

An Analysis of Tax Morale and Tax Compliance in the Informal Sector

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Abstract

The research focused on examining tax morale and its impact on tax compliance within the informal sector, specifically among small and medium enterprises (SMEs) in Harare. The primary aim of this study was to evaluate the degree of tax morale and its influence on the tax compliance behaviour of SMEs operating in Harare. To achieve this, the study employed a quantitative research methodology. Data were gathered through the distribution copies of a questionnaire to various SMEs in Harare. The results indicated that the level of compliance among SMEs was very low because of low tax morale. Tax morale is particularly problematic in the context of Harare's SMEs because the capital city's economic activities are heavily influenced by a complex regulatory environment and high levels of informality, leading to a diminished sense of civic duty among business owners to comply with tax obligations. The study ultimately concluded that most SMEs were not inclined to pay taxes voluntarily. It was recommended that tax authorities undertake efforts to educate SMEs about various tax-related issues to improve their understanding and compliance. Additionally, the study advised that more severe penalties be imposed on those who engage in tax evasion to deter non-compliance and encourage adherence to tax obligations.

Keywords: *Informal sector, Tax compliance, Tax morale*

1. Background Of The Study

“One of the most practical, reliable, and sustainable sources of income and revenue mobilisation avenue open to governments worldwide since time immemorial, remains taxes” (Bitzenis & Vlachos, 2018:34). “Governments rely largely on taxation as a source of revenue for public expenditure. However, developing nations have reportedly been routinely posting revenue deficits in their national budgets, both in the current and capital accounts, because of revenue leakages and shortages” (Maina, 2016). “These issues have highlighted the need for governments in developing nations to increase tax revenue and broaden the tax base because of declining tax revenues and overburdened taxpayers because of the narrow tax base and dependence on a small number of taxpayers” (Ligomeka, 2019:56).

These dilemmas have noted the contribution made by the existence of a large informal sector in developing countries, which hinders the governments’ ability to mobilise adequate revenues through tax collections (Akinboade, 2015; El Badaoui & Magnani, 2020). Moreover, Karas and Reznakova (2021:45) assert, “In developing countries, the informal sector has largely been represented by Small to Medium Enterprises (SMEs), which have evolved over time to become a fundamental part of many economies.” Karas and Reznakova (2021:98) further postulate that “SMEs play a crucial role in providing stable employment, fostering sustainable growth, and driving innovation”. Zimbabwe is no different; its informal sector has significantly impacted the country’s gross domestic product (GDP) and has emerged as the largest source of employment in the country. “In response to the growing informal business activities, the Zimbabwe Revenue Authority (ZIMRA) implemented Presumptive Tax legislation to expand the tax base and ensure informal businesses contribute to tax revenues” (ZIMRA, 2022:45). “The rise of the informal sector in developing nations has often been seen as an effort to evade regulations and a deliberate strategy to avoid tax payments” (Wadesango, Denford, & Wadesango, 2020:65).

This perspective has become quite prominent, as tax compliance within the informal sector is often evaluated based on the design and effectiveness of the tax system itself, without sufficiently considering the

role of tax morale. Waris (2009:65) suggests that “most researchers and scholars have researched and written about the challenges of tax noncompliance from the point of view of the tax authorities with little focus being given to the taxpayers’ perspectives, attitudes, and willingness to comply with tax regulations, particularly within the informal sector, is a gap that this research aims to address”. Despite the crucial role of the informal sector in the economy and the presence of tax legislation, SMEs in Zimbabwe have exhibited low levels of tax morale and noncompliance. “The implementation of presumptive tax has not led to substantial revenue increases” (Buchn, 2018:43). According to Williams (2019:120), “this limited revenue generation can be linked to the reluctance of SMEs to comply and their low tax morale”. In addition, “Tax morale has increasingly become a key focus in studying voluntary tax compliance, with researchers contending that... tax morale and tax compliance are inextricably linked” (Kaplanoglou & Rapanos 2015:43). SMEs are crucial to Zimbabwe’s economy, representing 64.1% of it and serving as the largest source of employment in the country. It is estimated that between 60% and approximately 80% of the population in Zimbabwe is engaged in informal economic activities. Additionally, Makiwa and Steyn (2019) report that the informal sector plays a significant role in the economy, accounting for 50% of Zimbabwe’s gross domestic product (GDP). Despite their substantial economic presence, their contribution to indirect taxes remains minimal relative to their overall size. The study consequently sought to evaluate the degree of tax morale and its influence on the tax compliance behaviour of SMEs operating in Harare.

2.1 Main Research Question

What is the degree of tax morale and its influence on the tax compliance behaviour of SMEs operating in Harare?

1. Sub-research Questions

- Is there a strong connection between tax morale and tax compliance?
- What advantages does tax compliance offer to SMEs?

2.2 Empirical Review Of Literature

2.2.1 Taxation in the Informal sector

According to Mpfu (2021:45), “The Informal Sector (IS) has undeniably been a major contributor to the growth of Zimbabwe's economy from its earliest days.” Additionally, “the swift growth and widespread emergence of the informal sector in developing countries are frequently viewed as intentional efforts to evade regulatory oversight and taxation requirements, according to FYS” (Mpfu, 2021:67). According to Schneider et al. (2016:87), “to evade paying income tax, value-added tax, and other forms of taxation,) describe the informal sector as all market-based legal production of goods and services that are intentionally concealed from public authorities”. Taxation of the informal sector is a complex and controversial subject with significant ramifications for taxation, economic growth, and development, sparking extensive debate in developing countries over the years. The core issue is finding a way to levy taxes on the informal sector without undermining its viability, hindering efforts to alleviate poverty, or adversely impacting the livelihoods of many people, especially in Zimbabwe where the economy largely operates informally (Ayee, 2018; Wadesango, Chibanda, & Wadesango, 2020).

Munjeri et al. (2017:65) suggest that “taxing the Informal Sector is a challenging endeavor that necessitates specialised methods for identifying, monitoring, and declaring earnings from informal activities, while also fostering an environment that encourages adherence to tax regulations among those operating in the informal sector”. Mpfu (2021:54) asserts that “in developing countries, more than fifty percent of potential tax revenue is often lost due to the complexities associated with taxing this sector, along with low tax morale and noncompliance”. Ligomeka (2019) and Wadesango and Ncube (2020) point out that the presence of a large, varied informal sector, along with issues such as corruption, low tax morale, insufficient tax compliance, and high levels of tax evasion pose significant barriers to effective revenue collection. Fajnzylber et al. (2019) define operators in the informal sector as those who are unregistered, mobile, not included in official statistics, small-scale, primarily cash-based, and lacking access to formal markets.

These characteristics render the informal sector challenging to tax, yet data demonstrating its economic significance suggests that taxation is necessary. The debate surrounding the taxation of the informal sector

centres on whether or not it should be taxed, with proponents arguing that taxation could foster the sector's growth, increase the overall tax burden, impose stricter labour market regulations, and potentially reduce tax morale (Joshi & Ayee, 2018; Horodnic, 2018; Wadesango, Sitsha, & Chirebvu, 2020). The extent of the potential tax gap arising from the untaxed informal sector further fuels this debate. While some researchers highlight the extent of the disparity between the taxes owed and those collected (Dube, 2020; BDO, 2017), others argue that, although the loss of tax revenue is considerable, it may not be as extensive as suggested.

Despite ongoing debates, presumptive tax systems have been introduced into the tax frameworks of developing economies to address the informal sector. “Zimbabwe adopted this tax framework in 2005 with the aim of broadening the tax base and enhancing revenue collection” (Rahim, 2015:89). “Presumptive tax is determined based on certain indicative and validated factors within the SMEs sector, such as the seating capacity of a bus” (Otekunrin, Matowanyika, & Tafadzwa, 2020:120). As noted by the ZIMRA (2020:156), “this form of indirect taxation uses estimated income to calculate the tax obligation”. “The presumptive tax framework was introduced in Zimbabwe primarily for its simplicity, especially in terms of reducing the compliance burden for low-turnover taxpayers, as well as to address tax avoidance and ensure a fair distribution of the tax burden” (Thuronyi, 1996:20).

2.2.2 Tax Morale in the Informal Sector

The informal sector (IS) plays a crucial significance and impact on the economic systems of nations that are in the process of development, significantly contributing to their gross domestic product (GDP) and providing substantial employment opportunities and job creation (Mpfu, 2021). In Zimbabwe, the informal sector has undergone significant expansion over time (Sikwila et al., 2016). According to ZIMRA (2022), this sector encompasses a range of different segments. These include individuals involved in transportation, owners of hairdressing salons, informal vendors, small-scale mining operators, traders engaged in cross-border commerce, producers in cottage industries, and professionals who are self-employed. “These categories highlight that Zimbabwe’s informal economy is predominantly comprised of informal sector enterprises, or non-formal SMEs” (BDO, 2017:76). “There is no universally accepted definition of SMEs that fully encompasses their characteristics in terms of the scale of the operation,

the total number of staff members, the annual revenue generated, the methods used for financial record-keeping, and the overall framework of the organization” (Gomes & Martins, 2020:189). Nonetheless, ZIMRA (2022:69) defines SMEs in Zimbabwe “as businesses employing between 5 and 40 people, with annual revenues and assets ranging from as low as Z\$50,000 to Z\$2 million”.

“Informal SMEs are typically small-scale operations with fluctuating revenue and minimal or no assets and they are often individually owned, and there is frequently no clear separation between the business's income and the owner's personal assets” (Gomes & Martins, 2020:189). Consequently, the imposition of presumptive tax on these informal SMEs is perceived as an added burden on taxpayers. This increased tax burden reduces their disposable income and diminishes their willingness to comply with tax regulations, thereby impacting their tax morale negatively (Lumumba et al., 2016), as discussed by Torgler (2016). In the context of tax compliance and noncompliance, tax morale plays a crucial role. Tax morale is defined as the inherent drive within individuals to meet their tax responsibilities willingly (Frey & Torgler, 2017; Wadesango, Chirembwe, Sitsha, & Wadesango, 2020). It can also be understood as the personal conviction or sense of duty to support the community through the act of paying taxes.

According to Fadi et al. (2016), tax morale includes the essential factors that influence taxpayers' motivation to fulfil their tax obligations. These factors comprise the prevailing social norms, the level of trust in governmental institutions, the assurance that government policies are effective, and the availability of public services and goods. Doreen et al. (2019:190) further note that “factors such as national pride and the wish to contribute to the betterment of one's society also play a significant role in influencing an individual's motivation to pay taxes”. Frey and Feld (2016:19) suggest that “tax morale is intrinsically connected to economic factors affecting tax morale”. According to Frey and Feld (2017:43)

these determinants are categorised based on the presence or absence of the fiscal social contract, which is reflected in the provision of public goods and services, the political mechanisms that govern these interactions, and the interplay among these three core areas

2.2.3 Tax Compliance among SMEs in the Informal sector

“Tax compliance is defined as the degree to which taxpayers adhere to their legal responsibilities concerning tax payments” (Doreen et al., 2019:67). According to Oats et al. (2018:76), “tax compliance involves the extent to which individuals or entities meet their obligations to pay taxes, ensuring that they do so in alignment with established legal requirements and regulations”. This includes accurately and timely filing tax returns, paying the correct amount of tax, and keeping proper records to substantiate their tax liabilities. Alm and Torgler (2017:87) offer a more straightforward definition, stating that “tax compliance is the degree to which taxpayers willingly meet their tax obligations without the need for enforcement actions”. Tax compliance is a critical concern for governments around the globe, who strive to improve it to achieve sufficient revenue collection (Bahloul et al., 2019; Wadesango & Magaya, 2021). By enhancing tax compliance through various strategies, including educational campaigns, outreach programmes, simplification of the tax system, and rigorous enforcement measures, governments are able to ensure a reliable and stable flow of public funds. This, in turn, supports the equitable distribution of public goods and services, contributing to the overall fairness and efficiency of the tax system.

Numerous studies and reviews have explored the intricate issue of tax compliance within the informal sector. Researchers have identified various factors that impact the tax compliance of SMEs operating in this sector. “These factors include societal norms, levels of trust, enforcement practices, penalties for noncompliance, and the perceived fairness and transparency of the tax system” (Mpofu, 2021:43). According to Joshi et al. (2020:89), “a key determinant of tax compliance in the informal sector is the perceived fairness of the tax system”. Furthermore, “taxpayers are more inclined to comply with tax laws if they view the tax system as just and transparent, regardless of whether they are part of the formal or informal sector” (Joshi et al., 2020:89). Alm and Torgler (2017:19) “demonstrated a positive relationship between voluntary tax compliance in Bolivia and the perception of a fair tax system”. “Conversely, when SMEs perceive the tax system as unfair, it can lead to reduced compliance rates and negatively affect tax morale” (Joshi et al., 2020:65).

“If the taxation of the informal sector is not properly managed, it can negatively influence the perceived equity of the overall tax system, which in turn affects tax compliance within the formal sector” (Ayee & Joshi, 2018:76). According to Joshi et al. (2020:65), “research has shown that the tax compliance practices of Small and Medium Enterprises (SMEs)

operating in the informal sector are particularly important, as they have a notable impact on the attitudes and behaviours related to tax compliance and payment within the formal sector”. “Essentially, this means that efforts to enhance tax compliance should focus on businesses within the informal sector” (Ayee, 2018:94). “Conversely, concerns about the fairness of the tax system can arise, leading to questions such as the treatment of the informal sector, which does not benefit from capital expenditures being deducted by utilising tax depreciation techniques such as capital allowances, which include special initial allowances and wear and tear provisions in Zimbabwe” (Tapera, 2017:54). The application of presumptive tax laws with fairness in mind may be perceived as lacking, potentially leading to negative effects on the tax compliance levels of small and medium enterprises (SMEs) that are functioning within the informal sector.

2.2.4 Tax morale and Tax Compliance

“Tax morale is defined as the inclination of taxpayers to adhere to tax regulations voluntarily, even without stringent enforcement or penalties for noncompliance” (Mohammed, 2019:23). This concept reflects a taxpayer's internal motivation to comply with tax laws. Tax morale can be assessed through several factors, including the satisfaction of the implicit social agreement, the clarity and responsibility in the way tax revenues are used, and the interaction among stakeholders built on a foundation of shared trust and mutual respect (Musimenta et al., 2017; Wadesango, Malatji, Mutare, & Sitsha, 2021). These aspects of tax morale indicate that tax compliance is closely connected to the personal motivation to pay taxes. In the informal economy, tax morale plays a significant role, as it strongly influences tax evasion and non-compliance, demonstrating an inseparable link between the two.

“Research indicates that in many nations that are in the process of economic development, including countries like Kenya, Tanzania, Mozambique, and Zimbabwe” (Malterud et al., 2016:187), tax collection from the informal sector often relies heavily on coercive measures to enforce compliance. Efforts to enhance voluntary tax compliance through persuasion receive minimal attention (Lisi, 2015). “Consequently, there is a notable association between high levels of tax non-compliance and low tax morale” (Williams, 2020:45). Williams (2020:98) highlights that “previous research has consistently demonstrated a negative relationship between tax morale and non-

compliance with tax obligations”. “In many less developed nations, tax morale is a critical factor influencing the level of compliance with tax collection” (Gomes & Martins, 2015:176). Tax morale reflects an intrinsic commitment to paying taxes as a civic duty (Fuest, 2018).

“The literature indicates a direct relationship between the extent of tax evasion and tax morale, as well as between the effectiveness of governance and tax morale” (Frey & Torgler, 2017:54). In a study examining the effectiveness of enforcing formal tax regulations within the informal economy of Cameroon, Dickerson (2018:90) states that “individuals are more inclined to voluntarily fulfil their tax obligations under three specific conditions: a) they appreciate the importance and benefits of the public goods and services offered; b) they recognise that their tax contributions play a role in funding these goods and services; and c) they are convinced that their own tax compliance will encourage others to fulfil their tax responsibilities as well”. According to Fuest (2018:167), “when these factors are present, taxpayers are strongly motivated to fulfil their tax obligations and are inclined to do so even when the likelihood of facing enforcement actions is minimal”.

2.2.5 Ways to Foster Tax Compliance in the Informal sector

The informal sector, encompassing unregistered enterprises and individuals who are self-employed, is often associated with relatively low levels of adherence to tax obligations (Fuest, 2018:23).

Nevertheless, research has identified various strategies to improve tax compliance within this sector. “An effective approach is to streamline tax regulations and procedures, as this reduces the administrative workload for taxpayers and increases their likelihood of complying with tax laws” (Cassar & Friedman, 2017:54). Furthermore, delivering tax education and ensuring that individuals in the informal sector receive clear and comprehensive information about tax regulations can improve their comprehension of these rules and have a beneficial effect on their behaviour regarding tax compliance (Kasipillai et al., 2017).

Another method to improve tax compliance involves utilising social norms to foster adherence to tax regulations. “Research has shown that social pressure can be a powerful tool in encouraging tax compliance, particularly within tightly-knit communities” (Andreoni et al., 2018:2).

By highlighting the benefits of tax payments and presenting non-compliance as a violation of societal expectations, tax authorities can motivate individuals in the informal sector to follow tax laws (Fuest, 2018:65).

Additionally, implementing incentive programmes and rewards for compliance behaviour can be an effective approach. For instance, a study conducted in Uganda revealed that providing a small financial incentive to taxpayers in the informal sector led to a noticeable enhancement in their compliance behaviour (Mayanja & Musoke, 2019).

Finally, strengthening the relationship between taxpayers in the informal sector and tax authorities is essential for promoting tax compliance. “By fostering trust and maintaining transparent and open lines of communication with informal sector taxpayers, tax authorities can enhance their willingness to adhere to tax regulations” (Kasipillai et al., 2017:54). Fuest (2018:5) states, “Encouraging tax compliance in the informal sector requires a holistic approach that encompasses simplifying tax rules, providing educational resources on taxation, utilising social norms, offering incentives, and improving engagement between taxpayers and tax authorities.” These measures, supported by empirical research, have the potential to significantly increase tax compliance rates within the informal sector (Paradzal, Wadesango, & Sitsha, 2023).

Governments encounter several significant obstacles when implementing strategies to enhance tax compliance and tax morale, which can impede progress in these areas. A primary challenge is the lack of formal registration and recognition of businesses within the informal sector. This absence of formalisation makes it difficult for tax authorities to identify and monitor taxpayers operating in this sector, often resulting in “insufficient tax compliance rates (Alm, 2020). Additionally, individuals in the informal sector often do not possess the required financial and technical resources to fulfil their tax obligations effectively. This includes challenges such as keeping accurate financial records and filing tax returns (Cassar & Friedman, 2017).

3. Research Methodology

The study employed a quantitative research methodology and gathered data using copies of a designed questionnaire. The questionnaire was designed using a combination of closed-ended and Likert scale questions to quantitatively access the participants’ attitudes and behaviours related to the study’s objectives. Clear and concise language was employed

throughout to ensure comprehensibility, while pilot testing was conducted to refine the questions and enhance reliability before full deployment. The focus of the study was on informal SMEs operating in Harare. The World Bank Enterprise Survey conducted in Zimbabwe in 2019 revealed that “about 92% of firms in Zimbabwe are informal”. Given that surveying all SMEs in Harare was not feasible, a random sample of 40 informal businesses was selected for the study. In this study, data collection was conducted, using a structured questionnaire designed to gather insights from a sample of 40 small and medium-sized enterprises (SMEs). The copies of the questionnaire were distributed electronically to ensure a wide reach and to facilitate easy response collection. The participants were selected based on specific criteria relevant to the study, ensuring a representative sample of the SME sector. To enhance response rates, follow-up reminders were sent to the participants after the initial distribution. The collected data were then compiled and analysed to draw meaningful conclusions regarding the subject matter of the research. This systematic approach allowed for a comprehensive understanding of the SMEs' perspectives and practices. To evaluate the dependability of the questionnaire as an instrument for research, a test-retest procedure was employed. This involved administering the questionnaire to a group of SMEs with similar characteristics to those in the final sample, but not included in the final analysis. The test was conducted again the following day to evaluate the consistency of the responses. The results showed consistent responses, indicating the validity of the questionnaire used. To maintain ethical standards and confidentiality, no personal information about the study participants was disclosed. The results were presented using pie charts, tables, and graphs, with these data visualisation techniques complemented by comments, interpretations, and explanations to clarify the findings.

3.1 Limitations of the Study

The researchers encountered reluctance from the respondents, who were concerned about disclosing sensitive information that could potentially impact their operations. To address these concerns, the researcher assured the participants that the information provided would be solely used for research purposes and that no identifying details would be revealed.

3.2 Validity and Reliability

To evaluate the reliability and validity of the questionnaire employed in the study, a test-retest approach was implemented, where the instrument was administered to a sample of participants, as well as a group of subject matter experts (SMEs) that shared characteristics with the sample but were not included in the final analysis. The same questionnaire was administered again the following day to assess the consistency of responses. The results indicated a high degree of consistency in responses across both groups, supporting the reliability of the instrument. Additionally, the consistent feedback affirmed the validity of the questionnaire as an effective research tool for capturing the intended data.

3.3 Ethical Considerations

In addressing ethical issues related to this study, the researcher is committed to upholding strict standards of confidentiality and protection for all participants. To ensure their well-being, the participants were fully informed of the researcher's intentions and the purpose of the study. Additionally, all results were aggregated and reported collectively to prevent any identification of individual participants. The researcher maintained the anonymity and confidentiality of the participants throughout the research process by securely storing data, using file encryption and assigning codes to identify the participants, further safeguarding their privacy.

4. Data Presantation And Analysis

Table 1: Type of business

Type of business		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Sole Trader.	16	39.0	40.0	40.0
	Transport operator	12	29.3	30.0	70.0
	Restaurant and/ Bottle store	7	17.1	17.5	87.5
	Hair Salon	5	12.2	12.5	100.0
	Total	40	97.6	100.0	
Total		40	100.0		

Table 1 illustrates the breakdown of business types within a sample of 40 informal sector SMEs. The categories of businesses included are Sole Traders, Transport Operators, Restaurants and/or Bottle Stores, and Hair Salons. Forty were businesses surveyed, and among the participants, 16 individuals, accounting for 39%, were Sole Traders. Additionally, 12 participants, representing 29.3%, were engaged in the Transportation sector. Seven individuals, or 17.1%, were involved in managing Restaurants and/or Bottle Stores, while five participants, making up 12.2%, operated Hair Salons. Sole Traders emerged as the most prevalent type, representing 40% of the sample. Transport Operators and Restaurants/Bottle Stores followed, comprising 30% and 17.5% of the businesses were represented by these sectors, respectively. Hair Salons were the least prevalent, comprising only 12.5% of the sample. It is important to acknowledge that this sample might not precisely represent the actual distribution of businesses within the region or across the industry due to its limited size. Nonetheless, the table offers a snapshot of the various business types present in the sample.

4.1 Reliability Analysis

Reliability Statistics	
Cronbach's Alpha	N of Items
.938	40

In psychometric research, Cronbach's alpha is a widely utilised statistical measure for evaluating the internal consistency and reliability of a set of items (Dickenson, 2028). This statistic helps in determining how consistently the items within a particular scale or questionnaire assess the same underlying construct or concept (Devos, 2020).

However, a low Cronbach's alpha value implies that the items may not be measuring the same underlying construct or might be addressing different constructs at once (Neuman, 2007). Conversely, a high Cronbach's alpha value indicates that the items are reliably measuring the same construct. In this research, the Cronbach's alpha coefficient is exceptionally high, standing at .938. This high value signifies that the 40 items in the set are reliably measuring the same construct with a high degree of consistency.

4.2 Taxation in the informal sector

Table 2: The informal sector should not be taxed.					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	SD	5	12.2	12.5	12.5
	D	6	14.6	15.0	27.5
	N	6	14.6	15.0	42.5
	A	10	24.4	25.0	67.5
	SA	13	31.7	32.5	100.0
	Total	40	97.6	100.0	
Total		40	100.0		

Out of the 40 participants, five individuals, or 12.2%, strongly disagreed with the idea that the informal sector should remain untaxed. Six respondents, accounting for 14.6%, disagreed with this notion, while six others, also representing 14.6%, expressed a neutral stance. Meanwhile, 10 participants, or 24.4%, agreed with the idea, and 13 respondents, making up 31.7%, strongly agreed. These findings suggest that most of the respondents, specifically 67.5%, were either in agreement or strongly in favour of the position that the informal sector should not be subjected to taxation. This perspective may stem from the view that “the informal sector already faces numerous challenges, such as limited access to formal financial services and insufficient legal protection” (Alm, 2016:76).

The debate over taxing the informal sector is contentious due to its substantial contribution to the economies of various nations. Proponents argue that imposing taxes on the informal economy could boost government revenue and promote formalisation. Further, Devos (2020) asserts, “Conversely, critics assert that taxation might further marginalize the informal sector, hinder its growth, and exacerbate existing difficulties”. Nonetheless, Schneider, Buehn, and Montenegro (2016:78) submit, “Research supporting this view suggests that informal businesses might struggle to meet formal tax requirements, and that imposing taxes might result in higher prices, decreased competitiveness, and lower profits.” To summarise, the survey results indicate that most respondents preferred not to impose taxes on the informal sector, which supports the viewpoint that such taxation could negatively impact its development and expansion

4.3 *Presumptive taxation is beneficial to the informal sector*

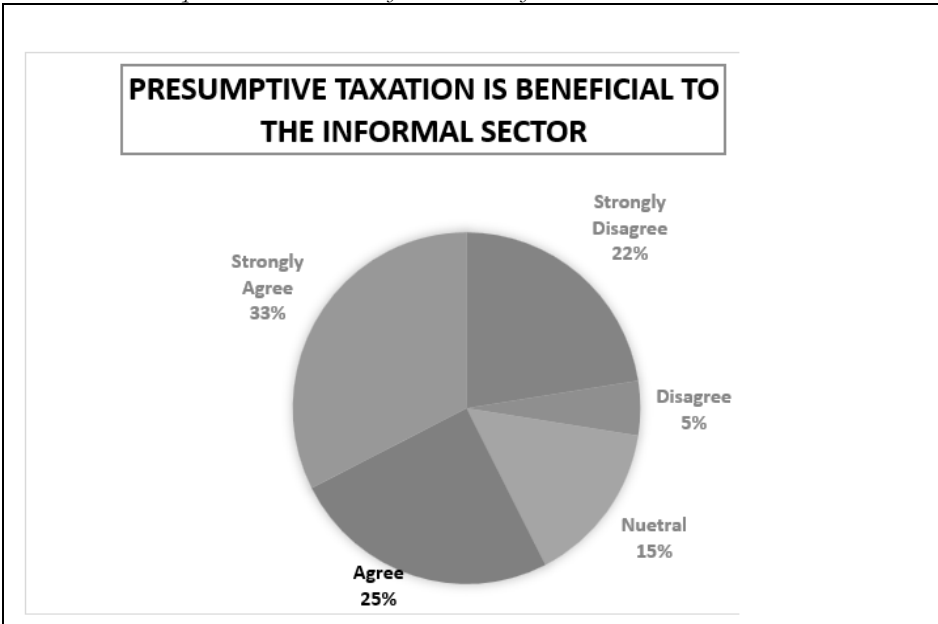


Fig. 1: *Presumptive taxation is beneficial to the informal sector.*

Out of the 40 respondents, seven individuals, or 22.0%, strongly disagreed with the statement that presumptive taxation is beneficial to the informal sector. Additionally, two respondents, representing 4.9%, disagreed with this assertion, while six respondents, or 14.6%, remained neutral. However, 10 participants, accounting for 24.4%, agreed with the statement, and 13 respondents, making up 31.7%, strongly agreed. The overall data suggest that a significant majority of the respondents, amounting to 67.5%, either agreed or strongly agreed with the notion that presumptive taxation is advantageous to the informal sector. Presumptive taxation, a simplified tax system, is often applied to small businesses and individuals with low incomes who may struggle with formal tax obligations (Alm & Tongler, 2017). This approach is commonly used in developing countries to enhance tax revenues and promote the formalisation of informal economic activities (Kogler et al., 2015).

Presumptive taxation offers several benefits to the informal sector, including reduced compliance costs, improved access to formal financial institutions, and increased tax revenue collection (Bhandari, 2020:87).

Research indicates that presumptive taxation can improve tax compliance among informal businesses, particularly those at the lower end of the market, and can also encourage these businesses to formalise their operations (Dickenson, 2018). However, some argue that “presumptive taxes may not be suitable for all informal businesses because they may not accurately reflect the businesses' actual income levels and could be subject to manipulation” (Delice, 2010). According to the survey results, most respondents believe that the informal sector benefits from the implementation of presumptive taxation

4.4 Presumptive taxation legislation is too complex

Table 3: Presumptive taxation legislation is too complex					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	SD	2	4.9	5.0	5.0
	D	5	12.2	12.5	17.5
	N	10	24.4	25.0	42.5
	A	12	29.3	30.0	72.5
	SA	11	26.8	27.5	100.0
	Total	40	97.6	100.0	
Total		40	100.0		

Among the 40 participants, two individuals, or 4.9%, strongly disagreed with the belief that presumptive taxation legislation is excessively complicated. In contrast, five respondents, representing 12.2%, disagreed with this view, while 10 respondents, accounting for 24.4%, took a neutral stance. Meanwhile, 12 participants, or 29.3%, agreed with the statement, and 11 individuals, making up 26.8%, strongly agreed. These results indicate that a significant majority, totalling 72.5% of the respondents, either agreed or strongly agreed that the presumptive taxation legislation is indeed overly complex. “This perception likely stems from the fact that presumptive taxation is designed to be a simpler tax system for small businesses and low-income individuals who may find it challenging to comply with more traditional tax requirements” (Delice, 2010:65). However, the complexity of presumptive taxation legislation might undermine its effectiveness in enhancing tax compliance among businesses that are not officially registered and supporting their transition to formal status is an important focus (Jackson, 2019). “Studies have shown that individuals who have limited financial means and lower levels of education tend to exhibit lower levels of adherence to tax regulations” (Lisi, 2015:34).

The intricate and burdensome nature of tax systems in numerous developing countries often results in lower tax compliance rates and diminished revenue collection (Bird & Wallace, 2003). Simplifying the tax code could potentially improve tax compliance and support the formalisation of businesses that are not yet registered. According to the results of the survey, most respondents felt that the presumptive taxation legislation was excessively complex. Streamlining the tax code and implementing presumptive taxation laws could enhance tax compliance and foster the formalisation of previously unregistered businesses.

4.5 Trust in the government influences tax morale

Table 4: Trust in the government influences tax morale

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	D	1	2.4	2.5	2.5
	N	5	12.2	12.5	15.0
	A	20	48.8	50.0	65.0
	SA	14	34.1	35.0	100.0
	Total	40	97.6	100.0	
Total		40	100.0		

Out of the 40 participants, one individual, or 2.4%, did not agree with the idea that trust in the government has an impact on tax morale. Meanwhile, five individuals, representing 12.2%, expressed a neutral opinion on the matter. Conversely, 20 respondents, accounting for 48.8%, agreed with the statement, and 14 participants, or 34.1%, strongly agreed with the notion that trust in the government influences tax morale. The findings reveal that a significant majority of the respondents, comprising 65.0%, either agreed or strongly agreed with the view that trust in the government is a crucial factor in influencing tax morale. Tax morale, defined as the internal drive of taxpayers to comply with tax regulations and willingly meet their tax responsibilities, is shaped by multiple factors. “These include perceptions of fairness within the tax system, the level of trust placed in government institutions, and the

effectiveness and quality of the public goods and services provided” (Becker, 1968). Studies have demonstrated that having trust in government can enhance tax morale by instilling a sense of confidence and legitimacy in the tax system (Feld & Frey, 2017; Torgler, 2017).

When taxpayers are confident that their tax contributions will be utilised effectively and serve the public interest, they are more likely to develop a positive attitude towards paying taxes and to adhere to tax regulations

(Dickenson, 2020). The survey results reflect this sentiment, showing that most participants agree that public trust in the government affects tax morale. This aligns with previous studies which suggest that trust in government can positively influence tax compliance and voluntary tax contributions.

4.6 The subsequent factors have an impact on tax compliance within the informal sector:

4.6.1 Fairness and transparency of tax authorities influence tax compliance

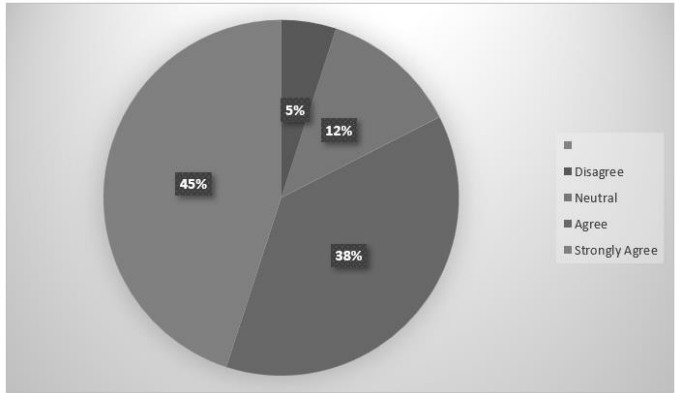


Fig. 2: *Fairness and transparency of tax authorities influence tax compliance*

The findings show that a substantial majority of the respondents, amounting to 55.0%, either agreed or strongly agreed with the notion that making tax regulations and procedures simpler could improve tax compliance within the informal sector. According to Schneider and Enste (2000:78), the term "informal sector" encompasses economic activities that operate outside the scope of government regulation and taxation. In this sector, tax compliance is generally low, which can be

attributed to the lack of formalisation and a prevailing distrust in governmental institutions (Alm & Torgler, 2017).

Streamlining and making tax regulations and procedures more straightforward can lead to improved adherence to tax obligations within the informal sector by reducing the administrative burden and costs associated with tax compliance (Alm & Torgler, 2017). “When tax laws and procedures are made more straightforward, taxpayers within the informal sector are better able to understand their tax responsibilities and adhere to legal requirements” (Bhandari, 2020). The survey findings reveal that most of the respondents are of the opinion that reducing the complexity of tax regulations and procedures could have a beneficial effect on tax compliance within the informal sector. This conclusion is consistent with previous studies which have shown that making tax regulations and procedures more straightforward can lead to higher levels of tax compliance within this sector.

5 Conclusion

The study finds that a significant number of SMEs were not fully adhering to tax regulations. While these businesses were aware of the existing tax rules, they often sought ways to avoid fulfilling their tax obligations. A key issue identified was that some SMEs struggled to understand the tax code, which hindered their ability to comply with tax requirements. Additionally, many SMEs felt no strong moral obligation to pay taxes, believing that the taxes they did pay were not utilised effectively. Furthermore, there was a perception among SMEs that the tax rates imposed were excessively high and unfair. The study highlights several critical factors influencing tax compliance among small businesses, including compliance costs, understanding of tax regulations, the frequency of tax audits, tax rates, and perceptions of government expenditure. These factors were found to significantly impact how SMEs manage their tax responsibilities, especially concerning the timely and efficient payment of taxes.

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