

# **Determinants of Tax Compliance among Small and Medium Enterprises in Tanzania: Insights from Ilala Municipality**

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**Abstract:** This study investigated on Determinant of tax compliance among Small and Medium Enterprises in Tanzania specifically Ilala municipality, Particular objectives included evaluating the influence of economic factors and taxpayer personal demographics on tax compliance. The descriptive cross-sectional survey design and quantitative research approach were used in the current study. The study's population consisted of 5324 Small and Medium Enterprises from Ilala Municipality, from where a random sample of 98 respondents was drawn. Structured questionnaires were used to collect data, which was then analyzed using The Multiple Linear Regression, which provided a comprehensive proof that helped to answer the research questions. The study's findings demonstrated a positive and statistically significant association between the study independent variables and the dependent variable. Taxpayer, economic, and institutional factors all influence taxpayers' willingness to engage in tax evasion, according to the regression analysis. Study findings reveal that all taxpayer predictors, including economic and institutional factors, have a significant impact on tax compliance since all have mean of above 3.0. Furthermore, regression analysis supports the findings, since all three factors were found to have a significant impact on tax compliance, with p-values less than the 0.05 cutoff limit. The study concludes Tax morality can help increase voluntary tax compliance on the country through this taxpayer will have a positive perception toward government spending. Maintaining tax fairness, appropriate and moderate levels of penalty, and keeping tax rates as low as possible can all foster taxpayers' voluntary compliance. Fairness in the execution of tax regulations should be enshrined, and tough measures to combat tax revenue corruption should be implemented.

**Keywords:** Taxpayers factors; Economic factors; Institutional factors

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## **Introduction**

Tax collection is a vital function for any country since it provides governments with the necessary income to fund the budget. This is only possible if countries have a tax-compliant society (Abu-Hassan, Yunus, and Ramli, 2017). However, non-compliance with tax laws is a persistent and

growing global issue to which a lasting solution is yet to be established (Gatora, and Mokaya, 2018). Non-compliance is defined as an individual's refusal to act in accordance with legal, social, cultural or institutional requirements.

In developing countries, non-tax compliance is a major predicament, particularly among Small and

Medium Enterprises, whose revenues account for 40-50 percent of the national Gross Domestic Product (Kira, 2017). High tax rates, high compliance costs, onerous registration procedures, inconsistency in enforcing tax laws and corruption make taxation a burden for the informal sector in African countries. Other issues of non-compliance include lack of formal business locations, the nature of business operators, high cost of tax collection, the aggressive attitude of actors, lack of patriotism and lack of trustworthy data (Mbilinyi & Mutalemwa and, 2020).

Therefore, governments should establish an atmosphere that allows small and medium businesses to develop while motivating them to pay taxes proactively. This could be accomplished if governments take substantial steps to provide a lasting solution for tax non-compliance. However, governments are hampered by non-compliance with tax laws and as a result, fluctuating revenue collection negatively affects national expenditure plans as it reduces the state's ability to project household income and assets needed. In most developing countries, small and medium enterprises (SMEs) dominate the business industry, and their stability has a significant influence on government income accumulation (Atawodi and Ojeka, 2018).

The government of Tanzania is particularly concerned about the growing mismatch between the levels of submitted annual income tax returns, tax assessment reports and voluntarily paid tax liabilities among SMEs (URT, 2020). Tanzania's small and medium-sized enterprises (SMEs) have a tax potential of 79 billion Tanzanian shillings per year, but only one billion in annual tax revenue is accrued. SMEs account for 98 percent of all registered enterprises in Tanzania, contributing 34.3 percent to GDP (URT (2020).

The Tanzanian government has made several efforts including street vendor registration, tax administration improvement and the use of electronic fiscal devices to combat tax evasion. However, a trend of non-compliance by SMEs still persists. With this understanding, therefore, this study investigated on predictors of tax compliance among SMEs in Ilala Municipality.

While the Tanzanian government's primary obligation is to guarantee that citizens have access to social services such as roads, hospitals, education, security, law and order, this depends

on the government's ability to collect taxes from citizens. However, Currently Small and Medium Enterprises (SMEs) do not pay tax voluntarily which is a disastrous situation. Tanzania's budget therefore remains in deficit, which prevents the government from successfully launching, executing and completing planned development initiatives (Aiko, 2013).

According to Tanzania Parliamentary Budget (2020/2021), one of the causes of government budget deficit is non-tax compliance where by estimated tax revenue mismatch with collected tax revenue. Kassa (2021), Ng'eni (2016), Kira (2017) suggested that high tax rates, complicated tax procedures, corruption, high compliance costs and inadequate social services as reasons for non-compliance. Kassa (2021) further argued that tax rates in Africa are so high that they slow down corporate growth. According to Augustine (2020) unfairness in taxation, poor systems and corruption are the leading reasons for non-tax compliance, particularly among small and medium businesses.

Researchers (Mannan, 2020 and Indrayani and Suhendra, 2016; argued that non-compliance is more widespread among small enterprises than among large businesses and that economic, institutional and taxpayer variables all contribute to non-compliance. The existence of a contextual gap is due to lack of critical appraisal for SMEs as most studies focused on all taxpayers and not on SMEs, particularly (Maisiba & Atambo, (2016) and Mutalemwa, (2018). Furthermore, according to economic deterrence, factors such as tax rate, the likelihood of being uncovered and the fines levied by the state influence taxpayers' compliance behavior (Ramidhuna, 2021). According to Allingham and Sandmo (1972) tax compliance theory contends that the government deters tax evasion through sanctions and audits; nevertheless, such efforts have not resulted in a viable solution to tax non-compliance in Tanzania (Kira, (2017).

### **Theoretical Framework**

This study was informed by two theories namely Economic Deterrence Theory and Allingham and Sandmo Theory.

#### ***Economic Deterrence Theory***

Economic deterrence asserts that, factors such as the tax rate, the likelihood of being discovered and the fines levied by the state influence

taxpayers' compliance behavior (Ramidhuna, 2021). Because compliance decisions are based on a cost-benefit analysis, the economic analysis indicates that a high probability of discovery for non-compliance and significant penalties for identified offenders would encourage higher compliance, hence maximizing tax revenue streams. Since taxpayer compliance is linked to a variety of factors, including individual taxpayer factors, economic factors and institutional factors, this theory of Economic Deterrence is relevant to this study (Munyoro, 2017).

### **The Allingham and Sandmo Theory**

The Allingham and Sandmo (1972) Theory stipulate that tax compliance theory holds that the government deters tax evasion through sanctions and audits. When a taxpayer considers the cost of dodging taxes is too low and they are unlikely to be detected or audited, they will choose to breach the law and avoid paying their taxes. When a taxpayer considers the cost of dodging taxes is too low and they are unlikely to be detected or audited, they will choose to breach the law and avoid paying their taxes. However, if a taxpayer considers the cost of compliance is excessive, they will avoid paying taxes. Tax systems and procedures that are complicated and time-consuming tend to encourage tax avoidance. Tax evasion is widespread among people who believe the tax rate is excessively high and punitive. Tax evasion, the likelihood of detection, the severity of punishment, and the high transactional costs connected with tax legislation all have a negative association. Since tax compliance is linked with moral obligation, affordable tax rate and fairness in tax administration, this theory of the Allingham and Sandmo is relevant to this study.

## **Methodology**

### **Research Design**

This study used a quantitative research approach and a descriptive Cross-sectional survey design in which the researchers explored the relationship between variables (Polit & Beck, 2014; Sedgwick, 2014; Xu, Rich, & Connor, 2016). The study sought to establish the relationship between the independent variables (Tax payer factors, Economic factors and Institutional factor and the dependent variable (Tax compliance). The study used a questionnaire, which was created and tested prior to its distribution to the selected SMEs. The purpose of testing the questionnaire was to ensure clarity of items.

### **Population and Sampling**

The target population consisted of 5324 small and medium firms from the Ilala Municipality that were registered as active businesses with the Dar es Salaam Region's TRA office (Municipal Business Officer Report, 2021). Both probability and non-probability sampling procedures were used to determine the sample. The non-probability sampling technique was applied in the selection of the study area which was chosen because, in comparison to other districts in the Dar es Salaam Region, it had a larger number of registered small and medium enterprises. Small and Medium Enterprises (SMEs) were recruited using probability random sampling through a formula, by Yamane (1967):

$$n = \frac{N}{1 + N \cdot e^2} \quad (1) \quad n = \frac{5,324}{1 + 5,324 \cdot (0.1)^2} = 98$$

Where n = sample size, N = total population, and e = standard error of sampling (10%). Upon inserting each variable's value into the formula, a sample size of 98 respondents was obtained.

**Table 1: Validity**

| <b>KMO and Bartlett's Test</b>                   |                    |         |
|--------------------------------------------------|--------------------|---------|
| Kaiser-Meyer-Olkin Measure of Sampling Adequacy. |                    | .663    |
| Bartlett's Test of Sphericity                    | Approx. Chi-Square | 247.853 |
|                                                  | df                 | 210     |
|                                                  | Sig.               | .038    |

### **Validity and Reliability**

As seen in Table 1, the researchers measured the validity by using Kaiser-Meyer-Olkin (KMO) and Bartlett's Test of Sphericity through the SPSS. The results extracted from the SPSS are presented in Table 1. The table indicates The sample sufficiency

index KMO by The Kaiser – Meyer Olkin which compares the sizes of observed correlation coefficients to the sizes of partial correlation coefficients for the sum of analysis variables , is 0.663 or 66.3 percent and it is reliable because it

is greater than 0.5 Or 50% which is the cut – off value.

For the reliability of the instrument to be established, researchers measured the instrument by using the following Cronbach's alpha formula where  $\sigma^2$  = variance of one test item.

$$r\alpha = \left( \frac{k}{k-1} \right) \left( 1 - \frac{\sum \sigma^2}{\sigma^2} \right)$$

Reliability Statistics shows the value of the Cronbach's alpha is 0.621 or 62.1 %, which is an acceptable value as appears in table 2.

**Table 2: Reliability Results**

| Cronbach's Alpha | N of Items |
|------------------|------------|
| .621             | 21         |

**Table 3 Multicollinearity**

| Factors                  |      |        |        |
|--------------------------|------|--------|--------|
| 1. Taxpayers factors     | R    |        |        |
|                          | Sig. |        |        |
| 2. Economic factors      | R    | .336** |        |
|                          | Sig. | .000   |        |
| 3. Institutional Factors | R    | .302** | .401** |
|                          | Sig. | .000   | .000   |

**Table 4 Normality of the factors**

|                        | N         | Minimum   | Maximum   | Mean      | Std. Deviation | Skewness  | Kurtosis   | Kurtosis critical ratio (c.r) |            |
|------------------------|-----------|-----------|-----------|-----------|----------------|-----------|------------|-------------------------------|------------|
|                        | Statistic | Statistic | Statistic | Statistic | Statistic      | Statistic | Std. Error | Statistic                     | Std. Error |
| Taxpayers factors      | 98        | 30        | 60        | 45.98     | 7.257          | -.031     | .146       | -.515                         | .292       |
| Economic Factors       | 98        | 5.00      | 27.00     | 12.0072   | 7.08284        | .995      | .146       | -.335                         | .292       |
| Institutions Factors   | 98        | 1         | 4         | 2.80      | .714           | -.285     | .146       | .018                          | .292       |
| Valid N (list wise) 98 | 98        |           |           |           |                |           |            |                               |            |

### Ethical Consideration

Ethical issues were considered during the collection of data where respondents were informed that the study is only for academic purpose and all information gathered would be treated confidentially. Furthermore, the questionnaire did not include names of respondents. Respondents were also notified that their participation based on their willingness.

### Statistical Treatment of Data

The influence of possible predictors of tax compliance was tested using one multiple linear regression model. The scores ranged from "strongly disagree" (1) to "strongly agree" (5) on a five-point Likert scale.

### Testing of Model Assumptions

#### Multicollinearity

Multicollinearity exists whenever an independent variable is highly correlated with one or more of

the other independent variables where  $r = 0.9$  and above (Pallant, 2005). Table 3 presents the correlation matrix for independent variables and as revealed, they were not highly correlated since the maximum  $r = 0.401$ . Therefore, all independent variables were included in the modeling procedure using the multiple linear regression models.

### Results and Discussions

**Research Question 1:** Do taxpayers' factors influence tax compliance among Small and Medium Enterprises (SMEs) in Ilala Municipality?

Findings in table 5 show that all taxpayer factors (TPF) scored over neutral points (3.0). These findings imply that tax knowledge and abilities can determine tax compliance attitudes. SME owners with greater tax knowledge are better able to manage complex tax systems and avoid the additional costs associated with complex

reporting duties, and are thus more likely to comply voluntarily. Kassa (2021) discovered that tax parity, tax knowledge, and moral obligation all had a substantial impact on taxpayers' intent to

engage in tax evasion. Alabede (2016) finds that a taxpayer's attitude on tax evasion has an impact on compliance behavior.

**Table 5: Taxpayers factors**

| <b>Taxpayers factors</b>                                    | <b>Mean</b> |
|-------------------------------------------------------------|-------------|
| I have adequate knowledge of taxation.                      | 3.459       |
| My taxation knowledge compels me to pay tax                 | 4.071       |
| I despise paying tax                                        | 3.347       |
| I have an obligation of paying tax                          | 3.816       |
| The way government spends tax revenue discourages taxpayers | 4.031       |

**Table 6: Economic Factors**

| <b>Economic Factors</b>                                      | <b>Mean</b> |
|--------------------------------------------------------------|-------------|
| SMEs' adequate working capital enhances their tax compliance | 4.031       |
| Affordable tax rates charged encourage tax compliance        | 3.918       |
| The level of income among SMEs influence tax compliance      | 3.888       |
| Total assets owned by SMEs foster their tax compliance       | 3.469       |
| Exorbitant debt discourages tax compliance                   | 3.622       |

**Table 7: Institutional factors**

| <b>Institution Factors</b>                                | <b>Mean</b> |
|-----------------------------------------------------------|-------------|
| Affordable tax rates encourage tax compliance             | 3.878       |
| Tax audits enhance tax compliance                         | 3.949       |
| The tax filing system ensures taxpayer compliance         | 4.020       |
| Fairness in tax administration facilitates tax compliance | 3.918       |
| Tax administration penalties facilitate tax compliance    | 3.694       |

**Research Question 2:** Do economic factors influence tax compliance among Small and Medium Enterprises (SMEs) in Ilala Municipality?

All economic parameters scored above neutral point (3.0) which means they may impact tax compliance. Bărbuț-Ămișu (2011) found that the most important determinants identified are economic factors such as income, working capital, audit probabilities, tax audit, tax rate, tax benefits, penalties and fines as well as non-economic factors such as attitudes toward taxes, personal, social and national norms.

Tax rates were discovered to influence tax compliance because it is considered that high tax rates lower income, making tax evasion more profitable. Absolute risk evasion, on the other hand, increases if effective income is reduced. These findings, which were backed up by Demessew (2020) demonstrated that elements such as tax system fairness, penalty, tax rate, taxpayer perceptions of government spending and compliance cost influence taxpayer voluntary compliance. As a result, maintaining tax fairness, reasonable and moderate penalties, using tax

revenues for social projects, keeping tax rates and compliance costs as low as possible increase voluntary compliance among taxpayers.

**Research Question 3:** Do institutional factors influence tax compliance among Small and Medium Enterprises (SMEs) in Ilala Municipality?

The results indicate that all institution parameters scored above neutral point (3.0) which means the factors may impact tax compliance. Results indicate that respondents came to an agreement that affordable tax rates encourage tax compliance, tax audits enhance tax compliance, the tax filling system ensures tax compliance fairness in tax administration facilitates tax compliance and tax administration penalties facilitate compliance.

**Research Question 4:** To what extent do taxpayers' economic and institutional factors affect tax compliance among Small and Medium Enterprises (SMEs) in Ilala Municipality?

The extent to which various components influence tax compliance was analyzed using the regression analysis. Regression analysis output

confirmed that there is a significant positive link between taxpayer compliance and the dependent variables namely tax payer factor, Economic Factor and Institutional factor as the p-value is 0.028, 0.032 and 0.035 which are lesser than the critical value (0.05).

The findings therefore reveal that Taxpayer Factor (TPF), Economic Factor (EF) and Institutional Factor (IF) influenced Tax Compliance (TC). Indrayani and Suhendra (2016) found similar results in their study on the influencing elements

of personal tax compliance on filing annual income tax returns. They also found that tax compliance is affected by awareness level of taxpayers, perceived service quality and perceived comfort of facilities. Permatasari (2020). Found that tax knowledge has a positive effect on tax willingness, *Bărbuț-Ămișu* (2011). Found the level of actual income, tax rate, tax audit, fines and penalties have significant impact on tax compliance.

**Table 8: Regression Coefficients' on the influence of each factor on Tax Compliance**

| Model | Unstandardized Coefficients |        |            | Standardized Coefficients Beta | T     | Sig. |
|-------|-----------------------------|--------|------------|--------------------------------|-------|------|
|       |                             | B      | Std. Error |                                |       |      |
| 1     | (Constant)                  | 23.055 | 3.527      |                                | 6.538 | .000 |
|       | TPF                         | 0.203  | .107       | .241                           | 1.895 | .028 |
|       | EF                          | 0.298  | .135       | .278                           | 2.205 | .032 |
|       | IF                          | 0.188  | .120       | .195                           | 1.565 | .035 |
|       |                             |        |            |                                |       |      |

a. Dependent Variable: TC

## Conclusions and Recommendations

It is concluded that Taxpayers' factor which is measured by tax knowledge and skills, attitude toward tax, Moral obligation and perception on government spending have an impact on tax compliance. Secondly, Economic factors that were measured by working capital, affordable tax rate, total asset and total liabilities have an impact on tax compliance. Thirdly, institutional factor which were measured by affordable tax rate, Tax audit, tax fillings, fairness in tax administration and tax administration penalties also have impact on tax compliance. Therefore, good stewardship of the government and tax officers, training, affordable tax rates and fairness in tax administration will provide a great incentive on the tax compliance of citizens.

It is recommended that tax revenue should be spent with prudence and that punitive measures should be imposed on civil servants who steal funds allotted for the execution of government projects. Taxpayers should be continuously trained in order to comply with the regulations governing taxation. Through training, they will be aware that the revenue generated from taxes is utilized to develop infrastructure, health centers and schools, among others. Policymakers are expected to review policies in order to improve tax compliance. The said review will include allocating sufficient funds for awareness campaigns, training, and workshops as well as devoting adequate resources for television and

radio sessions that will educate the public about the importance of tax compliance. Simple Tax system automation is essential. Therefore, the government must allocate sufficient funds to enable the Tanzania Revenue Authority to buy Information Technology Infrastructures that would allow proper implementation at all levels.

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