

FACTORS INFLUENCING SMALL AND MEDIUM SCALE ENTERPRISES' TAX COMPLIANCE INTENTION IN SRI LANKA: SPECIAL REFERENCE TO MATALE DISTRICT

A. Dharmakeerthi^{1,*} and P. R. Weerathunga²

^{1, 2} Department of Accountancy and Finance, Rajarata University of Sri Lanka, Mihintale, Sri Lanka

*Corresponding author (email: amalidharmakeerthi02@gmail.com)

INTRODUCTION

Tax compliance has become a challenge and significant concern for tax administrators around the world, with finding ways to characterise and illustrate the supposed forms of non-compliance and finding ways to reduce it. Tax compliance can be defined as the degree to which a taxpayer complies or fails to comply with the tax rules of their country. As for Ajzen's (1991) Theory of Planned Behavior (TPB), people's behaviour depends on the fact that they have a purpose for it. According to Alm (1999), individuals do not like paying taxes and take various actions to reduce their tax liabilities. Hence, tax evasion creates a "tax gap", which can be broadly defined as the difference between the taxes that would be paid if all obligations were fully met in all instances and taxes that are produced and collected (Canada Revenue Agency, 2020). According to Atuguba (2006), as cited in (Kuug, 2016), the advancement of a country rest primarily on taxation; therefore, in the absence of adequate revenue, progress efforts will be hindered. Thus, taxpayers' compliance with tax laws is essential to keep the system working and support the programs and services that improve lives.

According to the economic data of Sri Lanka, tax to GDP had continuously decreased, and tax evasion, poor tax administration, a gamut of tax exemptions, and discretionary and ad-hock tax policy changes were the reasons. In 2014, the tax-to-GDP ratio dipped to 10.1 per cent; numerous efforts have increased voluntary tax compliance (Moramudali, 2019). The Government of Sri Lanka recognizes SMEs as the backbone of the economy, as it accounts for more than 75% of the total number of enterprises, provide 45% of the employment and contribute to 52% of the Gross Domestic Production (GDP) (Ministry of Industry and Commerce, 2015). And SMEs are considered even more critical with providing many primary services and materials to large businesses and believing they will one day evolve into large enterprises. However, the general perception of SME tax compliance is that SMEs do not pay taxes.

According to Akinboade (2015), as cited in (Heenkenda et al., 2016), SMEs are low-income generators and less tax compliant compared to large businesses and were considers hard-to-tax group from the informal sector. But, there are still many SMEs who comply with the tax requirements. And the intentions of their tax compliance had influenced by many factors. However, compared to other countries, there are not many articles and journals published in Sri Lanka about the influencing factors to SME tax compliance to serve as literature. Therefore, this study will focus on the factors that influence the tax compliance intention of SMEs in the Sri Lankan context by using TPB as a theoretical framework. This will enhance

the literature regarding factors influencing the tax compliance intention of SMEs in the Sri Lankan context. Further, this study can aid policymakers in improving voluntary tax compliance. The remainder of this study is organized as follows. The next section describes the conceptual framework and methodology adopted in this study. After that, the results of the analyses and a discussion are made. The conclusions derived are explained in the last section.

METHODOLOGY

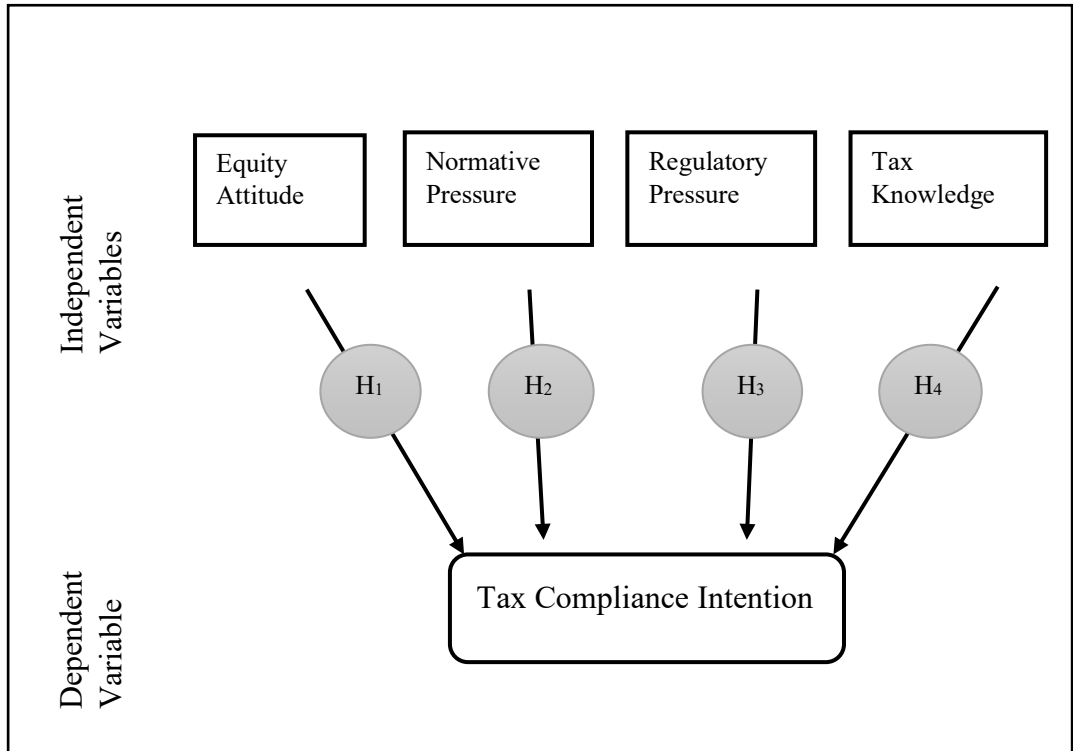


Figure 1 Conceptual Framework

The study has conducted to identify the factors influencing tax compliance intention of SMEs in the Sri Lankan context using the Quantitative method and deductive approach. The population comprises small and medium taxpaying enterprises (employees less than 200) in the service sector, registered under the Sri Lanka Inland Revenue Department. According to the Department of Census Statistics (DCS) 2019 data, the sample of this research is limited to the SMEs in the Matale district, which are limited to 10,381 enterprises as per the DCS statistics in 2019. With the current tax system, most small enterprises are not liable to pay taxes.

Hence, the researcher has collected data from 150 tax-liable SMEs in Matale District.

Based on the conceptualization, the following hypotheses can be developed.

H₁: There is a positive relationship between equity attitude (perception towards fairness) and tax compliance intention of SMEs in Sri Lanka.

H₂: There is a positive relationship between Normative Pressure and tax compliance intention of SMEs in Sri Lanka.

H₃: There is a positive relationship between Regulatory pressure and tax compliance intention of SMEs in Sri Lanka.

H₄: There is a positive relationship between Tax Knowledge and tax compliance intention of SMEs in Sri Lanka.

The data were analyzed using descriptive statistics such as mean and standard deviation as well as inferential statistical techniques such as correlation and regression analysis

$$TCI = \beta_0 + \beta_1 EA + \beta_2 NP + \beta_3 RP + \beta_4 TK + \epsilon$$

Where, TCI – Tax Compliance Intention

EA – Equity Attitude

NP – Normative pressure

RP – Regulatory Pressure

TK – Tax Knowledge

β_0 – Constant

$\beta_1 - \beta_4$ = Regression Coefficient

RESULTS AND DISCUSSION

The results of the descriptive analysis, correlation analysis and the ordered logistics and panel versions of the multivariate regression analyses are presented with the resulting discussion in this section.

Table 1 Descriptive Analysis of Variables

	N	Min	Max	Mean	SD
TCI	116	1.00	5.00	3.50	.818
TK	116	1.00	5.00	3.47	1.072
RP	116	1.00	5.00	3.86	.935
NP	116	1.00	5.00	3.15	1.181
EA	116	1.00	5.00	3.06	.859
Valid N (listwise)	116				

As the mean value 2.5-3.5 was considered to represent the moderate level of compliance intention while 3.5 above were proved as good compliance intention, above table 1 prove that all the variables, except the RP, influence to have a moderate level of TCI to SMEs. Yet, RP was proved to have a good compliance intention impact on SMEs with 3.86 of the mean value.

Table 2 Correlation between the Variables

	TCI	TK	RP	NP	EA
TCI	1				
TK	.783**	1			
RP	.753**	.767**	1		
NP	.751**	.742**	.799**	1	
EA	.226*	.369**	.252**	-.034	1

** . Correlation is significant at the 0.01 level (2-tailed).

* . Correlation is significant at the 0.05 level (2-tailed).

As for table 2, NP, RP, and TK correlation proved that their correlation with TCI is moderately positive. And their significant value was 0.000 ($P < 0.05$). However, EA correlation was proved to have a weak positive relationship with 0.226 of Pearson correlation. And the significant level of EA was 0.015, which is lower than the decision criteria of $P < 0.05$.

The value of R Square is 0.693. It means that independent variables contributed to 69.3% of the variation in TCI of SME taxpayers. Therefore, the model is proved as a good prediction.

Table 3 Multiple Regression Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	F	Sig.
1	.833 ^a	.693	.682	.48457	62.774	.000 ^a

^aPredictors: (Constant), EA, RP, NP, TK

According to Table 3 the P-value is 0.000 ($p < 0.05$). This indicates that all independent variables have a significant relationship with the dependent variable, tax compliance intention. And the 62.774 F value has proven the predictive power of all independent variables and explains that it is unlikely to all of the coefficients equal zero.

Table 4 Coefficient Correlation of Variables

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	T	Sig.
1	(Constant)	.575	.208		2.762	.007
	TK	.405	.104	.386	3.878	.000
	RP	.164	.081	.205	2.027	.045
	NP	.278	.102	.303	2.719	.008
	EA	.031	.049	.043	.626	.533

^aDependent Variable: Tax Compliance Intention

According to the survey data presented in table 4, NP, RP, and TK has a significance level below 0.05. This indicates the influence of the variables was significant. However, the significance level of EA is 0.533. It indicates the responses for EA are highly volatile. Hence it doesn't make a good component to make predictions of the influence it has on tax compliance intention.

According to the above table, the multiple regression can be calculated as follows;

$$TCI = 0.575 + (0.031 EA) + 0.278 NP + 0.164 RP + 0.405 TK + 0.208$$

According to the findings of the research equity attitude (perception towards fairness) was proved to have no significant influence over tax compliance intention of SMEs. However, previous studies by (Barbuta-Misu, 2011) and (Torgler et al., 2003) proved that horizontal

equity and perception towards government spending and trust have a significant influence on tax compliance intention.

Palil (2010), Benk and Budak (2011), and Battiston and Gamba (2016) suggested the moral and social pressure a taxpayer receives from one's family, friends, one's values and beliefs, as well as the peers' pressure influence their tax compliance intention. This finding can also support the previous research by (Alm, 2018; Atawodi & Ojeka, 2012; Kariuki & Zachary, 2019), that being audited or penalised positively impact taxpayers' tax compliance intention. Also, tax knowledge was proved to have a positive influence on the tax compliance intention of SMEs. This can support the findings of the previous studies conducted by Oladipupo and Obazee (2016), Atawodi and Ojeka (2012), and Kariuki and Zachary (2019), which state the positive relationship between tax knowledge and tax compliance intention.

CONCLUSIONS AND IMPLICATIONS

According to the study's findings, tax compliance is wide and complex. Among the several determinants that influence the tax compliance influence of SME taxpayers, independent variables selected for the study proved to have a collective positive influence on the tax compliance intention. As regulatory pressure and tax knowledge of the SME taxpayers were found to have a significant positive impact on tax compliance intention, the normative force was also proved to positively influence the tax compliance intention. And surprisingly, equity attitude (perception towards fairness) had no significant influence on the tax compliance intention of SMEs. Therefore, public policymakers need to use persuasive methods (changing attitudes and norms) and conventional coercive methods (subjective control) to encourage voluntary tax compliance.

Tax education and conducting seminars are relatively low in Sri Lanka compared to developing and developed countries. As the study proved the positive influence of SME taxpayers' tax knowledge on tax compliance intention, it is suggested to conduct seminars and other suitable methods to improve the tax knowledge of taxpayers to increase voluntary tax compliance. As the researcher faced the problem of limited literature regarding the topic in the Sri Lankan context, this study will help enhance the literature regarding SMEs' tax compliance intention, especially in the Sri Lankan context. In addition, this study will be helpful to future researchers who aim to find the determinants of SME tax compliance intention in Sri Lanka using TPB as a theoretical framework.

Keywords: Equity attitude, normative pressure, regulatory pressure, tax compliance intention, tax knowledge

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