

# INTERNATIONAL JOURNAL OF RESEARCH IN COMMERCE & MANAGEMENT

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## CHALLENGES OF NON-TAX COMPLIANCE AMONGST THE SMALL AND MEDIUM ENTERPRISES (SMEs) IN ZIMBABWE

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### ABSTRACT

*Tax plays an important role in economic development and in the growth of Small and Medium Enterprises (SMEs). However, non-tax compliance among SMEs in Zimbabwe is very high. This study was conducted on SMEs in Bulawayo, Gweru and Harare Central Business Districts (CBDs) to establish and rank the factors that encourage non-compliance with tax obligation by SMEs in accordance with the Zimbabwe Tax Regime. The findings were presented in terms of factor loadings, eigenvalues and percentage variances. There were four factors that ranked high as causes for non-tax compliance of SMEs in Bulawayo, CBD are Complexity of the tax systems, norms, economic factors, deterrence to tax evasion and possibilities of tax evasion. It was found that the complexity of the tax system affect non-tax compliance of SMEs to a greater extent followed by norms and economic factors. Possibilities to tax evasion were found to affect non-tax compliance of SMEs to a lesser extent followed by deterrence to tax evasion. In conclusion, there is a great relationship between non-tax compliance of SMEs in Bulawayo and the existing tax system. Norms have a higher relationship with non-tax compliance but its lower than that of the tax system. Economic factors also possess a little higher relationship to non-tax compliance but it's lower than of norms. On the other hand deterrence to tax evasion has the second least relationship to non-tax compliance. Possibilities to tax evasion possess the least relationship to non-tax compliance as compared to the five factors causing non-tax compliance of SMEs.*

### KEYWORDS

Tax evasion, non-tax compliance, small and medium enterprises, tax system, economic growth.

### INTRODUCTION

Albanesi, Stefania and Christopher, (2006) states that globally most of the SMEs operate in the informal sector of the economy, depriving their countries of the tax revenue which might be used for the stabilization of the economy, the redistribution of income and the provision of services in the form of public goods. On the other hand, (Goriwondo, 2012) observed that the Government of Zimbabwe is losing large sums of tax revenue through non-tax compliance of SMEs, hence this research seek to establish the factors that are causing non-tax compliance of SMEs in Bulawayo CBD, Zimbabwe so as to formalise the SMEs sector and improve the public revenue and hence improving the standards of living of every Zimbabwean citizen. According to the (OECD, 2008) report SMEs are the majority business taxpayers in most developing countries and the Reserve Bank of Zimbabwe (RBZ), (2009) also added that SMEs represent over 95% of enterprises that generate over 50% of private sector employment as such their non-tax compliance levels directly impact on government tax revenue collections. Goriwondo, (2012) States that Zimbabwe has one of the poorest public service delivery system in the African region and insufficient public revenue is one of the causes of this. Academic scholars frequently make extensive research on tax compliance or non-compliance in the field of taxation in order to assist revenue authorities to minimise public revenue lost through non-tax compliance behaviour. The problem of tax non-compliance is as old as taxes themselves (Braithwaite, 2009). It is generally accepted that tax non-compliance and tax evasion exists in every country and Zimbabwe is no exception. Tax noncompliance by Small and Medium Enterprises (SMEs) is an expensive and pervasive problem (Deloitte, 2013). In Zimbabwe, the problem of tax non-compliance became even more significant with the formation of a statutory body (Zimbabwe Revenue Authority) by the Zimbabwean government in 2001 to administer revenue collection that includes dealing with non-tax compliance issues. A review of the non-tax compliance behaviour indicated that previous researchers found broad factors such as deterrence to Tax evasion, possibilities of tax evasion, norms, economic factors and fairness of the tax systems and trust to the revenue body and the Government to be the major umbrella causes of non-tax compliance in many countries (Braithwaite, 2009). Therefore this research seeks to examine whether these factors apply to the Bulawayo Central Business District (CBD) context in Zimbabwe.

### NEED FOR THE STUDY

Several developing countries such as Malaysia, Singapore have seen their economies grow in leaps and bounds because of the contribution of the small and medium enterprises (SMEs) as a result of deliberate government thrusts in that direction. Most of these governments have however failed to craft tax regimes that draw in these enterprises into the taxation regime bases in order to realise full potential for revenues collection. Therefore, this study recommends to the government of Zimbabwe through its taxes authority Zimbabwe Revenue Authority (ZIMRA) to craft a flexible tax system that would improve the tax compliance of SMEs in Zimbabwe. Particularly the tax system that incorporates the canons of taxation by Adam Smith would be most appropriate in these circumstances. Adam Smith suggested four canons of taxation that is, the canon of 'equity', 'certainty', 'convenience' and 'economy'. The government should also consider increasing tax incentives such as tax exemptions and tax holidays to encourage voluntary compliance which will encourage more tax payers to comply as findings shown that 'norms' were one of the serious causes of non-tax compliance. It is also recommended to the government to levy SMEs at lower percentages of taxes to allow enough funds for business development and better chances of survival in tough economic situation and in the competitive market such as Zimbabwe.

## STATEMENT OF THE PROBLEM

The Zimbabwe Revenue Authority (ZIMRA) came up with strategies like the fiscalisation, to reduce the high rates of non-tax compliance amongst businesses and this has enabled it to meet its quarterly revenue targets though the larger part of the SMEs sector is operating informally. Despite of measures and efforts instituted to capture the revenue inflows from the informal sector, which continues to account for a significant portion of economic activity, revenue contribution to the fiscus remains insignificant due to low tax compliance, as indicated by only 2% of the SMEs registered with ZIMRA (Finscope SME Survey, 2012). It is against this background that this study seeks to find the factors causing the non-tax compliance of SMEs in Zimbabwe.

## OBJECTIVES OF THE STUDY

1. To determine what factors are causing non-tax compliance by SMEs in Zimbabwe.
2. To determine the extent to which the following factors cause non-tax compliance among SMEs in Zimbabwe.
  - Deterrence to Tax evasion
  - Possibilities to tax evasion
  - Norms
  - Economic factors
  - Fairness of the tax system and trust to the Revenue body and Government

## METHODOLOGY

The researcher used quantitative descriptive method, based on the survey of 235 owners of randomly selected Small and Medium Enterprises from Bulawayo, Gweru and Harare. These were drawn from an approximately 1500 Small and Medium Enterprises (SMEs) in these three major towns in Zimbabwe. The survey was administered using a self-constructed questionnaire with 32 item questions. Data was analysed using the statistical package for social sciences (SPSS).

## LITERATURE REVIEW

Tax laws often do not require a proper definition of the term "SME" at all. They indirectly define small businesses by defining eligibility criteria for incentives and special regimes targeted at SMEs. The Value Added Tax (VAT) threshold is a typical example of such an approach. It defines up to what level of turnover a business is not required to register for VAT without necessarily mentioning that the businesses below the registration threshold are to be qualified as SMEs. Such thresholds and eligibility criteria for special regimes may be found in several tax laws; therefore, there is no consistent approach in the tax system to determine which businesses are considered small businesses (Baurer, 2005). While definitions of SMEs vary from country to country, they can also vary within the same country depending on who is providing the definition (Bhorat, 2003). The SME Association of Zimbabwe defined small (turnover less than \$ 240 000 or assets less than \$ 100 000) and medium enterprises (turnover and assets above the thresholds for small enterprises but less than \$ 1 million each) (www.smeaz.org). Finscope Zimbabwe SME Survey (2012) defined SMEs by the number of employees (according to the Small Enterprises Development Corporation Amendment of 2011) including individual entrepreneurs (0 employees), micro (1-5), small and medium size businesses (6-75). A review of the non-tax compliance behaviour indicated that previous researchers found broad factors such as deterrence to tax evasion, possibilities of tax evasion, norms, economic factors and fairness of the tax system and trust to the revenue body and Government to be the sole causes of non-tax compliance in many countries (Braithwaite, 2009). Adam Smith stated that the principles used to assess the tax system. Other authors and books refer them as criteria, goals or objectives. Arguably, and perhaps simplistically, within any tax system there is the equivalent of a vision, mission and values. The vision constitutes the purpose of taxation. The mission identifies the forms of taxation and the methods of administration, collection and enforcement. The principles equate to the values that underlie the tax system (Baurer, 2005). Adam Smith in *The Wealth of Nations* published in 1776 outlined four principles of an ideal tax system. These principles are equity, certainty, convenience and economy. These principles are important to the creation of tax policy, because it is only when these principles are upheld that effective taxes are implemented in a manner which satisfies the stated purposes of a tax system (Murphy, 2004). Principles or Canons of Taxation by Adam Smith

### 1. CANON OF ABILITY OR EQUALITY

A good tax system should possess the quality of equality. All citizens should borne government expenditure according to ability. This does not mean that the rich and poor alike should pay tax, nor does it mean that all should pay same rate of tax. It simply means equality of sacrifice. It implies that all should pay tax according to ability. This indicates that there should be progressiveness in tax.

### 2. CANON OF CERTAINTY

According to Adam Smith the amount, time and method of tax should be clear and certain. This helps tax payers to make adjustment in income and expenditure. This also ensures the government about the source and amount of tax revenue. In an atmosphere of uncertainty, the tax payers become confused and the tax authorities have tendency to be corrupt.

### 3. CANON OF CONVENIENCE

According to Adam Smith while imposing tax, the time and method of tax payment should be convenient to the tax payers. A convenient tax system encourages tax payers to pay tax in time.

### 4. CANON OF ECONOMY

According to Adam Smith a good tax should possess canon of economy. This means that the amount of Tax should be minimum and its cost of collection should be lower than the revenue raised from it.

## TAX ADMINISTRATION

It is one thing to make policies, rules and regulation in an attempt to attain a desired goal or objective and it is another thing to implement these policies, rules and regulation. Efficiency and effectiveness should be the watch word in designing a tax administration structure that will give the desired result (Braithwaite, 2009)

Put differently, tax administration in Nigeria is the responsibility of the various tax authorities as established by the relevant tax laws (Kiabel and Nwukah 2009). The fiscal autonomy granted the three tier of government had led to multiplicity of tax. Tax payers and corporate bodies had been subjected to multiple levies or charges of tax of same name in different form. This had increased evasion and avoidance as such payment either eat deep into the profit of business or affect negatively, the distributable income of the individual.

Modern taxation systems have the capacity to impose a heavy burden on taxpayers, and particularly on taxpayers in the small business sector. As has been noted before, that burden typically consists of three elements. In the first place there are the taxes themselves, whether they are taxes on the profits, the products or the employees. Secondly, there are the efficiency costs (variously referred to as deadweight losses or excess burden), involving tax-induced market distortions. And finally there are the operating costs of the tax system: the costs to the government (ultimately borne by taxpayers) of administering and collecting the taxes (usually referred to as administrative costs), and the costs expended by taxpayers in complying (or sometimes not complying) with their tax obligations (usually referred to as compliance costs) (Cialdini, 2001).



## ANALYSIS OF THE STUDY

TABLE 1: TOTAL VARIANCE EXPLAINED

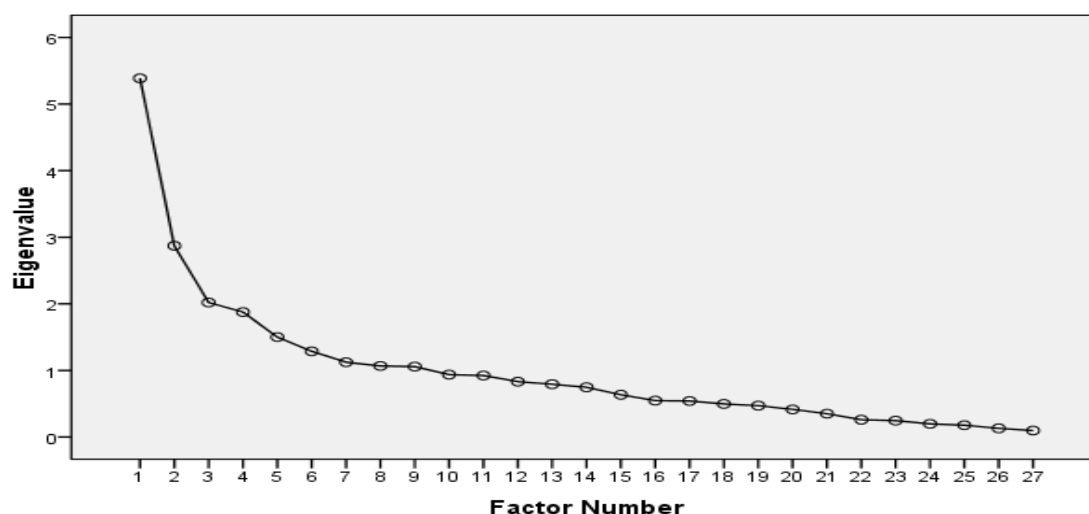
Factor	Initial Eigenvalues			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	5.388	19.954	19.954	4.952	18.342	18.342
2	2.872	10.638	30.592	2.427	8.987	27.329
3	2.020	7.482	38.074	1.610	5.964	33.293
4	1.876	6.950	45.024	1.365	5.057	38.349
5	1.501	5.560	50.584	.877	3.247	41.597

Extraction Method: Principal Axis Factoring

Principle Axis Factoring was used to extract the 5 most important factors affecting Non-tax compliance amongst SMEs in the Bulawayo CBD. In this analysis, only the first five factors were retained. The table above lists the eigenvalues associated with each factor before extraction, after extraction and after rotation. The eigenvalues associated with each factor represent the variance explained by that particular factor. The five factors are (Factor 1) Complexity of the tax system, (factor 2) Norms, (factor 3) economic factors, (factor 4) deterrence to tax evasion and (factor 5) possibilities to tax evasion. According to the responses received, complexity of the tax system was rated the one with the greatest effect towards non-tax compliance of SMEs in Bulawayo, CBD. Possibilities to tax evasion was rated the one with the least effect to non-tax compliance. In the above table, we are most interested in the "Extraction Sums of Squared Loadings" which represents the "work" done by the factor analysis. As can be seen, the first eigenvalue is equal to 4.952, and corresponds to 18.342% of the variance in the original data. The second eigenvalue is equal to 2.427, corresponding to the second factor, is associated with 8.987% of the variance in the original data. The third eigenvalue is equal to 1.610, corresponding to the third factor, is associated with 5.964% of the variance in the original data. The fourth eigenvalue is equal to 1.365, corresponding to the fourth factor, is associated with 5.057% of the variance in the original data. The fifth eigenvalue is equal to 0.877, corresponding to the fifth factor, is associated with 3.247% of the variance in the original data. Together, the five factors explain 41.597% of the variance in the original data. The extent to which each factor affected the non-tax compliance of SMEs of Bulawayo CBD is derived from the percentage of variance of each factor and from the table above, the factor with the highest cause is the complexity of the tax system (% variance of 18.342%), followed by norms (% variance of 8.987%), then Economic factors (% variance of 5.964%), followed by deterrence to tax evasion (% variance of 5.057%) and the factor with the least affect is possibilities to tax evasion (% variance of 3.247%).

FIG. 1

## Scree Plot



In the scree plot the eigenvalues are plotted from largest to smallest. The factor with the highest eigenvalue has the greatest cause to non-tax compliance of SMEs in Bulawayo CBD and in the scree plot it is factor 1 (Complexity of the tax system). This explains the lack of Adam Smith's canons of taxation in the tax system which is canon of equality, certainty, convenient and economy. The second factor with effect close to the complexity of the tax system is factor 2 (Norms), then factor 3 (Economic factors), followed by factor 4 (Deterrence to tax evasion) and the one with least effect is factor 5 (possibilities to tax evasion). This factor is located at the bend and that is where the retention of factors stops. The rest of the factors are ignored.

## FINDINGS AND SUGGESTIONS

The following were the findings of the study:

1. Five important factors causing non-tax compliance of Bulawayo, CBD were identified and these were:
  - a. Complexity of the tax system
  - b. Norms
  - c. Economic factors
  - d. Deterrence to tax evasion
  - e. Possibilities to tax evasion
2. Among the 5 factors causing non-tax compliance of SMEs in Bulawayo, CBD:
  - a. Complexity of the tax system was identified as the factor which has the greatest effect towards non-tax compliance than the other factors. It had a percentage variance of 18.342% and it occupied the highest point on the scree plot.

- b. Norms were found to be the second to complexity of the tax systems in terms of the effect to non-tax compliance of Bulawayo SMEs. It had a percentage variance of 8.9872% and it occupied the second highest point on the scree plot.
- c. Economic factors were identified as the third in terms of its effect to non-tax compliance of Bulawayo SMEs.
- d. Deterrence to tax evasion was rated the fourth in its effect to the non-tax compliance of Bulawayo SMEs
- e. Possibilities to tax evasion were found to be the factor with the least effect towards the non-tax compliance of SMEs in Bulawayo, CBD. It had a percentage variance of 3.247% and it found on the bend of the scree plot.

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