A Critical Review of the Characteristics of Presumptive Tax Systems in Developing Countries

MUNYARADZI DUVE
LECTURER
DEPARTMENT OF ACCOUNTING & INFORMATION SYSTEMS,
GREAT ZIMBABWE UNIVERSITY, MASVINGO, ZIMBABWE
e-mail: mduve@gzu.ac.zw

DANIEL P. SCHUTTE, Ph.D.
PROFESSOR
SCHOOL OF ACCOUNTING SCIENCES,
NORTH-WEST UNIVERSITY, POTCHEFSTROOM, SOUTH AFRICA
e-mail: danie.schutte@nwu.ac.za

SUMMARY

This paper considers the effect of the presumptive tax system characteristics on the tax compliance behaviour of small businesses in developing countries. Since the concept of presumptive taxation involves several features influencing the formalisation of small businesses, this paper seeks to survey three key areas of literature: targeted taxpayers, thresholds and timeframe. This paper differs fundamentally from previous studies in that it analyses presumptive tax system characteristics. A descriptive review approach was followed in evaluating the empirical literature on presumptive tax system characteristics. A content analysis was then performed on literature about categories and sub-categories provided in the classification framework. The review highlights similarities and conflicting evidence of presumptive tax system characteristics in transforming the compliance behaviour of small businesses. It was concluded that the blended use of information technology and existing presumptive tax systems can facilitate the movement of small businesses from the informal to the formal sector.

Keywords: presumptive tax system; targeted taxpayers; threshold; timeframe; tax compliance behaviour
Journal of Economic Literature (JEL) codes: H25; H71; O1
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INTRODUCTION

A large informal economy is often considered to be a major obstacle in the implementation of income taxes in developing countries (Memon, 2013:40). A lack of appropriate compliance management and a voluntary compliance tradition facilitated the rapid development of the underground economy in many developing countries (Engelschalk 2015:277). The idea that small businesses have a greater opportunity for tax evasion than formal businesses is also well documented (Ogembo 2018:4). Estimations indicate that in several countries in the world, most of small business activities are carried out in the informal economy (Engelschalk 2015:277). Small businesses have adopted several strategies to evade compliance, including the payment of bribes to tax authorities (Nyamwanza *et al*., 2014:3). In certain situations, some small businesses use political influence to remain outside of the scope of the tax legislation, while others simply cheat by claiming improper deductions or under-reporting income and sales (Bird & Wallace, 2015:121). Ogembo (2018:4) observed that small businesses normally do not register voluntarily with the tax authority, do not keep proper books of accounts, are not prompt in filing tax returns and have a significantly higher rate of evasion.

Some tax authorities have succeeded, but with difficulty while others lack control in fostering voluntary tax compliance in particular among small businesses, the so-called hard-to-tax firms (Bucci 2019:1). Vaillancourt and Clemens (2008:56) argued that tax compliance leads to the incurrence of additional non-production time and expenses such as employing personnel to undertake the tax activities, time and effort required to understand tax procedures. As a result, non-compliance is high amongst small businesses.

For these reasons, changing and simplifying the tax system for small businesses has become an obvious element of tax reform in many developing countries (Engleschalk 2015:278). Many countries have switched to a presumptive form of tax and such tax systems are now an integral component of the tax systems of many countries (Memon 2013:41). Besides, Memon (2013:43) contends that presumptive tax systems are recommended for their simplicity to facilitate taxpayers' compliance and enforcement by the tax administration. The rationale behind the use of presumptive tax systems is to reduce taxpayers' compliance costs, reducing administration costs of compliance and enforcement management, and bridging the way from informal to formal activities (Pashev 2006:401).

Presumptive tax system characteristics vary greatly concerning their design, coverage, and implementation (Kundt, 2017:9). A good presumptive tax system should include a transition mechanism to link itself to the general tax system (Bird & Wallace, 2015:127).

Presumptive taxation involves the use of proxies for ascertaining an income tax and is expressly designed to sacrifice accuracy of measurement to achieve substantially better compliance or lower enforcement costs (Logue & Vettori 2010:31). Similarly, Thuronyi (2015:103) suggests that presumptive taxation involves the use of indirect means to ascertain tax liability, which differs from the usual rules, based on the taxpayers' account. The concept covers a wide variety of alternative means of determining the tax base, ranging from methods of reconstructing income based on administrative practice, which can be rebutted by the taxpayer, to true minimum taxes with tax bases specified in the legislation (Thuronyi 2015:103). In its common application as a proxy for income tax, the tax liability is based on the presumed capacity to earn income rather than on actual income (Pashev 2006:399). Besides, presumptive taxation is applied when the tax base is too small or hard to verify, owing to limited administrative resources or improper accounting practices (Pashev 2006:399). Logue and Vettori (2010:31) arrived at a similar conclusion by suggesting that the more closely the approximation to the idealised distributional consequences of the target base, the more equitable the tax system will be. Generally, the term presumptive taxation covers several procedures under which the desired base for taxation is not measured but is inferred from some simple indicators which are more easily measured than the base itself (Bucci 2019:2).

Presumptive tax systems entail various design characteristics including thresholds, the taxpayers targeted or the timeframe of use. Thresholds can be used to minimise the number of taxpayers that the system has to deal with in the first place (Thuronyi 2015:107). The appropriate threshold for a presumptive tax system has to take into consideration the small business development strategy of the country and the actual capacity of its tax administration (Engleschalk 2015:288). Those with income lower than the entry threshold can be exempted (Thuronyi 2015:107). This is in line with the philosophy of progressive taxation that calls for exempting those with low incomes from tax (Thuronyi, 2015:107). Below some thresholds, small businesses are untaxed and above the minimum threshold, they are in the presumptive tax system (Bird & Wallace 2015:143). If the turnover or assets value exceed the ceiling of a presumptive tax system, the small business operator is deemed to be out of the system and should move to the standard tax system (Bird & Wallace 2015:143). With improving clarity and quality of tax policy and an increasing capacity of tax administration, the threshold should eventually be lowered, and more taxpayers brought into the standard tax system (Engelschalk 2015:289). Besides, either clear thresholds for presumptive tax systems are based exclusively on the business turnover, or turnover combined with other criteria, for example, the number of employees or value of assets (Bird & Wallace 2015; Engleschalk 2015:290). However, the threshold must not necessarily be constant in the long run (Engelschalk 2015:289). Thus, thresholds should be revised systematically so that they continue to achieve their goals. For instance, inflation may be rampant and the exit threshold in real terms may become so low that the presumptive tax system is effectively eliminated (Bird & Wallace 2015:143).

Presumptive tax systems are targeted at self-employed and small to medium-sized enterprises in the informal sector (Pashev, 2006:414; Dube & Casile 2019:54). This is because they are simpler to administer than direct taxes on income as informal sector operators are not required to keep detailed records of their activities, as is required under the standard tax system (Dube & Casile 2019:48). Small businesses form the core cluster of the informal sector. The small business sector includes farmers, traders, small- scale manufacturers, service sectors such as lawyers, doctors, repair workshops and restaurants (Memon 2013:42). Similarly, Pashev (2006:399) noted that taxpayers targeted under presumptive tax systems can include those with a high propensity to evade taxes such as small businesses, agriculture, the service sector and the self-employed. The variations lie in the definition of what exactly is a small business (Pashev 2006:414). The common reference to the legal definition of small businesses is hardly useful for the design of the presumptive tax system, as it includes fairly heterogeneous groups with widely differing abilities to pay and related compliance costs and risks (Pashev 2006:414). The informal sector is hard to tax and presumptive tax systems are recommended for their simplicity to facilitate the compliance of small businesses by simplifying income tax procedures and consequently reducing compliance costs (Memon 2013:43). As a result, many developing countries have introduced some form of simple presumptive taxation for small businesses that are not registered under the standard tax system (Dube & Casile 2019:54).

Unlike thresholds and targeted taxpayers, the timeframe involves placing limits on the number of years that a taxpayer can be taxed under the presumptive tax system (Bird & Wallace 2015:143). A major flaw of most presumptive tax systems is that they do not include explicit plans for leading taxpayers out of the special system into the standard tax system (Bird & Wallace 2015:143). In principle, a country may choose to phase out the eligibility of special taxpayers for instance by establishing a limited period of eligibility for a simplified system, or it may phase out the presumptive tax system entirely (Bird & Wallace 2015:144). The presumptive tax system timeframe should be defined, and a taxpayer should not be allowed to make use of the system indefinitely; otherwise the prolonged availability of a presumptive tax system creates a new class of taxpayers who tend to remain forever and avoid the transition to the formal sector (Memon 2010:79). It is, therefore, a pertinent goal of a presumptive tax system that those in the presumptive tax system might perhaps be assumed to graduate automatically after a certain number of years (Bird & Wallace 2015:144). Generally, most presumptive tax systems do not specify an exact number of years a small business can be taxed under the system (Bird & Wallace 2015:79).

Presumptive tax systems face some challenges. Aditya (2020:54) claims that presumptive tax systems can be subject to abuse that comes from the differential treatment of small businesses to any other common taxpayers. Besides, a poorly designed system for small businesses becomes an obstacle to increase their turnover above the threshold, which creates an obstacle to migrating upward out of the system (Aditya 2020:54). Another serious problem is how to exclude large and medium enterprises from operating under the presumptive tax systems by deceiving the tax office in the name of small enterprises (Bird & Wallace 2015:128). The apparent intentions of presumptive tax systems may not be attained owing to their imprecise goals, the lack of follow-up and the general disconnect created between them and the standard tax system (Bird & Wallace 2015:127; Aditya 2020:54).

This paper provides some policy implications revealing which presumptive tax system design characteristics could be effective in influencing the behaviour of small businesses towards voluntary compliance and reducing the informal economy in a simplified manner. We aim to provide a wide overview of the presumptive tax system and consider how different design characteristics of presumptive tax systems could affect the tax compliance behaviour of small businesses. To achieve this, we evaluate the implications when small businesses move from the informal sector to the formal sector. In this case, the design characteristics of presumptive tax systems can play a significant role in the reduction of the informal sector and an increase in the voluntary tax compliance of small businesses.

This paper is organised into four sections. The first section provides a background to the characteristics of presumptive tax systems. Besides, this section discusses the purpose of a presumptive tax system and its limitations. The second section presents the methodology adopted in this paper. In the third section an analysis of presumptive tax systems thresholds, taxpayers targeted and a timeframe for system use is provided. Finally, Section 4 provides concluding remarks and suggests recommendations for future research.

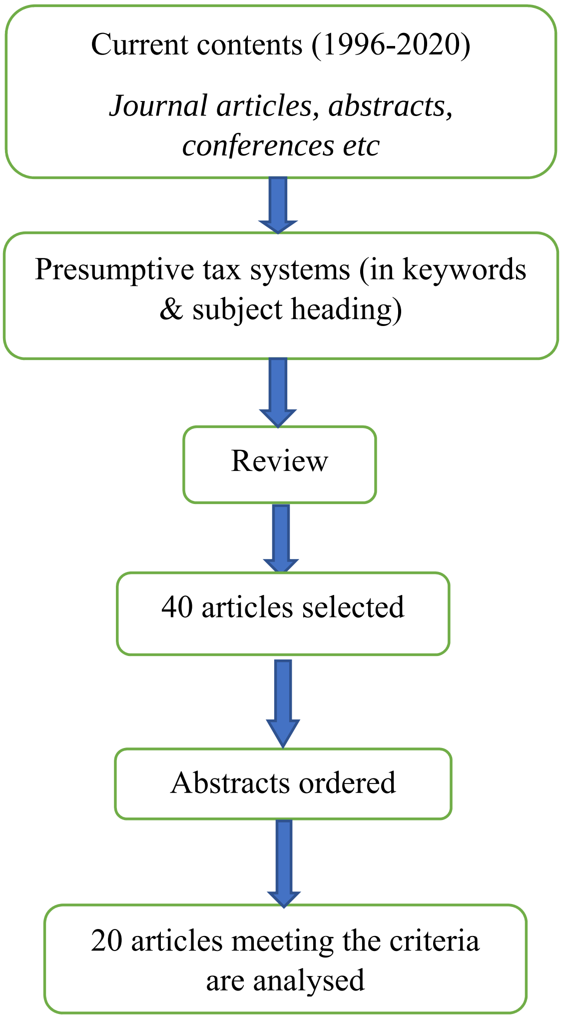
In the above discussion, an overview of presumptive tax system design characteristics and their purposes and limitations has been considered. It is important, however, to also explain the methodology adopted in this paper.

METHODOLOGY

The purpose of the paper is to evaluate the design characteristics of presumptive tax systems using a descriptive review research method. Descriptive reviews are used to reveal interpretable patterns from existing literature (Schlagenhaufer & Amberg, 2015:3). According to Yang and Tate (2009:41) a descriptive review produces some quantification often inform of frequency analysis, such as publication time, research methodology and research outcome. Descriptive reviews summarise individual papers/studies and provide details of the research methods and results of cited studies (Jaidka et al. 2013). Such a review method often has a systematic procedure including searching, filtering and classifying processes (Yang & Tate 2009:41).

A descriptive review follows a systematic and transparent procedure including searching, screening and classifying studies (Petersen, et al. 2015). Grant and Booth (2009) argue that descriptive reviews map out and categorise existing literature from which to commission further reviews and or primary research by identifying gaps in the research literature. Initially, the reviewer needs to conduct a comprehensive literature search to collect as many relevant papers as possible in an investigated area (Yang & Tate 2009:41). The completeness of searching is determined by time or scope constraints, with a synthesis of research evidence summarised in graphical or tabular form (Grant & Booth 2009:94). An individual paper is treated by the reviewer as one data record and identifies trends, patterns among the articles surveyed. In addition, a descriptive review incorporates coding of all relevant papers within a target area on certain characteristics (King & He 2005). In essence, each study included in a descriptive review is treated as a unit of analysis and the published literature as a whole provides a database from which authors attempt to identify any interpretable trends or draw conclusions about the merits of existing conceptualisations, propositions, methods or findings (Pare et al. 2015). Thus, the outcome of such a review is often claimed to be representative of the current state of the research domain (Yang & Tate 2009).

In the context of this paper, the procedure for conducting the descriptive review of literature is described in detail after the schematic strategy adopted, which is shown in Figure 1. The schematic strategy reflects the road map of the critical review for the empirical literature on presumptive tax systems and their design characteristics as used in developing countries. In Figure 1, the descriptive review of the literature was carried out in two phases: article selection and article analysis. The research articles were selected in a four-step process (searching for relevant journal articles, abstracts and conferences; use of keywords in searching; review of articles; and article selection). Then the second phase (analysis) was completed in a three-step process (articles were selected on the basis of the title; abstracts obtained, and analysis of articles meeting the criteria) as shown in Figure 1. The reviewers first searched for relevant articles using keywords and titles targeting research papers, abstracts and conferences published from 1996 to 2020. The title alone was used to determine whether to accept or reject the research papers or whether the abstracts should be obtained. By comparing the results, the reviewers then reach a consensus to include or exclude the research paper in the analysis. This gave a total of 40 articles selected for meeting the criteria of the study. These were further examined in the second phase by ranking abstracts and 20 articles were left for analysis. During the analysis phase, the content of the selected research papers was analysed using a checklist from the classification framework shown in Table 2. Four dimensions were analysed: presumptive tax systems in use, taxpayers targeted by the system, thresholds in use and finally the timeframe of use.



Source: Durand et al. 2007:126

Figure 1. Strategy used for literature review

The review process involved three phases that include filtering, classification and the evaluation of the selected articles.

Filtering process

To identify relevant articles within the domain of presumptive tax systems and their design characteristics, research papers were included in the review if they reported on empirical research and their focus fitted that of presumptive tax systems. Identification and location of relevant articles were done using a search engine known as Google Scholar.

Using online database searches as a primary literature collecting approach has become an emerging culture for modern researchers (Yang & Tate 2009:40). The electronic search refines the inclusion and exclusion criteria on issues of journal articles. From the articles identified, keywords 'presumptive tax systems/methods' and 'presumptive tax system design characteristics' were used for search purposes. Forty articles were identified for detailed review and the articles were imported directly into an Endnote database. This was done to check for duplicate articles; here, those without author names or written by anonymous authors were discarded (Yang & Tate 2009:40). Furthermore, following further review and discussion twenty publications were eliminated because they did not focus on presumptive tax systems and their characteristics but rather on different facets of presumptive taxation. This process left 20 research papers for review. The publication dates of the twenty articles reviewed ranged from 1996 to 2020. The filtering process required the reviewer to make more decisions for inclusion and exclusion by first reading all research papers (Schlagenhaufer & Amberg 2015:5) on presumptive taxation.

Classification process

A literature classification was developed based on categorisation of the research focusing on the twenty articles which remained after the filtering process. Specific sub-categories were assigned to each article. The first step was an initial reading of the twenty research papers. Codes were generated from article keywords, analysis of article abstracts and, where deemed necessary, to explicate the content of the paper further (Yang & Tate 2009:41). Furthermore, axial coding was applied, which involved inductive as well as deductive procedures in order to correlate the located concepts and categories found in the first stage further into categories and sub-categories (Schlagenhaufer & Amberg 2015:6). The next step was to further group the content of the selected twenty articles into three dimensions: thresholds, taxpayers targeted and timeframe. This grouping is based on assigning the single most applicable topic category to a group of related sub-categories (Yang & Tate 2009:42). The content analysis furthermore targeted the intervention that was carried out in promoting voluntary tax compliance among small businesses taxable under the presumptive tax system. The content of the selected articles is analysed using the checklist in Table 1.

Table 1
Classification of topics in presumptive taxation

Topics	Sub-topics
Presumptive taxation	Presumptive tax systems, design characteristics
Presumptive tax systems	Lump-sum, turnover/gross receipts, indirect assessments, third-party reporting, asset-based
Design characteristics of presumptive tax systems	Rebuttable/irrebuttable, minimum/maximum, thresholds, taxpayers targeted, timeframe

Source: Compiled by authors

Following a descriptive review approach, we provide an overview of the current developments in the design characteristics of various presumptive tax systems by conducting a systematic literature classification using the classification scheme. A descriptive review of literature is deemed as the most appropriate to support the creation of a classification framework (Schlagenhaufer & Amberg 2015:3).

RESULTS AND ANALYSIS

Based on the classification framework shown in Table 2, four top categories were identified and 13 subcategories were developed for the top categories. For meeting the inclusion criteria, papers needed to focus on presumptive tax systems and their design characteristics in developing countries: 20 articles qualified. Categories and sub-categories were described, and attention was given to avoid overlapping of sub-categories. For a better understanding of presumptive tax system design characteristics, sub-categories were introduced. The results are reported in terms of four components on the analysis checklist: presumptive tax systems, taxpayers targeted, thresholds and timeframe.

Presumptive tax systems (PT)

The articles were reviewed to determine the specific presumptive tax systems in developing countries. As presented in Table 2, the presumptive tax systems from 20 articles selected were analysed. Three main types of presumptive tax systems were identified: (1) lump-sum tax system, (2) turnover/gross income tax system and (3) third-party reporting system.

Lump-sum tax system

This system is prescribed for a wide range of trades and professions (Memon 2010:83). It is normally introduced by enacting a separate tax law where a different economic base is used and the tax law is titled accordingly and the system is given different names from country to country for example lump-sum, license fee and patents (Memon 2010:83). Under a lump-sum tax system (PT1), taxpayers pay a fixed amount per period (quarterly, semi-annually or annually) based on an individual's profession or trade (Memon 2010:116; Dube & Casile 2019). Taxpayers can be divided into categories based on the type and amount of capital equipment used in the business, location, type of activity, or the number of years a person has been out of school (Memon 2010:117). Bird and Wallace (2015:133) argue that the estimate maybe applied on some specific basis on an individual basis and the amount assessed maybe a simple lump-sum tax based on the average income of a particular trade or profession or on sales, employees, assets and location information. The main aim of a lump-sum tax system is to achieve some degree of equity through differentiation among groups of taxpayers (Pashev 2006:404). Groups are delineated by economic activity or profession and the tax liability is set according to the average income potential of the respective group (Pashev 2006:404). The basic idea is to take advantage of data that are easier for tax officials to obtain than the information required to calculate actual taxable income as specified by law (Bird & Wallace 2015:137).

Turnover/gross income tax system

For turnover/gross income tax systems (PT2), the reviewers sought to identify taxpayers targeted, thresholds used, and the timeframe of system use for qualifying small businesses. Turnover or gross income-based tax systems can be structured in different ways (Engelschalk 2015:283). One alternative is to apply the same tax rate to all businesses subject to the tax, irrespective of the business activity (Engelschalk 2015:283). A second alternative is to divide the small business community into a number of business segments with different tax rates for individual segments. This takes into account the different profit margins in business segments, although the number of segments under a turnover-based system is relatively small (Engelschalk 2015:283). A third alternative is to introduce a progressive tax on gross income where different tax rates are applicable to different levels of gross income (Engelschalk 2015:284). The legislation in the case of gross income or turnover tax provides a minimum-tax type of presumption, whereby the taxable income of a business can be less than a specified percentage of gross receipts of the business (Thuronyi 2015:108). For this basis, the tax has the same economic benefits as a turnover tax rather than a net income tax (Thuronyi 2015:114). Gross receipts are levies on an identifiable component of a business activity and have been used in many countries (Bird & Wallace 2015:138). Memon (2010:82) contents that under a gross income or turnover tax system, the actual tax base is replaced by a proxy base for example turnover and gross income substitute for income respectively. Both turnover and gross income are then subjected to the prescribed tax rates. The substitution of the actual base with a proxy base is legislated either through inserting or deeming a provision in the tax code, or by enacting a separate law (Memon 2010:82). Presumed turnover tax on the same component of a business activity or on the one source or class of income is then subjected to the prescribed tax rate (Thuronyi 2015:116; Memon 2010:82). The tax rate is charged on turnover or gross income generated for example per year.

Third-party reporting system

Finally, the third-party reporting (PT3), was evaluated against the characteristics of taxpayers targeted, thresholds in place and the timeframe of use. Since small business records are usually not available, the demand has increased gradually to reach third-party information to reconstruct small business income. With a global revolution in information technology, the adoption of indirect tax assessments based on third-party reporting information in both developed and developing countries has increased (Slemrod et al. 2017, cited in Bucci 2019:8). This tax system has been in use in countries such as United States of America, Chile, Ecuador, Denmark and Brazil (Bucci 2019:19). In such a case, the tax authority verifies the accuracy of taxpayer's reports using information reported by third party. Third parties that the tax authority can address to obtain information are employees, banks, investment funds, pension funds or companies' trading partners (Bucci 2019:10). The revenue authority originates pre-populated returns that are sent to taxpayers in either paper form or electronically for their confirmation, or if necessary, to obtain any additional information required to enable a final assessment to be made (Forum on Tax Administration 2006:4). Third-party information reporting is a tool used to address the problem of asymmetrical information between fiscal authorities and taxpayers (Bucci 2019:9). Information reported by third parties under the law is processed for matching with tax records to detect cases of inaccurate returns or return non-filing (Forum on Tax Administration 2006:5). Slemrod et al. (2017:155) pointed out that, the possibility to match reported data with information reported by disinterested third parties allows to obtain higher compliance rates at fair costs. Information reported by third parties can concern the overall taxable income achieved by individuals or companies or only a component of taxable income such as the value of revenues earned by taxpayers (Bucci 2019:10). Third-party reporting is an effective enforcement device and the adoption of such an instrument strongly simplifies tax collection (Bucci 2019:11). The assessment of third-party information is normally done once per year.

Taxpayers targeted (TT)

The taxpayers targeted gave a general view on the categorisation of small businesses taxable under several presumptive tax systems in developing countries. Sub-categories aggregating multiple taxpayers targeted include micro-businesses (TT1), small businesses (TT2) and medium-sized enterprises (TT3). Micro, small and medium-sized enterprises cover different types of taxpayers under the presumptive tax systems. The distinction is by the size of the business, which can be identified using several bases. Different definitions were used to define and group taxpayers as micro, small or medium-sized enterprises in different developing countries. For tax purposes, often a single criterion or a combination of a number of criteria is used to specify small businesses (Haque 2013:64). The most common criteria that are used for defining small businesses include gross turnover, gross income, net assets, taxable income, number of employees and equity (Haque 2013:64). In Zimbabwe, small businesses are defined in terms of the Small and Medium Enterprise Act and the tax legislation. The Small to Medium Enterprise Association of Zimbabwe (2018) defines a small business as a business with turnover of less than US$240,000 or assets of less than US$100,000 while those with assets and turnover above US$100,000 and US$240,000 but less than US$1 million should register as medium enterprises. The Small and Medium Enterprise Act (6th of 2011) defines small businesses by classifying them as micro, small and medium enterprises according to the number of employees, total annual turnover and gross value of assets excluding immovable property. The SMEs Act classifies a business as micro if it has less than five employees, an annual turnover of up to US$30,000 or has a gross value of assets of up to US$10,000. It further classifies a business as small if it has 6 to 20 employees, an annual turnover of US$30,001 to US$500,000 or assets with a gross value of US$10,001 to US$250,000. In addition, the SMEs Act classifies a business as medium if it has 31 to 75 employees, an annual turnover of US$500,001 to US$1,000,000 or assets with a gross value of US$250,001 to US$500,000. The Zimbabwe Revenue Authority (ZIMRA 2019) defines a small business as an enterprise with 6 to 40 employees, annual turnover of US$50,000 to US$500,000 or assets valued between US$50,000 to US$1 million, while a medium-sized entity is treated as a business with 41 to 75 employees, annual turnover and assets between US$1 million and US$2 million. There are conceptual similarities in the definition of small businesses by the SME Association of Zimbabwe, SMEs ACT and ZIMRA. The SME Association of Zimbabwe focuses on turnover and assets while the SMEs ACT and ZIMRA focus on number of employees, turnover and assets. However, differences are noted in the values attached to the indicators used in identifying and defining small businesses. All the three sources have disregarded the legal structures and degree of formalisation, factors which are principal in defining small businesses (Munyanyi 2018:31).

Thresholds (TH)

Based on the classification framework, thresholds constitute the different inclusion and exclusion criteria that are used for identifying micro, small and medium-sized enterprises taxable under different presumptive tax systems. From the 20 articles selected, thresholds used for the inclusion or exclusion of enterprises include turnover/gross income level (TH1), the value of assets (TH2), the number of employees (TH3) and business trade (TH4). A turnover/gross income threshold (TH1) category identifies the lower limit and the upper limit of turnover/gross income level for the inclusion or exclusion of micro, small and medium enterprises in the presumptive tax system. The value of assets (TH2) measures the monetary value of physical and intangible assets owned by the micro, small or medium business operator. This is used to estimate the size of the business and its tax liability. The number of employees category (TH3) is popular in many developing countries for the estimation of the tax liability of micro, small and medium enterprises in developing countries. Presumptive tax systems sometimes use the number of employees to classify a business as a micro, small or medium operator. In this case, the number of employees is associated with the presumptive tax payable. Finally, a business trade (TH4) can be used in estimating the turnover/gross income of micro, small or medium enterprise under a presumptive tax system. A business trade relates to the economic sector to which the micro, small or medium-sized entity undertakes its activities. Thus, a presumptive tax system can use a small business's line of trade to approximate its tax liability.

Timeframe (TF)

The timeframe (TF) is used to define the specified length of the period in which a micro, small or medium-sized enterprise is taxable under a presumptive tax system. From the review of the selected papers, the timeframe was expressed as: definite (TF1), or silent (TF2). A definite category (TF1) refers to a presumptive tax system where enterprises are taxable for a limited or specified period. Finally, a silent timeframe (TF2) serves that a presumptive tax system does not pronounce the maximum period an enterprise can stay in the presumptive tax system. Table 2 summarises the classification framework with a matrix of results from the 20 reviewed research papers.

Table 2
Matrix of results on presumptive tax system design characteristics for developing countries

Author(s)	**Paper number**	**Country/ Year**	**Presumptive tax systems**			**Presumptive tax system characteristics**								
						Taxpayers targeted			**Thresholds**				**Timeframe**	
			Lump-sum	Turnover/GI	Third-party	Micro	Small	Medium	Turnover/GI	Assets	No. of employees	Business trade	Definite	Silent
Bongwa	1	Ethiopia/ 2009	x	x			x		x		x			x
Boonzaaier et al.	2	South Africa/ 2019		x			x	x	x					x
Danquah & Osei-Assibey	3	Ghana/ 2018	x			x	x	x				x		x
Dube & Casile	4	Zimbabwe/ 2019	x			x	x	x	x	x	x	x		x
Getachew	5	Ethiopia/ 2019	x	x		x			x		x			x
Haji & Haji	6	Tanzania/ 2015	x	x		x	x	x	x					x
Iordachi & Tirlea	7	Romania/ 2016		x		x			x		x		x	
Joshi et al.	8	Ghana/ 2014	x			x	x	x		x		x		x
Megacom	9	Egypt/ 2005		x		x	x	x	x					x
Memon	10	Pakistan/ 2013		x		x	x	x	x					x
Nabaweesi & Nakku	11	Uganda/ 2013		x			x		x					x
Ogembo	12	Kenya/ 2018		x		x	x	x	x					x
Oladipupo & Obazee	13	Nigeria/ 2016		x		x	x	x	x					x
Saleheen	14	Bangladesh/ 2012	x	x			x		x					x
Schutte et al.	15	South Africa/ 2019		x		x	x		x		x		x	
Sebele-Mpofu & Mususa	16	Zimbabwe/ 2019	x			x	x	x		x	x	x		x
Sebikari	17	Uganda/ 2014		x			x		x					x
Taube & Tadesse	18	Ghana/ 1996	x			x	x					x		x
Udoh	19	Nigeria/ 2015			x	x	x		x					x
Zulaikha & Basuki	20	Indonesia/ 2017		x		x	x	x	x				x	
			10	14	1	15	18	11	16	3	6	5	3	17

The categories were sorted alphabetically with a count of findings used to sort sub-categories within each category. The individual articles were numbered from 1 to 20 for easier reference. The content analysis of the papers reviewed provided additional information that aids in the understanding of how taxpayers are targeted and how thresholds and timeframes can be conceptualised and assessed. The matrix of results shows the findings for each research paper analysed in this study using the three categories of presumptive tax systems (taxpayers targeted, thresholds and timeframe). It is evident that all the papers analysed reported some scores on some of the sub-categories with the lowest number of findings recorded in Paper 11 (Ogembo 2018) and the highest findings reported in Paper 4 (Dube & Casile 2019). The papers contained between four and nine findings. Hence, the research papers in this direction took an evaluative standpoint and describe potentially effective approaches designed to establish the tax compliance of small businesses. The papers reviewed showed a tendency to include some, but not necessarily all, of the specific categories of design characteristics of presumptive tax systems. In addition, the analysis of the papers also revealed the design characteristics of presumptive tax systems as critical in influencing the tax compliance behaviour of small businesses. However, it should be noted that although a paper-by-paper analysis revealed the characteristics of categories such as presumptive tax system, taxpayers targeted, thresholds and timeframe, these were not necessarily described in detail in some instances. The reviewers analysed the articles by the presumptive tax system, taxpayers targeted, thresholds and timeframe.

Distribution of the articles by presumptive tax systems

In the majority of the articles reviewed, the results show that the lump-sum tax system (10 papers, 50% of the reviewed papers), turnover/gross income tax system (14 papers, 70%) are common presumptive tax systems employed in developing countries with third-party reporting system (1 paper, 5%) being the least infrequently written about in the academic literature. The turnover/gross income tax system might be the leading system due to its proximity to the estimated tax liability of small businesses. Besides, a lump-sum tax system proved to be also popular in the taxation of small businesses in developing countries, with third-party reporting named by Paper 19 (Udoh 2015) being viewed as uncommon in most developing countries.

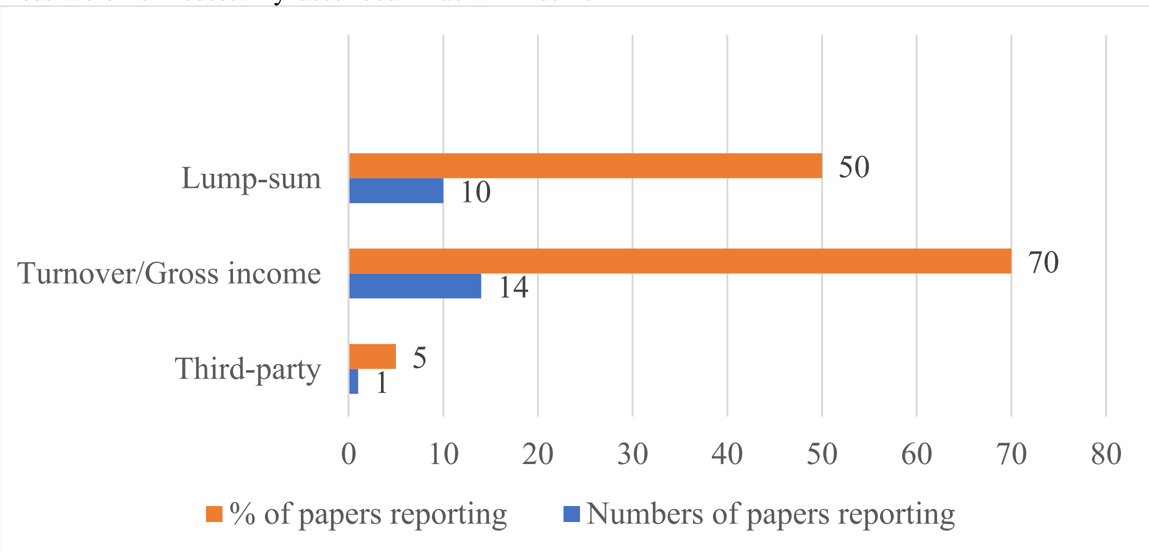


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Figure 2. Distribution by the type of presumptive tax system

Design characteristics are an important feature in any presumptive tax system. However, regardless of their differences in structure and characteristics, all presumptive tax systems are meant to bring non-compliant small businesses into the normal tax system. Several presumptive tax methods adopted by developing countries are not useful policy tools in increasing tax revenues, formal registration or voluntary tax compliance of small businesses (Bucci 2019). This is attributed to the limited enforcement power of fiscal authorities, often accompanied by the unsuitability of presumptive tax policy tools, which are not well designed and not fully integrated into the general tax system (Bucci 2019). The articles that were reviewed mostly focus on the presumptive tax systems and the variables that affect their design issues were not much emphasised (Bucci 2019; Dube & Casile 2016; Taube & Tadesse 1996).

Figure 2 reveals the distribution of articles for each presumptive tax system sub-category. Clearly, turnover tax and lump-sum tax systems are two major methods used in the taxation of small businesses in developing countries. This is unsurprising. Their simplicity and relatively low administrative costs have always been an important reason for developing countries to adopt them. However, a very small number of papers regarded a third-party reporting system as an infrequent method in the taxation of small businesses in developing countries. This may be because the value and the implications of a third-party reporting system are still under-recognised in facilitating the tax compliance of small businesses.

For the purpose of this study, taxpayers targeted, thresholds and timeframe are of great interest in influencing the compliance behaviour of small businesses under a presumptive tax system. Taube and Tadesse (1996) recommended that presumptive tax systems that make use of indicators seem to work best when they use information and documentation from third parties, especially from government agencies. Results from certain papers (20%) show that some developing countries employ a combination of two different presumptive tax systems for the taxation of small businesses. This is common where small businesses are segmented into specific categories using various bases and thus a presumptive tax system is specifically designed targeting a specific small business group. In such countries, the presumptive tax liability is determined using the level of turnover and a fixed amount.

Distribution of the articles by taxpayers targeted

The reviewed articles showed that micro (15 papers, 75% of the reviewed papers), small (18 papers, 90%) and medium-sized (11 papers, 55%) businesses are the taxpayers targeted by presumptive tax systems implemented in developing countries. Small and micro businesses are the most frequently named groups, with medium-sized enterprises completing the groups targeted by presumptive tax systems. Haji and Haji (2015) and Dube and Casile (2019) provided different groups taxable under presumptive tax systems, as shown in Table 2. Other views were noted in Megacom (2005) and Joshi et al. (2014). It is worth mentioning that some papers employed one definition for small businesses to refer to micro, small and medium-sized enterprises (Saleheen 2012; Sebinenko 2016; Nabaweesi & Nakku 2013). Various definitions and terms were therefore used to describe micro, small and medium-sized enterprises.

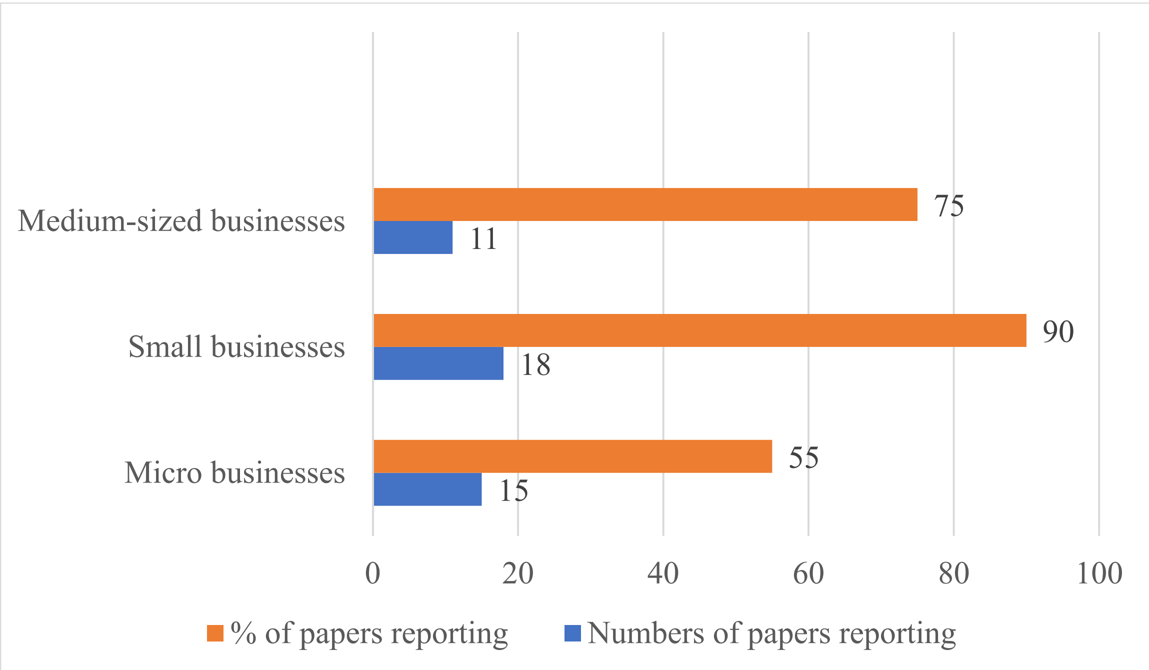

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Figure 3. Distribution of the articles by taxpayers targeted

One significant finding of the study evidenced by taxpayers targeted under presumptive tax systems was the various groups that meet the inclusion criteria. Further, data from the papers reviewed confirm the complexity of classification and definition of businesses taxable under presumptive tax systems. However, there was a consistent pattern of research confirming taxpayers targeted by different presumptive tax systems as micro, small and medium-sized businesses, as shown in Figure 3. The application of the presumptive tax system has been limited to small and medium-scale businesses having difficulties in keeping formal or proper books and records (Haji & Haji 2015). The analysis also revealed that most papers agreed that the design and implementation of presumptive tax systems are meant for encouraging the tax compliance of micro and small businesses. The extent to which presumptive tax systems are used varies from country to country (Iordachi & Tirlea 2016). This is because the appropriate design of presumptive tax systems will depend on the problems the government desires to solve, for example, what types of taxpayers form the source of problems under the normal rules (Iordachi & Tirlea 2016). Several papers demonstrated that sources of information and bases used to identify and classify taxpayers targeted as micro, small or medium-sized vary across countries and presumptive tax methods in use. Additionally, most of the papers reviewed reflected that a clear definition of taxpayers targeted by the presumptive tax system reduces abuse of the system by large organisations or capable small businesses which should be taxable under the normal tax system. This demonstrates that directing a presumptive tax system towards a specific group of taxpayers has the potential to influence their tax compliance behaviour.

Distribution of the articles by thresholds

Turnover/gross income level [16 papers, 80% of analysed papers], number of employees [6 papers, 30%], business trade [5 papers, 25%] and value of assets [3 papers, 15%] were identified as thresholds used for the inclusion and the exclusion criteria of small businesses taxable under presumptive tax systems in developing countries. Figure 4 shows that most of the papers identified turnover/gross income level as the common threshold used in setting the upper limit of turnover when moving small businesses from the presumptive tax system to the standard tax system.

The literature showed that several presumptive tax systems use more than one threshold beside turnover level [Papers 1,4,5,7,8,15,16] for the inclusion criteria of small businesses in the tax system. However, most of the selected articles do not discuss specifically the design of thresholds of presumptive tax systems, but rather focus on the implementation of presumptive tax systems in general. In 9 out of the 20 papers, the authors were interested in presumptive tax systems more directly related to intervention in developing countries [Papers 1,4,5,6,7,10,13,16,18]. The main variable measured was the implementation and the use of several presumptive tax systems. The evaluation of the literature shows that the presumptive tax methods, turnover/gross income level, asset values, number of employees vary from country to country. For instance, it is optional for small businesses to choose whether to be taxable under presumptive tax systems [15,20], whilst it is mandatory for any small business that meets the set thresholds to be taxable under the presumptive tax system [Papers 1,2,3,4,5,6,7,8,9,10,11,12,13,14,16,17,18,19]. It was discovered that indicators like the value of assets, number of employees and business location/trade are mainly used in lump-sum presumptive tax systems [Papers 1,3,4,5,6,7,8,16,18]. These papers also indicated that a fixed presumptive tax charge is levied on small businesses in similar circumstances [Papers 4,5].

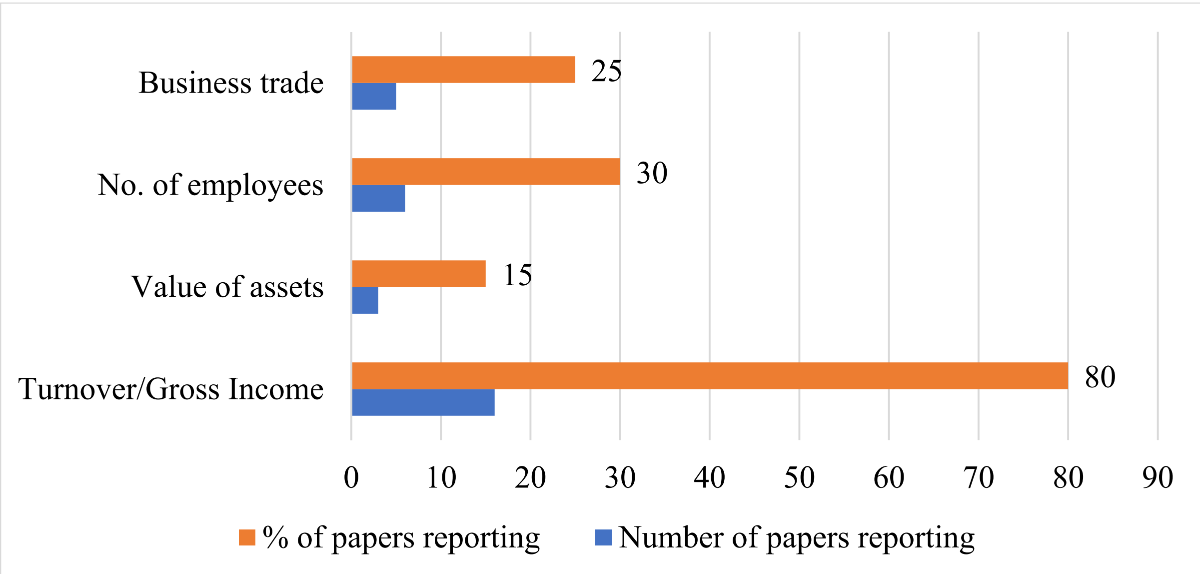

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Figure 4. Distribution of the articles by thresholds

One of the major patterns that emerged from the review of papers selected was the frequent use of turnover as a threshold for the inclusion criteria of small businesses in the presumptive tax systems. The establishment of a tax threshold has, therefore, the potential to remove a large portion of the hard-to-tax small businesses from the income tax net (Thuronyi 2015). The rapid growth in the use of turnover as a threshold suggests that developing countries consider it as a better reflection of the tax liability of small businesses. Additionally, the use of business trade, the number of employees and the value of assets are also common in some developing countries, despite being on the decline side. The lower use of these thresholds may imply an inaccurate estimation of small businesses' tax liability. This lack of clearly defined thresholds makes it hard for presumptive tax systems to improve the tax compliance of small businesses. The lump-sum presumptive taxes implemented in developing countries have no entry thresholds and they tend to be regressive by taxing those with lower incomes proportionately more (Dube & Casile 2016). Several papers reveal that thresholds vary from country to country (Rajaraman & Bhende 1998, Bird & Wallace 2015, Thuronyi 2015, Bongwa 2009).

Distribution of the articles by timeframe

Only 3 of the reviewed articles (15%) gave information on a definite timeline concerning the length of period small businesses can stay in the presumptive systems used in developing countries, as illustrated in Figure 5. In analysing a definite timeframe, papers [7,15,20] revealed that if the small business records income above the upper limit of the threshold, then it has automatically been taxable under the normal income tax. In Papers 1,2,3,4,5,6,8,9,10,11,12,13,14,16,17,18 and 19 no timeframe is mentioned for the small businesses under the presumptive tax systems in use. For instance, Getachew (2019) reported that small businesses have been operating from as less than two years to more than 10 years under the turnover and lump-sum presumptive tax systems in Ethiopia. This has been caused by the non-existence of a time-limit (Ogembo 2018) on how long a taxpayer can benefit from the presumptive tax system.

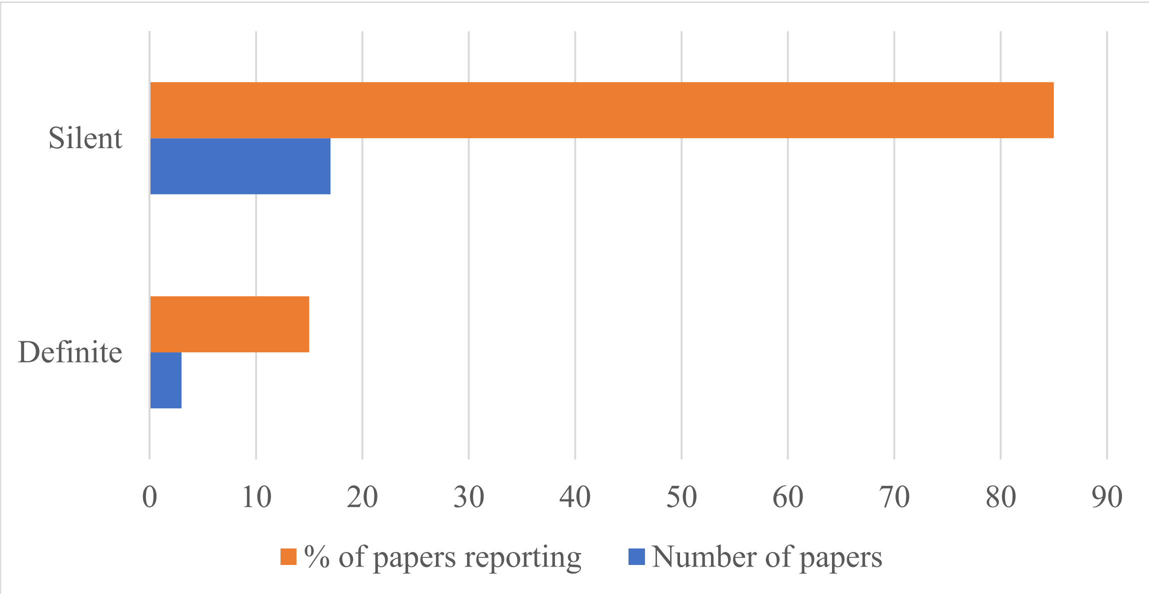

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Figure 5. Distribution of the articles by timeframe

In many of the research papers reviewed, the specification of the variable timeframe was missing or incomplete. For example, the timeframe was specified in less than a quarter of the studies utilised. Those studies revealed that in South Africa, micro-businesses remain locked in for three years once they have opted for the turnover tax and this acts as a restrictive measure (Visser 2016). The evidence on the timeframe for presumptive tax systems revealed that particularly where the tax liability is much less than that in the normal tax system should be defined and a taxpayer should not be allowed to make use of the system indefinitely (Memon 2010). However, in most of the papers reviewed, the timeframe was unspecified or silent. This lack of timeframe information in most papers reviewed makes the interpretation of results and comparison of presumptive tax system features impossible. The analysis of the presumptive tax system without a defined timeframe in many developing countries revealed the lack of monitoring of small businesses under the system. The current presumptive tax systems in place do not stipulate the time limit on how long the small business can stay in the presumptive tax system (Ogembo 2018). As a result, the thresholds that are in place are not capable of moving businesses that grow out of the presumptive tax system into the normal tax system This implies that small businesses can stay or hide under the presumptive tax for a very long period or the entire duration of their lifespan. This undermines the objective of moving small businesses from the informal to the formal sector.

Analysis of small business taxation problems in selected developing countries

In Zimbabwe, the presumptive tax system is mostly a lump-sum system differentiated by economic activity sector and levied on a quarterly basis (Dube & Casile 2019). Furthermore, in the transportation industry, the presumptive tax system tries to differentiate income-earning capability by using indications such as the number of seats or the size of the vehicle in tonnes. As a result, the tax system is presumed to be progressive. The difficulty with Zimbabwe's lump-sum presumptive tax system is that it is horizontally inequitable, with effective rates ranging from 10% to 20% at the lowest income level across all activity classifications (Dube & Casile 2019). The presumptive tax system is regressive in terms of vertical equity. Because other activity classifications pay lump-sum payments regardless of income level, people with lower incomes pay a higher proportion of their income in presumptive taxes than people with higher incomes (Dube & Casile 2019). Countries such as Romania, Tanzania, and South Africa, on the other hand, employ a turnover tax system to tax small firms. Tanzania’s turnover tax system employs a segmental organisation of the tax administration with separate departments to deal with small businesses. In Tanzania, the Block Management System (BMS) is a method that is suited to the demands of particular sorts of small businesses (Haji & Haji 2015). However, the lack of records for registered small businesses has hampered Tanzania’s implementation of the turnover tax system. Like Tanzania, South Africa has a progressive turnover tax regime. Tanzania’s turnover tax structure ensures a minimum of vertical and horizontal equity (Haji & Haji 2015). The presumptive tax system in Tanzania has the disadvantage of favouring small businesses with strong profit margins, as well as some small businesses under-declaring their revenue (Haji & Haji 2015). Similarly, despite the advent of the South African turnover tax system, small firms are not necessarily using it as intended (Schutte et al. 2019). This is due to a lack of understanding of the turnover tax scheme. Furthermore, because small businesses are expected to maintain a sophisticated accounting system to assess their cashflows, profit or loss positions, the turnover tax system raises their tax compliance expenses (Schutte et al. 2019; Haji & Haji 2015). Generally, small firms contribute very little to overall tax revenues and do not graduate into the normal tax system in either the lump-sum (Zimbabwe and Ghana) and turnover tax systems (South Africa and Tanzania) (Dube & Casile 2019; Schutte et al. 2019; Danquah & Osei-Assibey; 2018; Haji & Haji 2015).

Ethiopian experience has demonstrated that it employs both a turnover-based and an indicator-based presumptive tax system (Getachew 2019). Nigeria, too, employs a mix of turnover-based systems and third-party reporting (Udoh 2015). The progressive turnover presumptive tax system lowers the tax burden between the upper and lower bands of the presumptive tax system, smoothing the transition to the regular regime (Getachew 2019). The problem with Ethiopia’s turnover-based system is that it is inefficient, and it discourages efficient enterprises by increasing their expenses (Getachew 2019). The lag time for daily sales estimating is another issue with the turnover-based method, since small firms tend to underestimate their income through their sales register devices (Getachew 2019). Furthermore, Ethiopia’s turnover tax system contains several turnover bands, resulting in convoluted tax ratings that are difficult for small enterprises to understand and that generate a high administrative burden. The dilemma is similar in Nigeria and Zimbabwe, where no statistics databases exist due to small business operators’ failure to register (Dube & Casile 2019; Udoh 2015). When it came to taxing small enterprises in Ethiopia, the combination of both turnover-based and indicator-based systems yielded benefits, such as when gross revenue was understated. The indicator elements are employed in this case in the turnover-based system as obvious counter-evasion elements from the perspective of the tax collector (Getachew 2019).

CONCLUSION

In this paper we discussed presumptive tax system design characteristics and their relative importance in the tax compliance of small businesses in developing countries. First, relevant presumptive taxation literature was collected, analysed and filtered from 40 research articles. A classification framework was developed to organise and systemise existing academic knowledge about presumptive tax system design characteristics. Literature was mapped to the classification framework and the review made it possible to work with 20 articles describing several presumptive tax systems used in developing countries and their design characteristics. This paper analysed the results of research papers that presented literature on presumptive tax systems used in developing countries with a focus on three design characteristics: taxpayers targeted, thresholds and timeframe. It further analysed presumptive tax system experiences in developing countries.

The question remains whether the characteristics examined in this paper – taxpayers targeted, thresholds and timeframe –paper are sufficient prerequisite design characteristics to guarantee the tax compliance of small businesses. In terms of taxpayers targeted, generally, there was a consensus from the papers reviewed that the presumptive tax systems are enforced on small businesses, professionals and individuals who carry out economic activities. It was also observed that the categorisation of the taxpayers targeted as micro, small or medium-sized varies from country to country and this complexity in definition made it difficult to evaluate the appropriateness of most presumptive tax systems in facilitating the tax compliance of small businesses in developing countries. It was found that despite directing presumptive tax systems to micro, small and medium-sized businesses, there was no significant change in their tax compliance behaviour. Regarding thresholds, there is some evidence that presumptive tax systems in most developing countries pronounce some upper limit threshold for moving small businesses from the presumptive tax system to the standard tax system. Several of them do not specify the lower limit threshold. Furthermore, the turnover threshold proved to be common in most developing countries. Despite its use, many small businesses in developing countries underreport their turnover and thus tax compliance is reduced. In addition, the value of assets, business trade and the number of employees provides at least some degree of compliance, as small businesses pay some form of tax regardless of their turnover level. However, many studies proved that they are not accurate in the estimation of presumptive tax liability and this in turn reduces tax compliance of small businesses. To make matters worse, most of the systems are silent about the length of period a small business should stay in the presumptive tax system. This implies that without properly designed features, the presumptive tax systems appear to be abused by capable small businesses and large organisations. This results in low tax revenues due to weak supervision and a lack of resources in monitoring small businesses' activities in developing countries. Therefore, many small businesses remain permanently in the presumptive tax system and there is no transition to the normal tax system. The literature acknowledged that the characteristics of presumptive tax systems play a significant role in the formalisation and tax compliance of small business operators in developing countries, if properly implemented and monitored. In a nutshell, although the taxpayers targeted, thresholds and timeframe exist to some extent in presumptive tax systems, their influence on the tax compliance of small businesses is still very low in developing countries. In summary, most presumptive tax schemes used in developing countries yield low revenue in comparison with other tax types and the uptake by small businesses is very insignificant.

RECOMMENDATIONS

There are no universal methods for designing and implementing presumptive tax systems. The characteristics of presumptive tax regimes vary from each country (Danquah & Osei-Assibey 2018). Nonetheless, this paper recommends the need for future research in blending existing lump-sum and turnover/gross income presumptive tax system with third-party reporting information systems that make use of information technology for the taxation of small businesses. The inference made is that the infusion of technology could divert presumptive tax systems that rely on cash-based transaction information to information that can be generated using technology, for instance through banking systems and mobile devices. This recommendation could lead to improved tax compliance of small businesses taxable under presumptive tax systems. Additionally, there is a need for more outreach programs to equip small businesses with basic bookkeeping skills and compliance issues. Further, the time limit should be clearly stated to eliminate businesses that intend to stay forever in the presumptive tax systems.

It is also suggested that the amount of presumptive taxes levied be supported by good research on sub-sector profitability, so that erroneous amounts are not levied on grounds of limited capacity. This is because segmenting the small business community enables distinct policies to be applied to each sub-group, and this trustworthy data will improve the tax system's fairness. Furthermore, for better planning, an emphasis on the database for effective assessment and collection from the small business sector is required, as this sector is difficult to catch within any country's tax net. More importantly, it is imperative for the government to create incentives for small enterprises to keep books and records, such as exempting a certain proportion of tax liabilities in exchange for thorough accounting. In a nutshell, the payment system should be automated and linked to bank payment modes to support a good presumptive tax system design, which necessitates the involvement of both the tax and banking authorities.

POLICY IMPLICATIONS

In general, the usefulness and practicality of the policymakers' recommendations for continued development of presumptive tax systems in developing and middle-income nations is fundamental to the study's success. Small businesses account for a higher percentage of tax defaulters, resulting in an increase in tax evasion and revenue leakage (Udoh 2015). The turnover-based approach can ease the transition to the conventional tax system, according to research findings and conclusions. This is because decreased turnover bands make it easier for small firms to grasp the tax system. In addition, lower rates for those who keep complete records of sales and costs may encourage small business owners to adhere to the presumptive tax. It is also critical for tax policymakers to recognise the need for tailoring a presumptive tax system to the needs of small enterprises. As a result, the presumed tax policy would be aligned with the capacity of the taxpayer, improving the system's fairness. While presumptive tax generates minimal income in the short term, it serves to bring businesses into the tax net, ensuring that they comply with the law as they grow. Adopting the study's recommendations could assist the further development of tax systems for small firms and expand the revenue base in developing and middle-income countries.

LIMITATIONS AND FUTURE RESEARCH

Despite the article's theoretical insights and contributions to the evolution of tax policy, the study has limits. The research was qualitative, and while this approach has some advantages, it falls short of capturing all of the design aspects of a good tax system. Only related literature on the design and implementation of presumptive tax systems in selected developing countries was considered. If analysis of existing literature is combined with primary data, the study could reveal a wealth of information about small business perspectives on presumptive tax compliance, which could be useful in further developments of presumptive tax systems. Despite the limitations mentioned, the insights brought about by this paper are enough to stimulate future research on further developments of presumptive tax systems. Thus, future research can focus on a comparative analysis of characteristics of presumptive tax systems and small businesses' tax perceptions in both developed and developing countries. This can facilitate further developments of taxation approaches for small businesses in developing, middle-income and developed countries through sharing experiences.

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