

Taxpayers' Perception and Direct Assessment Tax Compliance of Micro and Small Enterprises in North-East, Nigeria

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ABSTRACT

This study assesses the taxpayers' perceived psychological behaviours of direct assessment tax (DAT) compliance of MSEs in North-East of Nigeria. The data for the study was collected using an online questionnaire administered to the 527 Micro and Small Enterprises in the North Eastern States of Nigeria. PLS-SEM (Smart PLS3) was employed to ensure validity and reliability of the instrument and to test the study's hypotheses. The result of the study revealed that direct assessment tax compliance is positively influenced by government spending, trust in authorities and fairness in tax system. However, perception on corruption was found to have no significant effect on DAT compliance.

Keywords: psychological behaviour, government spending, equity and fairness, corruption, trust in authorities, tax compliance

INTRODUCTION

Direct Assessment is a tax appraisal directly on persons who generated their income from self-employment, where taxpayers under this category are expected to file tax return of preceding income earned without a notice from the tax authorities using appropriate tax forms (Bello et al., 2021). It is a method through which personal income generated by self-employed persons are assessed and taxed. However, taxpayers under this category are notified to pay their taxes within two months in an event they failed to file return within the stipulated timeframe while tax collection of on assessments that are under appeal or protested will remain in abeyance pending the settlement of the protest or plea and must be filed and paid not later than a month (Bello et al., 2021).

Tax compliance is reporting tax burden to the appropriate tax authority in observance with relevant tax laws and regulations (Jackson & Milliron, 1986). Tax compliance is viewed as a process where taxpayers filed appropriate tax returns by disclosing all taxable income precisely and paying the accurate tax liability in conformity with relevant tax laws and regulations (Palil (2010). Taxpayers noncompliance has become an alarming phenomena globally which affect revenue generation for both developed and emerging economies (Muhibudeen, 2018). Though, tax noncompliance is a universal quandary experienced in both developed and developing countries, however, it is more prominent in the developing countries (Kim, 2008; Mas'ud, 2017; Sarsiti, Trisnowati, Widiastuti, & Budiwinarto, 2018), due to the presence of large unregistered businesses and absence of accurate database of taxpayers (Mas'ud, 2017; Terkper, 2003). Hence, revenue from PAYE constitutes about 95% of revenue from PIT in developing countries (Mas'ud, 2017), and for this reason there is need for more effort by both government and the researchers towards improving tax revenue from self employed individuals (Direct Assessment Tax), this is in line with what International Monetary Fund (IMF) reported in 2011 that only 5% of self-employed individuals from developing countries population paid PIT as against 50% in the developed countries.

Several studies were conducted on psychological determinants of taxpayers' compliance where trust in tax authorities, perceptions on good governance, corruption and tax system fairness and equity were identified.

There exist a unanimously agreement in literature among researchers that taxpayers trust in tax authorities has significant relation with tax compliance (Batrancea et al., 2019; Irawati, Ali, Rura, & Arifuddin, 2019; Saruji, Mohdali, & Mohamed, 2019). Furthermore, consistent result on the relationship between judicious government spending and tax compliance was observed (Assfaw & Sebhat, 2019; Palil, Hamid, & Hanafiah, 2013; Tilahun, 2018). However, (Deyganto (2018); Kuria and Omboi (2016); Manaye (2018)) argued that, perception on government spending does not influence taxpayers' compliance. Perception of tax system fairness and equity in relation to tax compliance was studied by (Hamza and Mulugeta (2018); Obaid, Ibrahim, and Udin (2020c); Tilahun (2018)) where significant relationship was recorded. However, (Deyganto (2018); Manaye (2018)) argued that tax fairness and equity has no significant effect on taxpayers compliance. Similarly, perception of corruption was found to have significant effect (Rosid, Evans, & Tran-Nam, 2018), whereas, (Basri and Dwimulyani (2018); Obaid et al. (2020c)) found no significant relationship with taxpayers' compliance.

In a collaborative survey conducted by the National Bureau of Statistics (NBS) and Small and Medium Scale Enterprises Development Agency of Nigeria (SMEDAN) it was revealed that there are 41.5million SMEs in Nigeria (PwC, 2020). Analysis further indicated that micro and small enterprises amounted to about 41.4million representing about 99.8% of total SMEs in Nigeria (NBS, 2020). Arguably, MSEs represent a large portion of the entire businesses in the country and contributed to more than half of the total employment in the country. They also contributed for almost half (48%) of the GDP within the period of five years. MSEs accounted for more than half of industrial jobs, nearly 90% of the manufacturing sector, almost 96% of businesses and 84% of employment in the economy (Olubiyi, 2021).

In terms of IGR per population for the geo-political zones in Nigeria, North-Eastern states witnessed the lowest internally generated revenue per population of N2,061 followed by North West region with an average of N2,855 in 2020. However, South Western region recorded the highest IGR per population with an average of N13,966 followed by the South-South region with an average of N8,694 (Oyekanmi, 2021). Compliance with tax payment is poorly experienced in North-eastern Nigeria compared to other regions of the country. This is evident where tax collection for 2020, indicates that DAT collection of the six states in the North-east Nigeria was very low with a total of N1,626,917,374 which constituted only 4.8% which is the lowest in the entire regions of the country with South west recording the highest with about 63.76% of the entire DAT collected in the country (NBS, 2020). Hence NBS, ranked North-East last in the country in terms of direct assessment tax collection in 2020. It is against this background, this study aims at determining psychological factors affecting direct assessment tax compliance of Micro and Small enterprises in the North-Eastern states of Nigeria.

Statement of Research Problem

Despite being the largest economy in Africa, Nigerian total tax to GDP is lower than that of South Africa and far below the continent average. The projected tax as a percentage of GDP for Nigeria is around 6%, whereas that for South Africa is 28% and the African continent average stood at 17%. Except for the United States, Nigeria likely has more tax administrators than any other nation in the world. However, the United States has a considerably more comprehensive database of taxpayers and payments than Nigeria's tax administration system. The tax to GDP ratio in the United States is 26%, which is more than 4 times greater than that in Nigeria (PwC, 2020).

Taxpayers' noncompliance remained a universal phenomenon and a subject of serious concern. Despite several workshops and sensitization programs organised by both Federal and states Revenue Services in Nigeria to creates awareness and educate self employed persons in order to bring more participants into the tax net, yet very little is achieved. This might have been as a result of high rate of non registration of micro and small enterprises (MSEs) with either corporate affairs commission or relevant state government agencies. To buttress the point above SMEDAN reported that states in the north east part of Nigeria are

among the highest in terms of non compliance registration status of MSEs with about 53.1% non-registered. Therefore, Nigeria is experiencing a serious problem of tax non compliance in almost every sector of the economy. FIRS has reported about N20.316 trillion unpaid bank taxes (Fowler, 2018) more than twice Nigerian yearly budget. Personal income tax more especially DAT contribution to Nigeria's total revenue remained insignificant and relatively small (Alabede, 2012), which is even a worse scenario in North East region of the country.

Several studies were conducted both in the developed countries such as UK, US, Germany, Italy, Sweden, and Romania (Bruner, D'Attoma, & Steinmo, 2018; D'Attoma, Volintiru, & Malezieux, 2017; Gangl et al., 2013; Kastlunger, Dressler, Kirchler, Mittone, & Voracek, 2010) and developing countries such as Nigeria, Kenya, Yemen, Ghana, Ethiopia, and South Africa (Daniel & Olusola, 2019; Lawal & Dandago, 2018; Mas'ud, Manaf, & Saad, 2019; Nurlaela, Mulyaningsih, Gumilar, & Avrianto, 2018; Obaid, Ibrahim, & Udin, 2020a; Okoye, 2019; Pratama, 2018; Wadesango, Mhaka, Bizah, Nyamwanza, & Haufiku, 2020) on the determinants of taxpayers' compliance. Despite these numerous studies conducted in the developing countries in regards to tax compliance few were conducted in Nigeria and non of these Nigerian studies was on direct assessment tax and more specifically in North Eastern States of Nigeria. Therefore, a study is eminent to determine psychological factors explaining direct assessment tax compliance in Nigeria with particular interest in North Eastern States of Nigeria.

Methodologically, this study noted that previous studies were conducted much earlier than now where their findings must have been overtaken by events which necessitate this study. Similarly, several studies across the globe indicated mixed results in their findings which necessitate the conduct of this study as well. Personal income tax, direct assessment tax to be specific, which is a product of level of output or income, suffered significantly during the period of pandemic and the insecurity situation in the study area. Therefore, the novelty of this study is relating to the study period, methodology and the measurement used in addition to the study area where informal taxpayers were studied. In view of the above mentioned gaps, this study will determine taxpayers' perception and psychological factors responsible for direct assessment tax compliance of MSEs in North East Region of Nigeria which comprises of Yobe, Taraba, Gombe, Borno, Bauchi and Adamawa States.

REVIEW OF EMPIRICAL STUDIES

Psychological Determinants of Direct Assessment Tax Compliance

This study identified Trust in Tax Authorities, Perceptions on Good Governance, corruption, and Fairness of tax system as the major psychological determinants of tax compliance. Hence this section presents the empirical review of these variables in relation to tax compliance and thereafter hypotheses are developed.

Perception on Government Spending and Direct Assessment Tax Compliance

Ali, Fjeldstad, and Sjurgen (2012), Palil et al. (2013), Modugu and Anyaduba (2014), Ocheni (2015), Manaye (2018), Tilahun (2018), Hamza and Mulugeta (2018), Assfaw and Sebhat (2019) found out that individuals who are more satisfied with public service provision are more likely to have higher tax compliant behaviour. Whereas, in the contrary Engida and Baisa (2014), Kuria and Omboi (2016), Deyganto (2018) found that perception on government spending has no significant effect on tax compliance.

Hypothesis one (H1): Perception on Government Spending has no significant effect on Direct Assessment tax compliance.

Perception on Corruption and Direct Assessment Tax Compliance

Basri and Dwimulyani (2018), Obaid, Ibrahim, and Udin (2020b) assesses the effect of perceptions of

corruption on taxpayer compliance. The studies revealed that perception on corruption has no significant effect on taxpayer compliance. However, Rosid et al. (2018), explains the actual relationship, in the context of PITs in Indonesia, between perceptions of corruption and deliberate underreporting. The study indicated that tax payers' attitudes and social norms about disclosing real income are negatively impacted by high levels of perceived corruption.

Hypothesis one (H2): Perception on Corruption has no significant effect on Direct Assessment tax compliance.

Fairness and Equity of Tax System and Direct Assessment Tax Compliance

Studies by Inasius (2018), Obaid et al. (2020b) revealed that perception of tax system fairness have significant influence on tax compliance of SMEs. However, Engida and Baisa (2014), Deyganto (2018) found that perception on tax system fairness have no significant effect on tax compliance.

Hypothesis one (H3): Fairness and Equity of Tax System has no significant effect on Direct Assessment tax compliance.

Trust in Tax Authorities and Direct Assessment tax compliance

Several studies were conducted on the effect of trust in authorities on tax compliance. Majority of the researches reveals that significant and positive relationship exist between trust in authorities and tax compliance (Zivanai, Felix, and Chalton (2016), Mardhiah, Miranti, and Tanton (2018), Augustine, Adewale, and Akeem (2019), Batrancea et al. (2019), Irawati et al. (2019), Mas'ud et al. (2019), Saruji et al. (2019), Youde and Lim (2019)). No study was found to indicate negative relationship between trust in tax authorities and tax compliance. Hence a consensus was reached as to the relationship between the variables. However, Taing and Chang (2020) investigated trust and tax compliance in Cambodia and found out no significant relation was recorded.

While an established direct relationship between trust tax compliance was a consensus of scholars Gangl, Hofmann, Hartl, and Berkics (2019), explored the mediating role of trust on the relationship between coercive power and tax compliance and implicit trust was found to mediate this relationship while reasoned based trust partially mediated the effect of legitimate power on tax compliance. However, Faizal, Palil, Maelah, and Ramli (2017), established that trust in tax authority do not mediate the relationship between justice and tax compliance.

Hypothesis one (H4): Trust in Tax Authority do not have significant influence on Direct Assessment tax compliance.

THEORETICAL REVIEW

Tax compliance went beyond the purview of economic theories, psychologists and sociologists have developed various theories explaining noneconomic factors affecting taxpayers' compliance. Factors such as moral, social influence, fiscal exchange, attitude, demographical characteristic, etc were identified by both psychologists and sociologists in relation to tax compliance. The proponents of these theories argued that likelihood of being detected do not determine compliance however taxpayers are driven by their moral and ethical values to comply. Therefore, these theories advocated for changing taxpayers attitude toward tax obligations as the only way to achieve improved compliance as against the deterrence theory that emphasises on increase penalty. The psychological and sociological theories (noneconomic theories) underpinning this study take into account the aforementioned cognitive theory and fiscal exchange theory.

Cognitive Theory

Research on tax compliance benefits from the application of cognitive theory, which shows how socializing affects compliance (Jackson & Milliron, 1986). The idea makes an effort to explain how people genuinely evaluate and represent their experiences before planning their subsequent behaviors (Hogg & Vaughan, 2005). The main factors influencing compliance, in this idea, are an individual's own morality and level of moral growth (Sutinen & Kuperan, 1999). Personal morality is the internal duty that a person has to act in accordance with his or her understanding of what is right or wrong. According to cognitive theory, a person's personality is a key factor in determining compliance. This study looked at the impact of psychological variables on tax compliance in light of the aforementioned idea.

Fiscal exchange theory

According to the fiscal exchange hypothesis, government spending may encourage compliance, and governments can boost compliance by making preferred commodities more readily available and efficient to residents (Cowell & Gordon, 1988; Levi, 1988; Moore, 2004). Alm, McClelland, and Schulze (1992) assert that views of the availability of public goods and services, justice and equity, and degree of corruption all have an impact on how compliant people are. Therefore, what taxpayers receive in direct exchange for their tax contributions in the form of public services is their key priority. According to this idea, views of public expenditure, corruption, justice, and equity serve as a foundation.

METHODOLOGY

This study adopted taxpayer opinion survey method based on the quantitative research approach in line with the positivist school of thought. The entire 3,640 managers or owners of self employed businesses registered with corporate affairs commission operating in North-Eastern states of Nigeria formed the population of this study. This study drives its sample using multistage proportionate cluster sampling technique. The sample of 351 was arrived at using Krejcie and Morgan (1970) where the sample size of this study is increased to 527 or by 50% (176) to remedy the likelihood of high non-response rate as suggested by Israel (2009). The data for this survey was collected using a well structured online questionnaire. Partial Least Square-Structural Equation Modelling (PLS-SEM) is used to analyse the data for the study.

RESULTS

Response rate

A total of 312 questionnaires administered online to Micro and Small Enterprises (MSEs) were retrieved. This represents a response rate of 59.2% and interestingly according to Sekaran (2003) and Rea and Parker (2014), response rate of 30% and 50% respectively are satisfactory for electronic data collection procedure.

Multicol linearity

The result of multicollinearity check indicated VIF values range from a minimum of 1.02 to a maximum of 1.95. Hence the values are significantly less than 10, and this indicated absence of multicollinearity problem among the exogenous variables.

The Measurement Model

The measurement model (outer model) assessment is the first step in PLS-SEM analysis. It focuses on the components' measurement, which reveals how good the indicators' (items') loads and relationships with various constructs are. (Hair, Gabriel, Silva, & Junior, 2019; Hair, Risher, Sarstedt, & Ringle, 2019). The

suitability of the measurement model can be assessed based on internal consistency and individual item reliability using Cronbach’s Alpha and composite reliability (CR); Convergent validity which assess individual constructs validity using average variance extracted; and ultimately Discriminant validity using Outer loadings, Fornell-Larcker criterion and Heterotrait-Monotrait criterion (HTMT).

Internal Consistency

This study examined CR, Cronbach’s Alpha and cross loadings in order to assess the reliability of items’ internal consistency by calculating Standard PLS algorithm. The result shows that some items were poorly loaded, for instance TRA1, PGS1&4, POC3&4 and TXC4 were found to be poorly loaded hence they were removed. The CR and Cronbach’s alpha values of the variables were found to have pass the recommended threshold values of 0.70 with CR values range between 0.727 to 0.888 (Hair, Gabriel, et al., 2019; Hair, Risher, et al., 2019; Henseler, Ringle, & Sinkovics, 2009) and acceptable minimum alpha value of 0.56 (Sekaran, 2003) indicating the reliability of the measurement model hence achieving internal consistency reliability.

Convergent Validity

The AVE values used in this study to evaluate convergent validity shows that all constructs had an AVE value greater than or equal to 0.50 which is above the threshold (Hair, Hult, Ringle, & Sarstedt, 2014; Hair, Risher, et al., 2019; Henseler et al., 2009), with values range from 0.50 to 0.67; with the exception of trust in tax authorities with AVE value of 0.401. However, scholars argued that unless item deletion with a value of up to 0.40 will lead to increase in composite reliability the item should be retained (Hair, Hult, et al., 2014; Hair, Risher, et al., 2019; Henseler et al., 2009), hence convergent validity is established.

Discriminant Validity

This study assessed discriminant validity using cross loading (Chin & Newsted, 1999); Fornell and Larcker (1981); and HTMT (Hair, Risher, et al., 2019). Furthermore, the results of Fornell and larcker criterion indicated that discriminant validity is achieved considering the fact that each construct AVE’s square root is above the correlation among the latent constructs. The result of HTMT indicates that discriminant validity has been achieved by establishing a correlation (HTMT values) between the constructs below 0.90 (Hair, Hult, et al., 2014; Hair, Risher, et al., 2019; Hair, Sarstedt, Hopkins, & Kuppelwieser, 2014; Wong, 2013). However, using both the three (3) methods of testing discriminant validity, it is evident that the validity is achieved where on the average all variables scaled at least two of the methods.

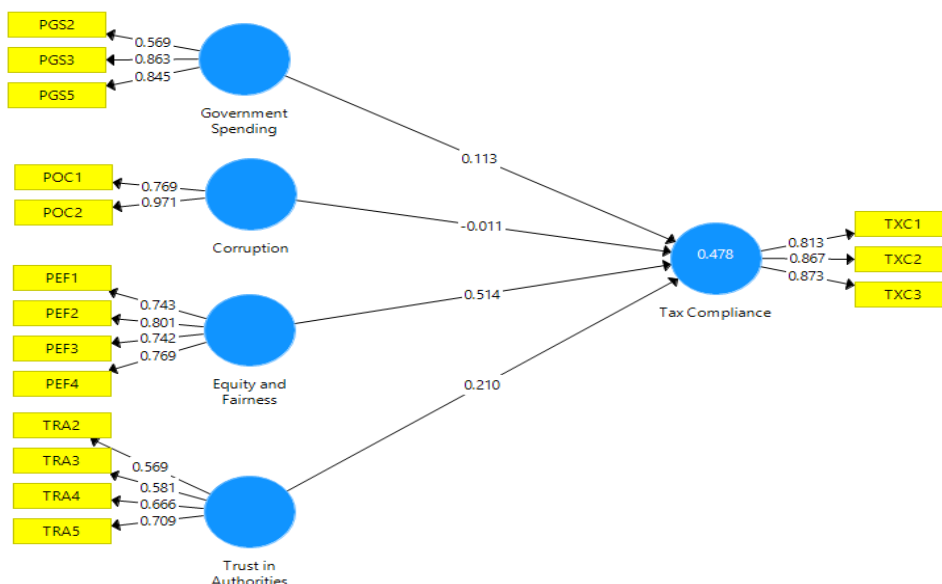


Figure 1: The Measurement Model

The Structural Model

A systematic model analysis of the structural model was carried out in order to accurately depict the results and evaluate the study’s assumptions. An analysis of the psychological influences on tax compliance is conducted before evaluating the structural model. The PLS-SEM algorithm was used to analyze the magnitude of the path coefficients, and the SmartPLS3.0 PLS-SEM bootstrapping process was used to analyze the relationship’s significance.

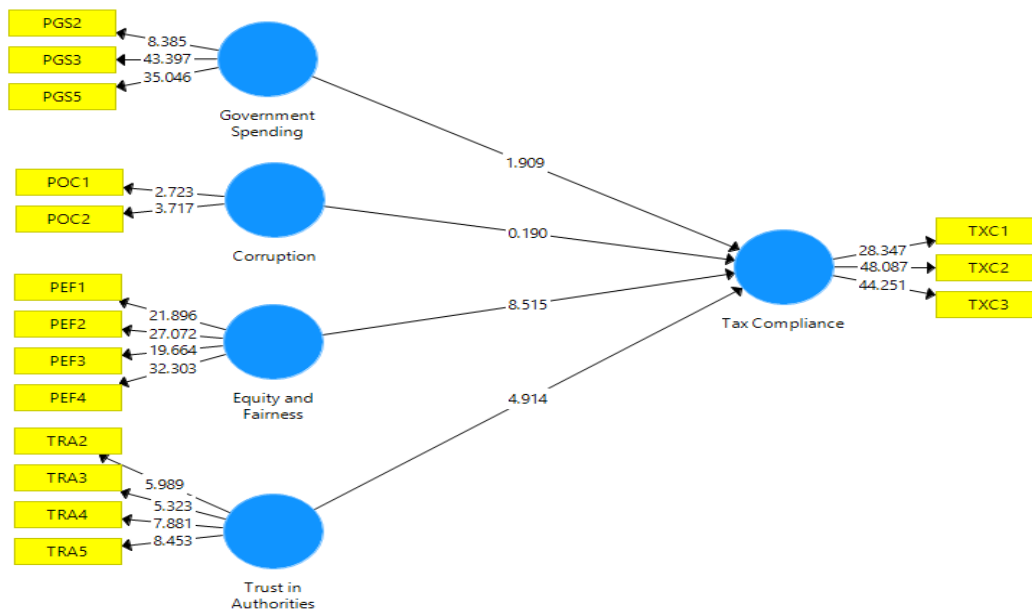


Figure 2: The Structural Model

DISCUSSION

Hypothesis one (H1) proposed that perception on government spending do not have significant influence on direct assessment tax compliance of MSEs in North-Eastern States of Nigeria. The result indicates that perception on government spending is positively related to tax compliance at 10% level of significance ($\beta = 0.113$ $t = 1.867$ $P = 0.062$). Statistically, if perception on government spending change by 1 direct assessment tax will change by about 11.3%, consequently null hypotheses is hereby rejected. This result indicates that when taxpayers perceived that government spending is good that can influence them to comply to tax payment voluntarily. However, with respect to hypotheses two (H2), the result suggests that perception on corruption do not influence direct assessment tax compliance of MSEs significantly ($\beta = -0.011$; $t = 0.198$; $p = 0.843$); therefore, H2 is accepted. Corruption does not impact to direct assessment taxpayers’ compliance because taxpayers perceive that direct assessment tax is high regulated and tight controlled by government were put in place. Nevertheless, hypotheses three (H3) is otherwise not supported due to the positive coefficient and significant p-value indicating that fairness of tax system positively influences direct assessment tax compliance ($\beta = 0.514$; $t = 8.434$; $p = 0.000$). this result indicated that an increase in how taxpayers perceive tax as fair leads to direct assessment tax compliance to increase by about 51%. Hence, fair tax system motivates taxpayers to comply with tax payments. Regarding hypothesis four (H4), the result shows a significant positive influence of trust in authority on direct assessment tax compliance ($\beta = 0.21$; $t = 0.493$; $p = 0.000$); hence, H3 is also rejected. When taxpayers’ trust on tax authorities is high that can improve payments of tax significantly.

Table 1: Tests of Hypotheses

Hypotheses	Path	Path Coefficient	Standard Error	T Statistics	P Values	Decision
H1	PGS -> TXC	0.113	0.061	1.867	0.062	Rejected
H2	POC -> TXC	-0.011	0.054	0.198	0.843	Accepted
H3	PEF -> TXC	0.514	0.061	8.434	0	Rejected
H4	TRA -> TXC	0.21	0.043	4.934	0	Rejected
	R squared	0.478				
	Q squared	0.335				

As demonstrated in Table 1 above, the psychological factors explain about 47.8% of the total variance in direct assessment tax compliance of MSEs in North-Eastern States of Nigeria. Hence, the endogenous latent variable for this study demonstrates an acceptable R^2 value which is considered as strong. Consequently, cross-validated redundancy using blindfolding procedure as recommended by (Hair, Hult, et al. (2014); Hair, Risher, et al. (2019)), reveals that the endogenous latent constructs (Direct Assessment Tax Compliance) confirmed predictive relevance, where endogeneous laten construct's Q^2 is greater than zero (0.335) which is within the range of predictive capability of the model (Hair, Hult, et al., 2014; Hair, Risher, et al., 2019; Henseler et al., 2009).

The result of the effect sizes (f^2) of the latent variables shows that all the four psychological determinants of direct assessment tax compliance have effect on tax compliance with the exception of perception on corruption with no effect size at all. However, small effect of 0.013 (perception on government spending), 0.073 trust in tax authorities and medium effect of 0.271 (perception on equity and fairness) were recorded.

CONCLUSIONS

According to the study's findings, direct assessment taxpayers' compliance is influenced by psychological variables (perceptions on government expenditure, corruption, equity and fairness of tax system and trust in authority).

Based on the conclusion above the study therefore recommends that taxpayers' perceptions on government expenditure, equity and fairness and their trust in authority need to be improve by way of treating them with all sense of fairness and equity by so doing taxpayers' confidence on tax authorities will increase and will translate to improve compliance. Similarly, trust can be achieved by providing necessary infrastructural facilities to the taxpayers which can build more trust that their tax money is been translated to developmental projects, hence improving compliance level.

By developing empirical data in the context of MSEs' direct assessment tax compliance, this work has made a contribution to the field of tax compliance. Despite this, further research may need to be done on the generalization of MSEs to other tax jurisdictions (Regions); more crucially, extra caution is required since differing definitions of micro and small firms apply, where this study used total assets and number of employees to categorised businesses as either micro or small. Similarly, the current study measured direct assessment tax compliance using five point Likert scales where the judgement of the respondents may vary with either pay as you earned tax or the entire personal income tax compliance. The findings therefore should be treated with caution with regard to other types of compliance apart from the direct assessment tax.

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