Unlocking Tax Compliance: Key Factors Influencing SMEs in Ubungo Municipal Council, Tanzania

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Abstract

This study examines the factors influencing tax compliance among Small and Medium Enterprises (SMEs) in Ubungo Municipal, Dar es Salaam, Tanzania. Using a cross-sectional research design, data were gathered from a sample of 150 SME owners through structured questionnaires. The study employed probability sampling, specifically simple random sampling, to select participants. Key findings indicate that older businesses and married owners are more likely to comply with tax obligations, while perceptions of corruption negatively impact compliance. Although higher education had a marginal effect, better access to tax services and a positive attitude towards taxation significantly contributed to compliance. The study also highlights challenges such as bureaucratic hurdles, corruption, lack of awareness, unfriendly tax administrators, and issues with Electronic Fiscal Devices (EFDs). Recommendations include enhancing tax education, streamlining tax administration, combating corruption, improving access to tax services, addressing technological challenges, and building trust in the tax system.

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1. Introduction

Tax revenues have become a crucial component of fiscal policy in developing countries, enabling governments to bolster their financial reserves and promote sustainable development (Jalles, 2017). Particularly in times of global economic challenges, domestic tax resources are essential for reducing unemployment and poverty, providing quality public services, and investing in infrastructure to stimulate growth. In this context, strong tax collection systems are vital for developing countries to consolidate their fiscal positions and effectively meet the needs of their citizens (Giesi & Bishagazi, 2022; Utouh & Kitole, 2024).

In developed economies, robust tax systems are fundamental to economic stability and growth. The collaboration between governments and local businesses plays a key role in achieving financial goals and fulfilling societal needs (Giesi & Bishagazi, 2022). In Africa, taxation is crucial for generating revenue to support public sector development. However, in many developing countries, including Tanzania, tax systems often fall short in generating sufficient revenue to meet the demands of growing governments, leading to deficits and increased borrowing (Jalles, 2017; Kitole & Utouh, 2023). Small and medium enterprises (SMEs) are significant contributors to the economies of developing countries, providing employment and driving innovation (Matarirano et al., 2019).

In Tanzania, tax revenue is a primary source of funding for critical projects such as infrastructure development, healthcare, and education. The Tanzanian government imposes taxes to ensure economic development and maintain social welfare, with a focus on efficient resource allocation and equitable impact across society (Elly, 2015; Kitole et al., 2024). Globally, SMEs drive economies, accounting for approximately 90% of business entities and over 60% of employment (Gamage et al., 2020; Kitole & Gneda, 2024). In developing countries, these businesses are essential for economic growth, poverty alleviation, and fostering a competitive environment through innovation (Elhusseiny & Crispim, 2021; Kitole & Sesabo, 2024).

The Tanzania Revenue Authority (TRA) is responsible for collecting taxes from various sources, including local businesses. According to the Income Tax Act No. 11 of 2004, businesses with an annual turnover exceeding 40 million TZS are registered for VAT, while those with lower turnovers are subject to presumptive taxation (Marandu et el., 2015). Despite the importance of taxes for national development, Tanzania faces challenges in tax collection from SMEs, which are crucial for financing public services and development projects.

A persistent problem in Tanzania is low tax compliance among SMEs, leading to significant revenue losses for the government (Hamisi, 2011; Kitole & Sesabo, 2022). Although various reforms and initiatives, such as the introduction of Electronic Fiscal Devices (EFDs) and taxpayer education programs, have been implemented, tax evasion remains widespread. Factors such as complicated filing procedures, high tax rates, lack of awareness, and multiple taxation contribute to low compliance (Wadesango et al., 2020).

Despite efforts to improve tax compliance, the specific factors influencing SMEs in Ubungo Municipal Council to pay their taxes remain unclear. Most existing studies focus on other regions or countries, leaving a gap in the literature regarding tax compliance among SMEs in this area. This study seeks to address this gap by exploring the determinants of tax compliance among SMEs in Ubungo Municipal Council, Tanzania.

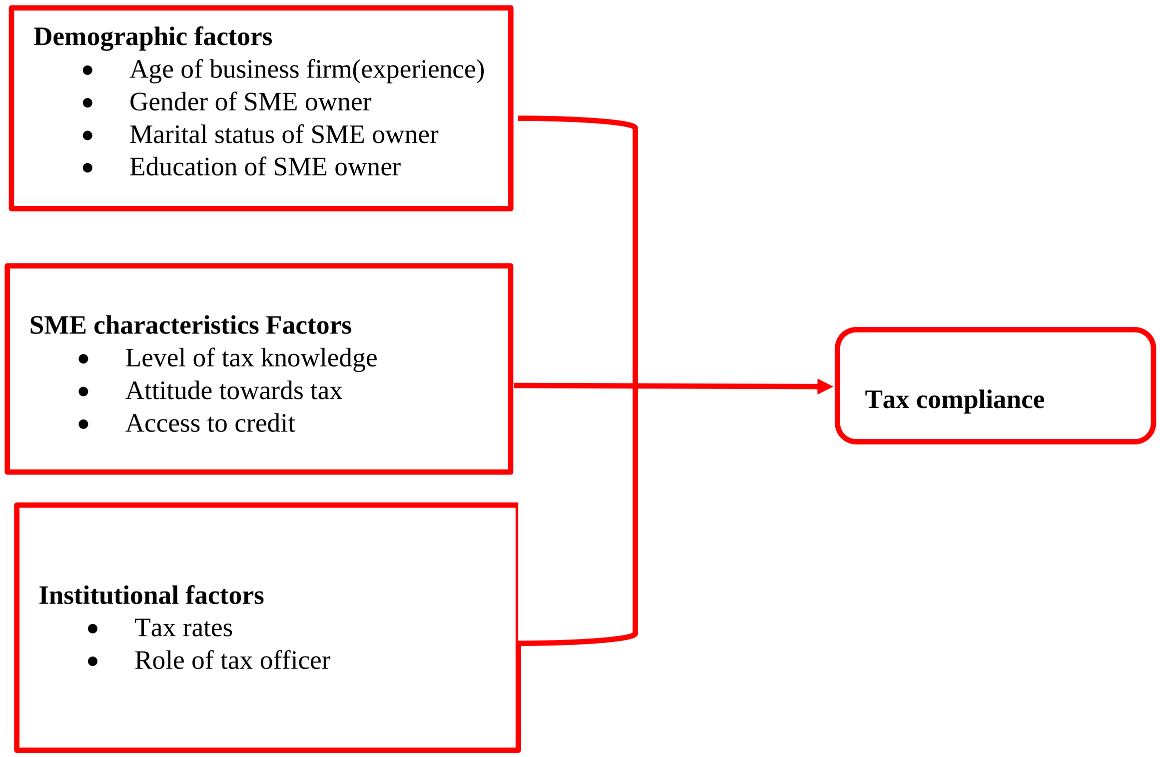
2. Theoretical Review

This study draws upon the Allingham and Sandmo (1972) model, a foundational theory developed to understand taxpayer compliance behaviours as cited by Aladejebi (2018). The theory posits that taxpayers are economically rational actors who weigh the costs and benefits of compliance. According to this theory, several factors influence the decision to comply with tax rules. One critical factor is the perceived risk associated with non-compliance—higher risks increase the likelihood of compliance, as taxpayers seek to avoid penalties. Additionally, taxpayers must possess adequate knowledge of the taxation regime and system, as informed taxpayers are more likely to comply with tax regulations (Hasseldine & Bebbington, 1991).

The theory further suggests that the rate of taxation and the likelihood of detection after non-compliance play significant roles in influencing tax behavior. Specifically, tax evasion is more likely to occur when audit chances are low and penalties are severe, whereas higher audit probabilities and stringent punishments tend to encourage compliance (Inasius, 2015; Inasius, 2019). This implies that robust laws, substantial penalties, and frequent audits can effectively reduce tax evasion by increasing the perceived risk of non-compliance.

Moreover, the theory incorporates individual taxpayer characteristics into the decision-making process, suggesting that compliance levels are also shaped by personal factors. For instance, the characteristics of small business firms can significantly influence their compliance behaviours, as highlighted in studies such as Lestary et al. (2021). This aspect underscores the importance of considering both economic and individual factors when analyzing tax compliance behavior, particularly among small and medium enterprises.

Figure 1. Conceptual framework



Source: Researcher design (2024)

3. Methodology

3.1 Research design and study area

This study employed a cross-sectional research design, focusing on small and medium business owners at a single point in time due to resource constraints, such as limited time (Dimoso & Andrew, 2021). Data was collected once to provide a snapshot of the current situation, making this design appropriate for the study's objectives.

The research was conducted in Ubungo District, officially known as the Ubungo Municipal Council, which is one of the five districts within the Dar es Salaam Region of Tanzania. Geographically, Ubungo is bordered by Kinondoni District and Kibaha in the Pwani Region to the north, Kisarawe District in the Pwani Region to the west, and Ilala District to the south and east. The district covers an area of 269.4 km² (104.0 sq mi). According to the 2022 National Tanzania Census, Ubungo District has a population of 1,086,912, comprising 519,925 males and 566,987 females (Omary& Pastory, 2022).

3.2 Sampling techniques and sample size estimation

The study utilized probability sampling techniques to ensure a representative sample. Specifically, simple random sampling was employed to select the sample, allowing every small and medium enterprise (SME) owner in Ubungo District an equal chance of being chosen to provide information on tax compliance.

To accurately analyze and draw conclusions about the phenomenon under study, it was crucial to select a sample that could provide the necessary data (Hennink et al., 2019; Kitole et al., 2023; Theodory & kitole, 2024; Kothari, 2004; Wang & Ji, 2020). Given the research objectives, the sample size needed to be appropriately balanced—neither too large nor too small. Several methods exist for determining the optimal sample size, and for this study, the formula developed by Yamane (1967) was used to calculate the sample size from the target population. This approach ensures that the sample is sufficiently precise to yield reliable and valid results.

$$n = \frac{N}{1 + N(e^2)}$$

Where: n is a required number of samples, N is a total population (1,086,912) and e is the error tolerance (level) or margin of error (0.05). Therefore, the estimated sample size of the study is 344 which was estimated through the following formula:

$$n = \frac{1{,}086{,}800}{1 + 1{,}086{,}912(0.05^2)} \approx 150$$

Therefore, the sample size used in this study is 150 respondents.

3.3 Model Specification

The study employed a logit regression model to identify the significant factors influencing tax compliance. The logit model is particularly well-suited for this study because it is designed to handle binary dependent variables, making it ideal for analyzing situations where the outcome is either tax compliance (1) or non-compliance (0). The logit model allows for the estimation of the probability that an SME owner complies with tax regulations, given a set of independent variables, by measuring the instantaneous effect that changes in these variables have on the predicted probability of tax compliance.

In this model, the dependent variable (Y) represents the binary outcome—either tax compliance (1) or non-compliance (0)—while the independent variables are the various factors hypothesized to influence this outcome. The logit model is advantageous because it provides insights into how changes in each independent variable affect the likelihood of tax compliance, while holding other covariates constant. The model specification used in this study is adapted from Anasel et al. (2024) and is presented as follows:
The logit model equation for this is expressed as follows:

$$Logit\ (P) = \ln\left(\frac{P}{1-P}\right) = \beta_0 + \beta_{1i}X_{1i} + \beta_{2i}X_{2i} + \cdots + \beta_n X_n$$

Whereas P is the probability of tax compliance (i.e., P=1P = 1P=1 for compliance and P=0P = 0P=0 for non-compliance), $\ln\left(\frac{P}{1-P}\right)$ is the log-odds of tax compliance, β_0 is the intercept term, $\beta_1 \ldots \beta_n$ are the coefficients of the independent variables, and $X_1 \ldots X_n$ are the independent variables, which could include factors like knowledge of tax regulations, perceived risk of non-compliance, ease of tax filing, income level, and other relevant factors.

This equation models the log-odds of an SME owner's likelihood of complying with tax regulations as a function of the various independent variables. The coefficients ($\beta_1 \dots \beta_n$) represent the change in the log-odds of tax compliance for a one-unit change in the corresponding independent variable, holding all other variables constant. On the other hand, the description of variables used in the estimation equation are presented in Table 1.

Table 1: Description and measurement of variables

Variable	Measurement	Category	Expected sign
Tax compliance by SME	1= Tax compliance 0= Otherwise	Binary	
Gender of SMEs owner	1 if a male 0 female	Dummy	+/-ve
Marital status of SME owner	1 if married 0 otherwise	Dummy	+/-ve
Education level of owner	1 if SME owner has no education 2 for primary education 3 Secondary education 4 Tertiary education 5 University	Dummy	+/- ve
Tax knowledge	1 have knowledge 0 otherwise	Dummy	+ve
Tax rates	1 high tax rates 0 otherwise	Dummy	+/- ve
Access to credit	1 have access to credit 0 no access to credit	Dummy	+ve
Role of tax officer	1 if corrupt 2 times 3 conveniences	Category	-ve
Tax attitude	1 if SMEs trust the government 0 otherwise	Dummy	+ve

Source; Own design 2024

4. Results and Discussion

4.1 SMEs owners' characteristics

Results in Table 2 present the general characteristics of the SME owners in Ubungo Municipal Council. The data show that a majority of the SME owners are male (54.67%), with females representing 45.33%. In terms of marital status, 64.00% of the respondents are married, while 36.00% are single. Educationally, 77.34% of the SME owners have some level of formal education: 31.33% have completed primary education, 35.33% have secondary education, 4.00% have tertiary education, and 14.00% hold a university degree. On the other hand, 22.66% have no formal education. This distribution suggests a relatively high level of literacy among SME owners, which may have implications for their business practices and success.

Table 2. Basic Respondent Information

Characteristics	Attributes	No. of Respondents (N=150)	Percentage (%)
Sex	Female	68	45.33
	Male	82	54.67
Total		**150**	**100**
Marital status	Single	54	36.00
	Married	96	64.00
Total		**150**	**100**
Educational level	No education	23	15.33
	Primary	47	31.33
	Secondary	53	35.33
	Tertiary	6	4.00
	University	21	14.00
Total		**150**	**100**

Source: Field data, 2024

4.2 The Determinants of Tax Compliance among SMEs Owners in Ubungo Municipal Council

Table 3 reveals several key determinants influencing tax compliance among SME owners in Ubungo Municipal Council, Dar es Salaam. The age of the business is a significant factor, with a marginal effect of 0.003 ($p < 0.001$), indicating that for each additional year of business age, there is a 0.3% increase in the probability of tax compliance. This finding aligns with the study by Ju and Kutan (2019), which noted that older businesses tend to have more established financial practices, leading to higher compliance rates. This suggests that as businesses mature, they become more familiar with tax regulations and develop more robust financial systems, contributing to better compliance.

Marital status is another important determinant, with married SME owners showing a 10% higher probability of tax compliance (marginal effect of 0.10, $p = 0.001$). This result is consistent with Wang et al. (2021), who found that marital stability often correlates with more responsible financial behavior, including tax compliance. Married individuals may have more stable household finances and a greater sense of responsibility, which could translate into more diligent tax practices. On the other hand, the impact of education on tax compliance is less pronounced. Only access to tertiary education shows a marginal effect of 0.012 (p = 0.415), indicating a 1.2% increase in compliance likelihood, which contrasts with Alm et al. (2019), who observed a stronger relationship between higher education and tax compliance. This suggests that while education contributes to compliance, its influence may be mediated by other factors in this context.

Perception of corruption negatively impacts tax compliance, with a marginal effect of -0.051 (p = 0.093), reflecting a 5.1% decrease in the probability of compliance. This finding is in line with Tran-Nam et al. (2020), who highlighted how perceptions of corruption can undermine trust in government and reduce willingness to comply with tax obligations. Conversely, access to tax services significantly enhances compliance, with a marginal effect of 0.022 (p = 0.018), indicating a 2.2% higher likelihood of compliance among SMEs with better access to tax services, supporting the findings of Ong'oa and Kariuki (2019). Additionally, a positive attitude towards taxation is crucial, showing a 3.8% increase in compliance likelihood (marginal effect of 0.038, p = 0.021). This aligns with Zhang et al. (2020), who noted that a favorable view of the tax system can significantly boost compliance rates, emphasizing the importance of fostering positive perceptions of taxation among SME owners.

Table 3. Logistic Regression Analysis Predicting Tax Compliance Among SMEs at Ubungo municipal, Dar es Salaam.

Predictor	Odds Ratio	SE	P>|Z|	Marginal Effect
Age of the business	1.26	0.08	0.000	0.003
Sex (Male)	2.88	2.29	0.183	0.018
Marital status (Married)	23.46	22.48	0.001	0.10
Education Level				
Primary Education	0.83	0.72	0.826	-0.00
Secondary Education	1.21	1.37	0.869	0.002
Tertiary Education	3.98	6.74	0.415	0.012
University Education	1.72	2.11	0.061	0.007
Corruption Perception	0.15	0.17	0.093	-0.051
Time to Comply	0.16	0.17	0.081	0.003
Knowledge of Tax Law	0.44	0.43	0.006	0.011
High Tax Rate Perception	1.28	0.99	0.747	0.004
Access to Tax Services	0.11	0.15	0.018	0.022
Positive Attitude	6.19	4.90	0.021	0.038

*Note: *SE = Standard Error*
Source: Research Data, (2024)

4.3 Challenges Faced by Small and Medium Enterprises to Pay Taxes

Small and Medium Enterprises (SMEs) in Mtwara face significant challenges in achieving tax compliance, many of which stem from bureaucratic hurdles. Approximately 10% of SMEs are adversely affected by complex and redundant tax filing procedures, leading to delays and increased costs. These bureaucratic obstacles mirror the findings of Ochieng and Bwisa (2013) in Kenya, where similar challenges were found to impede the efficiency of tax compliance processes. The complexity of tax systems often discourages SMEs from timely compliance, as navigating through the required paperwork and approvals can be both time-consuming and costly.

Corruption presents another major barrier, affecting 20% of SMEs. The demand for bribes and unethical practices by tax officials creates a significant disincentive for compliance. This aligns with the findings of Söderbom and Teal (2022) in Ghana and Kitole and Sesabo (2024) in Tanzania where corruption among tax officials similarly discouraged businesses from fulfilling their tax obligations. When SMEs encounter corrupt practices, their willingness to comply diminishes, leading to lower tax compliance rates and perpetuating a cycle of mistrust between businesses and tax authorities. Additionally, a lack of awareness or understanding of tax requirements poses a challenge for 24.67% of SMEs. This challenge, as highlighted by Lusardi and Mitchell (2014), underscores the critical role of financial literacy in promoting tax compliance. Without a clear understanding of tax obligations, many SMEs struggle to meet their responsibilities, leading to inadvertent non-compliance.

Table 4. Challenges Faced by Small and Medium Enterprises to Pay Taxes

Challenges	**Number of Respondents (SMEs)**	**Percentage**
Bureaucracy in paying Taxes	15	10%
Corruption	30	20%
Difficulty in paying Taxes(awareness)	37	24.67%
Unfriendly Tax Administrators	23	15.33%
Infrastructure problems (EFDs machines)	45	30%
Total	**150**	100

Source: Research Data, 2024

Unfriendly interactions with tax administrators further complicate tax compliance for 15.33% of SMEs. Negative experiences with tax officials, such as uncooperative attitudes and lack of support, discourage SMEs from engaging with the tax system, echoing Jenkins and Newell's (2013) findings in South Africa. These adversarial relationships foster a reluctance to comply, as businesses feel unsupported and unfairly treated. The most significant challenge reported by 30% of SMEs is related to Electronic Fiscal Devices (EFDs), including issues such as malfunctioning devices and inadequate technical support. This problem is consistent with challenges noted by the OECD (2018) in developing countries, where the implementation of EFDs has been fraught with technical difficulties, further complicating tax compliance for SMEs. These challenges highlight the need for targeted interventions to address the specific obstacles faced by SMEs in Mtwara, ensuring that tax systems are both accessible and supportive for small businesses.

5. Conclusion and Recommendations

This study concludes that several factors significantly influence tax compliance among SMEs in Ubungo Municipal Council. The key determinants identified include the age of the business, marital status of the business owner, education level, perception of corruption, access to tax services, and a positive attitude towards taxation. The findings indicate that older businesses are more likely to comply with tax regulations due to their established practices, while married business owners tend to demonstrate higher compliance, potentially due to greater financial stability.

Education emerged as a critical factor, with higher levels of education correlating with increased tax compliance. The study also revealed that the perception of corruption negatively impacts compliance, as distrust in tax authorities discourages adherence to tax obligations. Conversely, better access to tax services and a positive attitude towards taxation were found to enhance compliance, emphasizing the importance of building a supportive and transparent tax environment. Furthermore, the perceived fairness of the tax system and the quality of services provided by tax authorities play pivotal roles in influencing compliance rates. High tax rates and the perceived risk of detection also contribute significantly to compliance behavior.

In light of these findings, the study recommends the implementation of comprehensive tax education programs to improve awareness and understanding of tax obligations among SME owners. Additionally, efforts should be made to enhance taxpayer services, ensuring that tax processes are accessible, transparent, and efficient. Addressing issues of corruption and ensuring the fairness of the tax system are also crucial steps in fostering a more compliant tax environment. By focusing on these areas, policymakers can create a more conducive environment for tax compliance, ultimately leading to improved revenue collection and sustainable economic growth.

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