BUSINESS ENVIRONMENT AND ATTITUDES TOWARDS TAX IN TANZANIA: Implication on Firm Compliance Behaviour

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Abstract

Compliance with tax in micro-enterprises is commonly described as a chronic problem in many emerging economies. Not much has been done to explore the problems of compliance in this sector. This paper sest out to attempt an empirical investigation of micro-firms; behaviour in tax compliance. A simple model of tax compliance is set out to guide the arguments and discussions in this paper.

Survey data from Tanzania are used in the analysis from which three major conclusions are derived. Firstly, micro business firms find it difficult to settle their tax liabilities in annual lump sum payments because retention of profits is too low or absent. Secondly, micro firms appear to be surrounded by future business uncertainties that propel them to adopt short-term rather than long-term business strategies.

Introduction

This paper aims at carrying out an empirical investigation into tax compliance at firm level in Tanzania. We set out a simple model of firms' compliance behaviour in Tanzania and explain tax evasion, tax complaints and confrontations with tax authorities[1]. To accomplish the objective, the discussion is organised in six sections. The introductory section is immediately followed by three sections, which build up theoretical arguments, methodology and data for carrying out the empirical analysis in Section 5. Section 6 is a conclusion and summary of the emerging policy issues.

Motivation

The local government system in Tanzania is charged with the role of providing services to its population. In doing so, local authorities receive subventions from the central government to meet their implied financial commitments. Over time, the central government has been decentralising its tax system in favour of local authorities. For example, licensing in the business sector and the resulting revenue is entirely left with the local government system as a source of own revenue (URT, Finance Bill, 1999).

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Mobilisation of own resources for meeting council financial requirements is one of the major challenges in the local government system in Tanzania. The system has remained over 70% dependent on the central government. The dependency is partly explained by a lack of effective and efficient tax management in the local government system. Over the years main sources of own revenue had been development, levy and crop cess in rural councils and business-related levies in urban councils. Recent tax reforms have however abolished development levy and a number of other taxes, which were described as a nuisance. With the onset of economic reforms, and the particular emphasis on the development of the private sector and enterprise skills, there is the potential for tax revenue for the local government system. The main source of firm tax revenue in local authorities in Tanzania is licence fees (particularly on micro firms as they take the larger of share the market). In addition, firms pay income tax alongside the licence fee. Also, big firms pay property tax, withholding tax, Pay as You Earn (PAYE) and value added tax. Appendix One provides government revenue by source for the period 1998 – 2003. Income tax and other taxes constitute about 20% of the total government revenue in Tanzania.

Local government authorities complain that a significant number of micro firms are not licensed; and councils' surprise inspections have not brought about major changes in compliance with local taxes. Poor service provision and weaknesses in tax management have made it difficult to tap tax revenue effectively from the existing and new micro firms. Implicitly, the contention suggests that firms are either under-taxed or motivated to evade tax. But it is difficult to justify under-taxing in a situation of massive complaints about tax and evasion; rather one needs to address the issues of compliance and management of tax. This is exactly what we would want to explore in the rest of the discussion. Do firms comply with government levies? We intend to carry out an empirical investigation into micro firms' attitudes and behaviour with respect to tax issues. The results will cast more light on the understanding of tax compliance at micro level.

Theoretical Issues and Modelling of Tax Compliance at Firm Level

Firms pay tax as a matter of fulfilling their financial obligations to the government in order to do away with the costs of non-compliance (i.e. mainly to avoid penalties and confrontation with tax authorities). Also, firms pay tax with anticipation that their terms of trade with government will be honoured. In principle, firms pay tax as business entities rather than individuals; and therefore, *a priori*, the firms' business environment matters in tax compliance. But firms are owned and, managed by people whose behaviour and other characteristics are different, and consequently, firm compliance with tax is also a function of owners or management characteristics. In large business organisations, there is a general distinction between company management and ownership. In this case, incentives for tax evasion are expected to be much less than those of self-style firm management and ownership. Hence, individual characteristics are on *a priori* less determining in large firm tax-compliance behaviour relative to other factors. This is particularly the case when performance of firms' management is also assessed on the basis of prompt payment of their liabilities, which include taxes. Moreover, the financial accounts of large firms are generally audited as a matter of principle from the shareholders' point of view; and a thorough and regular auditing of firm business reduces the chances of tax evasion (Feinsten, J.1991).

Contrary to large firms, small firms or micro enterprises are generally family-based in terms of ownership and management. Firm tax compliance at this level is, among other things, largely dependent on family or individual owners' characteristics. At this level, it is the firm owner who pays the tax as an individual rather than the management, and as a result, tax compliance also suffers from the owners' characteristics.

On the other hand, tax authorities find it difficult and expensive to carry out auditing in micro enterprises; and therefore firms find it easy to evade tax. The government of Tanzania, for example, has for a long time transferred the licensing of micro enterprises to local governments as a source of own revenue. Small business firms are many in Tanzania; they are spread all over the country. Local authorities find it difficult to institute and manage graduated income tax of small firms. The local government system lacks appropriate professional auditing personnel for ensuring thorough and effective firm tax auditing. As a result, local authorities have in place systems of lump sum or block tax for micro firms rather than profit or income graduated tax systems. For example, the business licence fee is usually paid in the form of an annual lump sum. This is a simple tax to manage since it does not rely on the firms' income, nor on their auditing. However, there are firms which operate without a licence, and therefore evade tax levied on firms. Furthermore, sometimes licenced firms fail or decline to renew their licences and continue with business as if they were licensed. The case of micro firms in Tanzania is interesting, and henceforth, given the author's experience with the country and the available data set, the discussion narrows down into a case study that focuses on micro enterprises in Tanzania.

The data at hand contain information about small firms in Tanzania, whose tax liabilities are mainly payable to local authorities in the form of a licence fee, implying that our analysis of micro firm tax compliance should focus on those firms that operate under licence and those that don't. The basic question is *'why do firms evade the licence fee?'* (and of course other taxes where applicable). There are three sources of incentives to evade tax; firm business environment-based explanation, owner characteristics, and the local government dimension, which comes in as a tax collection effort and the terms of trade. We shall highlight the incentives for tax evasion and build up a theoretical framework that will constitute the basis of our empirical analyses.

Firm business environment

A firm is a business entity that invests in order to generate profits or benefits. In the course of its operations, a firm might face competitive markets or situations that reduce its earnings to the point that the firm finds it unable to pay its creditors and potential liabilities like the licence renewal fee. Likewise, future firms'-businesses' expectations might be associated with uncertainties, which compel the firm to reconsider its renewal of the business licence. It is also arguable that tax evasion makes firms' products more competitive relative to others (Mushi, 2003). Hence, the firm business environment is a determinant in the settlement of taxes and other liabilities.

Owner's characteristics

Small firms are generally owned by family-based individuals who also make business decisions for the firm. Returns from the firm's operations accrue directly to the owner who is also responsible for the settlement of its liabilities. But individual taxpayers are rational decision makers who are inclined to evade tax when the opportunity cost of such evasion is outweighed by the benefits from non-compliance. Unlike large firms where proceeds from tax evasion do not benefit managers directly, owners of small firms benefit directly from tax evasion. As a result, compliance with tax in the latter category is inclined to suffer from the owner's characteristics that influence decision-making in the settlement of tax liabilities.

Tax collection effort and terms of trade

Tax collection effort refers to the effort exerted by the tax authority to increase or sustain the collection rate through an improved tax management system (administration and/or reviewed tax rates). Tax evaders speculate concerning the capacity of tax authorities. For example, a weak licence inspection effort or system will create incentives for firms to operate underground. As pointed out earlier, auditing and other follow-up of in micro enterprises can be expensive; as they keep rarely records and some are constantly mobile or may be operating during out-of-offise hours. It is also difficult to draw the boundary between which firms to license and which not, because business activities vary from organised dealers or producers to home based micro enterprises.

Firms pay tax expecting that the government will provide services (i.e. social and commercial services) accordingly. But terms of trade between firm taxpayers and the government are not necessarily *quid pro quo* in practice; sometimes governments fail to deliver the public services required for creating a business-enabling environment. The failure reduces the opportunity cost of tax evasion, which in turn motivates firms to go into business without licensing them or paying other taxes.

Hence, a reduced form of firm tax compliance function has four vectors:

$$Taxcompliance(firm) = f(T, I, E, B), so that f_T > 0, f_B > 0, f_E > 0, and f_I \lesseqgtr 0 \quad ---(1)$$

where

- ***T*** is a vector of firm business environment explained by the size of the firm, profits, ownership, type of business, location of the firm, age of the firm, investments in the firm, accounts, turnover, firm's inputs, competition in the market, number of taxes paid by the firm, amount of taxes paid and firm's history of prosecution because of non-compliance, etc;
- ***I*** is a vector of the owners' characteristics: income, age, education, family size, geographical location, attitude towards the government, number of taxes paid, total firm tax burden, knowledge about the behaviour of other taxpayers, fees levied on public services, corruption, and politics;
- ***E*** is a vector of the tax authorities' effort such as detection rate, penalties, enforcement mechanisms, collection methods, receipts, auditing by tax authorities, integrity of tax officials, and the time spent in dealing with tax issues.
- ***B*** is the benefits, which the firm thinks it enjoys from the tax. These include access to commercial and social services. We would want to estimate the firm compliance function as an econometric model and complement the discussion with descriptive analysis.

Methodology

Tax systems vary between countries; specific local characteristics (e.g. culture and politics) have resulted in the practice of different tax systems in different countries. These are factors, among others, which explain tax compliance. It is beyond the scope of this paper to look at all the factors that explain firm tax compliance in different countries. Our focus is, however, on tax compliance in micro firms in Tanzania. The choice of the country is based on the local knowledge of the author and the available information from the micro firms' survey data in Tanzania for the year 2000. Micro firms provide simple information, which can be easily linked to the local business environment, attitude to tax and terms of trade with the local government system.

Empirical analysis of tax compliance requires information on the characteristics of taxpayers and the current status of their tax liabilities. The latter would then fit in as a dependent variable in an econometric estimation of the model set out earlier in Section 2. In this case, there would be two categories of respondents, the compliant and the non-compliant taxpayers, which would then be matched with their firm business environment and owner or management characteristics. This form of categorisation would, in principle, permit an econometric estimation of a limited dependent variable model. But this requires a considerable number of observations and consistent information on the variables. Nonetheless, econometric estimation is not the only option for estimating the compliance model set out in Section 2. Descriptive methods are also powerful tools of analysis, and therefore complementing econometric estimation with descriptive analysis provides robust explanations for the empirical results.

Estimation techniques

The compliance model set out in Section 2 needs further manipulation before it suits econometric or discrete choice model techniques. In Section 2, we indicated that the dependent variable is categorical, taking the values of one when compliance is observed or zero otherwise. This would imply that the probability (P) that a firm complies with a given tax, t_f is expressed as follows:

$$\ln\frac{P_{t_f}}{1-P_{t_f}}=\alpha+\beta_1 T+\beta_2 I+\beta_3 E+\beta_4 B \text{------------------------} (2)$$

Where $\beta_1, \beta_2, \beta_3$ and β_4 are vectors of parameters that we would want to estimate; and B, I, E and B are vectors of covariates that might influence compliance with tax at firm level.

However, the available survey data do not have information for firms that evade tax; rather, the data show firm attitudes towards the current levies[1]. Firms were asked to indicate whether the current taxes are too high, reasonable or low. We have mentioned earlier that we would want to focus on micro firms in order to match service provision, firm performance, attitude and compliance with taxes. Micro firms in Tanzania have at least one levy in common, that is the licence fee, on which all the firms in the sample were asked to indicate their views[1]. We would like to make use of this information to gauge tax compliance at firm level. There are two categories of response; firms that indicate that 'licence fees are high' and those that indicate that the fee is 'reasonable or low'. An important question is how are firms' perceptions or attitude towards tax generated. The process that generates the perceptions stems from the theory of *marginal utility of income*; the same level of tax is generating different perceptions among individual taxpayers; and thus the tax reflects different marginal sacrifice in utility of income. Hence, the perception that. The 'tax is low' reflects a lower marginal sacrifice relative to the perception that the 'tax is high.' The latter respondents are inclined to evade tax because the perception that a given tax is 'high' reflects a higher opportunity cost of compliance relative to other responses. Invariably, we could state that the perception that a given tax is 'low' reduces the opportunity cost of tax compliance. This setting fits well in the compliance model set out earlier in this section. The implied binary logit model measures the probability that a firm faces a relatively higher marginal sacrifice of tax compliance and, given other factors, the firm's likeliness to evade tax increases.

The rest of our discussion is empirical results of the theoretical issues raised in sections two and three. We start by a brief overview of the data set used in the empirical investigation.

Data

Taxes are mandatory obligations and as such there are few researchers who bother to carry out studies on compliance with tax. But solutions to tax evasion rely heavily on the knowledge about why people evade tax. Understanding tax compliance requires interviews with taxpayers and analysis of secondary data from tax payment schedules. In view of the said information, researchers from Norway (CMI), Tanzania (REPOA) and Demark (CDR) carried out fieldwork surveys to obtain and compile information about tax compliance at firm level in Tanzania. The survey took place in October –November 2000 in four selected districts in Tanzania. Sample selection was based on concentration of firms' activities by location and fieldwork logistics.

The firm survey was carried out in three districts of Dar es Salaam region; Kinondoni, Temeke and Ilala; and Moshi urban council in Kilimanjaro region. A total of 173 firms were visited and interviewed.

Empirical Results

Descriptive Results

The firm survey data indicate that many business firms in the sample opened up just after 1990. This is the period when major reform measures were instituted in Tanzania, resulting in the removal of economic structural constraints and opening up of the economy. Many firms in the sample have between 1 – 5 employees, and few have between 10 and 30. Of course this is a direct indication that we are dealing mainly with micro enterprises in our sample, with the median firm size employing about three people[1].

About 60% of the firms in the sample are dealers in the retail business. Restaurants, hotels and bars constitute 6% of the sample; but also the retail business category includes many small dealers in food and beverages (about 50%).

Form of business organisation, tax liability and compliance

Food firms falling under the retail category are less organised compared with those registered as restaurants or pubs. The licence fee for restaurants is more expensive than that for a food dealer. Moreover, restaurants find it difficult to operate without a licence because they are few and better located for inspection by tax authorities. Food vendors are micro initiatives spread all over Tanzania; it therefore becomes difficult on the side of tax authorities to institute thorough inspections. This weakness constitutes one of the incentives for tax evasion on the side of food retailers, who are basically family business enterprises. In this context, firms choose a form of organisation, which among other things reduces its tax liabilities. With this view, many micro dealers in the food industry prefer to operate as *mama nitilie* (food vendors) to either avoid business licensing or to pay a relatively small business licence fee. The survey data show that the business licence applies to all firms in Tanzania but is normally graduated with the type of business activity.

We argued earlier that family or individually owned firms are more inclined to evade tax relative to other forms of ownership. Of course there is the issue of size versus ownership; micro firms are generally characterised by family or individual forms of ownership and, as a result, in the context of our descriptive analysis, the effect of the two is inseparable.

Table 1 shows the type of business organisation and recorded complaints about licence fees. The results in the table show an increasing potential for tax compliance as the firm's ownership changes from family and sole proprietors to more diversified forms of ownership and management. This is derived from our earlier inseparability contention of ownership and size. For example, 50% of respondents with family-based enterprises complained that licence fees are too high, but only 20% and 30% of partnerships and limited companies complained about licence fees, respectively.

This raises an important question: are micro (family or individual) firms faced with a higher tax burden than the relatively big business organisations? The answer to this question requires a look or firms' turnover and tax burden.

TABLE 1: Form of business organisation and compliance with tax: Licence fees

Present legal status of the firm	*Firm perception/compliant about business licence*		*Total*
	Firms complaining that the current licence fee is too high	Firms convinced that the current licence fee is reasonable	
Family enterprise	50%	50%	100%
Sole proprietorship	39%	61%	100%
Partnership	20%	80%	100%
Limited company (Tanzanian)	30%	70%	100%
Subsidiary of multinational corporation	One firm	One firm	
Other (NGO)		One firm	One firm

***Source:** 2000 Tax compliance survey data in Tanzania*

Figure 1 is a graphic description of firm business performance and tax liabilities. The figure gives interesting results; the tax burden appears to be proportional to the firms' income. Invariably, we could state that vertical equity persists in the sample data. But these results do not give us the source of micro firms' complaints about taxes. Earlier on, we indicated that micro firms are required to pay the business licence every year, and, by implication, the tax complaints in micro firms are directed at licence fees. This raises the need to extend our analysis to firms' licence fees in relation to returns.

FIGURE 1: Firm business performance and tax liabilities for 1999[1]

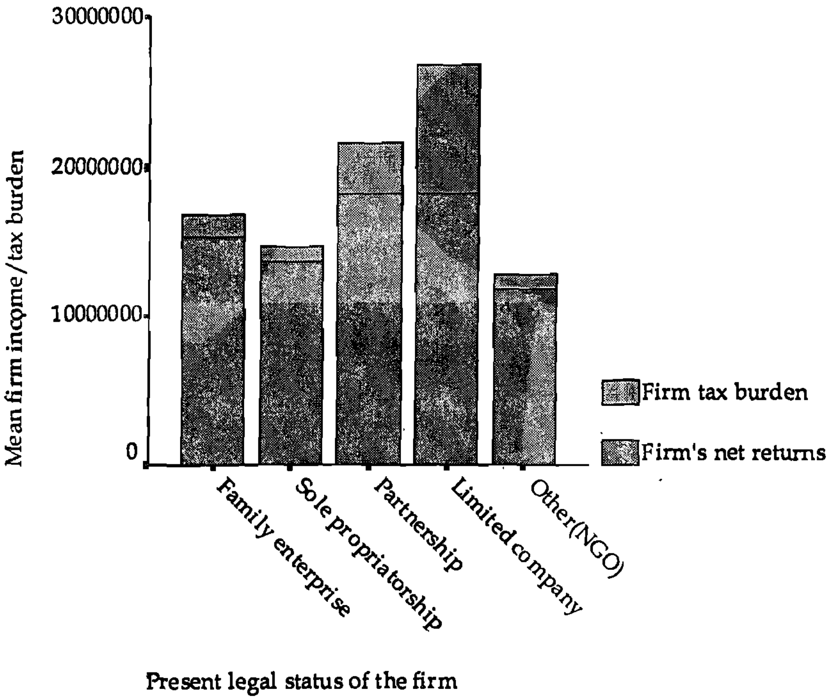
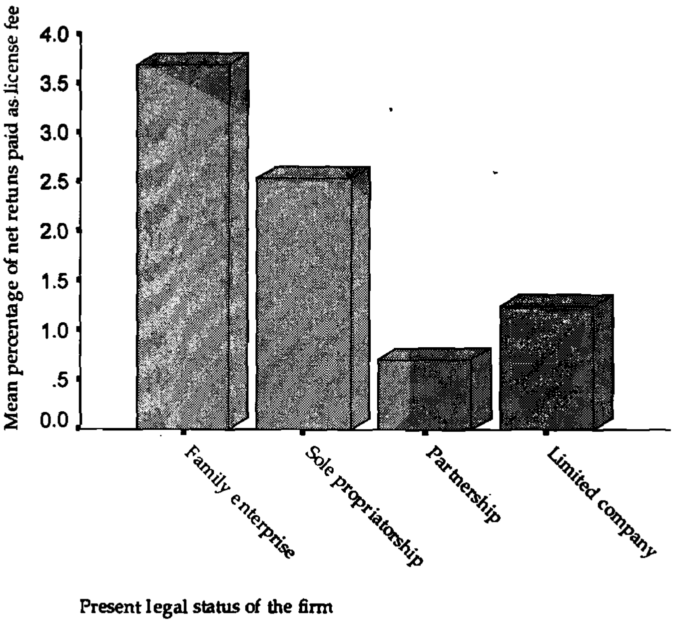


Figure 2 shows firms' cost of business licence in relation to net returns. The figure reveals that the relative price of a business licence for the relatively small firms (family and sole proprietors) is generally high. Family-owned firms and sole proprietorships had their incomes chopped by between 2.5 and 3.6% to pay the business licence fee, while it was less than 1% for their larger firms. But it is true that other firms in the sample paid more than one tax, and therefore making no difference with regard to the total firm tax burden. Nonetheless, micro firms' incomes are relatively small and unpredictable.

FIGURE 2: Firms business licence fee as a percentage of firms' net returns



Moreover, as mentioned earlier, micro firms' incomes are rarely retained in the business, let alone the small net flows per time, and, as a result, firms ~~find it~~ difficult to pay license fee in just one annual instalment. Big firms pay more than one tax, which be paid out in different periods, since they stand as separate taxes rather than one tax as the case with micro firms. So the issue is not vertical equity of the tax system as such, but distribution of the payments over the tax period in relation to firm's income size and flows. Micro firms pay their tax before the start of business, and thus the tax does not necessarily reflect future business prospects.

Contrary to micro firms, relatively big organised business entities effect their financial transactions through the banking system. These firms have internal accounting systems that keep financial records. Firms' financial liabilities are not, in principle, paid out of someone's pocket, but rather from their bank accounts. The latter distinction is important in the analysis of micro firms' financial affairs because their earnings are not necessarily confined to the business. Income earned from micro firms at family or individual level is generally transferred directly to meeting other binding family financial needs. Business enterprises are left with inadequate financial balances, which make it difficult to meet lump sum payments of their liabilities. This is actually the root cause of the complaints. Licence fees are paid once annually. For example, the minimum business licence fee in Tanzania is Tshs. 40,000, which is obviously not much if paid in several instalments over time[1]. But the fee appears to be on the high side for micro enterprises typical of '*mama nitilies,*' when it is paid in just one annual instalment that constitutes about 3.5% of the firm's net return. The argument is that returns from micro enterprises are meagre and spread over time; and since retention in the business is difficult, the firms find it difficult to settle substantial annual liabilities that are paid in annual lump sums.

Institutional weaknesses and firms' behaviour on tax issues

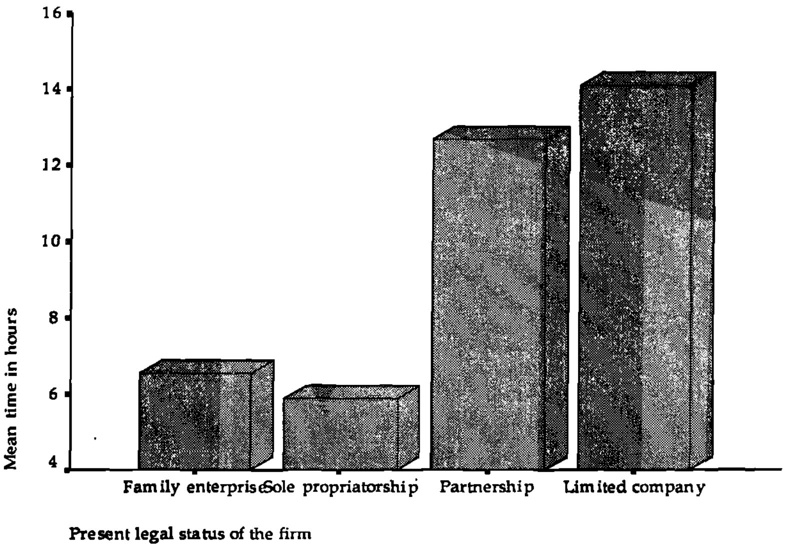
Corruption in Tanzania has been cited as an additional cost to firms' transactions (Chaligha et al., 2001; REPOA, 2001). Corruption increases the firms' operating cost. If they are compelled to incur extra costs (in the form of unofficial payments) in addition to the normal business taxes, the relative opportunity cost of tax evasion decreases, and therefore there is a motivation for non-compliance. Nevertheless, non-compliance is associated with unofficial payments to keep someone's business from being harassed by the tax authority. These payments may be higher than the actual business licence, but since they are in the form of week-to-week or month-to-month deals between tax officers and business owners, they do not constitute a big single annual payment as is the case with the licence fee. This form of unofficial payment has dual benefits for the dealers; given the penalty imposed on corrupt tax officers on one side, and taxpayers on the other, the officer benefits from the illegal payments, while the business owner is able to spread the said business costs conveniently over time under the protection received from the tax officer. These are costs, which the firm would find it difficult to pay otherwise in the form of tax in just one annual lump sum, let alone business uncertainties. Hence, the spreading effect reduces short-term financial pressure although the annual sum of the illegal payments might by far outweigh the licence fee. The deal also helps the business owners whose future is surrounded by business uncertainties to avoid licence purchase. The resulting mutual relationship between the tax officers and the business entities perpetuates an extra source of income to complement the meagre salaries paid by the local government system in Tanzania. In addition, benefits arising from unofficial payments may also be mutually enjoyed by the entire local government revenue office in order to protect the unofficial deals. Apparently, this is a weakness in the tax management systems, which benefit corrupt taxpayers and tax officers at the expense of government revenue.

Evidence from the survey data shows that 46% of the respondents made unofficial payments in order to get connected to public services. Analogously, 60% of the respondents reported that they had paid "something extra" unofficially in order to get a licence or permit. In general, 44% of the respondents indicated that they usually incur unofficial costs when dealing with tax issues. For example, cases of unofficial extension of a licence, payment period or deadline involve a discussion between tax officers and the firms'. owner. Nonetheless, illegal tax deals involve substantial time opportunity cost on the part of the taxpayer, and therefore the question that we attempt to tackle next is whether the said cost constitutes a disincentive to firm tax evasion.

Opportunity cost and firms' behaviour in tax deals

The analysis of the survey data shows that almost all firms are involved in time-costly deals with tax authorities. Figure 3 provides an illustration of the time cost of tax deals and the form of business organisation. The figure indicates that relatively big business organisations spend more time negotiating their tax liabilities compared with small firms.

FIGURE 3: Firm legal status and time opportunity cost of tax deals

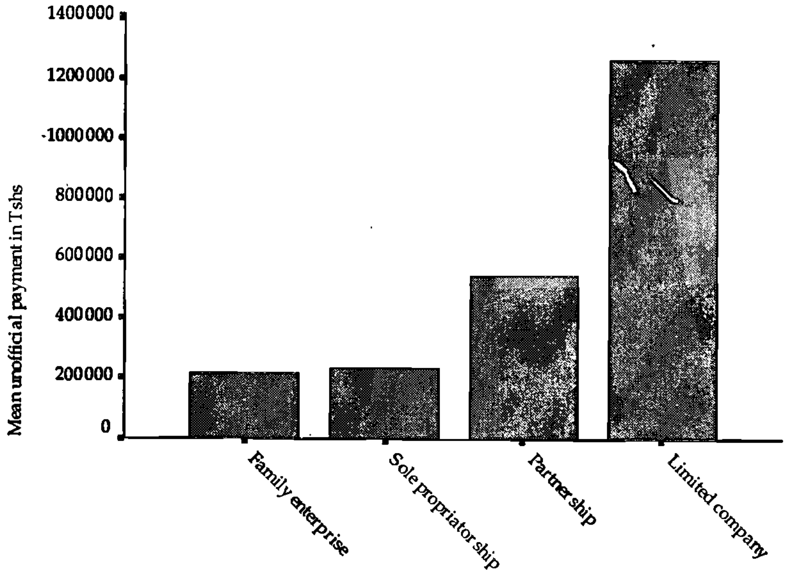


This is an indication of the loopholes in the tax system that tends to favour relatively big firms. These include exemptions and under declarations. This is also a reflection of the fact that big firms pay a number of taxes apart from the licence fee, and therefore need more time to sort out tax issues. Their "illegal" tax deals are also financially costly relative to micro firms. (See Figure 4).

Contrary to big firms, micro firms pay few taxes, i.e. the business licence; and as such they do not need so much time for tax deals. But also micro firms tend to offer simple bribes to tax officials in exchange for continued protection against harassment from the tax authority (Figure 4).

Firms' level of unofficial payments is an implicit indicator of the magnitude of the evaded tax. The rationality principle ensures that the gain from evasion is not less than the corresponding costs; and therefore it is plausible to conclude that unofficial payments were less than the corresponding tax liabilities.

FIGURE 4: Firmrs' unofficial payments in 1999



Present legal status of the firm

We have also indicated earlier that firms pay unofficial fees to facilitate procurement of a business licence or permit from the local government tax authority. The time opportunity-cost increases the cost of compliance with firms' tax, and so with the incentives for tax evasion. The time cost is also an inconvenience to firm owners, and therefore provides an incentive for tax officers to ask for unofficial payments in order to facilitate firms' tax deals. The survey results show that 53% and 38% of the respondents mentioned corruption as a severe and moderate problem to their business, respectively. About 94% of the respondent firms in the survey claimed that tax officers should be blamed for tax evasion. The survey data also shows that about 80% of the respondent firms felt that part of the tax was not being used to provide public services. The evidence from the survey asserts that a mutual understanding between tax officers and firm taxpayers perpetuates corruption in tax issues at the local government level. The two sides have mutual benefits, which are negotiated through unofficial tax deals. This again suggests a weakness in tax management in the local government system.

The results of the descriptive analysis of the firm survey data have raised a number of factors that explain non-compliance with tax at the firm level. The factors include the size of the firm, nature of ownership, high tax rates, corruption, timing of tax payment, and the time cost involved in tax deals. These, among others; are why micro firms decline to make prompt payment of their tax liabilities. However, we do not know yet the strength of the individual effect of each of the covariates of tax compliance at the firm level. We would want to understand, for example, whether it is the time cost of dealing with tax issues that matters most or the terms of trade with local authorities. This particular analysis calls for an econometric estimation of the model set out earlier on in Section 2, which was further expounded on in Section 3. In the rest of this section we present regression results of the model and their interpretations.

Regression results

Table 2: Marginal effects from logit (from 0 to 1 or evaluated at the mean elsewhere)

Probability that a firm will complain about its business license fee, N = 155,

Explanatory Variable	Coefficient	Std. Error	Significance (p-values)
Firm's location	0.5052***	0.1959	0.010
Education of the owner	- 0.0228*	0.0136	0.092
Respondent owners	0.0483	0.0850	0.571
Firm size (number of employees)	- 0.0368***	0.0150	0.014
Present legal status of the firm	0.8644**	0.0932	0.036
Firm's turnover	4.6500	6. 4100	0.942
Status of firm level competition	0.0702	0.1069	0.512
Time spent dealing with tax every month	- 0.0115	0.0104	0.269
Use of tax to provide social services	- 0.0423	0.1120	0.705
Knowledge about firms, which have happened to pay tax plus penalty	- 0.2108**	0.1115	0.059
Cons	- 0.1980	0.2367	0.403

Log likelihood = - 81.9945

* = level of significance, at 10%, 5% and 1% respectively.

In principle, the business licence fee should be paid irrespective of the owners' or businesses' characteristics; tax is paid as a mandatory obligation. Tax payment has two dimensions from the payer's point of view: one is the fulfilment of the law, and second is terms of trade with the government. The latter dimension constitutes the taxpayer's handle for self-initiated or "voluntary compliance" with the tax. On the other hand, the tax law and the management of the tax system determine the opportunistic behaviour of involuntary tax compliance. If public services are poor, compliance with tax will need to be re-enforced by law (involuntary compliance), and therefore differences in compliance among taxpayers is explained by opportunistic behaviour and loopholes in the tax management system rather than the terms of trade with the government. The regression results of the compliance model set out in Section 1 appear to be consistent with this contention. The use of tax to provide public services does not account for the differences in the taxpayers' perceptions about whether the licence fee is 'high' or 'low'. As noted earlier in the descriptive analysis, it is the form of business organisation and the weaknesses in the tax management system that matter. The regression coefficients for the legal status of the firm and firm size are statistically significant at the level of 5% and 1%, respectively. These results suggest that micro sole proprietors and family businesses are more inclined to evade tax than other corresponding forms of ownership. They also suggest that small firms have a higher probability of evading the licence fee relative to big business organisations. This is also an indication that micro firms are surrounded by complaints about tax, which form potential opportunities for tax defaulters.

Firm location in our compliance model captures the differences in tax effort by the tax authorities. There are two locations in our sample, Moshi urban and Dar es Salaam city council. The results show that firms located in Dar es Salaam complain about tax more often than their counterparts in Moshi.

Taxpayers' knowledge about penalties to defaulters is part of the process that generates attitudes to or perceptions of tax. Business firms that have happened to be penalised because of non-compliance, or firms that know other firms which have been penalised are less likely to take the risk of tax evasion. The results in Table 4 are consistent with this contention. Firms' knowledge about penalties to tax defaulters reduces the probability of complaining about high taxes. Analogously, the results show that education reduces complaints about taxes. Education increases access to information about licence fees and other taxes, which in turn affects the process of attitude or perception formation.

Nevertheless, notwithstanding the results, there are a few problems to note. Information on all relevant variables of the model was not available. For example, information from non-licensed business activities does not feature in the survey data. As a result, information on the perception about the level of taxes has been used to gauge compliance in the econometric estimation of the model. However, there are no serious shortcomings in the results that arise from these constraints.

Conclusions and Policy Issues

Conclusions

In general, this study has shown that micro business firms, which are predominantly sole proprietors, find it difficult to settle their tax liabilities in annual lump sum payments as owners depend on the day-to-day income from their business activities to meet other needs outside the business set-ups. In addition, micro firms are surrounded by future business uncertainties that propel them to adopt short-term business operation strategies[1]. As a result, micro firms' payment objective function is to minimise investment expenditure against unrealised long-term future plans.

Policy issues

The results of this study imply that local tax authorities are facing a dual challenge; not only there a need to clean up the tax management system, but also at the same time to put in place a better system that matches business fees with micro firms' returns and short-term decisions.

The time cost for dealing with tax issues has been observed to be significantly high. Simplicity in business-licence or permit processing would ensure a more efficient management system, which would reduce illegal tax deals.

The results of this study have also shown that for tax compliance purposes, individual or family ownership of business firms is less desirable relative to partnerships and other forms of ownership. For tax revenue enhancement and efficient tax collection, consolidated business entities or large firms are more desirable in the economy than having many individually owned and managed small firms.

The results also seem to encourage publicity of tax issues as a short-term strategy by tax authorities for curbing loopholes in the tax management and enhancement of tax compliance.

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Appendices

Appendix 1: Percentage Government Revenue by Source 1998 - 2003

Year	Import/Excise Duty	VAT	Income Tax	Other Taxes	NON - TAX REVENUE
1998/99	54.36	18.40	14.32	6.47	6.44
1999/00	53.33	17.31	16.32	5.84	7.20
2000/01	54.93	20.04	12.87	5.40	6.76
2001/02	54.72	20.52	12.82	5.85	6.09
2002/03	54.97	20.51	14.94	5.27	4.31

Endnotes

[1] Earlier studies on tax compliance by Odd and Semboja (2001), and Mushi (2002) examine household compliance with development levy in Tanzania
[2]The survey data are discussed later in this section.
[3] Also, the tax law requires firms to pay income tax annually.
[4] The number of employees is a proxy for firm size in this context.
[5] Firms' net returns are their incomes net of investment during the period.
[6] For example, monthly payment of the licence fee implies that the holder would pay a monthly fee of Tshs 3,330.
[7] Micro firm competition is high in urban areas; entry and exits are fairly easy due to, among other reasons, the existing loopholes in the tax management.