

Effectiveness in Tax Payment by Rural Micro Enterprises in Tanzania

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Abstract

Taxation in Tanzania started from colonial era, it is a very important source of government revenue; hence it enables the government to finance its functions including administrative, social, protective, and development functions. Despite the fact that, tax is compulsory payment that enables the government to finance its various activities, many residents still do not like paying tax. Therefore, this study assessed effectiveness in tax payment by rural micro enterprises in Meru district in Tanzania. The study collected and used both primary and secondary data. Primary data were collected from a sample of 200 respondents including tax assessors, business owners, and employed managers through questionnaires and interviews. The study revealed that, there was no effectiveness in tax payment by rural micro enterprises in Meru district in Tanzania. It was recommended for the government through TRA to provide taxpayer education and training, lowering the tax rates, creating friendly relationship with tax payers, removal of tax incentives or exclusion among big corporations, and good governance of tax collected.

Keywords: Effectiveness, Micro Enterprises, Tax, Tax Compliance

1. Background of the Study

Tax is a very important source of the government revenue and important determinant of the economy of any country (Malima, 2013). The adequacy of tax revenues collection allows the government to finance its operations ranging from administrative activities, protective activities, infrastructure constructions, and provision of social services to its people. Tax as a compulsory charge is old as government” and the levels of taxes have been changing with time depending on the role of the government. It is one of oldest source of government revenue for running governments’ affairs and it has been related to many historical developments (Juma, 2013; James and Nobe, 1997). In the United States (USA), taxation can be traced to the colonial epoch in 1700’s, and according to Kelly (2013) USA taxation by Britain during colonial era led to the American Revolution. In America taxation is argued to have led into democracy when rebellions declared “No Taxation, no representation” (Brautigam, 2008). After the independence of America, in 1789 the congress used its mandate power to charge tax and tariffs were first imposed and became the core sources of the government revenue up to civil war outbreak in 1861. The impact of the war made the government to multiply its excise taxes and introduced more new taxes to cover the damages of the war. In 1894 Federal levied taxes on individuals and in 1895, tax was abolished claiming that it was contrary to the constitution, but in 1913 amendments to the constitution were made to remove restrictions (The World Book Encyclopedia, 1992).

In Europe, taxation enabled to increase the government accountability to their citizens and it became the most vital tool to European economic development (Brautigam, 2008). In Africa, for example in South Africa tax can be traced in colonial era whereby the colonialists were levying taxes and some of the taxes introduced by the colonialists are still up to the present (Mkandawire, 2010; Alvaredo and Atkinson, 2010). In East Africa, taxation can also be traced to the colonial period when the colonialists started imposing poll (head) tax. Recently there have been a number of debates concerning tax harmonization among the East African countries including Tanzania, Kenya, Uganda, Rwanda, and Burundi; the aim being to simplify trade among partner countries.

Developing countries need to adequately manage its sources of revenue to enhance the speed of developments (Ebeke, 2010). This is because sufficient revenue decreases the degree of dependence of the government to donors for its developments (Komanya, 2013). It also offers the government with the ability to make different development decisions. In Tanzania basically, domestic revenue is one of the key branches of taxation system and countries within Southern African Development Community (SADC) and East Africa Community (EAC) economic blocks. While statistics show improvements in the area of tax collection, a large group of eligible taxpayers is yet to be reached (Ministry of Finance and Economic Affairs of Tanzania, 2013). The literature suggests unprofessional methods of keeping records by entrepreneurs, low tax knowledge, bureaucratic procedures and corruption inhibit the revenue collection process in developing countries (Kitillya, 2011; The Policy Forum of Tanzania, 2010). In order to reach many clients and act more effectively, the Tanzanian revenue authority re-defined its administration system to include small administrative blocks (Bugeni, 2012). Although the aim of re-defining the administrative structure was to maximize efficiency in identifying and managing new customers, this goal is yet to be met (Bugeni, 2012; Interview). Improving domestic tax revenue

collections can easily be enhanced through many ways including voluntary tax compliance by the clients (tax payers). Therefore, this study assessed the effectiveness in tax payment by rural micro enterprises in Meru district in Tanzania.

2. Statement of the Research Problem

Tax is the main source of government revenue. There are number of challenges associated with tax collection which are inefficiency administration, costs of collection, corruption, and lack of effective tax payment. Willingness and effectiveness in tax payment by tax payers is a big challenge and in most societies people practice tax avoidance and tax evasion so as to minimize or eliminate tax liability. This causes government to collect less tax revenue which leads to budget deficit and increase in national debt. The study by Jensen & Wohlbier (2012) suggests voluntary compliance of clients to tax return as the key success factor for the revenue authority to meet its statutory obligations. Despite the fact that tax is a compulsory payment which enables government to generate revenue, many people still do not like paying tax. It is the intention of this paper to assess the effectiveness in tax payment by rural micro enterprises in Meru district in Tanzania.

3. Objective of the Study

To assess the effectiveness in tax payment by rural micro enterprises in Meru district.

4. Significance of the Study

This study will be helpful to the government through Tanzania Revenue Authority (TRA) by increasing tax revenue collection. It will help tax officials to be in position to collect more tax through realization of the proper strategies for collecting tax revenue from rural micro enterprises. Also the study is educative to owners of rural micro enterprises and other tax payers on the importance of payment of tax to the government.

5. Research Methodology

The study collected and used both primary and secondary data. Primary data were collected in 2013 from a sample of 200 respondents including tax assessors, business owners, and employed business managers in Meru district through questionnaire and interviews. Interviews were conducted to TRA officials and other respondents so as to supplement the information collected through questionnaires. In data analysis, qualitative data analysis techniques was used. The Statistical Package for Social Science Research (SPSS) software was used as an instrument of data analysis. Descriptive statistics was used in the analysis, tables and graphs were used in the presentation of the findings.

6. Presentation and Discussion of the Findings

6.1 Demographic Characteristics of the Respondents

Category of the Respondents: Tax assessors were 10 (5%) of the respondents, business owners were 120 (60%), and employed managers were 70 (35%).

Age: 106 (53%) of the respondents were between the age of 36 to 45 years, 52 (26%) between 45 to 65 years, and 42 (21%) were more than 65 years.

Gender: 120 (60%) of the respondents were male and 80 (40%) were female.

Education Level: 134 (67%) of the respondents completed primary education, 40 (20%) completed secondary education, 20 (10%) were first degree holders, and 6 (3%) of the respondents were having postgraduate degree qualification.

Commencement of Business: 10 (5%) of the respondents reported their business commenced between the year 1990 and 1995, 20 (10%) commenced between the year 1996 to 2001, 50 (25%) commenced between the year 2002 to 2007, and 100 (50%) commenced between the year 2008 to 2013.

Table 1. Demographic Characteristics of the Respondents

Variables		Frequency	Percent
Category of the respondents	Tax assessors	10	5.0
	Business Owners	120	60.0
	Employed Managers	70	35.0
Age (Years)	36-45	106	53.0
	46-65	52	26.0
	Over 65	42	21.0
Gender	Male	120	60.0
	Female	80	40.0
Education level	Primary	134	67.0
	Secondary	40	20.0
	First degree	20	10.0
	Postgraduate	6	3.0
Commencement of Business (Year)	1990 - 1995	10	5.0
	1996 - 2001	20	10.0
	2002 - 2007	50	25.0
	2008 - 2013	100	50.0

6.2 Effectiveness in Tax Payment by Rural Micro Enterprises in Meru District

The intention of Tanzanian government through TRA is to ensure that all taxpayers submit the information about their businesses voluntarily annually for evaluation and make tax payment accordingly. This study assessed the effectiveness in tax payment by rural micro enterprises in Meru district. In assessing the researchers considered proper records keeping, payment of tax in time, voluntary payment of tax, and compliance of tax regulations. The researchers used the Likert scale of five points, the scale included strongly disagree (SD), dissatisfied (D), neutral (N), agree (A), and strongly agree (SA). From the study, it was generally revealed that, there was no effective tax payment by rural micro enterprises in Meru district in Tanzania as majority of respondents (82%) supported (Figure 1).

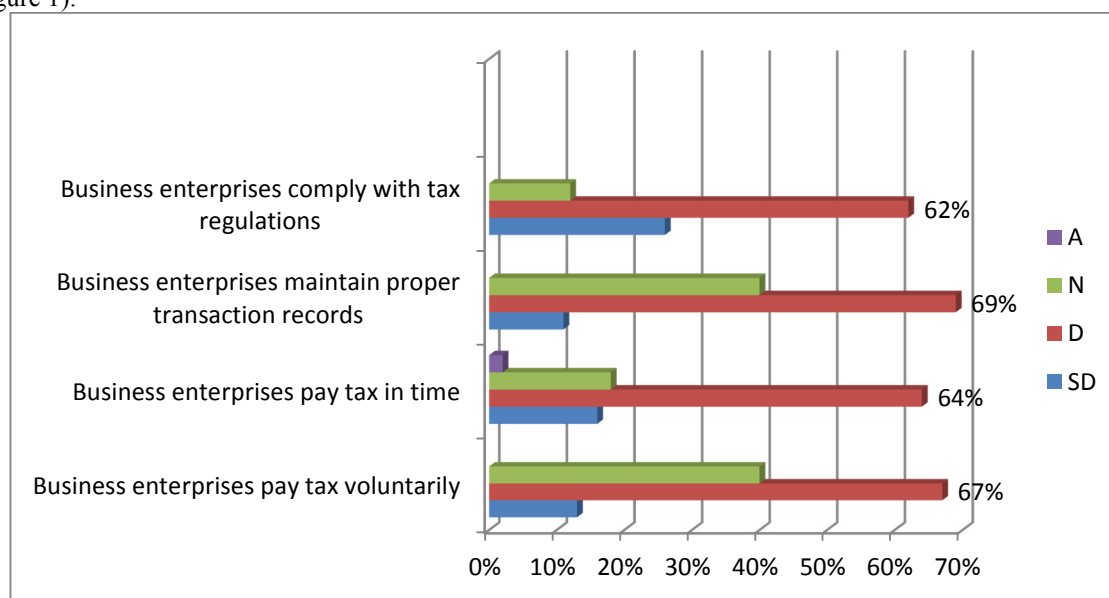


Figure 1. Effectiveness in Tax Payment by Rural Micro Enterprises

6.2.1 Proper Maintenance of Transaction Records

The study findings revealed that most of rural micro enterprises in Meru district were not maintaining proper transaction records as respondents supported by 138 (69%) respondents (Figure 1). Further analysis showed that 22 (11%) of the respondents strongly agreed with this, and 40 (20%) of the respondents were neutral (Figure 1). This indicates that a large number of rural micro enterprises do not maintain proper transaction records; therefore TRA needs to make more efforts so that people may maintain proper transaction records for tax purposes. The results of the findings correlate with study done by Thuronyi (1996) which shows that most of small businesses do not maintain proper accounting records. According to Kimungu and Kileva (2007) it is arguable that, micro

enterprises do not maintain proper accounting records mainly due to illiteracy on the side of taxpayers, however it is also costly (Ongwamuhana, 2011). Due to lack of enough records by rural micro enterprises TRA opted to charge tax on basing on presumptive tax system, in this system the tax is based on annual turnover (Income Tax Act, 2008). Further analysis from the presumptive tax system, those small businesses which do not maintain proper records pay more tax in all categories compared to those who do not keep records (Income Tax Act, 2008). This again increases the tax burden although its intention is to encourage enterprises keep proper transaction records. For example, in the first category there is no difference because those with turnover less than 4 million Tshs. pay nil, but in the category of 4 mil. to 7.5 mil Tshs, above 7.5 mil to 11.5 mil Tshs, above 11.5 mil to 16 mil Tshs, and above 16 mil to 20 mil Tshs. pay Tsh 20,000 Tshs., 42,000 Tshs, 59,000 Tshs, and 130,000 Tshs. in excess respectively (Table 2). This paper call rural micro enterprises owners and employed managers to keep proper records for their business transactions to be able to determine their business performance as well as reducing tax liability since those businesses which do not keep proper records pay more tax than those businesses which keep proper records.

Table 2. Presumptive Tax Rates in Tanzania

Turnover Per Annum	Tax Payable where incomplete records are not kept	Tax payable where complete records are kept
Tshs. 4,000,000 or Less	Nil	Nil
Tshs. 4,000,000-7,500,000	100,000	2% of the turnover in excess of 4,000,000
Tshs. 7,500,000- 11,500,000	212,000	Tshs.70,000 plus 2.5% of the turnover in excess of 7,500,000
Tshs. 11,500,000-16,000,000	364,000	Tshs.170,000 plus 3.0% of the turnover in excess of Tshs.11,500,000
Tshs.16,000,000-20,000,000	575,000	Tshs. 305,000 plus 3.5% of the turnover in excess of 16,000,000

Source: Tanzania Income Tax Act (2008)

6.2.2 Payment of Tax in Time

In regards to payment of tax in time, it is reported that majority of rural micro business enterprises were not paying tax in time as respondents supported by 128 (64%) as indicated in Figure 1. The researchers also revealed that 32 (16%) of the respondents strongly disagreed that payment of tax were made in time, 36 (18%) of the respondents were neutral, and 4 (2%) of the respondents agreed that they were paying tax in time (Figure 1). This indicates that most rural micro enterprises were not paying tax in time; therefore TRA (Meru branch) has to take initiatives to encourage and enforce business enterprises in the area to pay tax in time.

6.2.3 Voluntary Payment of Tax

Regarding if rural micro enterprises pay tax voluntarily, the study revealed that most of the enterprises were not paying tax voluntarily as supported by 134 (67%) as depicted in the Figure 1. The researchers further reported that 26 (13%), and 40 (20%) were neutral (Figure 1). These results are likely the same to the study done in Tanzania by Ongwamuhana (2011) which concludes that voluntary tax payment in Tanzania has not been attained effectively because a large number of business enterprises do not pay tax voluntarily. Tax is justifiable by many, but voluntary tax payment is a problem, since people dislike paying tax (Ongwamuhana, 2011). Both primary and secondary study concludes that, people dislike paying tax regardless of their understanding of its importance. Therefore efforts have to be made by TRA to ensure both voluntary tax payment and enforcement are in practice.

6.2.4 Compliance with Tax Regulations

Regarding compliance to tax regulations, the study revealed that majority 124 (62%) of the respondents disagreed that rural micro enterprises comply with tax regulations (Figure 1). Also it is reported that 52 (26%) of the respondents strongly disagreed, and 24 (12%) of the respondents were neutral (Figure 1). Low tax compliance is caused by many factors including low follow up by tax officials, low penalty, high tax rate and couple of procedures. The findings are similar to the study by International Tax Dialogue (2007) which states that, the lower rate of compliance among small tax payers is due to low detection risks and penalty, coupled with high compliance costs in comparison to the income level. The findings further show that, poor incentives to voluntary tax compliers are another setback. The study by Ongwamuhana (2011) and (IPAR) also indicates that, small businesses find it very costly to comply with tax policies. The same study conducted by (Atawodi and Ojeka, 2007) states that, although tax revenue is important for running various government projects tax compliance among Small and Medium Enterprises (SMEs) is poor. Scholars argue that high tax rates and complex filing procedures are the most crucial factors causing non-compliance of SMEs. Therefore the literature study indicates that, most small business enterprises do not comply with tax regulations and one of the reasons might be costs of tax compliance as indicated by Ongwamuhana (2011).

7. Conclusion and Recommendations

Even though tax is important and very crucial to the development of any country, the study revealed that majority of the respondents agreed that most of the rural micro enterprises in Meru district were not having effective tax payment. They were not complying with tax payment by not paying tax in time, paying tax voluntarily, and not keeping business transaction records properly.

The study recommends that effective tax payment by rural micro enterprises can be enhanced through the following strategies:-

- *Education and Training*
Entrepreneurs and public at large should be educated about the necessity of paying tax voluntarily, since some people might not know the importance of tax. Education should go hand in hand with persuading taxpayers to comply with voluntarily tax payment. Where taxpayers do not comply voluntarily, enforcement should be applied.
- *Good Governance*
The government should ensure that, the revenue collected from taxes is optimally utilized in social and development activities. If the tax paid is reflected in social and development activities, the rate of compliance will increase and vice versa.
- *Lowering Tax Rates*
The government should lower the tax rates among micro enterprises in order to boost their businesses and motivate them paying tax. Studies show that one of the reasons for tax avoidance and evasion is high tax rates, therefore if tax rates will be reduced, the rate of compliance will increase.
- *Creating Friendly Relationship with Tax Payers*
Tax officials should create friendly atmosphere with taxpayers in order to motivate them to comply with tax payment.
- *Removal of Tax Incentives or Exclusion among Big Corporations*
The government should not give tax exemptions to big corporations with the intention of attracting investors, since this is not realistic and discourage small tax payers in paying taxes. For example mining companies with big investments have been enjoying tax exemptions and this leads to decrease in much of the government revenue.

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