The Effects of Tax Incentives on Small and Medium Enterprises Compliance in Moshi District, Tanzania[1]

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Abstract: This study investigates the impact of tax incentives on the tax compliance behavior of small and medium enterprises (SMEs) in Moshi, Tanzania. It specifically examines the influence of various tax incentive components on SME compliance and explores the challenges SMEs face in utilizing these incentives. A cross-sectional research design was employed, with a purposive sample of 100 SME operators selected through non-probability sampling techniques. Data were analyzed using STATA and SPSS. A descriptive method and a binary logistic regression were employed to examine the relationships between tax incentives and compliance. The findings reveal that tax allowances, effective communication about incentives, taxpayer training and education, and simplified tax procedures have positive and statistically significant effects on SME tax compliance. Conversely, access to credit was found to have a negative and significant effect on compliance. Additionally, corruption and lack of awareness were identified as major barriers hindering SMEs from fully benefiting from available tax incentives. To enhance tax compliance among SMEs, the study recommends that the government improve transparency in tax incentive provision to combat corruption and simplify tax collection procedures to make compliance more accessible. These measures have the potential to foster voluntary compliance and increase the overall effectiveness of tax incentive policies.

Keywords*: Small and Medium Enterprises (SMEs), Tax Incentives, Tax Compliance*

Os Efeitos dos Incentivos Fiscais na Conformidade das Pequenas e Médias Empresas no Distrito de Moshi, Tanzânia

Resumo: Este estudo investiga o impacto dos incentivos fiscais no comportamento de cumprimento fiscal das pequenas e médias empresas (PMEs) em Moshi, Tanzânia. Examina especificamente a influência de vários componentes dos incentivos fiscais na conformidade das PMEs e explora os desafios enfrentados por estas empresas na utilização desses incentivos. Foi utilizado um desenho de pesquisa transversal, com uma amostra intencional de 100 operadores de PMEs selecionados por técnicas de amostragem não probabilística. Os dados foram analisados utilizando STATA e SPSS. Empregaram-se métodos descritivos e regressão logística binária para examinar as relações entre incentivos fiscais e conformidade. Os resultados revelam que abatimentos fiscais, comunicação eficaz sobre incentivos, treinamento e educação dos contribuintes, e procedimentos fiscais simplificados têm efeitos positivos e estatisticamente significativos na conformidade fiscal das PMEs. Por outro lado, o acesso ao crédito apresentou efeito negativo e significativo na conformidade. Além disso, corrupção e falta de conscientização foram identificados como principais barreiras que impedem as PMEs de aproveitar plenamente os incentivos fiscais disponíveis. Para aumentar a conformidade fiscal entre as PMEs, o estudo recomenda que o governo melhore a transparência na concessão dos incentivos fiscais para combater a corrupção e simplifique os procedimentos de arrecadação fiscal para facilitar o cumprimento. Essas medidas têm o potencial de estimular a conformidade voluntária e aumentar a eficácia geral das políticas de incentivos fiscais

Palavras-chave: *Pequenas e Médias Empresas (PMEs), Incentivos Fiscais, Cumprimento Fiscal*

Los efectos de los incentivos fiscales en el cumplimiento de las pequeñas y medianas empresas en el distrito de Moshi, Tanzania

Resumen: Este estudio investiga el impacto de los incentivos fiscales en el comportamiento de cumplimiento tributario de las pequeñas y medianas empresas (PYMES) en Moshi, Tanzania. Específicamente examina la influencia de varios componentes de los incentivos fiscales en el cumplimiento de las PYMES y explora los desafíos que enfrentan para utilizar dichos incentivos. Se empleó un diseño de investigación transversal, con una muestra intencional de 100 operarios de PYMES seleccionados mediante técnicas de muestreo no probabilístico. Los datos fueron analizados utilizando STATA y SPSS. Se aplicaron métodos descriptivos y regresión logística binaria para examinar las relaciones entre los incentivos fiscales y el cumplimiento. Los hallazgos revelan que las concesiones fiscales, la comunicación efectiva sobre los incentivos, la capacitación y educación de los contribuyentes, y la simplificación de los procedimientos fiscales tienen efectos positivos y estadísticamente significativos en el cumplimiento tributario de las PYMES. En contraste, el acceso al crédito mostró un efecto negativo y significativo en el cumplimiento. Además, la corrupción y la falta de conocimiento fueron identificadas como las principales barreras que dificultan que las PYMES aprovechen plenamente los incentivos fiscales disponibles. Para mejorar el cumplimiento tributario entre las PYMES, el estudio recomienda que el gobierno mejore la transparencia en la provisión de incentivos fiscales para combatir la corrupción y simplifique los procedimientos de recaudación fiscal para hacer más accesible el cumplimiento. Estas medidas tienen el potencial de fomentar el cumplimiento voluntario y aumentar la efectividad general de las políticas de incentivos fiscales.

Palabras clave:*: Pequeñas y Medianas Empresas (PYMES), Incentivos Fiscales, Cumplimiento Tributario*

Introduction

Small and Medium Enterprises (SMEs) are widely recognized as vital drivers of economic growth, employment generation, and innovation, particularly in developing countries. Globally, SMEs represent more than 90% of all businesses and contribute over 50% of total employment (World Bank, 2022; Dimoso & Andrew, 2021). Tax revenues are essential in enabling governments to invest in economic infrastructure and provide critical public services such as education and healthcare, thereby enhancing the welfare of citizens (Sinambela & Putra, 2021). In many countries, tax incentives, including tax exemptions, credits, and reduced rates, are key policy tools used to improve SME performance and sustainability. These incentives are designed to reduce business costs, promote tax compliance, and encourage reinvestment and expansion (Kitole & Genda, 2024; Sinambela & Putra, 2021; OECD, 2021).

Across Africa, SMEs are equally crucial, accounting for more than 80% of employment and making significant contributions to GDP (AfDB, 2020; Kitole & Utouh, 2023). However, these businesses face considerable challenges such as limited access to finance, complex regulations, and burdensome tax systems. To address these issues, several Sub-Saharan African governments have introduced targeted tax incentives. For instance, Ghana's National Entrepreneurship and Innovation Plan includes tax holidays for start-ups, while Rwanda provides preferential corporate tax rates to support SME formalization and growth (IMF, 2022). These policies aim to foster a more enabling environment for small businesses to thrive and integrate into the formal economy.

In Tanzania, SMEs play a significant role in national development, contributing approximately 35% to GDP and accounting for more than 95% of all registered businesses (URT, 2021). Tax incentives in Tanzania serve multiple purposes, including stimulating local entrepreneurship and attracting foreign direct investment (FDI). The government provides a range of incentives such as tax holidays for strategic sectors like agriculture and manufacturing, VAT exemptions for microenterprises, and simplified tax procedures under the Presumptive Tax System (TRA, 2023; Utouh & Kitole, 2025). For example, agricultural firms may receive up to 100% tax exemption to boost investment in food security and rural areas (TRA, 2023). These measures are designed to lower the cost of doing business and promote inclusive economic growth.

Despite these initiatives, tax revenue remains the primary source of public financing in Tanzania, yet tax compliance among SMEs remains low (Jalles, 2017). Although SMEs contribute significantly to GDP and employ over 5 million people (URT, 2020), they continue to underperform as a tax base. To address this, the government has adopted strategies such as formalizing street vendors and introducing Electronic Fiscal Devices (EFDs) to improve compliance (Omary, 2022; Giesi & Bishagazi, 2022). Nevertheless, the actual tax collection from SMEs falls far short of its potential. While the estimated tax potential from SMEs is around 79 billion Tanzanian shillings annually, only about 1 billion is collected (Wadesango et al., 2020; URT, 2020). Key barriers include complicated tax procedures, high rates, limited education on tax obligations, and overlapping tax jurisdictions (Keraro, 2017). Specifically, the research will explore the types of tax incentives available to SMEs, how these incentives influence tax behavior, and the challenges SMEs face in accessing and utilizing them within the Moshi District.

Theoretical underpinnings

The study draws upon the compliance theory, which describes the condition of individuals who obey the rules and regulations that apply. Tyler (2021) explains two basic aspects or views related to legal compliance, namely instrumental and normative. The instrumental perspective speculates that individuals are motivated by self-interest and assumptions ut changes in attitudes and behavior. The Tax compliance theory, particularly as framed by Tyler (2021), provides a useful lens through which to understand SME behavior. It distinguishes between instrumental compliance, which is motivated by fear of penalties or economic gain, and normative compliance, which arises from an

internalized obligation to obey laws. These theoretical underpinnings are reflected in empirical findings across various contexts. For instance, further studies such as (Peng et al, 2024) consistently show that when tax incentives reduce costs and are perceived as fair, SMEs are more likely to comply. However, incentives alone are insufficient without reinforcing elements such as clear communication, effective administration, and alignment with taxpayer expectations, which collectively enhance both instrumental and normative motivations.
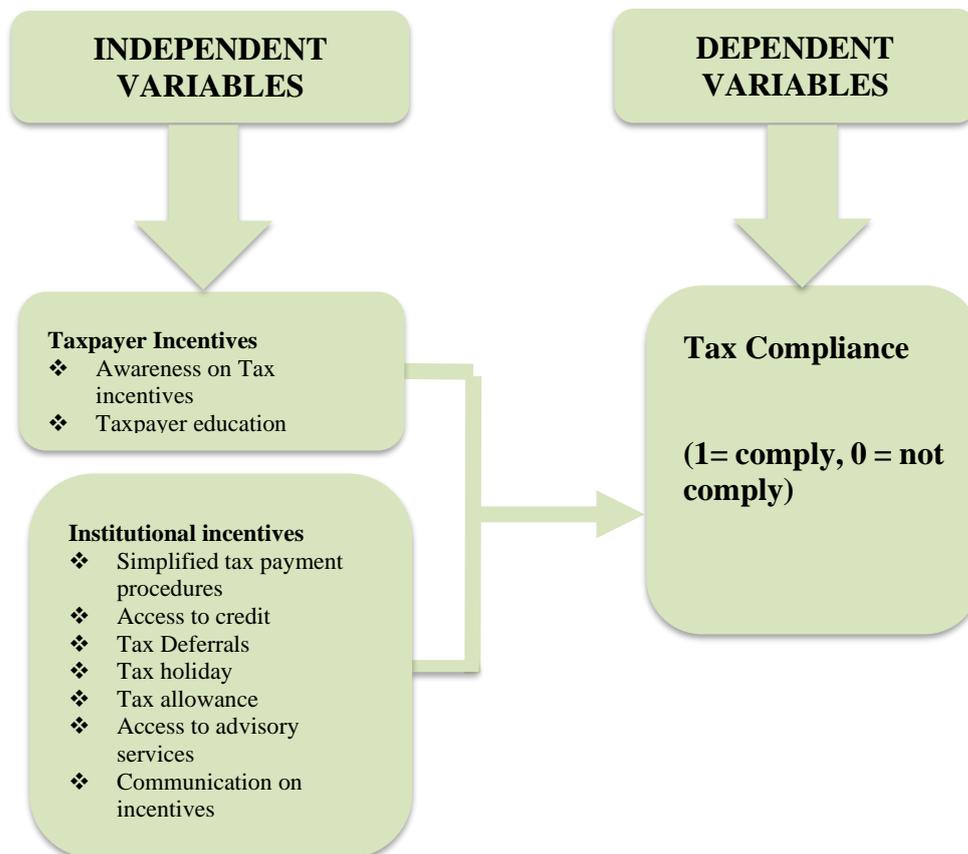
Empirical underpinnings

Evidence from Tanzania highlights that tax incentives, when well-implemented, can positively influence tax compliance among SMEs. Findings suggest that compliance is significantly enhanced by measures such as tax holidays, simplified procedures, and sector-specific exemptions (Magasha et al., 2025; Mchukwa & Mbwambo, 2024). Simplified tax systems often reduce the administrative burden and compliance costs for SMEs, indirectly improving their engagement with formal tax regimes. Nonetheless, these studies tend to isolate tax compliance from broader SME development, focusing on regulatory ease rather than exploring how these incentives may also facilitate firm-level growth, job creation, or business sustainability dimensions this current study seeks to unify.

The role of taxpayer education is also prominent in shaping compliance behavior, particularly where it overlaps with understanding and awareness of tax incentives. Studies show that SMEs with better access to tax education are more likely to comply with tax obligations and take advantage of available incentive schemes (Akaro, 2023; Mwesiga & Twamzihirwa, 2024). Improved knowledge about rights, responsibilities, and available reliefs contributes to voluntary compliance. However, although awareness contributes to better tax behavior, these studies often do not explore how this increased understanding translates into measurable business outcomes such as reinvestment, expansion, or improved resilience, areas of concern for the current research.

While many studies affirm the growth-enhancing effects of tax incentives, such as tax holidays and investment allowances, they frequently overlook the compliance mechanisms necessary for accessing these benefits (Miriti, 2025). Evidence suggests that incentives reduce financial burdens and promote SME reinvestment and innovation (Obafemi et al., 2021; Imran et al., 2024). However, the separation of growth from compliance in many of these studies limits their ability to inform integrated tax policy. Moreover, incentives can sometimes have unintended effects: in certain contexts, such as Uruguay, tax holidays have been shown to reduce compliance by encouraging evasion behaviors when regulatory oversight is weak (Dunning et al., 2025). This duality suggests that incentive design must be matched with robust compliance monitoring to ensure effectiveness.

Administrative and structural barriers further complicate the relationship between SMEs and tax incentives. Limited resources, poor access to information, multiple overlapping taxes, and inadequate technical capacity can prevent SMEs from fully benefiting from incentive schemes (Edmund, 2024; Kwara & Lawal, 2024). Inconsistent implementation and unclear eligibility criteria create uncertainty and discourage firms from engaging with formal tax systems. Although these issues are often observed across countries, their specific manifestation varies by context, and studies from outside Tanzania may not fully capture the local institutional and economic conditions, such as those present in Moshi District. Hence, localized research remains crucial to tailor effective policy responses.

Although existing literature has explored either the effect of tax incentives on SME compliance or their impact on business growth, few studies have comprehensively examined both aspects together (URT, 2020). This study addresses that gap by analyzing the relationship between tax incentives and tax compliance among SMEs in Moshi District, Tanzania. It aims to offer practical insights for policymakers and tax authorities on designing more effective tax incentive frameworks that support both compliance and business sustainability (Omary, 2022).

Source: Research design, 2025

Figure 1: Conceptual framework

Table 1: Indicating measurement of variables

No	Variable	Measurement
1	Tax Compliance	1 = Comply 0 = Not comply
2	Access to Credit	1 = Access 0 = No access
3	Tax Deferrals	1 = Has deferral 0 = No deferral
4	Simplified Tax Payment Procedures	1 = Simplified 0 = Not simplified
5	Awareness of Incentives	1 = Aware 0 = Not aware
6	Taxpayer Training and Education	1 = Received training/education 0 = Did not receive
7	Communication on Incentives	1 = Received communication 0 = Did not receive
8	Tax Allowance	1 = Received allowance 0 = Did not receive
9	Tax Holidays	1 = Received holiday 0 = Did not receive
10	Access to Advisory services	1 = Access 0 = No access

Materials

A cross-sectional research design was employed, where data were collected from study respondents at one point in time without any repetition from sample respondents (Mushi, 2024). The Study Area was the Moshi District in the Kilimanjaro region. The study utilized a purposive sampling (non-probability sampling method) to select 100 small and medium enterprise owners from 100 different SMEs. Purposive sampling was used since it involves intensive analysis of the phenomenon in the selected SMEs within a specified time**.** Based on the nature of this study, which eyes on the impact of tax incentives on SME tax compliance and growth, both primary and secondary data were used. Primary data was used and collected directly from the targeted study respondents (SME). Secondary data was collected from various district reports to obtain additional information on small and medium enterprises in the Moshi district.

The study employed a structured questionnaire as data was collected directly from the field. The questionnaire contained a series of closed-ended type of questions. Furthermore, the study will employ the questionnaire method of data collection since it enables data collection from a large sample size at a low cost and reasonable time, and they are easy to administer and analyze (Nyimbo & Mushi, 2025).

Model specification and estimation

This study used a binary logistic model to examine the relationship between tax incentives and SMEs' tax compliance. A binary logistic regression was applied to analyze how tax incentives influence the tax compliance behavior of Small and Medium Enterprises (SMEs) in Moshi District, Tanzania. This method was chosen because the dependent variable is binary, indicating compliance or non-compliance. Binary logistic regression is suitable when the outcome is categorical with two possible results, as in this study where SMEs are categorized as either complying or not complying with tax regulations (Sabapathy et al, 2025).

$$Y^* = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \ldots + \beta_n X_n + \varepsilon$$

Where: Y* is the latent (unobserved) compliance level, β_0 is the intercept, X`s are independent variables such as age of firm, awareness on tax incentives, access to credit, tax deferrals, training and educations on tax incentives, communications on tax incentives, simplified tax payment procedures, tax allowance, tax holiday and access to advisory services, β's are the coefficients representing the effect of each predictor, ε is the error term. The observed compliance (Y) is categorized as:

$$y = \begin{cases} 1, if\ y^* \le z_0 \\ 0, if\ z_0 < y^* \le z_1 \\ J, if\ z_{j-1} \le y^* \end{cases}$$

$Z_0 < Z_1 < \ldots < Z_{j-1}$ are the parameters to be estimated, Hypothesis $\varepsilon \sim N\ (0, 1)$, Standardize the variance of the disturbance term to 1. The logistic Model assumes that there is an underlying continuous latent variable (Y^*) that determines the observed compliance categories. The probability of an individual being in a particular compliance category is given by:

$$P\ (Y = j) = \Phi\ (\mu_j - X\beta) - \Phi\ (\mu_{j-1} - X\beta),\ \text{for } j = 1, 2, 3$$

Where $\Phi\ (.)$ is the cumulative normal distribution function, and μj represents threshold parameters that differentiate compliance levels. The likelihood function for the Ordered Probit Model is expressed as:

$$L\ (\beta, \mu) = \prod [\Phi\ (\mu_j - X\beta) - \Phi\ (\mu_{j-1} - X\beta)]$$

Where the parameters β and μ are estimated using Maximum Likelihood Estimation (MLE).

The estimated coefficients indicate how changes in explanatory variables affect the probability of SMEs belonging to a particular compliance category. To further interpret the model, the marginal effects of each independent variable on the probability of each compliance category were computed. The marginal effect for an independent variable X_k on the probability of outcome j is given by:

$$\partial P(Y=j)/\partial X_k = \beta_k * [\varphi(\mu_j - X\beta) - \varphi(\mu_{j-1} - X\beta)]$$

Where $\varphi(.)$ represents the probability density function of the normal distribution

Results and discusión

Description of respondents' characteristics

The results presented in Table 2 provide a descriptive overview of SME owners' perceptions regarding various aspects of the taxation environment. One of the key findings is that credit access remains a balanced issue, with 52% of respondents indicating they have access to credit, while 48% do not. This near-even split highlights that although some SMEs can leverage financial support to meet tax obligations or expand their businesses, a significant portion remains financially constrained. Similarly, access to tax deferrals, a common form of tax relief, also shows a 52% uptake, suggesting that just over half of SMEs are benefiting from deferred payment arrangements, which can ease short-term financial pressures.

The data further reveal that awareness of taxation-related matters is relatively high, with 60% of respondents reporting being aware of tax systems or obligations. However, the availability and utilization of advisory services appear insufficient, with 52% of respondents not having access to such support. This gap suggests that while awareness may be increasing, practical guidance and professional support for navigating tax procedures remain limited. Moreover, 58% of respondents feel that tax payment procedures are not simplified, indicating a widespread perception that administrative processes are overly complex and potentially discouraging compliance.

Table 2: Description of the SMEs owners' perceptions on taxation

Variable	Categories	No. of Frequency	Percentage (%)
Credit access	Access to credit	26	52
	No access	24	48
Tax deferrals	Tax deferrals	26	52
	Not use	24	48
Awareness	Aware	30	60
	Not aware	20	40
Advisory services	Advisory services	24	48
	Not access	26	52
Simplified payment procedure	Simplified	21	42
	Not simplified	29	50
Communication on incentives	Yes	27	54
	No	23	46
Training and education	Yes	17	34
	No	33	66
Tax allowance	Yes	22	44
	No	28	56
Tax holiday	Yes	11	22
	No	39	78

Source: Research Data, 2025

A concerning trend is seen in the area of training and education, where only 34% of SMEs

reported receiving any form of training, compared to 66% who did not. This lack of capacity-building opportunities limits SMEs' ability to understand and effectively respond to tax obligations or take advantage of available incentives. Additionally, only 44% of respondents acknowledged receiving any tax allowances, and just 22% reported benefiting from tax holidays. These low figures indicate limited access or uptake of key incentive mechanisms, which may be due to inadequate dissemination of information or restrictive eligibility requirements.

Lastly, although communication about incentives was reported by 54% of SME owners, the relatively low utilization of tax allowances and holidays suggests that communication alone may not be enough. There appears to be a disconnect between information dissemination and practical implementation, possibly due to bureaucratic hurdles or mistrust in the system. Overall, the data suggest that while some foundational elements for supporting SME compliance and growth through tax policy are in place, there are significant gaps in execution, particularly in training, simplification, advisory access, and actual utilization of tax incentives. Addressing these areas would be critical in creating a more inclusive and enabling tax environment for SMEs.

Relationship between tax incentives and SME tax compliance among small and medium enterprises in Moshi District.

The results reveal a significant negative relationship between tax holidays and tax compliance, as indicated by a coefficient of -0.4157605 (p = 0.001). This suggests that while tax holidays are designed to ease financial pressure, they may unintentionally reduce compliance, possibly by creating loopholes that some SME owners exploit to evade taxes. These findings align with Dunning et al. (2025), who observed a similar pattern in Uruguay, where tax holidays were misused for tax avoidance. However, this contrasts with the perspective that tax holidays can promote SME growth, as emphasized by Obafemi, Araoye, and Ajayi (2021), who found that such incentives facilitated business reinvestment and expansion. This divergence highlights the importance of monitoring how tax incentives are applied in practice, ensuring they encourage growth without undermining the integrity of the tax system.

Table 3: Logit regression results examining the impact of tax incentives on small and medium enterprises' compliance in Moshi district.

Variable	dy/dx	Std. Err.	z	P>|z|	[95% Conf. Interval]		X
Tax holiday	-0.4157605	0.13	-3.20	0.001	-0.670565	-0.160957	0.22
Access to credit	-0.0057918	0.20335	-0.03	0.977	-0.404347	0.392763	0.52
Tax deferrals	0.0991984	0.20361	0.49	0.626	-0.29986	0.498257	0.52
Simplified Tax Payment Procedures	0.3406571	0.19911	1.71	0.087	-0.049597	0.730911	0.56
Awareness of Incentives	0.2953569	0.1954	1.51	0.131	-0.087626	0.67834	0.6
Taxpayer training	0.5965106	0.16185	3.69	0.000	0.2793	0.913721	0.54
Communication on Incentives	0.4033856	0.17597	2.29	0.022	0.058495	0.748276	0.58
tax allowance	0.4575638	0.17341	2.64	0.008	0.117694	0.797434	0.52
Advisory services	0.0021726	0.2001	0.01	0.991	-0.390013	0.394358	0.54

Source: Field Data, 2025

The analysis further shows that access to credit services has a negative but statistically insignificant impact on tax compliance, with a coefficient of -0.0057918 (p = 0.977). Although credit is often viewed as a financial enabler, this result implies that access to credit does not necessarily translate into improved tax behavior. In some cases, it may even reduce compliance, as SMEs prioritize debt repayment over meeting tax obligations. Similarly, while tax deferrals exhibit a positive effect on compliance (coefficient = 0.0991984), the relationship is statistically insignificant (p = 0.626). These findings suggest that while such measures may provide short-term relief, their

effectiveness in promoting tax compliance remains limited without complementary policies such as financial education or enforcement.

In contrast, several policy variables show significant positive effects on compliance. Simplified payment procedures, for instance, are positively associated with compliance (coefficient = 0.3406571, p = 0.087), supporting the idea that reducing procedural complexity can increase taxpayers' willingness to comply. This aligns with findings by Mchukwa and Mbwambo (2024), who reported that streamlined tax systems improved compliance among Tanzanian SMEs. Taxpayer education emerges as one of the strongest predictors of compliance, with a significant positive coefficient of 0.5965106 (p = 0.000). This result underscores the critical role of education in building awareness of tax responsibilities, reducing evasion, and enhancing voluntary compliance, as previously highlighted by Akaro (2023) and Mwesiga and Twamzihirwa (2024).

Communication about tax incentives and tax allowances also shows statistically significant positive impacts on compliance. Communication has a coefficient of 0.4033856 (p = 0.022), indicating that clear and consistent information dissemination increases compliance by improving SMEs' understanding of benefits and obligations. Similarly, tax allowances significantly improve compliance (coefficient = 0.4575638, p = 0.008), likely because they reduce the financial burden on businesses, incentivizing them to formalize and participate in the tax system. These results are in line with Magasha et al. (2025) and Obafemi, Araoye, and Ajayi (2021), who emphasize the importance of well-structured incentives in encouraging tax compliance and supporting SME growth. Although advisory services showed an insignificant positive effect (coefficient = 0.0021726, p = 0.991), their potential influence on raising awareness and guiding businesses cannot be entirely dismissed and may warrant further qualitative investigation.
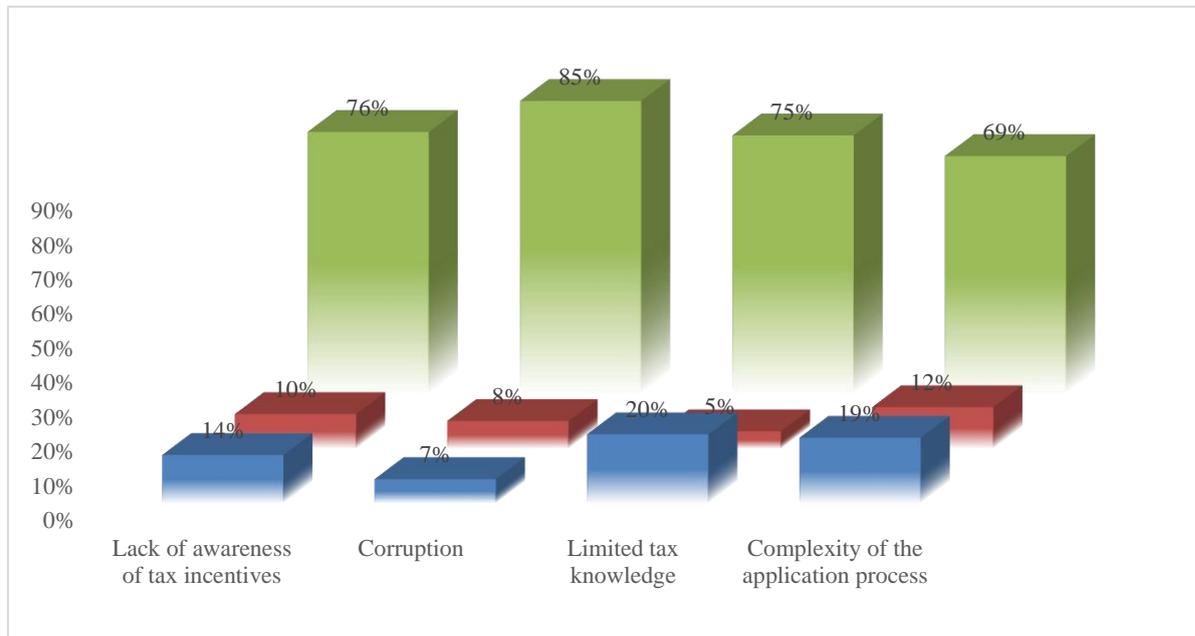
Table 4: link test for the logit regression model assumptions

compliance	Coef.	Std. Err.	z	P>|z|	[95% Conf. Interval]	
_hat	1.475323	0.4331676	3.41	0.001	0.62633	2.324316
_hatsq	0.1940245	0.5886025	0.19	0.49	0.0203667	0.3676823
_cons	-0.3723463	0.4870525	-0.76	0.445	-1.326952	0.582259

Source: Research Data, 2025

The results of the link test in Table 4 assess whether the logit regression model is correctly specified. In this diagnostic test, the variable _hat represents the predicted values from the model, while _hatsq represents the squared predicted values. For a correctly specified model, _hat should be statistically significant, confirming that the model has explanatory power, and _hatsq should be statistically insignificant, indicating no major specification errors such as omitted variables or incorrect functional form. In this case, _hat is significant (p = 0.001), which confirms that the model's predictions are meaningfully associated with the dependent variable (compliance). Importantly, _hatsq is not statistically significant (p = 0.49), which suggests that there is no evidence of specification error in the model. Therefore, the results confirm that the logit model is properly specified and reliably explains the relationship between the independent variables and tax compliance among SMEs.

Challenges encountered by SMEs in utilizing tax incentives

Source: Field data, 2025

Figure 2: Challenges encountered by SMEs in utilizing tax incentives

The findings from Figure 2 reveal several critical barriers that hinder small and medium enterprise (SME) owners particularly farmers from fully benefiting from tax incentives. A significant majority (76%) indicated that lack of awareness is a major challenge, suggesting that government communication and outreach about available incentives remain insufficient. With only 10% disagreeing, it is evident that most respondents feel uninformed about existing support programs. Similarly, limited tax knowledge was identified by 75% of respondents as a constraint in accessing and utilizing incentives, highlighting the uneven distribution of taxpayer education. These insights point to the need for targeted awareness campaigns, simplified educational materials, and community-based training initiatives to bridge the information gap and improve participation among underserved groups.

In addition to informational barriers, systemic and procedural challenges further limit equitable access to tax incentives. An overwhelming 85% of respondents agreed that corruption and political favoritism obstruct fair access to subsidies, indicating that bribery and preferential treatment undermine the integrity of these programs. Moreover, 69% of SME owners find the application process too complex, citing bureaucratic requirements, unclear guidelines, and digital hurdles that particularly affect those with limited literacy or technological access. These findings underscore the importance of institutional reforms, such as enhancing transparency, simplifying procedures, integrating digital tracking systems, and offering hands-on assistance to applicants. Addressing both informational and procedural gaps will be essential for ensuring that tax incentives achieve their intended goal of supporting SMEs equitably and effectively.

Conclusion

This study has critically examined the impact of tax incentives on the compliance behavior of Small and Medium Enterprises (SMEs) in Moshi District, Tanzania, offering nuanced insights into how fiscal policy influences the informal sector. The findings demonstrate that tax incentives particularly when supported by simplified payment procedures, targeted taxpayer education, and direct financial relief such as tax allowances play a significant role in enhancing SME tax compliance. The positive relationship between tax allowances and compliance underscores the importance of designing flexible and responsive tax policies that reduce the financial strain on SMEs. However, the

research also reveals that awareness alone is insufficient to drive compliance; without supportive infrastructure, simplified procedures, and practical guidance, even well-informed SMEs may struggle to meet their tax obligations. These findings are consistent with the Theory of Planned Behavior, which suggests that intentions and actions are influenced by both the perceived ease of compliance and external enabling conditions. By addressing both behavioral and structural factors, this study contributes a comprehensive perspective to the literature on SME tax policy in developing contexts.

Despite the promising role of tax incentives, the study also identified key structural and institutional barriers that limit their effectiveness. A significant proportion of SMEs lack access to advisory services and training, while many encounter bureaucratic challenges in applying for or utilizing available incentives. Inconsistent communication, limited outreach, and complex administrative procedures further reduce the potential of these schemes to encourage formalization and sustained compliance. These challenges highlight systemic weaknesses that diminish the perceived fairness and legitimacy of the tax system core components of Compliance Theory. When SMEs perceive the tax environment as inequitable or burdensome, they are less likely to comply voluntarily. Therefore, enhancing institutional capacity, promoting transparency, and strengthening service delivery through the Tanzania Revenue Authority (TRA) and other actors is essential to close the gap between policy design and real-world outcomes.

Moreover, this study emphasizes that tax incentives alone are not a panacea for improving compliance or stimulating SME growth. Their effectiveness heavily depends on complementary measures such as taxpayer education, equitable access to information, and efficient service delivery. A holistic policy framework that integrates simplified procedures, flexible deferral options, and community-based support mechanisms will better align with the operational realities of Tanzanian SMEs. In particular, building the capacity of local tax officials, expanding multilingual and accessible education campaigns, and digitizing incentive application processes can significantly enhance outreach and effectiveness. These reforms are essential for transforming tax incentives from passive policy tools into active instruments of economic inclusion and formalization.

In conclusion, tax incentives have the potential to support both compliance and growth among SMEs in Moshi District, but only when embedded within a broader system of institutional support, administrative reform, and taxpayer empowerment. The insights from this study not only fill a critical gap in the Tanzanian fiscal policy discourse but also offer practical recommendations for designing more inclusive, efficient, and equitable tax systems. As Tanzania continues to pursue inclusive economic growth, a more integrated approach to SME taxation grounded in transparency, simplicity, and capacity-building will be key to unlocking the full potential of its entrepreneurial sector.

Policy implication

The findings of this study emphasize the urgent need for the Tanzanian government, particularly the Tanzania Revenue Authority (TRA), to enhance both the design and implementation of tax incentive programs targeting Small and Medium Enterprises (SMEs). A key area for policy intervention is the improvement of communication and information dissemination regarding available tax incentives. Many SMEs in Moshi District remain unaware or poorly informed about the benefits and processes involved in accessing these incentives, limiting their reach and impact. To address this, the TRA should adopt a multi-channel outreach strategy, leveraging digital platforms, local business networks, and community workshops to ensure timely, clear, and accessible information reaches all SMEs, including those in rural or underserved areas. Moreover, simplifying and standardizing eligibility criteria and application procedures will help reduce ambiguity, enhance transparency, and make it easier for SMEs to engage with the formal tax system.

Beyond improving awareness, policy efforts must focus on building the capacity of SMEs to effectively utilize tax incentives and meet their tax obligations. This includes expanding training, advisory services, and taxpayer education programs that are tailored to the specific needs and literacy

levels of small business owners. The study shows that such support significantly boosts compliance and engagement. Partnerships between the government, financial institutions, development agencies, and SME associations can be leveraged to deliver these services at scale. In parallel, tax administration reforms should aim to reduce procedural complexity and financial strain through mechanisms like simplified tax payment systems, flexible deferrals, and the adoption of technology-driven tools such as mobile platforms and electronic filing. Together, these interventions will create a more inclusive, transparent, and supportive tax environment that encourages SME formalization, increases compliance, and contributes to broader economic development across Moshi District and Tanzania as a whole.

Limitation

A limitation of this study is its reliance on cross-sectional data, which only captures a snapshot of SME tax compliance at a specific point in time. This design restricts the ability to observe changes in tax compliance behavior over time, thereby limiting the potential for examining long-term trends and the sustainability of tax incentive effects. Furthermore, the study is based solely in Moshi District, and while this provides valuable insights, the findings may not be directly applicable to other regions of Tanzania or Sub-Saharan Africa due to possible regional differences in economic conditions, tax administration, and SME characteristics. Additionally, the purposive sampling technique used to select SMEs may introduce selection bias, as it only includes businesses deemed relevant to the study's focus, potentially excluding important perspectives from a broader range of SME owners. These limitations should be kept in mind when interpreting the findings and considering their generalizability to a wider population of SMEs.

Area for Further Study

Future research could explore the long-term impact of tax incentives on SME tax compliance behavior by adopting a longitudinal study design that tracks changes over time. This approach would provide a better understanding of how tax incentives influence compliance in the long run and whether their effects diminish, persist, or grow stronger over time. Expanding the study to other regions of Tanzania or other Sub-Saharan African countries would help gain a more comprehensive understanding of how local economic conditions and institutional frameworks shape SME compliance behavior. Further research could also examine the role of digitalization in enhancing tax compliance, especially through the use of mobile platforms or online tax systems, which might simplify tax processes and increase SME engagement. Additionally, qualitative studies could offer deeper insights into the barriers SMEs face when using tax incentives, shedding light on personal experiences and challenges that quantitative data might overlook. These avenues of research would significantly contribute to designing more targeted and effective tax policies.

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