

DEVELOPMENT OF A CONCEPTUAL FRAMEWORK FOR STUDYING THE FACTORS THAT ARE ASSOCIATED TO THE TAX COMPLIANCE**K.G Asela Gamini Bandara and Dr. W.M.R.B. Weerasooriya¹****ABSTRACT**

This review paper aims at suggesting a new model instead of relying on the conceptual frameworks which were based on the previous empirical examinations however when developing this new model, the researcher considered the tax information, taxpayers' attitudes and tax compliance costs as independent variables as suggested by the other scholars. The willingness of the taxpayers to pay taxes considers as a moderating variable because it influences the relationships between each of the independent variables with the dependent variable. On the other hand, new researchers have more opportunities to practice this proposed model as a foundation when they decide to carry out new research in the same field in the future. Therefore, the proposed model will set a new direction for future research that will help future researchers to understand the significance of the various concepts. It will apply to any particular taxpayers' group in Sri Lanka as well as globally and also future researchers can be able to justify to what extent this new model will be applicable when they decide to carry out similar research in the future.

Keywords: Tax compliance, taxpayers' Attitudes, Tax information, Tax compliance cost

I. INTRODUCTION

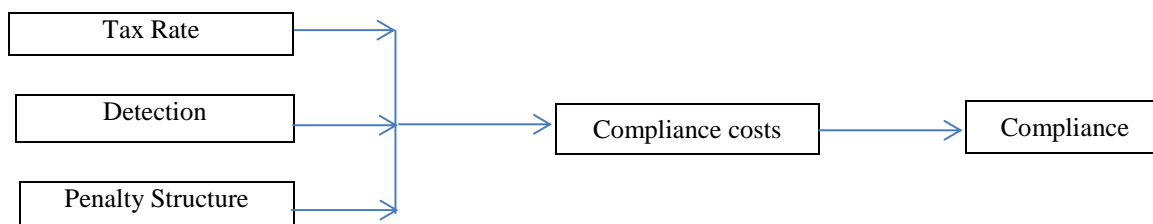
Tax compliance has been becoming an important phenomenon across the globe, therefore, most of the researchers in every part of the world are developing different types of conceptual frameworks to study the different factors, which influence the tax compliance and its relationships with other variables. According to Cobham, (2005) tax compliance is a problem for many countries although it has been improving for many countries. For example, it is one-third of GDP in rich countries, Latin America and the Caribbean 17% of GDP and low-income countries showed less than 15% of GDP and on the other hand, tax compliance is a serious challenge facing tax administrators around the world and further despite the various tax reforms undertaken by governments to increase tax revenue over the years, but recent evidence has proven that the contribution of income taxes to the government's total revenue remained consistently very low and is increasingly declining Alabede, (2011). Income tax has remained the most worrying tax system in any country in the world Kiabel and Nwokah, (2009) therefore, it remains a big challenge to low-income countries like Sri Lanka. Hence, it is important to study this particular area in more depth. The researchers called Masinde and Makau, (2010) point out that tax compliance is now recognized as a multifaceted construct. The other scholars such as Jackson, (1986) has expressed some views on variables in the analysis of tax compliance behavior. There are two main methods available to understand tax compliance issues: the economic approach is based on economic rationality while behavioral approach disciplines such as psychology and sociology.

The basic model (As shown in Figure (1-2)) which is based on the economic approach is built by Becker, (1968) and Allingham and Sandmo first applied the basic model in the area of tax compliance study in 1972. This model is based on two theories namely expected utility theory and deterrence theory. The expected utility theory elaborates taxpayers as perfectly amoral utility maximizers, who prefers to evade taxes whenever the expected gain increases the cost of evasion (Allingham and Sandmo, 1972). The deterrence theory is emphasized with the effects of sanctions and sanction threats Cuccia, (1994), where an increase in the severity of penalties and the certainty of their imposition will discourage undesirable behavior (Pate and Hamilton, 1992).

The framework was built based on this economic approach. Within this framework, the tax rate, the probability of detection and the penalty structure determine the cost of tax compliance, which finally determines taxpayer compliance behavior. This framework is sometimes known as the financial self-interest model, which can be presented as follows (Figure (1.1)).

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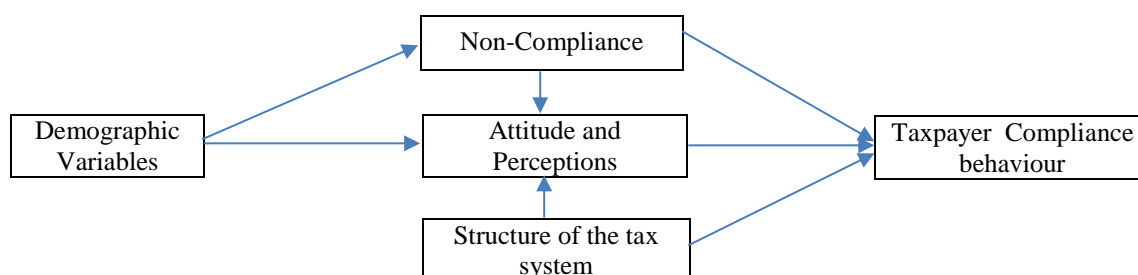
Figure (1-1): Financial Self Interest Model



Source: Fischer, Wartick, and Mark (1992)

In contrast, the behavioral approach assumes that individuals are not simply independent and selfish but they interact according to differing attitudes, beliefs, and norms Elffers, (1991). According to Julian, who revealed that noncompliant corporations are more likely to be managed by executives who have failed to comply with their individual income tax obligations. Moreover, another US study by Hanlon, Mills, and Slemrod, estimated corporate tax non-compliance to be 13% of the tax liability, as measured by deficiencies suggested upon audit investigation, and further Abdul Jabbar examined the corporate tax noncompliance of SMEs using a survey approach. This approach incorporates psychological and sociological factors such as age, gender, ethnicity, education, culture, peer influence and tax morale as factors that may affect taxpayer compliance behavior. This model is important as it indicates that demographic variables indirectly influence tax compliance behavior through their effects on non-compliance attitudes. The expanded model can be illustrated as shown in the below Figure (1-2).

Figure (1-2): Expanded Model of Taxpayer Compliance



Source: Fischer. (1992)

Both the economic and behavioral approaches have contributed to the understanding of tax compliance behavior. A study designed to incorporate both the approaches as a single approach is not likely to be effective in explaining the tax compliance behavior of taxpayers. The empirical literature on tax compliance has been concerned mainly with individual taxpayers while the analysis of corporate tax compliance has been neglected. Rice explained that the difficulty in capturing analytically the non-compliance decisions of corporate taxpayers was a possible explanation for the lack of research on corporate tax evasion. A comprehensive review of the extensive literature on factors influencing individual tax compliance behavior uncovered three main categories of determinants of such behavior. These categories include demographic, economic and behavioral determinants. Demographic determinants include age, gender, education, and occupation, while economic determinants include income level, income source, tax rates, and sanctions. Behavioral determinants include complexity, fairness, peer influence and ethics.

II. CONCEPTUAL FRAMEWORK FOR THE RESEARCH

The researcher has focused on six independent variables (tax rate, tax information, taxpayers' attitudes, legal framework, the cost of tax compliance and the demographic characteristics associated with SMEs) and in addition, also considered the level of tax compliance as a dependent variable. The researcher has constructed the following model as appeared in Figure (1-3), which was based on the recent research done in Sri Lanka however, this model has its weaknesses and strengths. The key strengths associated with this model are easy to construct hypotheses to show the linear relationship between each of the independent variables with the dependent variable, easy to understand the links between them and also it provides more opportunities for researchers to apply such different forms of relationships into practical situations

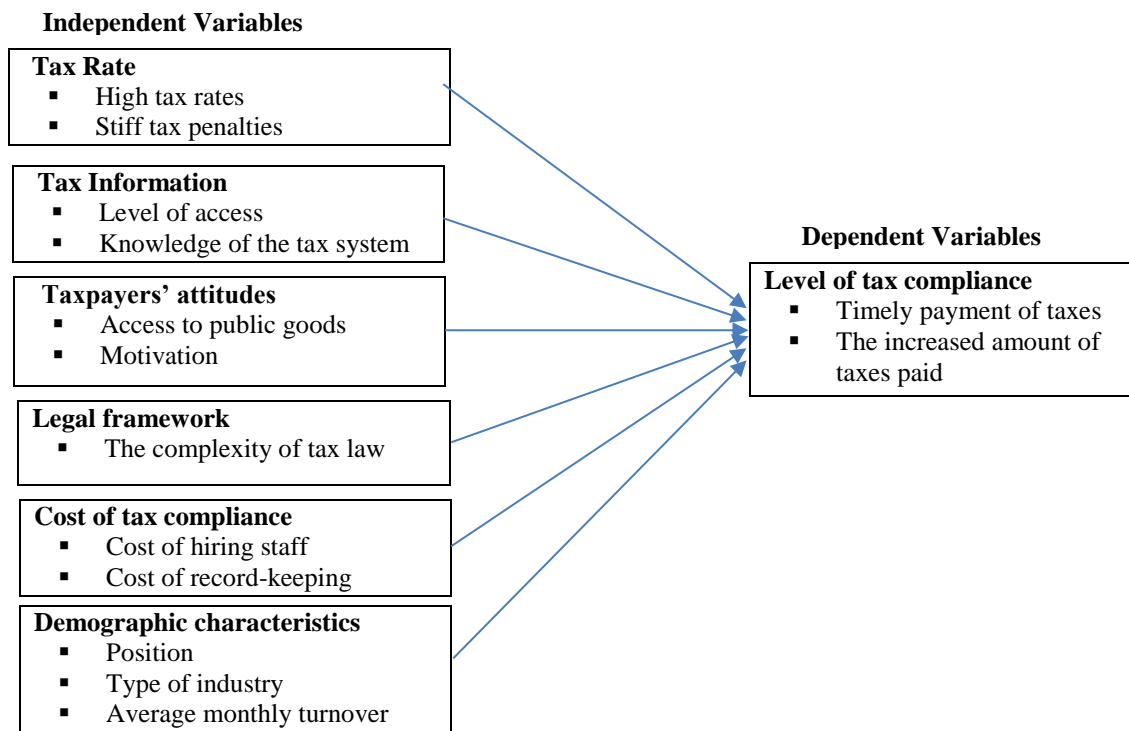
Based on the conceptual framework mentioned under the figure (1-3), the researcher constructed the following hypotheses to test the relationships between each of the independent variables and the dependent variable as well as to test the impact that demographic characteristics may have on the level of tax compliance in the SME sector companies in Sri Lanka

- H₁:** There is a relationship between the tax rate and the level of tax compliance in the SME sector companies in the central province in Sri Lanka.
- H₂:** There is a relationship between the tax information and the level of tax compliance in the SME sector companies in the central province in Sri Lanka.
- H₃:** There is a relationship between the taxpayers' attitudes and the level of tax compliance in the SME sector companies in the central province in Sri Lanka.
- H₄:** There is a relationship between the legal framework and the level of tax compliance in the SME sector companies in the central province in Sri Lanka.
- H₅:** There is a relationship between the cost of tax compliance and the level of tax compliance in the SME sector companies in the central province in Sri Lanka.
- H₆:** There is an impact that demographic characteristics associated with SME sector companies on the level of tax compliance in the SME sector companies in the central province in Sri Lanka.

Through using these hypotheses, the researcher enables to test to what extent research objectives will be met after carefully evaluating the findings of the research.

But still, there are some drawbacks associated with it. The major drawbacks are some of the variables which were considered as independent variables under this framework but those were considered as moderate variables under the previous literature, therefore, create a bit of confusion among the new researchers hence, it is better to re-evaluate those variables before applying for similar research in future. In addition, according to the findings of the study, which indicate that the Adjusted R Squared for all value tells us that this model accounts only for 31.1% of variance in the tax compliance by SMEs and further out of five independent variables considered but with independent variables such as taxpayers' attitudes and the legal framework which only led to creating significant relationships with the dependent variable. In other cases, relationships might be negative or positive but insignificant.

Figure (1-3): Model constructed for the research

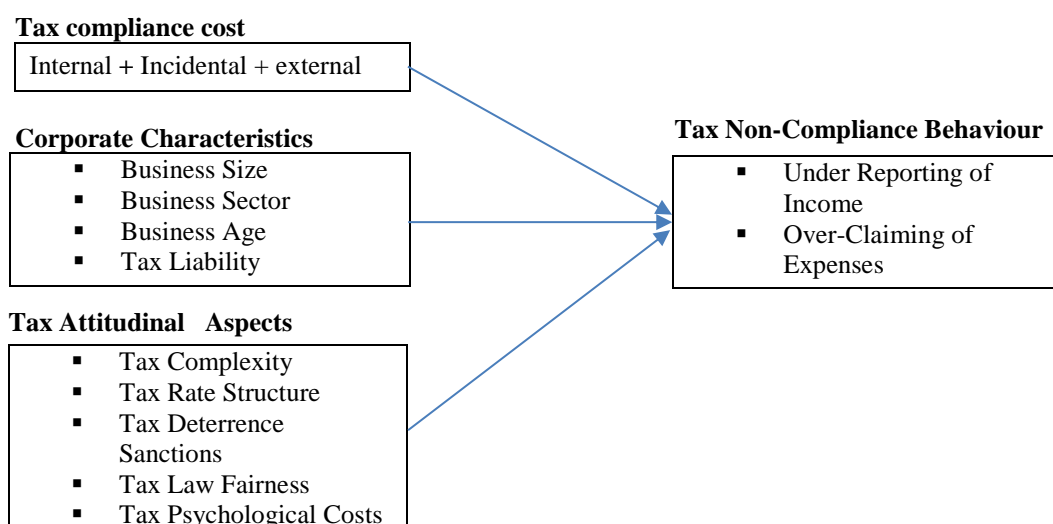


Source: The researcher

Conceptual Framework developed by Sapiei, N.S., Kasipillai, J. and Eze, U.C

The scholars such as Sapiei, N.S., Kasipillai, J. and Eze, U.C (2014) developed the following conceptual framework for their study, which was based on research gaps ascertained from the previous literature relating to the factors influencing the level of tax compliance behavior. The primary aim of developing this model as shown in Figure-(1-4) was to determine the extent of the link between the independent variables (corporate characteristics, tax compliance costs, and tax attitudinal aspects) and the dependent variable (tax non-compliance behavior). The researchers constructed three main hypotheses to show the relationships between the dependent variable and the each of these three independent variables but also built up several sub-hypotheses to show the relationship between each of the components come under some independent variables (corporate characteristics and the tax attitudinal aspects) and the dependent variable. The model which has been shown in the Figure (1-4) was solely developed to investigate the tax compliance behaviors of the large corporate taxpayers instead of focusing on SMEs. According to the previous empirical evidence, which shows that business age, tax rate, industry sector and incentives on the compliance behaviors of corporate SMEs were not conclusive and also it has been highlighted that limited empirical research was utilized to evaluate the compliance behavior of corporate taxpayers. The significant proportions of tax compliance literature based on the determinants of tax compliance behavior of individual taxpayers in addition, no research so far has attempted to study large corporate taxpayers utilizing the taxpayer self –reporting approach and also limited literature on the compliance decisions of corporate taxpayers is mostly restricted to studies on corporate determinants utilizing government reported data. Hence, very little is known about the influence of tax compliance costs and economic and behavioral factors on taxpayer compliance behavior.

Figure (1-4): Research Model developed by Sapiei, N.S., Kasipillai, J., and Eze, U.C



Source: Sapiei, N.S., Kasipillai, J. and Eze, U.C (2014)

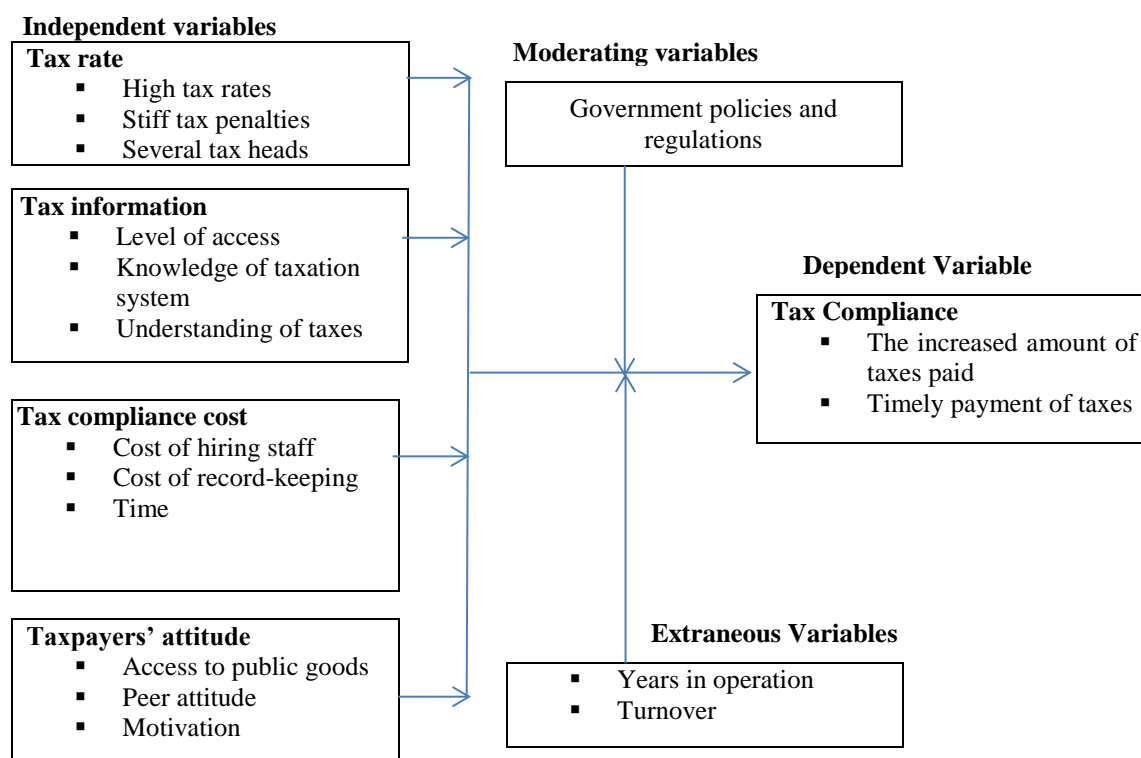
Conceptual Framework developed by Mwangi, P.C.N

The scholar called Mwangi, P.C.N. (2014) had considered government policies and regulations as moderate variables while years in operation and the turnover considered as extraneous variables. The main objective of constructing the model as appears in the (Figure (1-5) was to identify the factors influencing tax compliance among Small and Medium Enterprises in Nairobi's industrial area in Kenya and also show the different types of relationships which occurred such as direct relationships between each of the independent variables (tax rate, tax information, tax compliance cost and the taxpayers' attitudes) with the dependent variable (tax compliance) and also how moderate variables (government policies and regulations), as well as extraneous variables (turnover and the years in operation), impact the relationships which occurred between each of the independent variables with the dependent variable.

Though researcher has considered government policies and regulations as moderating variables plus turnover and years in operation as extraneous variables to show the separate impacts on the relationships between each of the independent variables and the dependent variable, findings exhibit the relationships occurred between each independent variable with the dependent variable but findings didn't clearly establish the moderating impacts on the relationships between dependent variable with the independent variables and also failed to show how turnover

and years in operation influence on the links between the dependent and the independent variables. Though the conceptual framework is drawn for the research by Mwangi, P.C.N. (2014) clearly shows the linear relationship between the dependent variable with each independent variable, findings didn't show whether the researcher has constructed hypotheses or sub-hypotheses to exhibit those relationships. Although research aimed to address the tax gap of under-reporting and underpayment of taxes, to what extent those issues were addressed still becomes questionable. Therefore, which provides clear evidence that this model has failed to address some of the issues substantially.

Figure-(1-5) Research Model developed by Mwangi, P.C.N

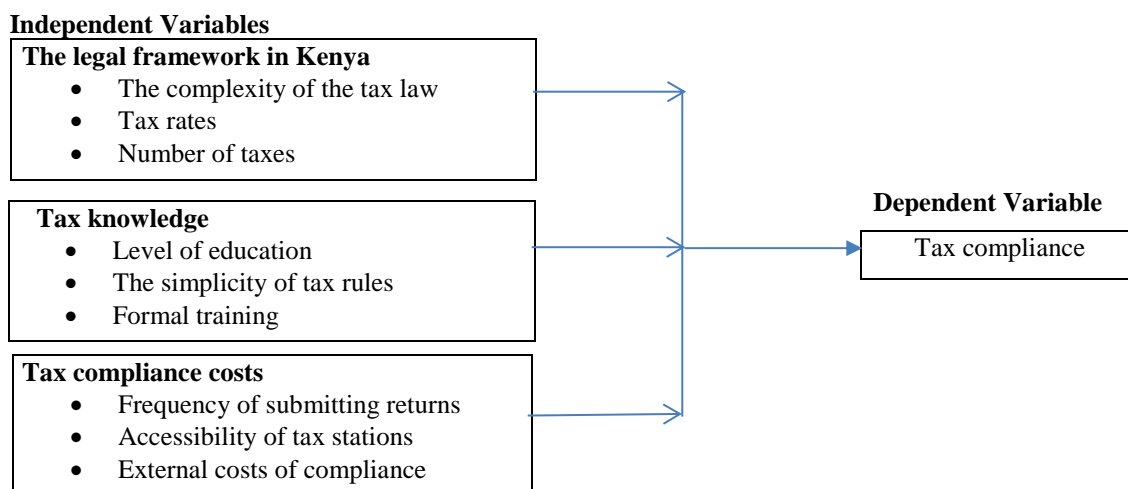


Source: Mwangi, P.C.N. (2014)

Conceptual Framework developed by Gachiku, M.W

The researcher called Gachiku, M.W.(2015) considered the legal framework in Kenya, tax knowledge and the tax compliance costs as independent variables and tax compliance as a dependent variable when developed the conceptual model to evaluate the tax compliance by small and medium enterprises in Nairobi North Tax Region in Kenya. The appropriate model can be shown as follows (Figure: (1-6) research model). When developing this model (Figure-(1-6) research model), the researcher was ignored the taxpayers' attitude as an independent variable because most of the taxpayers believe that attitudes don't encourage tax compliance meanwhile the findings of the study concluded that tax system in Kenya was unfair as a result of that, factors considered under this model need to be re-evaluated to correct this situation. The researcher has solely relied on the correlation test instead of setting separate three main hypotheses to show the link between the legal framework in Kenya with tax compliance, tax knowledge with tax compliance and the tax compliance costs with the tax compliance. The researcher can also test whether the different components of each independent variable can have a significant influence on tax compliance. This can be tested by the construction of several sub-hypothesis but this has not been considered here but according to the findings of the correlation test established the significant relationships between the three independent variables (legal framework in Kenya, tax knowledge and the tax compliance costs) with the dependent variable (tax compliance). Undoubtedly, the researcher managed to establish a strong relationship between the tax compliance costs with the tax non- compliance behavior and thus created a negative relationship with tax compliance behavior and this can be further improved by promoting sound accounting practices that will greatly reduce the cost of hiring professional services.

Figure: (1-6): Research Model constructed by Gachiku, M.W



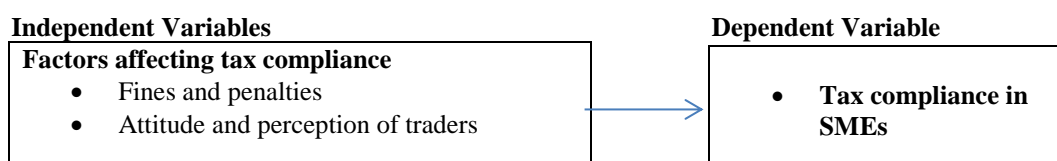
Source: Gachiku, M.W.(2015)

Conceptual Framework developed by Chebusit, C., Namusonge, G. S., Biraori, O.E., and Kipkoech, E.C

The four African researchers called Chepkurui Chebusit, Prof. G. S. Namusonge, Otaki Evans Biraori, and Ezekiel Chirchir Kipkoech used a model as exhibited in the Figure : (1-7) for the research considering fines and penalties and attitude and perception of traders as independent variables while Tax compliance in SMEs used as a dependent variable. The model developed by these researchers has its strengths as well as weaknesses. The researchers considered using attitude and perception of taxpayers as an independent variable because evidence suggests that attitude and perceptions of the taxpayers play a crucial role in their compliance decisions such as perceptions of government spending, perception on the fairness of the tax system as well as ethics towards compliance. For example, when an increase in the attitude of SMEs, tax compliance also improves. This agrees with Eriksen and Fallan (1996) that taxpayers' attitude towards the tax system has an influence on tax evasion and eventually, it impacts on tax compliance decision and also it agrees with Oriviska and Hudson (2002) that attitudes to tax evasion are accepted by many SMEs who are mostly benefiting from it but some taxpayers for example taxpayers in Hong Kong have less favorable attitude towards the tax system because of lower level of tax compliance Chan,(2000).

These four researchers including some studies suggest that an increase of penalties can have undesirable effect and result in more tax avoidance Kirchler,(2007) and further Alm, (1992) expresses some views regarding the fines which affect the tax compliance but the impacts was virtually very low in addition, the findings from effectively utilizing this model revealed that even though huge investments are made in the auditing function, uncovering “ hidden cash” is never going to be an easy task unless having an effective audit trail and also these findings have been agreed with the findings of the Ahmed and Braithwaite (2005), who uncovered that SMEs have more opportunities for tax evasion but very little resources available for in the field of tax auditing, however, the major drawback is that it is too simplified model and also considered only a few variables (fines and penalties and the attitude and perceptions of traders) which affect to tax compliance when conceptual framework was developing for the study. The model can be presented as shown in the below Figure: (1-7).

Figure: (1-7): Research Model developed by Chebusit, C., Namusonge, G. S., Biraori, O.E., and Kipkoech, E.C



Source: Chebusit, C., Namusonge, G. S., Biraori, O.E., and Kipkoech, E.C (2014)

III. RESEARCH OBJECTIVES

The purpose of this review paper is to recommend a conceptual framework with the intention that any prospect study can explore the relationships between the dependent and the independent variables when it applies to any particular taxpayer group in Sri Lanka.

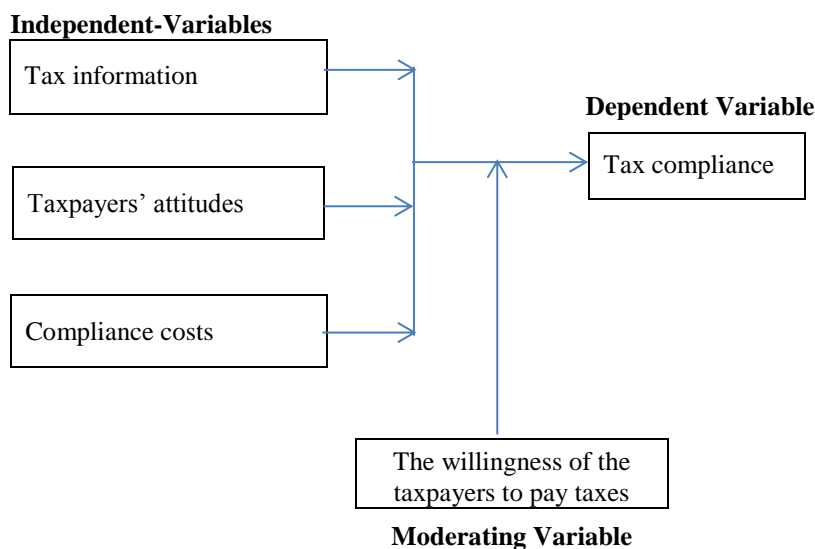
IV. METHODOLOGY

This study mainly focuses on developing the conceptual framework for future applications purpose in Sri Lanka. Therefore, it reviews the previous literature brought by the previous scholars to identify the relevant concepts and the relationships belong to the particular phenomenon. At the very outset, the researcher was studied around 200 research articles consist of abstracts, which were published by various organizations and the other different authors. Finally, around 100 articles were drawn and reviewed to ascertain relevant concepts and the associate links exist between them.

V. DEVELOPMENT OF THE CONCEPTUAL MODEL

The researcher has concentrated on the models developed by the previous scholars Mwangi, P.C.N. (2014), Gachiku, M.W.(2015) and the Sapiei, N.S., Kasipillai, J. and Eze, U.C (2014) for the study undertaken recently to evaluate the factors influencing on the tax compliance among Small and Medium Enterprises in Sri Lanka. A detailed questionnaire was designed to seek the responses from the taxpayers regarding the indicators set out in connection with each variable mentioned above however the model which based on the research consisted of different variables from the models developed by the previous various scholars plus made few modifications to them. The following model can be developed as a study model which can be practiced for any researchers when starting to carry out similar research in future, therefore, the research model based on the recent study is replaced by the currently developed conceptual model to carry out any study in connection with the tax compliance. The proposed model can be exhibited as follows however when developing this model alternatively, the researcher can consider the willingness of the taxpayers to pay taxes as a moderating variable because which influences the relationships between each of the independent variables with the dependent variable. The proposed model can be exhibited as shown in the figure (1-8).

Figure: (1-8): The proposed model for future research



Source: The researcher

Based on the above proposed model (figure-(1-8)), the researcher considered three independent variables such as tax information, taxpayers' attitudes and the tax compliance costs which were previously used by other scholars such as Mwangi, P.C.N. (2014), Gachiku, M.W.(2015) and Sapiei, N.S., Kasipillai, J. and Eze, U.C (2014).

VI. CONCLUSIONS

This review paper recommends a conceptual framework model for any future researchers to evaluate the impacts of the independent variables on tax compliance. Therefore, the proposed model of this review paper will set a new direction for future research that will help to understand the significances of this new model. If it makes sense in the future studies, then it will apply to any taxpayers' group in Sri Lanka as well as globally and also it helps to measure the extent to which the research objectives will be met in future similar contexts.

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