A STUDY OF FACTORS AFFECTING TAX COMPLIANCE AMONG SMEs IN ZAMBIA

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Abstract: **Governments engage into various strategies to raise resources to finance among other things their developmental projects. From its domestic base collecting revenue from SMEs is one of them. However, tax compliance among small and medium taxpayers is a challenge and is very poor. It is for this reason that the researcher embarks on this study to assess the factors that affect tax payer compliance among the SMEs in Zambia. The sampling frame for this study is the main business activity the representative SME are engaged in and the length of time the business has been in operation. The sample size will be 50 small and medium size enterprises taxpayers, in the Kamwala Shopping area in Lusaka. Among the notable factors identified as affecting tax compliance among SMEs are the high level of cost for tax compliance for SMEs brought about by the long process for filing in returns; inadequate or lack of proper knowledge on tax compliance and its benefits for SMEs and also the negative attitude of SMEs towards tax compliance. The study therefore, will make recommendations that the process of filing in for taxes be shortened and the need for use of expert agents be removed into to shorten the process and reduce costs. It will also be recommended that the Authority enhances its taxpayer education to enlighten the SMEs on the many incentives available for the sector and how they could be accessed. Lastly, government should consider widening the incentive base to attract and change the attitude of SMEs towards being tax compliant.**

Keywords: **Kamwala, Revenue, SMEs, Tax compliance, Tax, Zambia, ZRA.**

1. INTRODUCTION

Small and Medium Enterprises (SMEs) are those types of businesses that keep their revenues, assets or a very minimum number of employees that are below a certain starting point for the purposes of tax. Aryeetey & Ahene (2004) is inclined to the fact that SMEs are the seedbed for indigenous enterprises and generate all the many small investments which otherwise would not have taken place. It is a very well-known fact that the revenue generated by government from the SMEs is very important as these that these SMEs perform an important role in the economy of a country and help them to continue running their businesses. Therefore, developing countries like Zambia need to promote the development of its private sector by creating an enabling environment to the growth of SMEs and strengthening the factors that lead to their business successes. And in helping the SMEs Governments employs different methods such as regularly giving out incentives which include favourable tax treatment to cushion their operations. Taxation is a significant method in which Governments raise their domestic revenue for various expenditure. According to Aghion et al. (2016), taxation is a major method by which Governments use to mobilize revenue for financing expenditure. In order to ensure compliance and prevent tax evasion among SMEs tax authorities must develop suitable approaches that will enhance tax compliance among SMEs (Lymer and Oats (2009). Mwangi (2014) describes tax compliance as a degree to which taxpayers conform with or fail to conform to the prescribed laws of a nation.

The main objective of this paper is to assess the factors that affect tax compliance among SMEs in Zambia. Specifically, the study will seek to address the factors that influence tax compliance by SMEs in connection with how tax compliance costs affect the tax compliance by SMEs, how the tax knowledge on tax compliance by SMEs affect compliance and how the attitude of SMEs towards tax affect tax compliance? The scope of the study is restricted to SMEs in the service and trading sectors. It is highly hoped that the outcome of the study will make an invaluable contribution to policy formulation concerning taxation in Zambia. The study will demonstrate that putting in place policies that make it easier for the taxpayer to voluntarily declare and pay the correct tax at a reasonable cost will increase government revenue. Furthermore, the study will provide a strong foundation on which future studies can be pivoted.

2. LITERATURE REVIEW

In Kenya there had been some empirical studies on the factors that determine tax compliance among SMEs. One study revealed that the tax in question did not yield optimistic results due to non-tax compliance remaining critically too high by SMEs and Micro-enterprises. According to Moyi and Njiraini (2005), the main reason for the situation was because the tax rates were high for most of the SMEs and this caused the continued low tax compliance. A study by Chipeta (2002) also exposed that high tax rates were connected with high tax burden therefore, lowering the income levels of SMEs and consequently, the high levels of non-tax compliance that was being experienced. Tax compliance costs could be thought of as all costs that resulted from procedures that taxpayers went through in trying to meet their tax obligations as supported by (Vihanto, 2000; Ojeka, 2012), who out rightly pointed out that planning, filing in of documents and hiring tax specialists, which constituted tax compliance costs, impacted greatly on the willingness by MSEs to pay taxes as they became due.

According to Gachiku (2015), empirical studies carried out in South Africa revealed that the process of paying tax obligations for SMEs was too expensive and was one of the factors that affected SMEs being tax compliant. This fact implied that most SMEs opted to be non-tax compliant to save their resources. It is common in most cases that high tax rates increased the level of non-tax compliance by SMEs. In his support Shahroodi, (2010) further advanced that SMEs tax compliance could be improved if the tax rates were low enough to attract SMEs to pay their obligations as they would not be overstrained by the taxes. Furthermore, Derwent (2000) alluded that it was empirically proven that high tax rates increased the cost of producing goods and services and also their distribution and selling, which would potential to reduce the productivity of SMEs.

The more tax information SMEs had in relation to tax issues at hand, the more likely it was that their compliance levels would be high. According to Wanjohi (cited in Mwangi, 2014) empirical studies revealed that SMEs viewed the tax regime used in Kenya as being unfair and this made them to engage in tax evasion schemes. Gachiku (2015) also postulated that findings of an empirical study indicated that most SMEs did not meet their tax obligations mostly because of insufficient tax information knowledge that they possessed. In Zambia following the liberation of the economy during the MMD era, the SME sector had winded. Langmead, et al., (2006) advanced that the exponential increase in the number of SMEs led to a proportionate increase in tax collection by the Revenue authority indicating that tax compliance by SMEs has not been high.

3. RESEARCH METHODOLOGY

3.1 Research Design

According to Saunders et al., (cited in Gachiku, 2015) a research design is a plan that directs a study in order for the set objectives to be achieved. It is an outline of collecting and analyzing the gathered data. According to Cooper (2003) a descriptive survey design is a suitable design for establishing cause and effect relationship between variables. Since this study is meant to establish a causal association between the determinants of tax compliance and SMEs tax compliance a descriptive survey design will be used in the study.

3.2 Sample Population

According to Mugenda and Mugenda (2003) a sample population is a small collection of individuals obtained from a population to form a sample. To select the representative SMEs the study will employ purposive random sampling method to gather the research data. To constitute the sample is 50 SMEs to be selected from the SMEs that are registered with the Zambia Revenue Authority (ZRA).

3.3 Sample Frame

The sampling frame is the main business activity the representative SME are engaged in and the length of time the business had been in operation. Other aspects of the background information is the size of the workforce employed and the educational levels of the respondent SMEs.

3.4 Sampling Size

The researcher will collect data from 50 small and medium size enterprises taxpayers, in the Kamwala Shopping area in Lusaka. Out of the 50 questionnaires administered, at least 48 participants answered and returned the questionnaires representing a response rate of 96%, while 2 participants did not return the questionnaires, representing 4%. According to Mugenda and Mugenda (2003), a response rate of 50% was good enough for data analysis and a response rate of 96% in this case was perfect. Therefore, it must be stated that the response rate of 96% justified that data analysis could be conducted.

4. RESEARCH ANALYSIS AND DISCUSSION

4.1 Response Rate

The response rate of 48 (96%) of the targeted respondents are expected to answer the questionnaire.

**Table 4.1.1: Response Rate**
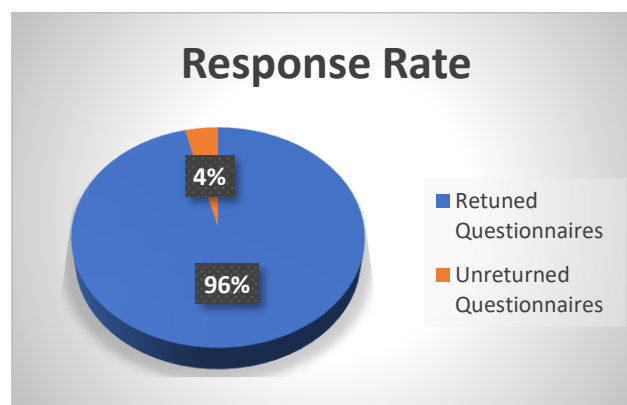
4.2. Sector Representation

The analysis was a demonstration of the main business activities that the responding SMEs were engaged in, with the most represented business activities being the trading sector, with a percentage representation of 70% and the service sector with percentage representation of 30%. The analysis indicates that most SMEs in the study population were in the trading sector of the economy.

Table 4.2.1: Sector Representation
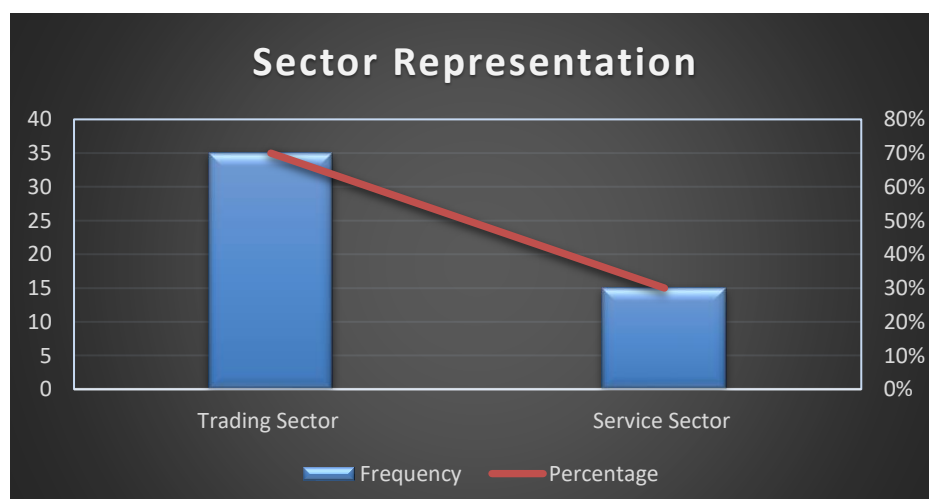
4.3 Years of Business Operation

Table 4.3.1: Years of business operation
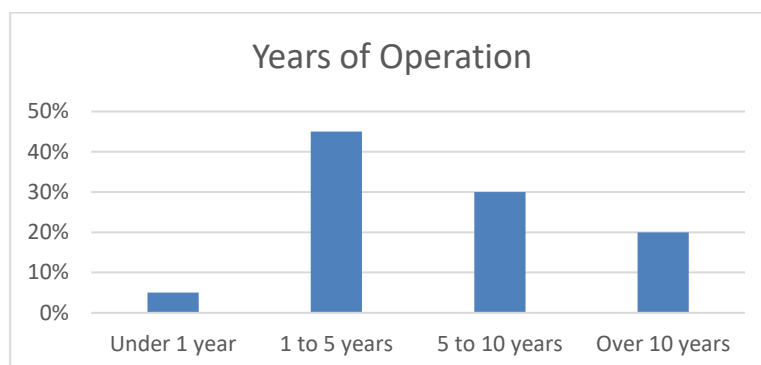
The study will also look at the length of time the business had been in operation as this could have an impact on their tax compliance levels. The results indicate that the length of time the business has been in operation ranges from less than 1 to above 10 years. The percentage representation for these SMEs is that 5% have been in operation for less than 1 year, 30% ranged from 1 to 5 years, and 45% have been in operation for 5 to 10 years while, 20% have been operating for over 10 years.

4.4 Size of Workforce

The study also seeks 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 have an influence on SMEs tax compliance. The results show that majority of the respondent SMEs at least have one or two workers with a representative percentage of 80%and 20% have no workforce.

Table 4.4.1: Size of Workforce

Size of Workforce	0 - 0	1 - 2
Percentage	20%	80%

4.5 Level of Education

The level of education attained by the respondent SMEs is also another assessment that will be made and it quite clear that most of the respondent SMEs have attained secondary education and the proportion of this group was 60%. The SMEs with tertiary education constituted only about 30% of the total number of respondents in the study, and 10% of the respondent SMEs only acquired a primary education qualification.

The indication from the findings is that majority of the respondent SMEs are of humble education background. This segment of demographic characteristics is critical as the tax compliance levels may be influenced by tax knowledge or education, which may be hampered by the level of education attainment. Regarding the study question on whether tax compliance is affected by the SMEs level of tax education, the respondents strongly agree that the tax laws and rules were are not easy to understand by SMEs who are non-professionals.

Table 4.5.1: Level of education
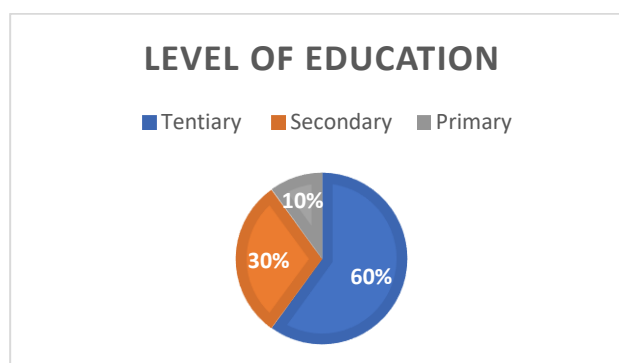
4.6 Statistical outcome

A three Likert scale was used with (3) representing agree, two (2) representing neutral and one (1) representing disagree:

Table 4.6.1: Statistical outcome

SN.	Question	3	2	1	N	Min	Max	Mean	SD
1	Cost of engaging tax agents and tax rates too high for SMEs	40	3	7	50	2	3	2.66	0.710
2	Lack or low knowledge and information on tax compliance and SME Incentives	35	10	5	50	1	3	2.6	0.663
3	SME attitude toward filing in returns for tax compliance	15	23	12	50	1	2	2.06	0.732

The statistical outcome indicates that the mean value for responses to the statement of cost of engaging agents and tax rates being too high for SMEs was 2.66, which approximately is 3 with a standard deviation of 0.710. The mean value for responses on the on compliance and incentives statement is 2.6, which is a clear indication that respondent SMEs feel that there is lack or low knowledge and information on taxes compliance is low. The study asked the respondents in order to establish their attitude by use of the following statements: the SMEs attitude towards tax is negative, and the statistical results are that the SMEs agree to this question. This is evidenced by mean value of 2.06 with a standard deviation of 0.732. SMEs perceive that government is not transparent in the use of the resources mobilized through tax collections and they are of the opinion that their monies were going down the drain hence the motivation to evade paying their taxes.

5. CONCLUSION

It must be stated that, while it is very true that SMEs face other tax related constraints where tax compliance is concerned, high tax rate makes quite a significant contribution to the rampant 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 withdraw themselves of the benefits that accrue from enhanced tax revenue for the government. These tax revenues can be used to implement developmental projects such as good road networks, which inspire the growth of SMEs. It must be revealed 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 concludes that tax compliance costs come as a result of the large number of tax returns that were to be submitted, and the cost of hiring experts to carry out paperwork concerning tax returns were quite too high. These variables had a positive relationship with tax compliance costs but negatively related to the tax compliance. The implication 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 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 existing tax laws to be quite difficult to understand particularly because of the low educational levels attained.

The study findings also reveal that tax information regarding tax compliance is not readily available. The study therefore makes a conclusion that tax compliance when SMEs are less educated about tax laws and regulations that exist in their economic dominion, the tax compliance levels are extremely reduced. The study also 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 opinion of the ruling government. When the taxpayer, according to the study findings perceive any inequality 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, it is recommended as follows:

6. RECOMMENDATIONS

6.1 Zambia Revenue Authority should establish measures to help reduce the cost of compliance and tax rates to make it cheaper for the SMEs

6.2 It is recommended that the Zambia Revenue Authority, ensures that SMEs are provided with services potential to moderate the need to hire skilled persons to do the paperwork in the administration of taxes.

6.3 Zambia Revenue Authority should enhance their tax education strategies attract tax compliance by SMEs. It is therefore, encouraged that tax education through various modes be given the serious attention that it deserves to increase tax compliance.

6.4 Holding discussions with SMEs to educate them on the many available incentives that government puts across to attract SMEs it is also should be given priority. This is a critical aspect of enhancing tax compliance by SMEs. This will help display the uncertainty between government and the SMEs.

Future research studies are encouraged to 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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