

# Effect of Tax Compliance Costs on Tax Evasion by Small and Medium Enterprises

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## ABSTRACT

This study examined the effect of tax compliance costs on tax evasion by small and medium scale enterprises (SMEs) in Akwa Ibom State. Survey research design was adopted in realising the objectives of the study. The population (1,887) of the study consists of all SMEs in Akwa Ibom, from where a sample size of 330 was drawn using Taro Yamane model. 330 copies of questionnaire were administered to Accountants and owner/managers of the selected SMEs across the three senatorial districts of Akwa Ibom State. The questionnaire was constructed on a 5-point Likert scale and was analysed using non-parametric tests such as mean, standard deviation and percentages. The questions in the questionnaire centred around tax evasion as dependent variable while independent variables were proxied as cost of registration for tax purposes; cost incurred in engaging tax professionals; complexity in the tax system; cost incurred in keeping books and accounting records for tax purposes; cost incurred in obtaining tax education information and changes in tax policy; time spent for tax purposes and cost implication of such time element. The findings of the study shows that 90% of the respondents agreed that the cost incurred by SMEs in registration for tax purposes is high and that this high costs leads to tax evasion. Also, 91% are in agreed that the complexity in the tax system is the reason why SMEs engage the services of external tax professionals to assist in tax matters and this leads to high compliance cost and the attendant tax evasion. 88% of the respondents agreed that high costs of keeping books and accounting records for tax purpose while those on obtaining information on tax policy is 94%. Also, 93% of the respondents agreed that the time spent by SMEs exclusively for tax purposes encourages tax evasion Finally, 89% of the respondents agree that the combined effect of all costs, other than tax liability, and the time spent in tax processes contributed to tax evasion by SMEs. Based on these findings it was concluded that there is a strong indication that compliance costs greatly affect tax evasion. It was recommended that Government should simplify tax policies in order to reduce compliance costs incurred by SMEs and tax professionals should reduce their charges for SMEs as a way of reducing their compliance costs.

**Key words:** taxation, tax compliance, compliance costs, tax evasion and SMEs

## INTRODUCTION

### Background to the Study

Globally, tax represents a major source of revenue to government for the finance of developmental programmes and projects. However, the amount of revenue to be generated by government from tax depends, among other things, on the willingness of the taxpayers to comply with tax laws regarding the payment of taxes as and when due. The unwillingness of tax payers to comply with tax laws often manifests in the form of tax avoidance or evasion. Although tax avoidance may be legally accepted to some extent, both have the tendency of reducing the amount of revenue generated by government and by extension reduce government expenditure in the economy. Thus, effort of government at all levels is usually aimed at ensuring high level of tax compliance among the citizenry.

Tax compliance, according to Ayuba, Saad and Ariffin (2016), implies the willingness of taxpayers to abide by the tax laws, disclose their actual income and remit the right amount of taxes on the due date to the relevant tax authority. This includes registration as taxpayer, maintaining required records for the purpose of taxation,

computing tax liabilities accurately, filing required tax returns timely and paying taxes correctly and within the specified period of time. It can also be described as the degree of willingness of a taxpayer to comply with tax laws and administration without threat or the application of any enforcement activity. On the other hand, failure to adhere to tax laws and policies, non-filing of tax returns, inaccurate or non-payment of tax liability, among others, is often referred to as tax evasion. Tax evasion has been identified as one of the fundamental problems of tax administration in developing countries, including Nigeria. The major consequence of tax evasion is that it robs government of the much-needed revenue to undertake developmental programmes.

According to Grigorios, Andreas and Michail, (2022), the cost of tax compliance refers to the expenses incurred by taxpayers in order to fulfill their tax obligations by complying with the requirements of the tax provisions. It also consist of the cost of collecting, remitting and accounting for tax on the products or profits of a business; cost of collecting, remitting and accounting for tax on the wages and salaries of employees (payroll tax); as well as the cost of acquiring knowledge to enable the above stated tasks to be done. Compliance costs normally include all costs associated with obeying tax laws, including planning and administration, in addition to the direct time and money spent filing paperwork. There is a general presumption that compliance issues such as tax compliance costs could be very enormous on small businesses, compared to big ones; and this could negatively affect compliance and thus enhance tax evasion.

Owing to the numerous demerits of tax evasion the subject has attracted quite a reasonable research attention, and these studies (Hove and Hove, 2016; Akpu and Ohaka, 2017; Nangih and Nkemakola, 2018) have identified some of the factors responsible for persistent tax evasion, especially in sub-Saharan countries (including Nigeria). Also, the potential importance of compliance costs in influencing compliance behavior of tax payers has equally been recognized in tax literature. However, the relationship between compliance costs and tax evasion, especially in the context of small and medium enterprises (SMEs), has not been sufficiently examined to the best of the knowledge of the researchers. The examination of this relationship becomes imperative given the assumed high rate of evasion by the SMEs and the search for measures of enhancing tax compliance by the operators in this sector.

Prior studies (Hove and Hove (2016); Kondwani (2024).; Fagbemi and Abogun, 2015) in this area have examined tax compliance issues of SMEs as well as tax evasion in this sector. It is however observed that these studies treated these two phenomena in isolation. Also, studies in this area have greatly ignored the effect of high compliance costs on compliance behavior of taxpayers. This study attempts to examine the components of tax compliance costs. The study also examined the effect of compliance costs on tax evasion by SMEs in Akwa Ibom State.

As noted by Fowler (2016), tax evasion has persisted in the Nigerian economy in spite of several measures in combating this menace. For instance, the Federal Inland Revenue Service (FIRS) reported recently that over 700,000 companies have not been captured in the tax net for the past 10 years (Fowler, 2016). This situation is even worse in the informal sector, where most of the SMEs operate.

Studies aimed at enhancing tax compliance or combating tax evasion in Nigeria have concentrated on large companies and financial institutions (Abdul and Wang'ombe (2017); Kurawa (2018)). However, it has been widely acknowledged that small and medium enterprises are the engine room of most economies, in some cases contributing as much as 70% to the GDP (Fagariba, 2016). This sector is also alleged to have a high rate of tax evasion; mainly because most of them operate in an informal way. It has however been argued that high tax burden could be part of the reason for informality. This study therefore aims to examine the relationship between tax compliance costs and tax evasion by SME operators. The study seeks to provide answers to the following research questions:

- i. What is the effect of cost of tax registration on tax evasion by SMEs?
- ii. What is the effect of cost of engaging tax professionals on tax evasion by SMEs?
- iii. What is the effect of cost of keeping tax accounting records on tax evasion by SMEs?

- iv. What is the effect of cost of obtaining information on tax policies on tax evasion by SMEs?
- v. What is the effect of the cost implication of time spent on tax matters on tax evasion by SMEs?

## LITERATURE REVIEW

### The Concept of Tax Evasion

Tax evasion refers to illegal practices by taxpayers, to escape from taxation. These practices include non-declaration of taxable activities, misrepresentation of income/profit and overstatement of allowable tax deductions (Michaelmas, (2023) and Onuorah, 2022). Although an illegal practice, tax evasion can occur as an isolated incident within activities that are legal in other aspects – legal. It can also occur in the informal economy where the whole activity takes place in an informal manner – this implies that the business is not only evading tax payments but is also not registered as formal enterprise.

The term tax evasion and tax avoidance are often mistakenly used, thus there is need to distinguish one from the other. Tax evasion is the failure to declare taxable activity whereas tax avoidance is the reorganization of economic activity, possibly at some cost, to lower tax payment (Michaelmas, 2023). Tax avoidance is legal, whereas tax evasion is not. However, both can be viewed as forms of tax non-compliance as they describe a range of activities that are unfavorable to a State's tax system (Usman, 2023).

Over the years, tax evasion has proved to be a very difficult problem in the tax system of almost all countries. In order to develop strategies and instruments for mitigating tax evasion, it is pertinent to foremost understand the different reasons underlying these problems. In Fagariba, 2016, the reasons for tax evasion were filed into two categories. The first category comprises factors that negatively affect taxpayers' compliance with tax legislation. These factors are low tax morale and high tax compliance costs. The second category contains reasons for the low ability of tax administration and fiscal courts to enforce tax liabilities. These factors are poor tax administration and inadequate tax audit/monitoring.

### Concept of Tax compliance

Tax compliance refers to the action of taxpayers to fulfil the obligation to carry out tax provisions by following recognized procedures and practices (Mianti and Budiwitjaksono (2021). According to Bruce-Twum, Schutte, and Asare, (2022), tax compliance is the readiness of taxpayers to operate in harmony as well as letter of tax laws. The authors further stated that tax compliance entails making, creating, submitting financial reports and making payments to the relevant tax authorities on time and in the necessary form. Fagbemi and Abogun (2015) argued that tax compliance is a behavioral issue of the tax payer. It is either a taxpayer pays his/her tax voluntarily or coerced to do so. The duo argued further that the level of tax compliance could be a function of the level of trust in government, as well as the ease of complying with tax laws. The higher the level of confidence the greater the level of compliance and vice-versa. Similarly, the easier the means of complying with tax laws, the higher the level of compliance and vice versa. According to Adekunle and Disu (2018), a complex tax system with high compliance costs may result in tax avoidance, evasion and tax fraud. Perhaps in agreement with Slemrod (2019), Mahangila (2017) argued that tax compliance cost is heavier among small businesses than large companies. This is because large companies have more capacity to absorb tax compliance costs than small companies with little capital base and turnover. Martins & Picoto, (2019) admonished that the simplification of tax processes and reduction in compliance costs will increase the profit that accrues to SMEs and thus improve their compliance with tax laws.

### Tax Compliance Issues in Nigeria

The issue of tax compliance in Nigeria is now likely to be a more significant aspect of tax policy. Recent developments in the tax system such as the implementation of self-assessment, the emergence of global economy and electronic commerce, may be perceived as providing more opportunity for non-compliance by taxpayers, and thus present greater challenges to the tax authorities. Non-compliance with the tax laws may take a variety of forms. For example, non-compliance occurs when individuals and firms under-report their

income, sales or over-claim deductions, exemptions or credits resulting in tax evasion or when they failed to file appropriate tax returns or to make tax payments in accordance with the tax laws. The most frequent and extreme form of non-compliance, according to Okolo and Boniface (2020) is tax evasion.

The importance of tax compliance to the development of an economy cannot be over-emphasized. This is because non-compliance leads to a reduction in tax revenues, which in turn affects public services received by the citizens. It also alters the distribution of income in unpredictable ways, such as by shifting the costs of taxation from dishonest persons to honest taxpayers and limits the capacity of the government to discharge its important functions. The cost of tax administration is two-fold, comprising the cost of the agency needed to administer tax laws and the larger cost to the public and businesses of complying with them. It is therefore less expensive to collect taxes through voluntary compliance than through the use of enforcement (Grigorios *et al.*, (2022).

### **Tax Compliance Costs**

The term ‘tax compliance cost’ has been defined differently by different authors. As noted by Mahangila (2017), the challenges faced in tax compliance cost research, particularly in the definition and measurement of compliance cost, remains a critical issue. Slemrod (2019), tax compliance costs are the costs incurred by taxpayers in meeting the requirements laid on them by the tax law and the revenue authorities, over and above the actual payment of tax and over and above any distortion costs inherent in the nature of the tax. He argued that these costs would disappear if the tax was to be abolished. The author listed the costs to include: the costs of collecting, remitting and accounting for tax on the products and profits of the business and on the wages and salaries of its employees; the costs of acquiring and updating the knowledge to enable this work to be done; the cost of obtaining knowledge or legal obligations and penalties associated with these taxes, as well as psychological and social costs (Stamatopoulos, I., Hadjidema, S., & Eleftheriou, K. (2017)).

Mahangila (2017) defined tax compliance costs as those costs incurred by taxpayers, or third parties such as businesses, in meeting the requirements laid upon them in complying with a given structure and level of tax. He identified what he described as the “hard core” of compliance costs, which are indisputably part of the costs of complying with tax requirements as including the following:

- a. the costs of labour/time consumed in completion of tax activities. For example, the time taken by a business person to acquire appropriate knowledge to deal with tax obligations such as Pay As You Earn (“PAYE”) or VAT; or the time taken in compiling receipts and recording data in order to be able to complete a tax return;
- b. the costs of expertise purchased to assist with completion of tax activities (typically, the fees paid to professional tax advisers); and
- c. incidental expenses incurred in completion of tax activities, including computer software, postage, travel, among others.

In addition to the above hard core of compliance costs, there are a number of other costs that need to be considered. For example, taxpayers suffer stress, anxiety and frustration as a result of attempting to comply with their tax obligations. These are the “soft core” compliance costs.

From the above definitions it is obvious that compliance costs of taxation are amount of resources expended by taxpayers, in addition to the amount of tax they are required to pay, in conforming to the requirements of the relevant tax law. Compliance costs are not only incurred by taxpayers directly but include all the costs incurred by their agents or parties involved in making possible the tax obligation of the tax payer is carried out effectively and efficiently.

### **Types of Compliance Costs**

World Bank & PwC, 2017 attempted to distinguish between compliance costs for individuals and companies. For individuals, such as employees, sole-proprietors and partners in a partnership business, compliance costs



may include: the costs of acquiring sufficient knowledge to meet legal requirements; cost of compiling the necessary receipts and other data; cost of making the relevant calculations and completing tax returns; payment for tax advisory services; all the incidental costs of postage, telephone calls, and travel to communicate with tax advisers or the tax office. Compliance costs for a business, on the other hand may include: the costs of collecting, remitting, and accounting for tax on the products or profits of the business, and on the wages and salaries of its employees; the costs of acquiring the knowledge to enable this work to be done including the knowledge of their legal obligations and penalties (Smulders, Stiglingh, Franzsen, and Fletcher (2017)).

In describing tax compliance costs, a distinction is often made between internal and external costs. Internal costs, according to Slemrod (2019), are those costs generated by the accounting and administration department of the company. It includes all the costs incurred by the staff of the organization in preparing all the information and documents for the fiscal authorities and consulting with external tax advisers, when arises. External costs, on the other hand are generated by the services from tax consultants, lawyers, and other advisory service providers. The external costs are much easier to identify and quantify. Internal costs are more difficult to quantify since they involve subjective estimations of the time spent on different tax activities. Some studies have revealed that in most companies the internal compliance costs are substantially more important than the external (Smulders, Stiglingh, Franzsen, and Fletcher (2016); Eichfelder & Hechtner, 2018).

### **Time Spent, Monetary Expenses and Psychological Costs**

The major component of tax compliance costs in the various definitions of the concept is the division of tax compliance costs into three parts, namely: time spent, monetary expenses and psychological costs. According to Bruce-Twum *et al.*, (2022), the total time spent contains employee costs (in-house staff) and external costs (fees paid to outside accountants and other advisors). Hours by internal staff can be converted in expenses by means of an average hour rate. The psychological costs refer to the effects upon a taxpayer having to deal with tax affairs, for example mental stress. However, in this study, the researcher concentrates on the cost implication of time spent on tax related matters, while psychological costs will be held as control variables. Within the monetary expenses, there is also the argument as to the actual expenses that are tax related and those relating to the normal accounting activities of the organization (Eichfelder & Hechtner, 2018). To these end monetary costs are further sub-divided into accounting costs and tax costs, as well as other forms of classifications.

According to Eichfelder & Hechtner, (2018) the first step in identifying tax compliance cost is to dissect accounting costs from tax costs in the overall internal costs of the organization, because of what he described as “joint cost problems.” Despite attempts by various researchers to separate tax compliance costs from the underlying costs of being in business, often referred to as “core accounting costs”, there is almost certainly some overlap between business or accounting costs and tax compliance costs. Based on this reasoning Eichfelder & Hechtner, (2018) argued that because of the uncertainty about the extent of overlap, most estimates of tax compliance costs can at best be only indicative. In this study, effort was made to identify the core tax related costs and these include: costs of registration for tax purposes, cost of engaging tax professionals for tax filing and related matters, cost of keeping accounting records for tax purposes and other additional tax-related costs.

### **Computational Costs and Tax Planning Costs**

In describing tax compliance costs there is also the need to distinguish between computational costs and planning costs. Computational costs, according to Slemrod (2019), are those unavoidable, involuntary costs while tax planning costs are avoidable, voluntary costs. For instance, Accounting computations involve costs which are inevitable for an organization. This include, the costs necessary to have a proper accounting system that already prepares the necessary information and calculates the amounts due for tax purposes. Planning costs on the other hand occur when a company tries to lower or avoid tax payments in a legal manner. This activity is part of good management practices designed to optimize the profitability of the company. To achieve this, it is imperative that the tax planning costs must be less than the savings obtained (Stamatopoulos *et al.*, (2017). Some of these avoidable planning costs according to Grigorios *et al.* (2022), contain planning and research costs and are considered as voluntary costs.

Many researchers and policy makers are in disagreement as to whether to include both costs as compliance cost (Grigorios *et al.*, (2022); Mahangila (2017). According to Grigorios *et al.*, (2022), only computational costs constitute legitimate measures of tax compliance costs. However, researchers like Bruce-Twum, *et al.*, (2022) argued that it is often almost impossible to disentangle the one computational cost and tax planning costs within the underlying business or accounting expenses, hence there is no justification separating them. In this study, the researcher used those computational costs that relate to tax matters as well as those relating to tax planning as components of tax compliance costs.

## Empirical Review

Over the years, several studies on tax compliance costs, tax evasion and the effect of compliance costs on tax evasion have been conducted in developed and developing countries across the world.

According to Abdul and Wang'ombe (2017), a complicated tax system makes it difficult and expensive for some taxpayers to comply with tax policies and procedures owing to the costs associated with record keeping and the need for specialized information. This has placed more pressure upon small and medium enterprises in developing countries, thus forcing them to operate outside official reporting system. (Eichfelder & Hechtner, 2018) argued that tax rules increase the labour costs which in turn provide a great incentive to avoid costs by working in the shadow or underground economy. Borrowing from economics, high compliance costs result in a deadweight resource costs on society, distorted production decisions, reduced investment, higher deficits, reduced tax equity and adverse price movements. Consequently, resentment of high compliance cost may lead to increased tax evasion, thereby reducing tax yields (World Bank & PwC, 2018). They further suggest that high compliance costs could be responsible for the high tax gap in developed countries given the fact that such economies relatively have efficient tax administration.

Bernard, Momba and Oluoch (2018) evaluated the influence of cost of tax compliance on tax compliance among the Export Processing Zone investors in Kenya. A cross-sectional survey design was used and the population of the study comprised 152 duly registered and licensed firms by the Export Processing Zone Authority. Primary data was gathered using structured questionnaires and captured through a 5-point type Likert Scale questionnaire. Data was analyzed by use of descriptive and inferential statistics, while Analysis of Variance (ANOVA), multiple regression and correlation analysis was carried out to test the hypothesis. The study findings indicated that the cost of tax compliance influences tax compliance to a great extent with a mean score of 4.02

Omondi and Theuri (2019) investigated the effect of taxpayer awareness and compliance costs on tax compliance among small scale traders in Nakuru town, Kenya. The study used a sample size of 302 which was drawn from the target population of 1416 licensed small scale traders by the County government of Nakuru. Structured questionnaire was used in collecting data. The data was coded and analysis was done using inferential and descriptive statistics. The findings of the study revealed that tax awareness and education has a positive and significant effect on the tax compliance, while the cost of compliance has a negative and significant effect on the level of tax compliance by taxpayers in Kenya. Enhanced trainings and sensitization of taxpayers were recommended in order to create awareness and reduce compliance costs

Smulders, *et al.*, (2016) also carried out a study on TCC in South Africa using the survey research method. The objective of the study was to determine the factors that affect the internal tax compliance costs of small businesses operating in South Africa. The multiple regression analysis was run per type of tax to identify the key factors that were considered to have a significant impact on the internal tax compliance costs of small businesses, in terms of hours spent internally on tax compliance activities. The findings of the study showed that the significant determinants of internal tax compliance costs included the following: sector (CGT and income tax), the education level of tax payers (income tax), legal form (VAT and income tax), number of employees (PAYE), turnover (turnover tax, income tax, PAYE and VAT), business age (turnover tax and CGT), type of accounting system (VAT), accounting knowledge of the respondent (PAYE and income tax), use of external service provider (PAYE and VAT).

Although studies on taxation in Nigeria are numerous in number, only few of them focused on tax compliance costs. Eragbhe and Omoye (2014) examined the effect of SME characteristics on tax compliance costs in Nigeria, specifically compliance costs in relation to VAT. Using the purposive sampling technique, a sample of 750 taxpaying SMEs across the six geo-political zones of Nigeria was selected for the study. The variables of SME characteristics tested against CCVAT were business age (LIFET), outsourcing (OUTS), employee size (WRKS), export status (FOT), turnover, (TURO), industry class (INCLAS) and distance to tax office (DISTANCE).

Their findings revealed that LIFET, TURO, INCLAS, DISTANCE and WRKS have a negative effect on TCC of VAT, while FOT and OUTS have a positive effect. However, going by their t-ratios, none of the variables appear to be significant. Thus, the study concluded that SMS attributes does not impact significantly on CCVAT in Nigeria. It was recommended that Policy makers in Nigeria should focus on external factors that might influence SMEs VAT compliance costs such as economic, political, social, technology and infrastructural facilities.

Abdul and Wang'ombe (2017) examined the influence of tax compliance costs on tax compliance behaviour among medium and large corporate taxpayers in Kenya. Survey data were collected from the tax managers or the accountants of selected firms using structured questionnaire. The study used a Structural Equation Modelling (SEM) technique in analysing its objectives, while controlling two key attributes of the tax system (complexity and fairness) as well as firm characteristics (business size, age industry and legal structure). The results of the study show that tax compliance in Kenya significantly declines with increase in tax compliance costs, particularly those related to understanding of the existing complex laws, changes in tax rules as well as general costs of meeting the compliance and regulatory requirements.

In Ghana, Fagariba (2016) carried out a study on the perceptions of causes of tax evasion in the Accra Metropolis of Greater Accra Region of Ghana. Data was collected from a sample of 150 small business traders through questionnaires, in depth interview, focus group discussions and key informant interview. Using Statistical Product and Service Solution (SPSS), version 19 (2012 edition), data was analyzed and translated into bar charts, pie chart and histogram for a clear illustration of the research findings. The study found that the perception of causes of tax evasion is related to many socio-economic factors such as poor tax education, high level of corruption in the government, high compliance cost, weak enforcement of tax laws, weak capacity of tax authorities to detect tax defaulters, loop holes in the tax net and issues of tax burden. Improved tax administration, computerized tax filing system and rigorous tax education were recommended as some of the ways to prevent tax evasion among small business traders in Ghana.

Nangih and Nkemakola (2018) examined the factors influencing tax evasion in Nigeria's informal sector. The study empirically studied the influence of sex, income level and tax morale on tax evasion in the informal sector. Data were obtained by means of questionnaire and analyses were performed using descriptive statistics, Ordinary Least Squares, and regression statistical tools. The findings of the study showed that sex and tax morale affects tax evasion positively, while income influences tax evasion negatively among informal sector operators in Nigeria. It recommends a reduction in the level of multiplicity in taxes and regular tax education to ensure voluntary compliance among informal sector operators in Nigeria.

Aladejebi (2018) conducted a study on tax compliance among SME owners in Lagos, Nigeria. The study used judgemental and random samplings in selecting 250 respondents to whom questionnaires were distributed to. The SPSS statistical package was used to analyse the data while chi-square test of association was used to test the relationship between the characteristics of the respondents and their level of compliance. The test results showed a significant relationship between the level of compliance and sex of entrepreneurs. The study concluded that female entrepreneurs, Limited liability companies and companies in operation for 7 years and above showed a higher level of compliance with tax regulations than male entrepreneurs, sole proprietors and businesses below 7 years respectively. The study recommended that tax amnesty and tax education as ways to improve the level of tax compliance among SMEs in Nigeria.

## METHODOLOGY

This study adopts the survey research design in executing its objectives. The study obtained data through structured questionnaire which was administered on the owner/managers and accounts/ finance officers of the select SMEs in Akwa Ibom State. The essence of this was to seek clarifications of the published and unpublished data and to collect useful facts about the effect of tax laws, the costs of fulfilling those laws and other compliance costs on tax evasion.

### Population

The population of this study consists of all Small and Medium Enterprises in Akwa Ibom State, Nigeria. According to a study undertaken by the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) and the National Bureau of Statistics (NBS) in 2017, the total number of SMEs in Akwa Ibom State is 1,887.

### Sample Size and Sampling Technique

The sample size of this study was determined using Yamane (1967) model. This model is stated as follows:

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

Where:

n = Sample size

N = Population size (finite population)

e = Error term (0.05 on the basis of 95% confidence level)

1 = Theoretical constant

From the above, n value (sample size) will be computed as follows:

$$n = \frac{1,887}{1 + 1,887 (5\%)^2}$$

$$n = \frac{1,887}{1 + 1,887 (0.0025)}$$

$$n = \frac{1,887}{1 + 9.435}$$

$$n = \frac{1,887}{10.435}$$

$$n = 330$$

Stratified random sampling technique was used in selecting the respondents for the study. The stratification was on the basis of the three senatorial districts of the State namely: Uyo, Ikot Ekpene and Eket senatorial districts as well as the different business sectors in the economy. This includes: agricultural sector, manufacturing sector, wholesale/retail business, hotel/restaurants, telecommunication, financial services and consultancy. In order that each of the strata or category of target population has an equal chance or probability of being included, samples were selected from the stratified groups randomly to respond to the questions in the questionnaire.



## Sources of Data and Methods of Data Collection

Data for this study consist of both primary and secondary data. Questionnaire was used for the collection of primary data; while secondary data was sourced from secondary sources such as textbooks, journals and research articles. In order to make it easy to obtain precise answers from the respondents, the researcher used close-ended questionnaire. The construction of the questionnaire for this study was based on extensive review of literature on tax compliance costs and tax evasion by SMEs. Available questionnaires from prior studies (example Bernard, Memba and Oluoch (2018); Nangih and Nkemakola (2018); Omondi and Theuri (2019) were modified in line with the objectives of this particular study. The questionnaire was structured into two main sections, consisting of thirty-three (33) questions. Section A consists of general information about the respondent’s background and their knowledge of taxation. These include their status, position in the business organization, educational and professional qualifications, knowledge of taxation, nature of business organization and type of business activity as well as size of the business while section B of the questionnaire consists of questions on the effect of compliance costs on tax evasion and factors that could reduce tax compliance costs and enhance tax compliance by SMEs. Given the nature of this study, the questions were constructed to ensure that sensitive information about the tax status of the respondents was not disclosed. To this end, most of the questions in the questionnaire were close-ended, except where respondents were required to suggest other factors that could reduce tax compliance costs for SME operators. The questions/statements in the questionnaire were designed on a 5-point Likert scale with a rating of 5 for strongly Agree (SA) 4 for Agree (A), 3 for Disagree (D), 2 for strongly disagree (SD) and 1 for Undecided (UD).

## Reliability of the Research Instruments

To ensure that the instrument provides adequate coverage of the topic under study the questionnaire was reviewed by three senior lecturers in the Department of Accounting of the University of Uyo, who are well knowledgeable on taxation issues.

The reliability of the questionnaire was also tested using Cronbach Alpha model. The data for this test were from the piloted questionnaire. The test gave a reliability coefficient (r) of 0.75. Similarly, the reliability of the check-list was tested using Cronbach Alpha model. The result of the Cronbach test gave a reliability coefficient (r) value of 0.91, hence the instrument is considered very reliable. Table 3.1 shows the result of reliability test computation, using Cronbach Alpha model.

Table 3.1: Reliability Test of the Research Instruments

Research Instrument	No. of Items	Cronbach Alpha Value	Indication
Questionnaire	10	0.75	Reliable

Cronbach’s coefficient alpha provides an indication of the correlation among items of the scale. The value ranges between 0 and 1; whereby 0 indicates low reliability while 1 indicates high reliability. To accept an instrument as reliable, it must have coefficient reliability (r) that is above 0.5 (Cho, 2016). The result from Table 3.1 indicates that the reliability coefficients have exceeded the minimum acceptable level of 0.7. This therefore, confirms the scales are reliable and could adequately reflect the reliable construct it is measuring.

## Validity of the Research Instruments

The content validity of the questionnaire was further established through the pilot study. Ten copies of the questionnaire were forwarded to a select group of respondents for review and inputs. All the comments, corrections and inputs received from the pilot study were incorporated into the final copy of the instruments. Also, construct validity was carried out in order to ascertain that the questionnaire effectively measured the concepts of tax compliance cost and tax evasion, the instrument was subjected to further validity check. First, the determinants of tax compliance costs, based on international best practices were reviewed in the course of constructing the questionnaire. Second, pilot tests as described above, were carried out to indicate that the instrument was be able to measure what it was intended to measure. Finally, the use of a five-point Likert

scale, instead of a ‘yes’ and ‘no’ responses, in the instrument also contributed to improving the construct validity of the questionnaire.

## DATA ANALYSIS AND DISCUSSION OF FINDINGS

### Tax Evasion and Tax Compliance Costs

To evaluate the effect of compliance costs on tax evasion, 330 copies of questionnaire were distributed to respondents in the three senatorial districts of the state, out of which 250 (representing 76%) were correctly completed and returned. The breakdown of the senatorial districts and their responses is presented in Table 4.1.

Table 4.1: Analysis of Questionnaire Distribution and Collection

Senatorial districts	Copies of Questionnaire Distributed	Copies of Questionnaire Received	Response Rate
Uyo	130	120	92%
Ikot Ekpene	100	70	70%
Eket	100	60	60%
<b>Total</b>	<b>330</b>	<b>250</b>	<b>76%</b>

Source: Field survey (2024)

### Demographic Background and General Attributes of the Respondents.

The socio-democratic attributes of the respondents, such as status of the respondent, gender, academic and professional qualification, tax registration status and nature of business are presented in Tables 4.2

Table 4.2: Frequency Distribution of Background of the Respondents

S/N	Variable	Frequency	Percentage	Cumulative Percentage
1	<b>Status</b>			
	Employee	136	54	54
	Owner/Manager	114	46	100
	<b>Total</b>	<b>250</b>	<b>100</b>	
2	<b>Gender</b>			
	Male	148	59	59
	Female	102	41	100
	<b>Total</b>	<b>250</b>	<b>100</b>	
3	<b>Academic Qualification</b>			
	WASC/GCE	5	2	2
	OND/NCE	48	19	21
	B Sc/HND	146	58	79

	M Sc/MBA/PhD	51	21	100
	<b>Total</b>	<b>250</b>	<b>100</b>	

Source: Field survey (2024)

Table 4.2 shows that employee has the highest respondents of 136 or 54% of the total respondents while owner/manager recorded 114 respondents representing 46% of the total respondents. This shows that a greater percentage of the respondents are those who are involved in the day to day activities of the organization and are knowledgeable about tax matters. The Table also shows that majority of the respondents (N=148, 59%) were male while (N=102, 41%) were female. This shows that there is a considerable gender balancing among the respondents. In terms of academic qualification, (N=146, 58%) of the respondents have obtained a bachelor’s degree or higher national diploma; while (N=51 or 21%) of the respondents have postgraduate degrees. This shows that most respondents have acquired higher academic qualification up to first degree and above. It therefore implies that the level of education among the respondents in this study is reasonably high; thus their participation has immensely enriched the quality of survey findings.

### Professional Qualification and Knowledge of Taxation

The professional qualification of the respondents and their knowledge of taxation were examined and the result is presented in table 4.3.

Table 4.3: Professional Qualification and Knowledge of Taxation

S/N	Variable	Frequency	Percentage	Cumulative Percentage
<b>4</b>	<b>Professional Qualification</b>			
	FCA/FCNA	26	10	10
	ACA/CNA	72	29	39
	FCTI/ACTI	50	20	59
	None	102	41	100
	<b>Total</b>	<b>250</b>	<b>100</b>	
<b>5</b>	<b>Knowledge of Taxation</b>			
	Very Good	30	12	12
	Good	108	43	55
	Not Very Good	104	42	97
	No Knowledge	8	3	100
	<b>Total</b>	<b>250</b>	<b>100</b>	
<b>6</b>	<b>Tax Registration (TIN)</b>			
	Registered	208	83	83
	Not Registered	42	17	100
	<b>Total</b>	<b>250</b>	<b>100</b>	

Source: Field survey, (2024)

Table 4.3 shows that majority of the respondents (148, 59%) are professionals of Accounting and Taxation. Correspondingly, 55% (138) of the respondents have good knowledge of taxation. With a higher number of respondents who are knowledgeable of taxation, it therefore implies that they will be able to provide accurate responses to questions/statements raised in the questionnaire.

### Tax Compliance Costs and Tax Evasion

Questions about tax evasion are as old as taxes and will remain an area of enquiry as long as taxes exist. As discussed extensively in section two of this study, several factors have been adduced as reasons for tax evasion. This study focused on one of the areas or factors which have not received much attention in tax evasion literature; and that is cost of compliance. To understand the effect of compliance costs on tax evasion, fifteen questions/statements were raised in the questionnaire to address these variables. The responses of the respondents to these questions are presented and analysed in Table 4.4.

Table 4.4: Analysis of Effect of Compliance Costs on Tax Evasion

Statement/Question	Response	Frequency	Percentage	Cumulative Percentage
1. The cost incurred by SMEs in registration for tax purposes is high	Strongly Agree	126	50.00	50.00
	Agree	99	40.00	90.00
	Disagree	18	7.00	97.00
	Strongly Disagree	7	3.00	100.00
	Undecided	0	0.00	100.00
	<b>Total</b>		<b>250</b>	<b>100.00</b>
2. The high cost of registration for tax purposes and the attendant inconvenience is a disincentive to tax compliance	Strongly Agree	128	51.00	51.00
	Agree	100	40.00	91.00
	Disagree	17	7.00	98.00
	Strongly Disagree	5	2.00	100.00
	Undecided	0	0.00	100.00
	<b>Total</b>		<b>250</b>	<b>100.00</b>
3. The high cost of registration for tax purposes and the attendant inconvenience encourages tax evasion	Strongly Agree	127	51.00	51.00
	Agree	102	41.00	92.00
	Disagree	13	5.00	97.00
	Strongly Disagree	8	3.00	100.00
	Undecided	0	0.00	100.00
	<b>Total</b>		<b>250</b>	<b>100.00</b>



4. The cost incurred by SMEs in engaging tax professionals for the preparation and filing of tax returns is too high	Strongly Agree	130	52.00	52.00
	Agree	98	39.00	91.00
	Disagree	13	5.00	96.00
	Strongly Disagree	9	4.00	100.00
	Undecided	0	0.00	100.00
	<b>Total</b>	<b>250</b>	<b>100.0</b>	

Source: Field survey (2024)

As shown in table 4.4 90% of the respondents are in agreement that the cost incurred by SMEs in registration for tax purposes is high. Also, 91% of the respondents agreed that the high cost of registration for tax purposes and the attendant inconvenience is a disincentive to tax compliance. To test the respondent’s understanding, the same question was asked in a different way and only 8% disagreed that the high cost of registration for tax purposes and the attendant inconvenience encourages tax evasion, while 92% agreed to the statement. On the costs incurred by SMEs in engaging external tax professionals to assist them in tax matters, 91% of the respondents confirmed that this cost is high, and thus could lead to tax evasion.

Table 4.5: Analysis of Effect of Compliance Costs on Tax Evasion

Statement/Question	Response	Frequency	Percentage	Cumulative Percentage
1. The complexity in the tax system is the reason why SMEs engage the services of tax professionals	Strongly Agree	130	52.00	52.00
	Agree	97	39.00	91.00
	Disagree	12	5.00	96.00
	Strongly Disagree	11	4.00	100.00
	Undecided	0	0.00	100.00
	<b>Total</b>	<b>250</b>	<b>100.00</b>	
2. The high cost of engaging tax professionals for tax purposes encourages tax evasion	Strongly Agree	125	50.00	50.00
	Agree	103	41.00	91.00
	Disagree	14	6.00	97.00
	Strongly Disagree	8	3.00	100.00
	Undecided	0	0.00	100.00
	<b>Total</b>	<b>250</b>	<b>100.00</b>	
	Strongly Agree	125	50.00	50.00
	Agree	98	39.00	89.00

3. The cost incurred by SMEs in keeping books and accounting records for tax purposes is too high.	Disagree	18	7.00	96.00
	Strongly Disagree	9	4.00	100.00
	Undecided	0	0.00	100.00
	<b>Total</b>	<b>250</b>	<b>100.00</b>	
4. The high cost of keeping accounting records for tax purposes and the attendant inconvenience is a discouragement to tax compliance	Strongly Agree	126	50.00	50.00
	Agree	96	38.00	88.00
	Disagree	20	8.00	96.00
	Strongly Disagree	8	4.00	100.00
	Undecided	0	0.00	100.00
	<b>Total</b>	<b>250</b>	<b>100.00</b>	

Source: Field survey (2024)

Most of the respondents (91%) are in agreement that the complexity in the tax system is the reason why SMEs engage the services of external tax professionals to assist in tax matters. Similarly, 91% of the respondents agreed that the high cost of engaging external tax professionals and the attendant inconvenience encourages tax evasion by SMEs.

Table 4.6: Analysis of Effect of Compliance Costs on Tax Evasion

Statement/Question	Response	Frequency	Percentage	Cumulative Percentage
1. The high cost of keeping accounting records for tax purposes encourages tax evasion	Strongly Agree	126	50.00	50.00
	Agree	90	36.00	86.00
	Disagree	24	10.00	96.00
	Strongly Disagree	10	4.00	100.00
	Undecided	0	0.00	100.00
	<b>Total</b>	<b>250</b>	<b>100.00</b>	
2. The cost incurred by SMEs in obtaining tax education and information about changes in tax policy is too high	Strongly Agree	120	48.00	48.00
	Agree	90	36.00	84.00
	Disagree	25	10.00	94.00
	Strongly Disagree	15	6.00	100.00

	Undecided	0	0.00	100.00
	<b>Total</b>	<b>250</b>	<b>100.00</b>	
3. The high cost of obtaining tax education and information about tax and complying with tax laws and processes is a discouragement to tax compliance.	Strongly Agree	123	49.00	49.00
	Agree	96	38.00	87.00
	Disagree	26	10.00	97.00
	Strongly Disagree	5	3.00	100.00
	Undecided	0	0.00	100.00
	<b>Total</b>	<b>250</b>	<b>100.00</b>	
4. The high cost of obtaining tax education and information about changes in tax policy and the attendant inconvenience encourages tax evasion	Strongly Agree	120	48.00	48.00
	Agree	94	38.00	86.00
	Disagree	25	10.00	96.00
	Strongly Disagree	11	4.00	100.00
	Undecided	0	0.00	100.00
	<b>Total</b>	<b>250</b>	<b>100.00</b>	

Source: Field survey (2024)

Table 4.6 shows that 89% of the respondents agreed that the costs of keeping books and accounting records for tax purposes is high. Also, 88% are in agreement that high costs of keeping books and accounting records for tax purpose and the attendant inconvenience is a discouragement to tax compliance. This means that 88% of the respondents are of the opinion that the high costs of keeping accounting records for tax purpose encourages tax evasion by SMEs. Also, 94% of the respondents agreed that the costs incurred by SMEs in obtaining tax education and information about changes in tax policy are too high. Accordingly, 97% of them are of the opinion that the high cost of obtaining information about tax and complying with tax laws and processes is a discouragement to tax compliance. This means that they agree that these could induce tax evasion.

Table 4.7: Analysis of Effect of Compliance Costs on Tax Evasion

Statement/Question	Response	Frequency	Percentage	Cumulative Percentage
1. The time spent by SMEs entirely or exclusively for tax purposes is considered too much	Strongly Agree	122	49.00	49.00
	Agree	90	36.00	85.00
	Disagree	26	10.00	95.00
	Strongly Disagree	12	5.00	100.00
	<b>Total</b>	<b>250</b>	<b>100.00</b>	
2. The time spent by SMEs entirely or	Strongly Agree	118	47.00	47.00

exclusively for tax purposes translates to huge amount in monetary terms	Agree	80	32.00	79.00
	Disagree	35	14.00	93.00
	Strongly Disagree	17	7.00	100.00
	<b>Total</b>	<b>250</b>	<b>100.00</b>	
3. The cost implication of time spent by SMEs exclusively for tax purposes encourages tax evasion	Strongly Agree	116	46.00	46.00
	Agree	78	31.00	77.00
	Disagree	38	16.00	93.00
	Strongly Disagree	18	7.00	100.00
	<b>Total</b>	<b>250</b>	<b>100.00</b>	
4. SME operators will willingly pay their taxes if these extra (compliance) costs were removed from tax processes	Strongly Agree	127	51.00	51.00
	Agree	102	41.00	92.00
	Disagree	13	5.00	97.00
	Strongly Disagree	8	3.00	100.00
	<b>Total</b>	<b>250</b>	<b>100.00</b>	

From table 4.7, 95% of the respondents agreed that the time spent by SMEs entirely or exclusively for tax purposes is too much for them; while another 93% confirmed that this time spent could translate to huge amount in monetary terms. Similarly, 93% of the respondents are in agreement that the time spent by SMEs exclusively for tax purposes encourages tax evasion. Interestingly, 92% of the respondents agreed that SME operators will willingly pay their taxes if these (extra) compliance costs were removed from the tax processes. Finally, 89% of the respondents agreed that the combined effect of all costs, other than tax liability, and the time spent in tax processes contributed to tax evasion by SMEs in Akwa Ibom State. The implication of the whole findings is that high tax compliance costs induce tax evasion among SMEs.

## CONCLUSION AND RECOMMENDATIONS

### Conclusion

This study was conducted to examine the effect of compliance costs on tax evasion by SMEs in Akwa Ibom State. From the findings of the study, tax compliance costs incurred by SMEs, which includes cost of registration for tax purposes, cost of engaging tax professional for filing and other tax matters, cost of keeping accounting records for tax purposes, cost of obtaining information about changes in tax policies and cost implication of the time spent entirely or additional or exclusive work for tax matters are high. Based on these findings, the researcher concluded that these compliance costs have significant effect on tax evasion. It is further concluded that the high rate of tax evasion by SMEs in Akwa Ibom State is caused more by the compliance costs than the actual tax liability.

### Recommendations

In line with the findings and conclusions of this study, the following recommendations are proffered towards minimizing tax compliance costs and also reducing tax evasion by SMEs operators:

- i. Government should simplify tax policies in order to reduce the complexity in tax registration processes.
- ii. Tax professionals should reduce their charges for SMEs as a way of encouraging their growth and sustainability.



- iii. Government and professional bodies should assist SMEs with simplified accounting system that will take care of their normal operations as well as serve tax purposes.
- iv. Tax authorities should endeavor to use modern techniques made possible by ICT in communicating information on tax policies to SMEs thereby reducing the cost of receiving such information
- v. Tax officers should visit SMEs to assist them in tax matters thereby reducing the time they would spend on such matters.

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