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Research Article

Effects of Turnover Tax on the Financial Performance of SMEs in Luanshya, Zambia

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About Article

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ABSTRACT

The intention of the study was to analyze the effect of turnover tax on business performance of Small and Medium-Sized Enterprises (SMEs) in Luanshya District, Zambia, with a bias towards profitability, cost management strategies and tax compliance. The study investigates the impact of the recently introduced 4% turnover tax by the country's revenue authority on SMEs with turnover of less than K800,000. This change in tax mechanism meant to broaden the tax base and increase compliance has in reality adversely affected performance of SMEs. Using a case study approach with mixed methods, purposive and simple random sampling techniques were employed to gain insights into the effects that turnover tax has on SMEs. A sample of 50 SMEs were randomly selected interviewed and questionnaires distributed. Descriptive statistics, multiple linear regression and Chi-square analyses were all performed on the collected data. Findings from a mixed methods study (n=50) indicate that turnover tax burden significantly reduced profits (β=-0.140, p=0.009), an indication that applying this form of tax negatively affects performance of business. Findings further indicates that properly managed costs mechanisms bear a positive impact of business performance in particular profits (b=0.1966, p=0.003). This is an indication that prudent operational approaches strengthen financial performance. Tax education (b=0.7598, $p<0.001$) showed a strong positive link to profitability. This showed the significance of educating SMEs on taxation. A positive relationship was also observed on correlation and chi-square analyses linking tax awareness to compliance ($r = 0.7598$; $\chi^2 = 16.32$, $p = 0.0026$). There was no significant association observed between demographic factors age (p =0.926) and size (0.201) and profitability suggesting that intrinsic factors like tax knowledge and cost control are more important than demographic characteristics. The study concluded that there is need to enhance tax literacy and better cost management structure to boost performance in the face of increased turnover tax.

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1. INTRODUCTION

1.1. Background of the study

In an effort to broaden tax base, increase revenue, simplify tax management and compliance, Zambia Revenue Authority (ZRA) introduced a turnover tax of 4% on SMEs with turnover of K800,000 and below. This tax mechanism is more complex to SMEs than what they are accustomed to such as Value Added Tax (VAT). Audretsch and Thurik (2021) and Ayyagari *et al.* (2018) notes that SMEs are important players in driving of economic growth, innovation and job creation in any economy. In spite of this notable contribution to national development, SMEs still face many challenges that limit their competitiveness and ability to continue to exist. Accoridng to Keuschnigg and Ribi (2019), taxation is one of those challenges limiting profitability, investment and long term existence.

Bedsley and Rosen (2019) acknowledges the importance of taxation for public revenue collection but also notes the effect of tax mechanisms on the operations of SMEs. And therefore, because of limited financial and human capital, SMEs are especially vulnerable to the burden of high tax rates and compliance demands (De Mooij & Ederveen, 2021). Therefore, it is imperative for both policy makers and business owners to appreciate how tax mechanism affect business growth and survival as it has a bearing on both ends. It is also important to highlight that SMEs are subject to many other taxes other than turnover tax and these include income, corporate, values added, payroll and property taxes which collectively impact business performance in different ways. Higher levels of these taxes can reduce the ability to reinvest. Value Added Tax (VAT) and sales taxes impact cost structures and consumer demand (Feld and Heckemeyer, 2011). Payroll and property taxes impact staff recruitment and location decisions (Hassett & Mathur, 2006).

Devereux and Griffith (2019) and Keen and Slemrod (2017) reported global differences in tax rates, exemption and costs that are linked to compliance and therefore creating varying effects of SMEs. Optimized tax systems and targeted incentives boosts business performance while complicated systems hinder entrepreneurship and innovations and therefore governments should endeavor to pursue inclusive growth by developing fair and efficient tax policies that support SME development.

1.2. Statement of the problem

Government of Zambia through the revenue collection urgency, ZRA implemented turnover tax of 4% on SMEs with turnover of K800,000 and below a. This was aimed to increased revenue through expanded tax base and boost compliance. However, despite this critical step in improving taxation administration, it is understood to significantly have an impact on the performance of SMEs (Simbyakula & Hampopwe, 2024). A similar conclusion was arrived at by Ngali (2020) who observed and reported that although taxation is necessary for collecting revenue for Government operations, it negative impact SME performance. Its therefore critical that Government balances between revenue collection and interest of SMEs such as business growth. However, SMEs in Luanshya faces challenges due to the manner in which turnover tax is applied on gross sales as opposed to net profits. This application of tax obligation on gross sales places disproportionate burden on SMEs especially those that operate with limited capital and relatively narrow profit margins (Shema *et al.*, 2024). Overall result of this tax system is reduced profit, limited reinvestment and cash flow shortages that eventually undermine business sustainability and growth prospects. This position is further compounded by the administrative complexities, tax illiteracy and inadequate access to professional accounting and advisory services (Mpolokeng *et al.*, 2016). Overall and despite all the government initiatives and strategies aimed at promoting SME growth, there is notable limited concrete data on how turnover tax affects SMEs in Luanshya. Without this evidence, tax policies risks hindering rather than supporting MSE growth. Therefore the study seeks to examine the impact of turnover tax on performance of SMEs in Luanshya district with primary objective of generating insights that can guide the formulation of more effective and business friendly tax policies.

1.3. Objectives

General objective

The study seeks to examine the effects of turnover tax on the performance of small business in Luanshya District, Copperbelt province of Zambia.

Specific objective

i. To examine the effects of turnover tax on Small and Medium sized Enterprises (SMEs) profitability in Luanshya.

ii. To analyze the effects of turnover tax on the cost management strategies of SMEs in Luanshya.

iii. To examine turnover tax compliance of SMEs in Luanshya.

1.4. Significance of the study

The significance of the study us multifaceted. Firstly, is seeks to offer insights for policy makers to create tax mechanisms that that takes into account the needs of SMEs and balancing that with business growth and sustainability. Stakeholders will also benefit from the challenges that the study seeks to explore to create regulations that support growth as opposed to hindering growth. Secondly, the study will offer further insights into effective means of to boost business performance as it explores variables such as cost management.

This in-depth knowledge on tax obligations equips SMEs owners to make smarter financial decisions. Furthermore, it highlights the role of tax education in promoting compliance thus reducing the risks associated with penalties or business closures. Thirdly, results will add to the strategies for revenue collection. The strategies help regulatory authorities to develop healthy relationships with SMEs that stimulate voluntary compliance without further burdening SMEs.

Finally, the study findings will provide key insights for SMEs that addresses staff recruitment and economic growth as SMEs are an important economic activity that provides jobs. Therefore, examining turnover tax effects on their viability informs strategies to protect jobs. Overall, SMEs success boosts investment, income generation and long term economic growth in the face of turnover tax obligations.

1.5. Scope of the study

The study inquired into the effects of turnover tax on key performance indicators of registration and active SMEs that are based in Luanshya district of the Copperbelt province of Zambia. Three key performance indicators amongst SMEs in the trade, services agriculture and informal sectors were prioritized and included profitability, cost management strategies and tax compliance. Sample size was made up of 50 SMEs purposely selected using a simple random sampling technique to ensure a balanced representation across the above stated sectors. Using a mixed methods approach, data was collected by conducting interviews and administering questionnaires on the most recent fiscal years with focus on key variables including tax awareness, firm size and business age. Excluded from the study were large corporations, multinationals and SMEs outside the catchment area of Luanshya district. The study adhered to research ethics principles and ensured participant confidentiality as well as voluntary participation

2. LITERATURE REVIEW

2.1. The effects of turnover tax on the profitability of small and medium-sized enterprises (SMES)

Annacondia and Van der Corput (2014) states that turnover tax is a tax form that is levied on gross revenue as opposed to net profit and Klemm (2021) adds that this tax system overlooks cost structures thereby putting a strain on businesses especially small firms that have lean profit margins. However, Joshi *et al.* (2014) argued in favour of this tax system by stating that it simplifies compliance and aids businesses to formalize their enterprises. But Tanzi and Zee (2001) observed that despite these positive contributions and benefits of turnover tax, it disproportionately burdens less profitable firms, reducing profitability and growth.

Bes (2007) work in the Latin America and Europe made a significant observation and found that simplified tax systems such as that of Brazil and Russia lowered administrative problems for SMEs. A similar observation was made by Paula and Scheinkman who stated that such tax regimes raises registration rates and lower compliance costs even if they do not necessarily improve firm's profitability. This position is supported by OECD (2020) that reported this form of taxation may reduce economic distortions in firms with limited administrative capacity and in many cases affect more the firms that have lean profit margins. The World Bank (2024) cautioned that due to these distortions, turnover tax often discourages business growth and reinvestment. In the United states, Wei and Wens (2019) similar findings that turnover tax makes compliance easier and lower administrative cost but also noted adverse effects such as discouraging the use of labor and capital in the face of other reported merits. Interestingly, evidence from Germany shows contrasting findings and highlights that the country's complex tax system has punitive effects related to business performance and in particular profitability. Several other studies reviewed showed the relation between tax and business performance such as Ramsa *et al.* (2025) that offered insights into such relationship by looking at combined effect of turnover, income, VAT and solidarity taxes. This study concluded that these tax combinations reduced net income by 10% and below demonstrating how sharp marginal tax increases can discourage growth by limiting the resources for reinvestments. This study also revealed that Germany startup founders are still facing ongoing challenges related to turnover taxation, in particularly during business exits and liquidity events. Another study by Lorenz *et al.* (2017) noticed that Germanys high tax rates that are often pegged above 45% on gross income creates a low margin environment. This tax system creates an environment that discouraged reinvestment and scaling up relative to lower U.S capital gains taxes that range between 15% and 20%. Although there are few studies in Germany that gives empirical evidence on the subject, overall evidence indicates that turnover and similar taxation systems alongside with strict regulations reduces SMEs profitability and economic activity. To the contrary, Wei and Wen (2019) and Guo (2023) reported in the U.S that turnover taxes make compliance easier but notes that it requires careful consideration to avoid the negative effects especially on labor, investments and firm's survival.

A study that offers insights into what may cause the effect of this taxation on profitability is one done by Rivaud-Danset *et al.* (n.d) that point out that SMEs are particularly vulnerable turnover tax because it does not consider business expenses, a situation that negatively affects cash flow and operating abilities. Studies by Keen and Mintz (2004) and Lazar (2024) collaborates this position by adding that businesses with elevated input costs face greater demerits that lead to lower profitability, limited reinvestment and diminished expansion. Opposing findings comes for studies by Terkper (2003) and Dilmurod (2025) who urges that turnover tax simplifies taxation allowing for avoidance reduction. As earlier stated, the world Bank warns of regressive nature and its effect of penalizing SMEs in the higher income band but with low profits.

Terkper (2003) and Dilmurod (2025) argue that turnover tax makes the tax code simpler and reduces tax avoidance. However, the World Bank (2016) warns that its regressive nature can penalize SMEs that generate high revenue but have low-profit SMEs. Chisumpa *et al.* (2020) concludes their study by emphasizing the inability to deduct operational costs discourages activities that require a lot of capita and thus hinder innovation. Evidence from Kenya add a totally different dimension to looking at turnover tax administration by adding the aspect of digitalization. Kandagor *et al.* (2024) together with Marion and Kurui (2024) demonstrated that tax education or awareness and the application of user friendly digital tools promotes compliance and supports increased profitability in Kenyan firms. But the media reports still insist that raising turnover rates still puts pressure on SMEs especially post Covid business recovery thereby lowering margins and causing staff retrenchments.

Ilodigwes (2019) study that focused on the impact of multiple taxation on efficiency of SMEs taken together with other regional studies adds the issue of harmonization and observes that multiple overlapping taxes reduce SMEs efficiency, profitability and reinvestment and thus proposing tax harmonization and simplified filing procedures or improved tax systems.

The local scenario follows a similar pattern to that observed in global and regional setting. The revenue authority, Zambia Revenue Authority (ZRA) imposed a 4% turnover tax on SMEs that have turnover of k800,000 and below, a move aimed at increasing tax base and revenue, simplifying administration and enhancing tax compliance. Studies by Mulenga (2021) and Chisha (2023) reported improved compliance but also pointed out that the decreased profitability for capital heavy SMEs because of the tax structures feature of not deducting expenses and costs. This raised in tax obligation as observed in studies by Masafwa (2021) and Simbyakula and Hampopwe (2024) reduces investment, threaten sustainability and discourage reinvestment. This position is also shared by findings from studies by Tengerapena *et al.* (2025) and Corlet-Walker *et al* (2021) who explored broader economic impacts. Mbise and Baseka (2022), McKenzie and Woodruff (2017), Pratama (2023) and Mwesiga and Twamzihirwa (2024) all highlights the advantages of digital platforms and taxpayer education for enhancing compliance and profitability. Simbyakyakula and Hampopwe (2024) whilst studying turnover tax effect on SMEs growth noted that this form of tax affects SMEs competiveness in the retail trade thereby damaging their financial health. The World bank agrees with other researchers such as Bartik (2017), Mazwi and Kasongo (2020) and Kamugisha *et al.* (2025) by advocating for tax incentives specifically for SMEs, tiered rates and profit sensitive structures to boost growth and innovation. There is also evidence from the Copperbelt and Lusaka cities that show that turnover tax harms profitability despite the benefits of simplifying tax application. Studies by Kapena and Haabazoka (2016), Chisumpa *et al.* (2020), Mwansa and Phiri (2025) and Nyirenda (2024) revealed that digital system and education can lessen and mitigate the negative effects of taxation. However, administrative inefficiencies, overlapping taxes, corruption and volatile levies severely undermine SME survival due to its impact on cash flow.

In concluding this discussion, Simbyakula and Hampopwe (2024) sums it up by stating that turnover tax in Zambia has a huge bearing on SME profitability, particularly for those with high capital requirement and low profit margin. Although digital tools and education helps to boost compliance, the broader tax mechanism, its rates, structure and enforcement demands reform to ensure SMEs can grow sustainably and formally.

2.2. Effects of turnover tax on the cost management strategies of the small and medium-sized enterprises (SMES)

The DG Internal Market, Industry, Entrepreneurship and SMEs (2022) whilst studying the costs that SMEs make to be compliant with tax obligations revealed disproportionate higher expenditure amounts that are incurred to meet these tax obligations. This expenditure is relative to the size of the firm. This situation often leads them to lower overheads, simplify operations and postpone investments that could potentially improve efficiency. These findings are also supported by Bird (2019) and OECD (2020) who noted the trend of lowering non-essential expenses such as marketing, training and maintenance as a result of turnover tax burden thereby preferring short term survival over long term productivity gains. Dond *et al.* (2025) made similar observation and reported that Indonesia's firms tax compliance costs affect how small businesses operate causing them to delay or lower their activities due to cash flow limitations. In contrast, these negative effects can somewhat be mitigated with simplified or digital compliance systems. For instance, Mbise and Baseke (2022) proposes that user friendly, safe and accessible digital tax platforms can lower compliance costs, a situation perceived to give SMEs more leverage to direct resources to core operations rather than administrative work.

In Africa, similar trends are observed starting with Masabo and Mwangi (2020) who found that SMEs facing high presumptive or turnover taxes in Kenya and Tanzania are often reducing staffing levels, delaying payments to supplier, using cheaper materials, or lowering inventory turnover to cope with financial burdens. TICGL (2023) also reports that the complex and multiple taxes further worsen cost management problems, especially for low-margin retail and service SMEs. Ghanaian researchers Abor and Quartey (2019) found that the costs associated with compliance amongst them record keeping and interactions with tax authorities usually limits firms' ability to invest into production and that small firms are more affected by turnover based tax mechanisms. In Zimbabwe, Tengerapena, Nyakurimwa and Mpofu (2024) noted that high taxes and complex regimes compels SMEs to cut operational and financial costs. This sometimes results in lowering of input quality or postpone capital investments to remain compliant. On a positive note, some studies suggest that well administered taxpayer education and simplified systems can partially help minimize these pressures, as firms with good awareness and administrative support are better placed to manage costs without severe reductions in operational efficiency.

In Zambia, recent evidence shows that changes to turnover tax have made cost management challenging for SMEs. According to ZRA (2025) firms with annual turnover of up to ZMW 5,000,000 now face a 5% turnover tax, raised from the previous 4% on ZMW 800,000, broadening the population of SMEs affected. Simbyakula and Hapompwe (2023) reported that SMEs in Lusaka are responding to this change by lowering discretionary spending, reducing staffing costs, renegotiating supplier agreements and postponing investments in technology or quality that do not influence turnover tax liability. Mwanza (2023) revealed similar trends in Solwezi, where seasonal or low-income SMEs adopt more a cautious approach to procurement strategies and cut non-essential spending to meet tax obligations.

Amchan Zambian (2024) whilst gathering feedback on turnover tax regime changes observed that firms in service sector having turnover earnings between K2 to K5 million expect tight margins with significant drop in expansion capacity forcing strict operational cost management choices. These findings are supported by those made by Tengerapena *et al.* (2025) who reported that high turnover taxes compel Zambian SMEs to adopt strict working capital management style, delay payments, reduce stock levels controlling receivables and at times sacrificing customer credit and long term competitiveness. MJ Consultants notes that the increased threshold supports formalization but also that this will simultaneously forces firms to cut back on marketing and growth expenses. Overall, the studies reviewed acknowledges that turnover tax simplify tax compliance and broaden tax base but at the same time notes that it places a burden on SMEs prompting them to adopt cost cutting measures such as lowering production thereby limiting innovation and potential for growth.

2.3. Turnover tax compliance of small and medium-sized enterprises (SMES)

Feng and Wen (2019) whilst exploring the optimal turnover tax threshold and tax rates for SMEs reported that this form of tax aims to lower administrative problems relative to profit based tax systems thereby making it easier for small firms to comply with the regulations. Simpler tax systems increase registration rates among firms which in turn aids in formalizing operations (World Bank, 2021). Analyses by the DG Internal Market (2022) and Okello *et al* (2023) showed that SMEs with accurate record keeping are more likely to meet tax obligations. But the levels of compliance often vary due to limitations associated with low tax literacy, gaps in record keeping and SMEs. Findings by Okello (2023) and DG Internal Market (2022) demonstrated that digital filings platforms and taxpayer education improve compliance buts also notes that overreliance on audits and penalties alone may results in lowering the trust of SMEs and therefore encourage tax evasion. Thus Wen (2019) concludes that an effective tax regime is one that balances clear thresholds with predictable obligations and offers taxpayer support to encourage compliance.

At regional level, studies continue to demonstrate similar trends on turnover tax effect on SMEs that have been explored by researchers already reviewed. Masabo and Mwangi (2020) revealed that in Kenya, Tanzania and South Africa make registration easier and cut down on paperwork for SMEs. A separate study by KRA (2019) in Kenya showed that compliance relies on managerial knowledge, record-keeping capacity and enforcement intensity. Mwangi (2014) focusing on Tanzania also that they often delay supplier payments and promote under reporting turnover to management fixed tax obligations which do not change with profits. Tis position is also supported by Lindeque (2018) who noted that tax rate structures in South Africa disproportionately and negatively affect low margin firms thereby reducing MSEs willingness to comply voluntarily. The world Bank (2021) however stressed that combining turnover tax regimes, education on literacy as well as user friendly digital tools improve outcomes on compliance. TICGL concludes by reporting that administrative and institutional issues that include overlapping local and national levies further weaken compliance across African SMEs.

The Zambia Revenue Authourity (ZRA) in an attempt to simplify tax administration, increase tax base and enhance compliance amonts SMEs introduced turnover tax system with update dthreshold and rates. Studies by Chinonyerem *et al* (2023) focusing on retails clothing SMEs in Lusaka revealed that despite increasing the tax base, many SMEs demonstrated low compliance to tax obligations casued by limited knowledge, poor record keeping and financial challenges. Another study in Solwezi district by the East African Financial Journal (2024) reported that several SMEs

In Zambia, the Zambia Revenue Authority (ZRA, 2025) implemented a simplified turnover tax system with updated thresholds and rates meant to broaden SME compliance. Research by Chinonyerem *et al.* (2023) in Lusaka's clothing retail business found that despite high registration rates, numerous SMEs exhibited low compliance caused by limited knowledge, poor record-keeping and financial constraints. Similarly, a study in Solwezi by the East African Finance Journal (2024) reported that many SMEs under reported or filled irregularly despite high registrations. This according to Mungule (2020) compels SMEs to often prioritize short term cash flow and delay tax payments to keep operational stability. Despite expanded coverage and increased formal registration, compliance remains inconsistent (PFK Zambia, 2025; MJ Consultants, 2025). Furthermore, consultancy and field reports (MJ Consultants, 2025; AmCham Zambia, 2025) showed that relying on manual bookkeeping increased compliance costs and error rates, while views of unfairness particularly with low-margin firms weakened voluntary compliance. The IGC (2023) further noted that SMEs in smaller towns like Luanshya face additional challenges due to limited access to tax education and weaker administrative support, which make compliance even harder.

3. METHODOLOGY

3.1. Research design

A mixed study research design was employed to inquire into the effects if turnover tax on small firms in Luanshya district. This type of research according to Nwogu (2021) helps to collect data from groups that share similarities to those of research objectives. This study design allowed for the collection of both qualitative and quantitative data. The mixed method approach included interview and questionnaire providing triangulated data thereby enhancing reliability and validity.

3.2. Target population

All registered and active small business in Luanshya districted formed the study populations. Luanshya district is a small mining town located on the Copperbelt Province of Zambia built around the mining township of Roan and a mine called Roan Antelope Mine. The Central Statistics Office (2010) data shows that the district has a population of about 212,864 and 4499 firms, of which 3240 are SMEs. The study however focused on small businesses in retails, services, agriculture and trade.

3.3. Sampling design

Purposive sampling technique was used to select SMEs to be included in the study. From these firms, a simple random sampling method was then used to select 50 SMEs. This method allows for equal chance of selection for each firm thereby reducing sampling bias and enhancing representation. Data was collected using structured interviews and questionnaires administered through in person and by phone. Structured and unstructured gave respondents opportunity to provide an elaborate and detailed insights into turnover experiences.

3.4. Sample size determination

50 respondents were selected from the study population to balance the need for in-depth inquiry into the practical experiences of business owners or managers on turnover taxation. Although 3240 SMEs are registered in Luanshya, only a small fraction met the operational criteria for this study. The sample size also meets the methodological requirements

for regression models that require at least 10-15 observations per predictor variable (Green, 1991) and also the Chi-Square tests that require minimum cell counts achievable with samples of 30 and above. Furthermore, comparable SME tax studies in Africa commonly uses samples ranging from 30 to 60 participants. According to Kothari (2010), such smaller but carefully selected samples can yield meaningful statistical and thematic insights in research. Therefore, a sample size of 50 SMEs provides adequate statistical power, representativeness and feasibility required to examine the effects of turnover tax on SMEs in Luanshya.

3.5. Data collection methods

Questionnaires, face to face interviews and phone interviews with business owners or managers were used to collect primary data. Academic journals, government publications and reputable online sources made up secondary data sources. This provided contextual background and supported effective triangulation that added credibility to the findings.

3.6. Data analysis

Frequency tables and charts were created from qualitative data analyzed. Inferential statistical tests such as multiple regression and Chi-square surveyed relationships between turnover tax and business performance. Software's, Stata and Excel were used for calculations. Qualitative data were analyzed thematic to organize responses, identify patterns and offer insights into SMEs' experiences.

3.7. Triangulation

Triangulation improves study validity and reliability by using multiple approaches (Patton, 2019; Denzin, 1978). Method triangulation combined qualitative and quantitative methods. Investigator triangulation involved checking and validating findings with supervisor and experts. Theory triangulation applied multiple framework that included Neoclassical Taxation and Tax Compliance Theories. Data source triangulation included SMEs that are of various sizes and sectors to ensure a complete understanding of the issues.

3.8. Limitations of the study

The study had several limitations that included a sample of 50 firms which might not reflect the full diversity of SMEs in Luanshya. Some respondents with limited knowledge struggled to apply theoretical frameworks to their real life tax experiences. Partial and non-responsiveness added another layer of limitation by reducing proportion of completeness. However, proper planning together with the use of triangulation addressed this challenge placing credibility on the final findings.

4. RESULTS AND DISCUSSION

4.1. Effects of turnover tax on small firm profitability

The study collected data from business owners and managers or any representative of the firm with adequate knowledge on turnover tax. 50 respondents were targeted in Luanshya district. The research sought insights from the respondents on the observed changes on profitability due to change in turnover tax threshold. From the 50 respondents, 80% or 40 out of 50 reported significant decline in profits. 20% or 10 out of 50 respondents indicated noting a small decrease.

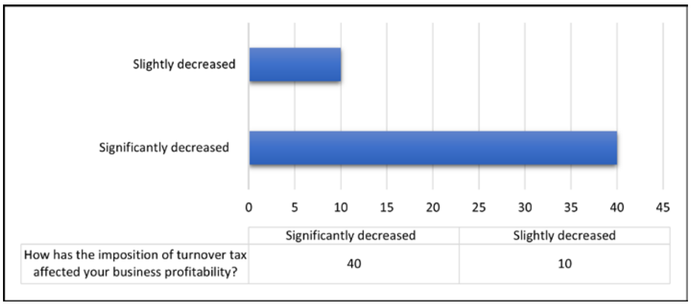

Figure 1. Effect of turnover tax of profitability

These findings were collaborated by those from regression analysis that demonstrated that turn over tax burden negatively affects profitability (β = -0.1400, p = 0.009). The findings suggest that despites evidence that tax reduces administrative complexities, it imposes a financial drain on SMEs especially those with small profit margins and are heavily reliant of capital. These results are consistent with those of Anaconda and Van der Corput (2014) who found that tax levied on gross revenue places disproportionate effect on low margin firm as compared to those on net profit tax mechanisms.

Table 3. Regression output

Profitability turnovertaxburden taxawareness costmanagement firmsize businessage			
Number of obs	- 50		
F< S, 44)	= 298.54		
Prob > F	=0.0000		
R-squared	=0.971		
Adj R-squared	=0.9681		
Rooe MSE	=.17211		
Source	**SS**	**df**	**MS**
Model	44 .2166171	5 8	0.84332341

Residual	1.30338294	44	0.02962234			
Toeal	45.52	49 .928979592				
Profieabiliey	**Coef .**	**Sed .Err .**	**e**	**P> l e l**	**(55% Conf . Ineerval]**	
TurnoverTaxBurden TaxAwareness CoseManagemene Firm Size BusinessAge-cons	-0.1400258	0.0508739	-2.75	0.009	-0.2425555	-0.037496
	0.7598382	0.0701626	10.83	0.000	0.6184347	0.9012417
	0.1969597	0.0639698	3.08	0.004	0.068037	0.325882
	0.0624275	0.0480513	1.30	0.201	-0.0344135	0.1592685
	0.0063749	0.0684213	0.09	0.926	-0.1315192	0.14426
	0.2813993	0.2416843	1.16	0.251	-0.2056834	0.76848

In addition, the study uncovered significant challenges in managing cash flow for the SMEs. All 50 respondents reported some challenges with meeting tax obligations and of note is the 40 that reported finding meeting tax obligations as very challenging and 9 described it as somewhat challenging and none reported being neutral. This clearly demonstrate the strain that this tax mechanism places on short-term liquidity and resource allocation. As a results, SMEs adopts coping mechanisms that include delaying supplier payments, cutting down on labor and postponing capital investments so as to meet short term tax obligations. Studies by Mutua (2015) and Ndlovu and Moyo (2018) in Kenya and South Africa confirms this position. But our study most importantly provides new evidence specific to Zambian SMEs especially those in smaller districts like Luanshya were access to tax education and digital tools are limited. The study also demonstrated varying effects on this tax mechanism on different sectors of the economy and in particular, retail and service sectors reporting the sharpest decline in profit margins therefore suggesting that effects are sector related. Findings from Simbyakula and Hampopwe (2024) and Lindeque (2018) aligns with these results by suggesting that low margin firms carry a heavier tax burden and that the recent change in tax threshold and rates in Zambia have made these challenges even worse. The significance of these findings lies in the relations between profitability and tax compliance. SMEs that are finding it difficult to meet tax requirements will resort to adopting measures that takes care of immediate financial need and foregoing expenditure on long term investment thereby limiting growth potential and diminishing efforts to becoming more formalized. This is consistent with findings by Joshi *et al.* (2014) and the World Bank (2024) who reported that turnover tax limit investment and growth potential despite the objective of enhancing administrative efficiencies and raising the tax base. The findings also stress the importance of digital tax systems and tax education in strengthening compliance and partly ease the financial strain (Mbise & Baseka, 2022; McKenzie & Woodruff, 2017).

4.2. Effects of turnover tax on business cost management

The research also examined cost management effects that come as a result of the implemented tax thresholds. Many respondents (84%, n=42) reported an increase in the cost of goods sold (COGS). This finding reveals that turnover tax has substantially influenced cost structures and operational strategies of SMEs in Luanshya. Furthermore, 76% (n=38) reported higher operating costs. Additionally, regression analysis revealed a statistically significant positive relationship between cost management and profitability (β = 0.1966, p = 0.003) implying that SMEs with good cost control measures are better placed to deal with shocks that come with increased turnover tax obligation.

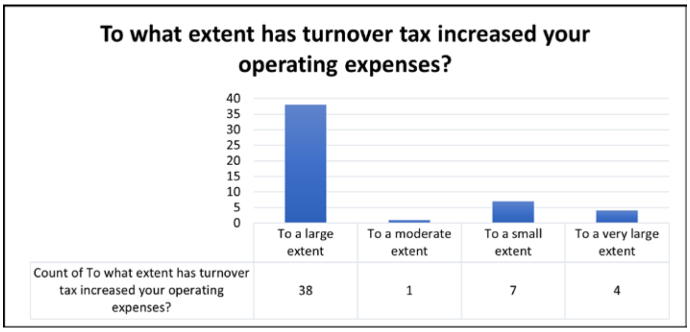

Figure 2. Turnover tax and operating costs.

Among the cost control measures adopted by SMEs, labor cuts formed the commonest. Increased reliance of temporal or contract workers accounted for most respondent reports (43.14%, n=22) while travel cuts and entertainment expenses accounted for 41.18% (n=21). Fewer SMEs (7.84%, n=4) re-engaged with suppliers and renegotiated supplier agreements and 5.88% (n=3) took other cost cutting measures. Minimal changes were observed in relation to reducing marketing and supply chain optimization (1.96, n=1) suggesting that SMEs focuses on immediate operational expenditures rather than strategic investment when confronted with tax obligation pressures. These findings align with other regional and global studies showing turnover tax often forces SMEs to cut costs in an attempt to maintain cash flow and remain compliant with tax regulations (DG Internal Market, 2022; Bird, 2019; Masabo and Mwangi, 2020). Study also revealed that turnover tax greatly impacted cash flow and financial planning with 80% of respondents (n=40) reporting significant drop in cash flow and 88% (n=44) facing extended accounts receivables periods. Further, 72% (n=36) transferred part or some of the resultant tax costs to consumers of their goods or services through price increase highlighting the need for trade-offs between compliance and business competitiveness. These findings show that turnover tax indirectly impact pricing and customer relations and are also consistent with with findings by Tengerapena *et al.* (2025) in Zambia and Abor and Quartey (2019) in Ghana.

Further, 68% (n=34) of respondents reported a significant drop in productivity and 26% (n=13) reported slight decrease and only a small proportion of 6% (n=3) observed no change. This drop is likely as a result of increased administrative demands, financial pressure and cost cutting measures. On research and development, 88% (n=44) of respondents observed drop in investments thereby limiting innovation and growth in the long run. There results correspond with global evidence that show indirect reduction in firm's competitiveness and investment as a result of turnover tax system (World Bank, 2024; Rivaud-Danset *et al.*, n.d; Mbise & Baseka, 2022). The findings also show differences in discount and promotional strategies as SMEs adjust as a result of cost pressures. Out of the 50 respondents, 21 stated that they had observed slight decrease in promotional efforts while 20 had cut then significantly thus reflecting varying methods adopted in an attempt to balance costs and retain customers. This variation shows the reactions of different SMEs to turnover changes influenced by size of firm, type of sector and current market position.

4.3. Effects of turnover tax on SME Compliance

Examining turnover tax against tax compliance, the study reported different findings under this tax change with 80% (n=40) of SMEs indicating accurately reporting tax returns and payments and 18% (n=9) indicating inaccuracies and a small proportion (2%, n=1) considered their filings as somewhat accurate.

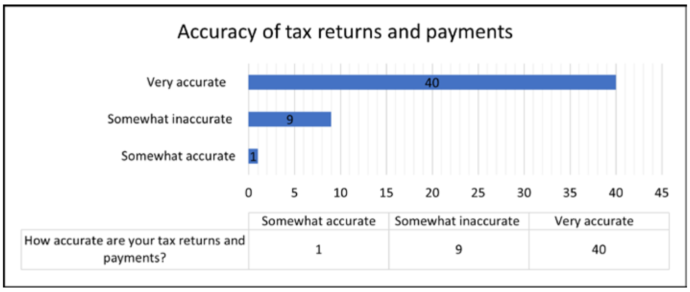

Figure 3. Turnover Tax and tax compliance

These findings suggest that many SMES keep high reporting standards. However, many other had challenges that can be linked to the complex nature of turnover tax rules and low literacy levels. This aligns with the reports from Feng and Wen (2019) and the DG Internal Markets (2022). Further analysis of the timeliness of filing showed that 62% (n=31) of respondents made submissions on time. Meanwhile 32% (n = 16) were occasionally late, 4% (n = 2) often on time and 2% (n = 1) frequently late. In spite of many SMEs reporting having made timely tax submissions, a small proportion faced delays in doing the same reflecting administration challenges and possible cash flow issues. The observation is consistent with findings by Masabo and Mwangi (2020). Further, 78% (n=39) of the respondents lacked valid tax clearance certificates suggesting that they are ongoing systematic problems in obtaining formal certification, a situation that may limit the potential to engage in business with Government or growing their businesses (IGC, 2023; ZRA, 2025). However, their record keeping practices were generally strong. 92% of the respondents (n=46) had complete and accurate tax invoices while 86% (n=42) reported having well maintained accounting records. This suggests that SMEs places value in maintaining business records even if faced with challenges with compliance. An inquiry into the frequency of audits showed that 76% (n=38) of the businesses were frequently audited. However, 70% (n=35) of the audited firms reported that dispute resolution methods were ineffective. This is an indication of a potential conflict between SMEs and tax authorities and highlights a systematic issue in handling conflict (Okello *et al.*, 2023).

Statistical analysis revealed a strong positive relationship between tax knowledge and profitability ($\chi^2 = 16.32$, $p = 0.0026$, $r = 0.7598$, $p < 0.001$). Still, 70% of SMEs acknowledged having limited tax law knowledge , 92% did not receive formal tax training and only 8% had provided employees training programs. This lack of tax knowledge likely adds to compliance challenges which mirrors findings from Mbise and Baseka (2022) and Chinonyerem *et al.* (2023), which linked low tax literacy to innaurate reporting and poor tax planning.

An overwhelming 98% of respondents on the issue of technology adoption reported using software on tax compliance and 88% fully integrating the software with their financial functions. The widespread use of digital tools likely improves accuracy and efficiency supporting the idea that integrated systems can help mitigate to some degree compliance issues (World Bank, 2021; TICGL, 2022). A small proportion of 6% of respondents reported partial integration and 2% without integration which shows that there are opportunities for system improvement for interoperability.

Overall, these findings show that SMEs, particular those in Luanshya have well established systems for record keeping required for effective tax filings and reporting. However, even after adopting the use of digital compliance tools, they still have challenges in making timely tax submissions, obtaining tax clearance certificates, resolving disputes and tax literacy. These issues have in impact on profitability emphasizing the need for taxpayer awareness programs, simplified procedures and deliberate support for SMES falling under the turnover tax regime (Okello *et al.*, 2023, Feng & Wen, 2019; ZRA, 2025).

Table 1. Summary of findings, comparative literature and reasons for contradictions

Objective	Summary of findings	Authors with similar findings	Authors with contradicting findings	Reasons for opposing findings
To analyze the effects of turnover tax on profitability of SMEs in Luanshya	There was statistical significant negative effect of turnover tax on profitability (β = -0.1400, p = 0.009). 80% of respondents reported profit declines; firms experienced reduced reinvestment and cash-flow pressures.	Annacondia and Van der Corput (2014), Klemm (2021), Mutua (2015), Ndlovu and Moyo (2018), Simbyakula and Hapompwe (2024),Tengerapena *et al.* (2025), Joshi *et al* (2014), Rivaud-Danset *et al* (n.d), World Bank (2024).	Uwizeye (2021), Bes (2007), Paula and Scheinkman (2007)	The variations in tax policy structure such as rate, threshold, and base as well as firm size, and sector structure play a role in outcomes. Studies that found found little impact were done in economies with simpler tax systems, better administration support or industries have higher profit margins.
To analyze the effects of turnover tax on cost-management strategies of SMEs	There was increased operating and compliance cost as a result of turnover tax. This forced SMEs to adopt short term cost-cutting measures such as using temporal labor, reducing travel, delaying investments. Regression analysis showed a positive link between cost management and profitability (β = 0.1966, p = 0.003).	DG Internal Market (2022); Bird (2019), Masabo and Mwangi (2020), Abor and Quartey (2019), Mbise and Baseka (2022), Tengerapena *et al.* (2025)	Bes (2007), Mbise and Baseka (2022)	Differences come from administrative ability, digital technology and support systems. SMEs that have well established tax payer education and online filing showed lower compliance related costs and less disruptions to cost management.
To examine turnover tax compliance of SMEs in Luanshya	80% of respondents reported correct tax returns and 98% used tax software. But 38% had late tax submissions and 78% lacked valid tax clearance certificates. Regression and chi square analyses showed a strong positive relationship between tax literacy and profitability (χ^2 = 16.32, p = 0.0026; r = 0.7598, p < 0.001).	Feng and Wen (2019), World Bank (2021), DG Internal Market (2022), Okello *et al.* (2023); Mbise and Baseka (2022), Chinonyerem *et al.* (2023)	World Bank (2021), Uwizeye (2021)	These contradictions come from differences in enforcement, taxpayer literacy and institutional ability. Countries with better digital tax systems and efficient dispute resolution procedures often see improved compliance outcomes.

4.4. Discussion

The study offers insights into the effects of turnover tax on SMEs in Luanshya with focus on financial, operational and compliance factors.

The study findings provide a clear look at the effect of turnover tax on small and medium-sized enterprises (SMEs) in Luanshya, Zambia. It highlights significant financial, operational and compliance challenges.

4.4.1. Impact on profitability

Literature from other scholars and researchers showed negative impact of turnover tax on profitability. Literature also acknowledges that despite these negative trends, tax regimes are necessary for simplifying processes and increasing the tax base. While tax regimes such as turnover tax is usually introduced to increase tax base and simplify compliance, evidence from this study indicates that this goal may come at the expense of firm performance. In this study, 80% (n=40) respondents reported seeing notable profit decline and 10% (n=10) reported slight decrease in profits. Further analysis using regression model collaborated these findings and showed the negative correlation of turnover tax on profitability (β = -0.1400, p = 0.009). This finding clearly highlights the economic burden of taxing gross revenue instead of net profit. The studies by Annacondia and Van der Corput (2014) and Klemm (2021) found that low-margin firms are more sensitive to turnover based tax system and thus collaborating the findings of the current study. The present study extends these insights to the Zambian context, especially in smaller towns where limited access to digital tools, financial literacy and tax education further intensifies vulnerability. The challenges observed was also noted on cash flow with 40 SMEs reported finding it very challenging to keep the required cash flow and 9 reporting finding it somewhat challenging. This demonstrate clearly the negative effect of turnover tax on meeting tax obligations for SMEs. To remain viable, SMEs adopt sustainability measures that keep their business running but at the same time keep up with turnover tax obligations. Respondents admitted to delaying supplier payments, reduce staffing levels as well as holding off long-term investments as part of these measures. Mutua (2015) and Ndlovu and Moyo (2018) made similar findings but our current study offers new insights for Zambia and in particular small towns with limited access to digital tool and tax education. From the sectoral perspective, the study indicates that retail and service SMEs are most adversely affect of because of the low-margin of profits and labor intensiveness that this type of businesses face when they are under turnover tax mechanism. The findings are consistent with those found by Simbyakula and Hampopwe (2024). Collectively, these findings highlight the need to consider sector-specific weaknesses when developing or designing tax policies.

4.4.2. Effects on cost management and operational strategy

Several Several SMEs (84%, n=42) admitted to observing significant increases in the cost of goods sold (COGS). 76% (n=38) of these reported higher operating expenses. These were collaborated by regression analysis that showed that effective cost management measures positively correlate with profitability (($\beta = 0.1966$, $p = 0.003$). This suggests that although turnover tax imposes significant financial pressures, SMEs adopt cost control measures to cushion some of the adverse effects. However, the dependency of SMEs on such measures underscores the extent to which turnover tax disrupts normal cost structures.

In response, many businesses focus on short-term operational changes rather than long-term strategic planning. They restructure labor force by increasing the use of temporal workers (43.14%, n=22) and cut on travel and entertainment (41.18, n=21). Fewer firms looked to renegotiate supplier agreements and changed their marketing and sully chain strategies. This trend highlights a shift to short term cash flow preservation and maintenance over long term strategic investment consistent with the findings by the DG Internal Market (2022) and Masabo & Mwangi (2020). Cash flow emerged as a critical point of strain. 80% (n=40) of the SMEs reported observing significant cash flow reductions while 88% (n=44) experienced longer account receivables periods. These liquidity challenges prompted 72% (n=36) to increase prices to cover the additional financial gap as a result of turnover tax obligation. While these price increases offer short term relief, they have long term risks and can therefore erode market competitiveness, push customers towards cheaper alternatives and weaken customer loyalty. In the long run, this will lead to reduces sales volumes and decreased market share which is an indirect consequence of implementing turnover tax. The results collaborates with observations made by Tengerapena *et al* (2025) and Quartey (2019) who highlight the cascading effects of tax burden on SME competiveness and financial planning. The study further revealed that 68% of the SMEs (n=34) observed notable decline in overall productivity and 88% (n=44) reduced their investment in research and development. These reductions indicate that turnover tax not only affects daily operations but undermines long-term business growth and innovation capacity. When SMEs redirect resources away from reinvestments, research and development, technological upgrades and capacity building, their long term survival becomes uncertain. The World Bank (2024), Rivaud-Danset *et al.* (n.d) and Mbise and Baseka (2022) agrees to this position and notes that adverse tax regimes often constrain firm's ability to innovate and remain competitive. Furthermore, variations in pricing and promotional strategies by SMEs demonstrates how factors such as business sector, firm size and market position influence their responsiveness to tax burdens. While some SMEs slightly raised promotions to retain customer, others significantly reduced on promotional spending (n=20) in an attempt to manage rising operational costs. These different strategies highlight the strategic trade-offs SMEs face between cost management and customer engagement and retention. Sector, firm size and market position ultimately shape their responsiveness to tax burdens and therefore demonstrating that the impact of turnover tax in not uniform but facilitated by wider business dynamics.

4.4.3. Implications for compliance

Reporting Reporting standards were kept at high standard with 80% (n=40) reporting to have accurately filed tax returns and 62% (= 31) reporting to have filed their returns on time. Despite this, several administrative challenges persisted. A large majority (92%) of the SMEs (n=46) had reported having incomplete tax invoices whole 78% (n=39) did not have the tax clearance certificates. Furthermore, 70% expressed dissatisfaction with dispute resolution processes. These findings suggest that although SMEs demonstrate willingness to comply, systematic administration challenges continue to hinder full compliance. This pattern aligns with findings by the Zambia Revenue Authority ZRA (2025) and Okello *et al.* (2023) who reported same procedural challenges.

Tax literacy presented another factor that affected compliance behavior. Regression model found a positive link between literacy and profitability ($\chi^2 = 16.32$, $p = 0.0026$; $r = 0.7598$, $p < 0.001$) suggesting that small firms suggesting that SMEs that are well equipped with tax knowledge tend to be more profitable and compliant. However, despite this clear benefit, a significant number of SMEs (70%) showed limited awareness of tax laws and 92% did not have formal training. This knowledge gap is likely to worsen compliance challenges and thus collaborating findings by Mbise and Basaka (2022) and Chinonyerem *et al.* (2023) who reported the importance of education in promoting voluntary compliance. The study also observed a significant shift toward digitalization and an increase in the adoption of technology with 98% of the SMEs admitting to using digital compliance software and 88% indicating having integrate these software's wit accounting systems. The trend is a clear demonstration of growing digitalization of tax management by SMEs and also reflects efforts that they are putting in strengthening the efficiency of tax operations through automation. However, integration challenges remain with a small fraction (6%) of respondents achieving partial integration while 2% had not achieves integration at all. These gaps suggest that while digital adoption is growing, SMEs continue to face interoperability issues and technical limitations that constrain full utilization of digital tax tolls. The world Bank (2021) and TICGL observes therefore that improving the integration of these systems have the potential of enhancing accuracy, simplifying and strengthening compliance.

4.4.4. Overall significance

Overall, the study findings suggest that turnover tax places significant financial and operation burden on SMEs despite the merits of easing administration. This burden showed a direct effect of this tax form on profitability, cost management, cash flow and compliance behavior. The study also revealed that SMEs responded to these burdens by cutting costs, adjusting prices and adoption of digital tools to handle their obligations effectively.

However, these coping measures adopted by SMEs did not completely resolve the ongoing challenges of low tax literacy, difficulties in obtaining tax clearance certificates and poor dispute resolution mechanisms. The new evidence highlights a structural dilemma that simplifying tax regimes does not automatically translate into compliance when underlying support systems remain weak. Feng and Wen (2019), Joshi *et al.* (2014) and the World Bank (2024) holds the same position and reported that burden of turnover tax on SMEs can unfairly affect small businesses when support systems are weak. Therefore, the study findings stress the need to offer awareness education on tax laws and have simplified tax procedures and policies that balances revenue collection and business growth. These measures if applied will help SMEs in smaller towns where businesses often operate with limited capital and administrative capacity.

5. CONCLUSION

Findings of the study indicate that implementing turnover tax affects financial performance, operational decisions and complaint behaviours of SMEs. Several SMEs had a sharp drop in their profits worsened by cash flow issues and the rising cost of goods sold and increased operating costs. Operational consequences included reduction in employee productivity and limited investment in research and development thereby weakening long term business competitiveness and innovation. Despite many SMEs keeping accurate tax records and adopting digital compliance tools, they still faced challenges in obtaining tax clearance certificates, resolving disputes and understanding tax laws. This is a reflection of ongoing gaps in tax education and administrative capacity. Overall, the findings highlight the need for balanced approach on revenue collection and sustaining support for firm's business growth especially those with low profit margins. While the study focused on a single district in Zambia which may restrict its broader applicability of the findings to other areas with varying economic conditions still offers valuable insights into how turnover tax affects business decision making, cost management and compliance practices.

RECOMMENDATIONS

The study suggests actions that support effective cost management such as tax education and adoption of digital tools. Policy makers therefore should consider the financial and operational realities of SMEs when designing tax policies that are aimed at broadening tax base to support compliance and sustainable business growth. It is also recommended that policy makers also pay particular attention to measure that reduce administrative costs and improve on tax education amongst business owners, managers and employees. This is in an effort to enhance the effectiveness of tax while at the same time strengthening SME sustainability. This can be achieved by offering trainings and undertaking tax awareness campaigns that strengthen the understanding of tax rules. Integration of digital compliance tools with accounting or financial management systems should be considered for simplified tax administration. Additionally, setting tax rates that are sector specific and matching profit margins and capital intensity will help ease the financial burden of low margin businesses. Furthermore, streamlining processes for tax clearance acquisition and improve the efficiency for resolving dispute quickly are important for building trust and encouraging compliance. Offering advisory services or incentives to promote better cost management and reinvestment can further help SMEs maintain operational efficiency, innovation and competitiveness even with the tax obligations. Collectively, these actions aim to balance the revenue goals of turnover tax with the broader goal of promoting SME growth, formalization and long-term economic development.

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