on the importance of bookkeeping to exit the presumptive regime for the standard tax system.

Keywords: MSMEs, presumptive tax, tax compliance, tax policy and Nigeria.

1.0 Introduction

Entrenching the culture of tax payment has been elusive, and this has been difficult for successive governments in Nigeria (Ofishe, 2015). This is why there have been different tax reforms to improve voluntary tax compliance in Nigeria (Odu, 2022). For example, the 2009 Finance Act was introduced to expand the Nigerian tax net and encourage voluntary tax compliance (Taiwoet al., 2019), and the recent ones have been the 2021 and 2023 Finance Acts, and the 2025 tax reform. Tax reforms are carried out for effective tax administration in Nigeria (Uwaegbute&Erikume, 2025). Besides, the National Tax Policy's main objective is to attain voluntary tax compliance (Section 1.5, National Tax Policy, 2017). Tax compliance is important to the economic development of any country (Blyce, 2024).

Tax compliance is seen as a civic duty, so citizens are enjoined to declare honestly all their income and the sources for tax purposes (Section 24(f) Constitution of Nigeria, 1999 as amended). However, there are tax compliance issues in Nigeria (Abdullahi, 2021; Ellawule et al., 2023). Literature (Aladejebi, 2018; Le et al., 2020) has shown that this tax non-compliance problem is

more prevalent with MSMEs in Nigeria. This greatly impacts the revenue generation of the government (Abdulaziz et al., 2022).

MSMEs are businesses that contribute a lot to the economic growth of nations; they contribute to 90% of businesses, 50% of employment and 40% of the GDP of developing countries (The World Bank, 2023). One of the challenges of MSMEs is record keeping; therefore, to make it simple and reduce compliance costs for SMEs, the United Nations Conference on Trade and Development (UNCTAD) suggests the implementation of financial guidelines for Small businesses (SMEGA) (UNCTAD, 2003). The guidelines recommend a format for record-keeping (Level 3 Guidance), simple for tax assessment purposes and other objectives.

Also, because of the lack of certainty in their income, Section 36(6) of PITA 2007, as amended, empowers the tax authorities in Nigeria to assess the MSMEs to tax using presumptive income tax. For better clarity and guidance on the implementation of the presumptive tax regime, the Presumptive Tax Regulation 2015 was promulgated (GEMS, 2016). Presumptive tax is a personal income tax on hard-to-tax businesses that do not have good books of accounts.

Bauchi State, Nigeria, is one of the sub-governments, faced with an infrastructure deficit, coupled with low internally generated revenue as such put in place policies to enhance its revenue generation. The State, therefore, domesticated and adopted the implementation of this presumptive tax. There is poor tax compliance in Bauchi State, hence it intends to collaborate with the Federal Inland Revenue Service (FIRS) to improve tax compliance in the State (Sani, 2024). It is a consensus that there is a tax compliance problem in Bauchi; however, it is not known how much of it is ascribed to presumptive tax. "The number of empirical studies that have evaluated the impact of presumptive tax regimes remains relatively limited" (Mas-Montserrat, 2023, p.9). There is little or no literature available to show that the effect of this presumptive tax rate on the tax compliance of MSMEs in Bauchi State has not been investigated. Therefore, this study aims to examine the effect of the presumptive tax on the tax compliance of MSMEs in Bauchi State, Nigeria.

2.0 Literature Review

Tax compliance is to ensure that taxpayers pay their taxes without being forced (Atawodi&Ojeka, 2012). A culture of tax awareness is regular and voluntary tax payment (Kurniawan& Daito, 2021). Effective tax administration helps the government improve revenue to finance projects (Oladele et al., 2019). Unfortunately, some of the taxpayers do not pay their taxes, so they employ all manner of tactics to reduce their tax liabilities, which is known as tax non-compliance (Dularif&Rustiarini, 2021).

Further, Mas'udet al. (2014) stated that tax compliance can be judicial and administrative. The authors expatiate further that administrative tax compliance is adhering to tax laws, while judicial tax compliance is accuracy in the filing of tax returns. Also, tax compliance is when one obeys tax laws by declaring all incomes, ensuring accurate calculation of tax liabilities, paying the liabilities as when they are due and timely filing of tax returns; and this is described as the four basic rules of tax compliance (Batrancea et al., 2012).

Tax noncompliance is intentional when the taxpayers refuse to discharge their tax obligations, which leads to tax evasion, while unintentional is when the taxpayers are ignorant of the laws (Alabede et al., 2011). Alabede et al. (2011) also explain categorisation of tax compliance: into committed, capitulative and creative tax compliance. Tax compliance is said to be committed when the taxpayers are willing to pay their tax obligations; capitulative when the taxpayers are

reluctant to pay their tax obligations, and creative when they employ tactics within the law to reduce their tax liabilities.

Presumptive Tax

A presumptive tax system, which is also known as a simplified tax regime, is a tax on the presumed tax base of businesses whose actual taxable income is difficult to assess accurately (Mas-Montserrat et al., 2023). The study asserts that the presumptive tax regime is a tax on hard-to-tax businesses with low income, and it is meant to reduce costs for tax compliance for taxpayers and tax authorities' monitoring costs. It is meant for businesses that cannot maintain accounting records (Orkaido et al., 2024). The main aim of the tax system is not to increase revenue generation but to increase the tax net and improve compliance (Mas-Montserrat et al., 2023).

The presumptive tax system has two regimes: lump-sum and based on indicators of economic activity (Mas-Montserrat et al., 2023). The lump-sum method is always low, and it is meant to accommodate many businesses and does not consider any business activity indicators, while presumptive tax based on economic activity considers different indicators (for example, turnover, machine capacity, location, input consumption, etc.).

Presumptive tax regime may be important; however, this regime has challenges too. The regime creates tax incentives for businesses to remain small below a certain threshold. Also, the regime encourages businesses to avoid tax payments by splitting their activities and evading tax payments through underreporting income (Mas-Montserrat et al., 2023). Ferry et al. (2023) state that there are three types of costs involved in presumptive tax compliance: explicit, implicit and psychological costs. The explicit costs are costs in hiring experts and employees for tax purposes; implicit costs are for time spent, inclusive of family members for tax purposes, while psychological costs are stress and anxiety experienced while complying with tax laws.

Theoretical Review

The theoretical framework of this study is Prospect Theory. A new alternative theory, the prospect theory, was propounded because of criticism faced by the expected utility theory decision-making under risk (Kahneman & Tversky, 1979). The prospect theory is a theory of choice where individuals are made to choose between alternatives that involve uncertainties. The theory is applicable in taxation; it gives the government and the tax authorities the choice to implement a presumptive tax on MSMEs, even though the revenue is not much compared to standard tax rates. This will make more businesses be captured in the tax net. Consequently, this will lessen the pain of revenue losses due to tax non-compliance and the gain of tax revenue from improved tax compliance from MSMEs.

Empirical Review

To measure the tax compliance of businesses in the informal sector in Nigeria, Dang and Zubairu (2023) adopted a purposive sampling selection method to select three States adopted by Growth and Employment in States (GEMS) for their pilot for presumptive tax implementation out of the 36 States for their study. The study employed difference-in-differences to analyse two groups: low-buy States (control group) and high-buy States. Secondary data collection was used, and it was found that the presumptive tax system has no significant effect on informal tax compliance in Nigeria. It is difficult to determine how the method (difference-in-differences) adopted for the analysis could measure the causal effect of the predictor and outcome variable.

In a study conducted to find the impact of reform on government revenue generation, Mmasa (2023) employed a microsimulation model to analyse household budget surveys and concluded

that presumptive tax improved tax revenue in Tanzania. The study focused on income from individual taxpayers, while this study focused on MSMEs. There is also a difference in tax jurisdiction.

Orkaido et al. (2024) employed a quantitative approach and a primary data collection method to administer questionnaires for their study. The study adopted a regression analysis tool and revealed that presumptive tax has a significant and positive effect on tax compliance. The study, however, adopted presumptive tax compliance as the outcome variable. Also, the study only used taxpayers in Category C in the Gedeo Zone in Ethiopia as the population and failed to define whether the data was collected from individuals or MSMEs. The study equally claimed that there is a limited study on presumptive tax compliance. There is little or no evidence to show that the tax compliance problem in Bauchi State, Nigeria, has been measured using presumptive tax. Based on this and the theoretical framework, the following hypothesis is developed to achieve the research objective: Presumptive tax does not have a significant effect on tax compliance of MSMEs in Bauchi State, Nigeria.

3.0 Methodology

A suitable method for selecting the samples was employed because of the large land mass and high number of the target population, MSMEs in Bauchi, Nigeria. The Yamane 1967 formula was employed in selecting the sample size for this study. This formula is important because it helps in determining the accuracy level of the population, and the conclusion drawn from the sample can be generalised (Cloud22, 2023). There are 1,167,941 MSMEs in Bauchi State, Nigeria (SMEDAN, 2021).

Sampling Technique and Sampling Size

A suitable method was employed to select the sampling size for the study. A proportional sampling technique was employed, and Taro Yamane's 1967 formula was adopted for the sampling size.

The formula is:
$$= N \{1 + N(e)^2\}$$

$$= \frac{1,167,941}{\{1 + 1,167,941 (0.05)^2\}}$$
$$= 400$$

Administration of Data Collection and Instrument

The questionnaires were self-administered because of a poor response rate from the questionnaires administered to the MSMEs through Google Forms and Kobo Collect. The response rate was 10% of the administered questionnaires. Google Forms and Kobo Collect are electronic means of collecting data from respondents. The SMEDAN report (2021) did not breakdown MSMEs based on local government areas; however, the Bauchi State Enabling Reform Action Plans (BERAP) and Progress Reports show that business activities are more concentrated in the following LGAs: Bauchi, Toro, Darazo, Tafawa Balewa, Bogoro and Ningi (Ahmed, 2024). Data was collected from the above-mentioned local government areas.

Measurement of Variable and Instrument

The study adopted a 5-point Likert scale. This method is adopted to avoid overwhelming the respondents. To measure attitude using a 5-point Likert Scale is good because it shows data to have a semblance of a normal distribution (Likert, 1932). Further, the study adopted the Batrancea et al. (2012) description of tax compliance for the tax compliance measurement. In measuring the tax compliance, the taxpayers must abide by the following four basic rules: the taxpayers

should declare the correct tax base to the authorities; correctly compute tax liabilities; timely filing of tax returns; and pay the amount due on time. The presumptive income tax is measured as provided for in Section 36(6) of PITA 2007, as amended and Section 29 of the Nigeria Tax Act (2025).

Ethical considerations: There is no personal relationship with a sponsor that could influence the outcome of the study. The study is also committed to the privacy of the participants. Further, consent of the participants was obtained and approved for this study. Furthermore, there is no bias in the data collection and the analysis.

4.0 Presentation Of Results And Analysis

To carry out the analysis, the data were cleansed, and the regression assumptions were equally checked. Four hundred sets of questionnaires were administered to the participants, out of which 282 were properly filled and collected for analysis, representing 71 per cent. A 50 per cent survey response rate is good (Cleave, 2020). The analysis shows that 10 respondents (3,11,16,25,40,59,84,113,182,187) have Z-scores above ± 3.29 and with extreme values. They are, therefore, deleted as suggested by Tabachnick and Fidell (2007).

Further, the reliability of the data was checked for consistency. Reliability is how consistent and stable a measurement of a phenomenon is (Hair et al., 2014). This is measured to help assure the internal consistency of the instrument. The internal consistency of a questionnaire can be measured through Cronbach's Alpha. Table 1 shows that the variables have a coefficient above the threshold of 0.7 as recommended (Hair et al., 2010; Sekaran&Bougie, 2010).

Table 1:
Reliability Statistics

Variables	N of Items	Cronbach's Alpha
Presumptive Tax	4	0.713
Tax Compliance	4	0.854

Source: Author's Analysis (2025)

To test whether the concepts are accurately measured, the study checked the validity of the data. The study checked for the construct validity, the correlation coefficient obtained, r_{xy} (0.258), is greater than the r critical value for Pearson from the table (0.138), as suggested by SPSS tests (2015), and Karachi (2021).

Employing both the Histogram and the Normality Plot shows that the data is normally distributed. The distribution line in the normal plot runs diagonally, meaning the normality assumption for regression has not been violated. For a parametric test, it is advised to have data that is normally distributed.

Also, the study tested for linearity between the independent and dependent variables as recommended by Tabachnick and Fidell (2007). The regression assumption for linearity is met because the scores of the distribution are concentrated at the centre with a rectangular shape in a scatterplot, as recommended by Hairet al. (2014). Further, Levene's test shows that the p-value, 0.069, is greater than 0.05, and this means the regression assumption for homoscedasticity is not violated. When Levene's test for homogeneity is at $P > 0.05$, that is, not significant, then the regression assumption for homoscedasticity is not violated (Coakes& Ong, 2011).

Hypothesis Testing

H0: Presumptive tax does not have a significant effect on tax compliance of MSMEs in Bauchi State, Nigeria. The objective is to examine the effect of presumptive tax on the tax compliance of MSMEs in Bauchi State, Nigeria.

The study tested the hypothesis that presumptive tax has a significant effect on the decision-making of MSMEs' tax compliance in Bauchi, Nigeria. The result from the regression analysis shows that presumptive income tax does not have a significant effect on MSMEs' tax compliance in Bauchi, Nigeria, $F(1, 270) = 0.170$, $p = 0.681$. With a $p > 0.05$, it equally shows that presumptive income tax plays an insignificant role in taxpayers' decisions to either comply or not with tax laws in Bauchi State, Nigeria. If a model is statistically not significant, it means the null hypothesis is not rejected. Also, there is a positive Standardised Coefficient Beta, which means there is a positive relationship between the predictor variable and the outcome variable. The result shows the potential that the higher the presumptive tax, the higher the tax compliance of MSMEs in Bauchi, Nigeria. With an R-squared of 0.001, this shows that the model has little or no effect on the variability in the taxpayers' compliance, and this means the change is explained by chance, that is, other variables not included in the model but could affect tax compliance. Had it been the p-value been less than 0.05, then the Unstandardized Coefficient B of 0.014 would have meant that for every unit of increase in presumptive income tax, there is a 0.014 unit change in tax compliance of MSMEs in Bauchi, Nigeria. Also, the f-value of 0.170 shows that the model does not significantly explain the amount of variation in the dependent variable.

Table 2:

Effect of Presumptive Tax on Tax Compliance of MSMEs in Bauchi, Nigeria

Variable	Unstandardized Coefficient B	t-value	p-value	R ²	Adj R ²	F-value
Constant	1.810	20.640	0.000			
PT	0.014	0.4118	0.681	0.001	0.003	0.170

Source: Author's Analysis (2025)

Table 3:

Summary of Regression Results

Hypothesis	Results
H ₀ Presumptive income tax does not have a significant effect on the tax compliance of MSMEs in Bauchi, Nigeria.	Supported

Source: Author's Analysis (2025)

Discussion of the Finding

The result shows that presumptive tax has no significant effect on the tax compliance of MSMEs in Bauchi State. However, there is a positive (direct) relationship between the presumptive tax and tax compliance, and this means an increase in presumptive tax causes an increase in tax compliance of MSMEs in Bauchi if other variables are held constant. This tax compliance behaviour indicates that there is insufficient evidence from the sample to conclude it is a true representation of the population. The positive relationship means that the tax burden or impact is too little to make the taxpayers react by employing tactics to either avoid or evade tax payments. This is so because Ameyaw and Dzaka (2016) assert that the tax burden makes taxpayers evade tax payments.

The implication of this is that the businesses may choose not to grow beyond the presumptive regulation's eligibility threshold. This can be achieved by inducing tax avoidance and evasion tactics by either splitting their activities or underreporting their income. When presumptive tax rates are favourable to businesses, they tend to employ tactics that will make them remain within the regime's eligibility threshold (Mas-Montserrat et al., 2023). Though the finding is statistically insignificant, it is imperative to educate the MSMEs on the importance of having good books of accounts. For example, Section 11 of the VAT Act 2007 as amended, Section 52 of the PITA 2007 as amended, Section 24 of the Stamp Duties Act 2004 as amended, and Section 8(3) of the Nigeria Presumptive Tax Regulation 2015 all emphasise the need to keep records for tax purposes.

This will resolve the problem of the tax authorities having to impose presumptive income taxes and using the "best of judgment" for tax assessment. Therefore, rather than use presumptive income tax, the tax authorities should impose Personal Income Tax to ensure either government revenue generation efforts are not affected or the taxpayers are not overburdened with tax. Section 12 of the Presumptive Tax Regulations 2015 provides an opportunity for taxpayers to exit the presumptive tax regime if they can keep records where income can be ascertained. Taxing MSMEs based on PITA is inevitable because the State Internal Revenue Services find it difficult to categorise the businesses. Doing this will build trust between the taxpayers and the tax authorities, which will lead to voluntary tax compliance by the MSMEs in Bauchi State, Nigeria. To summarise the findings, the study found that presumptive tax does not have a significant effect on tax compliance of MSMEs in Bauchi, Nigeria. This is a confirmation of an earlier study by Dang and Zubairu (2023). However, this study does not confirm the previous study by Mmasa (2023). This could be because of differences in analytical tools or differences in tax jurisdiction.

5.0 Conclusion And Recommendations

The effect of tax collection using a presumptive method on MSMEs' tax compliance in Bauchi State, Nigeria, was investigated. The 1,167,941 MSMEs in Bauchi State served as the population of the study. A proportional sample selection technique was adopted. Taro Yamane's 1967 formula was employed to determine the sample size. Using the simple regression analysis tool, the study found that presumptive tax has no significant effect on tax compliance of MSMEs in Bauchi State, Nigeria. This implies that not complying with tax laws by MSMEs in Bauchi State has little or nothing to do with the presumptive tax regime.

Recommendations

The study made the following recommendations to policymakers, relevant tax authorities and organisations based on the findings and conclusions, which could improve voluntary tax compliance, which is the main objective of the National Tax Policy. To tax authorities: Impose tax rates that are not beyond the ability of the MSMEs to ensure that either government revenue generation drives are not hampered or the MSMEs are not overburdened with high taxes. To MSME operators: MSMEs are advised to have a proper bookkeeping culture. Keeping good books of account reduces the use of presumptive income tax and "best of judgment" by the tax authorities, and equally reduces the probability of being prosecuted.

Limitations of the Study

In spite of the contribution of this study to knowledge, there are some limitations. Many factors affect tax compliance; however, this study focused on presumptive income tax. Also, the study's domain is MSMEs and Bauchi State as a case study; as such, there is a challenge in the generalisation of the study in all sectors and in Nigeria. This study will be limited to the factor and area mentioned.

Suggestion for Further Study

Knowledge was identified based on the limitations of the study. Therefore, future studies should expand the participants of the study to find the effect of other factors, such as tax rates and tax audits, on tax compliance of MSMEs in Bauchi State, Nigeria. This is important because of the government tax policy in the State.

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