



**Factors Influencing Tax Evasion: The Perception of Sri Lankan
Medium-Sized Taxpayers**

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ABSTRACT

This quantitative study investigates the taxpayers' perceptions of tax evasion. The tax evasion determinants were considered as institutional, economic, socio-psychological, and political and legal factors. Using a 5-point Likert scale, this study looked at 436 medium-sized entrepreneurs in the Colombo district to determine the most influential determinant of tax evasion. The survey responses were gathered through a questionnaire. The results show that socio-psychological and economic factors have a significant and negative impact on medium-sized taxpayers' income tax evasion behaviour while institutional and political and legal factors have a weak association on tax evasion. The findings show that tax evasion is influenced by socio-psychological factors such as fairness of the tax system, moral obligation, and social influences, as well as economic factors such as tax rates, penalties, audit, and taxpayer privileges. The results highlight that in the Sri Lankan context, socio-psychosocial factors are regarded as a very crucial determinant that impacts individual income tax evasion. In addition, it offers insight into the influence of gender of business owner on tax evasion behaviour. Results suggest that medium-sized taxpayers' tax evasion behaviors could be changed if tax policy decisions contemplate more on taxpayer's psychological condition and affordability to pay tax. Distributing the tax burden to a greater number of taxpayers will help to increase tax compliance.

1. Introduction

Tax evasion is of great concern because it limits government's revenue collection. Alstadsæter et al. (2022) denotes that combating tax evasion will support to enhance tax net, increase the progressivity of the tax system, and reduce income inequality among citizens. The COVID -19 pandemic created an unbearable pressure over tax administrations. As a result, tax administrations impose an additional burden on taxpayers to comply their with tax obligations. The people's lifestyles, and business practices have changed dramatically due to unexpected shock and experience with the pandemic. Therefore, tax administrations should reconsider the legacy compliance approaches in order to improve taxpayer responses and maximise tax compliance (Dom et al., 2022).

Tax revenue of Sri Lanka to GDP was around 11.9% prior to the COVID-19 pandemic and was 8.8% in 2022 (Central Bank, 2022). The country's weak economic activity resulted in a decrease in revenue earned by companies and individuals, resulting in the decline of collection of total tax revenue. The situation is not due to taxpayers' unwillingness to comply, but rather to the tax burden, which has had a significant impact on businesspeople who have faced various economic disruptions. The taxpayer, who had previously paid some tax, missed the tax payment for a variety of reasons such as cash flow issues, decrease in business profit, and difficulties in locating third-party assistance to complete tax returns and finalize tax liabilities. During the COVID-19 pandemic, the Sri Lankan tax administration has played a significant role in maintaining a taxpayer-friendly environment and assisting taxpayers in meeting their compliance obligations. The tax administration created an online payment platform to meet the needs of taxpayers during the period (Inland Revenue, 2021). Tax administration believes that combating tax evasion is one of the most effective ways

of increasing tax compliance (Mooij et al., 2020).

Tax evasion is twofold: monetary transactions and non-monetary transactions (Schneider & Klinglmaier, 2004). The study investigates tax evasion in relation to monetary transactions, which can take various forms such as failing to register as a taxpayer, failing to declare income, underreporting income, and overreporting expenses (McGee & Maranjian, 2006). Another fact is that the business environment has implications for tax evasion (Nadirov & Aliyev, 2015). The large untaxed informal sector is a major problem in taxation. According to the World Bank (2020), globally, 70% of the labor force is employed in the informal sector that belongs to various business categories. The annual labour force survey of 2018 conducted by the department of Census and Statistics recorded the percentage of employment in the informal sector of Sri Lanka as 58.7% (Wimalaweera, 2020), which makes integration into the tax system difficult. Besides, tax evaders shift the tax burden onto honest taxpayers, thus violating the tax principle of efficiency (Barrios et al., 2017).

The literature contains that tax evasion reduces the amount of revenue that the statutory system could generate while lowering its productivity. The purpose of the study is to investigate the causes of tax evasion by assessing taxpayers' experiences and perceptions of the current tax system. The study can alert tax administration to prioritize the authors' identified determinants to choose efficient techniques and control tax evasion practices. The pandemic situation may increase tax evasion even further. As a result, policy decisions are required to improve tax compliance and government support. The rest of the paper is structured as follows. The theoretical and empirical literature are covered in Section 2. Model development and hypothesis are covered in Section 3. Section 4 discusses the study's sample, datasets used to estimate a

measure of tax evasion, and data analysis. Section 5 discusses tax evasion among Sri Lankan medium-sized entrepreneurs, as well as concluding remarks and policy implications.

1.2 Literature Review

According to James and Alley (2002, p. 32), tax compliance is citizens' willingness to act in accordance with the tax law and administration without any enforcement activity. Tax non-compliance includes both tax avoidance (tax reduction within the legal framework) and tax evasion (criminal failure to pay tax liabilities) (Rosid et al., 2018). Becker's (1968), analysis of individuals' tax non-compliance behaviour contended that the likelihood of detection and penalty would influence a taxpayer's decision to comply. Argument by Allingham and Sandmo (1972), claimed that the taxpayers would weigh the opportunity cost of declaring actual tax liability and then paying tax against the financial cost of failing to comply with the law. Later social psychology models attempted to examine the factors affecting taxpayers' compliance behaviour in terms of social norms and personal norms (Devos, 2008). Nguyen et al. (2020) observed eight factors which influence non-compliance. The theoretical background of tax compliance reveals varied reasons for the non-compliance situation over years of research, and the non-compliance factors are still debatable.

1.2.1 Tax Evasion Determinants

Clotfelter (1983) posits that tax evasion has grave consequences to government revenue as well as to voluntary compliance. In line with that argument, Alm and Kasper (2020) state that tax evasion strains the country's financial system while discouraging honest taxpayers. However, tax evasion is less likely a serious offence compared to other crimes such as drug related crimes, violent crimes, commercial crimes, property crimes, and traffic offences (Aljaaidi et al., 2011).

Increased tax evasion may reduce the supply of public goods and services to all citizens. According to the OECD (2010), deterrence, personal norms, social norms, chances, to comply or not to comply, fairness and trust are important determinants of taxpayers' tax compliance. Tax policy measures proposed by the government and implemented by the tax administration should aim to reduce tax evasion and encourage people to pay their taxes (OECD, 2021).

During the COVID-19 period, tax administration is confronted with situations in which businesses are not registered with Inland Revenue or are registered but failed to present correct income declarations and pay the tax liabilities calculated by themselves. Non-compliance by taxpayers happened due to pandemic issues such as health, cash, third-party consultation, low revenue, psychological imbalance, and mental illness (Sekiraqa et al., 2021), which cannot be treated as evasion. Therefore, tax officials should clearly identify the reasons for tax evasion behaviour before enforcing action against honest taxpayers and discourage their compliance decisions (Kastlunger et al., 2013).

A study by Ameyaw and Dzaka (2016) on determinants of tax evasion discovered that tax evasion is caused by a variety of factors such as administrative, demographic, economic, and fiscal factors. Oduro et al. (2018) concluded that the economic factors and institutional factors have a positive impact on individual tax evasion, whereas socio-cultural factors have no effect. Literature shows that many institutional, demographic, political and legal, economic, and psychological factors all contribute to understanding tax evasion among various nations. This study aims to investigate the most influential determinant of tax evasion behaviour among medium-sized entrepreneurs in Sri Lanka, with a focus on the entrepreneurs doing business in the Colombo district.

We are of the view that the studies have investigated the influential factors of tax evasion independently, but no one has combined the factors into a truly multidisciplinary study in the Sri Lankan context. The study intends to overcome this gap by scrutinizing the factors that influence tax evasion using a Structural Equation Modelling (SEM) approach.

1.2.2 Institutional Factors and Tax Evasion

Tax evasion has long been a source of contention in the field of taxation. The influence of the institutional factors has demonstrated that tax evasion actions can occur in either direction due to good or bad institutional practices (Yamen et al., 2018). Powerful institutions like the government, regulatory bodies, and tax administrations play a key role in combating tax evasion by enacting laws and policies that assist entrepreneurs in making investment decisions.

Alm and Liu (2018) indicate that corruption significantly impacts tax evasion and larger bribes increase evasion more. According to Amoh and Ali-Nakyea (2019), in the majority of emerging economies, there are multiple types of dominant corruption dimensions that fuel tax evasion. Kumar and Neha (2020) studied a sample of 202 respondents to analyze the causes of tax evasion in Nepal and concluded that one of the significant reasons for increased evasion is a lack of efficient tax administration or indiscipline in the tax system. Individuals' compliance decisions change in different economic and legal environments; therefore, greater taxpayer understanding of tax administration is required to reduce tax evasion (Kong & Wang, 2014). The authors are of the view that strict legal action on corrupt activities, increased public employee salaries, improved transparency, and reduced discretionary power of the tax administration will support to minimize tax evasion, so the hypothesis is formulated as follows.

H1: The relationship between institutional factors and tax evasion is negative.

1.2.3 Economic Factors and Tax Evasion

The analysis considers the relationship between tax rate and tax evasion. The empirical studies aim to explain the link between tax evasion and tax rate, and the results reveal that taxpayers escape higher rates by reporting their income legally (Mengistu et al., 2021). Another viewpoint supported by Slemrod (2019) is that tax rates cannot be easily adjusted in the actual world and that very few people would experiment with the rate.

Tax audit is also accepted as one of the crucial factors which determine tax evasion. Detailed audits can search for information to bring tax evaders to the system. The opposite view is that an increase in tax audits result in an increase in tax evasion (Ameyaw & Dzaka, 2016). The probability of being audited, reduce tax evasion significantly (Allingham & Sandmo, 1972; Mengstu, 2022). Similarly, Stankeviciusa and Leonas (2015) states that the efficient audit functions can reduce the shadow economy while increasing the government revenue. Mengstu (2022) notes that the relationship between the penalty rate and tax evasion is negative and significant. In line with the argument, Ameyaw and Dzaka (2016) elucidate that penalty charges discourage taxpayer compliance attitude therefore, increase evasion.

As the debate on the relationship between economic factors and tax evasion is not conclusive, the hypothesis is as follows:

H2: Economic factors and tax evasion have a negative relationship.

1.2.4 Socio-Psychological Factors and Tax Evasion

In this study, socio-psychological factors were defined as individual characteristics

that may lead to tax evasion, which include attitude and trust in tax administration as well as the fairness of the tax system. Tax equity and taxpayer attitudes have been identified as influential factors in tax non-compliance (Kirchler, 2019). The study by Abdul-Jabbar et al. (2020), from a behavioural aspect, particularly the social influence perspective, urged that fair tax system, the ethical values connected with individual moral attitude, and the faith in tax administration supported by peer interaction impact taxpayer's compliance decision. Furthermore, the authors noted that there are conflicting conclusions on the relationship between socio-psychological factors and tax evasion after reviewing a large body of previous literature, so the following hypothesis is developed.

H3: The relationship between socio-psychological factors and tax evasion is negative.

1.2.5 Political and Legal Factors and Tax Evasion

(Khlif & Amara, 2019) confirmed that political connections are positively associated with tax evasion which discourage honest taxpayers. A weak legal system will create a highly corrupt environment. Legal action for non-complaint taxpayers will reduce tax evasion while increasing tax revenue (Kirchler et al., 2008). According to Salhi et al. (2020), the operation of actual corporate governance mechanisms and a strong legal system can reduce tax evasion. Similarly, Montenegro (2021) emphasized that national governance is a significant determinant of tax evasion at the country level.

The literature signals that a strong legal system can reduce tax evasion. Khan et al. (2017) note that the taxpayers who have political connections comply less with tax obligations. The following hypothesis is derived based on literature.

H4: There is a negative relationship between political and legal factors and tax evasion.

1.2.6 Role of Demographic Factors on Individual Tax Evasion

Jackson and Milliron (1986) found that individual's age and gender have a positive relationship with taxpayer compliance. According to the literature, older people are more likely to comply with tax obligations than younger entrepreneurs, and females are less likely than men to evade taxes (Nguyen, 2022). Women are less risk-taking than men, so they contribute more to the state (Hasseldine & Hite, 2003).

The economic effects of the COVID-19 pandemic have not been distributed evenly among entrepreneurs. Some business sectors, such as construction, tourism, education, hotel, and entertainment, have been severely impacted, while others, such as e-commerce, have gained opportunities to expand further in the industry (Dissanayake & Premarathna, 2020). Therefore, the income generation of vulnerable businesses during the pandemic faced many cash flow difficulties and recorded mostly losses. Perhaps the business owners complied with tax system before, but the current situation limits their ability of fulfilling requirements in the tax system. Because the pandemic created havoc on the informal economy (OECD, 2020), tax evasion may be more prevalent than previously thought. Even though the researchers pay less attention on business nature in tax evasion studies this research consider business nature as demographic factor. However, the study aims to examine tax evasion with more focus on institutional, social-psychological, political, and legal, and traditional factors the authors do not attempt to analysis of the influence of demographic characteristics but the mediating impact. Hence, no hypothesis is derived for socio-economic and demographic variables, thus age, gender, and business nature will be measured as the mediating variables.

1.3 Conceptual Framework and Research Hypotheses

The study model developed with five constructs: tax evasion (TE), institutional factors (IF), economic factors (EF), socio-psychological factors (SPF), and political and

legal factors (PLF) are endogenous latent variables while demographic and socioeconomic factors are considered as the moderating variables. The conceptual framework is shown in Figure 1.

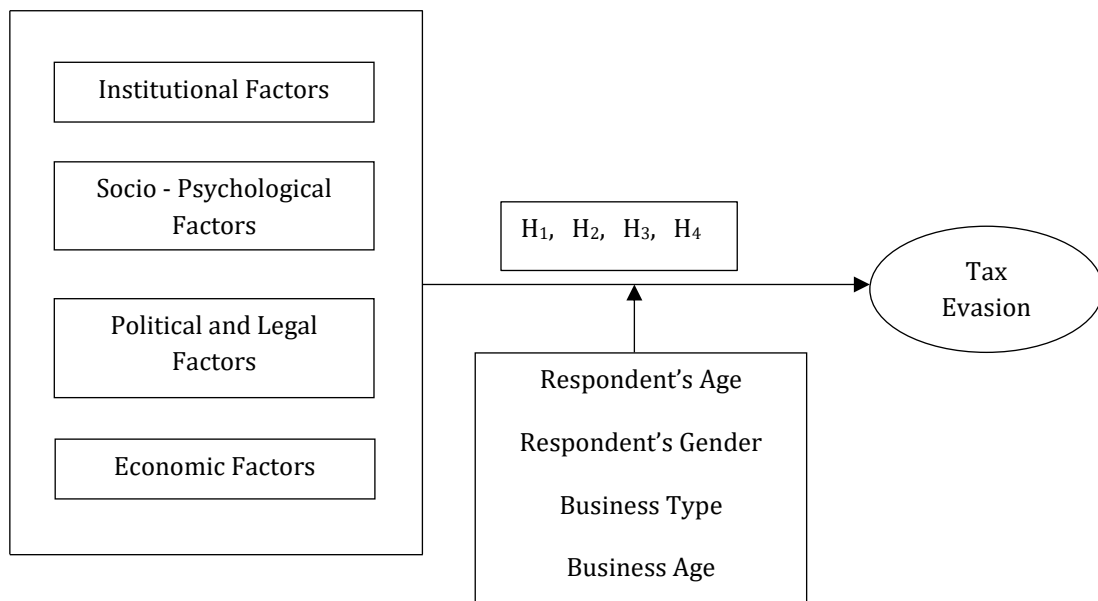


Figure 1. Conceptual Framework

Table 1. Operationalization of Variables

Variable	Dimensions	Literature	Question items
Institutional Factors (IF)	Corruption among tax officers	(Yamen et al., 2018)	Q1 - Q5
	Infrastructure facilities		
	Tax officer's behaviour		
	Tax officer's efficiency		
	Tax administrators' understanding of their role		
Socio-Psychological Factors (SPF)	Fairness and transparency of tax system	(Al-Rahamneh et al., 2022; Kirchler, 2019)	Q17 - Q20
	Taxpayer trust in tax authority		
	Correctness of reports		
	Understanding of tax obligations		
Political & Legal Factors (PLF)	Simplicity of tax law	(Asif et al., 2020)	Q21 - Q24
	Policy changes		
	Unclear tax law		

	Political influence		
Economic Factors (EF)	High rates	(Ryšavá & Zídková, 2021)	Q6 - Q12
	Changing rates		
	Benefits		
	Penalty		
	Tax audits		
	Harassments		
	Equal application of penalty		
Tax Evasion (TE)	Effective spend of tax money	(Kirchler et al., 2008)	Q13 - Q16
	Government development		
	Tax loopholes		
	In return benefits		

2. Materials and Methods

2.1 Design of Research

The study employed quantitative techniques, primarily Structural Equation Modeling (SEM) and Confirmatory Factor Analysis (CFA). Tax Evasion (TE) was used as the dependent variable while Institutional factors (IF), Socio-Psychological factors (SPF), Political and Legal factors (PLF), and Economic factors (EF) were treated as independent variables. A questionnaire was utilized to obtain the data for this cross-sectional survey. Each construct in this study was evaluated using three – four indicators following Hair et al. (2014). The operationalization of variables was illustrated in Table 1.

2.2 Data Collection

The survey was created on Google forms and distributed via email. The study collected data from 436 medium-sized entrepreneurs registered with Inland Revenue in Sri Lanka using a simple random sampling strategy. The survey was open to 500 medium-sized taxpayers, and 436 unique responses were received, representing an 87 percent response rate. Participation in the survey was entirely voluntary, and participants were free to leave at any time. Furthermore, no incentives were given to the participants. The

questionnaire was presented in both English and Sinhala to ensure participants' language comprehension. The researchers completed the translation, which was then approved by an English-Sinhala translator. The data was coded and entered a matrix in Microsoft Excel before being analyzed with the Statistical Package for Social Sciences (SPSS) and AMOS.

2.3 Participants

Table 2 shows the demographics of the participants in the survey. Accordingly, there were 88.7 percent men and 11.9 percent women who participated in the survey. This, however, reflects the ratio of male and female business owners in Sri Lanka. In terms of age, the dominant group was aged above 50 years comprising almost 60% of the sample. The other group aged below 50 years made 40% of the sample. In terms of the business type taken, the highest percentage was recorded from the services sector amounting to 44.27 while manufacturing and exports lie around 11 %. Most of the participants represented businesses that have experience of less than 25 years in the industry while 41% of the respondents represented businesses that were more than 25 years. All latent variables in this study, namely IF, SPF, PLF, EF, and TE, were measured using a five-point Likert scale ranging from Strongly Disagree (1) to Strongly Agree (5). The descriptive statistics for the latent variables are shown in Table 3.

Table 2. Descriptive Statistics for Sample Respondents (N=436)

Discription	Category	Total number of responses	Response rate (%)
Gender	Male	384	88.07
	Female	52	11.93
	Total	436	100
Respondent's Age	31-40 years	66	15.14
	41-50 years	355	76.83
	Above 51years	33	7.57
	Total	436	100
Business Type	Export	48	11.01
	Service	193	44.27
	Manufacturing	52	11.93
	Wholesale & Retail	41	9.4
	Other	102	23.4
	Total	436	100
Business Age	Below 25	259	59.4
	Above 25	177	40.6
	Total	436	100

Table 3. Descriptive Statistics of the Latent Variable

		SD	D	N	A	SA	n
	Institutional factors (IF)						
IF1	Q1 The level of corruption among tax officers is high	0.5	11.2	12.6	52.1	20.2	421
IF2	Q2 The infrastructure facilities available with the tax system motivate taxpayers to comply	19.3	16.1	20.0	15.4	25.0	418
IF3	Q3 Tax officers treat taxpayers friendly	28.7	25.2	19.0	19.1	4.1	419
IF4	Q4 Tax officers efficiently take action to detect tax evaders	30.5	33.5	15.7	15.6	1.5	422
IF5	Q5 Tax administrators clearly understand their role in increasing tax compliance	23.4	40.4	15.0	15.4	1.5	417
	Economic factors (EF)						
EF1	Q6 Tax rates are very high	2.4	1.4	2.5	9.5	84.1	422
EF2	Q7 Tax rates get changed frequently	1.3	3.0	3.4	20.4	68.7	422
EF3	Q8 Tax benefits help to reduce tax evasion	0.5	1.1	2.0	10.8	81.2	417
EF4	Q9 Tax penalty supports to reduce tax evasion	2.0	1.8	1.6	12.4	79.0	422
EF5	Q10 Effective tax audits reduce tax evasion	1.2	3.4	7.6	23.4	60.0	417

EF6	Q11 Tax officers harass taxpayers when doing audits	1.0	1.1	2.5	16.1	75.6	420
EF7	Q12 Charging penalty is not equally apply among all taxpayers	0.6	1.0	3.0	18.3	73.6	421
	Tax Evasion (TE)						
TE1	Q13 Taxpayer's money is spent effectively	26.4	27.1	33.7	13.5	0	426
TE2	Q14 Tax revenue is used for the development of the country	53.2	27.5	14.2	2.8	0	426
TE3	Q15 There are many loopholes in the tax system	3.2	13.2	22.7	57.6	1	426
TE4	Q16 Paying tax will return more benefits to me	61.5	13	21.1	2.6	1.8	422
	Socio-Psychological factors (SPF)						
SPF1	Q17 Tax system is fair and transparent	92.6	3.2	0	0.5	0.3	421
SPF2	Q18 Taxpayers have trust in tax administration	82.1	11.0	2.5	1.1	0	422
SPF3	Q19 Most of the people pay tax correctly	85.4	7.8	1.6	0.9	1.3	423
SPF4	Q20 Paying tax is an obligation of each person	76.0	14.7	0.9	1.4	4.0	423
	Political and Legal factors (PLF)						
PLF1	Q21 Tax law is not easy to understand	1.4	8.0	85.8	0.7	1.2	423
PLF2	Q22 Government change tax policy frequently	0.7	5.5	88.8	0.9	1.8	423
PLF3	Q23 Some of the sections in tax law is not clear	0.2	1.4	91.1	1.1	2.9	422
PLF4	Q24 Political influence in tax system is high	0.5	1.0	94.3	1.9	2.3	420

Source: Compiled by the authors

When **Institutional Factors** are considered, "The level of corruption among tax officers is high", 52.1% records the highest agree scale while almost 54 % of the respondents disagree with the statement related to the friendliness of tax officers "Tax officers treat taxpayers friendly". Altogether, 64% of the respondents are unhappy about the efficiency of tax officers in taking effective action on tax evaders while 64% of the taxpayers disagree on the matter of "Tax administrators clearly understand their role in increasing tax compliance". Moreover, a little more than 55% of the taxpayers were dissatisfied with

the infrastructure facilities available in the tax system.

The responses of **Economic Factors** reveal the taxpayers' thoughts towards the different aspects of tax administration, collection, and tax utilization in the country. The highest response rate among all the categories is 84.1%, which recorded strongly agreed for "Tax rates are very high". More than 88 % of the respondents agree that the tax system is volatile, changing the tax rates frequently. A vast majority of the respondents strongly agree with the possibility of reducing tax

evasion through the tax benefits (Tax benefits help to reduce tax evasion - 81.2%) while the majority, 91.4% agree with the "effectiveness of tax penalties in reducing tax evasion. Behavior of the tax officers are shown to be aggressive in conducting tax audits as evidenced from "Tax officers harass taxpayers when doing audits" (91.7%). Further, discrimination seems to be highly evident among the taxpayers while seriously violating the "equality" property in the system. It was shown that almost 92 % of the sampled taxpayers have accepted the statement "Charging penalty is not equally applied among all taxpayers".

In terms of **Socio-Psychological Factors (SPF)**, the highest response rate (92.9%) is reported for taxpayers' attitude towards the fair and transparency of the tax system. It was believed that the tax system is not fair and not transparent. The respondents strongly disagree believing that most of the people do pay tax correctly, recorded 93.2%, while rejecting that "Paying tax is an obligation of each person".

Relatively higher percentages are reported in the neutral category for the dimension of "**Political and Legal Factors (PLF)**". Easiness of understanding the Tax law, frequency of changing the tax policy, unclear sections of the tax law and regarding the political influence on the tax system seem to be not very significant factors for the taxpayers. Neutral responses varied from 86% to 95% for this category.

In terms of the dependent variable, Tax Evasion, 61.5% respondents strongly disagree with the statement "Paying tax will return more benefits to me." Furthermore, the percentage of respondents who agree with the statement "There are many loopholes in the tax system" is the second highest (57.6%) among the four variables studied. However, the proportion of taxpayers who believe that "tax revenue is used for the development of the country" is

also high. More than half of those polled disagree with the statement "Taxpayer money is spent effectively."

2.4 Model Evaluation

2.4.1 Latent Construct Reliability

Cronbach's alpha is summarized in Table 4 for each of the constructs evaluated. According to George and Mallery (2003), an alpha frequency of 0.7 represents a more reliable level, while a value greater than 0.8 indicates a higher level of reliability. The alpha coefficients for social and psychological characteristics and tax evasion are above 0.7, showing that those variables have an appropriate level of internal consistency. It can be concluded that all the latent constructs were characterized by good internal consistency allowing further analyses.

2.4.2 Model Requirements

All the indicator variables' skewness values ranged from -.032 to 1.2, with only 3 indicators reporting values higher than 1. In the meantime, all the indicator variables exhibiting univariate normality have Kurtosis values lower than 7. The Mardia's coefficient was used to gauge multivariate normality. The Mardia value for this study was 18.67, which is far lower than the suggested cut-off of 624 when the multivariate normality of the 24 observed variables were considered. As a result, the study meets both the univariate and multivariate normality assumptions (refer to Table 5).

As shown in Table 6, SPSS curve fitting feature confirms that the dependent variable, TE, was regressed against each independent variable, IF, SPF, PLF, and EF. At the 1% level of significance, the F-value for the linear relationship between IF and TE was 148.502. The linear relationship between SPF and TE had a significant F-value of 85.458, while curve fitting between PLF and TE had F-values of 18.65 and 12.52, respectively. The F

values for all other forms, such as quadratic and cubic forms, were lower than the total number of variables. As a result, all independent latent constructs and the dependent variable were reported. As a result, all independent latent constructs and the dependent variable reported satisfactory levels of linearity between each pair, confirming the study's linearity assumption.

The highest Pearson correlation value reported in Table 8 was -0.349 between SPF and EF, indicating that no significant multicollinearity existed among independent variables. As shown in Table 7, the variance inflation factor (VIF) ranges from 1 to 2, well below the cut off of 10. The values confirmed

that there were no collinearity issues among the model's predictors. Tolerance values for all observed variables are greater than 0.10 in the second column of the same Table 7, indicating the absence of multicollinearity.

Table 8 shows the relationship between all variables in the current study. They are correlated with each other at conventional levels with expected size and statistical significance. The Pearson correlation coefficients for the variables ranged from 0.036 (the lowest, between EF and PLF) to 0.349 (the highest, between EF and PLF) (the highest, between EF and SPF) indicating that the expected relationships between all variables are satisfactory.

Table 4. Reliability Values: Cronbach Alpha

Latent variable	Alpha level	Status
Institutional factors (IF)	.683	Acceptable
Socio-psychological factors (SPF)	.828	Good
Political and legal factors (PLF)	.661	Acceptable
Tax evasion (TE)	.864	Good
Economic factors (EF)	.875	Good

Source: Author compilation

Table 5. Normality Measures for Indicator Variables

Variable	Skew	Kurtosis	Variable	Skew	Kurtosis
IF1	-0.183	-1.197	TE1	-0.424	-0.698
IF2	0.525	-0.627	TE2	-0.214	-0.486
IF3	-0.293	-0.945	TE3	-0.177	-1.003
IF4	-0.301	-0.739	TE4	-0.727	0.753
IF5	-0.631	-0.255	EF1	-0.251	-0.809
SPF1	-0.032	-0.957	EF2	0.175	-0.622
SPF2	-0.366	-0.763	EF3	-0.248	-0.474
SPF3	-0.327	-0.876	EF4	-0.682	0.829
SPF4	-0.123	-0.945	EF5	-0.935	1.816
PLF1	0.517	-0.118	EF6	0.726	0.574
PLF2	1.019	1.286	EF7	0.847	1.023
PLF3	-0.099	-0.783			
PLF4	-0.920	1.359	Variable		18.67

Table 6. Functional Forms between Dependent and Independent Variables: Linearity

Equation*	F Values**			
	IF	SPF	PLF	EF
Linear	148.502	85.458	18.650	12.562
Quadratic	78.815	48.369	9.578	7.891
Cubic	52.562	33.542	6.852	6.760

*Dependent TE; ** p<0.001

Table 7. Collinearity Diagnosis: Tolerance and VIF Values

Observed Variable	Collinearity Statistics	
	Tolerance	VIF
IF1	0.835	1.197
IF2	0.568	1.760
IF3	0.770	1.298
IF4	0.415	2.411
IF5	0.414	2.416
SPF1	0.597	1.674
SPF2	0.648	1.543
SPF3	0.349	2.862
SPF4	0.399	2.504
PLF1	0.890	1.124
PLF2	0.869	1.151
PLF3	0.639	1.564
PLF4	0.664	1.506
TE1	0.686	1.457
TE2	0.368	2.719
TE3	0.351	2.848
TE4	0.443	2.255
EF1	0.453	2.209
EF2	0.536	1.866
EF3	0.491	2.035
EF4	0.649	1.540
EF5	0.679	1.473
EF6	0.606	1.651
EF7	0.562	1.781

Table 8. Pearson Correlations and Square root of AVE

	IF	SPF	PLF	EF	TE
Institutional factors (IF)	0.769				
Social & Psychological factors (SPF)	0.175	0.742			
Political and legal factors (PLF)	-0.038	-0.176	0.835		
Economic factors (EF)	-0.206	-0.349	0.036	0.603	
Tax evasion (TE)	-0.223	-0.338	0.140	0.240	0.656

** Correlation is significant at the 0.01 level (2-tailed). Extraction Method: Principal Component Analysis. Rotation Method: Oblimin with Kaiser Normalization.

2.4.3 Overall Model Fit Indices of the Measurement Model

The overall model fit of the measurement model considers how well the measurement theory fits the hypothesized measurement model in three categories: absolute fit indices, incremental fit indices, and parsimony-fit indices. Accordingly, Model $\chi^2 = 671.297$, $df = 273$ and CMIN /DF recorded 2.76, implying that the measurement model is well fitted to the observed data. As shown in Table 9, the Root Mean Square Error of Approximation (RMSEA), is 0.064 for the estimated model, and the significance of PCLOSE rejects the null “RAMSEA is greater than 0.05”. The current study’s Root Mean Square Residual (RMR) value (RMR =0.030) is less than the critical value of 0.05. When incremental fit is considered, GFI (Goodness of fit index) and adjusted GFI (AGFI), which represent the overall amount of covariation among the observed variables that the model can account for, are 0.932 and 0.917, respectively. The Comparative Fit Index (CFI) value for the model is greater than 0.9 (CFI=0.906), and Normed Fit Index (NFI) value of this study is 0.861 indicating a good overall fit of the measurement model. All the incremental fit

indices exceed or are close to 0.9, indicating that the measurement model is well-fitting. The model fit indices all meet the criteria for a well-fitting measurement model.

2.4.4 Validity of the Measurement Model

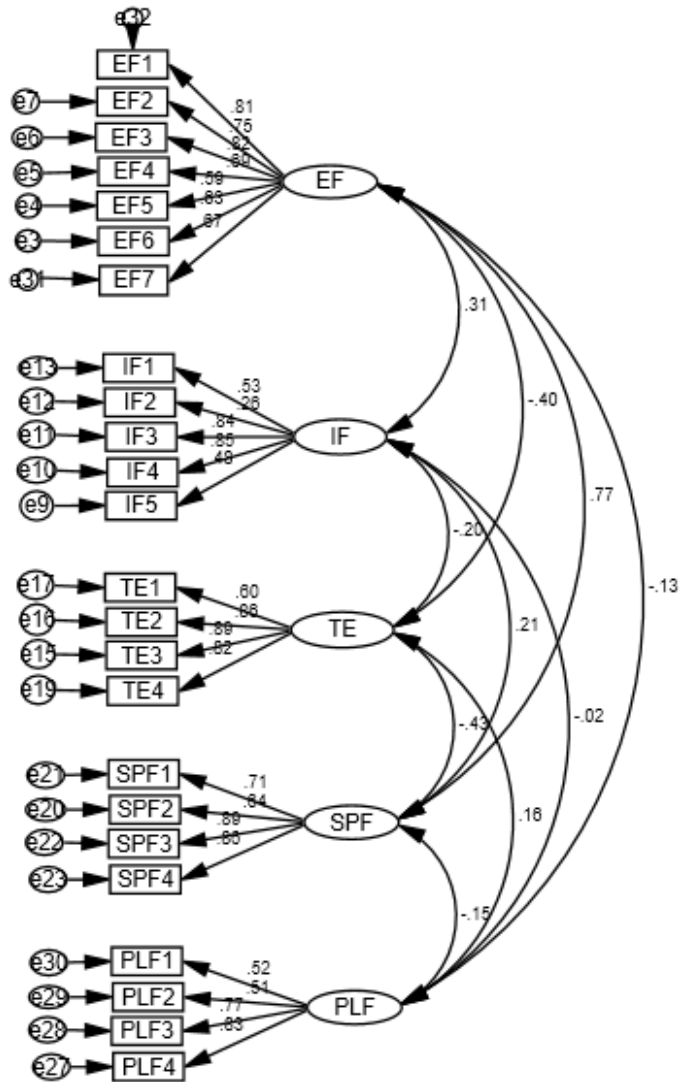
The convergent validity is primarily validated by computing the Average Variance Extracted (AVE) standardized loadings and the construct reliability (CR) for all variables. The AVE values reported in Table 10, for the SPE, IF, and PLF are all greater than 0.5, while the AVE values for the other two constructs, TE and EF, are 0.430 and 0.364, respectively.

With the exception of IF5, which is close to 0.5, and IF2, which is nearly 0.3, all of the factor loadings are greater than 0.5 and significant. All latent constructs have CR values greater than 0.7, indicating that the measurement model used in this study has a high level of convergent validity in terms of construct reliability (refer Table 10). The results of all three indicators presented in Table 9, indicate that the measurement model depicted in Figure 2 has a satisfactory level of convergent validity.

Table 9. Model fit Indices of the Measurement Model

Category	Model fit index	Index value	Threshold	Comment
1. Absolute fit	RMSEA	0.064	<0.05 good fit; < 0.08 moderately fit	Satisfied
	GFI	0.932	>0.90	Satisfied
	RMR	0.030	<.05	Satisfied

2. Incremental fit	AGFI	0.917	>0.80	Satisfied
	CFI	0.906	>0.90	Satisfied
	NFI	0.861	>0.90	Satisfied
	TLI	0.883	>0.90	Satisfied
3. Parsimonious fit	CMIN/df	2.763	<3 good	Satisfied



Model fit indices: $\chi^2 = 671.297$, $df = 273$, CFI = 0.906, RMSEA = 0.064, TLI = 0.883, RMR 0.030

Figure 2. Graphical Representation of Measurement Model

In Table 08, the numbers along the diagonals represent the AVE square roots for the pertinent variables, whereas the values below the diagonals represent correlations. All the inter-variable correlations, as shown in Table 08, are lower than the pertinent AVE square root values, validating the measurement model used in the current study's discriminant validity. To get around the limitations of the Fornell-Larcker criterion, Heterotrait-monotrait criteria (HTMT) for discriminant validity is examined after Henseler et al. (2015). The model's discriminant validity is demonstrated by the

HTMT value of 0.137, which is significantly lower than the threshold of 0.85. As shown in Table 08, all correlations between constructs in the measurement model are in the expected direction (positive) and statistically significant, ensuring the measurement model's nomological validity. The reliability of the measures of all constructs is assessed by using the Cronbach's alpha reliability coefficient. As depicted in Table 10, alpha coefficients of all the observed variables are greater than or approximately 0.7 indicating an acceptable level of reliability.

Table 10. Standardized Factor Loadings, AVE and CR Values

		SPE	IF	TE	PLF	EF
	Socio-Psychological factors (SPF) α : 0.828 TVE 27.361%					
SPF1	Tax system is fair and transparent	0.683				
SPF2	Taxpayers have trust in tax administration	0.614				
SPF3	Most of the people do not pay tax correctly	0.911				
SPF4	Paying tax is an obligation of each person	0.838				
	Institutional factors (IF) α : 0.683 TVE 10.33%					
IF1	The level of corruption among tax officers is high		0.532			
IF2	The infrastructure facilities available with the tax system motivate taxpayers to comply		0.255			
IF3	Tax officers treat taxpayers friendly		0.854			
IF4	Tax officers efficiently take action to detect tax evaders		0.837			
IF5	Tax administrators clearly understand their role in increasing tax compliance		0.487			
	Tax evasion (TE) α: 0.864 TVE 8.848%					
TE1	Taxpayer's money is spent effectively			0.580		
TE2	Tax revenue is utilized for the development of the country			0.855		
TE3	There are many loopholes in the tax system			0.877		
TE4	Paying tax will return more benefits to me			0.803		

	Political and Legal factors (PLF) α : 0.661 TVE 6.794%					
PLF1	Tax law is not easy to understand				0.509	
PLF2	Government change tax policy frequently				0.505	
PLF3	Some of the sections in tax law is not clear				0.761	
PLF4	Political influence in tax system is high				0.848	
	Economic factors (EF) α : 0.875 TVE 5.893%					
EF1	Tax rates are very high					0.806
EF2	Tax rates get changed frequently					0.745
EF3	Tax benefits help to reduce tax evasion					0.794
EF4	Tax penalty supports to reduce tax evasion					0.688
EF5	Effective tax audits reduce tax evasion					0.611
EF6	Tax officers harass taxpayers when doing audits					0.657
EF7	Charging penalty is not equally apply among all taxpayers					0.680
	AVE	0.550	0.591	0.430	0.698	0.364
	CR	0.853	0.852	0.736	0.902	0.791
	Extraction Method: Principal Component Analysis.					
	Rotation Method: Oblimin with Kaiser Normalization.					
	a Rotation converged in 13 iterations.					

Table 11. The Fitness Indexes of the Structural Model

Category	Model fit index	Index value	Threshold	Comment
1. Absolute fit	RMSEA	0.079	<0.05 good fit; 0.05 - 0.01 mediocre fit	Satisfied
	GFI	0.946	>0.90	Satisfied
	RMR	0.027	<.05	Satisfied
2. Incremental fit	AGFI	0.922	>0.80	Satisfied
	CFI	0.895	>0.90	Satisfied
	NFI	0.903	>0.90	Satisfied
	TLI	0.901	>0.90	Satisfied
3. Parsimonious fit	CMIN/df	3.736	<3 good <5 acceptable	Satisfied

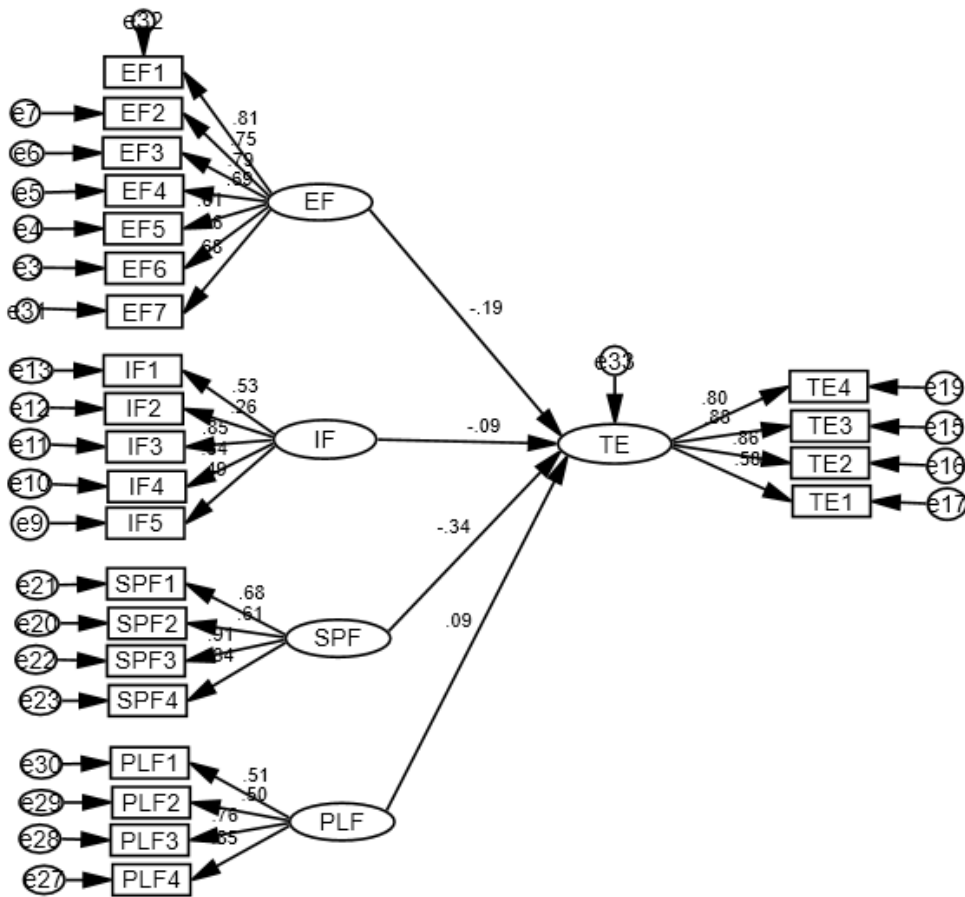


Figure 3. Graphical output of SEM

2.4.5 Assessment of the Structural Model

The discrepancy ratio ($2/df$; df = degrees of freedom), the adjusted goodness-of-fit (AGFI), the comparative fit index (CFI), the normative fit index (NFI), and the root mean square error of approximation were used to evaluate the structural model's goodness-of-fit (RMSEA). As given on Table 11, $\chi^2 = 930.19$, $df = 249$, $AGFI = 0.925$, $CMIN / df = 3.736$, $TLI = 0.901$, $CFI = 0.895$, $IFI = 0.851$, $NFI = 0.903$, $RMR = 0.027$, $RMSEA = 0.079$. For a good model fit, the discrepancy ratio should be smaller than 5; the AGFI should be higher than 0.8 while CFI and NFI should be greater than 0.9. Meanwhile, for a good fit, the RMSEA should be less than or equal to 0.08 and less

than 0.05 for an excellent fit. The findings indicate that the model is adequate for testing the hypotheses established in this study.

As reported in Table 12, Economic and socio-psychological factor path estimates are significant (1 percent level of significance) and in the expected direction. Tax evasion appears to be unrelated to institutional, political, or legal factors (10 percent level of significance).

Path coefficients (β), critical ratios, and related p-values were used to test the study's four hypotheses (refer Table 12). The findings show that "Socio-Psychological Factors" have the most influence on tax

evasion behavior, with a direct and negative relationship with tax evasion ($\beta = -0.384$; $P < 0.001$), supporting hypothesis three. Furthermore, Economic Factors have a direct and negative relationship with Tax Evasion ($\beta = -0.191$; $P < 0.001$), supporting hypothesis two. Political and legal factors (H4) have beta values of 0.93 and institutional factors (H1) have beta values of 0.89, respectively.

However, these two factors appear to be only marginally significant in explaining tax behavior in the context.

A multigroup analysis was performed to examine the mediating effect of respondent age, gender, business age, and business type on tax evasion. Table 13 and Figures 4a and 4b show the results.

Table 12. Path Coefficients Estimated Through Structural Equation Modeling (SEM)

			Estimate	S.E.	C.R.	P
TE	<---	EF	-0.191	0.077	-3.693	***
TE	<---	IF	-0.089	0.078	-1.711	0.087
TE	<---	SPF	-0.344	0.082	-6.522	***
TE	<---	PLF	0.093	0.241	1.748	0.080
EF1	<---	EF	0.806	0.146	12.039	***
EF2	<---	EF	0.745	0.074	16.15	***
EF3	<---	EF	0.794	0.056	17.392	***
EF4	<---	EF	0.688	0.061	14.656	***
EF5	<---	EF	0.611	0.087	12.673	***
EF6	<---	EF	0.657	0.061	13.86	***
EF7	<---	EF	0.68	0.066	14.434	***
IF1	<---	IF	0.532	0.027	15.547	***
IF2	<---	IF	0.255	0.212	4.737	***
IF3	<---	IF	0.854	0.173	13.032	***
IF4	<---	IF	0.837	0.156	13.039	***
IF5	<---	IF	0.487	0.182	7.422	***
TE1	<---	TE	0.683	0.067	12.102	***
TE2	<---	TE	0.614	0.055	19.261	***
TE3	<---	TE	0.911	0.056	19.681	***
TE4	<---	TE	0.838	0.163	12.034	***
SPF1	<---	SPF	0.580	0.028	15.657	***
SPF2	<---	SPF	0.855	0.057	13.616	***
SPF3	<---	SPF	0.877	0.630	12.516	***
SPF4	<---	SPF	0.803	0.051	20.407	***
PLF1	<---	PLF	0.509	0.145	9.429	***
PLF2	<---	PLF	0.505	0.113	9.358	***
PLF3	<---	PLF	0.761	0.850	17.24	***
PLF4	<---	PLF	0.848	0.082	12.466	***

Table 13. Mediating Effect: Gender

Regression Weights: (Male)						
			Estimate	S.E.	C.R.	P
TE	<---	EF	-0.150	0.076	-1.989	0.047
TE	<---	IF	-0.126	0.071	-1.766	0.077
TE	<---	SPF	-0.683	0.092	-7.444	***
TE	<---	PLF	0.397	0.248	1.599	0.110
Regression Weights: (Female)						
			Estimate	S.E.	C.R.	P
TE	<---	EF	-0.085	0.196	-0.433	0.665
TE	<---	IF	0.203	0.135	1.509	0.131
TE	<---	SPF	0.104	0.113	0.92	0.358
TE	<---	PLF	0.622	0.130	12.51	***

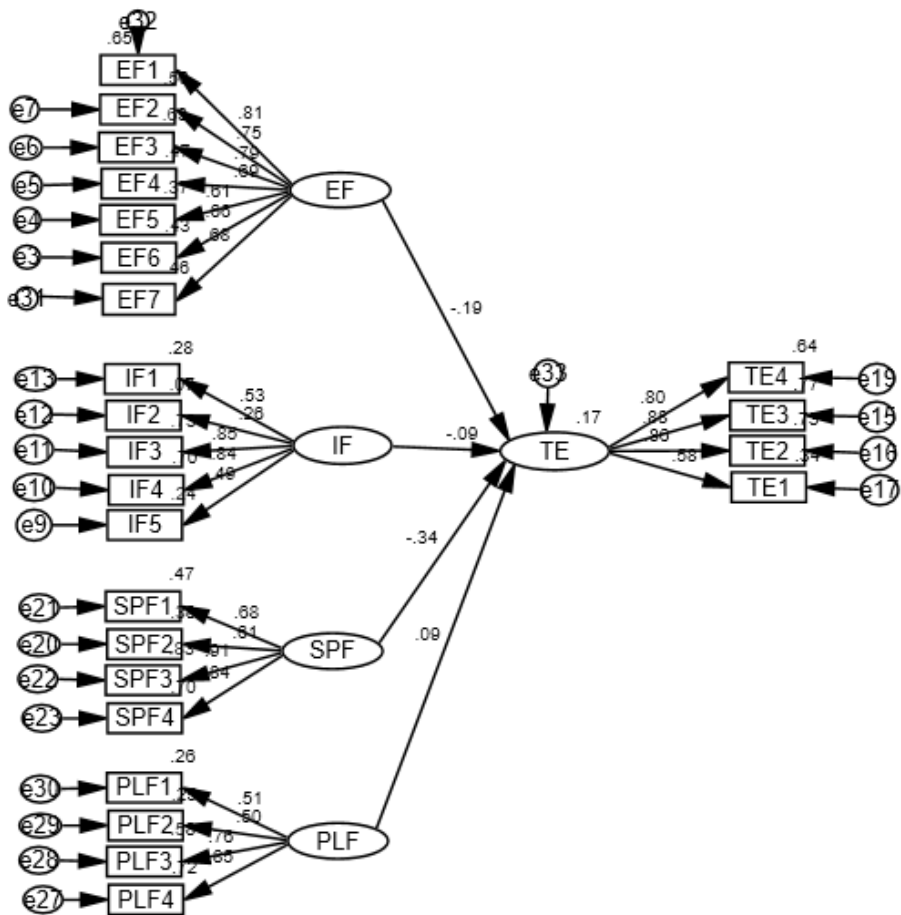


Figure 4a. Mediating Effect of Male

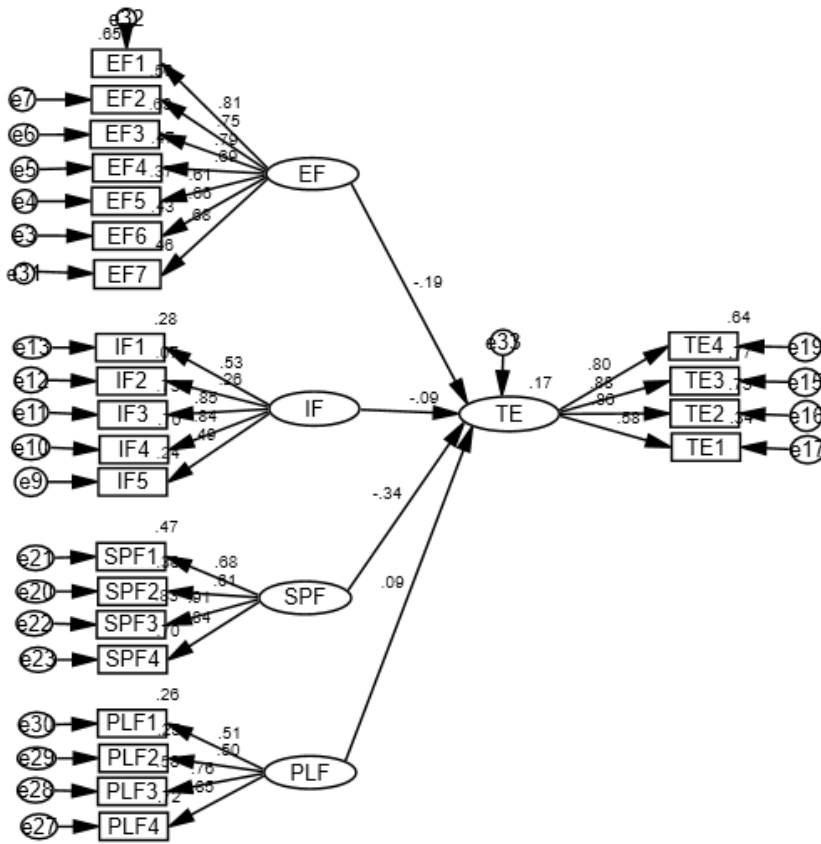


Figure 4b. Mediating Effect of Female

This study assumed that respondent’s Age, respondent’s Gender, Business age and Business type mediate the relationship between IF, EF, SPF, PLF, and Tax evasion. However, the followed standard testing procedures discussed in methodology section clearly showed that there is no such significant mediating effect of respondent’s Age, Business age and Business type but respondent’s Gender.

The Chi-square difference between unconstrained and constrained model ($\Delta\chi^2=10.9$) was significant at 5% proving an existence of a mediating effect between male and female on Tax Evasion. The results in Table 13 show the inequality of parameters in

structural paths between male and female groups. When the male is considered β value related to EF and IF are -0.150 and -0.126 respectively.

These two path coefficients are weakly significant at 10% level of significant while it is not significant for females. SPF is strongly negatively significant at 1% level for male. However, for females, this factor is positive but insignificant.

When PLF is calculated, the male group has a value of 0.397, which is insignificant. In contrast the path value of PLF is 0.622 is strongly positively significant ($P<0.001$) for females.

3. Results and Discussion

The study investigated the impact of Institutional Factors on tax evasion (H1) and discovered that the factors are only marginally significant. Making a comment on the items considered to measure Institutional Factors necessitates direct involvement with tax officials and the environment, which busy entrepreneurs lack. Because they lack knowledge and experience in dealing with tax officers, business owners frequently hire a resource person or ask their accountants to appear and settle tax matters on their behalf. The findings are not strongly supported with Alm and Liu (2018), Amoh and Ali-Nakyea (2019), and Kumar and Neha (2020).

The study checked for the association between tax evasion and Economic Factors and revealed that the factors are negatively related to tax evasion, while accepting H2. Tax audit is a necessary component in the tax system to improve firms' reporting compliance despite tax audit's considerable shock and challenge for cashflow of the enterprises. According to Mitu (2018), the tax officials' proper understanding of the audited financial statements, related transactions, and the positive interaction with taxpayers are required to develop a sound tax compliance culture. Kiri (2016) concluded that an increase in probability of tax audit will discourage non-compliance and decrease tax evasion level while high penalty rates tend to bring tax evasion down. The findings of Kasper and Alm (2022) show that the quality of tax audits resulted different effects in individual compliance decision. Effective audits increase tax compliance while weak audits discourage genuine taxpayers. Medium-sized firms lack expert staff, experience in record keeping and accounting, availability of funds to hire reputable auditors, and technological know how to deal with audits. In addition, frequent tax rate changes, and fewer tax benefits for taxpayers will support to reduce tax evasion. Another economic fact is that the penalty imposed for

non-compliance with tax obligations: error assessment of taxpayer's own tax liability, failure to file a tax return reporting that liability on due date, and failure to pay the liability on due date is required as a tool to bring the taxpayer to the system but the punishment should be equal to all, unless the genuine taxpayers are discouraged to remain in the system, which leads to the creation of a tax evasion culture. The result of Economic Factors was congruent with that of Ryšavá and Zídková (2021).

Next, the important finding of the study was the strong and negative relationship between Socio-psychological Factors; fairness of the tax system, trust in the tax regime, taxpayer willingness to comply with tax obligations, and people's understanding of tax administration and income tax evasion. As a result, the hypothesis H3 is reported as accepted, implying that an increase in tax fairness and taxpayers' trust in tax administration will reduce in tax evasion among medium-sized taxpayers. The findings are consistent with the recent empirical literature, which also confirmed a significant and negative influence of social and psychosocial factors on tax evasion (Al-Rahamneh. et al., 2022). Also, the result could be attributed to medium-sized taxpayers' perceptions of fairness in the tax system and transparency in tax administration. The findings confirm that a sense of unfairness and distrust in the tax system increases the probability to evade compliance. Tax evasion will be discouraged by an accountable and transparent tax compliance system, which is consistent with the Social Influence theory, which states that people are heavily influenced by the thoughts and actions of their peers and close ones (Battiston & Gamba, 2016). Policymakers who prioritize tax equity and psychological factors choose a regressive taxation system, proportional taxation, progressive taxation, or a combination of all above. There is no issue with the choice, but such a method should be implemented equally because socio-

psychosocial factors have been identified as a major determinant of tax evasion in the Sri Lankan context.

Furthermore, the results indicate that political and legal factors have a minor impact on tax evasion. Respondents were quizzed on tax law, changes in tax policy, and political control over tax matters. The strained relationship could be caused by business owners being more concerned with their operations than with tax issues. Accounting issues are resolved with the involvement of a third-party person because the accountant or auditor assists them in resolving tax-related issues. Furthermore, there is a low correlation between institutional factors and tax evasion. Again, medium-level taxpayers do not deal directly with tax law; instead, they seek legal advice. As a result, entrepreneurs are unable to gain additional experience or knowledge about the relationships between taxation and legal or political issues.

Age, gender, and business nature were found to be influential among the socioeconomic and demographic variables considered in the study to measure the mediating effect on tax evasion, whereas age, business age, and business type had no such significant mediating effect on individual tax evasion. In line with Kasper and Alm (2022), the study results show that individual tax compliance behaviour is significantly affected by the person's gender.

The study concluded that socio-psychological factors and economic factors are more powerful determinants of tax evasion than institutional, legal, and political factors. Furthermore, among the social-economic and demographic variables considered in the study, taxpayer gender has a significant influence on an individual's decision to engage in tax evasion. The moderating effect demonstrates that male taxpayers in Sri Lanka are more likely to engage in tax evasion. Tax evasion is discouraged by a sound legal system that ensures fairness and

equity. This study's findings are important to academics, tax policymakers, scholars, and other stakeholders.

4. Conclusion and Recommendation

In Sri Lanka, tax evasion among medium-sized taxpayers is an issue. Medium-sized businesses account for the majority of the business world, tax evasion by medium-sized taxpayers has a significant impact on government revenue. Despite previous research into various economic and behavioral aspects of tax evasion, there have been no conclusive findings added to the body of knowledge. This study combined institutional, economic, socio-psychological, political, and legal factors to provide empirical evidence as well as a novel perspective on the issue of tax evasion that may aid in a better understanding of the issue. It also sheds light on the impact of the gender of business owners on tax evasion behavior.

Socio-psychological and economic factors, according to the findings, have a significant and negative impact on the income tax evasion behavior of medium-sized taxpayers, whereas institutional, political, and legal factors have a weak association with tax evasion. These findings suggest that socio-psychological factors such as the fairness of the tax system, moral obligation, and influences from others in society, as well as economic factors such as tax rates, penalties, audit, and taxpayer privileges, influence taxpayers' perspectives on tax evasion.

This suggests that if tax policy decisions take the taxpayer's psychological state and ability to pay tax into account, medium-sized taxpayers' tax evasion behaviors may change. Spreading the tax burden across a larger number of taxpayers will aid in increasing tax compliance. Furthermore, the findings provide tax administration with a better understanding of what factors to consider when implementing new strategies to reduce tax evasion.

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