Factors that influence Tax Compliance by SMEs in Zambia: A case study of Ndola Central Business Centre.

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ABSTRACT

Tax revenue is such an important part of revenue for governments including the Zambian government. In other words, tax is quite a critical aspect in the managing of national income. SMEs, who constitute a large group of the country's business entities, contribute a lot to this aspect of the economy. Sadly, tax compliance by SMEs is quite a worrying affair as the levels of compliance are quite low. The study therefore aimed at interrogating the factors that influence tax compliance among SMEs in the Ndola Business Centre.

The data used in this study was collected with the help of guided questionnaires. Tables and charts were employed in the presentation of the result of the analysis. A statistical tool called PSPP was used in the analysis of data so as to establish the factors that influence tax compliance by SMEs. It was established that high tax rates negatively affected the SMEs tax compliance. High tax compliance costs, low levels of tax education and the negative attitude of SMEs towards tax were other factors that adversely affected tax compliance.

Keywords: Tax Compliance, SMEs, Ndola Central Business Centre, Zambia

1.INTRODUCTION

Tax is a significant mode through which governments raise domestic revenue. This assertion is supported by Aghion et al. (2016) who posited that taxation is one of the means governments use in mobilizing revenue for financing its expenditure. Tax compliance as stated by Mwangi (2014) is the degree to which taxpayers comply with or fail to comply with tax decrees of a nation. According to Lymer and Oats (2009) it is imperative that tax authorities devise appropriate strategies that would help in curbing tax evasion, thereby enhancing tax compliance SMEs. This view is supported by the International Finance Corporation (2003) which aptly posits that tax authorities must put in place such strategies that would arrest the situation of tax evasion by SMEs, which usually involves SMEs scheming to operate outside the tax net. According to Moyi and Njiraini (2005) in developing

countries, tax authorities have a huge task of ensuring that tax compliance by SMEs is enhanced as much as possible. This can be achieved by making sure that the SMEs are formalized so that they are captured under the tax net.

According to Gachiku (2015) empirical studies that have been conducted in South Africa indicated that making SMEs to be tax compliant was hampered by the fact that SMEs found the process of making good of their tax obligations to be expensive. This implies that most SMEs elected to be non-tax compliant to save resources. . It is common in most instances that high tax rates tend to escalate the level of non-tax compliance by SMEs.This is supported by Shahroodi, (2010) who posited that SMEs tax compliance can be enhanced if the tax rates are low enough to attract SMEs to pay as they will not feel overburdened by the taxes. There is empirical evidence to that effect. According to Derwent (2000) it is empirically proven that high tax rates increase the cost of producing goods and services, their distribution and selling, which has a potential to reduce SMEs productivity.

There have been other prior empirical studies on the determinants of tax compliance among SMEs that have been conducted in Kenya. One empirical study revealed that the tax in question did not yield positive results in that the non-tax compliance by SMEs including Micro-enterprises remained critically high. According to Moyi and Njiraini (2005), the main reason for this status quo was that the tax rates were high by most of the SMEs. This triggered the continued low tax compliance by the SMEs. A study by Chipeta (2002) revealed that high tax rates are associated with high tax burden, lowering the income levels of SMEs, hence the high levels of non-tax compliance witnessed. Tax compliance costs can be thought of as all costs that result from formalities that taxpayers must go through in trying to meet their tax obligations. This is backed by (Vihanto ,2000; Ojeka, 2012), who appropriately pointed out that planning, paperwork filing, and the hiring of tax experts, which constitute tax compliance costs, impact quite significantly on the willingness by SMEs to pay taxes as they fall due. The more tax information SMEs have about tax issues at hand, the more probable it is that their compliance level would be high. Gachiku (2015), posited that findings of an empirical study did indicate that most SMEs did not meet their tax obligations particularly due to the fact they had insufficient tax information. According to Wanjohi (cited in Mwangi, 2014) empirical studies revealed that SMEs perceived the tax regime used in Kenya as being unfair and this made them to engage in tax evasion schemes. The SME sector in Zambia, has puffed up following the liberalization of the Zambian economy. Langmead, et al., (2006) posits that the exponential increase in the number of SMEs has led to a proportionate increase in tax collection by the Revenue authority indicating that tax compliance by SMEs has not been high.

This formed the root for this study, which sought to make a critical evaluation of the factors that influenced tax compliance by SMEs in the Ndola's Central Business Centre. This paper is aimed at

evaluating the determinants of tax compliance by SMEs in the Central Business Centre of Ndola. Ndola is the Provincial Capital of the Copperbelt province in Northern Zambia. The quest to address the main objective of this article is broken down to answering the questions: What is the influence of tax rates on tax compliance by SMEs? How do tax compliance costs affect the tax compliance by SMEs? What is the influence of availability of tax knowledge on tax compliance by SMEs? How does the attitude of SMEs towards tax affairs affect their tax compliance? The study targeted SMEs in the trading, service sectors of the economy as well as manufacturing SMEs. The outcome of study makes an invaluable contribution to policy formulation regarding taxation in Zambia. The study will show that with policies in place which makes it easier for the taxpayer to voluntarily declare and pay correct at a reasonable cost, will increase government revenue. The study has also given solid foundation on which future studies can be pivoted through the enough documentation of determinants of tax compliance and how they influence tax compliance by SMEs. The rest of the paper is divided as follows: Section 2 which is follows is discuss the Theories that affect tax compliance; Section 3 is the summary of the data methods and source; Section 4 gives the research findings and their discussions; while the last sections concludes and makes recommendations including suggesting room for future research. Section 2 follows next.

2. TAX COMPLIANCE THEORIES

There are three key theories highlighted in this portion of the section on the factors that influence tax compliance by SMEs. These theories resonate well with the objects of this study. The theories are: Planned behavior, Tax Morale and the Allingham and Sandmo, AS Theories.

2.1. Theory of Planned Behavior

The theory of planned behavior posits that behavior of an individual is well thought out. Klee et al. (2000) postulates that in a society, the behavior of the members is always provoked by certain dynamics in deliberate style. These motivating factors that largely manipulate the behavior of members of a society fall in the continuum of behavioral, normative, and control beliefs.

Planned behavior theory is hinged on intention. The occurrence of an individual's behavior is exclusively reliant on intention. This implies that, intention motivates behavior of a member of a given society. Intention is synonymous with attitudes shown by an individual towards a given behavior. Klee et al. (ibid) postulated that the mindset or attitude of taxpayers is a critical determinant of their tax compliance.

The theory resonates well with the study as it sought to meticulously evaluate SMEs behaviors or attitude towards tax. In short, the study hunted to comprehensively interpret SMEs attitude towards tax, and how the attitude influenced their tax compliance.

2.2. Tax Morale Theory

Tax morale theory posits that morale, as an individual factor stimulates an individual's tax compliance. It explains the link between a taxpayer's morality and tax compliance. In other words, tax morale is a significant predictor of tax behavior. This implies that tax morality endeavors to explain the causal relationship between taxpayer's morality and the behavior of taxpayer. Waweru (2004) stated that individual is likely to exhibit tax compliance if the individual operates in a society where tax evasion is detested. Conversely, the individual is likely to be non-tax compliant if the society in which one operates cherishes tax evasion.

This relates to the study in that SMEs are more probable to be tax compliant if their perception about the government is quite positive in that they perceive it to be transparent, honest and accountable in the use of taxpayers' money.

2.3 The Allingham and Sandmo Theory (AS Theory)

The Allingham and Sandmo theory postulates that taxpayers can be discouraged from engaging themselves in tax evasion scheme. Yitzhaki (2002) posits that government can discourage taxpayers from tax evasion by the enough sanction mechanism it institute. Government can as well ensure tax compliance by conducting tax audits on a regular basis.

Tax cost of compliance is such a critical predictor of SMEs tax compliance. Taxpayers are demotivated to engage in tax evasion if they look at the tax compliance to be low. The sources of the tax compliance costs are basically constituted by cumbersome systems and procedures such as filing tax returns and all the paperwork involved in the paying of taxes. Yitzhaki (2002) stated that SMEs are more probable to exhibit non-tax compliance if in the process of complying with tax legislations, there are many hurdles faced as the lengthy bureaucratic processes.

3. DATA AND METHODOLODY

Collection of research data, according to Sekaran (2003) forms a very critical part of any inquiry (research). The method employed in the gathering research data is largely dependent on the type of data under consideration. The sampling technique that the researcher employed in the study was purposive random sampling to select 10% of 945 SMEs registered with the Zambia Revenue Authority, ZRA that constituted the sample, giving a sample of size of 95 SMEs. A sample according to Mugenda and Mugenda (2003) is a small assemblage individual obtained from a population.

Saunders et al., (cited in Gachiku, 2015) defines a research design as a plan that directs a study in order that the set objects can be achieved. It is an outline of collecting and analyzing the data gathered. A descriptive survey design was used in the study. According to Cooper (2003) a descriptive survey design is a suitable design for establishing cause and effect association between variables. This study was meant to establish a causal association between the determinants of tax compliance and SMEs tax compliance. This research study involved the utilization of descriptive analysis, with general questions and partly a Likert – scale, which was derived from the concepts as demonstrated in the Figure 1 below.
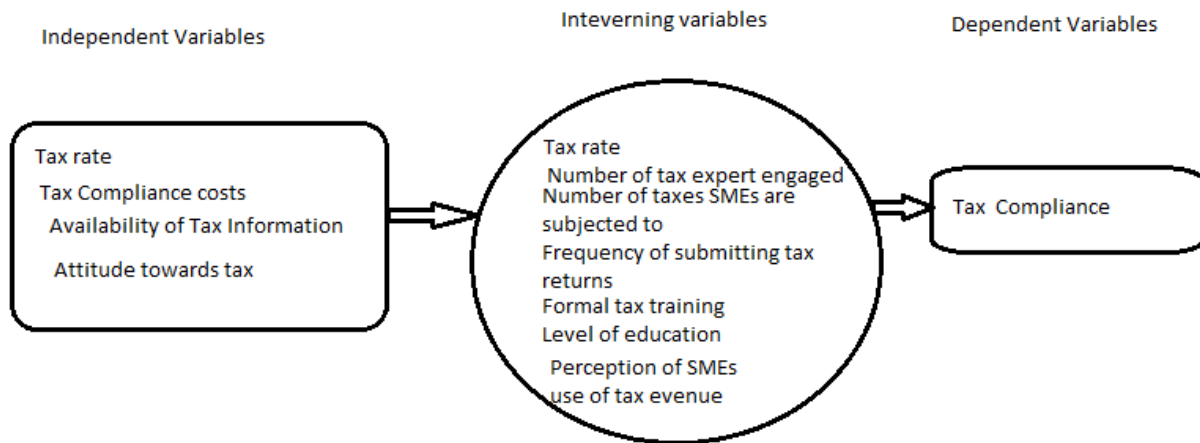
Source: Researcher's own construction, 2019

Figure 1: Conceptual Framework

Source: Authors computations (2020)

The main business activity the responding SME is engaged in and the length of time the business has operated. Other facets of the background information were the size of the workforce employed by the SME and the educational levels of the respondent SMEs. The researcher collected data from eighty two (82) small and medium size enterprises taxpayers, in the Central Business District of Ndola City. The response rate of 84% of the targeted respondents in the research duly answered the questionnaires, while 16 % did not participate. It must be mentioned that the response rate of 84 % warranted that data analysis be conducted. According to Mugenda and Mugenda (2003), a response rate of 50% is enough for data analysis and a response rate of 84% is excellent.

4.RESULTS AND DISCUSSION

4.1. Main business activity of Respondents

The figure 2 below follows is a demonstration of the main business activities that the responding SMEs were engaged in. As can be seen from figure 4.2, the most represented business activities were the trading sector, with a percentage representation of 50%, followed by the service sector which had a representation of 26%. The manufacturing sector had a representation of 12% indicating that most SMEs in the study population were in the trading sector of the economy.
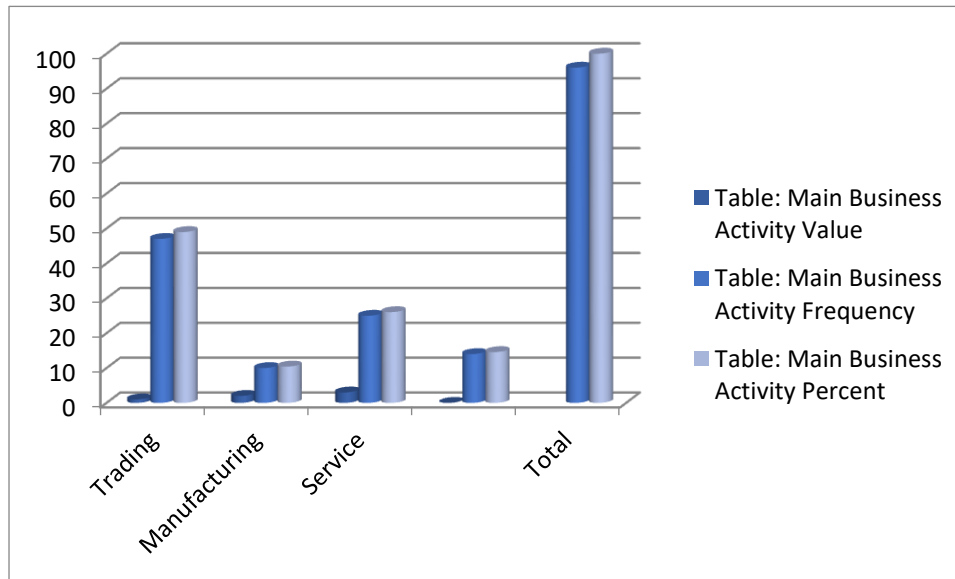

Figure 2: Main business activity of Respondents

Source: Authors computations (2020)

4.2. Length of time business has operated

It was also critical that the study takes a meticulous look at the length of time the business has operated as this could have an impact on their tax compliance levels. Figure 3 depicts the length of time the business has been in operation. Most of the SMEs in the sample population had indicated that they had been operational in their respective businesses for a period of over 10 years. The percentage representation for these SMEs was about 29%, while those that had operated for a period between 1 to 5 years was about 22%. The representation of SMEs who had been in business for a period between 5 to 10 years was 20%, and the least representation was that of SMEs that operated for a period less than 1 year.
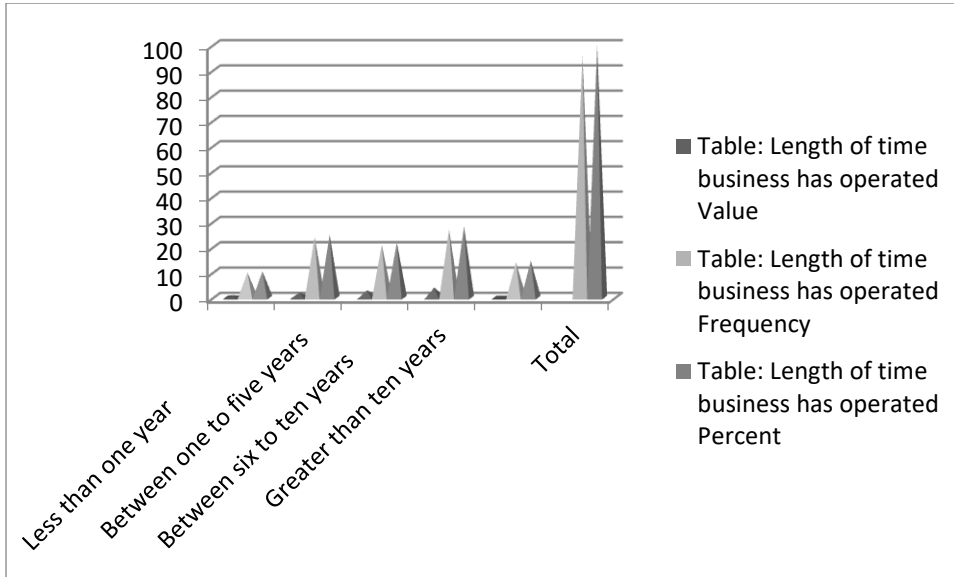
Figure 3: Length of time business has operated

Source: Authors computations (2020)

4.3. Size of work force employed by the respondent SME

The researchers also sought to establish the size of the work force engaged by the SME as it is quite a critical demographic characteristic, which to some extent can be an influence on SMEs tax compliance. The figure shows that majority of the respondent SMEs, 40% had a workforce that was less than ten years with a small proportion of the respondents.
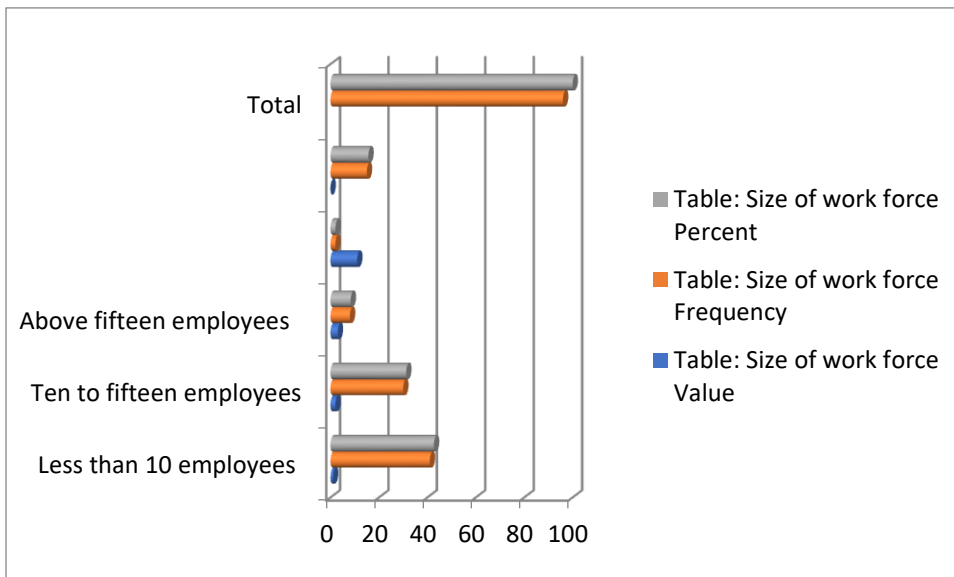

Figure 4: Size of work force employed by the respondent SME

Source: Authors computations (2020)

4.4. Level of Education of Respondents

Figure 5 depicts the level of education attained by the respondent SMEs. It quite clear from the figure that most of the respondent SMEs had attained secondary education and the proportion of this group was 46%. The SMEs with tertiary education constituted about 20% of the total number of respondents in the study, and 16% of the respondent SMEs only acquired a primary education qualification. The indication from these finding was that majority of the respondent SMEs were of humble education background. This segment of demographic characteristics was critical as the tax compliance levels may be influenced by tax knowledge or education, which may be hampered by the level of education attainment.
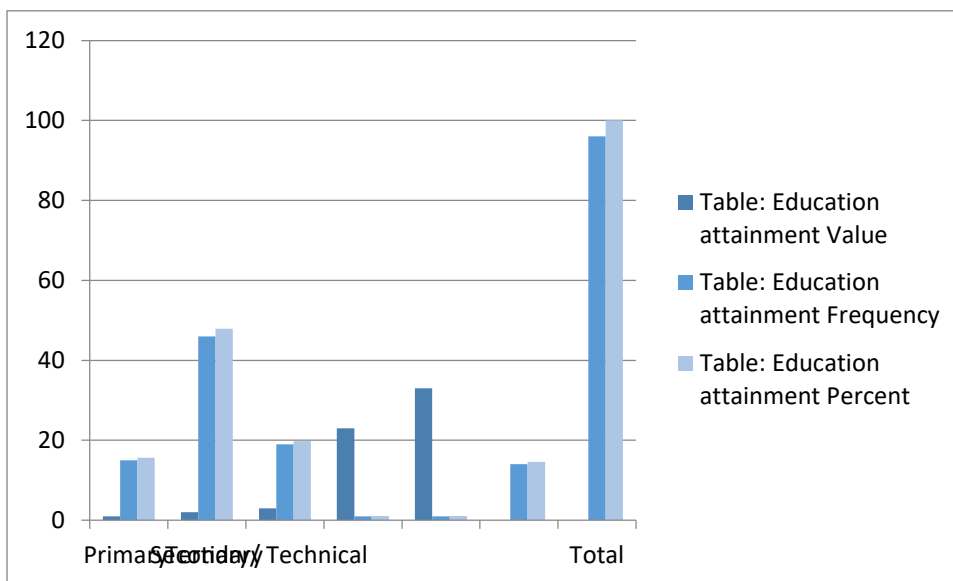

Figure 5: Level of Education of Respondents

Source: Authors computations (2020)

4.5. Factors that affect tax compliance among SMEs

4.6. Tax Rates and tax compliance by SMEs

The respondent SMEs in the study were posed with question on their view about the tax rates that they were subjected to. That was on a 5-likert scale, with strongly agree = (5); Agree = (4); Neutral = (3); Disagree = (2); strongly disagree = (1). As can be seen from the mean values, majority of the respondents agreed that the tax rates were high. This indication is shown by the mean value of 3.64, with a standard deviation of 1.08. On the number of tax returns that were supposed to be submitted, the mean value was 4.02, with the standard error standing at 0.7. This indicates that the SMEs that participated in the study agreed to the statement that the number of tax returns that were to be submitted were too much.

Table 1: Valid cases = 96; cases with missing value(s) = 14.	Column1	Column2	Column3
Variable	N	Mean	Std Dev
Tax rates are too high most SMEs	82	3.64	1.08
The numbers of tax returns that must be submitted are too much	82	4.02	0.7

Figure 6: Tax rate and tax compliance

Source: Authors computations (2020)

It must be mentioned that the intuition that tax compliance reduces with an increase in the tax rates. Studies have shown that when SMEs, precisely those in the trading sector perceive the tax rate to be high, their perception is that they pay more than necessary in terms of taxes. This is backed by Park and Hyun (2003) who posit that most empirical studies revealed that a hike tax rate leads to tax evasion.

4.7. Tax Compliance costs and tax compliance

The study sought to investigate the impact compliance costs on tax compliance. The tax compliance cost variable was represented by the following statements. The numbers of tax returns that must be published are too much and the cost of hiring experts to do the paperwork regarding tax returns is too high. The statistical results indicate that the respondents SMEs were agreeable to the statement that number of tax returns that were to be published were too much as shown by the mean value of 4.02, with a standard deviation of 0.7. The respondents also affirmed to the statement the cost of hiring experts to do the paperwork regarding tax returns were too high. This is on the premise that the statistical output gives a mean value of 4.34, which implies they agreed to the statement

Table 2: Valid cases = 96; cases with missing value(s) = 14.	Column1	Column2	Column3
Variable	N	Mean	Std Dev
The numbers of tax returns that must be submitted are too much	82	4.02	0.7
The cost of hiring experts to do paperwork regarding tax returns too high.	82	4.34	1.21

Figure 7: Tax compliance costs and tax compliance

Source: Authors computations (2020)

Compliance costs, it must be mentioned have a tendency to escalate with the number of taxes that SMEs are subject to, and the rate at which tax returns are submitted.

4.8. Tax Education and Compliance

As regards the study question as to whether tax compliance was affected by the SMEs level of tax education, the respondents strongly agreed to the statement that the tax laws and rules were not easy to understand by SMEs who were non-professionals. The statistical outcome indicates that the mean value for responses to this statement was 4.62, which approximately was 5 with a standard deviation of 0.7. The responses on the statement that information on tax laws and rules not readily available to the SMEs was 3.29, which is a clear indication that respondent SMEs felt that information on taxes was n not easily available.

Table 3: Valid cases = 96; cases with missing value(s) = 14.	Column1	Column2	Column3
Variable	N	Mean	Std Dev
Tax laws and rules are not easy for a non-professional to comprehend	82	4.62	0.7
Information on tax laws and rules not readily available to the SMEs.	82	3.29	1.12

Figure 4.8: Tax education and tax compliance

Source: Authors computations (2020)

4.9. Taxpayers attitude towards tax and compliance.

The study questioned the respondents in order to establish their attitude by use of the following statements: the SMEs attitude towards tax was negative, and the statistical results were that the SMEs agreed to this question. This was evidenced by mean value of 4.07 with a standard error of 0.77. This was on the premise that they perceived government not to have been transparent in the use of the resources mobilized through tax collections. The SMEs were of the opinion that their monies were going down the drain hence the motivation to evade paying their taxes.

Table 4: Valid cases = 96; cases with missing value(s) = 14.	Column1	Column2	Column3
Variable	N	Mean	Std Dev
Taxpayers/SMEs attitude towards taxes is negative.	82	4.07	0.77
SMEs/ taxpayers perceive government is not transparent in the use of taxpayers money	82	4	0.68

Figure 6: Taxpayers' attitude and tax compliance

Source: Authors computations (2020)

5.CONCLUSION AND RECOMMENDATIONS

It must be pointed out that, while it is very true that SMEs face other tax related hurdles or constraints in so far as tax compliance is concerned, high tax rate make quite a significant contribution to the prevalent non-compliance in so far as tax payments are concerned, and acts as a motivation for most of the SMEs to remain in the informal sector. The result is that SMEs deprive themselves of the benefits that accrue from enhanced tax revenue for the government. These tax revenues can be used to execute developmental projects such as

electricity and good roads, which stimulate the growth of SMEs. It must be mentioned from the onset that the study has made a conclusion that when the tax compliance costs are high, the result is an increase in the tax non-compliance. The study further concluded that tax compliance costs came as a result of the large number of tax returns that were to be submitted, and the cost of hiring experts to do paperwork regarding tax returns were quite too high. These variables had a positive relationship with tax compliance costs but negatively related to the tax compliance. What this implies, according to this study is that when the number of tax returns to be submitted increases, the tax compliance cost increase but tax compliance reduces. Equally, an increase in the cost of hiring experts to do perform such functions as doing the paperwork, increase, the tax compliance costs also increase but the tax compliance plummets. The respondents particularly stated that they found information on subsisting tax laws to be quite difficult to understand particularly because of the low levels of education attainment. The study findings also revealed that tax information was also not readily available. The study therefore made a conclusion that tax when SMEs are less educated about tax laws and regulations that subsist in their economic jurisdiction, the tax compliance levels are tremendously reduced. The study concludes that when the SMEs have a negative attitude towards tax, their compliance levels are tremendously reduced. In one way or the other, SMEs develop this negative attitude towards tax based on their perception of the government. When the taxpayer, according to the study findings perceive any disparity between the taxes they pay and the public spending benefits that accrue, they are more likely to evade taxes. In view of all the challenges discussed throughout the paper, we make the following recommendations:

1. The state should institute measures which help deescalate the tax rates unlike stricter measures.

2. It is recommended that the tax authority, the Zambia Revenue Authority, ZRA must make sure that SMEs are provided with such services have the potential to reduce the need to hire skilled persons to do the paperwork in the administration of taxes.

3. Tax education is yet another means of enhancing tax compliance by SMEs. It is therefore encouraged that tax education through the holding of tax seminars must be given the attention that it deserves if tax compliance must be enhanced.

4. In order to improve tax compliance by SMEs, it is also highly recommended there must be genuine dialogue between the SMEs and the party representing government. This is critical aspect of enhancing tax compliance by SMEs. This will help array the mistrust between government and the SMEs.

Future research studies must focus on SMEs from other tax regions that have different settings as the rural setting to ascertain how consistent the findings will be regarding the concept at hand. The study must also be formed on trying to establish specifically the factors that stimulate SMEs to be tax compliant.

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