ASSESSMENT OF FACTORS INFLUENCING TAX EVASION BY SMALL AND MEDIUM ENTERPRISES: A CASE OF BUKOMBE DISTRICT, GEITA REGION

PERAGIUS COSMAS

A DISSERTATION SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION IN FINANCE (MBA)

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CERTIFICATION

The undersigned certifies that he has read and hereby recommends for acceptance by the Open University of Tanzania a dissertation entitled: "**Assessment of Factors Influencing Tax Evasion by Small and Medium Enterprises: A Case Study of Bukombe District – Geita Region"** in partial fulfilment of the requirements for the award of the degree of Master of Business Administration in Finance.

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Dr. France Shayo

(Supervisor)

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(Date)

…………………………………………

Dr. Chacha Matoka

(Supervisor)

…………………………………

(Date)

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DECLARATION

I, **Peragius Cosmas**, declare that, the work presented in this dissertation is my own original work and that it has not been presented to any other University or institution for a similar or any other degree award. It is in this regard that I declare this work is originally mine. It is hereby presented in partial fulfilment of the requirement for the Degree of Master of Business Administration in Finance (MBA).

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Signature

15/10/2023
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Date

DEDICATION

This work is dedicated to my lovely wife and children, especially my wonderful daughter Precious Peragius for her outstanding support throughout the entire Master's program. A special feeling of gratitude to my loving parents, Cosmas and Dina Mashanda whose word of encouragement and push for persistence still ring in my ears. I also dedicate this work to my friends for their support during the process especially Nanciety Mulashani for her time proofreading. .

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Without forgetting my parents for the prayers and ambition of seeing my success, my friends and colleagues who helped me in diverse ways and encouraged me to complete this work. May the Almighty God fulfil and meet their wishes.

ABSTRACT

The study assessed the factors influencing tax evasion by small and medium enterprises in Bukombe District in Tanzania. It adopted the descriptive design for the cross-sectional data which was administered to the sampled population. It was guided by the question on how economic and non-economic factors influence tax evasion as well as the influence of taxpayers' perception of tax evasion in Bukombe. The population of the study was the small and medium business enterprises (SMEs), simple random sampling was employed to select a sample size of 100. The study used a structured questionnaire. The statistical package for social sciences was used for analysis and data were presented in figures and tables. The study objectives were tackled on the basis that economic factors, non-economic factors and taxpayers' perceptions were influencing tax evasion in the area by 61% from the regression analysis opening chances of other factors by 39%. The finding presents tax rate and size of the business to have significant influence on tax evasion in the area. The SMEs in Bukombe had a positive attitude on paying tax. Although it was concluded that higher tax rates and unequal tax rate ratio to their business income were influencing tax evasion as well as inadequate knowledge on tax modalities and laws. It was concluded that the factors assessed were influencing tax evasion in the area and higher penalties and frequent auditing were the means to reduce tax evasion. The study recommends the authorities to sensitize SMEs on tax knowledge to avoid tax evasion, to ensure a relative amount of tax rate ratio by suggesting more research to be done on the extent of tax evasion in the area and on the other factors influencing tax evasion than economic, non-economic and taxpayers' perceptions in the area.

Keywords; *Tax, Tax gap, Tax evasion, Small and Medium Enterprises.*

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF ABBREVIATIONS AND ACRONYMS

A-S   Allingham- Sandmo

EFD   Electronic Fiscal Device

FGD   Focus Group Discussion

GDP   Gross Domestic Product

GST   Goods and Services Taxes

MPL   Multiplier Perception Layer

MPL   Multilayer Perception Layer

NBS   National Bureau of Statistics

OECD   Organisation for Economic Co-operation and Development

PAYE   Pay As You Earn

SME   Small and Medium Enterprises

SPSS   Statistical Package of Social Science

TCCIA   Tanzania Chamber Of Commerce Industry and Agriculture

TRA   Tanzania Revenue Authority

URT   United Republic of Tanzania

USA   United State of America

VAT   Value Added Tax

CHAPTER ONE

INTRODUCTION

1.1 Chapter Overview

This study presents the background of the study, statement of the problem, research objectives, and significance of the study and scope of the study.

1.2 Background of the Study

One of the problems facing developing countries is the lack of speedy, even-handed and sustainable economic growth. Studies advocate that the problem of economic growth can be overcome by having a stable budget position (Bird, 1992). The most imperative thing is that revenue must be adequate to finance government investment in human capital development and allocate a higher proportion of expenditures to social expenditures (education, health) and provision of basic infrastructure such as water, reliable electricity, communication systems infrastructure, a good transport system and other public social services. In any country, taxation policy acts as a fundamental element for economic policies and also helps to ensure the country's economic growth and improvement of its global competitiveness (Taha and Loganathan; 2008).

In order to achieve all these services, governments require an efficient and well-designed tax system equipped with strong tax administration. However, there is low tax collection leading to low revenue in most of the developing countries. One of the reasons behind this is inefficient and ineffective tax administration which causes widespread tax avoidance and evasion (Okoye and Ezejiofor; 2014). Since 1988, Tanzania has been implementing fairly comprehensive tax reforms as part of a

widening economic reform program to bolster growth and achieve sustained macroeconomic stability (low inflation, prudent fiscal stance, stable exchange rate and favourable balance of payments position). Reforms on the fiscal front have focused on improving revenue administration, reduction of tax rates, simplifying the tax structure, introducing value added tax and broadening of the tax base. In spite of these reforms, Tanzania still has a relatively low tax to GDP ratio which is 14.4 percent which lies considerably below average for sub-Saharan Africa.

The efforts of collecting tax revenues cannot be achieved unless there is strong tax administration which ensures proper tax collections and minimizing or engulfing tax evasion (Galinoma, 2019). The main advantageous of effective tax administration is to help countries to collect all taxes appropriately and also to rethink on the proper ways of administering tax revenues, tax evasion and fight against corruption on taxation issues. In addressing the importance of internal generated revenues, Adenugba and Ogechi (2013) reveal that revenue administration agencies are very important in fostering revenue collections; however; this is only possible if countries have a tax-compliant society (Abu-Hassan, Yunus, and Ramli, 2017). However, non-compliance with tax laws is a persistent and growing global issue to which a lasting solution is yet to be established (Gotora and Mokaya, 2018). Non-compliance is defined as an individual's refusal to act in accordance with legal, social, cultural or institutional requirements.

In developing countries, non-tax compliance is a major predicament, particularly among Small and Medium Enterprises, whose revenues account for 40-50 percent of the national Gross Domestic Product (Kira, 2017). High tax rates, high compliance

costs, onerous registration procedures, inconsistency in enforcing tax laws and corruption make taxation a burden for the informal sector in Tanzania and developing countries in general. Other issues of non-compliance include lack of formal business locations, the nature of business operators, high cost of tax collection, the aggressive attitude of actors, lack of patriotism and lack of trustworthy data (Mbilinyi & Mutalemwa, 2020).

Therefore, governments should establish an atmosphere that allows small and medium businesses to develop while motivating them to pay taxes proactively. This could be accomplished if governments take substantial steps to provide a lasting solution for tax non-compliance. However, governments are hampered by non-compliance with tax laws and as a result, fluctuating revenue collection negatively affects national expenditure plans as it reduces the state's ability to project household income and assets needed. In most developing countries, small and medium enterprises (SMEs) dominate the business industry, and their stability has a significant influence on government income accumulation (Atawodi and Ojeka, 2012).

The Government of Tanzania is particularly concerned about the growing mismatch between the levels of submitted annual income tax returns, tax assessment reports and voluntarily paid tax liabilities among SMEs (URT, 2020). Tanzania's small and medium-sized enterprises (SMEs) have a tax potential of 79 billion Tanzanian shillings per year, but only one billion in annual tax revenue is accrued. SMEs account for 98 percent of all registered enterprises in Tanzania, contributing 34.3 percent to GDP (URT, 2020).

Kira (2017) suggested high tax rates, complicated tax procedures, corruption, high compliance costs and inadequate social services as reasons for non- compliance. He further argued that tax rates in Africa are so high that they slow down corporate growth. According to Gotora and Mokaya, (2018) unfairness in taxation, poor systems and corruption are the leading reasons for non-tax compliance, particularly among small and medium businesses. However, despite the Tanzanian government making several efforts including street vendor registration, tax administration improvement and the use of electronic fiscal devices (EFDs) to combat tax evasion, a trend of non-compliance by SMEs still persists.

With this understanding, therefore, the current study uses the Allingham and Sandmo tax theory. According to the theory, tax evasion is widespread among people who believe the tax rate is excessively high and punitive. Accordingly, likelihood of detection, the severity of punishment (penalty), and the high transactional costs connected with tax legislation are all associated with tax evasion. In addition, since tax avoidance is linked with moral obligation, affordable tax rate and perception of fairness in tax administration are expected to have a bearing on tax evasion.

For the purpose of this study, the above factors are categorized as follows: economic factors which include penalty and tax rate; non-economic factors which include likelihood of detection and attitudes towards taxes; and factors associated with taxpayers' perception which include perception of fairness in tax administration as well as perception about tax knowledge. This study assesses these factors so as to establish those which are more evident in explaining tax evasion in Bukombe

District of Geita Region.

1.3 Statement of the Problem

It is widely familiar that among the objects of tax reforms is to improve the efficiency of the tax administration and hence reduce tax evasion. Although the practical evidence is mixed, it seems that measures of tax reforms in some developing countries, Tanzania included, have not helped to reduce tax evasion (Manamba, 2017). Tax compliance is an important issue for countries around the world when Governments seek revenue to meet public needs. Tax evasion generates costs for the economy, creates bad models for individuals and businesses and consumer's resources in an inefficient way (Alm and Torgler, 2011). It is important to review factors that influence tax evasion so that governments can manage them through fiscal policies.

Simser (2008) observed tax evasion could be said to occur when individuals or organizations intentionally fail to conform to their tax responsibility. According to Asada (2010) tax evasion represents some of the perplexing problems facing the Tanzanian economy. The reality in Tanzania demonstrates that there is still very little voluntary compliance. The insufficient quantity of state tax revenue relative to gross domestic product (tax ratio), which is 11.5% in 2018 vs the optimal rate of 15–17%, reflects this. Tanzania had a tax-to-GDP ratio of roughly 12 percent, which the International Monetary Fund (2016) claimed was extremely low even by the standards of low-income countries.

Over the past years, the Government of Tanzania has focused itself on raising revenue from a limited number of sources such as taxation on drinks, fuel, cigarettes

and tobacco products, Value Added Tax and Pay as You Earn (PAYE) being the major focus of taxes. The current general consensus amongst the citizens is that these sectors are already overtaxed and Government cannot impose any further taxes.

Despite all these efforts made by the government through its respective authorities, still there is informal economy via tax evasion, and this is commonly observed in small and medium enterprises. Studies have shown that economic, non-economic and personal factors are responsible causes of tax evasion in many developing countries. However, none of them were done in Bukombe District. This study therefore intends to assess the factors that are leading to tax evasion by traders in Bukombe District of Geita Region.

1.4 Objective of the Study

1.4.1 General Objectives

The main objective of this study was to determine the factors influencing to tax evasion by traders in Bukombe District, Geita Region.

1.4.2 Specific Objectives

In attaining the general objective, the following specific objectives were examined in order to address factors that lead to tax evasion such as;

 i. To determine economic factors influencing tax evasion in Bukombe District, Geita Region.

 ii. To determine non-economic factors influencing tax evasion in Bukombe District, Geita Region.

   iii.   To determine the influence of taxpayers' perception on tax evasion.

1.5 Research Questions

   i.   How do economic factors influence tax evasion in Bukombe District?

   ii.   How do non-economic factors influence tax evasion in Bukombe District?

   iii.   How does taxpayer's perception influence tax evasion in Bukombe District?

1.6 Significance of the Study

i) Practical Significance

It is worthwhile to conduct this study simply because; the result might be used to improve the management practice of the Tanzania Revenue Authority (TRA). It also intends to help the management and stakeholders to understand challenges and solutions of the tax evasion problem. Nevertheless, it intends to enable the governing body, specifically the management, and the higher responsible body to be aware of what can increase the performance of the TRA especially on the part of tax collection. Generally, the findings and recommendations of this study will help authorities entrusted with the tasks of maintaining, foreseeing and implementing matters relating to tax evasion in TRA.

ii) Academic/Researchers

The undertaking to determine the factors that are leading to tax evasion for eligible traders a case study of Bukombe District, Geita Region could enrich the research centre in the Open University and Tanzania in general provide standard of the research that could receive wider recognition. Also through these findings and analysis, the study provides more understanding and insights regarding managing

collection of the tax. This research is referred as an initiation for those who are interested to conduct a detailed and comprehensive study regarding tax evasion.

iii) Policy significance

Policy development in this study assists the Government and other stakeholders, example politicians to determine the importance of having a better tax administration. Also due to the changing world, this study creates awareness to the policy makers to understand the importance of investing on the employees for institution or company performance which is responsible for paying tax in enhancing development.

1.7 Scope of the Study

This study focused on factors that are leading to tax evasion for eligible traders which covered the area of Bukombe District in Geita Region. The study determined the nature of the business of the small and medium business owner, assessing the tax systems and procedures and determination of the perception of the Bukombe taxpayers on their responsibility of paying tax.

1.8 Organization of the Study

This research is organized into five chapters. Chapter one contains introduction which covers background information, problem statement, research objectives, research questions, significance of the study, scope of the study, ending with organization of the study. Chapter two reviews the definition of key terms, extensive empirical literature reviews of the work done by other researchers and theories behind the study. Chapter three covers methodological requirement of the study,

research design, sampling and population, and procedure of data collection and analysis. It is followed by chapter four which covers data presentation, analysis and discussion of the study. And the last chapter which is chapter five covers summary of the findings, conclusion and recommendation.

CHAPTER TWO

LITERATURE REVIEW

2.1 Chapter Overview

This chapter reviews and defines the key study terminologies and gives theoretical and empirical evidences of the study. It also presents some important literature that relates to the research problem under the case study. This review will help the researcher to see how the research questions had been addressed by other researchers and how they had proposed.

2.2 Conceptual Definitions

2.2.1   Tax

Tax is the amount of money paid to the government by the person (juristic or natural) on whom it is imposed often accompanied by a tax return filed by the taxpayer. It includes income tax, corporate tax, Value Added Tax (VAT) and import taxes. In other words, a tax may be defined as a "pecuniary burden laid upon authority". Hence it is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to legislative authority. It is therefore referring to any contribution imposed by responsible authority.

Tanzania Revenue Authority (2008) defines taxation as a compulsory levy or charge imposed by the State on her citizens and non-citizens that is usually payable in monetary terms while taxes are defined as compulsory financial contributions made by a person or body of persons towards the expenditure of a public authority. In addition, there are two types of taxes namely, direct and indirect taxes; direct taxes are levied directly on people's income from employment, business or ownership of

property or investment while indirect taxes are based on consumption.

2.2.2 Taxation

Taxation as defined by Mugerwa (1990) is a sovereign right the state uses to transfer resources from private use to public use in the way that is most suitable and consistent with the economic goals of the society. According to Kogler et al. (2015), taxation is a compulsory contribution imposed by a public authority irrespective of the exact amount of service rendered to the taxpayer in return. While to Orsbrnes (1984), taxation is the imposition of duties to raise revenue. Taxes play a much larger role in society and the general economy than the mere raising of revenues.

2.2.3 Tax Evasion

Tax evasion refers to the process of using illegal means by which to avoid paying taxes. Typically, tax evasion involves an individual or corporation mispresenting their income to the respective revenue authority. Mis-presentations can be done through understating sales revenue, inflating allowable expenses. Tax evasion is different from tax avoidance because evasion is completely illegal action while tax avoidance makes use of loopholes available in applicable tax laws to minimize tax burden.

Tax evasion is quite a popular phenomenon; it has been in existence for quite a long time and still continues to impose growing challenges to the tax authorities in several countries in the world regardless of the country's level of development. Developed, developing and even underdeveloped countries face challenges over tax evasion. Talking of the world, the United States of America (USA) is leading having very high tax loss due to tax evasion.

2.2.4   Tax Gap

Toder (2007) defined tax gap as the difference between the amount of tax legally owed and the amount actually collected by a government, while the gross tax gap is the difference between tax liability in any year and the amount of tax that is paid voluntarily and on time; and net tax gap is the gross tax gap in any tax year less payments of that year's tax liability that come in later through either voluntary late payments or enforcement activities. Payments of interest and penalties associated with late payments or underreported tax liability are not counted in either the gross or net tax gap measures. The impact of transfer pricing and thin capitalization in the economy is that the contribution of income taxes by foreign companies (multinationals) is minimal. The multinationals arrange their affairs in such a way that they pay the minimum amount of tax in high tax jurisdictions.

2.2.5   Small and Medium Enterprises

These are categorized as businesses that have revenues, assets and a certain number of employees under a certain threshold. The definition of Small and Medium Enterprises (SMEs) depends on the country's set up depending on different guidelines of economic sectors across the industry that defines a small business. SMEs play an important role in the economy by providing employment to a good number of people and help in innovation of the country standard in inclusion of the society in tax payment.

Governments offer incentives such as favorable tax, treatment and better access to loans to help them maintain their business. According to OECD (2021), in Africa SMEs share the commonality of separating business according to the business size or

structure despite their differences in capital. Many employees are found to be working in SMEs and contribute about 50% of employment and an estimate of 40% in countries.

In Tanzania the government defines SMEs according to the sector, employment size, and capital invested. They are grouped as micro, small and medium size enterprises in non-farm activities which include manufacturing, mining, commerce and services. TCCIA (2021) asserted that the SMEs in Tanzania is taking 95% of all business and 35% of the nation's GDP. Thus in order for the SMEs to stay beneficial to the government and enjoy the support of attention for development, paying tax is among its core obligations in performing their activities.

2.3 Theoretical Literature Review

This section addresses the theories that were considered relevant to the study. Due to economic expansion, the demand of theory was immense to be thought. And tax evasion from the beginning was given a priority. Different theoretical structures were developed such as theory of taxation that based on cost, tax evasion literature for the theory of optimal tax design and analysis of tax administration with implication on recent development. These are theories that address the question of taxation and tax compliance and evasion among taxpayers. This study is guided by the theory of Allingham and Sandmo (A-S) theory.

2.3.1   The Allingham and Sandmo Theory

Allingham and Sandmo theory were developed in 1972 on income tax evasion with extended model on direction to tax administration and compliance. It states that tax rate is ambiguity effect on tax evasion. This ambiguity has been represented on

popular belief and is possibly active on tax system. It has set up the Expected Utility Maximization Model based on the assumption of rational man. They made theoretical analysis of the system of tax evasion; the study of tax evasion has become popular ever since. Generally speaking, punishment and the audit rate are the main determinants of tax evasion for most countries. According to the theory higher gross income increases evasion if people engage willingly in risk activities as they become wealth. Lower rates tend to have incentive effects on tax evasion. But it does not reduce tax evasion in reality.

The Allingham and Sandmo (1972) Theory also stipulates that tax compliance theory holds that the government deters tax evasion through sanctions and audits. When a taxpayer considers the cost of dodging taxes is too low and they are unlikely to be detected or audited, they will choose to breach the law and avoid paying their taxes. However, if a taxpayer considers the cost of compliance is excessive, they will avoid paying taxes. Tax systems and procedures that are complicated and time-consuming tend to encourage tax avoidance.

Also the theory is subjected to the model that simplify real life situation apart from uncertainty of an audit. It also assumes that fulfilling tax return is uncertainty due to lack of assurance of an audit performed by authority and bad repercussion in case of undeclared income. Although it has been criticized that it does not consider other form of uncertainty; the sanction could be penalized financially or jailed. Tax evasion is widespread among people who believe the tax rate is excessively high and punitive. The likelihood of detection, severity of punishment, and the high transactional costs connected with tax legislation all has a negative association.

Since tax compliance is linked with moral obligation, affordable tax rate and fairness in tax administration, the theory of Allingham and Sandmo is relevant to this study for it covers the different concern of evasion to the sanction engaging in the market.

2.4 Empirical Literature Review

2.4.1 Economic Factors' Influence on Tax Evasion

There are a number of reasons for some economic activities to go unrecorded in the official statistics. Among these, the most prevalent is tax evasion. When income tax is imposed at a higher rate on poor taxpayers, it is difficult for them to pay the amount charged; thus, they are forced to deviate from their moral and this then causes them to respond immorally towards the implemented tax system. Tax evasion for developing countries is apparently higher due to inefficiency in tax administration systems (Alm, et al., 1992).

In Tanzania one of the important areas where tax evasion has been reported to be a severe problem is customs duties. Tsikata, (1999) finds large discrepancies for Tanzania between revenue as simplified by the published tariff and the estimated import volumes versus actual receipts. The differences are explained by a combination of exemptions, corruption, smuggling across official entry points (ports and roads) and smuggling across unofficial entry points (unguarded borders).

In Malaysia, a study conducted by Mansor (2012). ''Estimating Factors Affecting Tax Evasion in Malaysia'' The main purpose of this study was to determine the factors affecting tax evasion and their relative contribution by using data from 1963-2010 for Malaysia. To achieve this aim, the study applied the Neural Network

method and used multilayer perception layer (MPL) with 5 factors for the input layer. MPL consists of a hidden layer with non-linear activation function in the hidden layer. Activation function in the hidden layer was the hyperbolic tangent; the number of units in the hidden layer was 19 and the soft max activation function was utilized in the output layer. After modeling, creating and training and running the neural network, we chose the best model with minimum error and came to the conclusion below. Based on the results of this study, in order to decrease tax evasion, policy makers should note that high rate of tax on income leads to high tax evasion.

Therefore, they should try to reduce the rate of tax on income, assets, and capital, corporate and others. Decreasing the restriction of law for trade, controlling inflation and decreasing the size of government are other suggestions that could lead to decreases in the size of tax evasion. Muazzam (2012), in Pakistan conducted a study on ''Reasons of Tax Avoidance and Tax Evasion'' in order to investigate the determinants of tax evasion. In the study, only strict economic determinants proposed by seminal models were taken. The study found that a considerable share of effective tax compliance cannot be explained by using these solely variables. However, the study found an ambiguous relationship between marginal tax rate or income and tax evasion. Also, it found the reasons of partial evasion such as: resentment toward illiterate persons that present only their salaries and wages as taxable income, and traders maintain inadequate records.

2.4.2 Non-Economic Factors' Influence on Tax Evasion

Rashedul (2013) in Bangladesh, conducted a study ''The Tendency Towards Tax

Evasion,'' whose main objective was to identify factors that influence tax evasion among taxpayers in Bangladesh. This research was done using survey method. A structured questionnaire was used to gather quantitative information from the selected sample which was developed using a Likert scale of one to five (1 being strongly disagree and 5 being strongly agree). Tax evasion is a serious crime that deprives a country off its available sources of revenue and as a consequence pushes its economy toward inflation. Corporate taxpayers are more involved in this crime than individual taxpayers as a result inflation rates have been in double digit. Government is trying to motivate taxpayers in paying the appropriate amount of tax but unethical taxpayers are always finding out the loopholes that exist in our current tax policy and continuing their tax evasion practice with pride.

Alm, et al., (1992) pointed out that the average of the tax inspection rate had been below 1%. According to A-S model, under such a low tax rate, most people would choose tax evasion. However, the tax compliance was not low in reality. Though facing economic stimulus of reporting lower income, some honest taxpayers were also willing to bear all the taxes. So A-S model cannot explain the tax confusion phenomenon. In fact, A-S model makes the income endogenous by adding the labor supply. Lawful measures such as increasing the punishment amount and the audit rate may reduce the effective wage rate, reducing the total labor supply.

However, if the labor supply curve bends backward, additional execution cost may actually increase labor supply and the amount of unreported income. Risk aversion may also interact with labor supply, leading to lower tax compliance. Many scholars

have taken the opportunity of A-S model to study the problems of tax evasion. In recent years, with the deepening of the research, scholars have found that conventional deterrence model based on A-S model can explain tax compliance and tax evasion.

Another study was conducted in the United Kingdom by Fuest and Riedel, (2009) ''Tax evasion, tax avoidance and tax expenditures in developing countries.'' The main objective was to review quantitative studies which try to estimate tax revenue losses due to tax avoidance and tax evasion in developing countries. Existing studies distinguish between estimates of the domestic component of tax evasion and tax avoidance and the international component.

The research employed a survey research design along with descriptive and hypothesis testing designs. Survey design entails selecting a few respondents from a population with an aim of generalizing the results to the entire population while descriptive statistics describes a phenomena and hypothesis testing uses inferential statistics to evaluate a proposition. However, many developing countries use special tax incentives like tax holidays, investment allowances, free enterprise zones or tax sparing provisions. Again, little statistical information on the level of existing investment incentives and their development over time is available.

2.4.3   Taxpayers' Perception Influences on Tax Evasion

Taxpayers' compliance has a positive linkage with their perceptions of the tax system (Schwartz, 2014). In accordance with a study by Walsh (2013) a fair tax system shows the taxpayers' willingness to pay the tax levied, how morally

responsible they view it to be, and how it affects the opposition to tax evasion. This is due to their conviction that government services are valuable enough to justify paying taxes. Because of this, there is evidence that the fairness of the tax system and taxpayer attitudes are positively correlated, as demonstrated by certain studies using correlation and regression analysis. Taxpayers tend to engage in tax evasion and are more likely to perceive that tax evasion is acceptable when they claimed that the tax system is unfair and inequitable to them.

In his study Bergen, (2006) examined factors determining tax compliance behavior in Tanzania and concluded that, tax compliance is positively related to factors such as ability to pay punishment structure and tax rates. Oppressive tax enforcement, harassment of taxpayers and discontent with public service delivery seem to increase tax resistance and may explain the widespread tax evasion. According to Amir (2010) in his study he found that tax evasion in Tanzania is influenced by high tax rates and government spending priorities.

2.5   Conceptual Framework

This study conceptualized with the two variables, dependent and independent variable whereby factors leading to tax evasion such as economic factors, non-economic factors and taxpayers' perceptions are independent variables and dependent variables are the result which is the tax evasion. The purpose of this study is therefore to assess the relationship between those two variables.

Independent Variable   **Dependent Variable**

```
┌────────────────────────┐
│ Economic Factors       │
│   - Penalty level      │
│                        │
│   -Tax rate            │
└────────────────────────┘

┌────────────────────────┐
│ Non-Economic Factors   │              ┌──────────────┐
│ - Possibility of       │              │ Intention to │
│   detection            │              │  Evade Tax   │
│ - Attitude towards tax │              └──────────────┘
└────────────────────────┘

┌────────────────────────┐
│ Taxpayers' perception  │
│   -  Tax fairness      │
│   -  Tax knowledge     │
│                        │
└────────────────────────┘
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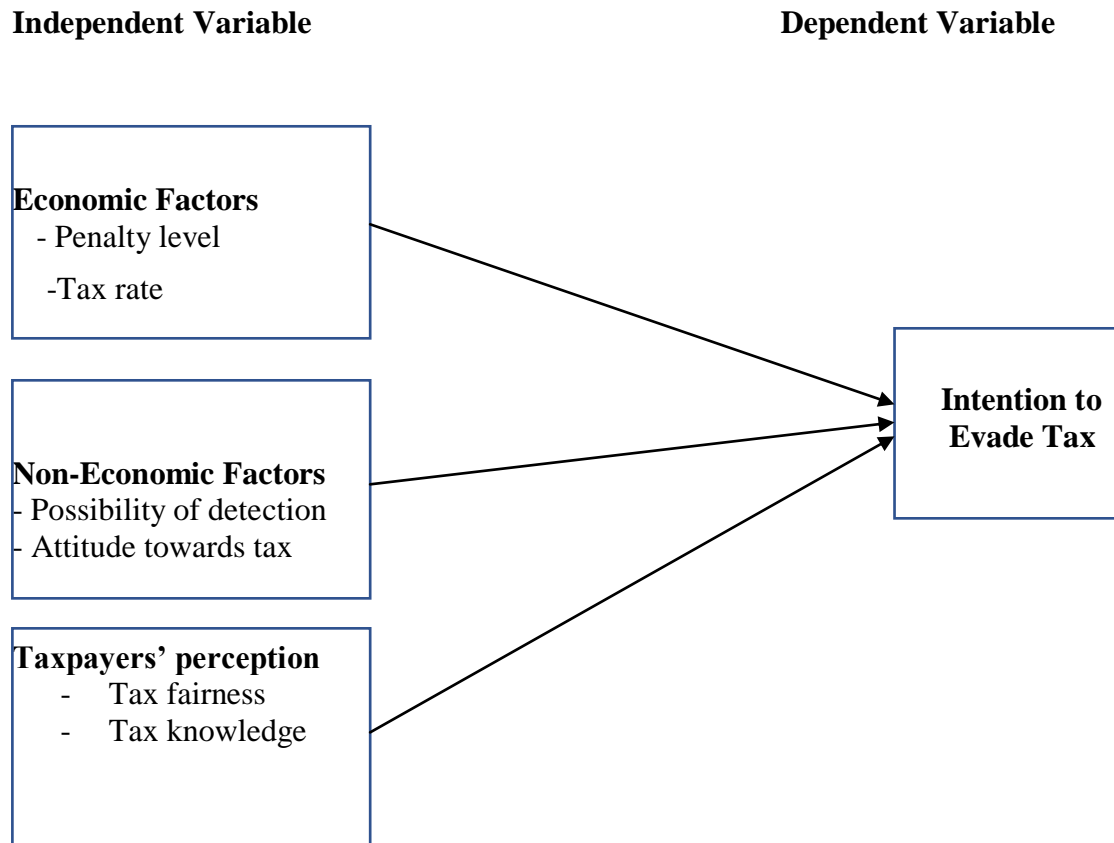
Figure 2.1: Conceptual Framework

Source: Conceptualized from Literature Review (2022).

2.6 Research Gap

Different studies which have been done in Tanzania on the subject matter at hand were conducted during 1990s, whereby the tax laws change periodically say VAT rate was 20% where the current rate is 18%. Therefore, the study is to take into account the current laws and enforcement measures. For instance, the use of EFD machines and online filing of tax returns. However, researchers Mannan (2020) and Indrayani and Suhendra (2016) argued that non-compliance is more widespread among small enterprises than among large businesses and that economic, institutional and taxpayer variables all contribute to non-compliance.

The existence of a contextual gap is due to lack of critical appraisal for SMEs as most studies focused on all taxpayers and not on SMEs particularly Maisiba & Atambo (2016) and Mutalemwa (2018). Furthermore, according to economic deterrence factors such as tax rate, the likelihood of being uncovered and the fines levied by the state influence taxpayers' compliance behavior (Ramidhuna, 2021). According to Allingham and Sandmo (1972) tax compliance theory contends that the government deters tax evasion through sanctions and audits; nevertheless, such efforts have not resulted in a viable solution to tax non-compliance in Tanzania (Kira, 2017).

Many studies had been done on tax evasion and tax avoidance but they have critically concentrated with analyzing the impacts caused by Tax Evasion and Tax Avoidance. Few studies have been done to demonstrate factors that influence taxpayers especially SMEs to evade tax in Tanzania. Therefore, the researcher in this study is trying to bridge the gap by critically assessing district-specific factors that influence taxpayers particularly SMEs to evade tax for the case of Bukombe District.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Chapter Overview

The major focus of this chapter is to introduce the research design, location of the study, sample size, research techniques (quantitative or qualitative), population of inquiry, sampling techniques, data collection instruments, type of data collected (primary and secondary data) and data analysis techniques employed in this study.

3.2 Research Philosophy

A research philosophy is a framework that guides how research should be conducted based on ideas about reality and the nature of knowledge (Collis and Hussey, 2014). The two main research philosophies are positivism and interpretivism. These philosophies represent two fundamentally different ways that we as humans make sense of the world around us. In positivism, reality is independent of us and researchers can therefore observe reality objectively. In interpretivism, reality is seen as highly subjective because it is shaped by our perceptions (Collis and Hussey, 2014).

Positivism originated in the natural sciences and focuses on scientific testing of hypothesis and finding logical or mathematical proof that derives from statistical analysis (Collis and Hussey, 2014). Positivists therefore tend to use large sample sizes and to produce precise, objective and quantitative data (Collis and Hussey, 2014). This research study is underpinned by the positivist research philosophy. This is because the study follows quantitative approach and is concerned with theory testing which is deductive in nature.

3.3 Research Design

Research design is defined as the plan of collecting and utilizing data so that desired information can be obtained (Creswell, 2006). In this study descriptive design will be used to establish the extent to which the selected factors contribute to tax evasion in Bukombe District. Descriptive research design is a hypothesis-based method that defines the primary subject matter of the research and tries to analyze it using different assumptions and techniques. The research design of this study used data collection techniques in which sample characteristics were inferred from population characteristics and the information about findings were presented based on sample studied.

3.4 Research Approach

In line with the positivism research philosophy, the research approach adopted for this study is quantitative and deductive. Quantitative approach is defined as scientific approach that evaluates precise, objective, and generalizable conclusions using statistical theories that are supported by simulated and empirical data (Kurten et al. 2022).

3.5 The Study Area

The study was conducted in Bukombe District, Geita Region. The district was selected due to the following reasons; firstly, it is among districts where no studies regarding tax evasion had been done; secondly, it is a growing town with increasing number of SMEs and thirdly, it is among areas with huge investment potential hence there is high possibility for improving government revenue. This is supported by the Tanzanian report on tax administration for the growing areas that it is immensely

important for SMEs to pay tax (URT 2019).

3.6 Target Population

Population refers to an entire group of individuals, events or objects having common observable characteristics. In other words, population is the aggregate of all that conforms to a given specification (David, 1991). The population of Bukombe district is estimated to be 407,102 as portrayed by national bureau of statistics of Tanzania (NBS, 2022). The target population of the current study in terms of number of SMEs in Bukombe District is estimated to be 2148 SMEs according to Tanzania Revenue Authority - Bukombe District. This depicts the district viability to this study and gives strength for the validation of the study for the presence of good number of SMEs.

3.7 Sampling Techniques

According to Kothari (2004) sampling is concerned with the selection of the subset of individuals from within a population to estimate characteristics of the whole population. Simple random sampling techniques were used for this study to select SMEs. Random sampling is the process that guarantees all the possible samples taken from the population have the same probability of being chosen, that is, all the elements of the population have the same probability of being chosen to belong to the sample (David, 2011). The researcher visited the data processing and registration unit, the office dealing with recording all taxpayers in the district through block management system. The lists of all registered and taxed SMEs were taken from Bukombe District trade office. Purposive method was used to select the number of respondents from the distributed list around the district randomly.

3.8 Sample Size

A sample is a smaller group obtained from the accessible population (Mugenda and Mugenda; 2003:10). A sample is a part of the population from which it was drawn (Yin, 2003). Sekaran,rash (2003) recommends the sample size to be at around 30 and 500 respondents. In multivariate research (including multiple regression analyses), the sample size should be several times (preferably 10 times or more) as large as the number of variables in the study. Since the current study has 4 variables, the minimum should be 40 SMEs. However, as the researcher wishes to increase the explanatory power and generalizability, the sample size for this study will be 100 SMEs' owners in Bukombe District.

3.9 Data Type

This study used primary data to collect information on tax evasion. Primary data is the data or information that has been generated by the researcher himself/herself, surveys, interviews, experiments, specially designed for understanding and solving the research problem at hand (Saunders, et al. 2012).

3.9.1   Sources of Data and Data Collection Instruments

Primary data were collected from SMEs in Bukombe District. Data collection was done through a structured questionnaire. According to Cresswell (1998) a questionnaire consists of a set of predetermined questions. Unlike interviews, questionnaires are used to collect opinion on a theme of interest from a large sample of respondents (Yin, 1994). A structured questionnaire with close-ended questions was self-administered to taxpayers who are SMEs in Bukombe District. The use of questionnaire to collect information in this study provides an easy way of

administration and analysis of data obtained (Mugenda and Mugenda, 2003).

3.9.2 Data Management

The quantitative data collected were cleaned and cleared before being entered in SPSS. Questionnaires were closely checked to ensure clarity and made sure all questions were attended by respondents. Quantitative data in SPSS were handled with care to make sure that they were not disturbed to the extent of giving different outputs.

3.9.3 Data Analysis and Interpretation

Data analysis, according to Marshall and Rossman (1999), is the process of giving the vast amount of gathered data organization, order, and significance. In quantitative data analysis, analysts utilize their critical and logical thinking to transform unstructured data into information that can be used to support or refute ideas. They also determine the frequency of variables and variations between variables. The primary objective of conducting a quantitative research study is to figure out the relationship between one independent variable and a dependent variable within a population by using correlation analysis, and also to interpret the meaning and value of data by using measures of central tendency and variability.

Correlation analysis, descriptive analysis and inferential analysis specifically multiple linear regression analysis to determine the relationship between one dependent variable and two or more independent variables, are analytical methods that were adopted in this study, together with the aid of Statistical Package of Social Science (SPSS) to analyze data quantitatively.

The following multiple linear regression model was used as the study's main statistical model:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \beta_7 X_7 + \beta_8 X_8 + \epsilon$$

Where:

$X_1, X_2, X_{2...} X_n$ represents (Economic factors, Non-economic factors and Taxpayer perception)

Y = Tax Evasion intention;

α = The Y intercept;

X_1 =; Penalty, X_2 = Tax r   rnudmate, X_3 = Possibility of detection, X_4 = Attitude to tax evasion, X_5 = Perception of tax knowledge, X6= Perception of fairness, X_7 = Years of operation, X_8 = Size of the business.

ϵ = error term

3.10 Validity and Reliability of Research Instrument

3.10.1 Validity of Research Instrument

Validity can be referred to as how accurate and meaningful the inferences are with respect to the research results. It refers to the degree or level in which the data analysis results truthfully represent the phenomenon that is being studied (Mugenda & Mugenda, 2008). This study relies on the instruments of measurement that were previously developed by other researchers in related research studies, as well as concepts generated from appropriate literature.

Content validity measures the degree to which instruments used adequately cover the questions that guide the research. The use of construct validity to test if individual scale items were used correctly and adequately operationalize the variables of the

study (Kane, 2013). This helps the researcher to establish both content and constructs validity for the differentiator with others to come with viable and valid results of tax evasion situation in Bukombe District.

3.10.2 Reliability of Research Instrument

Reliability is the degree of consistency that the instrument or procedure demonstrates (Best & Kahn 2006). The Cronbach's coefficient alphas (α) were used to determine the reliability of items in the questionnaire. The coefficient of 0.7 Alpha was considered appropriate in the average measure of the questionnaire items.

3.11 Research Ethical Consideration

On the significance of ethics in research situation, Smith (1985) states that the dilemma occurs when two or more values that are necessary present themselves in mutually exclusive ways, conflicting to each other. The conflict set of values may involve goals, processes or results of a research. The researcher will establish fair and clear agreement with the participants that clarify the obligations and responsibilities of each participant beforehand. The researcher respects individuals' freedom in order to allow them to participate effectively.

CHAPTER FOUR

RESULTS, FINDINGS AND DISCUSSION

4.1 Chapter Overview

In this chapter, the study findings and presentation were grounded based on the data collected from SMEs in Bukombe District, Geita Region. The study aimed to assess the factors influencing tax evasion by small and medium enterprises in Bukombe District. It based on the question of how economic and non-economic factors influence tax evasion as well as perception toward tax in the district. The data collected targeted the SMEs owners and business managers to test their compliances on tax payments. The researcher managed to interview 100 respondents that were intended. The information gathered is presented in tables, charts and figures accompanied with short description and explanation to the obtained information. The model analysis demonstrations of the data are also presented.

4.1.1   General Information for SMEs

This is information based on general demographic characteristics of the sampled SMEs in the area to determine their influence in tax around the area if any.

4.1.2   Gender Distribution

Gender of the respondents interviewed in Table 4.1 shows that out of 100 SMEs owners/managers interviewed, 34 percent were female while 66 percent were male. The presence of males and females showed considerations of gender among those that participate in economic activities in Bukombe District. Although gender seemed to be uneven in the area among the SMEs, it has great influences on tax evasion in the area. The presence of a greater number of males in business on tax reveals the

higher commitment to tax payment. Females were more vigilant in tax evasion than men as contended by Meleq & Erjus, (2022). Thus in the area the presence of the category group suspected of tax evasion is a subject of concern to the institution to pay attention in its tax collection administration in Bukombe District.

Table 4.1: Gender of Respondents

Variables	Frequency	Percent
Female	34	34
Male	66	66
Total	100	100

Source: Research survey.

4.1.3 Age Distribution

Among the sampled SMEs respondents were from the age of 18 to 55 and above years. The findings are presented in Table 4.2. The age is categorized in four groups: the 18-30 age group accounted for 19 percent, while 31-43 age group accounted for 42 percent and 44-55 age group taking 35 percent leaving the 56 and above age group accounting for 4 percent.

Table 4.2: Age Group of Respondents

Age group(years)	Frequency	Percent
18- 30	19	19
31-43	42	42
44-55	35	35
56 and above	4	4
Total	100	100

Source: Research survey

4.1.4 Education Background

Based on sampled population in Figure 4.1, majority of respondents had certificate education level (about 28%), followed by primary and secondary level (about 21%), followed by respondents with diploma level (about 19%), followed by Bachelor's

degree (about 17%), followed by vocation training (about 12%), followed by informal education at about 3% while Master's degree has zero percent. This study survey tried to sample all categories of business traders with different professions and suggested that all respondents had sufficient qualifications to provide reliable information from their working field regarding tax evasion in the area.
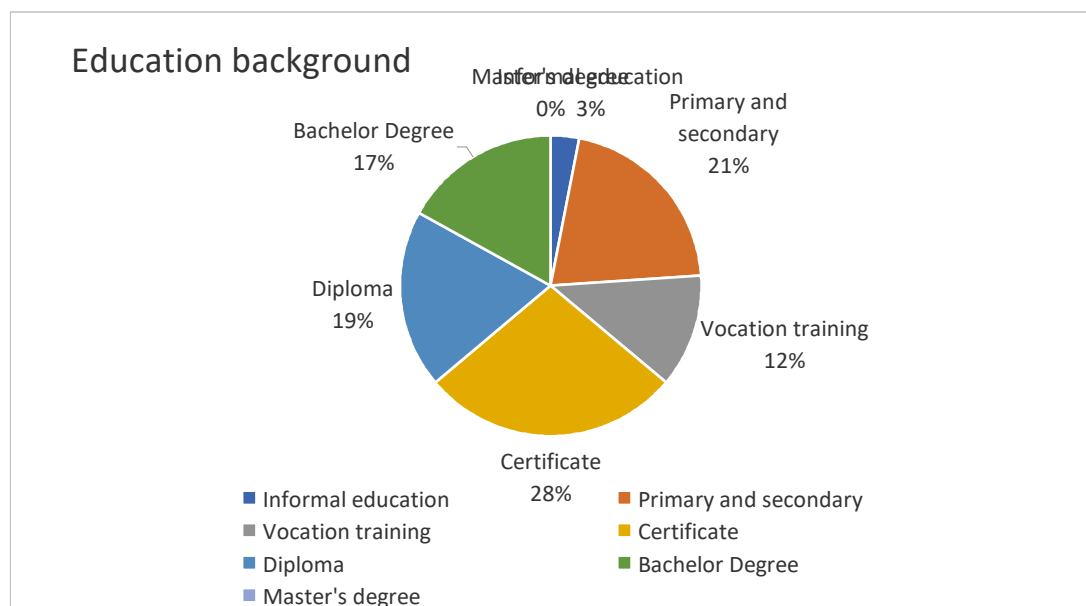
Figure 4.1: Education Background
Source: Research survey, (2022).

4.1.5 Area of Business Specialization

Among the SMEs interviewed in Bukombe District as shown in Figure 4.2, were from different areas of business specialization in which 20% was from agriculture sector, 38% from retail and wholesale traders, 18% from transportation, 20% from mining, manufacturing accounting for 3% while 1% was from tourism. In this study the involvement of businesses in different economic sectors offered the researcher an opportunity to obtain relevant information on tax evasion among the respondents in the district.
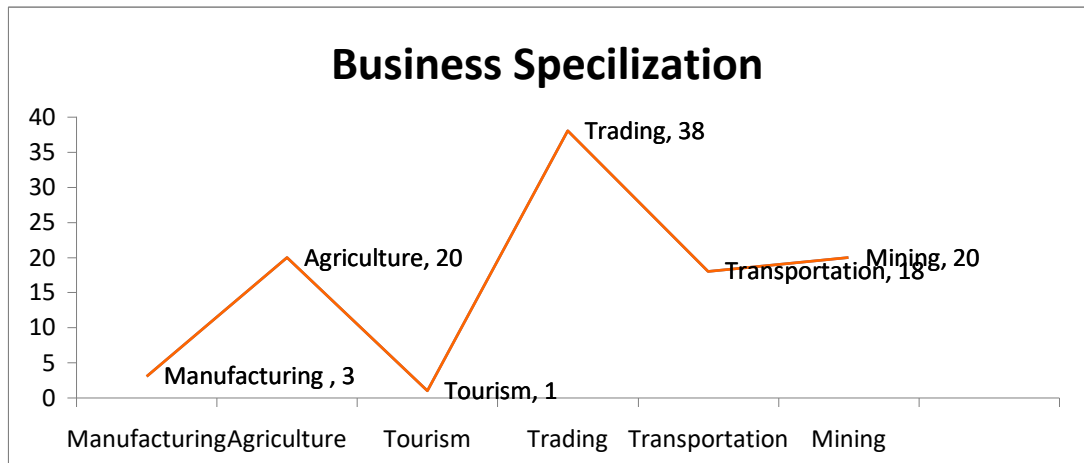
Figure 4.2: Business Specialization
Source: Researcher's survey

4.1.6   Years of Operation

Due to different seasons in different economic sectors available in certain districts, most businesses undergo certain challenges that might lead to drop-out. But for the case of Bukombe District the business performers tend to have positivism on their business operations.
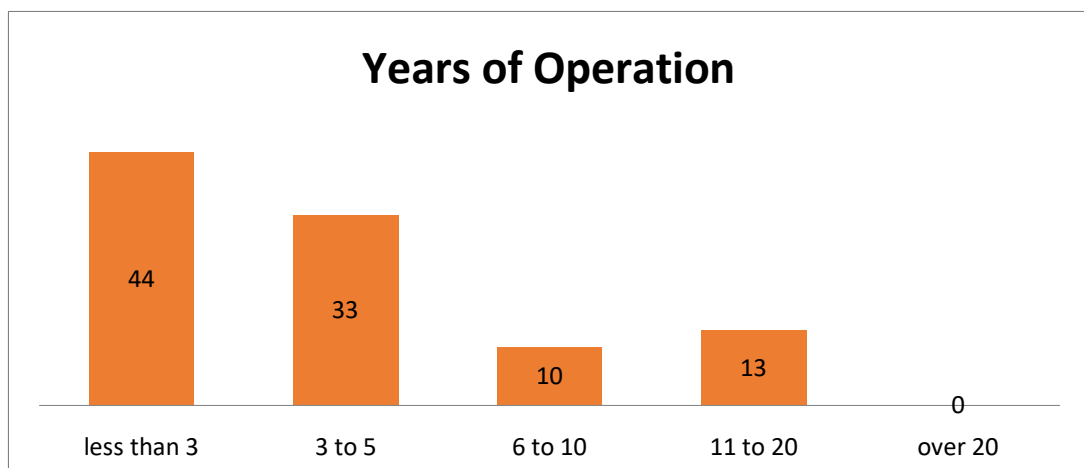
Figure 4.3: Years of Operation
Source: Research survey, (2022).

Figure 4.3 shows the years of operation in groups whereby a large number of businesses in operation (less than 3) years about 44 respondents, followed by the

category of (3 to 5) years about 33 respondents, followed by (11 to 20) years by 13 respondents, the category of (6 to 10) years for 10 respondents while (over 20) years accounting for zero in the area.

The existence of different years in business operation portrays the level of understanding of different forms of tax for performing a business. The result shows that numbers of years (less than 3) have many respondents in business showing new businesses being opened and the agencies responsible for tax issues should work harder to make sure the principles of paying tax are taken into consideration.

4.1.7 Value of Business Capital

Of the sampled respondents below in Table 4.3, 4.5 million accounted for 38%, 6 million to 200 million accounted for 56 percent taking a large number of businesses in the sample, 200 million to 800 million accounted for 4 percent and above 800 million accounted for 2%.

Table 4.3: Value of Business Capital

|	Frequency	Percent
Below 5 Million	38	38
6 to 200 Million	56	56
200 to 800 Million	4	4
Above 800 Million	2	2
Total	100	100

Source: Research survey, (2022).

4.1.8 Number of Employees

From the sampled interviewed SMEs in Bukombe District most of the business employees belong to (1- 4) group for 58 percent and 42 percent on the (5-49) of employees while (50-99) and above have zero employees.

Table 4.4: Number of Employees

No. employee group	Frequencies	Percentage
1-4	58	58
5-49	42	42
50-99	0	0
100+	0	0

Source: Research survey, (2022).

4.2 Economic Influences on Tax

4.2.1. Penalty to SMEs

From the study survey in Table 4.5 as shown below, the level of penalty was examined by imposing a question like how likely were the SMEs willing to pay the penalty if tax evasion is detected in their business?. The findings are presented in percentage basing on the given ranks presented as *1 = strongly disagree; 2 = Disagree; 3 = neither agree nor disagree; 4 = Agree; 5 = strongly agree.* The result showed that for the sampled interviewed, 55% of respondents would agree to pay small penalty if the Authority detects tax evasion, 20% respondents remained neutral to whether they agree or disagree, 15% respondents strongly agree while 10% respondents disagree and none strongly disagree.

Likewise, to the payment of substantial penalty 42% of business owners agree to pay and the same percent for the neutral ones, 6% disagree while 5% strongly agree and disagree. Also for the acceptance to be audited for the coming years 56% respondents agree, 25% respondents strongly agree and 15% disagree and 4 % had nothing to say while none of the respondents strongly disagree to be audited for the coming years. For the case of facing criminal prosecution if tax evasion is detected, the result showed that more than half of respondents, about 58% strongly disagree, 12% disagree while 26% neither agree nor disagree and 4% had the courage to face

criminal prosecution leaving none to strongly agree in facing criminal prosecution as

shown in Table 4.5.

Table 4.5: Factors for Tax Evasion

	1	2	3	4	5
ECONOMIC INFLUENCES ON TAX EVASION	**Percentage of respondents in ranks**				
I. Penalty					
Payment of small penalty if office detects tax evasion	0	10	20	55	15
Payment of substantial penalty if tax evasion is detected	5	6	42	42	5
Acceptance for being audited in more detail in coming years if tax evasion is detected	0	15	4	56	25
Courage to face criminal prosecution if tax evasion is detected	58	12	26	4	0
II. Tax rate					
Proportion between tax and income earned	32	28	26	14	0
Higher than expectation	0	2	15	30	53
Lower tax than what I would expect	56	32	12	0	0
NON-ECONOMIC FACTORS					
I. Possibility of Detection					
Agreement to be audited if taxing authorities accept a particular deduction in a case scenario	0	0	12	48	40
Agreement to be audited if taxing authorities disallow the deduction	62	23	10	05	0
Likely to be audited for 2022 tax return	0	25	32	43	0
II. Attitude towards tax evasion					
Tax evasion is good	52	30	16	2	0
Engaging in tax evasion is wise	48	10	12	8	12
Tax evasion can be useful	32	14	22	8	24
I find the concept of tax evasion attractive	54	24	4	8	10
I think I would pay less taxes if I engaged in tax evasion	38	18	32	5	7
I would be pleased if I paid less taxes because I engage in tax evasion	13	10	10	24	43
Cheating on taxes is pleasant	32	48	20	0	0

Source: Research survey, (2022).

4.2.2. Tax Rate

On the sampled population on the influence of tax evasion, the amount of tax

charged was observed basing on proportion of tax and income earned. The result in

Table 4.5 shows that 32% strongly disagreed on the proportion of income earned and

tax rate charged accompanied by 28% of respondents who disagreed. This

proportional ratio was undetermined to 26% as to whether it is proportional or not and 14% agreed on the proportionality while none of them strongly agree. The tax rate also was determined through expectation.

This tries to focus on higher expectation of tax to income ratio on the SMEs in the area and the result in Table 4.5, shows that none of them strongly disagree the presence of higher expectation on tax, 2% disagreed, 15% were neutral and 30% agreed on higher expectation of tax while 53% respondents strongly agreed for the presence of higher expectation of tax. The influences also were observed on low tax ratio than a business could expect. The results revealed 56% strongly disagreed and 32% disagreed on low tax ratio than expected, 12% respondents were unidentified to any rank while zero respondents agreed and strongly disagreed to be charged lower than expected.

4.2.3. Possibility of Detection

In identifying the influence of non-economic factors for tax evasion the extent of agreement to be audited if taxing authorities accept a particular deduction in a case scenario were determined. The results indicated in Table 4.5 shows that, zero percent of the respondents strongly agree and disagreed to be audited, 10% had nothing to say on either and 48% agreed and supported by 40% who strongly agreed to be audited if taxing authority accepts a particular deduction. For the case of agreeing to be audited if taxing authorities disallow the deduction the result showed that 67% strongly disagrees while 23% disagreed and 10% for neither agreed nor disagree. Likely to be audited for 2022 tax returns lay between disagreeing and agreeing whereby 25% disagreed, 32% neither agreed nor disagreed while 43% agreed to the

possibility upon detection.

4.2.4. Attitude Towards Tax

For the sample surveyed on attitude towards tax, different responses were obtained as shown in Table 4.5. The results show that most of the respondents strongly disagree that tax evasion is not good by 52% while only 2% agreed that it is good. Also 48% strongly disagreed that tax evasion is wise and 12% had different attitude finding it wise by strongly agreeing. On if tax evasion can be useful, the percentage is distributed among the respondents whereby 32% strongly disagreed, 14% disagreed, 22% neither agreed nor disagreed while 8% find it useful and 24% strongly agreed that tax evasion can be useful.

The rate of finding the usefulness of tax evasion could make a loophole for attempting evasion which gives the Authority to strengthen territories over tax collection. Although 54% strongly disagree on the concept of tax evasion to be attractive, 43% respondents strongly agreed to engage themselves in tax evasion by paying less amount of tax charged. However most respondents disagreed on cheating to pay tax and find it unpleasant among the SMEs in Bukombe District as depicted in Table 5.5.

4.2.5. Perception of Fairness

Among the queries depicted by this study is to determine the perception of fairness for the SMEs as the influencing factor for tax evasion in Bukombe District. It assessed if the tax burden among taxpayers is fairly distributed or if the government policies on tax were to the interest of the citizen and their average is fair to the

economy, also if taxes are so heavy to the extent that tax evasion is an economic necessity for many companies to survive as well as cheating on taxes to be justifiable in light of the unfairness of the tax system. The assessments were observed in ranks per each category and averaged presented in the figure as observed. The results showed that the respondents strongly disagreed by 38% on the fairness of the tax burden that it is not fairly distributed and the policies were not on citizens' favor and it's not easy to cheat for economic necessity or any either. While some disagreed by 28%, some respondents were neutral on the fairness at 8%, 18% agreed while 8% strongly agreed on the interviewed subject.
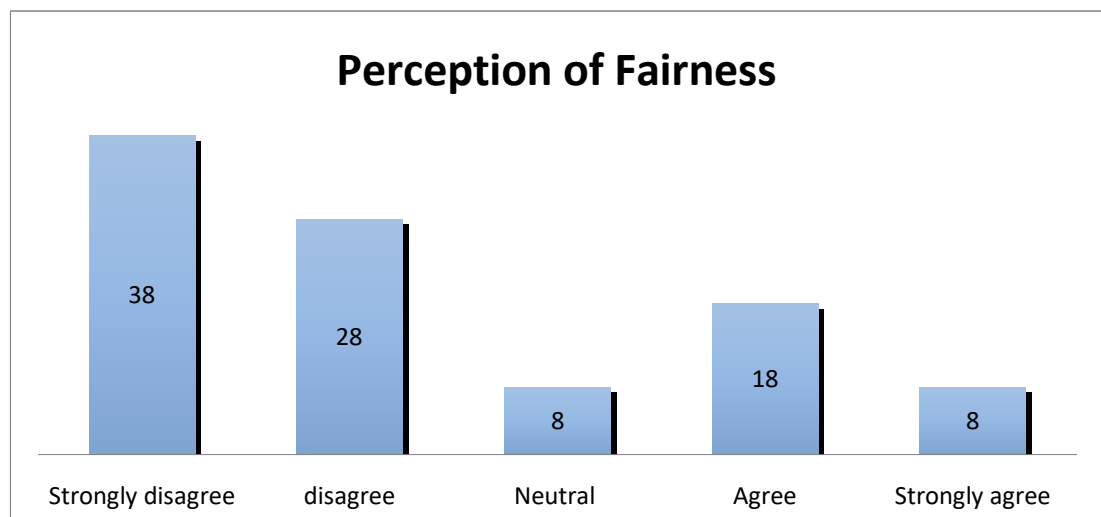
Figure 4.4: Perception of Fairness
Source: Research survey, (2022).

4.2.6. Perception of Fairness in Knowledge

From the study results perception on knowledge was among the influencing factors in Bukombe District observed as well. 2% strongly disagreed on Tanzanian tax system and tax laws to be too complex to be understood by taxpayers. Also disagreed that the business use tax laws and tax consultants in a creative way to reduce tax liability, also disagreed on tax avoidance does not violate the rules but

goes against the spirit of the laws as well as the use of tax avoidance depends on the taxpayer's knowledge and information. 2% respondents strongly disagree, 12% disagreed, 16% were neutral, 18% agreed while 52% strongly agreed as shown in Figure 4.5.
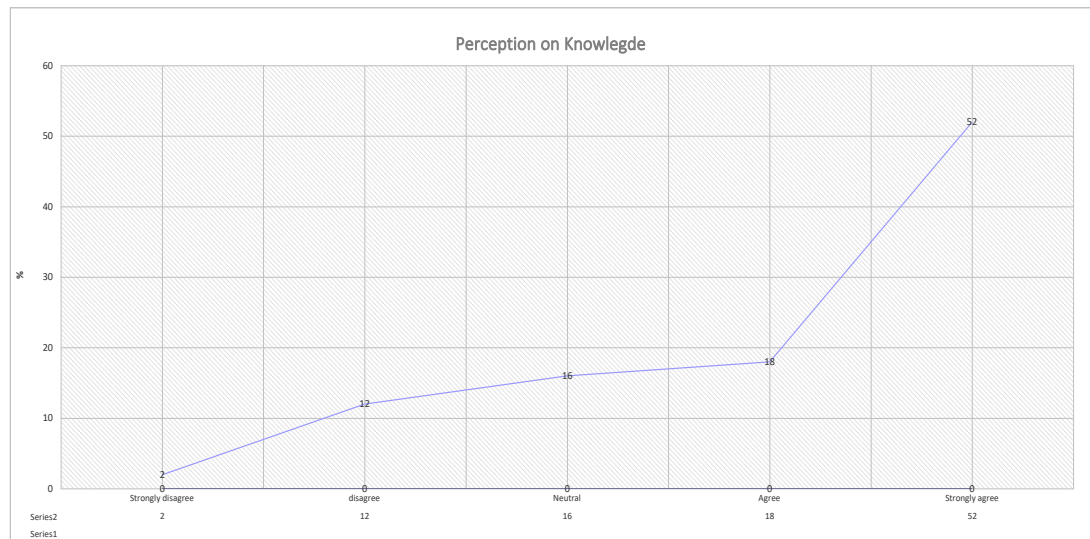
Figure 4.5: Perception on Tax Knowledge
Source: Research survey, (2022).

4.3. Regression Analysis on Tax Evasion

In order to assess the factors influencing tax evasion, the regression analysis was conducted among the SMEs representatives in Bukombe District. From the regression analysis the significant factors influencing tax evasion are tax rate and size of business. Other factors such as penalty, possibility of detection, perception of fairness, attitude towards tax, perception of tax knowledge and years of operation were observed to have no any significant influence on tax evasion. This implies that tax rate and size of business in the area were the main factors influencing tax evasion in the area.

Other factors analysed seem to be inversely related to the dependent variable. This implies that regression model results are significantly better prediction of available

factors influencing tax evasion in Bukombe District. The coefficient summary presented in Table 4.8 showing the dependent and independent variable indicator with P-values ranging on 0.05% that leads to conclusion that the model is statistically significant defined by:-

$Y = 1.223 + 0.067X_1 + 0.146X_2 + 0.44X_3 - 0.081X_4 + 0.096X_5 - 0.130X_6 - 0.102X_{7+} 0.084 X_8$

In Table 4.6, Analysis of Variance (ANOVA) is an initial step in analyzing factors that affect the dataset. It was presented in the study showing how different available factors influence tax evasion to SMEs by examining the degree of variations among factors. Gujarat (2004) in his study contended that if F-ratio is equal or close to 1 it portrays inexistence of variance between factors. This shows the validity of the data in this study since F ratio is greater than 1 meaning there is an existence of true variance in motivational factors in the study, as shown in Table 4.6.

Table 4.6: ANOVA[a]

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	10.251	7	1.464	2.641	.013[b]
Residual	94.272	170	.555		
Total	104.522	177			

a. Dependent Variable: Tax evasion
b. Predictors: (Constant), *tax rate, penalty, possibility of detection, attitude towards tax, perception of fairness, perception of tax knowledge, years of operation, size of the business*

The model summary expressed in Table 4.7 from the regression analysis revealed positive and negative correlation between available factors influencing tax and tax evasion which shows adjusted R square equals to 61 percent and the model is significant (p = 013) meaning the model is well explained by the variables.

Table 4.7: Model Summary

Model	R	R Square	Adjusted R square	Std. Error of the Estimate	R Square change	F Change	Sig. F Change
1	.313[a]	.098	.061	.745	.098	2.641	.013

Predictors: (Constant), *tax rate, penalty, possibility of detection, attitude towards tax, perception of fairness, perception of tax knowledge, years of operation, size of business.*

Table 4.8: Coefficients (a)

Variables		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
	(Constant)	1.223	.225		5.443	.000
X1	Tax rate	.067	.075	.072	.902	.037
X2	Penalty	.146	.077	.153	1.891	.060
X3	Possibility of detection	.044	.071	.054	.626	.532
X4	Attitude towards tax	-.081	.086	-.085	-.943	.347
X5	Perception of fairness	.096	.081	.105	1.182	.239
X6	Perception of tax knowledge	-.130	.074	.148	-1.746	.081
X7	Years of operation	-.102	.088	-.107	-1.161	.247
X8	Size of the business	.084	.076	.067	.887	.020

a. *Dependent Variable: tax evasion*

b. *Predicator: tax rate, penalty, possibility of detection, attitude towards tax, perception of fairness, perception of tax knowledge, years of operation and size of the business.*

From the regression results available factors influence tax evasion by 61 percent while 39 percent can be attributed to factors other than economic, non-economic and perception. Table 4.8 shows that only tax rate and size of the business are the significant variables that have effect on tax evasion in the area. Although other variables are not significant they are said to be available in the area but they do not have statistically significant influence on tax evasion.

Tax rate in this study results was revealed to influence tax evasion because it is considered to have higher effects on income since higher tax rate lowers income and makes evasion to be preferable by the SMEs. This may increase loopholes risk to evasion, some businesses could withdraw their income, and they could change the

form of their business by splitting into vendors as a way of evasion. In this case tax rate poses higher risk to tax evasion to the SMEs. This was similarly presented by Omary and Pastor, (2022) demonstrating that higher tax rate influences compliance and since it is considered to lower income that makes evasion profitable among the SMEs in Bukombe District.

Also the size of the business significantly affected the evasion rate in the area since the higher the size of the business in Tanzania the more the tax-free favours depending on the amount of capital invested in the business. The higher the size of a business the higher the tax evasion and vice versa. This means that the higher the capital invested in a business the more adjustments and favor a business seeks from the authorities to evade tax through the principle of paying less in government conditions. The larger the size of the firm the less room for being detected whether it evades or not due to the different activities conducted and identifying products the business deals with. This is supported by Mutalemwa, (2018) who established that larger burden of the firm's operations affect more small size of the firm though might lead to loss if detected by authorities. Similarly, Maleq & Erjus (2022) also established that tax rate; size of firm and gender had an impact on tax evasion. The higher income earners enjoy the benefit of tax since their burdens are not felt as high as low income earners.

Muazzam, (2012) evaluated the reason of tax avoidance and tax evasion considering only economic factors and the results show that tax evasion can't be predicted by solely variables by identifying the ambiguities of the marginal tax rate and evasion. This gives this study inclusion of economic, non-economic and perception on tax to

provide a room of evasion rate in the area. Although the result shows that tax rate and size of the business influences tax evasion significantly, it recognizes the availability of other factors as shown in the regression analysis. The inverse relation on the independent variable to the dependent variable in our model results means a lot to the evasion tendencies in the district.

Penalties are among the variables found in the study area but with insignificant effect to tax evasion from the result basing on P-value. But from the model it seems to have negative effect on the dependent variable that is an increase of penalty rate by 14.6 percent leads to a unit decrease on tax evasion rate. This implies that as penalty increases among SMEs in Bukombe District it may lead to a unit decrease of tax evasion habits. This is supported by Allingman and Sandmo (1972), who contended that increasing the penalty rate promotes the compliance behavior.

Also the study found that the business with many years of operation is subjected to fewer tendencies in tax evasion. The result model shows as the years of operation decrease by 10.2 percent, it leads to an increase in tax evasion in the area. This implies that new businesses and the businesses with few years in operation have higher tendencies to tax evasion compared to the businesses that have been in operation for many years. The more the business operates the more the operation procedures are understood and the cost of tax evasion which leads to lower acts of tax evasion. This was supported by Simser (2008) in his study of tax evasion and avoidance which concluded that age and years of operation have influence on tax evasion. A taxpayer who has been in business for a long time engages less in tax evasion tendencies.

For the case of tax fairness the findings show that the more authority became fair to the SMEs in collecting tax the more evasion decreases while perception on knowledge toward tax evasion shows that, as it increases it leads to a decrease in tax evasion. This implies that the more SMEs understand the importance of tax the lower they tend to evade. This is similar to Oladipo *et al.* (2022) on the study of impact of tax fairness and tax knowledge on tax compliance behavior in Nigeria. In his study he found higher education rate on tax lowers the rate of evasion and the more fairness leads to increase in evasion.

4.4 Discussion

This study is appropriate to assess the factors influencing tax evasion by small and medium enterprises in Bukombe District. From the study analysis; tax evasion is a complex phenomenon, it is difficult to be determined directly and can be influenced by several factors. According to Erjus, (2022) influencing factors for tax evasion complexity, some factors like fines, administration factors, corruption and unfair competition can be avoided while some factors can't be avoided to reduce the level of evasion. This study observed the influencing factors for tax evasion in Bukombe District based on economic factors which included penalty and tax rate, non-economic factors based on possibility to detection and attitude toward tax as well as perception rate based on perception on tax fairness and perception on tax knowledge.

4.4.1 Economic Factors Influencing Tax Evasion

Penalty is among the categorized economic factors influencing tax evasion determined in Bukombe District. From the study findings only 55% respondents agreed to pay small penalty in case tax evasion is detected while 10% respondents

disagreed, leaving 20% undetermined. Also for the case of substantial penalty SMEs 42% respondents were undetermined while 42% agreed leaving 11% disagreeing to pay the penalty. This paved a room to be questioned as to whether they could be audited in their businesses and 58% respondents agreed to be audited.

Also the study continued to see their level of facing criminal prosecution if evasion was detected in their businesses but 58% respondents disagreed to face the criminal prosecution. Through paying penalty most of the SMEs lowered the tax evasion tendencies since they were not ready to pay substantial penalties and audited for the fear of facing criminal prosecution if tax evasion is detected. This is similar to the study by Manamba, (2015) on the tax evasion and tax rate that the higher the penalty the lower the tendencies of tax evasion to most of the firms.

Tax rate was among the economic factors influencing tax evasion based on proportionality between the taxes imposed to a business and income of business taxpayers. 32% respondents strongly disagreed and 28% disagreed on the proportionality, meaning that the tax rate imposed to a taxpayer is not proportional. This creates a sense of unfairness for the SMEs to the taxing authority and creates a room for tax evasion. This was supported by Yunus, (2017) on proportionality of the imposed tax in taxing system in the nation to small businesses that it fuels the poor collection of taxes and leads to slowing down development.

Also the tax rate was determined through expectation and majority (about 53%) agreed on higher expectation of tax rate compared to their business income. The higher expectation on tax rate hinders new entry in business which might influence

scarcity of goods and services offered by the SMEs and raise commodity prices in the area. This is argued by Galinoma, (2019) on new tax revenue in Tanzania; the higher the tax rate the more open doors to tax evasion by the business. Also the tax rate was observed on the existence of low tax ratio in the area than businesses expect. 82% respondents disagreed on the existence of low tax ratio as an influence of tax evasion. This assertion reveals that tax evasion in the area is triggered by the higher expectation of tax charges unproportioned between the higher tax imposed and the business income.

4.4.2 Non-Economic Factors Influencing Tax Evasion

Possibility of detection for tax evasion can be detected from different perspectives; in the area it was assessed through various questions. Pham, (2020) argued that the increase in fines strongly helps to detect the possible gap to evade than being audited. This goes contrary with our study result which observed the possibility of tax evasion detection through deduction of a particular amount and their willingness to be audited. 48% respondents agreed and 40% respondents strongly agreed to be audited if there is deduction in case of any tax evasion scenario while 62% respondents strongly disagreed to be audited if deductions are disallowed and most of them remain undetermined if their business could be audited for the 2022 tax returns. The result implies that low possibility of detection influences and initiates tax evasion gap and the state of unwillingness to be audited in case of disallowing deduction shows that there are tendencies of tax evasion in the area.

Attitude on tax evasion as a non-economic influencing factor contributes much in identifying the tax evasion behavior among the SMEs. This assertion is similar to

Karanja (2019) for his argument that individual attitude towards tax may predict tax evasion behavior. From the result findings majority did not find tax evasion to be a good thing, 54% respondents disagreed on it to be attractive in the area and disagreed to the statement that evasion is a wise thing. The sense of paying less when evading tax was supported by SMEs but they disagreed cheating on tax and found it to be unpleasant among their businesses. This reveals that the attitude of evasion for SMEs in Bukombe District does not support evasion.

4.4.3 Taxpayers' Perception

Fairness in tax was observed on the amount of tax charged per income of business generation. It considered the burden felt if bearable or not to the SMEs. The findings reveal that 38% disagreed on the fairness of the amount charged to the taxpayer since the burden of tax is not fairly distributed among taxpayers and the government. While it is difficult to evade tax in the light of fairness as well as economic necessity, 26% respondents agreed that it happens sometimes to evade on the essence of economic necessity if tax burden is unfair. The state of unfairness in tax burden has been projected by many taxpayers not only in Bukombe District but in Tanzania at large as well described in Tanzania revenue collection reports (URT, 2020). Thus the higher burden to the taxpayers among SMEs in Bukombe District despite cheating to be indirectly justified in the light of fairness, some tend to evade due to economic necessities.

Perception of fairness in knowledge has been differently determined through education and awareness rate in different cases in Tanzania. Taxation system in Tanzania is predominated with higher level of illiteracy to the laws and obligation to

the amount of tax imposed to the businesses and is mostly in many areas in the country (Gotora and Mokaya, 2018). The closure of the businesses due to attempting tax evasion is due to lack of knowledge on tax and the market situation. This is similar to our study findings in the area which assessed perception on knowledge basing on some questions understanding tax system and laws. Majority of respondents agreed that Tanzania tax system and tax laws are too complex to be understood. Also agreed that tax avoidance depends on taxpayers' knowledge. Although the results show that there is good education level in most of SMEs, it goes against their perception on taxation knowledge. More efforts should be geared by the taxing authority in enforcing understanding of tax laws among the SMEs in the area.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

This study was carried out to assess the factors influencing tax evasion by small and medium enterprises in Bukombe District with the aim of steering government authorities in performing their responsibilities toward tax administration. The study reviewed the available factors that are economic factors based on tax rate and penalty, also on non-economic factors based on possibility of detection and attitude toward tax. Also it considered the taxpayer's perception and knowledge on tax.

Descriptive survey was used for this study and 100 SMEs from different shades of available economic activities that were subjected to paying tax were randomly sampled to respond for the study. Questionnaire as an instrument for data collection was self-administered to the respondents for better results. SPSS Version 20 was used in data analysis and the computed results were represented in graphs, tables and charts. Interviews were also applied in some cases to collect information.

The descriptive statistics results established that size of the business capital lies between 6 -200 million among the SMEs by 56% and the years of business operation to most SMEs lies between 0-3 years. The study found that among the represented sample males accounted for higher percent than females by 66% and most of the respondents aged 31-43 years accounted for 42%; the highest level of education was graduates, certificates and diploma which reveal that the SMEs are subjected to maturity on business efficiency in understanding the issues of tax in running business operations.

The number of employees lies at 1-4, about 62%. Correlation results established a strong significant variable that affects the tax evasion in the area which is tax rate and size of the business and also recognized the presence of other factors that were not significant such as penalty on tax, years of operation, perception on tax knowledge, fairness with tax evasion and attitude towards tax as well in Bukombe District. The regression model results established that the independent variables explained 61% of variation in dependent variable. The findings found that regression model was significant since the P-value (0.00 < 0.05) at 95% confidence level.

5.2 Conclusion

The study found that tax rate is significantly affecting tax evasion. The higher the proportion between tax imposed and income of a taxpayer to the businesses the lower the tendencies to evade tax; also higher tax expectation increases tax evasion rate. This means the higher tax rate basing on high expectation and unproportioned tax ratio influences tax evasion in the area. Based on these findings the study concludes that tax rate plays a key role in determining the tax evasion rate among SMEs in Bukombe District.

The study also revealed that the size of a business affects tax evasion in the area and it is significant. This is due to the amount of capital invested in a business; the higher the size of a business the more likely to be subjected to the evasion since it employs a good number of people and the government authority is likely to reduce the amount of tax to some of its operations in ensuring its performance. The low size business tends to evade tax due to the experience of tax burden and is likely to be subjected to the evasion and others due to its small size that hides its true

income.

Penalty was among the analyzed variables among the SMEs in Bukombe District. From the percentage rank that was observed, it was seen to be un-preferable by the SMEs, although due to their presence it made them to avoid evasion and act according to the tax laws. Thus as higher penalties are imposed to the businesses the lower the evasion rate is experienced among SMEs. This designates that the authority should impose more penalties in the area to decrease the evasion tendencies.

Also the findings of the study established that possibility of detection influences tax evasion among the SMEs. This indicates that particular deductions for the identified case scenario ensures the businesses to be audited and if deductions are disallowed the audit disagreed. The study concludes that the agreement to be audited due to deductions indicates directly the presence of tax evasion in the area and the higher possibility to detection lowers tax evasion. The government authority should ensure it offers frequent auditing and detect the tax evasion tendencies to ensure possible means to eliminate evasion in the cases.

Also the study found that attitude is affiliated with so many issues as the good prediction of the SMEs behavior to tax evasion. In this study majority disagreed to see tax evasion as a good thing, wise and pleasant. Thus it concludes that the attitude of SMEs in Bukombe District does not influence tax evasion. Also the study findings reveal that perception of fairness on tax influences tax evasion in the area. This is due to the higher burden of tax imposed and higher expectation of tax rate supposed to be paid among the SMEs. In the description it shows that

there is unfairness on the amount imposed by the authority to the SMEs in tax charged and this creates the habits of the taxpayers to hide their real income on the face of higher expectation to pay large amounts of tax. The study concludes that the authority should impose the tax fairly and make sure the SMEs understand clearly the taxing mode to avoid the contradiction of unfixity that leads to tax evasion in Bukombe District.

Also the findings of the study revealed that years of operation and knowledge on tax systems and laws lower tax evasion in the area. The more the businesses have been operated the higher they avoid tax evasion and the more individuals became knowledgeable on tax laws and system the higher they avoid tax evasion habits. From the study, results show that many businesses in Bukombe District have not been operating for many years, meaning they are the new entries in the business and few have been in operation for many years. Thus the authority should increase inspection of the new businesses and should enforce tax authority to play their role in provision of knowledge and impose appropriate measures to fight tax evasion.

5.3 Recommendations

By assessing the influencing factors for tax evasion available in the study area, based on the conclusion from the study findings and other literature, the researcher recommends the following to enforce taxation authority to set proper strategies to reduce tax evasion among SMEs. The taxing authority should ensure the knowledge on importance of paying tax and understanding tax laws as well as tax system imparted to the SMEs is clearly known. This will help the tax officers to collect tax

according to underlying tax laws and regulations and SMEs will be fostered to pay tax. The government through taxing authority should ensure proportionality between the tax burden and the operating businesses in the area. This is due to the underlying tax laws being unproportioned to the nature of business. Sometimes SMEs engage in the tax evasion issue due to burden of tax which will be taxed if all business activities and the business incomes will be open to tax authority.

Also it should avoid the higher tax expectation by businesses to give a room for the new businesses not to hide their income on the light of higher tax rate. Some businesses have high turnovers with less income in relation to those turnovers. Expecting much tax basing on business turnovers to some businesses will ultimately lead SMEs to involve in tax evasion issues. Some deductions should not be disallowed on a certain time interval to identify the tax evasion scenario in the area through auditing and enhance the knowledge when detected.

5.4 Suggestion for Further Studies

Since the study assessed the influencing factors for tax evasion by small and medium enterprises in Bukombe District and the analysis revealed that the factors identified are influencing by 61% giving a room to other factors like social factors, cultural and political factors as well to be researched. Also the study based on tax evasion; more study could be done on the extent of evasion in the area, and the rate of compliance among the SMEs as well.

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APPENDICES

Appendix I: Research Schedule and Estimated Research Budget

A. Research Schedule

S.N	Research Activities	Duration
1	Background to the study	1 week
2	Research problem	1 week
3	Research objectives	1 week
4	Research questions	1 week
5	Literature review	3 weeks
6	Research methodology	1 week
7	Data collection	1 week
8	Data analysis and Interpretation	3 weeks
9	Findings, conclusion and recommendations	2 weeks
10	Reviewing work for final submission	1 week
11	References	1 week
	Time Line	**16 weeks**

B: Estimated Research Budget

S.N	Particulars	Amount(TSHS)
1	Stationery services and materials	200,000.00
2	Questionnaires and Data Collection	1,000,000.00
3	Data Analysis software and utilities	500,000.00
4	Binding and preparation of Dissertation Report	500,000.00
5	Publication costs	500,000.00
6	Contingency/Miscellaneous	200,000.00
	GRAND TOTAL	**2,900,000.00**

APPENDIX III: Survey Questionnaire

Dear Respondent,

This survey is about the assessment of the factors influencing tax evasion behaviour by SMEs in Bukombe District. The survey will take approximately 6 - 10 minutes of your time to complete. Any information obtained in connection with this study will remain confidential and used for academic purposes only. No one will be identified in any written reports and only group data will be presented. You are free to withdraw your participation at any time. If you have any questions about the questionnaire or the research in general, please feel free to contact the researcher through the following contact:

Peragius Cosmas, The Open University of Tanzania, Email: pcosmas06@gmail.com

P.O.Box Box 110, Dar Es Salaam, Mob: 0753 800353

GENERAL INFORMATION

1. Indicate the sub-sector to which your business belongs (Please tick one)

   Manufacturing ☐   Agriculture ☐   Tourism ☐   Trading ☐

   Transportation ☐   Mining Fishing ☐   Others (Specify) …… ☐

2. How many full-time staff does your business currently employ? (Please tick one)

   1 – 4 ☐   5 – 49 ☐   50 - 99 ☐   100+ ☐

3. What is the value of your business's capital investment (in Tshs)? (Please tick one)

   Below 5 Million ☐   above 5 to 200 Million ☐

   Above 200 to 800 Million ☐   above 800 Million ☐

4. For how many years has your business been in operation? (please tick one)

Less than 3 ☐   3 – 5 ☐   6 – 10 ☐   11 -20 ☐   Over 20 ☐

Please indicate the extent to which you agree or disagree with the following statements by applying a tick (√) using the following guidelines: *1 = strongly disagree; 2 = Disagree; 3 = neither agree nor disagree; 4 = agree; 5 = strongly agree*

S/N	STATEMENT	RESPONSE				
		1	2	3	4	5
A	ECONOMIC INFLUENCES ON TAX EVASION					
	1. Penalty					
A1	If the tax office detects tax evasion, I will pay relatively small penalty					
A2	If the tax office detects tax evasion, I will pay relatively substantial penalty					
A3	If the tax office detects tax evasion I will be audited in more detail in coming years					
A4	If the tax office detects tax evasion, I will face criminal prosecution					
	II. Tax rate					
A5	The amount of tax that I pay is proportional to the income that I earn					
A6	The amount if tax that I pay is higher than what I would expect					
	The amount of tax that I pay is lower than what I would expect					
B	NON-ECONOMIC FACTORS					
	I. Possibility of Detection					
B1	To what extent do you agree that get audited if taxing authorities accept a particular deduction in a case scenario?					
B2	To what extent do you agree that If you are audited, the taxing authorities will disallow the deduction?					
B3	Your 2022 tax return will likely be audited					
	II. Attitude towards tax evasion					
B4	Tax evasion is good					
B5	Engaging in tax evasion is wise					
B6	Tax evasion can be useful					
B7	I find the concept of tax evasion attractive					
B8	I think I would pay less taxes if I engaged in tax evasion					
B8	I would be pleased if I paid less taxes because I engage in tax evasion					
B10	Cheating on taxes is pleasant					
C	TAXPAYER'S PERCEPTION					
	I. Perception of Fairness					
C1	Tax burden among taxpayers is fairly distributed					
C2	Government implements tax policies fairly to the interests of all citizens in the country					
C3	The tax system and tax rate for the average taxpayer are fair in relation to the economy					

C4	Taxes are so heavy that tax evasion is an economic necessity for many companies to survive					
C5	Cheating on taxes is justifiable in light of the unfairness of the tax system					
C6	Taxpayer's perception of fairness has an impact on the willingness to pay taxes					
	II. Perception of tax knowledge					
C4	Tanzanian tax system and tax laws are too complex to understand by taxpayers					
C5	The complexity of tax laws contributes to the "tax gap" that is what tax is owed and what is paid.					
C6	Our business used tax laws and tax consultants in a creative way to reduce tax liability					
C7	Tax avoidance does not violate the rules but goes against the spirit of the laws					
	The use of tax avoidance depends on the taxpayer's knowledge and information					
D	**INTENTION TOWARDS TAX EVASION**					
D1	If I had the opportunity, I would cheat on taxes					
D2	I would never cheat on taxes					
D3	I may cheat on taxes in the future					

Sources: Pham et al. (2020) & Oladipo, et al., (2022).

Thank You Very Much for Your Kind Co-Operation

**THE OPEN UNIVERSITY OF TANZANIADIRECTORATE OF
POSTGRADUATE STUDIES
REQUISITION FORM FOR RESEARCH CLEARANCE LETTER**

Date: 06 December 2022

1. Name of Student PERAGIUS COSMAS

2. Gender: MALE

3. Registration No. PG202001804   Year of Entry: 2020

4. Faculty: Business Management

5. Programme: MBA - FINANCE

6. Research Title: Assessment of Factors leading to Tax Evasion by Small and Medium Enterprises in Bukombe District of Tanzania

7. Tentative dates for data collection: From 12th December 2022 to 20th December 2022

8. Student Email: pcosmas06@gmail.com

9. Student Phone Number: 0753 800353

10. Research Locations / Site: Bukombe District, Geita Region

SIN	Region	District Council Municipality	Name of Organization	Contact Person and Postal Address	Place
1	Geita	Bukombe District	Tanzania Revenue Authority	Andrew Mgeta, Tanzania Revenue Authority, P.O.Box 263, Geita	Geita
2					
3					

11. Date of submission 6th December 2022 **Signature** ....

12. Comments by Supervisor

 The proposal is ready for data collection.

Name of Supervisor **Dr.** *France Shayo* Signature   Date *08/12/2022*