

Determinants of Rental Withholding Tax Compliance: A Case of SMEs in Arusha, Tanzania

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Abstract: This study investigated about determinants of rental withholding tax compliance in Arusha, Tanzania. This study used the descriptive correlational design. The descriptive part of the design addressed the first research question while the correlational part addressed the second research question. The sample of the study was 90 drawn from 1,700 SMEs. The study employed a questionnaire as data source. Validity of the questionnaire was established through expert judgment. To ensure reliability of the results, the researcher conducted a pilot study to a small sample of 35 individuals with similar characteristics as the sampled respondents. After data analysis, the pilot study data yielded the Cronbach's Alpha of above.700. Treatment of data involved mean scores and regression analysis. The study concludes that tax compliance is low among the SMEs in Arusha City. Awareness of compliance benefits is a contributing factor toward effective compliance. Based on the conclusions, the study recommends a serious intervention by providing awareness among the SMEs in Arusha City on the importance of their withholding tax compliance. As revealed by the findings and corresponding conclusions, the awareness will raise the rate of compliance.

Keyword: Compliance; withholding tax; small and medium enterprises; Arusha Tanzania.

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Introduction

Taxation is a major source of income in most economies (Djawadi & Fahr, 2013). In both developed and developing countries, taxation remains the core source of governments' revenue. Due to the crucial role played by taxation on public revenues, most governments employ various strategies to ensure effective collection of taxes. One strategy is using withholding tax as a means of effective collection of some identified direct taxes including rental income tax. Withholding tax is the obligatory tax by law to be withheld by a party for each payment made to another contracting party from the income or service rendered (URT, 2004). In other words, withholding tax is an income tax paid to tax authorities by the payer of the income and not by the recipient of the same income. That

means this tax must be withheld (deducted) from the amount of income due to the recipient.

The importance of withholding tax as a means of effective tax collection is emphasized by OECD (2014) in this era of the digital economy. The source shows that the challenges related to taxation in the digital economy can be addressed by the creation of a withholding tax on digital transactions.

In the United Republic of Tanzania (URT), withholding tax was introduced in the Income Tax Act (ITA) of 2004, Revised 2019. Section 82 subsection (1) requires a resident individual who pays a dividend, interest, natural resource payment, rent, or royalty with a source in the URT, to withhold from payment an income tax at the rate specified in the act. Before the last amendments to the Act in July 2022, Subsection (2) of the same section exempted from withholding tax, rental

payments made by individuals not conducting a business. However, NBS (2022) shows that the use of withholding tax in collecting rental income tax has not raised enough revenues from rental income taxation compared to other direct taxes. Withholding tax Compliance on rental payments has remained very low since then, yielding very little public revenues from rental services.

According to NBS (2022), twelve Financial Years reviewed (2009/10 to 2020/21) indicated that the contribution of rental income tax to total direct taxes remained averagely below 80 billion Tanzanian shillings amid the vast growth of total direct taxes. Revenues from total direct taxes grew by 331% from Tshs. 1.461 trillion in 2009/10 to Tshs. 6.301 trillion in 2020/21 while revenues from withholding tax on rental payments, on the other hand, remained stagnant over the period. Withholding tax collections from rental payments indicated slight growths and falls over the 12 financial years amid the growing real estate sector in Tanzania (Kongela, 2013).

In 2018, for example, rental services in Tanzania generated TZS 4,492 billion (US\$ 1,991 million) in economic activity, accounting for 3.5 per cent of GDP (Gardner, et al. 2020). The minimum potential withholding tax revenues in 2018 according to the tax rates by URT (2004), was TZS 449.2 billion. But the actual amount collected from rental services as withholding tax in 2018 was TZS 94.5 billion only (NBS, 2022), accounting for only 21% of the potential collections and leaving out 79% of the potential withholding tax on rental payments, uncollected.

The largest portion of withholding tax from rental payments is from Small and Medium Enterprises (SMEs). According to Subsection (2) (d) of section 82 of the ITA, the withholding agents on rental income are institutions, firms or individuals who lease land, buildings or aircraft to conduct business. Most of the business establishments which pay rent are SMEs which, according to MITI (2003), make up a major percentage of Tanzanian active businesses. MITI (2012) estimated that the small and medium-scale business sector contribution to the national GDP was about 27.0% of Tanzania's GDP.

Literature Review

This section presents related literature and studies. The section is organized into subheadings as follows:

Tax Compliance

Tax compliance has been defined as reporting of tax liability to the relevant authority in compliance with applicable tax laws and regulations (Jackson & Milliron, 1986). It has also been defined as a process in which taxpayers file all the required tax returns by declaring all income accurately and paying the exact tax liability using applicable tax laws and regulation (Palil & Mustapha, 2011).

Tax compliance can be in two forms: administrative and judicious compliance. Administrative compliance refers to compliance with the applicable tax laws as stipulated in the relevant regulations, whereas judicious compliance refers to the accuracy in filing the tax return forms (Chow, 2004). Compliance can be through enforcement by relevant authorities or through voluntary or willingness of the taxpayers. Tax compliance enforcement is through powers conferred on the relevant authorities to force the taxpayers to pay while voluntary means morality of the taxpayers to pay tax willingly. Thus, voluntary tax compliance has been defined as filing and reporting of tax returns, correct self-assessment of tax due and payment of taxes before or on the due date without enforcement (Baer & Silvani, 1997).

Government Spending

Government Spending is explained in the Fiscal Exchange Theory. According to this theory, compliance rises when taxpayers perceive the availability of public goods and services (Alm et al., 1992). This means the public is mainly concerned with what they directly get in form of public services as a return of the taxes they pay (quid pro quo). Individuals may pay taxes because they value the government's goods and services, understanding that their contributions are required both to help finance the goods and services and to encourage others to contribute (Fjeldstad & Semboja, 2001). Anane and Asamoah (2015) found that respondents did not 'enjoy' the benefits of paying tax because they didn't see good sanitation and hygienic markets with the required infrastructure such as clean toilets and clinics. Ayele (2019) investigated several factors, including government expenditure perceptions, to see how they influenced income tax compliance in Bahir Dar City (Ethiopia). The study's findings revealed that public perceptions of government spending had a direct and significant impact on income tax compliance. Kinyua (2014) investigated the factors that influence landlords' voluntary tax enforcement in Nairobi County, Kenya.

The results revealed that people's attitudes and perceptions of politicians' misuse of public funds had a significant impact on tax compliance among Kenyan taxpayers with rental income.

Withholding Tax Rates

A Swiss Philosopher Jean-Jacques Rousseau (1712-1778) developed the theory of the ability to pay. His emphasis was that more revenue will be generated when more people can pay the tax due to affordable tax rates. This means the tax base will be expanded by including more taxpayers because they are capable to pay taxes (Shemdoe, 2015). As Mahenge (2018) puts it, there will be no quid pro quo because taxpayers will be willing to pay taxes to authorities since they are aware of and are capable to pay the taxes. Using cross-country data, Masud et al. (2014) investigated the effect of the tax rate on tax compliance in Africa. The data revealed a significant negative link between tax rates and tax compliance and that tax rate has a negative impact on tax compliance. Ayele (2019) in their study indicated that lack of ability to pay was among the factors that had direct and significant effect on income tax compliance. The author recommended the Government to minimize or adjust to reasonable tax rates to increase the compliance behavior of taxpayers and also increase tax revenue and reduce tax evasion & avoidance.

Tax Education

An economist Adam Smith in 1776 advanced the Ability to Pay Theory, adding the factor of tax knowledge on it. According to Smith (1776), fairness in taxation should take into account the circumstances of the taxpayers, such as their ability to pay taxes in accordance with their requirements as a family and themselves. Tax knowledge, or certainty, should imply that taxpayers have a thorough understanding of the purpose and methodology of taxation.

Studies have shown a link between tax education and tax compliance. In their study, Thananga et al. (2013) found a low degree of full compliance with the rules of the rental income tax policy. One of the reasons for non-compliance was a lack of understanding of the rental income tax policy, particularly knowledge of the requirements of the policy. Anane and Asamoah (2015) also found that tax knowledge is very significant in evaluating the level of tax compliance of the small traders in the Obuasi Municipality of Ghana. Kamil (2015), examining the impact of taxpayer awareness,

knowledge, tax penalties and service tax authority on tax compliance in Indonesia found that taxpayer knowledge has a favorable and considerable impact on individual taxpayer's compliance.

Tax Administration

Tax administration can be explained in simple language as a system which decides how tax legislations are applied through making tax policies (Mansfield, 1988). Tax administration has to link the legal statutes to the practical implemented systems of tax. Tax administration in the context of this study means tax systems that affect fiscal deficits and also burdens of tax of real estate sector particularly on rent. Kamil (2015) showed that even taxpayers with a high degree of tax knowledge sought for loopholes to minimize tax responsibilities. Tax penalties were also discovered to have a good and significant link with the individual taxpayer compliance. The author concluded that the more successful the implementation of tax penalties, the higher the tax compliance rate. In addition, the Tax Authorities Services have a positive and considerable compliance connection. This implies that the better the tax authority service, the higher the tax compliance rate.

Musau (2015) investigated factors that influence SMEs' tax enforcement in Nairobi County. The results of the study showed that as an individual's understanding of the difficulty of evading taxes rises, so does the probability of SMEs in Nairobi County tax compliance increase.

Berhane and Yesuf (2013) assessed the challenges and opportunities of Business House Rental income taxation in Regional state of Tigray. Their findings showed inefficiency and insufficient number of business house rent tax assessment and collection officers in the regional state of Tigray Finance and Economic Development Bureau. Due to this and other factors, negligence, delay in tax payment and evasion are taken by taxpayers as solution to escape from payment of proper business house rental income taxes.

Masawa (2017) conducted a study on determinants of voluntary tax compliance in Tanzania from taxpayers' perspectives with a case study of small and medium enterprises (SMEs) in Dar es Salaam and found that SMEs compliance with tax laws and regulations is largely influenced by tax authority service quality, quality of public governance, fair tax related laws, regulations and the trust of the taxpayers.

Methodology

Research Design

This study used the descriptive correlational design. The descriptive part of the design addressed the first research question while the correlational part addressed the second research question.

Study Settings

The study took place in Arusha City, Tanzania. According to KCIC (2020), Arusha is one of Tanzania's ten regions with most of industrial firms. Furthermore, Arusha is one of five regions in Tanzania, where the presence of Small Businesses amounts to at least 10% of all businesses, with the others being Dar es Salaam, Kilimanjaro, Kagera and Manyara. However, when it comes to higher medium-sized businesses, only Arusha has a higher than 5% proportion of SMEs. Therefore, Arusha

stands out as the ideal location for this study based on the available data on SMEs distribution in the country.

Validity and Reliability

A questionnaire was used in data collection. Validity of the questionnaire was established through expert judgment to make sure that the items in the questionnaire measured what they were intended to measure.

To ensure reliability of the results, the researcher conducted a pilot study to a small sample of 35 individuals with similar characteristics as the sampled respondents. After data analysis, the pilot study data yielded the Cronbach's Alpha of above .700 as seen in Table 1, meaning the results were reliable.

Table 1: Reliability test by Cronbach's Alpha

SN	Variable	Cronbach's Alpha	Decision
1	Government Spending	.863	Reliable
2	Tax Level	.817	Reliable
3	Tax Education	.815	Reliable
4	Tax Administration	.885	Reliable
5	Compliance	.799	Reliable

Table 2: Sample Size for the Study

Targeted Population	±3%	±5%	±10%
500	345	220	80
1000	525	285	90
3000	810	350	100
5000	910	370	100
10,000	1000	385	100
100,000	1,100	400	100
1,000,000	1,100	400	100
10,000,000	1,110	400	100

Source: Kalpana (2011)

Data Analysis

Data from the questionnaires was coded and then analyzed using the Statistical Package for Social Sciences (SPSS) version 20 in terms of Regression Analysis. Regression Analysis is a statistical approach for analyzing the connection between independent variables and a dependent variable.

Population and Sampling

The target population for this study was composed of SME Tenants operating in Arusha City. Arusha had 1,700 SMEs (KCIC, 2020) which represent this study's population. The sample size choice was as per Kalpana (2011) on the sample size to be considered in surveying. Table 2 summarizes Kalpana's suggestions of samples depending on the population size.

Therefore, this study utilized 90 respondents at the margin error of 10% from among the 1,700 SMEs operating on real estate in Arusha.

Results and Discussion

This section presents the results of the study. It begins with presentation of the demographics of respondents and then analyzes the data according to research questions.

Demographics of Respondents

The study engaged 90 respondents as sample. The sample represented both genders equally. With regards to age, 20 (22.2%) respondents had the age of 25 years or below, 18 (20%) had the age of between 26 and 35 years, 32 (35.6%) had the age of between 36 and 45 years and 20 (22.2%) had the

age of 46 years and above. According to these findings a bigger portion of the respondents had the age of between 36 and 45 years.

Regarding business experience 38 (42.2%) respondents had been tenants for five years or below, 20 (22.2%) had been tenants for between 6 and 10 years, 17 (18.9%) for between 11 and 15 years and 15 (16.7%) for 16 years and above. Hence a bigger portion of respondents had been tenants for 5 years or below.

The distribution of respondents according to their education level indicates that 41 (45.6%) respondents had primary education, 25 (27.8%) had secondary education and 24 (26.7%) had university or college education. Therefore, the majority of respondents had primary education.

The distribution of respondents according to their monthly rental payments shows that 30 (33.3%) respondents had monthly rental payment of Tshs 100,000 or below, 21 (23.3%) were paying between Tshs 100,001 to 300,000 per month, 14 (15.6%) paid between Tshs 300,001 to 500,000 monthly, 12 (13.3%) had monthly rental payment of between Tshs 500,001 and 1,000,000 and 13 (14.4%) paid above Tshs 1,000,000 monthly.

Analysis and Discussion

This study sought to establish determinants of rental withholding tax compliance among the SMEs in Arusha, Tanzania. The study was guided by two research questions. The first research question

showed the perception of respondents regarding withholding tax compliance. The second research question sought to establish the influence of selected factors on tax compliance.

Research Question 1: What is the perception of respondents regarding withholding tax compliance?

This research question sought to establish the level of tax compliance, using mean scores and standard deviations. The responses to the questionnaire appear in a five point scale, ranging from strongly disagree (1), disagree (2), undecided (3), agree (4) and strongly agree (5). The mean scores were interpreted as follows: 4.50-5.00=strongly agree, 3.50-4.49 = agree, 2.50-3.49= undecided, 1.50-2.49= disagree and 1.00-1.49= strongly disagree.

Table 1 presents the compliance to withholding tax among the selected SMEs respondents. In the table the mean scores ranged between 1.50 and 2.49, which means respondents disagreed with all the statements in the table.

Particularly, they disagreed that they remit the withheld amounts of withholding tax to TRA and that they file returns related to withholding tax. They also disagreed that they withhold 10% of their rental payments to their landlords, that they pay the right amounts of withholding tax and that their landlords agree with the deductions of rentals as withholding tax.

Table 1: Response of SME tenants on Withholding Tax Compliance Level

Item in the questionnaire	Mean	Std. Dev	Interpretation
I remit the withheld amounts of withholding tax to TRA	1.9111	1.15772	Low Compliance
I file returns related to withholding tax	1.8889	1.12624	Low Compliance
I withhold 10% of my rental payments to my landlord	1.8778	1.13006	Low Compliance
When I comply, I pay the right amount of tax	1.7111	1.08353	Low Compliance
My landlord agrees with the deductions of tax	1.5444	0.99618	Low Compliance

This finding indicates that the compliance of respondents is low. The results support those by Anane and Asamoah (2015), which discovered that the majority of small business owners in the Obuasi Municipality, Ghana did not file income taxes. The results are likewise in line with those of Thananga et al. (2013), who investigated the factors influencing landlords' compliance with the rental income tax policy in Nakuru Municipality and discovered that overall compliance was low.

Research Question 2: Is there a significant relationship between tax compliance and selected independent variables?

This research question sought to establish the relationship between tax compliance and selected independent variables namely government spending, withholding tax level, tax education and tax administration. The study employed the multiple regression analysis to establish whether the aforementioned independent variables have any effect on tax compliance as described in table 2 to 4.

Table 2: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.827 ^a	.684	.680	.56217

a. Predictors: (Constant), Tax Education

Table 3: Analysis of Variance (ANOVA^a)

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	60.093	1	60.093	190.147	.000 ^b
	Residual	27.811	88	.316		
	Total	87.904	89			

a. Dependent Variable: Withholding Tax Compliance

b. Predictors: (Constant), Tax Education

Table 4: Excluded Variables^a

Model	Beta In	t	Sig.	Partial Correlation	Collinearity Statistics Tolerance
1. Government Spending.	.120 ^b	1.916	.059	.201	.897
2. Withholding Tax Rates	.078 ^b	1.181	.241	.126	.811
3. Tax Administration	.047 ^b	.739	.462	.079	.908

a. Dependent Variable: Compliance

b. Predictors in the Model: (Constant), Tax Education

Table 2 shows the model summary whereby education is the only predicting factor among the four independent variables. Therefore, tax education is a significant predictor of withholding tax compliance. The correlation coefficient, which is the relationship between withholding tax compliance and tax education is .827 and the coefficient of multiple determinations is .680. Table 3, on the other hand, shows the Analysis of Variance with the Sig of .000 which is lesser than the critical value (.005) meaning, tax education is a significant predicting factor for withholding tax compliance on rental payments by SMEs. Furthermore, table 3 shows coefficients whereby only tax education is included in the model and the rest of the independent variables are excluded.

The results on Tax Education resembles studies conducted by other scholars. Kamil (2015) for instance, examined the impact of taxpayer awareness, knowledge, tax penalties and service tax authority on tax compliance in Indonesia and concluded that taxpayer knowledge has a favorable and considerable impact on individual taxpayer's compliance. Similarly, a study by Thananga et al. (2013) investigating factors affecting landlords in Nakuru (Kenya) Municipality's compliance on rental income tax policy. The study reported low degree of full compliance with the rules of the rental income

tax policy. One of the reasons for non-compliance was lack of knowledge of the rental income tax policy. Findings of this study also agrees with Hantono (2021), who examined the impact of tax knowledge, tax awareness and tax morale toward tax compliance boarding house tax and indicated that tax knowledge has great impact on tax compliance.

Finally, table 4 indicates that three independent variables (government spending, Withholding tax rates and tax administration) are excluded from the model. This shows that the three variables do not have any effect on tax compliance. These results differ from selected previous studies. For example, Ali et al. (2013) attempted to identify factors that influenced tax compliance attitudes in Kenya, Tanzania, Uganda and South Africa. The study found that services offered by their governments enhanced the possibility of citizen's voluntarily complying with tax payments. Similarly, Ayele (2019) discovered that positively perceived government expenditure has a positive impact on income tax compliance. The study of Masud et al. (2014) revealed that low tax compliance results from high tax rates while high tax rates results in high tax compliance.

Conclusions and Recommendations

The study concludes that tax compliance is low among the SMEs in Arusha City. Therefore, there is a missing tax compliance support from the studied SMEs. While awareness of compliance benefits is a contributing factor toward effective compliance, government spending, withholding tax rates and tax administration do not relate with tax compliance. This finding is contrary to previous study findings which indicated positive links between the independent variables and tax compliance. Therefore, the role of government spending, withholding tax rates and tax administration toward compliance varies from one context too another.

Based on the conclusions, the study recommends a serious intervention by providing awareness among the SMEs in Arusha City on the importance of their withholding tax compliance. As revealed by the findings and corresponding conclusions, the awareness will raise the rate of compliance.

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