

Attitude Towards Tax Compliance among SMES in Tanzania

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Abstract

The study aimed at profiling attributes articulating SMEs' tax compliance in Tanzania. A survey strategy was used in data collection whereby a total of 158 SMEs were involved. Data were analyzed through factor reduction and descriptive statistics run for frequencies as well as percentages. Findings showed that issues articulating SMEs' tax compliance include a feeling that business owners are paying a fair tax, when reasons for paying tax are well known among tax payers, simplicity of tax laws, nature of reporting requirements and tax rates or amount charged. When factors influencing SMEs' attitude towards tax were classified, three groups were formed. *Economic factors*, which include audit frequencies, compliance and non-compliance, meaning the same thing in terms of financial costs, penalties for non-compliance/severity of fine, financial implications, complexity of tax system, likelihood of being caught and levels of tax rates. *Psychological factors* had two variables, namely, equity and fairness; and tax exemptions.

The last encompassed *social factors* including variables like rate of evasion of the other tax payers, the impact of tax compliance and public services provided by the government. In terms of priority, economic factors were the most relevant and constituted the highest score in terms of explained variance (34 %). This paper notes that as dynamic as human behaviour is, which is not easily predictable does the tax payers in changing time and space. Thus, findings from this study provide an indication of varying tax payers' attitudes contingent to time and space as defined by rulings from the

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government, tax policies as well as laws and implementation thereof by the tax authority. Additionally, it was found out that tax payers face several hurdles including poor skills and knowledge about tax; multiple taxation; cumbersome records and reporting procedures; stiff competition; timing for payments; and inapt tax officers' behaviour(s). The study recommends that responsible institutions should simplify tax procedures, eliminate bureaucracies and educate tax payers for better tax compliance.

Key words: Economic factors, psychological factors, social factors, SMEs, tax compliance, tax noncompliance

Introduction

Tax compliance has been a concern since time immemorial. There have been numerous discussions around factors influencing tax compliance. It is still debatable whether edicts from economics and behavioural science apply equally across contexts as well as taxpayers, while traversing time and changing environment (Nkwe, 2013; James and Alley, 2004). Thus, the body of knowledge covering tax payers' attitude and factors influencing the same is broad and general. But it is believed that the propensity towards tax is multifaceted and cannot be explained using a single theory or following a simple strand of knowledge. Yet, tax payers' context has a far reaching influence on their attitudes towards tax. Thus, variables that could hold water at a certain period of time may not necessarily traverse time and changing environment, particularly regulations and policies, tax systems and others. James and Alley (2004) argue that development such as e-commerce, emergency of global economy and self-assessments are new considerations that influence on tax compliance. Regardless of body of knowledge used to explain tax compliance, it is much highly relevant to relate compliance behaviour with a particular context. By context, it is in

reference to variables such as policies, enforcement strategies and tax systems' penchant and tax payers' roles as well as position across these variables.

Exemplifying changing environment, the event of tax evasion in Tanzania that led to massive loss of government revenue was purely related to an era characterized by laxity from the government (Daily News 7th December, 2015). With the new regime, it seems that compliance has increased (World Bank, 2016).

“The new administration has taken bold measures to crack down on tax evasion, with this measures resulting in consistent over-performance in tax revenue collection” (*World Bank, 2016*).

Thus, pointing to a convergence of variables such as tax payers' motivation or intention to comply or not, the state of law enforcement and guardianship as well as tax systems are important preconditions thereby suggesting compliance being contingent on time and space given the changing environment. The remainder of this paper expounds on theories, methodology and findings that epitomize our concerns.

The Theoretical Context

Overtime, scholars have explained tax compliance using a number of edicts. This paper extends the discussion by adapting the edicts from routine activity theory to tax compliance knowledge. This theory is anchored on the fact that crime occurs in an event of a convergence (in time and space) of three factors. A motivated offender, a suitable target and in event of absence of capable guardianship (Cohen & Felson, 1979). In the same vein, tax compliance or non-compliance may occur in the absence or presence of tax payers likely to avoid or evade tax. The other factor is presence of a suitable target, seen as representing loose or poor tax rules and regulations.

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There is reckon to Fischer’s tax compliance model (Chau and Leung, 2009), which offers variables that constitute compliance. The model emphasizes on demographic attributes such as age, gender and education; non compliance opportunity including income level, source and occupation; attitudes and perceptions such as fairness of tax system, peer influence; and tax system/structure whereby there are aspects related to complexity of the tax system, probability of detection and penalties including tax rates. Put together, these factors overarch tax compliance theory and corroborate noncompliance conjecture suggested by this paper in the ensuing paragraphs.

Thus, the question about tax compliance and noncompliance lies in realms related to crime. Convergence of three factors (Figure 1.1) makes it easier and possible for crime to occur (Cohen and Felson, 1979). If noncompliance is looked at as a form of crime, some conditions could encourage or deter it (Figure 1.2).

Figure 1.1: *Routine Activity Theory*

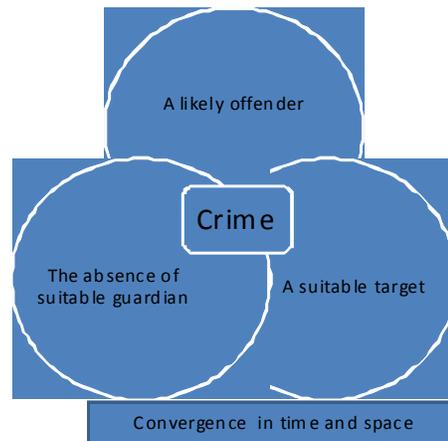
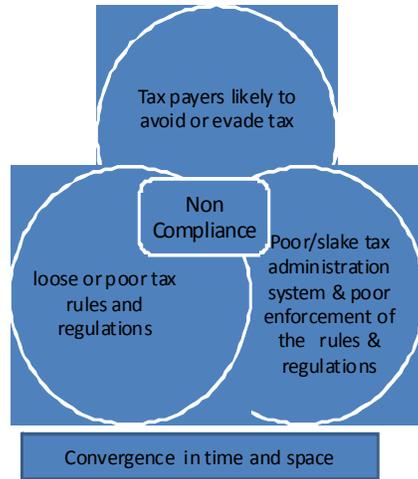


Figure 1.2: Non-Compliance Scheme



Thus, noncompliance relates to committing crime in a manner that three aspects that favour tax evasion or avoidance converge. In this model, noncompliance includes both evasion and avoidance that reduce taxation by illegal means and reduce taxation by legal means, respectively (James and Alley, 2004). Reality of avoidance is based on the fact that tax payers who intend to avoid taxes may take advantage of weak tax regulations for their own advantage and actually, maximizing their utility beyond acceptable tax norms. Such activities could include delays and appeals, artificial transactions, and fraudulent tax exemptions together with holidays, which take advantage of loose tax systems. All could amount to noncompliance. Studies related to tax compliance have also highlighted factors such as transparency, tax payers' willingness and collection process as well as mechanisms are important. Kirchler (2007) put forward determinants of tax compliance, including social psychological determinants that consist attitudes, norms, fairness perceptions as well as motivational aspects;

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political determinants, which bare complexity of law and tax system, and fiscal policy; and economic determinants describing rational decision-making process; and the effect of audits, fines, tax rates including income. However, Sapiei and Kasipillai (2013) argue that both economic and behavioural approaches have contributed to understanding of tax compliance behaviour. As seen, noncompliance is versatile, comprising a number of mingling factors.

Looking at economic principles, Becker in 1968 (cited in Sapiei and Kasipillai, 2013) analyzed criminal behaviour using an economic framework known as economics-of-crime model. In general, taxpayers are seen as perfectly unprincipled utility-maximizes, who choose to evade taxes whenever an expected gain exceeds the cost of evasion. Deterrence is about effects of sanctions and sanction threats (Atawodi and Ojeka, 2011; Sapiei and Kasipillai, 2013). These aspects tend to shape the behaviour of taxpayers located in a certain place. The theory suggests that taxpayers are influenced by economic motives such as profit maximization and probability. As such, tax payers tend to analyze alternative compliance paths, for instance, whether or not to evade tax, the likelihood of being detected and the resulting ramification and then select an alternative that maximizes their expectations.

Putting this in context, tax rates, detection probabilities and penalty structure determine monetary costs of compliance, which determine taxpayers' compliance behaviour. Application of the economic approach in studying tax compliance has been observed in a number of empirical studies (Casey and Scholz, 1991; Loo, 2010). For instance, Walsh (2012) found out that tax compliance is determined by five broad factors: deterrence; norms (both personal and social); fairness and trust (in tax administration); complexity of the tax system; the role of government; and the broader economic environment. In fact, most studies have indicated that there is a clear interaction among factors such as income, tax rate as

well as tax penalty and that there is an interplay with psychological factors such as tax payers' norm, moral as well as attitude; and social factors including demographic factors (Brook, 2001).

The apex to this discussion is that there is a need for further empirical findings to ascertain if the existing variables apply equally across contexts. Chau and Leung (2009) propose that tax compliance research has mainly focused on developed countries. They (*ibid.*) further argue that developing countries are particularly vulnerable to tax noncompliance and thus, calling for more empirical as well as institutional research about tax compliance behaviours in the contexts. This paper took a step in bridging the lacuna and sought to attest on how the three proposed noncompliance aspects interact and which among them weight more than the others. Along these lines, challenges faced by tax payers are also established.

Methodology

The study used survey techniques particularly cross-sectional survey involving SMEs in Dar es Salaam, Tanzania (Saunders, *et. al.*, 2007). The *raison d'être* of determinants of tax compliance are evident and thus, possibly gathered from the field. Generally, positivists assume that reality is objectively given and can be described by measurable properties, which are independent of the observer (researcher) and his or her instruments.

The population for this study involved individuals or objects known to have similar characteristics that involved SMEs owner/owner managers. According to Copper and Schindler (2006), population for study should consist individuals or elements that fit a certain specification. Then SMEs were considered as having similar characteristics and subjected to similar tax requirements. Dar es Salaam was selected because it is a business hub in the country and many SMEs are found operating in this region. It was anticipated that findings from Dar es salaam though not generalizable would offer an indication of compliance in the country.

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Research endeavours were geared to collect data from a small sample to represent the entire population (Babbie, 1992). Thus, data were collected through convenient sampling whereby the researcher selected respondents deliberately to include only SMEs. A total of 158 respondents were involved in this study. Collected data were analyzed through factor reduction in order to establish relevant classes. Additionally, descriptive statistics were run to find frequencies and distribution. Table 1.4 shows adequacy of the data with results showing the degree of common variance among variables as meritorious given the KMO values of 0.805 with Bartlett's Test of Sphericity 78 at P less than 0.000. Furthermore, factor loading from the varimax rotation was found greater than 0.3, ranging from 0.532 to 0.854 (Table 4.6), an aspect, which indicates high level of reliability and validity (Falk and Miller, 1992).

Findings

Respondents Characteristics

Respondents' distribution by age, gender and education background is shown in Table 1.1. As such, this sample distribution depicts a fairly good representation of different respondents' age groups, education background and gender. It was important to capture these attributes because arguments hold that demographic attributes indirectly affect the taxpayer's propensity towards compliance or noncompliance (Chau and Leung, 2009). Though it was beyond the scope of this paper to search for the relationship between these attributes and compliance, it is important to have a fair representation in each of the demographic attribute to avoid bias.

Table 1.1: Respondents Distribution by Age, Gender and Education
 Respondents Sample Distribution (N is 158)

Demographic Variables		
Age	N	Percent
18-27 Years Old	36	22.8
28-37 Years Old	40	25.3
38-47 Years Old	38	24.1
48-57 Years Old	24	15.2
Above 57 Years Old	20	12.7
Gender		
Male	75	47.5
Female	83	52.5
Education Level		
Primary Education	6	3.8
Secondary Education	45	28.5
Certificate/Diploma	52	32.5
Bachelor degree	48	30.4
Post graduate	7	4.4

Furthermore, it was necessary to ensure that different firms based on their size and age in business are represented. Combined, source and income level tend to influence on tax compliance (Andreoni *et. al.*, 1998). Thus, having a fair representation of different firms would ensure validity of findings. Table 1.2 presents distribution of respondents by business size and duration in business. All indicate there is a good representation of firms based on size and duration.

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Table 1.2: *Firms Distribution by Size & Duration in Business (N is 158)*

Variables	N	Percent
Business Duration		
Less than 5 Years Old	55	34.5
5-10 Years Old	69	43.7
Above 10 Years Old	34	21.5
Firm Size		
Micro (< 5 employee)	64	40.5
Small(5-49 employee)	59	37.5
Medium(50-99 employee)	35	22.2

In this study, firm size was represented by number of employees as an aspect adopted from Tanzania SMEs' Policy of 2003. Despite the other variables used to measure firm size in SMEs policy such as capital and sales, scholars have recommended use of number of employees due to the fact that such information is easy and less complicated for data collection as well as data analysis.

Tax Attributes Articulating SMEs' Tax Compliance

Among others, the paper aimed at profiling tax attributes articulating SMEs' compliance, Table 1.3 shows factors/variables related to tax that tend to influence on taxpayers' propensity. The variables were ranked based on their importance.

Table 1.3: Attributes Articulating SMEs' Tax Compliance

Factors	N	Min	Max	Mean	Std. Deviation	Rank
A feeling that you are paying fair tax	158	1	5	3.97	1.103	1
Reasons for paying taxes are well known	158	1	5	3.97	1.120	2
Tax laws are easy to understand	158	1	5	3.92	1.086	3
Reporting requirements for tax purposes are not complicated	158	1	5	3.75	1.162	4
The tax rate/amount charged in various taxes are reasonable	158	1	5	2.66	1.362	5
Record keeping for tax purposes are not tedious	158	1	5	2.63	1.361	6
Timing for paying taxes allows for easy compliance	158	1	5	2.59	1.419	7
Penalties and interests charged for non-compliance are fair	158	1	5	2.54	1.430	8
Valid N (based on list)	158					

To a large extent, SMEs' compliance was found to be influenced by such characteristics as a feeling that business owners paying a fair tax tend to motivate taxpayers to comply. Otherwise, if there is a feeling that the tax to be paid is unfair, they tend to shy away or avoid tax. Secondly, if reasons for paying taxes are well known among tax payers, they make it easy and stimulate as well as accelerate tax compliance. Thirdly, majority of respondents reported that tax payers will comply if tax laws are easy to understand. This makes it easy for SMEs to follow through and fulfill their obligations. These findings corroborate Kirchner's (2007) determinants. But ranking is important in order to assign an appropriate weight accordingly.

Additionally, SMEs' compliance was said to be much influenced by nature of reporting requirements. This implies that if procedures are less bureaucratic with minimum routines, it is more likely that compliance will increase. Considering the five most important factors, tax rates or amount charged could as well influence compliance. That is, reasonable rates are more desirable than higher tax rates. Record keeping, timing and penalties

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were mentioned among factors that tend to articulate tax payers' attitudes (see also Batrancea *et. al.*, 2012).

Furthermore, evaluation of tax compliance ought to consider how taxpayers see or perceive their state. Meaning that services offered and all other tax parameters born by the state influence on the tax payer's behaviour and compliance (Batrancea *et. al.*, 2012). In tandem with other factors, these attributes determine compliance. Said otherwise, tax payers' views on tax policy, public goods, and tax regulations constitute socio-psychological determinants of tax compliance behaviour (Xin *et. al.*, 2015; Batrancea *et. al.*, 2012).

Classification of Factors Influencing SMEs' Tax Compliance in Tanzania

The study classified attitudes towards tax compliance. It involved performing factor reduction and grouping factors into three categories. The KMO and Bartlett's tests Table 1.4 shows that the data were adequate for factor analysis. Obtained KMO and Bartlett's Test of Sphericity values were acceptable and allowed for factor analysis (see Table 1.4; Hutcheson and Sofroniou, 1999, Field, 2005). Results showed KMO values of 0.805, with significant Bartlett's Test of Sphericity at p less than 0.000 (Table 1.4). These results show that the degree of common variance among variables is meritorious and the data were adequate for further analysis.

Table 1.4: *KMO and Bartlett's Test*

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.805
	Approx. Chi-Square	555.647
Bartlett's Test of Sphericity	Df	78
	Sig.	.000

Table 1.5: Total Variance Explained

Component	Initial Eigen values			Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
	1	4.386	33.738	33.738	4.386	33.738	33.738	3.918	30.138
2	1.569	12.071	45.809	1.569	12.071	45.809	1.713	13.178	43.316
3	1.126	8.663	54.472	1.126	8.663	54.472	1.450	11.156	54.472
4	1.066	8.203	62.675						
5	.909	6.990	69.665						
6	.832	6.400	76.065						
7	.682	5.246	81.311						
8	.590	4.536	85.847						
9	.455	3.499	89.346						
10	.425	3.269	92.615						
11	.395	3.039	95.654						
12	.301	2.314	97.968						
13	.264	2.032	100.000						

Factor analysis was employed using Maximum Likelihood and varimax rotation with Kaiser Normalization. The value of each eigen value obtained for the three factors were greater than 1.0, ranging from 1.126 to 4.386 (Table 1.5). The factor loadings after varimax rotation were greater than 0.3, ranging from 0.532 to 0.854 (Table 1.6). The variance explained by the three factors was 54.472 or 54.5 percent. Additionally, there was no variable with significant loading on more than one factor. Given the fact that the analysis was confirmatory in nature, three factors were obtained.

Labeling the Factors

The three extracted factors were labeled as follows: First, Economic Factors, which include such variables as audit frequencies, compliance and noncompliance, meaning the same thing in terms of financial costs,

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penalties for non-compliance/severity of fine, financial costs, complexity of tax system, likelihood of being caught, and levels of tax rates. These attributes combined constituted about 34 percent of the explained variance. The second, labeled psychological factors has two variables, namely, Equity and Fairness; and Tax Exemptions. The variables constituted 12 percent of the explained variance. The third factor labeled Social Factors comprised three variables, namely, rate of evasion of others, impact of tax compliance and public services provided by Government. This dimension made about 8 percent of the explained variance (see Table 1.5). Given the aim of this study, it was confirmatory in nature and intended to establish convergence of three aspects of tax. The extracted factors explained this phenomenon by more than 54 percent. From results, it can be deduced that SMEs’ attitude on tax compliance is multi-dimensional, which combines economic, psychological and social factors. Further discussion follows in the ensuing section.

1.6: Rotated Component Matrix^a

Components/ Factors	1 Economic Factors	2 Psychological Factors	3 Social factors
When audit frequencies are reasonable	.854		
Complying and not complying mean the same thing in terms of financial cost	.790		
Penalties for noncompliance/severity of fine	.741		
Financial costs	.729		
Complexity of tax system	.729		
Likelihood of being caught	.571		
The levels of tax rates	.532		
Equity and Fairness		.805	
Tax exemptions		.796	
Rate of evasion of others			.698
Impact of tax compliance			.623
Public services provided by Government			.563

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization.

a. Rotation converged in 4 iterations.

Looking at the three factors from the perspective of the proposed noncompliance scheme (Figure 1.2) and if we are to re-draw the ven diagrams, each structure of the ven diagram will be different in terms of size. The size reflects variance explained by economic, psychological and social factors, 34, 12 and 8 percent, respectively. Though it was suggested that convergence of these factors is highly important (see also Kamleitner *et. al.*, 2012), differences in the structures might suggest the extent of efforts to be directed for each in order to do away with convergence. Both the government and revenue authority must work concurrently in formulating tax policies and rules as well as set up mechanisms for their implementation in a manner that will curb noncompliance. Any loose end in the economic- psychological-social factor continuum suggests a convergence and a loophole that tax payers could leverage as well as avoid or evade tax.

The differences in size and variables defining each factor suggest the aspect of context as being important. Thus, from the context of this study, audit frequencies, when compliance-noncompliance has the same financial implications and penalties, complexity of the tax system, likelihood of being caught and tax rates are more important because they articulate tax payers' compliance. Combined, these economic factors explained 34 percent of the 54 percent explained variance. Thus, tax compliance is more of an economic decision and that when avoidance or compliance results into gains or lose, majority will avoid tax and the reciprocal is true. Equity and fairness, on one hand, and tax exemptions, on the other, comprise the second important influencing factors. This suggests that treatment extended by the government to other tax payers has far reaching effects in terms of compliance (see World Bank, 2016). A feeling of unfairness and being very generous may have negative consequences, creating a big number of firms that would not comply. Thus, it implies that government decisions and policies on exemptions together with a show of fair treatment may

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stimulate or bar some SMEs' compliance attitudes and behaviours. Tax payers learn from treatment others receive from the same tax collecting unit and the government, in general. Such information could discourage or encourage tax payers.

Social factors, which explained 12 percent of the extracted variance, had the rate of evasion of others, suggesting that SMEs join whatever wagon is, should there be less evasion then the tendency is to learn to do what others are doing. Or else, when aversion is high, they learn to avoid tax like what others in the same community are doing. Secondly, the impact of tax compliance will stimulate or deter compliance in the same manner as the rate of evasion. Lastly, there are public services provided by government. The fact that tax payers feel they receive a positive feedback in terms of services provided by the government, they tend to comply otherwise, they avoid paying tax in the absence of government social services.

Therefore, tax compliance is a function of several factors, though with varying weight, the most important is their convergence. Thus, one intending to address tax compliance should take on board all of the three factors and pay more attention to economic, psychological and social factors in that order of importance. This, it is believed, is due to issues pertaining to the context under study. For others, ethics and social aspects may occupy the first tier, given the level of ethics and moral obligations, as argued by Kamleitner and colleagues (2012). But, in literature review, it was suggested that convergence of factors/conditions resulting to crime is a matter of in time and space. Both are dynamic. It implies that the weight and thus, size of the ven diagram structure may vary, depending on time and space. Therefore, they are dynamic. Dynamic like human behaviour, which is not easily predictable, so do the tax payers in changing time and space. Thus, findings from this study provide an indication of varying tax payers' attitudes contingent to time and space as defined by rulings from the government, tax policies and laws including their implementation.

Challenges facing SMEs to comply with tax law

The study sought to identify challenges faced by SMEs in endeavours to comply with tax requirements. This was deemed important due to the fact that tax payers' attitude and behaviours are much affected by environment. Several challenges were identified and ranked.

Table 1.7: *Challenges Facing SMEs to Comply with Tax Laws*

Factors	N	Min	Max	Mean	Std. Deviation	Rank
Poor skills and tax knowledge	158	1	5	4.13	1.161	1
Multi taxation	158	1	5	4.05	.929	2
Cumbersome record keeping	158	1	5	4.03	.944	3
Stiff business competition	158	1	5	3.79	1.059	4
Timing for tax payments	158	1	5	3.72	1.350	5
Tax officers behavior	158	1	5	3.59	.924	6
Tax language and communication	158	1	5	3.58	1.425	7
Who collect tax (councilor, TRA)?	158	1	5	2.46	1.399	8
Valid N (in terms of list)	158					

Table 1.7 shows several challenges facing SMEs in regard to tax compliance. The most important factors as ranked by respondents were poor skills and knowledge about tax among SMEs, followed by presence of multiple taxation, which, in most cases, led to confusion and burden among tax payers. Additionally, cumbersome record keeping was among notable challenges and stiff competition because tax payers tended to think or believe that taxes scooped their profits, on one hand, but they failed to price their commodities to include the required tax in the eve of stiff competition, on the other hand. It was disclosed that to compete through cost leadership tempted them to avoid or evade tax as means to reduce

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cost of an item. That happened when there were loopholes in the tax administration process and thus, tax payers found it as an easy option. Timing for payments could also be a red tape towards compliance, particularly when paying tax is set at repeated frequencies. Considering the most important five challenges, the last was tax officers' behaviour. The manner in which tax collectors or officials approach SMEs could lead to problems, particularly when there is poor communication among them.

Conclusion

Findings from this study suggest that the propensity of SMEs towards tax is versatile, requiring appropriate mechanisms that ensure all three aspects including economic, psychological and social factors are implemented in a way that stimulates compliance. Yet, the fact that there will always be changes in administration, policies and tax laws over time and space, compliance will also change. Thus, strategies set up to improve tax compliance have to consider the changing environment. With challenges abounding, increased noncompliance could persist due to the fact that tax payers are subject of change based on prevailing challenges. One has to keep these hindrances at minimum possible so as to enhance/accelerate compliance.

From the findings, the paper recommends that tax payers are treated to be relevant actors with potential to change as the tax environment evolves. The major efforts should be towards addressing the weak link in the continuum, economic-psychological and social factors. While addressing susceptibility in the link is important, addressing challenges faced by tax payers may alter the tax payers' behaviour in a positive manner. Thus, the study recommends to responsible institutions that they should simplify tax procedures, eliminate bureaucracies and educate tax payers for better compliance.

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