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# Barriers to tax compliance for medium, small, and micro enterprises (MSMEs) in Zambia



- In brief:**
- This study examines the barriers that contribute to the low levels of tax compliance among MSMEs in Zambia.
  - The brief presents findings from an original survey conducted among 1390 respondents in 52 market hubs in Lusaka and Central province of Zambia.
  - The researcher finds a tax compliance rate of on average 30 percent among these MSMEs.
  - The findings reveal several key barriers to tax compliance among this group:
    - MSMEs report low business profitability and high tax rates as key individual barriers to compliance.
    - These businesses also report facing intractable logistics to paying taxes to the Zambia Revenue Authority (ZRA).
    - Perceived and actual levels of audit are low with only 7.4 percent of MSMEs having ever been audited for compliance.
    - MSMEs have negative perceptions about what revenue collected by the state is used for further dampening the desire to comply.
  - The author makes several policy recommendations for improving compliance among MSMEs.

*This project was  
funded by IGC  
Zambia*

## Overview of the research

In developing countries, including Zambia, tax compliance among Medium, Small, and Micro Enterprises (MSMEs) tends to be low. The reasons for this are numerous and often complex. Many MSMEs tend to be informal, small, and generate low profits, which often presents a challenge for revenue authorities to invest resources into enforcing compliance, which might prove cost ineffective. On the other hand, the benefits of bringing MSMEs into the tax net are equally important. The most compelling reason being that MSMEs can make an important contribution to revenue collections. Formal tax compliant MSMEs also tend to be more productive and compliant with other laws such as environmental and labour regulations. Most importantly, tax compliance tends to foster a stronger fiscal contract between citizens and their governments leading to greater accountability and transparency. An important aspect, which this brief presents findings on, is to examine the barriers that exist that lower the levels of tax compliance among MSMEs in Zambia.

## Methodology

An original survey was undertaken in April and May 2018 among 1390 MSMEs in Lusaka and Central Provinces of Zambia. The data collection tool employed was a survey containing questions on five key sections: general demographic data, socioeconomic factors, business information, tax compliance measures, political participation and attitudes, and reliance on services. It also explored many of the oft-cited barriers to tax compliance, such as low rates of monitoring and enforcement of the tax law. A conjoint experiment was also embedded in the study to shed light on the social and group-level dynamics of tax compliance. A three-stage sampling approach was used to sample MSMEs in 52 market hubs. The first stage involved selecting two commercially active provinces within Zambia: Central and Lusaka. The second stage involved drawing a stratified random sample of markets. The final stage involved a random walk protocol to sample individual respondents. The sampling protocol resulted in an average of 23 respondents per market and 1390 respondents in the sample total.

## Policy motivation of the research

This project is a result of a partnership between the Zambia Revenue Authority (ZRA), the International Growth Center (IGC), and the research team. It arose out of initial interest by the ZRA to understand the potential uptake of mobile tax payment solutions amongst MSMEs in Zambia. The research team broadened the study design to look into the various barriers to tax compliance that MSMEs face with the aim of better understanding the tax behaviour of MSMEs in Zambia and possibly provide insights applicable in other sub-Saharan African countries.

## Key findings

### **Tax compliance among MSMEs in Zambia is on average at 30 percent**

Using a variety of measures, the study finds a compliance rate average of 30 percent. To counter social desirability bias a list experiment is used to determine compliance behaviour. List experiments provide a measure of tax compliance less prone to social desirability bias than direct questions. In this method, respondents answer a question about the number of things they spent money on within the last year. The respondents are randomly assigned to one of two lists: one list (the control group list) includes four items on which they spent money; and the other list (the treatment group list) includes those same four items plus a sensitive item (in this case, paying business taxes to ZRA). The respondent answers this question with only one number, and the difference in means across the treatment and control groups reveals the proportion of respondents who are spending money on the fifth item, which is paying business taxes to ZRA.

We asked respondents to say the number of items <sup>1</sup> on the following list they spent money on within the last year:
Tyre repairs for a bicycle
New clothes for your spouse
School fees for a female child
Medical bills for a relative
ZRA taxes on your business (Only asked to Group A)

The average number of items the treatment group spent money on in the last year was 2.41, while the control group was 2.11. The difference between these averages is 0.30. This means 30 percent of MSMEs paid ZRA taxes on their business in the last year. Our p-value, which measures the likelihood that these results could be due to random chance instead of indicative of a true trend in the population, is essentially zero. Therefore, we can conclude that the rate of paying ZRA business taxes is about 30 percent in the population of MSMEs we surveyed.

## Barriers to tax compliance in Zambia

The survey findings reveal that MSMEs face a number of barriers that limit their participation in the tax system:

Barrier	Findings
<ul style="list-style-type: none"> <li><b>MSMEs report low business profitability and perceived high tax rates as key barriers.</b></li> </ul>	<ul style="list-style-type: none"> <li>Over 63 percent of responses identified the most significant barrier to paying taxes to be low business profitability.</li> <li>The next most common choice was that taxes were too high (20.5 percent). Together, these account for over 80 percent of the sample.</li> </ul>
<ul style="list-style-type: none"> <li><b>There are intractable logistics to paying taxes to ZRA.</b></li> </ul>	<ul style="list-style-type: none"> <li>Ten percent of the sample rated the distance to a ZRA office as the number one barrier to tax compliance. This is important, as almost 47 percent of respondents who pay taxes do so by going to a ZRA office, far outpacing any other specific option.</li> <li>The uptake of other payment solutions such as mobile payment and online platforms is low.</li> <li>For instance, less than 1 percent of respondents use mobile money although 64 percent indicated that they would pay using mobile money.</li> </ul>
<ul style="list-style-type: none"> <li><b>Perceived and actual levels of audit are low.</b></li> </ul>	<ul style="list-style-type: none"> <li>The majority of respondents had never experienced a tax audit with only 7.4 percent of respondents having ever been audited.</li> <li>MSMEs that have been audited before have been audited between two to three times.</li> <li>Only 30% of respondents have heard of a fellow business being audited.</li> <li>From the academic literature and policy studies in other countries, we know that it is</li> </ul>

	<p>critical for taxpayers to believe there is a risk of real consequences for failing to pay taxes. With under 10 percent of the MSMEs surveyed ever experiencing any consequences, and less than a third even being aware that <i>others</i> have experienced any consequences, it is clear both the perceived and actual risk of consequences are low.</p>
<ul style="list-style-type: none"> <li>• <b>MSMEs have negative perceptions about what collected revenue is used for.</b></li> </ul>	<ul style="list-style-type: none"> <li>• MSMEs believe that only a third of revenue collected is used to provide public services in their area. They also believe that about a third of revenue is lost through corruption. While another third is used to finance the operations of the ZRA. This negative perception has the potential to dampen tax morale.</li> </ul>

## Policy recommendations

### 1. Ease the logistical burden of compliance for MSMEs

Renewed efforts need to be made to ease the burden of complying with the tax system. Key areas that need to be further explored include bringing tax collection services closer to MSMEs and providing information on various payment methods, particularly mobile payment solutions.

### 2. Use innovative low-cost solutions to reduce barriers to compliance

A promising option is the use of innovative and scalable solutions to increase compliance. An example of this would be to capitalise on social networks to increase compliance among MSMEs. In other countries, the use of peer influence and programmes that use social media to leverage or change existing social norms have been found to be effective.

### 3. Improve awareness of tax system

Publicising the applicable tax burden facing MSMEs would be beneficial as a lack of tax awareness contributes to perceptions of a high tax burden. There is a perception that paying taxes is optional, and it is critical to heighten a sense of tax morale through information.