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A proposed model on the determinants of tax non-compliance behavior among small corporate taxpayers in Nigeria: The indirect effects of public governance quality and compliance cost

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Abstract: In view of the declining oil prices and production challenges, Nigeria economy which is highly dependent on oil revenue must enhance its taxation to ensure stable flow of revenue for financing development. This study is a proposed model of small corporate taxpayers' tax non-compliance behavior in Nigeria. This study reviews previous literature and developed its model based on deterrence and social exchange theories. This study extends the findings of previous studies by investigating the direct influence of the role of tax tribunal and the moderating and mediating effects of public governance quality and tax compliance costs respectively on non-compliance behavior of small corporate taxpayers in Nigeria. If the model is validated, this study would continue to collect data and analyze accordingly with the hope that the findings of the final study would help in formulating policy to curtailing tax non-compliance and hence increasing government revenue from taxation

Key words: Corporate tax non-compliance, individual tax non-compliance, Voluntary tax compliance.

1. Introduction

Stable flow of revenue is prerequisite for the operation and sustenance of every government. Taxation stands to be one of the oldest and certain source of revenue to governments. Hence, taxation accounts for significant percentage of Gross Domestic Product (GDP) of many developed and developing countries. For instance, In the UK and Australia the average GDP to tax ratios are 23.06% and 20.83% respectively for the period of 2010 to 2012 (World Bank, 2015). On the other hand, in the developing countries of similar economic status to Nigeria, such as South Africa and Kenya, the average ratio for the same period reported by the same source are 26.07% and 19.6%. In the case of Nigeria, the ratio has been reported to be disappointing with an average of 1.90% for the period under consideration. The Nigerian GDP to tax revenue ratio is below the recommended level of 15% for low-income countries like Nigeria (Cobham, 2005). This ratio indicates the under performance of the tax revenue in Nigeria which call for serious investigation to bridge this gap. This situation is requiring more attention especially in this period of decreasing government revenue. Recently, the oil revenue has decreased by about 50% because of the recent fall in oil prices and decreased production due to the militant oil facility destruction in the Niger Delta. Therefore, reducing tax non-compliance among all classes of taxpayers (individual and corporate) can bridge the gap in the government revenue and provide a stable means of diversification for the government revenue sources. Hence the situation requires comprehensive model to investigate the factors that explain the tax non-compliance behavior of the taxpayers for better tax policy and increasing government revenue. The next section of the paper provides summary of related literature review to guide the development of the proposed model of the study. Section three discusses the development of the proposed mode which is based on the deterrence and social exchange theories. The section also discusses the contribution of the study to corporate tax non-compliance literature. The final section provides conclusion of the paper.

2. Literature Review

The literature of tax non-compliance has been bias to individual tax compliance behavior despite the huge revenue contribution of corporate taxpayers (Atanassov & Liu, 2014). Most of the studies concentrated on individual taxpayers (Alabede, Ariffin, & Idris, 2011b; Allingham & Sandmo, 1972; James Alm et al., 2012; James Alm, Bahl, & Murray, 1990; Fischer, Wartick, & Mark, 1992; Kirchler, 2007; Palil & Mustapha, 2011; Saad, 2009; Srinivasan, 1973; Torgler, 2007). The classical studies explained tax non-compliance behavior based on deterrence measures (Allingham & Sandmo, 1972; Srinivasan, 1973). They emphasized that tax non-compliance decision is determine by the detection probability and the cost of penalty. The non-compliance behavior analysis of the classical studies is based on the economic theory of Becker (1968). However, this approach has been criticized of being limited and inconclusive because tax compliance is a complex phenomenon that can be explained by other factors from psychological and social angles (James Alm, 1999; Casey & Scholz, 1991; Jackson & Milliron, 1986). The preceding studies tried to bridge this gap by extending the tax non-compliance model to include the psychological and social determinants of tax non-compliance behavior (Weigel, Hessing, & Elffers, 1987). Hence, Jackson and Milliron (1986) identified 14 determinants of tax non-compliance behavior in their compressive review of the determinants of tax non-compliance behavior. Fischer et al. (1992) latter classified these 14 determinants into four categories. (1) Demographic factors: age, gender and education. (2) Tax-system structure variables: tax rate, penalty, probability of detection and the complexity of tax system and tax authority contact. (3) Non-compliance opportunity factors: income level, income sources and occupation. (4) Attitude and perception: fairness, ethics and peer influence. Several studies extended the Fischer's model by incorporating more determinants of tax non-compliance behavior. For instance, Mustafa (1996) added knowledge and understanding of tax. Chau and Leung (2009) suggested the influence of culture on tax compliance behavior. More recently, a Nigerian study investigated the direct influence of public governance quality, ethnic diversity and indirect effects of personal financial condition and risk preference (Alabede, Ariffin, & Idris, 2011a). Moreover, Alabede, Idris and Ariffin (2011) added the influence of perceived tax service quality. It has been acknowledged that most of these studies of tax compliance focused on individual tax non-compliance behavior and were conducted in the developed countries and other foreign countries (Atanassov & Liu, 2014; Joulfaian, 2014).

Focusing on corporate tax non-compliance behavior, the limited studies of corporate taxpayers identified several factors that influence corporate tax non-compliance behavior. Like the individual tax compliance studies, the early studies of corporate taxpayers focused on tax structure variables and were based on the Allingham and Sandmo model (AL model). Specifically, the studies have investigated the impact of tax rate, detection probability/audit, penalty and public disclosure profit performance (Joulfaian & Rider, 1998; Kamdar, 1997; Mills, 1996, 1998; Murray, 1993; Rice, 1992).

Later on, other studies conducted incorporated firm characteristics, social and institutional factors such as managers' personal income tax compliance, national culture, trust, corruption, fairness of legal system, governance quality, enforcement technology, political incentives and cultural norms (Alon & Hageman, 2013; Hanlon, Mills & Slemrod, 2005; Joulfaian, 2009; Richardson, 2006, 2008; Slemrod, 2007; Tsakumis, Curatola & Porcano, 2007).

Although several studies have investigated different factors that influence corporate tax non-compliance behavior, Alm (1999) and Jackson and Milliron (1986) had acknowledged that tax compliance behavior may be explained by other factors outside those in the basic model or that captured by the theory. They stressed that other variables may well be relevant in explaining this complex behavior. Similarly, Alms, Martinez-Vazquez and Torgler (2010) showed that the relationship between tax non- compliance behavior and its determinants is complex and need alternative approaches for better understanding of the phenomenon. Hence, this study proposed the direct influence of the role of tax tribunal and the indirect effects of public governance quality and tax compliance costs to extend the literature of corporate tax non-compliance behavior. In addition, this study will be conducted in a developing country of Africa. Thus, this study answered the call of (Alon & Hageman, 2013; Andreoni, Erard, & Feinstein, 1998) that there is need for more studies on corporate taxpayers especially in non-developed countries.

3. Proposed Model and Contribution

The current study proposed a model to investigate small corporate tax non-compliance behavior in Nigerian context. The model consists of 10 variables in which nine influence tax non-compliance behavior. The discussion of the variables focused on the new variables introduced in this study to extend the literature of corporate tax non-compliance; namely, direct effect of role of tax tribunal and the indirect effects of tax compliance costs and public governance quality. Moreover, the proposed model combines deterrence, voluntary and institutional factors. Figure 3.1 presents the proposed model of this study. The model incorporates tax rate, audit penalty and complexity as tax structure variables (Fischer et al., 1992). While, this study considers fairness of the tax system, public governance quality and effective role of tax tribunal to be factors that can encourage voluntary compliance. Finally, bribery, role of tax tribunal and tax compliance costs are considered as institutional factors in the tax system as they become regular part of the system that influence compliance decision.

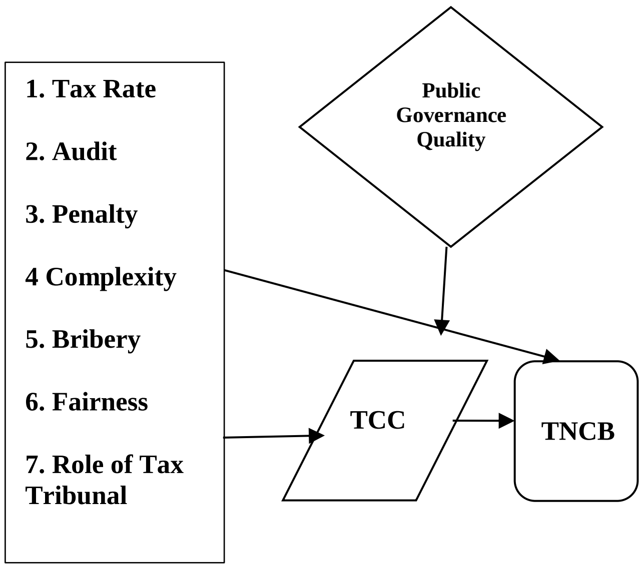

Figure 3.1: Proposed model of the current study

The relationship between tax structure variables and tax non-compliance behavior has always been important to tax literature and policy. This is proven by the fact that the theories and classical models of tax non-compliance behavior were based on tax structure variable. Moreover, the tax enforcement mechanisms namely, audit and penalty has always been a focus of most tax regimes in either developed or developing country. Moreover, this study underpinned the relationship between tax rate, audit and penalty and tax non-compliance behavior based on deterrence theory of (Becker, 1968). According to this theory, a taxpayer is considered as rational being who gambles between the cost of detection and punishment and successful tax evasion (non-compliance) (Allingham & Sandmo, 1972). In other words, tax non-compliance is determined by the level of detection probability and severity of penalty. In the theory, tax rate determines the amount of the tax payment as well as the amount evaded.

The relationships between all the other influencing variables and tax non-compliance behavior were supported with social exchange theory. Social exchange theory proposes that social relationships are established based reciprocity and that the relationship sustained where both parties get more benefits. Starting with the relationship between complexity and tax non-compliance behavior, simplicity is one of the qualities of a good tax system in the canon of taxation. Thus, complex tax system creates difficulty to the taxpayers in the process of paying their taxes. The process of meeting this civic responsibility should be made as simple as possible. Hence, if the government provided policies that make the payment of taxes simple, the taxpayers will reciprocate by paying their taxes. Complexity is also considered as another important variable associated with tax structure (Devos, 2007). In the case of bribery, the taxpayers may take the advantage of the corrupt tax authority's staff by giving bribery in order to reduce their tax liability. For fairness, the small corporate taxpayers may perceive that the tax system is unfair by allowing them to operate under the same laws with large companies (e.g. paying tax based on the same income tax rate). In return, for the unfair treatment, the small companies may engage in non-compliance.

3.1 Tax Tribunal and Small Corporate Tax Non-compliance Behavior

Tax tribunal is a quasi-judicial court with authority to judge tax disputes between the tax authority and the taxpayers. Tax tribunals are part of the judicial system which are responsible for administering justice (Ransome, 2008). Tax tribunal is expected to be effective in settling tax cases and passing fair judgment based on its jurisdiction. Hence, the taxpayers will have confidence and get encouraging on the system and in turn comply with the tax laws. On the other hand, fair punishment of the guilty through penalties, etc., can send a message to other taxpayers to comply. In Nigeria, the tax tribunal has been established to ensure fairness and transparency of the tax system in order to encourage compliance. More importantly, the tax tribunal is set with the objective of reducing the delays (of the regular court system) in the litigation of tax disputes and hence improve the taxpayers' confidence in the system. Obayemi (2015) emphasized the importance of efficient and fair tax tribunal to both taxpayers and tax authority as major stakeholders in the appeals process in Nigeria.

Studies of procedural justice indicated that authorities that treat subjects with respect, trust, fairness, and justice, will enjoy cooperation of the subjects (Murphy & Tyler, 2008). Thus, the subjects will comply with the laws of the authority. Therefore, if the role of the judicial system is efficient and fair this should help to make all subjects abide by the laws and create confidence in all the systems of the country. Moreover, empirical evidence has shown that there is connection between procedural treatment and trusting in authority (Murphy, 2004). Thus, this study proposes, in the Nigerian context, that the role of the tax tribunal have negative influence on small corporate tax non-compliance behavior.

3.2 Tax Compliance Cost as Mediator

Sandford, Godwin and Hardwick (1989) defined tax compliance cost as "The costs incurred by taxpayers, or third parties such as businesses, in meeting the requirements laid down upon them with a given tax structure". Hence, tax compliance costs involve the extra costs incurred by the taxpayer in the process of complying with the tax law. Small corporate taxpayers, in Nigeria, operate under the self-assessment system. Under this system, taxpayers are expected to assess themselves and make the tax payment. Hence, the SAS shifts more responsibilities to the taxpayer that make it necessary for the taxpayer to incur extra costs for hiring the services of a tax consultant and additional records-keeping. Under high detection probability and high penalty, the taxpayers may find it necessary to incur high tax compliance costs in order to file the correct returns to avoid punishment. Similarly, when the taxpayers have high perception of fairness and the system is uncorrupted, they may be willing to incur the extra cost to make sure they file the correct returns. Conversely, under an unfair and corrupt tax system, they may not be willing to incur the extra costs to make sure they file the correct returns, especially when the audit and penalty structures are weak. Consequently, tax compliance costs may be the fundamental reasons why the taxpayer complies or does not comply.

Based on the social exchange theory, when the taxpayers perceive the tax system to be fair and uncorrupt they may reciprocate by complying with the tax laws. However, excessive tax compliance cost is the reason that discourages voluntary compliance (Yesegat, 2009). Although, there is lack of empirical attention to the mediating role of compliance costs, a number of studies have considered its direct effect on compliance behavior (Abdul Jabbar, 2009; Das-gupta, 2002; Nur-tegin, 2008; Sapiei & Kasipillai, 2010; Slemrod, 2004; Yesegat, 2009). Finally, the current study proposes the mediating effect of compliance cost between the relationships of the determinants of corporate tax non-compliance behavior and the non-compliance behavior.

3.3 Public Governance Quality as Moderator

Besançon (2003) described public governance quality as a provision of public goods and services with a high order of excellence. In many countries, the level of compliance with laws may be explained by the political conditions as the political system determines economic activities (Torgler & Schneider, 2007). Hence, Alms et al. (2010) argued that when taxpayers receive an adequate supply of public goods, their willingness to pay tax increases. From the theoretical viewpoint, the social exchange theory offers the basis for the moderating role of public governance quality on the relationship between tax non-compliance and its determinants. As mention earlier, the theory proposes that social relationships are based on subjective costs and benefits associated with the relationship (Homans, 1961). Thus, even if the relationship between tax non-compliance and its determinants is weal, taxpayers' consideration of quality of public goods and services may change the relationship to be strong. Torgler and Schneider (2007) opined that when citizens receive an adequate supply of public goods, their willingness to contribute to the government also increases.

Empirical evidence have shown that public governance quality has influence on tax compliance behavior (Alabede, Ariffin, et al., 2011a; J Alm & Gomez, 2008; James Alm, Jackson, & Mckee, 1992; Saidu & Dauda, 2014; Wallschutzky, 1985). However, corporate tax compliance literature showed that the relationship between corporate tax non-compliance behavior and some of its determinants were inconsistent. For example, Rice (1992) and Joulfaian (2000) reported that tax rate influences corporate tax non-compliance behavior; whereas Kamdar (1997) found no relationship between the two variables. Also, Sapiei and Kasipillai (2013) reported Significant influence of fairness on tax non-compliance whereas Abdul Jabbar (2009) reported the opposite. In the same vein, DeBacker, Heim and Tran (2012) found significant effect of corruption on non-compliance, but Alon and Hageman (2013) reported insignificant effect. Hence, inconsistency of findings indicates that the relationships are not conclusive. Thus, there is need for introduction of moderator variable which may interact with the direct variables and strengthen the relationship between the independent variables and the dependent one. In line with the submission of Baron and Kenny (1986) that a moderating variable can be introduced when there is inconsistency, the current study proposes that efficient provision of public goods and services may interact with the independents variables in the model and reduce non-compliance.

4. Conclusion

Giving the declining oil prices and production challenges that drastically reduced Nigeria revenue generation, the country must enhance its taxation to ensure stable flow of revenue for financing development. In this regard, the current study proposed a comprehensive model of small corporate taxpayers' tax non-compliance behavior in Nigeria to enhance tax revenue generation from this integral part of corporate taxpayers. This study reviews previous literature and developed its model based on deterrence and social exchange theories. This study extends the findings of previous studies by investigating the direct influence of the role of tax tribunal and the moderating and mediating effects of public governance quality and compliance costs respectively on non-compliance behavior of small corporate taxpayers in Nigeria. This study is a foundation of a main study which would continue to collect data and analyze accordingly if the model is validated. This study is set with the hope that the findings of the final study would help in formulating policy to curtailing tax non-compliance and hence increasing government revenue from taxation.

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