

# Exploring the Influence of Turnover Tax Compliance on Financial Performance of Small and Medium Enterprises (SMEs): A Case Study of Solwezi Central Business District, Zambia

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## Abstract:

*This study explores the influence of Turnover Tax compliance on the financial performance of Small and Medium Enterprises (SMEs) in Solwezi Central Business District (CBD), Zambia. Taxation plays a crucial role in a country's economy, as revenues from sources such as Turnover Tax and Value-Added Tax support public service delivery and promote economic growth. Despite this, Zambia continues to face challenges in achieving its full revenue potential. SMEs, in particular, represent a significant yet underutilized source of tax revenue, posing an obstacle to sustainable public financing and national development. Data were collected through structured interviews with 20 SMEs operating in the retail sector. Findings reveal that while many SMEs are registered for Turnover Tax, there are persistent challenges with timely filing and payment compliance. Contributing factors include limited understanding of tax responsibilities, inefficiencies in digital platforms, and a lack of structured taxpayer education. The study further identifies that the influences of tax compliance vary across enterprises. Some SMEs experienced reduced profitability and constrained growth, particularly those with seasonal or low income. The study concludes that improving tax compliance and financial performance among SMEs requires a combination of administrative reform, digital innovation, and capacity-building initiatives tailored to the SME context. Aligning tax policy more closely with the practical needs of SMEs is essential. The government should consider introducing greater tax incentives and exemptions, reducing compliance costs, curbing corruption, and improving the accountability and accessibility of the Zambia Revenue Authority (ZRA) services.*

**Keywords:** Small and Medium Enterprises (SMEs), Zambia Revenue Authority (ZRA), Tax Compliance, Turnover tax, Financial Performance

## 1. Introduction and Background

### 1.1 Background

Small and Medium Enterprises (SMEs) play a vital role in Zambia's economic development by contributing to job creation, income generation, and poverty reduction. In regions such as Solwezi, the growth of SMEs has been particularly significant, especially within the retail and service sectors. However, for these enterprises to

thrive, a fair and effective tax environment is essential. In response to the need for a simplified tax system, the Zambian government introduced the Turnover Tax (TOT) in 2008, aimed at easing the compliance burden for SMEs by taxing gross revenue rather than net profits. Managed by the Zambia Revenue Authority (ZRA), TOT was designed to improve tax compliance among smaller businesses, promote formalization, and enhance public revenue collection. As of 2025, the tax threshold has been adjusted to include businesses with annual turnovers of up to ZMW 5 million, and the rate was increased from 4% to 5%. Despite these reforms, compliance challenges persist, ranging from limited awareness of tax regulations and digital system inefficiencies to perceptions of unfairness in taxing gross income regardless of business profitability. While tax compliance is intended to support national development and enhance business legitimacy, its actual influence on the financial performance of SMEs in Solwezi remains a subject of debate. By examining compliance behaviors, administrative challenges, and financial outcomes, the study aims to provide insights that can inform policy reforms and support strategies tailored to the realities of Zambia's SME sector.

Turnover Tax (TOT) is a simplified taxation system that is levied on a business's gross income or turnover rather than its net profit. It is typically designed for small businesses with relatively low annual revenue, providing a less complex alternative to traditional tax regimes (Thabani & Mwale, 2020). In Zambia, TOT was introduced through the Finance Act of 2008 to ease the tax compliance burden on small enterprises. It replaced the earlier presumptive tax system and was intended to offer a more predictable and straightforward approach to tax administration for Micro, Small, and Medium Enterprises (MSMEs). The Zambia Revenue Authority (ZRA) is responsible for administering TOT alongside other tax instruments such as Value Added Tax (VAT) and Corporate Income Tax (CIT). In addition to collecting taxes, ZRA plays a central role in enforcing tax laws, facilitating business registration, and promoting overall tax compliance. Importantly, in areas like Solwezi Central Business District (CBD), revenue generated from TOT supports public infrastructure, utilities, and services, creating a more conducive environment for SMEs to operate and expand. Under the 2025 tax compliance policy, TOT in Zambia applies to businesses with annual turnovers of up to ZMW 5 million, a revision from the previous threshold of ZMW 800,000. The tax rate was also increased from 4% to 5% for businesses earning between ZMW 12,000 and ZMW 5,000,000. Notably, enterprises engaged in sectors such as mining and consultancy, or those registered for VAT, are excluded from this regime. These changes, effective January 1, 2025, were introduced to improve the equity and efficiency of tax collection among small businesses, in recognition of Zambia's dependence on tax revenue for national development.

Tax compliance has become increasingly recognized as a critical element of financial management for SMEs, significantly influencing their profitability, operational sustainability, and long-term growth (Keji & SSendagi, 2024). Although the TOT regime was intended to improve compliance through simplification, several studies indicate persistent challenges. High tax rates, complex filing procedures, and limited taxpayer awareness have been cited as significant barriers to effective compliance (Munthali, 2020). Specifically, in Solwezi, Thabani and Mwale (2020) found that many SMEs face financial strain due to the structure and implementation of TOT, which negatively affects profitability and business expansion. Addressing these systemic challenges is essential to enhancing compliance levels and ensuring that the financial performance of SMEs is not adversely influenced. It is within this context that the current study seeks to explore the influence of turnover tax

compliance on the financial performance of SMEs operating in Solwezi, Zambia. Understanding this relationship will provide evidence-based insights to inform future tax policy and SME development strategies

### 1.2 Statement of the Problem

Small and Medium Enterprises (SMEs) are pivotal to Zambia's economic development, specifically, Solwezi, yet their financial performance is significantly influenced by how they comply with Zambia's Turnover Tax (TOT) system. Introduced to simplify tax obligations for small businesses, the TOT regime has, in practice, posed persistent challenges. Studies have shown that high tax rates, complex filing procedures, and limited awareness of tax regulations continue to hinder compliance among SMEs (Phiri & Simpasa, 2021; Munthali, 2020). In Solwezi specifically, research indicates that many SMEs face financial strain due to the structure and implementation of TOT, resulting in reduced profitability and constrained business growth (Thabani & Mwale, 2020). Despite these concerns, there is limited empirical evidence directly linking TOT compliance to the financial performance of SMEs in Solwezi's Central Business District (CBD). Without such insights, policymakers risk implementing effective reforms that do not adequately support SMEs. Therefore, this study seeks to explore the influence of turnover tax compliance on the financial performance of SMEs in Solwezi CBD, with the aim of informing more responsive and sustainable tax policies.

### 1.3 Objectives of the Study

- i. To assess Turnover Tax compliance among SMEs in Solwezi CBD.
- ii. To identify the challenges SMEs, face in complying with Turnover Tax regulations in the Solwezi CBD.

## 2. Literature Review

### 2.1 Tax compliance and its influence on the Financial Performance of SMEs

Turnover tax compliance involves following tax obligations related to a business's gross income or revenue. This type of taxation was especially important for Small and Medium Enterprises (SMEs), as it ensured that businesses paid taxes based on their turnover, regardless of profit. According to Namusonge et al. (2021), turnover tax compliance had a significant influence on the financial performance of SMEs, as it promoted financial discipline, reduced the risk of penalties, and built business credibility. They argued that compliant SMEs were more likely to maintain accurate financial records, which in turn supported effective financial planning and improved decision-making. In line with this, Houghton et al. (2022) suggested that SMEs that complied with turnover tax regulations tended to exhibit better financial performance due to reduced penalties and increased eligibility for financial support and government programs.

Masabo and Mwangi (2020) highlighted that non-compliance with turnover tax obligations imposes significant financial strain on SMEs through fines and interest charges, adversely affecting cash flow, profitability, and long-term sustainability. In contrast, Maina and Kamau (2019) observed that many SMEs perceive tax compliance as burdensome due to the complexity of tax systems and the associated costs, which discourages full compliance and undermines business performance.

Ochieng (2020) emphasized that compliance enhances access to formal financial services, particularly bank loans, as tax clearance certificates are often required during credit evaluations. This improved access to

finance supports business expansion and operational efficiency, positively influencing financial performance. However, Wanjiru (2018) noted that even tax-compliant SMEs sometimes face difficulties obtaining credit due to challenges such as inadequate collateral and high lending rates, suggesting that while tax compliance is beneficial, indicating that tax compliance alone did not guarantee financial success.

## 2.2 Challenges Small and Medium Enterprises (SMEs) Face in Complying with Turnover Tax

According to Namusonge et al. (2021), many SMEs faced difficulties complying with turnover tax regulations due to limited knowledge and understanding of tax laws. They argued that most small business owners lacked formal training in taxation, which led to unintentional non-compliance and frequent mistakes in tax filing. This challenge was common in several developing countries where tax education had not been well integrated into business development services.

In Ghana, Asante and Affum (2020) found that a major barrier to turnover tax compliance among SMEs was the complexity of the tax system and inadequate taxpayer support from the Ghana Revenue Authority. They noted that small businesses often struggled to interpret tax laws and were discouraged by bureaucratic processes and inconsistent information provided by tax officials.

In contrast, Musau and Ligami (2019) observed in Kenya that high compliance costs also contributed significantly to non-compliance among SMEs. They argued that the costs of hiring tax professionals or acquiring accounting software were often unaffordable for small businesses, forcing them to rely on manual records that were prone to errors and omissions. This situation increased the risk of incorrect tax reporting and attracted penalties.

Furthermore, Chikati (2021), writing on Zimbabwean SMEs, highlighted that lack of access to digital infrastructure limited the ability of small businesses to comply with online tax filing requirements. Many SMEs operated in remote or informal settings with limited internet access, making digital compliance efforts ineffective.

In Nigeria, Adeoye and Olatunji (2018) found that fear of over-taxation and distrust in the government's use of tax revenues also discouraged compliance. They argued that when SMEs perceived taxation as unfair or corrupt, their willingness to comply was reduced.

Additionally, studies conducted in India and the Philippines by Singh and Patel (2020) argued that SMEs struggled with compliance due to frequent changes in tax policies and the complexity of the Goods and Services Tax (GST) systems. In Indonesia, Rahman and Utami (2019) found that a lack of digital literacy among small business owners made online tax filing challenging, even when infrastructure was available. Similarly, in Latin America, Alvarez and Gutierrez (2021) reported that bureaucratic inefficiencies and corruption in tax administration discouraged voluntary compliance among SMEs.

Overall, the literature revealed that SMEs faced numerous challenges in complying with turnover tax regulations. These included limited tax knowledge, high compliance costs, poor access to digital platforms, complex regulatory systems, and mistrust in tax authorities. Addressing these barriers required governments to simplify tax systems, enhance taxpayer education, and improve digital and administrative support to ensure that SMEs met their tax obligations effectively.

### 2.3 Empirical Studies on Turnover Tax Compliance

Empirical studies show varied influences of turnover tax compliance on SME financial performance across regions. Studies in Asian countries such as India and the Philippines highlighted tax policy volatility and regulatory complexity as major obstacles to compliance. According to Singh and Patel (2020), India's frequent policy changes and overlapping tax categories confused small business owners, particularly those operating informally or in rural areas. In Latin America, particularly in Argentina and Brazil, corruption, inefficiency, and low institutional trust significantly hinder voluntary tax compliance among SMEs. Gonzalez and Ramirez (2020) found that in Argentina, perceptions of tax revenue misuse discouraged compliance, while Silva and Neto (2019) reported that inconsistent enforcement and bribery in Brazil weakened system legitimacy, leading to widespread underreporting and informal operations.

In contrast, In Kenya, Ochieng (2019) found a positive correlation between tax compliance and increased profitability, as compliant SMEs accessed favorable credit and government subsidies. Similar findings from Uganda and Tanzania (Okello & Mugisha, 2021; Mbaraga & Kamanzi, 2020) linked compliance to enhanced credibility and reduced audit risks. Conversely, in Zambia, Tembo and Chikulo (2022) reported that non-compliant SMEs faced cash flow challenges, prioritizing short-term liquidity over tax obligations, leading to arrears and penalties that stunted growth. Zambia's complex tax filing processes further discouraged compliance, especially among rural and informal businesses. Additional research highlighted that high tax rates and low awareness hindered financial performance (Phiri & Mumba, 2023), with many SME owners lacking financial literacy to manage tax requirements effectively. Nonetheless, compliant SMEs in Zambia reported higher profits, better access to government contracts, and improved relations with financial institutions (Nkhoma & Banda, 2021). These findings underscore the critical role of turnover tax compliance in SME financial health and suggest that simplifying tax procedures, raising awareness, and adjusting tax rates could enhance SME stability and growth in emerging economies like Zambia.

### 2.4. Theoretical Framework

#### Theory of Planned Behavior (TPB)

The Theory of Planned Behavior (TPB), developed by Ajzen (1991), was widely used in behavioral studies, including tax compliance research. Theory of Planned Behavior suggested that an individual's intention to perform a behavior, in this case, complying with turnover tax, was influenced by three components: attitudes, subjective norms, and perceived behavioral control. According to Kamil (2021) found that among Zambian SMEs, subjective norms, such as influence from fellow entrepreneurs and community leaders, significantly affected turnover tax compliance behavior. In the context of Small and Medium Enterprises, the TPB was relevant as it helped to explain why some SME owners complied with turnover tax obligations while others did not. Attitude toward the behavior referred to the SME owner's evaluation of tax compliance. If they believed that compliance led to improved financial credibility or avoided penalties, they were more likely to comply.

### **Institutional Anomie Theory (IAT)**

The Institutional Anomie Theory (IAT), originally developed by Messner and Rosenfeld (1994), expanded on social structure theories and explained how institutional imbalance, particularly the dominance of economic institutions over others, such as legal or normative institutions, created an environment conducive to non-compliance. According to Siahaan et al. (2017), IAT explained why in developing countries with weak institutional frameworks, many SMEs perceived tax evasion as a necessary survival approach. This phenomenon was especially evident in mining regions like Solwezi, where rapid economic growth was not matched by adequate institutional support. Moreover, Chifamba and Munongo (2020) highlighted that in the Zambian SME context, limited trust in the Zambia Revenue Authority (ZRA) and perceptions of systemic inequality led many businesses to feel justified in avoiding taxes, reinforcing the tenets of IAT

## **3. Research Methodology and Design**

### **3.1 Research Philosophy and Approach**

This study adopted an interpretivist research philosophy, emphasizing the importance of understanding the subjective experiences and perceptions of Small and Medium Enterprise (SME) owners and managers in the Solwezi Central Business District. Instead of aiming to generalize findings, the research focused on providing a context-specific understanding of how Turnover Tax compliance impacts SME financial performance (Ryan, 2018; Saunders et al., 2019). The research approach for this study was qualitative, as it was suitable for this research because it allowed for an in-depth exploration of the complex social and economic behaviors related to tax compliance. This approach was beneficial because it enabled data collection through in-depth interviews, capturing rich, qualitative information and identifying recurring patterns and themes in compliance behavior (Creswell & Creswell, 2018).

### **3.2 Research Strategy**

This study adopted a multi-strategy approach with qualitative dominance, combining descriptive and exploratory strategies to thoroughly examine both observable outcomes and underlying contextual factors related to Turnover Tax compliance and SME financial performance. The descriptive strategy focused on systematically measuring financial indicators such as profit margins, revenue growth, and operational efficiency to identify trends linking tax compliance to financial performance, addressing the “what” question (Kumar, 2019). Concurrently, the exploratory strategy investigated qualitative aspects like SME perceptions, administrative challenges, and tax awareness through interviews and open-ended surveys, uncovering subjective and less quantifiable factors (Saunders, Lewis & Thornhill, 2019). Integrating descriptive and exploratory methods enhanced the study’s ability to generate empirical data alongside rich contextual insights, ensuring a comprehensive understanding of the influence of Turnover Tax compliance on SME financial performance, consistent with the research onion framework (Saunders et al., 2019).

### **3.3 Sampling Frame**

The sampling frame comprised Small and Medium Enterprises (SMEs) in the retail sector operating within Solwezi Central Business District, a major commercial hub in Zambia’s North-Western Province. This

location was chosen for its relevance in examining the link between Turnover Tax compliance and financial performance. A well-defined sampling frame was developed to identify accessible and relevant participants, ensuring representativeness and minimizing sampling bias in line with best practices (Taherdoost, 2016).

### 3.4 Sample Size and Sampling Techniques

In this research, the sample size was 20 Medium Enterprises (SMEs) in the retail sector operating within Solwezi Central Business District in Zambia. The determination of the sample size in this study was guided by the concept of theoretical saturation, which occurs when additional data collection no longer yields new themes, insights, or patterns relevant to the research questions (Guest, Bunce & Johnson, 2006). This aligns with Creswell's (2021) recommendation that qualitative interview-based studies typically require between 5 and 25 participants, depending on the scope and design.

Purposive sampling technique was employed in this study to ensure that data were collected from participants with specific knowledge and experience related to the research focus which was Turnover Tax compliance and its influence on the financial performance of SMEs in Solwezi Central Business District

### 3.5 Data Collection Techniques

Semi-structured interviews were employed as the data collection method for this study, as they are particularly well-suited to qualitative research due to their ability to explore participants' views, experiences, and interpretations in depth (Saunders et al., 2019). A total of 20 participants were selected and interviewed, representing a diverse range of business sectors, enterprise sizes, and experiences with Turnover Tax compliance (Creswell & Creswell, 2018)

### 3.6 Data Analysis Methods

This study employed a Reflexive thematic analysis, utilizing the six-phase framework proposed by Braun and Clarke (2006), to analyse qualitative data collected through semi-structured interviews with SME owners and managers in Solwezi Central Business District. Thematic analysis is a method for systematically identifying, analysing, and reporting patterns (themes) within qualitative data, and is widely used in applied social research due to its clarity and flexibility (Creswell, 2021).

### 3.7 Credibility and Trustworthiness Considerations

The study emphasized credibility and trustworthiness, consistent with the interpretivist research philosophy that prioritizes authentic participant experiences (Saunders, Lewis & Thornhill, 2019). Triangulation using semi-structured interviews and document reviews enhanced result validation (Creswell & Creswell, 2018), while member checking allowed participants to verify transcripts and interpretations. Dependability was ensured through a detailed audit trail (Lincoln & Guba, 1985), and transferability was supported by rich contextual descriptions (Shenton, 2004). Confirmability was addressed through researcher reflexivity to minimize bias (Saunders, Lewis & Thornhill, 2019). These measures reinforced the study's integrity and the credibility of its conclusions regarding Turnover Tax compliance and SME financial performance.

#### 4. Research Findings and Discussion

The study revealed several key insights regarding turnover tax compliance among SMEs. While most businesses are formally registered, consistent and accurate compliance remains a challenge due to limited awareness, procedural complexity, and resource constraints. As noted by Respondent 1: *“We are registered, but sometimes we miss deadlines because the process is overwhelming.”* Another added: *“Yes, it is fair because it is easy to understand, and complying is not an issue for me.”*

Compliance obligations were found to reduce liquidity and hinder growth, although they also promote financial discipline and transparency. This was indicated by a respondent who stated: *“Paying tax on revenue and not profit hurts us when business is slow.”*

A significant training gap exists, with many SMEs lacking access to adequate tax education and calling for more localized support. As noted by a third respondent: *“I understand the basics, but I’ve never received any formal training.”*

The current turnover tax model is widely perceived as inequitable, particularly for smaller firms during periods of low income. As remarked by a fourth respondent: *“The system should consider our costs before charging tax.”*

Lastly, despite these challenges, SMEs acknowledged that tax compliance enhances business credibility and improves access to financing and formal markets. As one SME owner noted, *“When we applied for a loan, the bank asked for our tax clearance certificate. It helped us get the funding.”*

#### 5. Conclusions and Recommendations

The study explored how turnover tax compliance influences the financial performance of Small and Medium Enterprises (SMEs) in Solwezi Central Business District (CDB). While many SMEs are registered for turnover tax, actual compliance is inconsistent due to limited understanding, digital platform challenges, and insufficient taxpayer education. Compliance presents mixed outcomes: it burdens profitability and growth, especially for low-revenue firms, but also fosters financial discipline, credibility, and improved loan access. Systemic issues like taxing gross turnover instead of profits highlight a misalignment between tax policy and SME realities. The study emphasizes that targeted reforms, digital solutions, and capacity-building can enhance compliance. Ultimately, it contributes to policy discussions by advocating for evidence-based, inclusive reforms that address the evolving needs of Zambia’s SME sector.

##### Recommendations

Based on the study findings, the following recommendations are proposed and grouped into short-term and long-term strategies to improve turnover tax compliance and promote SMEs.

##### Short-Term Recommendations:

- i. ZRA should develop simplified, mobile-friendly tax filing tools to ease compliance for SMEs.
- ii. Frequent, localized awareness campaigns and training sessions in local languages should be conducted to improve SME understanding of turnover tax.

- iii. Short-term incentives such as penalty waivers or public recognition should be introduced to encourage new tax compliers and build trust.

**Long-Term Recommendations:**

- i. The government should consider restructuring the turnover tax framework, potentially shifting to profit-based or tiered models to reduce financial pressure on SMEs.
- ii. Tax education should be integrated into entrepreneurship programs, trade school curricula, and SME incubators to address knowledge gaps.
- iii. Formal partnerships should be established between ZRA and institutions like local authorities, banks, and business networks to provide sustained tax advisory, financial literacy, and mentorship support for SMEs.

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