

FACTORS INHIBITING TAX COMPLIANCE AMONG THE SMALL MEDIUM ENTERPRISES (SMEs) IN KABOMPO DISTRICT CENTRAL BUSINESS ZAMBIA.

(Paper ID: CFP/1586/2020)

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ABSTRACT

Tax is an important stream of revenue for government's development projects and therefore all efforts must be made by governments to ensure that it is accurately and efficiently collected so as to facilitate the government's operations. In an effort to maximize collection of revenue and efficiency in tax administration, key changes to tax policy evolving around ensuring equity, further widening the tax base, promoting increased investment and in so doing, reducing the tax compliance burden, have in the recent past been made by the Zambian government. This study sought to identify the factors that inhibit tax compliance in Zambia, specifically focusing on SME's operating within Kabompo central. The researcher outlined a detailed literature review and identified the variables for this research to be tax rate, availability of tax information, tax compliance cost and attitude of SME's. The research was a descriptive survey. Given the large population of registered taxpayers in Kabompo, a sample size of 50 was picked as representative, to be the focus of this study. To ensure that various diverse categories of taxpayers and business entities were included in the survey, stratified sampling technique was adopted. Data was collected using self-administered questionnaires and an interview guide. The collected data was consequently analysed using Statistical Package for Social Scientist software and the findings of the research presented using tables. The findings of the study

revealed that with regard to tax rate as a factor influencing SMEs compliance, the majority view that Zambia has high tax rates with several different tax heads and this consequently hinders their level of compliance. The lack of readily available information relating to tax matters accounted to a great per cent as a reason for non-compliance. The lack of information contributed to the inability of the taxpayers to correctly calculate the taxes payable; another form of non-compliance. The SMEs view that if more information would be availed to them in form of tax seminars and literature, this would demystify the complex concept of tax and greatly motivate them to be compliant. The findings of this study further revealed that 75% of the SMEs interviewed incur more than Kwacha 20,000 monthly, as costs of tax compliance. Some of these costs include bookkeeping, and internet costs. Additionally, the taxpayers do feel and strongly agree that the taxation system in Zambia is in great need of improvement. By gaining an understanding of these underlying factors, ZRA and the government will be able to make changes that will greatly improve taxpayers' tax compliance level, with the end result being increased government revenues, allowing the tax authority to give quality service to taxpayers and the government as a whole providing more and improved utilities to the public.

ABBREVIATIONS AND ACRONYMS

CGT Capital Gain Tax

GDP Gross Domestic Product

GOZ Government of Zambia

IEA Institute of Economic Affairs

PAYE Pay as you earn

PIN Personal Identification Number

SME Small Medium Enterprises

TMP Tax Modernization Program

TOT Turnover Tax

USD USA Dollar

VAT Value Added Tax

ZRA Kenya Revenue Authority

CHAPTER ONE: INTRODUCTION

1.0 Background of the study

Tax Compliance can be defined as the degree to which a taxpayer complies (or fails to comply) with the tax rules of his country, for example by declaring income, filing a return, and paying the tax due in a timely manner. While Tax evasion can be defined as the failure by a person or business to comply with the tax obligations. It is a serious challenge to tax authorities in both the developed and developing countries. It diminishes the mobilization of resources that governments need to invest in critical areas of social and personal development including health, education and infrastructure development (Cummings, 2007). In 2011, it cost governments worldwide about 5.1 % of their Gross domestic Product (GDP). In Europe tax evasion constitutes about 8% of the GDP of economies in the region. In North and South America, tax evasion costs economies 2% and 10% of their GDP respectively. Even in the most advanced economies in the world, tax evasion undermines revenue collection substantially (Rile, 2011). Countries like Italy and Greece have vowed to crack down on tax evasion and cash transactions

for goods and services that fall below the authorities' radar. Germany and Britain signed an agreement with Switzerland about recovering some tax revenue from accounts held by their citizens in Swiss banks. South America has the world's largest shadow economy compared with its G.D.P. followed by Africa and Europe, where income hidden from the tax authorities amounts to about 20.5 percent of G.D.P. That compares with 10.8 per cent in North America. Of the three South African countries of Zambia, Zimbabwe, and South Africa, tax evasion as a function of GDP is high. South Africa loses the least amount in tax evasion: In 2011, it lost 768 million USD, followed by Zimbabwe at 1.9 billion USD, and Zambia loses slightly over 2 billion USD. In 2014, the informal economy constituted 33% of the GDP in Zambia and represented 7% of total government expenditure. The tax burden in Zambia would thus be high, standing at about 30.9%. If the Zambian government is to increase its social expenditure, then it needs to reduce tax evasion in the informal economy (Bwalya, 2015). Taxpayers' behaviour towards tax system has evoked great attention among many Revenue Authorities in the World especially in Developed Countries. However, it is debatable on what has been done towards the study of taxpayers behaviour towards tax system in developing countries as they concentrate more in studies which would increase their budgets bottom-line in terms of huge revenue collection and enforcement efforts at the expense of studies on taxpayers behaviour which would make increase in this tax revenue to be realized and enforcement efforts work. Perhaps the less developed countries are not to blame as they run on budget deficits hence, scarce resources to see through such studies which are perceived as adding no direct value to revenue collection. Empirical evidence on the ground shows there has been hostility between the taxpayers and tax collectors on issue relating to

tax compliance (Porcano, 2016). However, in Zambia measures have been introduced to expand the tax base; rationalize the tax structure to make it more equitable; reduce and rationalize tax rates and tariffs; reduce trade taxes and increase them on consumption to support investment; and seal leakage loopholes (Moyi and Ronge, 2006). Government launched the VAT in 1990 to increase revenue through the expansion of the tax base. Tax policies introduced during the Patriotic Front Government are internet taxes, sales tax and many more.

1.1 Statement of the Problem

Tax plays an important role in the growth of any economy so tax evasion is harmful to the economy. Tax evasion hampers government revenue collection thus inefficiency in Government spending because it diminishes the capacity of the state to mobilize domestic revenues, resources that are needed for investments. In 2010, for example the amount lost to tax evasion represented about twice the amount the country spent on health care. Tax evasion also damages the country's growth capacity by discouraging both local and foreign investors. The high tax rate and burden in Zambia, which is related to the high levels of tax evasion, is the leading disincentive to business activity (Bwalya 2015). The increasing trend of disparity between the levels of submitted annual income tax returns, reported tax assessments and voluntarily paid tax liabilities, among SMEs, on the one hand, and the trend of business birth and growth, on the other hand, has been a cause of worry to the government of Zambia. This resulted in the government offer of an olive branch to taxpayers through the tax amnesty announced by the Minister for Finance in Zambia in 2015 (GRZ 2015). A study of the Parliamentary Budget Office (parliament2015) shows that in 2016 the government could have increased the tax base by approximately Kwacha

59.3 million if the tax evasion among SMEs was addressed. According to the ZRA annual report for year ended 2016, the amount lost in form of taxes was Kwacha 98 million which can be directly attributed to the informal sectors and SMEs (ZRA 2015). Furthermore, according to ZRA annual report of 2018 Kabompo District is among the least Districts where tax compliance is concerned. The District has a 30% compliance rate (ZRA 2015). The SMEs are continuously expanding and has the potential to increase the revenue flows but which have been otherwise left out of the tax bracket. Generally, if the informal sector remains untaxed, and as more people transition in to the sector, the government is likely to continue losing billions of kwachas. Such a scenario will impact on government's ability to achieve its revenue targets and consequently its development agenda. The question as to why some people pay tax while others do not has raised a lot of concern among economists, governments and tax administrators alike. Tax revenues have, for quite some time, remained low relative to the number of both registered and non-registered firms and individuals who are legally qualify to pay tax. Continued low revenue collection levels for government is detrimental to economic development of this nation. (Cobham, 2014). A large segment of the informal sector, especially the SMEs in Kabompo District in North Western Province exhibit low tax compliance levels. This is a great loss of revenues meant for public expenditure. It is for this reason that research need to be undertaken to identify the factors inhibiting tax compliance among small and medium enterprises in Kabompo District. It is also instructive to note that there is little research that has been done in this area. In this context SMEs in Kabompo District exhibit low tax compliance levels and this requires an understanding on the determinants of tax compliance to enable the government to improve

on its tax collection among the SMEs in Kabompo District.

1.2 Research Objectives

1.2.1 General Objective

To investigate the factors inhibiting tax compliance among the Small and Medium Enterprises (SMEs) in Kabompo District central business.

1.2.2 Specific Objectives

This study was guided by the following objectives:

- i. To assess the influencing of availability of information on tax compliance among the Small and medium Enterprises SMEs.
- ii. To ascertain the effect of tax rates on tax compliance among the Small and medium Enterprises SMEs.
- iii. To establish Small and Medium Enterprises (SMEs) attitude towards tax compliance.
- iv. To determine the extent to which costs incurred by Small and Medium enterprises in being tax compliant influence their level of tax compliance.

1.3 Research Questions

This research was guided by the following research questions.

- i. How does the availability of tax information influence tax compliance among the SMEs in Kabompo District?
- ii. To what extent do tax rates in Zambia explain tax compliance among the SMEs in Kabompo District?
- iii. How does the attitude of Small and Medium Enterprises about tax influence tax compliance?
- iv. To what extent does the cost of tax compliance explain tax compliance among Small and Medium Enterprises?

1.4 Significance of the study

The government is not able to collect the required taxes from the targeted tax payers. From the SME point of view, tax evasion is driven generally by a perception that the tax burden is too high. This poses a number of problems to tax systems, raising difficult questions over how tax policies and tax administration may influence tax compliance incentives and behaviour. The compliance tax burden on the Informal Sector may be high relative to that of large companies (higher unit cost in relation to turnover). Further, the cost of complying with a given set of tax rules and regulations is generally high. This study focused on how social, cultural and personal factors influence tax compliance. It is anticipated that the results of this study will provide concepts and grounds on which to develop a framework. The knowledge accruing from this study could benefit the Government of Zambia and its revenue collection body Zambia Revenue Authority in its effort to design suitable tax policies for SMEs. This study has provided concepts which to develop a framework to explore tax compliance behaviour among SMEs. It has opened the underlying factors that promote tax compliance. The research will be useful to the business community and organization's management teams for purposes of knowing the tax compliance environmental factors and how the conditions can be improved or dealt with. Finally, the research will be of interest to scholars and researchers who may require developing and advancing their knowledge in the field of tax compliance and administration.

1.5 Assumptions of the study

It was assumed that the respondents would be willing to participate in the study, be co-operative and provide accurate information when responding to the research questions.

1.6 Limitations of the study

Time constraint was a limiting factor because the study is to be concluded within a short time. Availability of funds was also a limiting factor to the study since the researcher is self-sponsored. There was no assurance that the respondents will return all the questionnaires duly completed, neither was there a guarantee that those who will be interviewed would respond to all the questions put forward to them comprehensively for fear that it would expose their noncompliance to ZRA. The researcher also only concentrated in the central part of the District. To counter some of these limitations, the researcher took leave from work to make time to interview the respondents and also sought for funding from relatives. The SMEs fear of participation was overcome by explaining to them the intent of the study and issuing the transmittal letter as well as the supervisors contact for verification purposes.

1.7 Description of the study

The study area, Kabompo Central had a high concentration of taxpayers falling under the SMEs category, and a wide variety of business activities. It was also within the convenience of the researcher, this made the process of data collection easy, cheaper and less tedious.

1.8 Operational definitions used in the study

Tax: A compulsory financial contribution imposed by a government to raise revenue, levied on the income or property of persons or organizations, on the production costs or sales prices of goods and services.

Tax Compliance: The Degree to which a taxpayer complies (or fails to comply) with the tax rules of his country, for example by declaring

income, filing a return, and paying the tax due in a timely manner.

Tax Evasion: It refers to the conscious or unconscious action and behaviour of a person who is liable to pay tax but who fails to fulfil this duty by either under reporting his tax liability or failing to account for his income generating activities altogether. Tax evasion also refers to the reduction or minimization of tax liability by illegal methods.

Tax Rate: The tax rate is the tax imposed by the federal government based on an individual's taxable income or a corporation's earnings. Kenya uses a progressive tax rate system, where the percentage of tax increases as taxable income. It can also be defined as the per cent of income paid as tax.

Tax Information: The knowledge or facts provided about taxes.

Tax Obligation: Responsibilities pertaining to tax payment and declaring of tax returns which a person duly registered and having a PIN is required to observe.

Tax Compliance cost: It refers to the expenditure of time or money in conforming with government requirements such as legislation or regulation.

Tax Attitude: The way of thinking or feeling about taxes

Tax Administration: It refers to the procedures attached to tax compliance including registration and filling of returns.

Small and Medium Enterprises: Those entities with full-time employees not exceeding 100 or annual sales turnover not exceeding Kwacha 200 million.

1.9 Organization of the paper

This report is divided into five key sections. Chapter one provides a background on the introduction of taxation system in Zambia. It particularly highlights the taxation policies and tax reforms that have been undertaken in Zambia over the years. The Chapter further states the statement of the problem, research objectives and research questions that the study aims to answer. The significance of the study and definitions of terms as used in the study are indicated in the same chapter. Chapter Two outlines the various schools of thought that have been brought forward with regard to tax compliance behaviour. The variables of the study are discussed with reference to studies conducted by other researchers as well as published material on the same. Chapter three outlines the research design and methodology to be used for purposes of completing the study. It also describes in details, the research design, target population, the sample, sampling procedure to be adopted as well as the data collection instruments. Chapter four contains data analysis, presentation and interpretation of the findings while chapter five provides a summary of findings, its discussion, conclusions and recommendations. This is followed by references and appendices sections.

CHAPTER TWO: LITERATURE REVIEW & CONCEPTUAL FRAME

2.0 Overview

This chapter outlined the various schools of thought revolving around tax compliance and evasion. This Chapter identified the various theories put across by various scholars in relation to tax compliance. For the research questions identified in Chapter One, the researcher highlighted the findings of different authors, on the factors influencing factors influencing tax compliance among SMEs.

2.1 Theoretical literature review

This study borrowed heavily from existing research that is increasing. It was influenced by the following theories which have been put across by various scholars with regard to adoption of technology in society.

2.1.1 The Tax Morale Theory

The tax morale theory was first advanced by German scholars centred around Gunter Schmolders known as Cologne school of tax psychology. Tax morale can be termed as the individual factor that motivates a person to comply with his or her tax obligations. As a determinant of tax behaviour, tax morals aim to explain how and why a tax payer morality influences his or her tax behaviour. Many studies have found out that tax evasion can be attributed to the tax morale (Mocetti, 2017). Tax payers would be inclined to evade tax when the communities in which they live or operate disapprove of tax evasion. Tax payers are more likely to comply with tax obligation if their friends, relatives and acquaintances comply with these obligations.

Also tax payers will evade taxes if they feel that other people are getting away with tax evasion. In other words, if a society tolerates tax evasion,

such a society would encourage tax evasion (Waweru, 2004). Religious beliefs are a variable in tax evasion as studies have shown that tax payers who have strong religious commitments or beliefs would likely be tax compliant even if they feel that the tax rate is high (Gee, 2006). In some instances tax payers can feel morally feel justified in evading taxes if they feel that the quality and quantity of public services and goods are unsatisfactory. The opposite is also true. In economies where the provision of public goods and services is satisfactory the evasion rates are low. Tax payers will tend to comply with their tax obligation if they feel that their government is honest, democratic and participatory and also if the tax payers feel they play a meaningful role in governance (Cummings, 2007). Thus tax payers attitude are important predictors of tax evasion thus the study aims to interpret the tax attitudes of SMEs and how it contributes to tax evasion.

2.1.2 The Allingham and Sandmo Theory (AS Theory)

This theory was advanced by Allingham and Sandmo. According to (Sandmo, 2014) The AS theory holds that the government deters tax evasion through a sanction arrangement and audits. A tax payer will decide to violate the fiscal laws and evade his or her tax obligations when he or she perceives that the cost of evading tax is too low, believing he or she does that he or she is unlikely to be detected or audited. Tax payers would also evade tax when he or she perceives the cost of compliance is high. Tax systems and procedures that are involving and cumbersome tend to encourage tax evasion. Tax payers who feel that tax rate is high and punitive will evade tax. There is a negative correlation between tax evasion, the probability of detection, the degree of punishment and high transactional costs associated with tax laws. Income tax evasion was pioneered by Allingham and Sandmo (2014),

where a rational and a moral taxpayer maximize expected utility, which solely depends on income. When caught, the agent must pay penalties, imposed on the amount of evaded income. A key comparative static result is that when the tax rate goes up, competing income and substitution effects might lead to more or less tax compliance.

The substitution effect encourages evasion since the marginal benefit of cheating goes up with the tax rate. On the contrary, the income effect tends to suppress evasion since a higher tax rate makes the taxpayer with decreasing absolute risk aversion feel worse-off, and thus decrease risk-taking. Therefore, the net effect is ambiguous. However, Shlomo Yitzhaki (2002) showed that when the penalty is imposed on the amount of evaded taxes, as it is under most current tax laws, the substitution effect vanishes. At the original optimum, the penalty paid on concealed income increases proportionally with the tax rate, and hence, there is no substitution effect. The remaining income effect is responsible for inducing the taxpayer to cheat less. Therefore, the net effect is better compliance. Yitzhaki's (2002) result is perhaps the single most important finding in the early tax evasion literature, having spurred a lot of remarkable extensions. The SMEs are prone to tax evasion as they face difficulties in complying with tax laws. They are expected to comply with strict deadlines, keep proper books of accounts. This kind of environment leads to tax evasion.

2.2 Empirical Literature Review

In an experimental study, (Feld, 2002) found that tax compliance is higher on average in an endogenous fine treatment in which subjects are allowed to approve or reject the proposal of a fine as compared to an exogenous fine treatment where the fine is imposed by the experimenter. The main explanation why people show higher

tax morale if they are allowed to vote on a fine is legitimacy. Compliance rates are higher if the fine is accepted than in the case the fine is rejected. Subjects who reject the proposal of the fine show a higher compliance rate than subjects in the exogenous fine treatment even if they know that the dominant strategy under the existence of the low fine is non-compliance. Combining econometrics and surveys methods, (Spicer, 2015) sought to investigate impact of attitude and social norms in the evasion decision; the data were collected from a 1974 survey in USA. Econometric results revealed that the propensity to evade taxation was reduced by increased probability of detection. Surprisingly, an increase in income reduced the propensity to comply. With respect to attitude variables, an increase in both inequity of taxation and the number of taxpayers who evade taxes known to a taxpayer made evasion more likely. This study also revealed that the experience of taxpayer of previous audits by the income department influences the compliance rates. According to Feldstein (2002) Tax avoidance and evasion are pervasive in all countries, and tax structures are undoubtedly skewed by this reality. Standard models of taxation and their conclusions must reflect these realities. This study first presents theoretical models that integrate avoidance and evasion into the overall decision problem faced by individuals. If the cost of evasion and avoidance depends on other aspects of behaviour, the choice of consumption basket and avoidance become intertwined. The study then relates the behaviour predicted by the model to what is known empirically about the extent of evasion and avoidance, and how it responds to tax enforcement policy. There are a variety of policy instruments that can affect the magnitude and nature of avoidance and evasion response, the elasticity of behavioural response is itself a policy instrument, to be chosen optimally. The study

reviews that is known about these issues, and introduces a general theory of optimal tax systems, in which tax rates and bases are chosen simultaneously with the administrative and enforcement regimes. To summarize, most empirical studies on the impact of tax rates support the assumption that high tax burdens have a negative impact on compliance.

2.3 Tax Compliance by SME's background

Tax plays an important role in the growth of Small and Medium Enterprises (SMEs) in low income countries like Zambia. The role of SMEs is critical in pushing the socio-economic development agenda of the country further. Therefore, alignment of the tax system to the environment specific SME growth needs can be considered an important agenda for the policy makers. In the 1970s, SMEs in Zambia were perceived as marginal to mainstream activity. They were typically cast as habitual avoiders and evaders however the 1980s the service sector took off and represented a higher and growing proportion of GDP in the country. SMEs are an important force for economic development and industrialization in poor countries. It is increasingly recognized that these enterprises contribute substantially to job creation, economic growth and poverty alleviation. The 2015 World Development Report suggests that creating "sustainable jobs and opportunities for micro entrepreneurs are the key pathways out of poverty for poor people" (World Bank, 2015). Like any other developing countries, Zambia has taken a number of measures to promote the growth of private sector and Small and Medium Enterprises (SMEs). SMEs were estimated to account for a significant share of Gross Domestic Product (GDP).

The government formulates and implements various policies aimed at increasing job

opportunities, development of infrastructure as well as income generation through the creation of new SMEs and improving the performance and competitiveness of existing one, the revenue collected from taxes represents the major funding source for governmental expenditures (Baurer, 2005). If the tax structure is not adequately designed to the specific environmental conditions, it may create a greater burden to the tax-paying organizations and eventually affecting the final consumer due to the shifter ability of tax. SMEs in developing countries often face difficulties when dealing with tax matters. It would be rare indeed not to hear complaints about the complexity and or ambiguity of the tax laws, high tax rates, and the lack of an integrated fiscal strategy that takes social taxes, and local taxes and fees into account when determining the overall tax burden placed on the business community (Baurer, 2005). This implies that as a policy maker and regulator, Government must consider the factors that could affect the competitiveness of the enterprises. Assessing the impact of tax systems on SMEs is not simply a matter of looking at tax rates. Tax systems play an important role in encouraging growth, investment and innovation and facilitating international trade and mobility. For SMEs key considerations are to minimize administrative burden while ensuring compliance, including considering the drivers and impacts of operating in the informal economy (Kolstad, 2006) indicated that taxes are perceived to be a major problem for both young and old firms.

Therefore, taxation has showing a way towards impacting small and medium enterprise. There are four broad categories of obligations identified as registration in the system, timely filling or lodging of the required information, reporting of complete and accurate information and payment of taxes in time. The definitions of SMEs differ from country

to country, region to region and there is no universal definition. Small and Medium Enterprises (SMEs) play an important economic role in many countries. In Zambia, for example the SME sector contributed over 50 percent of new jobs created in 2010 but despite their significance, most SMEs evade tax. Nevertheless, the factors that attribute to the tax evasion among SMEs are not well understood. Hostility towards tax compliance dates back to history of taxation. Taxes are considered a problem by everyone, not surprising, taxation problem date back to the earliest recorded history.

Zambia is ranked among low income countries and low compliance countries and is further faced with the difficult task of ensuring efficient and effective tax administration. According to a research conducted in Zambia by other scholars, the problem of tax non-compliance among business firms constrains the realization of revenue collection targets by Zambia Revenue Authority (ZRA). The research aimed at investigating the relationship between the size of taxpayer's income, inspection by the tax authorities, use of tax registers and VAT compliance. A sample of 233 registered firms was selected and data collected using self-administered questionnaires to personnel in finance department of the selected firms. The data was analysed both descriptive and correlation analysis. The study revealed that VAT non-compliance is high among the middle-income business firms and that Inspection of business firms by tax authorities had a slight positive relationship with VAT compliance ($r = 0.15$, $p < 0.05$) The study revealed that effective and regular use of Tax Registers had a significant positive relationship with VAT compliance ($r = 0.622$, $p < 0.05$). The study recommends that stringent compliance measures and close monitoring should be observed among the mid-

sized private firms. Tax authorities should also encourage effective use of tax registers through regular but impromptu inspections (Naibei, 2012)

Tax compliance is low among SMEs as a result of several factors such as poor management and internal control practices as many of the enterprises are merely trying to make ends meet. Another contributory factor to low tax compliance among SME's is the informal approach to establishment, operation and dissolution which creates an ease of mobility, consequently making it difficult for the tax administration to keep pace with them. Cash-based economies have also had inadequate accounting records and audit trails in practice. Tax compliance is low among SMEs also because compliance costs for the SMEs are much higher relative to larger business operations that they are competing against. In addition, small businesses have limited resources and technical capacity. Often, the priority of a tax administration is to focus on large taxpayers because of the high delinquency rate and low revenue yields associated with small businesses, with very little enforcement action. This ultimately encourages non-compliance (Masinde, 2010). From the perspective of tax administration, the major obstacle which hinders government in ensuring that the SME is incorporated in the taxation bracket is the nature of businesses. The small sizes of the businesses make it easier for them to remain outside the taxation bracket. Mistrust and weak structural dialogue between informal sector and government is another factor that hinders taxing of the informal sector. There is a general mistrust between tax agents and taxpayers, with agents perceiving the SME as tax evaders, unwilling and unable to pay their taxes. The operators too are wary of government agencies' high-handedness in collection of taxes.

There is lack of structured dialogue between the SME and the government as well as other law enforcing authorities. This has led to mistrust and prevents the sector from engaging constructively with the government in reform processes.

Other bottlenecks according to a publication of the IEA budget information program include the lack of opportunity to grow and adapt good culture of corporate governance. The informal sector has limited access to training and professional services that would enable them adapt to a sound culture of corporate governance. (Osambo, 2009) Complicated tax systems and numerous processes (licensing etc.) make it difficult and expensive for start-up firms to act in good faith. Policies regarding the informal sector are poorly coordinated and disseminated across five different but related government ministries namely finance, trade, industrialization, local government and labour. This confusion often places sector operators at a disadvantaged position more so in terms of accessing policy updates. The current policy reforms regarding business regulations and taxation laws and systems have been formulated with little participation of the informal sector. As a result, many workers and business entrepreneurs in the informal sector feel left out (Chipeta, 2012) In addition, most prospective entrepreneurs are not aware of business start-up regulations and taxation procedures, mainly due to lack of effective information dissemination strategies on government policies. This prevents the sector operators from entering into formal economy and tax evasion and corruption as normal way of doing business. The informal sector operators who opt not to pay taxes and do business without licenses operate incognito in back alleys and roadsides. They are often mobile and, in most cases, engage in running battles with law enforcement and council authorities. In the

process of evading taxes, they end up paying more money in the form of bribes, to the law enforcers. Spicer and Lundstedt (2013) pointed out that SMEs have more possibilities to avoid taxes than larger taxpayers.

They also have more opportunities for tax evasion and opportunities might further increase with the number of different income sources. Hence, in compliance decisions the level of income might interact with its source. The importance of how one's economic status is perceived was demonstrated by (Vogel, 2015) taxpayers who reported improvements of their economic status were less compliant than others who reported deterioration of their financial well-being. A positive relation of SMEs income and tax compliance also found empirical support. Other studies found no relation of income level and tax compliance. Self-reported compliance behaviour was not related to income among Swedish taxpayers.

2.4 Tax rate and tax compliance

It is generally believed that a high tax rate is the main cause of tax evasion. Incentives to evade tax depend on the marginal rates of taxation because these govern the gains from evasion as a sum of the sum evaded (Kaldor, 2011) One major tax evasion is the high personal income tax rates which tend to lead tax payers to evade tax. Too many and complicated rules and regulations imposed by the government tend to lead to tax evasion. Businesses find it generally difficult often not profitable to do business legally. The heavy taxation is also a subject of worry not only in developed countries like USA but also in Zambia and other less industrialized countries in Africa and Latin America. For instance, taxes in Zambia confront the large manufacturing sector in different shapes and shades example: import duties, export and excise duties, sales and VAT,

withholdings and income taxes, and PAYE (ZRA 2014). The high levels of taxation of SMEs in Africa and in Zambia in particular, warrants attention on accelerated research areas aimed at addressing the overall effects of taxation on SMEs (Osambo, 2013). By studying taxation behaviour in five different countries (USA, Gambia, Nigeria, South Africa and Zambia), Derwent (2000) concluded that increased tax burden is a major threat. The results show that the increase in tax rates leads to higher production, distribution and selling costs which lead to higher prices and as a result consumer change their buying behaviour. People react to the higher prices by buying less of the product. When sales fall, some manufacturers cut back on production and some workers may lose their jobs. The productive resource that is land, capital, labour and entrepreneurship are allocated to other industries or go unused. For instance, when the government increase taxes on items such as beer and cigarettes for the purpose of realizing revenue and discouraging their consumption people tend to buy local brews. Whenever prices increase due to increase in tax rates; prices of goods and service increase and there is a drop in the consumption rate and a decrease in sales volumes which leads to retarded growth of SMEs. Tax payment is among the outflows of cash from the business which reduce the purchasing power of an enterprise. This is due to the fact that a large amount of cash collected is used to pay taxes rather than to expand the business.

Some studies suggest that high tax rates foster evasion. The intuition is that high tax rates increase the tax burden and, hence, lower the disposable income of the taxpayer (Chipeta, 2002). However, the level of the tax rate may not be the only factor influencing people's decision about paying taxes. In fact, the structure of the overall tax system has an impact as well. If, for

example, the tax rate on corporate profits is relatively low, but individuals are facing a high tax rate on their personal income, they may perceive their personal tax burden as unfair and choose to declare only a part of their income. Similarly, large companies can often more easily take advantage of tax loopholes, thereby contributing to the perceived unfairness of the system. Tax rates and the overall structure of the tax system, therefore, have a significant effect on the disposition to evade and avoid taxes.

2.5 Tax information and tax compliance

Standard models assume that tax payers are fully informed of all the aspects that cover the tax reporting processes. However, this is a strong assumption and not the case (Andreoni Jerald, 2009). Tax research has shown that the degree of information is an important factor on the behaviour of tax payers and how it influences tax evasion. Less educated tax payers are less exposed to tax compliance information and are less informed about relevant tax compliance information and thus are more prone to tax evasion. Some tax payers find the complexity of tax information more difficult to understand than others. This complexity may lead to unintentional non-compliance if tax payers have problems maybe in filling of tax returns.

In Zambia ZRA adopted the self-assessment system of paying taxes. The responsibility of declaring and paying the correct taxes is vested on the tax payer. A tax payer is required by law to file a self-assessment return by the end of the six months after year end. After filing the returns, Zambia Revenue Authority (ZRA) reviews them and if it has reason to believe that a tax payer did not disclose the correct taxes, it is empowered under the law to carry out an in-depth tax audit to verify the information disclosed by the tax payer. This is where problems start. The tax payer then

goes through the rigorous process that is both time consuming and costly for errors or omissions that would have been avoided had advance tax rulings been in place (Muiru, 2012). Further, businesses contemplating significant transactions are often faced with the problem of not knowing, with some degree of certainty, what the tax outcome of those transactions would be. This uncertainty could sometimes mean a deal is aborted because an adverse tax treatment could make it commercially non-viable. The situation is further complicated by the complexity of our tax laws and the fact that they are subject to change from time to time.

The way business is conducted has also become more sophisticated due to the geographical spread of enterprises. We have recently witnessed many multinational companies set up operations in Zambia in keeping pace with the wave of globalization. The world has become a global village but it is unfortunate that our tax laws have not kept pace with this trend. For instance, it is not a wonder to find a company producing goods in one country and selling in another country to benefit from tax advantages in low tax jurisdictions. The complexity of business transactions makes the application of intricate tax laws that have generally not kept pace particularly problematic. Tax payers often find themselves in difficult situations while making important business decisions as tax laws may not be clear as to the treatment of complex business transactions. Our tax legislation does not provide for advance tax rulings though in practice, tax payers seek the Commissioner's interpretation of various tax laws or tax implications of certain business transactions. Sometimes this is done on a no-name basis in order to retain confidentiality (Muiru, 2012).

Zambia has a complex tax system that makes it expensive for taxpayers to comply with an

increased cost of doing. It is costly to implement occasioning losses in Zambia's economy. The more complex a tax system is the more costly is its administration and the more expensive it is for people to comply with it. Taxes administered in Zambia include corporate income tax, personal income tax, Value Added Tax (VAT) and withholding tax. Corporate income tax rate is 30 per cent, personal income tax rate ranges between 10 per cent and 30 per cent, VAT rate is 15 per cent and while withholding tax rates begin from 3 per cent and depend on income source and whether one is a Zambian or not (Government of Republic of Zambia, 2014).

2.6 Tax compliance cost and tax compliance

A compliance cost is expenditure of time or money in conforming to government requirements such as legislation or regulation. For example, people or organizations registered for value added tax have the extra burden of having to keep detailed records of all input tax and output tax to facilitate the completion of VAT returns. This may necessitate them having to employ someone skilled in this field, which would be regarded a compliance cost. Compliance costs normally include all costs associated with obeying the law, including planning and administration, in addition to the direct time and money spent filing paperwork. Businesses especially small ones often face heavy costs in the process of preparing, filing, and paying taxes in addition to the burden of tax payments. These compliance costs, added to fines, penalties, and the risks of inspections and demands for bribes, often deter business creation and growth in developing and transition countries. A tax compliance cost survey can provide useful information for the design of reforms to reduce compliance costs and risks for small businesses. This note highlights key findings of tax compliance cost surveys conducted in South

Africa, the Republic of Yemen, Ukraine, and Peru that measured the burdens on business.

These surveys helped fine-tune the design of reforms to lower costs for businesses and improve their competitiveness (Coolidge, 2010). High compliance costs can result in tax avoidance, tax fraud, and inhibit investment by way of diminishing competitiveness of the country in terms of taxation attractiveness (Ojeka, 2012). The full cost of a tax system is more than simply the amount of tax paid. It also includes the cost of tax planning and paperwork. Economists call these "tax compliance" costs, and the IRS estimates Americans spend 6.6 billion hours per year filling out tax forms—including 1.6 billion hours on the 1040 form alone. In a study carried out on tax compliance and simplifications (OECD, 2004) established that compliance costs tend to increase with the number of taxes that an entrepreneur is subject to, the complexity of the tax rules, the frequency of submitting tax returns and the number of levels of government involved in levying and collecting taxes. Taxes introduce complexities and costs not relevant to SMEs and the complexities may increase where more than one level of government is involved for example the devolved government in Zambia. This results to SMEs avoiding the paying of taxes as it affects the business.

2.7 Taxpayer's attitude and tax compliance

Tax payer's attitude maybe influenced by many factors which eventually influence taxpayer's behaviour (Ambrecht, 2012). Some of these factors which influence tax compliance behaviour and tax compliance behaviour are many and are different from one country to another and from one individual to another. They include taxpayers perception of the tax system and revenue authority; peer attitude; tax payers understanding of tax system and tax laws; Motivation such as

rewards and penalties; Cost of compliance; enforcement efforts such as audit; probability of detection; difference across culture; Equity of the tax systems and demographic factors such as sex, age and size of income. There is a very strong relationship between the taxpayers' attitudes and tax compliance in Zambia, in that taxpayer's attitudes encourages tax compliance in and all that influence the taxpayers' attitudes equally affect the taxpayers' compliance with the tax requirements. In a research conducted in Zambia (Zulu, 2015) the following conclusions were arrived at: First, most taxpayers view the Zambian tax system as unfair. This was because most respondents differed that they are paying a fair share of tax; that their neighbours or friends, the tax laws are not easy to understand such as calculation of tax filing and paying dates. Secondly, some of the factors for tax non-compliance were found to be: the inability to understand tax laws, for example, rates of tax, filing and paying dates, a feeling that they are not paying a fair share of tax, negative peer attitude, and a belief that their neighbours are not reporting and paying tax honestly, and non-rewarding taxpayers.

The attitude issues from the various studies rotate around the tax fairness; improper use of revenue collected by government and pure intent to evade payment of tax for the collective good vis-à-vis the individual interest. Attitudes represent the positive and negative evaluations that an individual hold of objects. It is assumed that attitudes encourage individuals to act according to them. Thus, a taxpayer with positive attitudes towards tax evasion is expected to be less compliant than a taxpayer with negative attitudes. Attitudes towards tax evasion are often found to be quite positive (Kirchler, 2001). Many studies on tax evasion found significant, but weak relationships between attitudes and self-reported

tax evasion (Trivedi, 2005). A model of tax evasion behaviour developed by Weigel, Hessing considers social and psychological conditions, including attitudes and moral beliefs about tax evasion's propriety, as antecedents of tax compliance. Data collected from fined tax evaders and honest taxpayers showed that attitudes explain in part self-reported tax evasion, but are insignificant predictors of actual behaviour. However, the correlations between self-reported tax non-compliance and attitudes are significant but fairly weak. These findings suggest a rather complicated relationship between tax evasion and attitudes; nevertheless, we can be confident in our general prediction that if tax attitudes become worse, tax evasion will increase (Lewis, 2005). The attitudes are important for both the power and the trust dimension. On the one hand, favourable attitudes will contribute to trust in authorities and consequently will enhance voluntary tax compliance. On the other hand, attitudes towards the authorities will be relevant for the interpretation of the use of power as benevolent or malicious. Tax attitudes in general also depend on the perceived use of the money collected and therefore are connected to knowledge (Kirchler, 2001).

2.9 Summary of literature review

From the review of literature, it is clear to date, there has been research exploring factors that influence compliance among SMEs. The main objective of this study was to identify the factors that affect tax compliance among SMEs. The research focused on tax rate, tax information, and tax compliance cost and taxpayers attitude. The research outlined in this paper aims to address the tax gap of non-filing, under reporting and under payment. The specific aim of the research is to gain insight into the factors that influence the tax compliance among SMEs in Zambia by focusing on those operating within Kabompo District. It is

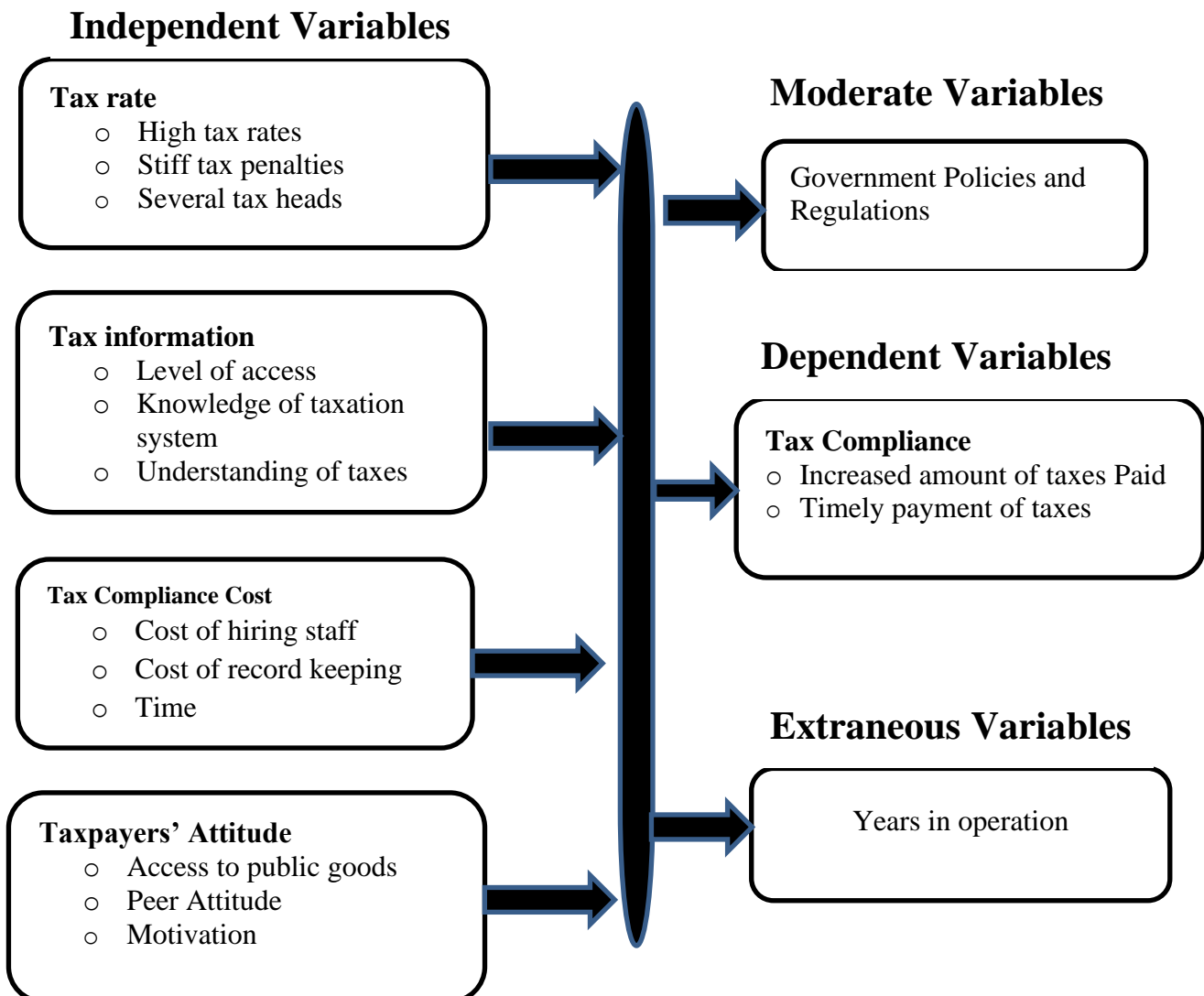
expected that the findings will help decision makers and particularly ZRA gain a better understanding of SMEs enabling them to plan and design services more effectively.

2.8 Conceptual Framework

This study assumes that the factors under discussion have a direct influence on tax

compliance among SMEs in Kabompo. The relationship between the dependent and the independent variables is illustrated in the conceptual framework presented in figure 1.

Figure 1. Conceptual Framework.



Source: Author, 2019

The independent variables are tax rate and system, tax information and education, tax compliance cost and taxpayers attitude. Tax rate and system as an independent variable influencing tax compliance is indicated by the complex nature of the tax system and high tax rate. Tax information and education is the second independent variable is characterized by the lack of knowledge of taxation by SMEs as well as misunderstanding of the taxation system. Tax compliance cost is characterized by the time it takes and the cost of compliance by SMEs. Taxpayer's attitude is indicated by the attitude their peers have with regards to tax compliance as well as the motivation tax compliance holds for the SMEs. The dependent variable for the study is tax compliance by SMEs government policies and regulations are the extraneous variables for this study.

CHAPTER THREE: RESEARCH METHODOLOGY

3.0 Overview

Given the limited time and resources, this chapter describes research design and the methodology used in the collection and data analysis for this study. It discusses population, sample size, sampling procedure, method used for data collection and methods of data analysis in the study. In order to achieve a well-researched and a holistic view of the study, measurable (quantitative) and immeasurable (qualitative) instruments were used. Qualitative was used because it enabled the researcher to have an in-depth perception of responses and feelings that would have been left out by quantitative instruments. Quantitative data was used to enable easier quantification of data.

3.1 Research design

A descriptive research design was adopted for this study. A descriptive research design was best for this study as it describes characteristics associated

with the subject population, and in particular factors that make them behave the way they do. According to Cooper and Schindler (Cooper, 2003) descriptive design discovers and measures the cause and effect of relationships between variables. Mugenda, (2003) state that a descriptive research determines and reports the way things are and attempt to describe possible behaviour, attitude, values and characteristics of such things. The study used a descriptive design because it enables the researcher to collect a large quantity of in-depth information about the population being studied. A survey design was appropriate as the data required for analysis needed to be collected from a large population that is SMEs operating in Kabompo District in the central area.

3.2 Research site

The research will be conducted in Kabompo rural District located west of North Western province in the central area 500 SMEs. The unit of analysis for the study was any SMEs registered by the Zambia Revenue Authority.

Table 3.2 Target Population in Kabompo District

TYPE OF ENTERPRISE	TARGET POPULATION
Small Scale Enterprise	300
Medium Scale Enterprise	200
TOTAL	500

Source Kabompo council

3.3 Secondary Data

Secondary data mainly refers to already collected data. The researcher will consult secondary data from books, articles, and journals, government policies as well as relevant associations and other studies directly related to the topic. This is vital to help the researcher improve understanding on the topic, identify gaps in knowledge as well as give a direction of the research and avoid plagiarism.

That mentioned, the data will be sourced from the internet and other relevant books to the study.

3.4 Primary Data

Primary data is first hand collected data or data obtained from the source. It will constitute the main form of information in this research as it will encompass new knowledge that will be generated thereof by the researcher. Primary data is important because it acts as empirical evidence that the researcher himself collect.

3.5 Sampling size and procedures

The researcher ensured a high degree of correspondence between the sampling frame and the sample population as the accuracy of the sample depends mostly on the sampling frame. The sample size is an important feature of any empirical study in which the goal is to make inferences about a population from a sample. In practice, the sample size used in a study is determined based on the expense of data collection, and the need to have sufficient statistical power. Sample size is important primarily because of its effect on statistical power. Statistical power is the probability that a statistical test will indicate a significant difference when there truly is one. (Morgan, 2001). The Krejcer and Morgan table was initially used to determine the ideal sample size for this study. N/k Where; N = Total number of companies in any given sector k = Every tenth organisation selected in succession from N to form the sample E.g. If the sample size was 500 Small and Medium Enterprise divided by 10 = 50 SMEs. The study adopted a systematic sampling technique. The respondent selected the first sample unit at random and then the remaining units were automatically selected in a definite sequence of the 10th. Hence the respondents were 50.

Table 3.5 Sampling Frame and Sample Size

TYPE OF ENTERPRISE	TARGET POPULATION	SAMPLE SIZE 10%
Small Scale Enterprise	300	30
Medium Scale Enterprise	200	20
Total	500	50

3.6 Data collection instruments

The study employed primary data collection. Primary data was collected through a self-administered questionnaire. The questionnaire adopted structured open ended as well as closed questions. The responses in the questionnaires helped in gaining an in-depth understanding of the factors influencing tax compliance among SMEs. The research instruments used in this study was a questionnaire and in-depth interviews. A questionnaire gathered statistically meaningful data on the perspectives of respondents on an issue of interest based on a set of predetermined questions. The questionnaire had three major sections. The first dealt with the biographic data, the second section dealt with the factors inhibiting tax compliance while the third section dealt with strategies that can improve tax compliance in Zambia. The researcher administered the questionnaire by himself. The researcher endeavoured to win the trust of the respondents and allowed the respondents to tell their stories freely to maximize on their self-disclosure as it is a sensitive topic in Zambia. During the interview section the researcher targeted selected Business owners, Managing directors, and accountants with a lot wealth in taxation matters. The researcher allowed the respondents to tell their stories freely to maximize their self-disclosure. In developing the questionnaire items the fixed choice and open-ended formats was used. In depth interviews

belong in philosophical terms to the constructivist or interpretive tradition. These kinds of interviews are functional in collating narratives of subjective realities or experiences. These interviews contain detailed expressions of the meanings and effect that phenomenon have on respondent. In depth interviews seek to explore the social and human phenomenon by asking the why question (Silverman, 2006). For the interviews, the researcher had predetermined questions grouped together to address particular objectives of the study. Majority of the questions were unstructured, so as to enable the researcher gather as much information as possible in regards to the factors influencing tax compliance among SMEs. Using interview method of data collection ensured that the questions were understood thus minimizing the risk of collecting incomplete and wrong information as it is with questionnaires particularly when people are unable to understand the questions properly. This data collection method was considered by the researcher as appropriate in providing safe basis for generalization and high accuracy.

Research validity and

3.6.1 Validity of Research

Validity is the degree to which an instrument measures what it is supposed to measure. (Kothari, 2004) Therefore, the term refers to the extent to which an instrument asks the right questions in terms of accuracy. The content validity of the research instrument for this study was determined through piloting, where the responses of the subjects were checked against the research objectives. For a research instrument to be considered valid, the content selected and included in the questionnaire must be relevant to the variable being investigated. The researcher performed the pilot test with a randomly selected sample of fifteen SMEs in Kabompo 's Central Business District. Content validity of the

instrument was also tested using a research expert's opinion, who was the research supervisor. The research expert independently judged the validity of the items in the questionnaire in relation to research objectives.

3.6.2 Reliability of Research Instrument

Reliability of an instrument is the measure of the degree to which a research instrument yields consistent results or data after repeated trials (Cooper, 2003). To test the reliability of the questionnaire as a research instrument, a test-retest technique was employed in which questionnaires were administering to a group of SMEs with similar characteristics as the actual sample size but not included in the final study. The test was repeated after two weeks. This was to establish the extent to which the questionnaire elicited the same responses every time it is administered. The findings were found to be consistent and therefore the questionnaire proved to be a reliable research instrument.

3.7 Data collection procedure

Data collection procedures began upon approval of the proposal after its defence. An introduction letter was issued to the sampled entities for consent to collect data from the respondents. The questionnaires were administered to the respondents directly by the researcher with the help of two research assistants in order to save on time. For those respondents who were not available for a sit-in filling of the questionnaire, it was e-mailed to them. The interviews were conducted at a time and place convenient to the respondents to provide an environment in which the respondents would feel free to participate.

3.8 Data Analysis

A careful analysis of the completed questionnaires was done to ensure that the collected data was accurate and consistent with other information

gathered. Pre-processing of collected data was done through editing to detect errors and omissions and making of corrections where necessary. Data was analysed by coding according to variables in the study for efficiency so as to reduce the replies given by respondents to a small number of classes. After completion of coding, the data was classified on the basis of common characteristics and attributes. The raw data was then assembled and tabulated in form of statistical tables to allow for further analysis. The Statistical Package for Social Sciences (SPSS) was used to aid in the statistical analysis of the data.

3.9 Ethical issues

Permission to carry out the study will be obtained from the school of education at the Information Communication University of Zambia in order to ensure the integrity of the research. An explanation on the purpose of conducting this research will be given before involving the potential respondent so as to reduce the possibility of misinterpretation of the study topic by the respondent. In avoiding imposition and infringing of privacy, the right of privacy will be observed by obtaining direct consent for participation from the respondent and measures will be taken to ensure confidentiality. The researcher will see to it that in his research won't hurt the participants either emotionally or socially. Moreover, the researcher will make sure that the participants are not physically hurt. He will also make sure that the participants are protected from stigmatization because noncompliance of tax is a sensitive issue. The researcher will also omit the names of the respondent to ensure anonymity.

CHAPTER FOUR: DATA ANALYSIS, AND DISCUSSIONS OF THE FINDINGS

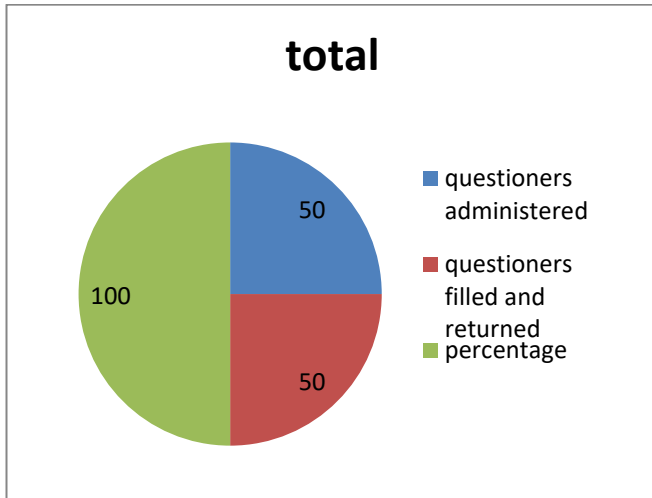
4.0 Overview

This chapter presented the data analysis, presentation and interpretation of findings on the data collected from registered SMEs in Kabompo central business area, based on the factors influencing tax compliance. To investigate the factors inhibiting tax compliance among the Small and Medium Enterprises (SMEs) in Kabompo District. The study sought to answer the research questions: What are the factors that influence tax compliance among the SMEs in Kabompo District? How does the availability of tax information influence tax compliance among the SMEs in Kabompo District? To what extent do tax rates in Zambia explain tax compliance among the SMEs in Kabompo District? How does the attitude of Small and Medium Enterprises about tax influence tax compliance? To what extent does the cost of tax compliance explain tax compliance among Small and Medium Enterprises. The study sampled 50 registered taxpayers operating within Kabompo central business area. The data was interpreted as per the research questions.

4.1 Response Rate

The study targeted 50 respondents in collecting data with regard to the factors that inhibit tax compliance among Small and medium enterprises in Kabompo rural central business area. Out of the 50 questionnaires issued, 50 were returned, giving a 100% response rate, as shown in Table 4.1.

Table 4.1 Response rate



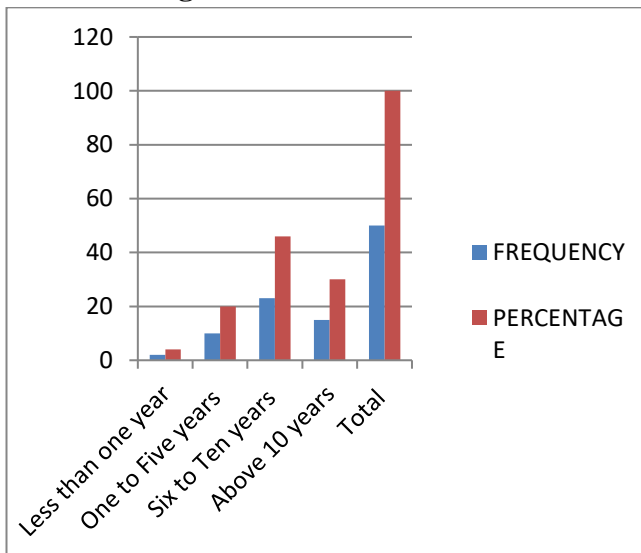
4.2 Demographic information

The study found it of paramount importance to establish the demographic information in order to evaluate the factors that inhibit tax compliance among SMEs in Kabompo central business area.

4.2.1 Age of Business

The researcher sought to determine the age business under which the respondents fall and the findings are shown in chart 4.3

Chart 4.2: Age of Business

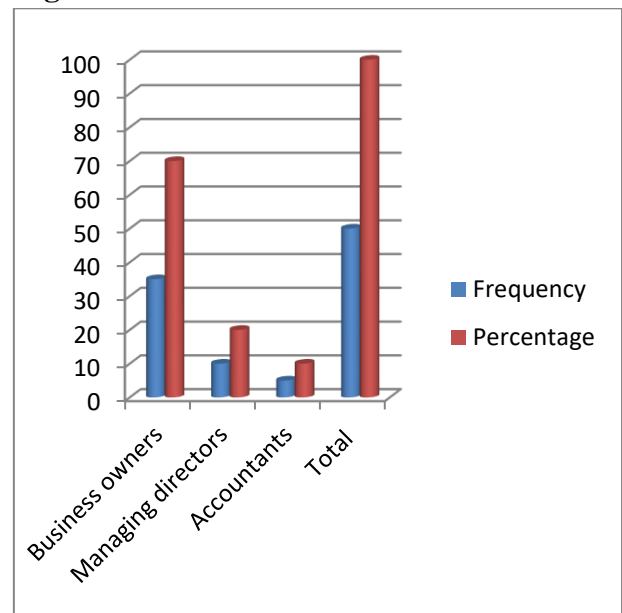


The findings revealed that 4% SMEs are less than one year, 20% are between one and five years, 46% are between six and ten years, and 30% are above ten years old.

4.3 Position of respondent in the organization

The positions of the respondents in the organization that constituted the objects of the study were obtained from the closed ended questions with room for specification of any other category of positions not listed. The expected object of this study was limited companies. However certain key individuals had to be interviewed through the questionnaires as the companies are artificial legal persons who cannot respond to questionnaires directly. The results of responses are shown in the frequency Chart.

Chart 4.3: Position of respondent in the organization

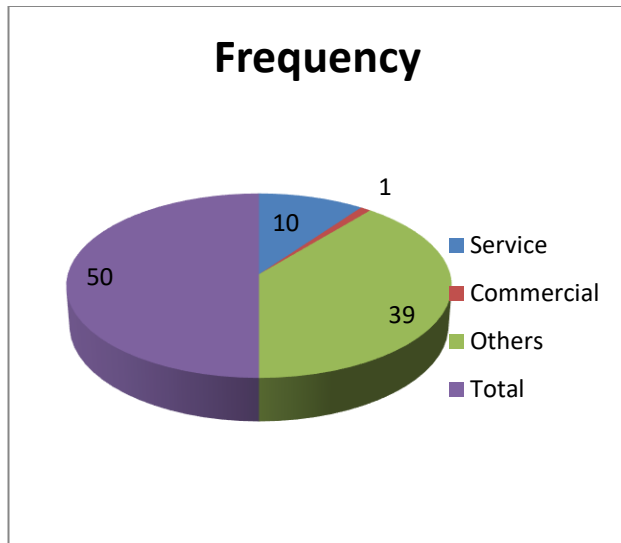


Out of the 50 respondents 70% were Business Owners, 20% were managing directors, 10% Accountants and 100% of the data was obtained from our focus group. This confirmed the reliability of the data sources as they emanated from key and responsible people in the organizations.

4.3.3 Type of business activity

The respondents were also asked to indicate their main business activity and the findings are presented in chart 4.4. below

Chart 4.4: Composition of business activity type



From the study findings as shown in chart 4.4, one of the respondents representing, 2%, engage in Commercial related activities, 20% were in the service industry, whereas 78% of the respondents were in the others category.

4.3.4 Personal Identification Number

The researcher inquired as to whether the respondents' business had a PIN. This was to determine that the businesses are registered for tax purposes as the PIN is a mandatory requirement for all operating businesses. The findings are presented in table 4.5.

Table 4.5: Number of respondents with PIN

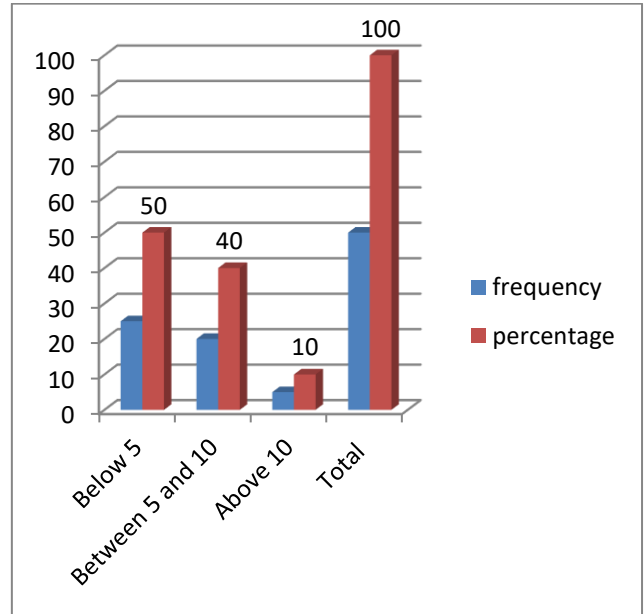
respondents with pin	frequency	percentage
Yes	50	100
No	0	0
Total	50	100

As shown in table 4.5, 100% of the businesses have a personal identification number. This was quite commendable as it shows that all the organisations that participated in the survey are duly registered for tax purposes.

4.3.5 Number of Employees

The study sought to find out the number of staff employed in the organizations as illustrated in table 4.6.

Table 4.6: Number of employees in the organization



The findings indicate that 25 of the SMEs who responded had the number of staff employed in their organization below 5. This was 50% followed by organizations with 5-10 employees representing 40%. The findings indicate that 10% of the respondents had above 10 employees.

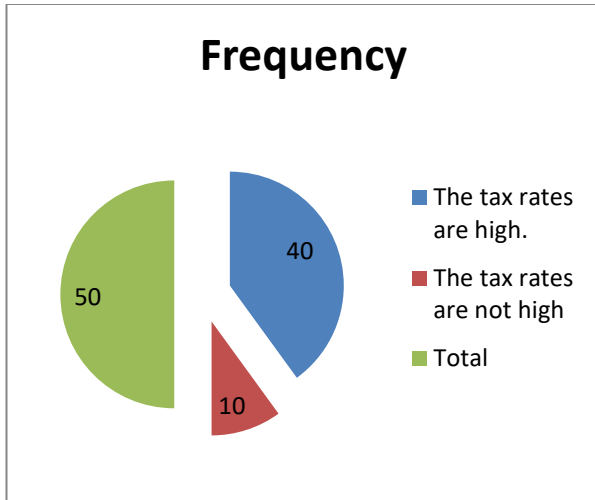
4.4 Tax rates

It is generally believed that a high tax rate is the main cause of tax evasion. Incentives to evade tax depend on the marginal rates of taxation because these govern the gains from evasion as a sum of the sum evaded (Kaldor, 2011). The researcher sought to find out the extent to which tax rates in Zambia explain tax compliance among SMEs.

4.4.1 SMEs Perception of Zambian tax rates

The researcher enquired as to whether the SMEs found the tax rates in Zambia high. The findings are presented in table 4.7.

Table 4.7: Perception of Zambian tax rates

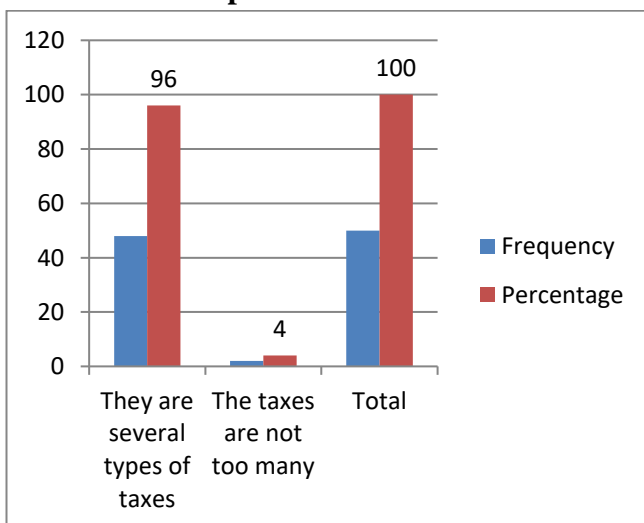


40 SMEs out of 50 which is 80% of the respondents think that the tax rates in Zambia are high while those who do not think that it is high were a minority and accounted for only 20%. It can therefore be deduced that to the majority of SMEs find the tax rates high.

4.4.2 SMEs Perception of the different types of taxes

The other aspect reviewed in the study is whether they are many different types of taxes that are usually payable to ZRA. The results of the study are shown in Table 4.8

Table 4.8: Perception of forms of taxes

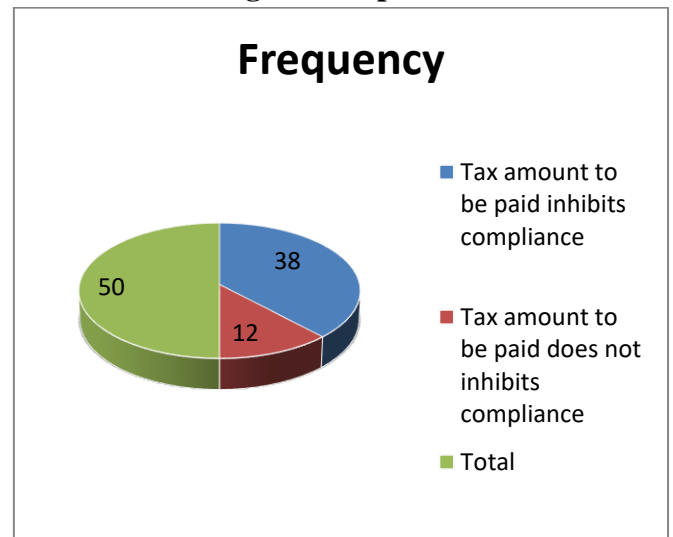


The results of the study showed that 96% of the respondents felt that the tax heads are too many, while only 4% felt otherwise. This is a clear indicator that majority of SMEs feel that the number and types of taxes demanded from them are too many.

4.4.3 Tax amount payable as a factor inhibiting SMEs tax compliance

The researcher sought to determine whether the SMEs compliance is influenced by the amount of tax to be paid. The findings are presented in chart 4.9.

Chart 4.9: Assessment of tax amount payable as a factor inhibiting tax compliance



38 out of 50 of respondents said the amount of tax payable does influence their level of tax compliance. They accounted for 76% of the respondents and the remainder 24% felt the amount payable does not influence tax compliance. The study can therefore conclude that to the majority of the SMEs, their level of compliance is greatly influenced by the tax amount due to ZRA.

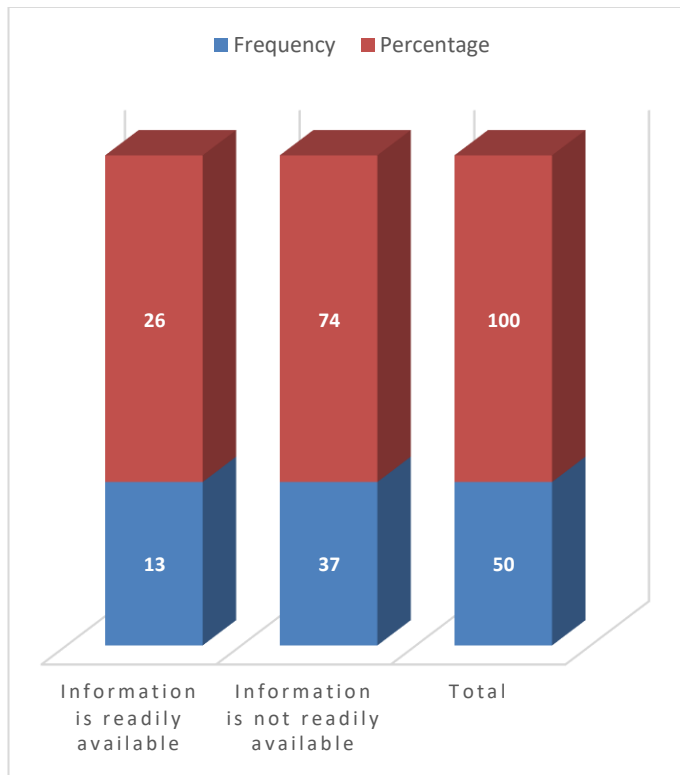
4.5 Availability of Tax Information

The concept of tax information was developed through the literature review in chapter two of this study and was conceptualized to mean the level of information at the disposal of the taxpayers to enable them comply voluntarily without prompting by the ZRA officials. The study looked at whether information about taxes was readily available to the taxpayers and how this availability of information affects tax compliance and whether an organisation is able to calculate its taxes correctly based on the information that has been disseminated.

4.5.1 Ready availability of Information

The survey sought to find out whether the respondents find information relating to tax matters readily available and how to go about it. The findings are shown as per the results in Chart 4.10

Table 4.10: Ready availability of tax information

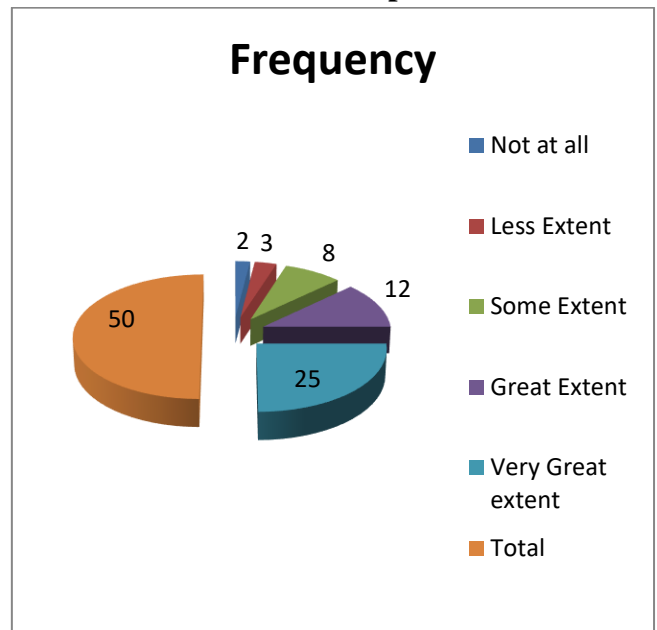


The study findings indicate that out of the 50 SMEs, 37 which is 74% of the respondents feel that information relating to tax information is not readily available while a small percentage of 26% representing 13 of the respondents find that information is readily available.

4.5.2 How tax information affects SMEs tax compliance

The respondents were requested to indicate whether the lack of or availability thereof of tax information affects tax compliance. The findings are presented in Chart 4.11.

Chart 4.11: Extent to which lack of tax information affects tax compliance

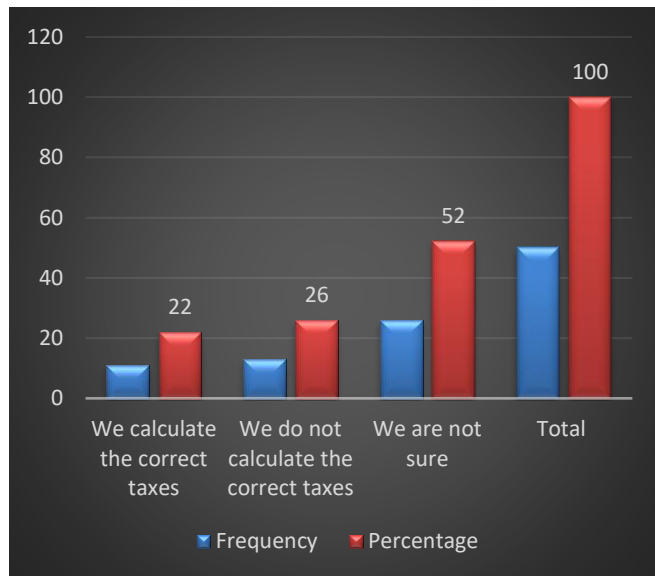


The results as shown in table 4.11 revealed that 50% of the respondents agreed that the lack of tax information affects their level of tax compliance to a very great extent. 24% of the respondents felt that their level of tax compliance was affected to a great extent by lack of tax information. This was followed by 16% who felt it was to some extent, 6% to a less extent and 4% not at all. It is therefore clear that for the majority of SMEs, the lack of tax information affects tax compliance to a very great extent.

4.5.3 Correct calculation of taxes based on available information

The study sought to establish whether SMEs are able to correctly calculate the taxes based on the available information. This was in a bid to determine whether the level of information relating to taxes affect tax compliance. Table 4.12 presents the findings.

Table 4.12: Correct calculation of taxes



The results of the findings as shown in table 4.13 revealed that 52% of the respondents are not sure whether they calculate the correct taxes, 22% felt they are able to correctly calculate taxes due from them while 26 % feel that they do not calculate the correct taxes, all based on the availability of tax information at their disposal. It can therefore be concluded that based on the information relating to tax available to SMEs, the majority of taxpayers are not able to correctly calculate tax due from them and may hence end up paying the incorrect amount. Analysis of correlation shows that ready availability of information about tax matters is positively related to the taxpayers’ ability to correctly calculate the tax due and payable to them. It can therefore be deduced with confidence that there is a genuine relationship between the ready availability of information on tax, the ability to

correctly calculate tax payable and the level of tax compliance; the more access an SME has to information on tax, the more likely it is that they will be able to correctly calculate tax due from them and consequently, the more likely it is that their level of compliance will be high.

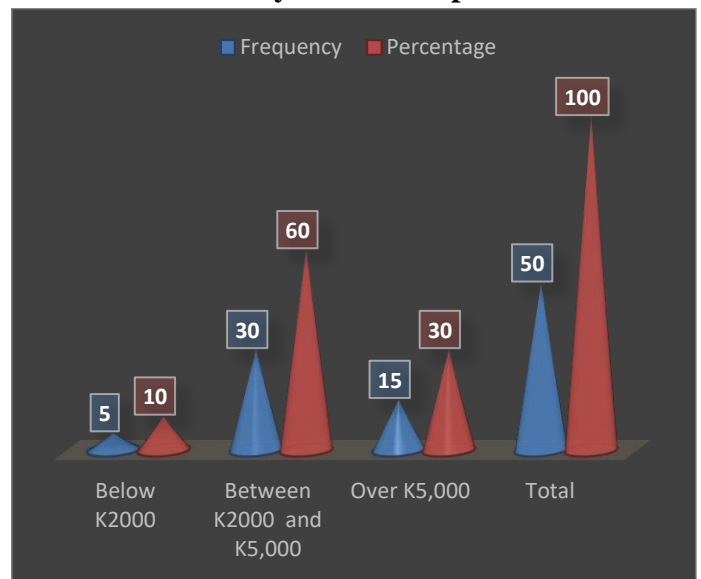
4.6 Tax Compliance cost

In most developing countries including Zambia, hiring tax professionals is an added cost to the SME’s (Group, 2010) and they therefore resort to doing their own tax returns, though they may not be well versed with taxation and the concept of filing returns. The cost of book keeping and recordkeeping is also a major cost to most SMEs. It is in this regard that this research sought to find out how compliance costs incurred by SMEs affect the amount of taxes remitted to ZRA by these business houses.

4.6.1 Monthly cost of compliance

The researcher found it of importance to find out on average how much an organisation spends monthly in compliance cost. This is a key indicator to find out whether the cost is too high hence affecting their compliance levels. Table 4.13 shows the results of the findings.

Table 4.13: Monthly cost of compliance

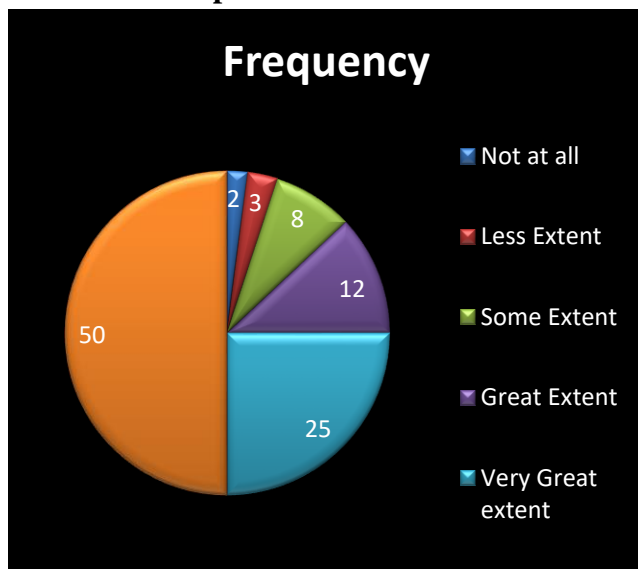


30 of the respondents with a monthly cost of between K2000 and K5000 accounted for 60%, followed by 30% who revealed they had monthly cost of over K5000. The study further revealed that only a meagre 10% had a monthly cost of below K2000.

4.6.2 How cost of compliance affects tax compliance

The respondents were requested to indicate whether the total cost incurred in being compliant affects their tax compliance as an organization. The findings are presented in table 4.14.

Table 4.14: Extent to which tax compliance cost affects tax compliance



The results as shown in table 4.15 revealed that 50% of the respondents of the study agreed that the costs, they incurred in being compliant affected their compliance levels to a very great extent. For 16% of the respondents, it was to some extent followed by 24% who felt that it was to a great extent, 6% to a less extent and 4% not at all. It can therefore be deduced that for the majority of SMEs, the costs they incurred in tax compliance affects their compliance levels to a very great extent.

4.6.3 Analysis of the various tax compliance costs

The respondents were requested to compare and indicate what they felt formed the highest tax compliance cost was. The findings are shown in table 4.15.

Table 4.15: Comparison of tax compliance cost

Cost	Frequency	Percentage
Hiring of Staff	15	30
Book Keeping	30	60
Software and internet	5	10
Total	50	100

30 of the respondents (60%) revealed that book keeping took the lion's share of its expenses among the compliance cost, this was followed closely by the hiring of professional staff at 30% at a distant third was the cost of software and internet usage at 10%.

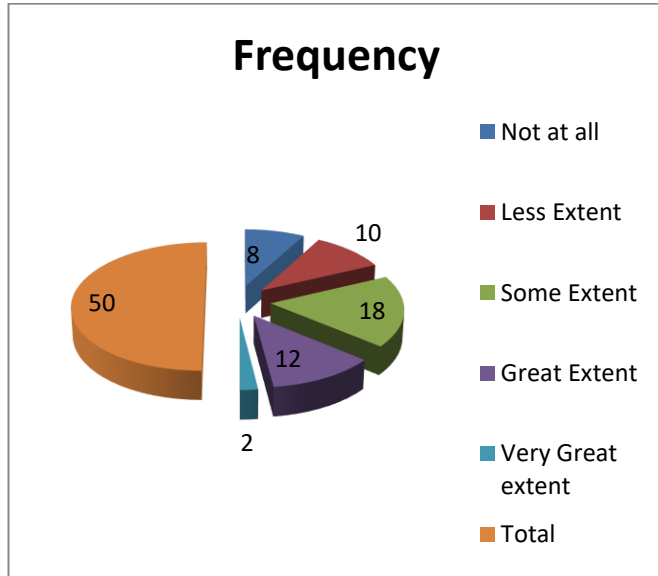
4.7 SMEs attitude about tax

The concept of attitude was reviewed through the literature review and interpreted to mean the measure of confidence a taxpayer has in a tax system. When a taxpayer feels there is unfairness in a tax system, the voluntary tax compliance becomes replaced with intentional tax evasion. The study therefore sought to examine how attitude about tax affects the income tax compliance of SMEs in Kabompo central business. The aspects looked at in this study include the extent of access by SMEs to public utilities financed by taxes, the value SMEs attach to the responsibility of paying taxes to the government, and the main reasons for the various attitudinal positions taken by the SMEs.

4.7.1 Access to public utilities and services

The study showed the results in respect of the extent to which access public utilities financed taxes as outlined in Table 4.16

Table 4.16: Extent of access to public utilities and services funded by tax

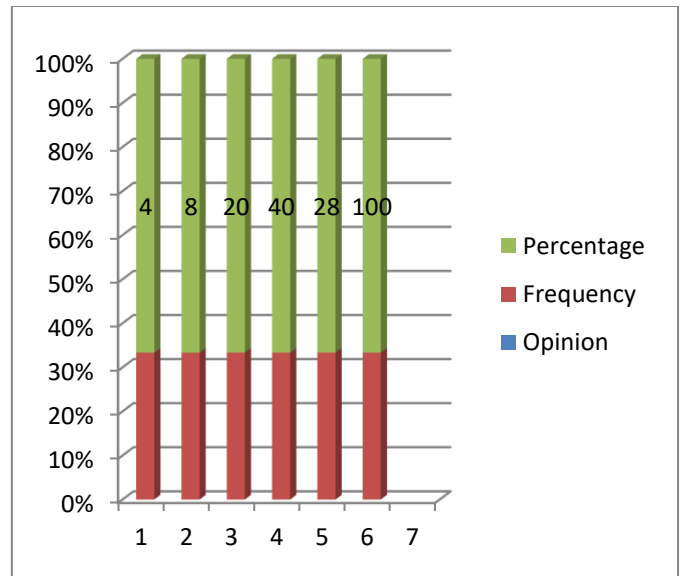


The results of the study were that 18% of the respondents felt that they had access to public utilities financed by the funds collected from taxes to some extent. 10% of the respondents felt that they access to public utilities to a less extent, and 24% of the respondents felt that they had to a great extent, 16% not at all while 4% to a very great extent access to public utilities financed by fund generated from taxes. The expectation of the study was that when the extent of access to public utilities by SMEs is high then the level of voluntary income tax compliance will be enhanced greatly. In this study only 64% accessed the public utilities to some, great and very great extent.

4.7.2 Value the SMEs place on payment of taxes

The other aspect examined was the extent which SMEs value the payment of income tax to the Zambian government. The results of the study were as per table 4.17.

Table 4.17: Extent to which SMEs value payment of tax to Zambian government

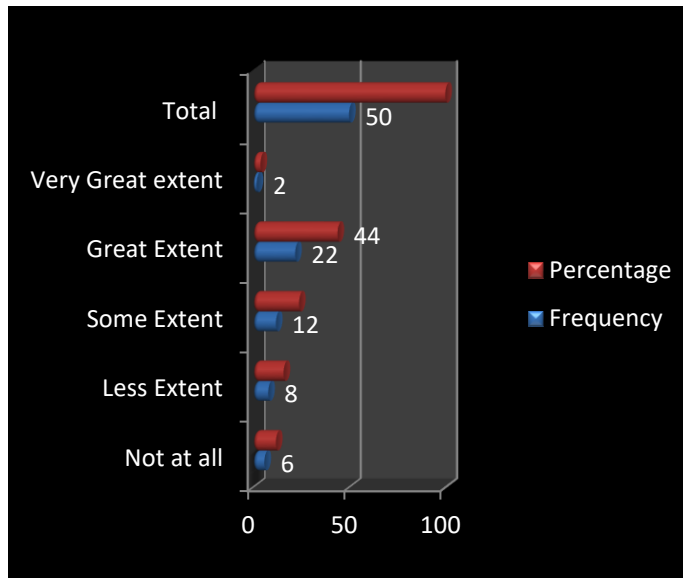


The results as shown in table 4.18 revealed that 40% of the respondent's value payment of taxes to the government to a great extent. 20% to some extent. The study further revealed that for 28% it is to a very great extent, 8% to a less extent and 4% not at all. The expectation of the study was that companies' voluntary compliance would be high when companies attach a lot of value to the payment of taxes to the government. In this study 88% attach value to some, great and very great extent to the payment of taxes to the government of Zambia. Thus, we can conclude that most SMEs do value payment of taxes.

4.7.3 Respondents view on the value other SMEs places on payment of taxes

The other aspect examined was the extent which the respondent viewed how other SMEs value the payment of income tax to the Zambian government. The results of the study were as per table 4.19.

Table 4.18: Extent other SMEs value payment of tax to Zambian government



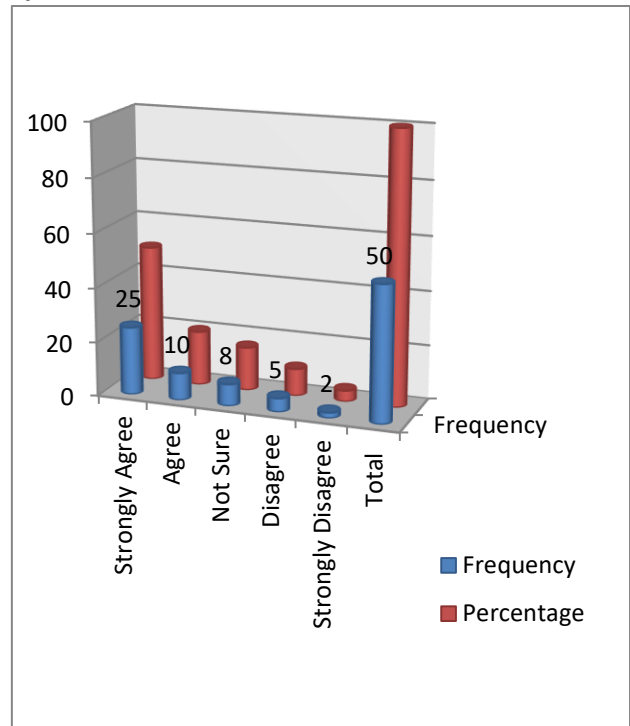
The study found out that 12 (24%) of the respondents view that other SMEs value payment of taxes to the government to some extent, 44% to a great extent. The study further revealed that 8% to a less extent, 12% not at all and 4% to a very great extent. We can conclude most respondents view other SMEs do value payment of taxes.

Analysis of correlation shows that taxpayer have access to public utilities offered as a result of collection of taxes is positively related to the value the SME places on payment of taxes to the government. The access to public utilities by the SME is positively related to their level of compliance. It can therefore, be deduced with confidence that there is a genuine relationship between an SMEs access to public utilities and level of tax compliance; the more an SME has access to public utilities made available by collection of taxes, the higher the value they will place on paying of taxes to the government and consequently, the higher their level of compliance.

4.7.4 Improving Zambian tax system

The researcher enquired as to whether the respondents feel that the tax systems in Zambia should be improved. The findings are presented in table 4.19.

Table 4.19: Opinion on improvement of the tax system



25 respondents strongly agreed with the statement accounting for 50% of the respondents. As shown in table 4.20, 20% agreed, 16% not sure, 10% disagree and 4% strongly disagreed. It can therefore be deduced that majority of SMEs in Kabompo central business area strongly feel that there is need for an improvement of the tax systems in Zambia.

4.8 Summary of the data analysis.

From the study findings, business owners were the major respondent group and many of most of the organisations were between 6 and 10 years old. Majority of respondents, 78%, are engaged in

other related activities as their main business activity and 100% of the respondents do have a PIN for their respective business and are thus duly registered with ZRA for tax purposes. The majority of respondents, accounting for 50% have their number of employees at below 5, hence falling well within the small enterprises bracket. With regard to tax rate, majority of the respondents do think that the tax rates are high in Zambia and that there are many different types of taxes demanded from them and this also hinders tax compliance. 76% of the respondents feel that the amount of tax to be paid by them greatly influences their level of tax compliance. The findings of the study revealed that with regard to availability of tax information, 74% of the respondents' view that information relating to tax matters is not readily available to them. This accounted for the majority who further feel that the lack of readily available information affects their tax compliance to a great extent. This challenge in accessing information translates to 52% of the respondents of the study feeling that they, in all honesty, are not sure that they do correctly calculate the amount of tax payable by them and hence may be a factor influencing their tax compliance. For the majority of the SMEs who participated in this study, majority spend between K2000 and K5000 monthly in tax compliance. Book keeping costs formed the highest expenditure in terms of tax compliance. They do feel that the tax compliance costs affect their level of tax compliance to a great extent. Majority of the respondents feel that they have access to public utilities to some extent and value the payment of taxes to the government. Furthermore, they also feel that their counterparts in the SME industry do value the payment of taxes to some extent. It is the feeling of the large proportion of respondents of this research that they strongly agree that the tax system in Zambia needs to be improved.

4.8.1 Tax rates

80% of the respondents think that the tax rates in Zambia are high. 96% agree that there are several types of tax heads which reduce tax compliance as most SMEs are not aware of ways to comply with the many different forms of taxes. 76% of the respondents agree that the tax amount due for payment does influence the tax to be paid. This is a clear indication that ZRA and the Zambian Government have not put in places ways of harmonizing the tax rates.

4.8.2 Availability of tax information

With regard to availability of tax information as a factor, the findings revealed that 74% of the respondents agree that information about taxes is not readily available, and 50% attest that the lack of information affects SMEs when it comes to tax compliance and 52% have are not even sure whether they are able to calculate the correct taxes.

4.8.3 Tax Compliance Cost

60% of the respondents which is 30 out of the 50 SMEs spend between 2000 and 5000 in a month in expenses which are directly related to tax compliance costs. Majority of the respondents agree that the cost of complying also affects tax compliance among SMEs, 60% ranks book keeping as the major cost when it comes to expenses directly related to tax compliance.

4.8.4 Taxpayers Attitude towards tax

64% of the respondents have access to public utilities this leaves a big group who feel they have no access to public utilities. This undermines tax compliance. However, the study did reveal that most SMEs do value payment of taxes to the government and they also feel that their counterparts, other SMEs, do also value the payment of taxes.

4.9 Discussion of findings

This section gives a detailed discussion of the findings from this study as per the objectives that the study sought to achieve.

4.9.1 Tax rates

SMEs feel that tax rates for the already several tax heads, that is, corporate tax, VAT and Pay As You Earn (PAYE) are either high or very high. A high tax rate erodes taxpayer's earnings and disposable incomes thus will have a negative effect on consumption and investments. It will also encourage tax avoidance and evasion as the opportunity cost to evade is high. This may be an expected reaction from taxpayers as no single taxpayer can rate a tax rate as 'low'. There is also the problem of defining the line between 'high', 'low' and 'fair'. The findings of this study do therefore agree with those of other researchers as discussed in the literature review. As interest rates go higher, the opportunity cost to evade becomes higher and thus taxpayers get tempted to evade. (Friedland, 2013). Zambia's tax rates compare favourably with that of her neighbours, Zimbabwe, Botswana and South Africa, who charge the same rates for corporate tax, withholding tax and VAT. However, given the large percentage of respondents who feel that they are high, there is need to revise these rates and make them more attractive to them. This will enhance tax collection by reducing evasion and enhance investments. For PAYE, a revision of tax bands should be pursued in addition to reducing tax rates which will also reduce the poverty level.

The respondents rate the current penalties as 'very high' or 'high'. This is true for VAT and income tax. The respondents observe that the present 2% per month interest is extremely high and punitive to allow any organization to effect payments. Sometimes penalties and interest alone are higher

than the principal tax. Penalties and interest arise out of late filing of returns and non-payment of taxes and non-disclosure of taxable income which is discovered during audit. Given the self-assessment system, audits can only be done after returns have been submitted. Hence there is some lapse of time from the time a return is submitted and the time when audit is carried out. Interest starts accruing from due date of the tax until the time an audit is complete. The penalty and interest rates are specified in the respective Acts. Since these are legislative requirements, ZRA can only act to reduce interest by carrying out audits more frequently and at regular intervals. The other option is to change law and thus lower rates. Studies done show that high penalties increase compliance but marginally.

4.9.2 Availability of tax information

The findings of this study revealed that majority of the respondents have a challenge in accessing information about taxes. As earlier discussed in the literature review section of this study, less educated tax payers are less exposed to tax compliance information and are less informed about relevant tax compliance information and thus are more prone to tax evasion. Some tax payers find the complexity of tax information more difficult to understand than others. This complexity may lead to unintentional non-compliance if tax payers have problems maybe in filling of tax returns. SMEs generally find the information given by ZRA fairly inadequate to enable them complete the tax returns expected from them. Some find the process to be complicated; requiring too much information thus a waste of time and resources, it is thus clear that there is a strong case for improvement of the information available. Majority of the respondents are in agreement that Taxpayer Education/Seminars plays a positive role in

enhancing tax compliance. Taxpayer education is one of the powerful tools of enhancing compliance. At this forum, knowledge is passed to taxpayers exhaustively and this enhances future compliance and through this knowledge the taxpayer is able to know the various rights and obligations accruing from services offered by ZRA. Communication channels open up and this enhances friendly relations between the taxpayer and the tax authority. Consequently, taxpayers also feel part and parcel of the policy making process. ZRA should strive to open 'Help' counters and website for taxpayers to seek help in dispensing information. Well-trained and knowledgeable staff should man the counters.

They should also enhance taxpayer education and remove the ambiguities in the VAT and Income Tax Acts.

4.9.3 Tax Compliance Cost

High compliance costs can result in tax avoidance, tax fraud, and inhibit investment by way of diminishing competitiveness of the country in terms of taxation attractiveness. (Ojeka, 2012). The respondents of this study feel that consultancy charges and the cost of hiring professional staff are expensive. Concerning the book keeping issues, it can be concluded that many SMEs resort to engaging professional tax consultants to be able accomplish the statutory requirement to accompany annual returns with audited accounts, and at the same time a good number of companies have computerized their accounting system to go around the requirement. All these efforts do amount to some cost borne by the taxpayer, and since there is a positive correlation between book keeping and income tax compliance; the government can endeavour to improve compliance by promoting sound accounting practices. Compliance costs, in form of fees charged by tax consultants, are positively correlated with noncompliance behaviour and thus negatively

correlated with tax compliance behaviour. Obtaining a tax clearance certificate is the highest motivation to comply with tax laws and regulations for most SME operators in Zambia. Because of the perceived technical nature of return filing, most taxpayers are forced to employ professional tax consultants. The Acts are legal documents with legal language which is complicated for ordinary taxpayers to comprehend and given the numerous legal amendments every year, taxpayers lack the necessary expertise to complete the tax returns. It also saves time and money by engaging a tax consultant to complete the return in the most efficient manner. However, few taxpayers can afford such professional services and, in most cases, hire nonprofessional agents like family members and friends. These sub-standard agents charge moderate fees but offer unprofessional services that result in misrepresentation of the business records/status.

4.9.4 Taxpayers Attitude towards tax

In terms of attitude of taxpayers toward payment of taxes to the government it can be concluded that majority of the companies had at least some access to the public utilities financed by taxes while at the same time valued the payment of taxes to the government of Zambia. This factor can be exploited to improve income tax compliance. With regards to perceptions of bureaucracy and corruption by tax administrators and government spending, those who engage in tax evasion often justify such behaviour by suggesting that the government wastes tax revenue and spends unwisely; such arguments can decrease voluntary compliance in the long run (Braithwaite, 2009) It is expected that if the government spends taxpayers' money wisely, for example on basic facilities like education, health and safety and public transportation, it is assumed that voluntary compliance will increase. In contrast, if taxpayers perceive that the government spends too much on

something else, taxpayers might feel betrayed and attempt to evade. In judging their own behaviour, people tend to believe the cause is due to external attributes and cannot be tax compliant. Therefore, the government should spend taxpayers' money wisely so that tax compliance will increase, thus the tax collection will also increase.

CHAPTER FIVE: CONCLUSION AND RECOMMENDATIONS

5.0 Overview

In this chapter the conclusion and recommendations to the study are drawn and research gaps are identified for future studies as the study aimed at determining factors inhibiting tax compliance among SMEs in Kabompo District Zambia.

5.1 Conclusion

Findings from the study reveal that all the identified factors have a direct influence on the tax compliance among SMEs. The tax compliance factors examined included tax rates, availability of tax information, tax compliance cost, and attitude of taxpayers toward payment of income tax. The study confirmed that ZRA why uses both voluntary tax compliance strategy alongside the deterrent measures strategy. Most of the respondents felt the tax rates should be reviewed, thus the government should relook at the tax rates currently charged to SMEs. On availability of tax information, information received by taxpayers is an important factor that contributes to their understanding of tax responsibilities, especially regarding registration and filing requirements. ZRA should address the complexities of annual tax returns, periodic variations in the tax laws, and levels of penalties and fines. They should pass this information regularly to SMEs via various channels like tax Seminars, Booklets and Media Channels. This will greatly improve the SMEs level of compliance as the great complexity

associated with tax matters will be demystified. On tax compliance cost, the companies confirmed to engaging the services of tax agents and professional staff to handle accounting issues. This cost is normally a burden to the SMEs.

SMES should be encouraged to improve their bookkeeping by offering incentives, such as application of a lower presumptive tax rate for small businesses meeting certain recordkeeping standards. The government should also engage the small holders in sensitization forums on how to reduce the cost associated with tax compliance. With regard to the attitude of taxpayers toward payment of taxes to the government, the study revealed that most of the companies felt they had at least some access to the public utilities financed by taxes while at the same time valued the payment of taxes to the government of Zambia. Taxpayers' attitudes encourage tax compliance in Zambia and what influence the taxpayers' attitudes, equally affect the taxpayers' compliance with the tax requirement i.e. taxpayers' attitudes encourage tax compliance in Zambia.

5.2 Recommendations of the study

Based on the findings of this study, the researcher came up with several recommendations to encourage tax compliance among SMEs. These include;

5.2.1 Tax rates and penalty rates

Consider lowering the tax rates to enhance collections. Lower tax rates make it less attractive to evade taxes as opposed to high rates. High penalty rates will increase compliance but only marginally. This penalty rates should be kept at an optimum level not to discourage taxpayers. Also consider uniform penalty rates for all tax heads.

5.2.2 Tax Return forms

The returns ought to be simplified and accompanying notes reconstructed into plain language that can be understood by all taxpayers. They should also be clear and brief but complete in detail to enable the taxpayers fill the return. In addition, where possible, simple computed examples should be incorporated in the notes. Returns should also be made readily accessible to both manual and computerized taxpayers. This will mean making available return forms in the ZRA web site for downloading by the taxpayers with computerized systems.

5.2.3. Taxpayer education

To enhance compliance there is need to intensify taxpayer education in terms of increasing the number of sessions and broadening coverage to include tax consultants. This will enlighten the taxpayers on existing law and any other tax liability. This will also provide a forum for taxpayers to air their complaints and or compliments. ZRA should also build offices in Kabompo District for easy accessibility of information.

5.2.4. Audits

Increased rates of audits that seek to reduce the time between audits will improve compliance, as taxpayers will fear the risk of being audited and penalized. The audits should also be broadened to cover a wider area with a possibility of conducting joint income tax and VAT audits based on modern audit tools. These measures are expected to result in enhanced tax collection improved sharing of information and time saving both to the authority and to the taxpayers. The criteria for selection of files for audits should be based on information given in returns and not random or subjective selection. This will make audits more productive and informative.

5.2.5 Improved Services

The authority should strive to give taxpayers high quality services as stipulated in the corporate plan. Most of the services provided by the authority like refunds, remissions and dispute resolutions were rated poor and thus there is every reason to improve them. Where possible, officers should endeavour to adhere to the taxpayers' charter in terms of service provision to taxpayers. 'Help' counters manned by technical and knowledgeable staff should be introduced and enhanced throughout the authority's offices to bring services closer to the taxpayers. This will also improve communication between the taxpayers and the authority. Other services worth introducing include payment of VAT directly into the banks- as is the case with PAYE, and modern technology such as telephone exchanges.

5.2.6 Training

There is need to continuously train technical staff to keep abreast with the tax law and any other changes therein. This way, the officers will impart proper and correct advice to taxpayers during the time of audits. Customer care lessons should form an integral part of this training. Recruitment of new taxpayers by the authority should be intensified and enhanced. This will broaden the tax base and reduce pressure on the complying taxpayers.

5.2.7 Building a ZRA office in Kabompo

There is also a great need for ZRA to build offices in Kabompo District. This will enhance tax compliance among the SMEs in the District. Dependence on online services alone is not effective as most of the people in Kabompo are illiterate were online usage is concerned.

5.2 Suggestions for further research

This study proposes the following areas for further study:

1. Factors affecting income tax compliance among SMEs in other regions of Zambia.
2. A study on the relationship between voluntary tax compliance strategy and the deterrence measures kind of strategy.
3. Factors that motivate SMEs to be tax compliant.

ACKNOWLEDGEMENT

I am greatly indebted to my Supervisors, Mr Lusaya Saviour and Mr Kaela Kamweneshe (IJMDR-Editor), who imparted invaluable knowledge to me about the research process and always found time to guide me despite his busy schedule. I wish to appreciate and thank the Board of Post Graduate Studies of the Information Communication University for giving me an opportunity to take this course. I sincerely wish to thank Rev. Joseph Kayombo for helping me to collect data for this research. To all other individuals and organizations that I have not specifically mentioned by name, please accept my gratitude for without your support, this report would have remained but a dream. Thank you all and God bless everyone.

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